First California Financial Group, Inc.
Form 10-Q
August 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from to

Commission file number 000-52498

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

Delaware (State or Other Jurisdiction of Incorporation or Organization)	38-3737811 (I.R.S. Employer Identification Number)
3027 Townsgate Road, Suite 300 Westlake Village, California (Address of Principal Executive Offices)	91361 (Zip Code)

Registrant’s telephone number, including area code: (805) 322-9655

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

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

x No o

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

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

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

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

29,220,893 shares of Common Stock, $0.01 par value, as of August 8, 2012

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

For the Quarterly Period Ended June 30, 2012

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

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

(in thousands, except share and per share data)	June 30, 2012	December 31, 2011
Cash and due from banks	$42,286	$40,202
Interest bearing deposits with other banks	54,980	21,230
Securities available-for-sale, at fair value	522,213	453,735
Non-covered loans, net	1,021,521	918,356
Covered loans	114,722	135,412
Premises and equipment, net	18,294	18,480
Non-covered foreclosed property	16,124	20,349
Covered foreclosed property	9,530	14,616
Goodwill	60,720	60,720
Other intangibles, net	12,743	13,887
FDIC shared-loss receivable	55,469	68,083
Cash surrender value of life insurance	12,883	12,670
Accrued interest receivable and other assets	36,339	34,924
Total assets	$1,977,824	$1,812,664
Non-interest checking	$609,320	$482,156
Interest checking	115,020	107,077
Money market and savings	505,111	486,000
Certificates of deposit, under $100,000	66,794	74,861
Certificates of deposit, $100,000 and over	274,142	275,175
Total deposits	1,570,387	1,425,269
Securities sold under agreements to repurchase	30,000	30,000
Federal Home Loan Bank advances	99,611	87,719
Junior subordinated debentures	26,805	26,805
Deferred tax liabilities, net	9,115	7,370
FDIC shared-loss liability	3,870	3,757
Accrued interest payable and other liabilities	6,859	8,637
Total liabilities	1,746,647	1,589,557
Commitments and Contingencies (Note 12)		
Perpetual preferred stock; authorized 2,500,000 shares		
Series A - $0.01 par value, 1,000 shares issued and outstanding as of June 30, 2012 and December 31, 2011	1,000	1,000
Series C - $0.01 par value, 25,000 shares issued and outstanding as of June 30, 2012 and December 31, 2011	25,000	25,000
	292	292

Common stock, $0.01 par value; authorized 100,000,000 shares; 29,267,184 shares issued at June 30, 2012 and 29,220,079 shares issued at December 31, 2011; 29,226,928 and 29,220,079 shares outstanding at June 30, 2012 and December 31, 2011, respectively		
Additional paid-in capital	174,437	173,062
Treasury stock, 40,256 shares at cost at June 30, 2012 and no shares at December 31, 2011	(215)	—
Retained earnings	30,572	25,427
Accumulated other comprehensive income (loss)	91	(1,674)
Total shareholders' equity	231,177	223,107
Total liabilities and shareholders' equity	$1,977,824	$1,812,664

See accompanying notes to consolidated financial statements.

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

(in thousands, except per share data)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest and fees on loans	$ 17,801	$ 17,236	$ 34,791	$ 32,368
Interest on securities	1,826	1,680	3,597	2,991
Interest on federal funds sold and interest bearing deposits	67	111	103	180
Total interest income	19,694	19,027	38,491	35,539
Interest on deposits	1,399	2,316	2,770	4,658
Interest on borrowings	908	877	1,852	1,937
Interest on junior subordinated debentures	155	334	469	665
Total interest expense	2,462	3,527	5,091	7,260
Net interest income before provision for loan losses	17,232	15,500	33,400	28,279
Provision for non-covered loan losses	500	500	1,000	3,000
Net interest income after provision for loan losses	16,732	15,000	32,400	25,279
Service charges on deposit accounts and other banking-related fees	769	858	1,600	1,755
Gain on sale of loans	195	—	245	—
Net gain on sale of securities	593	490	594	490
Impairment loss on securities	—	—	(28)	(1,066)
Loss on non-hedged derivatives	(296)	—	(407)	—
Gain on acquisitions	—	466	—	35,202
Other income	2,107	1,376	3,810	1,718
Total noninterest income	3,368	3,190	5,814	38,099
Salaries and employee benefits	6,786	6,572	14,662	12,640
Premises and equipment	1,681	1,603	3,216	3,142
Data processing	820	814	1,621	1,875
Legal, audit, and other professional services	1,639	1,568	2,575	3,228
Printing, stationery and supplies	83	112	166	208
Telephone	217	208	444	374
Directors’ expense	123	100	252	206
Advertising, marketing and business development	358	428	881	797
Postage	57	65	114	121
Insurance and regulatory assessments	599	750	1,080	1,413
Net loss on and expense of foreclosed property	838	486	593	5,738
Amortization of intangible assets	549	624	1,143	1,040
Other expenses	1,043	687	1,849	1,548
Total noninterest expense	14,793	14,017	28,596	32,330
Income before provision for income taxes	5,307	4,173	9,618	31,048
Provision for income taxes	2,122	1,756	3,848	13,043

Net income	$ 3,185	$ 2,417	$ 5,770	$ 18,005
Preferred stock dividends	$ (313)	$ (313)	$ (625)	$ (625)
Net income available to common stockholders	$ 2,872	$ 2,104	$ 5,145	$ 17,380
Net income per common share:				
Basic	$ 0.10	$ 0.07	$ 0.18	$ 0.61
Diluted	$ 0.10	$ 0.07	$ 0.17	$ 0.61

See accompanying notes to consolidated financial statements.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (unaudited)

(dollars in thousands)	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Other comprehensive income:				
Unrealized loss on interest rate cap	$ (68)	$ (228)	$ (114)	$ (222)
Unrealized gain on securities available-for-sale	1,124	2,776	3,704	3,945
Reclassification adjustment for gains included in net income	(593)	(490)	(594)	(490)
Other comprehensive income, before tax	463	2,058	2,996	3,233
Income tax expense related to items of other comprehensive income	(178)	(852)	(1,231)	(1,348)
Other comprehensive income, net of tax	285	1,206	1,765	1,885
Net income	3,185	2,417	5,770	18,005
Comprehensive income	$ 3,470	$ 3,623	$ 7,535	$ 19,890

See accompanying notes to consolidated financial statements.

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

(in thousands)	Six Months Ended June 30, 2012	2011
Net income	$5,770	$18,005
Adjustments to reconcile net income to net cash from operating activities:		
Provision for non-covered loan losses	1,000	3,000
Stock-based compensation costs	1,172	232
Gain on acquisition	—	(35,202)
Gain on sales of securities	(594)	(490)
Gain on sales of loans	(245)	—
Net loss on sale and valuation adjustments of non-covered foreclosed property	1,463	5,301
Net gain on sale and valuation adjustments of covered foreclosed property	(1,025)	(18)
Impairment loss on securities	28	1,066
Amortization of net premiums on securities available-for-sale	3,060	1,917
Depreciation and amortization of premises and equipment	1,063	1,017
Amortization of intangible assets	1,143	1,040
Change in FDIC shared-loss asset	(1,847)	(1,157)
Loss/(gain) on disposal of premises and equipment	23	(150)
Increase in cash surrender value of life insurance	(213)	(219)
Change in deferred taxes	1,745	1,446
Increase in accrued interest receivable and other assets, net of effects of acquisition	(2,186)	(11,187)
Decrease in accrued interest payable and other liabilities, net of effects of acquisition	(1,665)	(3,194)
Net cash provided (used) by operating activities	8,692	(18,593)
Purchases of securities available-for-sale, net of effects from acquisition	(219,787)	(85,858)
Proceeds from repayments and maturities of securities available-for-sale	97,607	63,300
Proceeds from sales of securities available-for-sale	53,752	21,011
Net change in federal funds sold and interest bearing deposits, net of effects from acquisition	(33,750)	13,256
Loan originations, purchases and principal collections, net of effects of acquisition	(90,087)	46,343
Purchases of premises and equipment, net of effects of acquisition	(1,029)	(1,228)
Proceeds from sale of premises and equipment	1	1,267
Proceeds from redemption of Federal Home Loan Bank and other stock	748	969
Proceeds from FDIC shared-loss asset	14,461	6,545
Proceeds from sale of non-covered foreclosed property	2,760	865
Proceeds from sale of covered foreclosed property	12,546	8,828
Net cash acquired in acquisition	—	122,119
Net cash (used) provided by investing activities	(162,778)	197,417
Net increase (decrease) in noninterest-bearing deposits, net of effects of acquisition	127,164	(3,371)
Net increase (decrease) in interest-bearing deposits, net of effects of acquisition	17,954	(103,370)
Net increase (decrease) in FHLB advances and other borrowings, net of effects of acquisition	11,892	(50,415)

Dividends paid on preferred stock	(625)	(625)
Purchases of treasury stock	(215)	—
Net cash provided (used) by financing activities	156,170	(157,781)
Change in cash and due from banks	2,084	21,043
Cash and due from banks, beginning of period	40,202	25,487
Cash and due from banks, end of period	$42,286	$46,530
Supplemental cash flow information:		
Cash paid for interest	$5,175	$7,109
Cash paid for income taxes	$8,425	$4,570
Supplemental disclosure of noncash items:		
Net change in fair value of securities available-for-sale, net of tax	$1,802	$2,014
Net change in fair value of cash flow hedges, net of tax	$(37)	$(129)
Non-covered loans transferred to non-covered foreclosed property	$—	$229
Covered loans transferred to covered foreclosed property	$6,065	$2,752
Acquisitions:		
Assets acquired	$—	$456,922
Liabilities assumed	$—	$436,498

See accompanying notes to consolidated financial statements.

NOTE 1 – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Organization and nature of operations – First California Financial Group, Inc., or First California, or the Company, is a bank holding company incorporated under the laws of the State of Delaware and headquartered in Westlake Village, California. The principal asset of the Company is the capital stock of First California Bank, or the Bank. The Bank is a full-service commercial bank headquartered in Westlake Village, California, chartered under the laws of the State of California and subject to supervision by the California Department of Financial Institutions and the Federal Deposit Insurance Corporation, or the FDIC. The FDIC insures the Bank's deposits up to the maximum legal limit.

On February 18, 2011, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of San Luis Trust Bank, or SLTB, located in San Luis Obispo, California, from the FDIC. The Bank acquired, received and recognized certain assets with an estimated fair value of approximately $367 million, including $139 million of loans, $99 million of cash and federal funds sold, $70 million of a FDIC shared-loss asset, $41 million of securities, $13 million of foreclosed property and $5 million of other assets. Liabilities with an estimated fair value of approximately $346 million were also assumed and recognized, including $266 million of deposits, $62 million of Federal Home Loan Bank advances, $15 million in a deferred tax liability, $3 million of a FDIC shared-loss liability and $0.4 million of other liabilities. The Bank recorded a pre-tax bargain purchase gain of $36.5 million in connection with this transaction. This transaction increased the number of the Bank's full-service branch locations to 19 and the Bank fully integrated the former SLTB branch location into its full-service branch network in June 2011.

On April 8, 2011, the Bank completed the acquisition of the Electronic Banking Solutions division of Palm Desert National Bank. The transaction included the division's customer base, core deposits, and employees. The Electronic Payment Services Division, or the EPS division, its new name under the Bank, issues prepaid cards and sponsors merchant acquiring services for all national and regional networks, including Visa, MasterCard, and Discover throughout all 50 states and U.S. territories. The Bank acquired cash of $85.4 million, recognized intangible assets of $6.0 million, assumed $91 million of deposits and recognized a pre-tax bargain purchase gain of $0.5 million in connection with this transaction.

On February 28, 2012, the Bank entered into a definitive agreement and plan of merger to acquire Premier Service Bank, a state-chartered commercial bank headquartered in Riverside, California for $2.0 million. As part of the merger, the Bank will acquire certain assets and assume certain liabilities and substantially all of the operations, including two full-service branches located in Riverside and Corona, California, of Premier Service Bank. The Bank will acquire approximately $140 million of assets, including $104 million of loans related to the transaction. The Bank will assume approximately $112 million of deposits related to the transaction. The transaction is expected to close in the third or fourth quarter of 2012.

In the second quarter of 2012, the Bank closed four branches as a result of an evaluation which measured near-term growth potential in the current economic environment, as well as the Bank's ability to continue to service clients' needs at nearby First California Bank locations. The closing of the branches is expected to result in pre-tax cost savings of approximately $1.4 million in 2012 and $2.7 million annually, thereafter. All material amounts related to the branch closures have been accrued and expensed as of June 30, 2012.

The Bank serves the comprehensive financial needs of businesses and consumers in Los Angeles, Orange, Riverside, San Diego, San Bernardino, San Luis Obispo and Ventura counties through 15 full-service branch locations.

Consolidation – The accompanying condensed consolidated financial statements include, in conformity with generally accepted accounting principles in the United States of America, the accounts of the Company, the Bank, Wendy Road Office Development LLC, a subsidiary of the Bank which manages and disposes of real estate, and SC Financial, an inactive subsidiary of First California. The Company does not consolidate the accounts of FCB Statutory Trust I and

First California Statutory Trust I, or the Trusts, in the consolidated financial statements. The Company does include, however, the junior subordinated debentures issued by the Company to the Trusts on the consolidated balance sheets. Results of operations for the three and six months ended June 30, 2011 include the effects of the FDIC-assisted SLTB transaction and the EPS division acquisition from the date of the acquisitions. All material intercompany transactions have been eliminated.

Basis of presentation – The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q as promulgated by the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnote disclosures normally required by generally accepted accounting principles for complete financial statements. In our opinion, all normal recurring adjustments necessary for a fair presentation are reflected in the unaudited condensed consolidated financial statements. Operating results for the period ended June 30, 2012 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the year ending December 31, 2012. In preparing these financial statements, the Company has evaluated events and transactions subsequent to June 30, 2012 for potential recognition or disclosure. The unaudited condensed consolidated financial statements should be read in conjunction with the audited condensed consolidated financial statements and notes thereto included in the Company's 2011 Annual Report on Form 10-K.

Reclassifications – Certain reclassifications have been made to the 2011 consolidated financial statements to conform to the current year presentation. The effects of reclassification adjustments had no effect upon previously reported net income or net income per common share calculations.

Management's estimates and assumptions – The preparation of the consolidated financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by management primarily involve the calculation of the allowance for loan losses, the carrying amount of deferred tax assets, the carrying amount of covered loans, the carrying amount of foreclosed property, the carrying amount of the FDIC shared-loss receivable and liability, the assessments for impairment related to goodwill and securities, the estimated fair value of financial instruments and the effectiveness of derivative instruments in offsetting changes in fair value or cash flows of hedged items.

Allowance for loan losses – The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated probable losses on existing loans that may become uncollectable, based on evaluations of the collectability of loans and prior loan loss experience. The evaluation includes an assessment of the following factors: any external loan review and any regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquent and nonaccrual loans, trends in the portfolio volume, effects of any changes in the lending policies and procedures, changes in lending personnel, present economic conditions at the local, state and national levels, the amount of undisbursed off-balance sheet commitments, and a migration analysis of historical losses and recoveries for the prior twenty-two quarters. Individual loans are also evaluated for impairment and if a portion of a loan is impaired, the impaired amount is charged-off or a specific reserve is allocated for that loan. Various regulatory agencies, as a regular part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was $18.3 million at June 30, 2012 and $17.7 million at December 31, 2011.

Non-covered foreclosed property - We acquire, through foreclosure or through full or partial satisfaction of a loan, real or personal property. At the time of foreclosure, the Company obtains an appraisal of the property and records the property at its estimated fair value less costs to sell. We charge the allowance for loan losses for the loan amount in excess of the fair value of the foreclosed property received; we credit recoveries, up to the amount of previous charge-offs, if any, and then earnings for the fair value amount of the foreclosed property in excess of the loan due. Subsequent to foreclosure, the Company periodically assesses our disposition efforts and the estimated fair value of the foreclosed property. The Company establishes a valuation allowance through a charge to earnings for estimated declines in fair value subsequent to foreclosure. Operating income and operating expense related to foreclosed property is included in earnings as are any ultimate gains or losses on the sale of the foreclosed property. Our recognition of gain is however dependent on the buyer's initial investment in the purchase of foreclosed property meeting certain criteria. The estimated fair value of non-covered foreclosed property was $16.1 million at June 30, 2012 and $20.3 million at December 31, 2011.

Covered foreclosed property - All foreclosed property acquired in FDIC-assisted acquisitions that are subject to a FDIC shared-loss agreement are referred to as "covered foreclosed property" and reported separately in our consolidated balance sheets. Covered foreclosed property is reported exclusive of expected reimbursement cash flows from the FDIC. Foreclosed covered loan collateral is transferred into covered foreclosed property at the collateral's net realizable value, less estimated selling costs.

Covered foreclosed property was initially recorded at its estimated fair value on the acquisition date based on similar market comparable valuations less estimated selling costs. Any subsequent valuation adjustments due to declines in fair value will be charged to non-interest expense, and will be mostly offset by non-interest income representing the corresponding increase to the FDIC shared-loss asset for the offsetting loss reimbursement amount. Any recoveries of

previous valuation adjustments will be credited to non-interest expense with a corresponding charge to non-interest income for the portion of the recovery that is due to the FDIC. The estimated fair value of covered foreclosed property was $9.5 million at June 30, 2012 and $14.6 million at December 31, 2011.

Deferred income taxes – The Company recognizes deferred tax assets subject to our judgment that realization of such assets are more-likely-than-not. A valuation allowance is established when the Company determines that the realization of income tax benefits may not occur in future years. There was no valuation allowance at June 30, 2012 or December 31, 2011. There were net deferred tax liabilities of $9.1 million at June 30, 2012 and $7.4 million at December 31, 2011.

FDIC shared-loss asset – The FDIC shared-loss asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the shared-loss agreements. The difference between the present value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted or amortized into non-interest income over the life of the FDIC shared-loss asset. Subsequent to initial recognition, the FDIC shared-loss asset is reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered portfolio. These adjustments are measured on the same basis as the related covered loans, at a pool level, and covered foreclosed property. Generally, any increases in cash flow of the covered assets over those previously expected will result in prospective increases in the loan pool yield and amortization of the FDIC shared-loss asset. Any decreases in cash flow of the covered assets under those previously expected will trigger impairments on the underlying loan pools and will result in a corresponding gain on the FDIC shared-loss asset. Increases and decreases to the FDIC shared-loss asset are recorded as adjustments to non-interest income.

FDIC shared-loss liability – Forty-five days following the tenth anniversary of the Western Commercial Bank, or WCB, and SLTB acquisition dates, the Company will be required to perform a calculation and determine if a payment to the FDIC is necessary. The payment amount will be 50 percent of the excess, if any, of (i) 20 percent of the intrinsic loss estimate minus (ii) the sum of (a) 20 percent of the net loss amount, plus (b) 25 percent of the asset discount bid, plus (c) 3.5 percent of total loss share assets at acquisition. The Company's estimate for the present value of this liability was $3.9 million at June 30, 2012 and $3.8 million at December 31, 2011.

Derivative instruments and hedging – For derivative instruments designated in cash flow hedging relationships, we assess the effectiveness of the instruments in offsetting changes in the overall cash flows of designated hedged transactions on a quarterly basis. The Company recognizes the unrealized gains or losses of derivative instruments directly in current period earnings to the extent these instruments are not effective. At June 30, 2012, the Company had $37.1 million notional interest rate caps to limit the variable interest rate payments on our $26.8 million junior subordinated debentures. Our 2012 second quarter effectiveness assessment indicated that these instruments were effective.

At June 30, 2012, the Bank had $240 million notional interest rate caps that do not meet the criteria for hedge accounting to manage the interest rate risk associated with its fixed rate securities and loans. The Company may enter into derivative contracts that are intended to economically hedge certain of its risks, even though hedge accounting does not apply or the Company elects not to apply hedge accounting. Derivatives not designated as hedges are marked-to-market each period through earnings.

Assessments of impairment – Goodwill is assessed for impairment on an annual basis or at interim periods if an event occurs or circumstances change which may indicate a change in the implied fair value of the goodwill. The implied fair value of goodwill is estimated by comparing the estimated fair value of the Company to the estimated fair value of the Company's individual assets, liabilities, and identifiable intangible assets. Impairment exists when the carrying amount of goodwill exceeds this implied fair value.

First California uses independent data where possible in determining the fair value of the Company and in determining appropriate market factors used in the fair value calculations. At December 31, 2011, the annual assessment resulted in the conclusion that goodwill was not impaired. No events occurred or circumstances changed since December 31, 2011 which indicated there was a material change in the implied fair value of goodwill.

An impairment assessment is performed quarterly on the securities available-for-sale portfolio in accordance with Financial Accounting Standards Board, or FASB, accounting standards codification guidance related to the consideration of impairment related to certain debt and equity securities. All of the securities classified as available-for-sale are debt securities.

If the Company does not intend to sell, and it is more likely than not that the Company is not required to sell a debt security before recovery of its cost basis, other-than-temporary impairment is separated into (a) the amount representing credit loss and (b) the amount related to other factors. The amount of the other-than-temporary impairment related to credit loss is recognized in earnings and other-than-temporary impairment related to other factors is recognized in other comprehensive income (loss). Other-than-temporary declines in fair value are assessed based on the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, the long-term financial outlook of the issuer, the expected future cash flows from the security and the Company's ability and intent to hold the security until the fair value recovers. Please see Note 4-Securities in this document for a detailed explanation of the impairment analysis process.The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be an other-than-temporary impairment in future periods.

No other-than-temporary impairment loss was recorded in the three months ended June 30, 2012 or 2011. For the six months ended June 30, 2012, we recognized an other-than-temporary impairment loss of $28,000 on a $1.0 million community development-related equity investment. For the same period in 2011, we recognized an other-than-temporary impairment loss of $1.1 million on two private-label CMO securities.

NOTE 2 – RECENTLY ISSUED AND ADOPTED ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurements (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 was issued concurrently with IFRS 13, Fair Value Measurements, to provide mainly identical guidance about fair value measurement and disclosure requirements. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS 13. ASU 2011-04 is effective during interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The adoption of this ASU did not have a material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. This standard eliminates the option to present components of comprehensive income as part of the statement of changes in stockholders' equity. This standard does not change the items which must be reported in other comprehensive income, how such items are measured, or when they must be reclassified to net income. This standard is effective for interim and annual periods beginning after December 15, 2011. Early adoption is permitted. This ASU was deferred with the issuance of ASU 2011-12 discussed below.

In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other – Testing Goodwill for Impairment. ASU 2011-08 provides guidance on the application of a qualitative assessment of impairment indicators in the review of goodwill impairment. The ASU provides that in the event that the qualitative review indicates that it is more likely than not that no impairment has occurred, the Company would not be required to perform a quantitative review. The provisions of ASU 2011-08 will be effective for years beginning after December 15, 2011 for both public and nonpublic entities, although earlier adoption is allowed. The adoption of this standard is not expected to have a significant impact on our consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 provides convergence to International Financial Reporting Standards, or IFRS, to provide common disclosure requirements for the offsetting of financial instruments. Existing GAAP guidance allowing balance sheet offsetting, including industry-specific guidance, remains unchanged. The new guidance is effective on a retrospective basis, including all prior periods presented, for interim and annual periods beginning on or after January 1, 2013. The Company does not expect that adoption of this standard will have a significant impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-12 defers the requirements of ASU 2011-05 to display reclassification adjustments for each component of other comprehensive income in both net income and other comprehensive income and to present the components of other comprehensive income in interim financial statements. During 2012, the FASB will reconsider the reclassification requirements and the timing of their implementation. Management is currently evaluating the impact both of these ASU's will have on the disclosures in the Company's consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, Intangibles – Goodwill and Other. ASU 2012-02 provides guidance on the application of a qualitative assessment of impairment indicators in the review of impairment of indefinite-lived intangible assets. The ASU provides that in the event that the qualitative review indicates that it is more likely than not that no impairment has occurred, the Company would not be required to perform a quantitative review. The provisions of ASU 2012-02 will be effective for interim and annual impairment tests performed for fiscal years beginning after

September 15, 2012 for both public and nonpublic entities, although earlier adoption is permitted. The adoption of this standard is not expected to have a significant impact on our consolidated financial statements.

NOTE 3 – ACQUISITION

On April 8, 2011, or the EPS Transaction Date, the Bank completed the acquisition of the Electronic Banking Solutions division of Palm Desert National Bank. The transaction included the division's customer base, core deposits, and employees. The Bank paid cash consideration of $5.5 million to purchase the EPS division. The Bank acquired cash of $85.4 million, recognized intangible assets of $6.0 million, assumed $91 million of deposits and recognized a pre-tax bargain purchase gain of $0.5 million in connection with this transaction. The Bank desired this transaction to expand its product and service offerings and diversify its sources of revenue.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the EPS Transaction Date. Results of operations for the year ended December 31, 2011 included the effects of the EPS acquisition from the EPS Transaction Date.

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

		(Dollars in thousands)
Assets Acquired:		
Cash	$	85,389
Intangible assets		6,005
Other assets		89
Total assets acquired	$	91,483
Liabilities Assumed:		
Deposits	$	91,018
Deferred taxes		195
Total liabilities assumed		91,213
Net assets acquired (after-tax bargain purchase gain)		270
Total liabilities and net assets acquired	$	91,483

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. The net gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed. The gain was recognized as non-interest income in the Company's Condensed Consolidated Statements of Operations. Non-interest expense for the second quarter of 2011 included integration and conversion expenses related to the EPS division acquisition of approximately $350,000. The "Salaries and employee benefits", "Data processing" and "Legal, audit, and other professional services" categories were affected on the Company's Condensed Consolidated Statements of Income.

On February 18, 2011, or the SLTB Transaction Date, the Bank assumed certain liabilities and acquired certain assets and substantially all of the operations of SLTB from the FDIC, acting in its capacity as receiver of SLTB, pursuant to the terms of a purchase and assumption agreement entered into by the Bank and the FDIC, or the Purchase Agreement. The Bank acquired, received, and recognized certain assets with a fair value of approximately $367 million, including $139 million in loans, $99 million of cash and cash equivalents, $41 million of securities and $13 million of foreclosed property related to the transaction. These acquired assets represented approximately 20 percent of consolidated total assets at March 31, 2011. The Bank also assumed approximately $266 million of deposits and $62 million of FHLB advances related to the transaction. The Bank also recorded an FDIC shared-loss asset of $70 million, a core deposit intangible of $0.3 million, deferred tax liabilities of $15 million, a FDIC shared-loss liability of $2.6 million and a premium on time deposits acquired of $0.8 million related to the transaction. The Bank continues to operate the one former SLTB branch location as part of the Bank's 15 branch locations. The Bank desired this transaction to expand its footprint into the California central coast region.

As part of the Purchase Agreement, the Bank and the FDIC entered into shared-loss agreements, whereby the FDIC will cover a substantial portion of any future losses on loans (and related unfunded loan commitments), foreclosed property and accrued interest on loans for up to 90 days. We refer to the acquired assets subject to the shared-loss agreements collectively as covered assets. Under the terms of the shared-loss agreements, the FDIC will absorb 80 percent of losses and share in 80 percent of loss recoveries. The shared-loss agreements for commercial and residential mortgage loans are in effect for 5 years and 10 years, respectively, from the SLTB Transaction Date and the loss recovery provisions are in effect for 8 years and 10 years, respectively, from the SLTB Transaction Date.

In March 2021, approximately ten years following the SLTB Transaction Date, the Bank is required to perform a calculation and determine if a payment to the FDIC is necessary. The payment amount will be 50 percent of the excess, if any, of (i) 20 percent of the intrinsic loss estimate ($99.0 million) minus (ii) the sum of (a) 20 percent of the net loss amount, plus (b) 25 percent of the asset discount bid ($58.0 million), plus (c) 3.5 percent of total loss share assets at acquisition. At the SLTB Transaction Date, the Bank estimated a liability, on a present value basis, of $2.6 million under this provision.

Under the acquisition method of accounting, the Bank recorded the assets acquired and liabilities assumed based on their estimated fair values as of the SLTB Transaction Date. Results of operations for the year ended December 31, 2011 included the effects of the SLTB acquisition from the SLTB Transaction Date.

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

	(Dollars in thousands)	
Assets Acquired:		
Cash and cash equivalents	$	98,820
Securities		40,972
Covered loans		138,792
Covered foreclosed property		12,772
FDIC shared-loss asset		70,293
Other assets		5,510
Total assets acquired	$	367,159
Liabilities Assumed:		
Deposits	$	266,149
FHLB advances		61,541
FDIC shared-loss liability		2,564
Deferred taxes		15,316
Other liabilities		437
Total liabilities assumed		346,007
Net assets acquired (after-tax bargain purchase gain)		21,152
Total liabilities and net assets acquired	$	367,159

The Bank based the allocation of the purchase price above on the fair values of the assets acquired and the liabilities assumed. The net gain represents the excess of the estimated fair value of the assets acquired over the estimated fair value of the liabilities assumed and is influenced significantly by the FDIC-assisted transaction process. Under the FDIC-assisted transaction process, only certain assets and liabilities are transferred to the acquirer and, depending on the nature and amount of the acquirer's bid, the FDIC may be required to make a cash payment to the acquirer. The Bank received a cash payment from the FDIC for $34.4 million. The book value of net assets transferred to the Bank was $23.6 million (i.e., the cost basis). The pre-tax gain of $36.5 million or the after-tax gain of $21.1 million recognized by the Company is considered a bargain purchase transaction under ASC 805 "Business Combinations" since the total acquisition-date fair value of the identifiable net assets acquired exceeded the fair value of the consideration transferred. The gain was recognized as non-interest income in the Company's Condensed Consolidated Statements of Operations. Non-interest expense for the first quarter of 2011 included integration and conversion expenses related to the SLTB acquisition of approximately $515,000. The "Salaries and employee benefits", "Data processing" and "Legal, audit, and other professional services" categories were affected on the Company's Condensed Consolidated Statements of Income.

In August 2011, the Bank exercised its option to purchase at fair value approximately $100,000 of furniture, fixtures and equipment related to the one SLTB branch location from the FDIC. The Bank also negotiated and executed a new five-year lease approximating current market rent for the one branch location.

The acquisition of assets and liabilities of SLTB were significant at a level to require disclosure of one year of historical financial information and related pro forma disclosure. However, given the pervasive nature of the shared-loss agreements entered into with the FDIC, the historical information of SLTB are much less relevant for purposes of assessing the future operations of the combined entity. In addition, prior to closure, SLTB had not completed an audit of their financial statements, and the Company determined that audited financial statements are not and will not be reasonably available for the year ended December 31, 2010. Given these considerations, the Company

requested, and received, relief from the Securities and Exchange Commission from submitting certain historical and pro forma financial information of SLTB.

NOTE 4 – SECURITIES

Securities have been classified in the consolidated balance sheets according to management’s intent and ability as available-for-sale. The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of securities available-for-sale at June 30, 2012 and December 31, 2011 are summarized as follows:

	June 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$32,083	$2	$(2)	$32,083
U.S. government agency notes	45,604	102	(7)	45,699
U.S. government agency mortgage-backed securities	183,276	3,033	(76)	186,233
U.S. government agency collateralized mortgage obligations	211,042	478	(594)	210,926
Private label collateralized mortgage obligations	11,461	—	(1,625)	9,836
Municipal securities	31,031	1,249	(41)	32,239
Other domestic debt securities	7,109	—	(1,912)	5,197
Securities available-for-sale	$521,606	$4,864	$(4,257)	$522,213

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. Treasury notes/bills	$45,151	$14	$(4)	$45,161
U.S. government agency notes	59,212	257	(23)	59,446
U.S. government agency mortgage-backed securities	132,141	1,616	(82)	133,675
U.S. government agency collateralized mortgage obligations	168,158	384	(368)	168,174
Private label collateralized mortgage obligations	15,853	—	(2,811)	13,042
Municipal securities	28,572	813	(60)	29,325
Other domestic debt securities	7,151	—	(2,239)	4,912
Securities available-for-sale	$456,238	$3,084	$(5,587)	$453,735

As of June 30, 2012, securities available-for-sale with a fair value of $46.9 million were pledged as collateral for borrowings, public deposits and other purposes as required by various statutes and agreements.

The following table shows the gross unrealized losses and amortized cost of the Company's securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2012 and December 31, 2011.

	At June 30, 2012					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. Treasury notes/bills	$18,053	$(2)	$—	$—	$18,053	$(2)
U.S. government agency notes	5,000	(7)	—	—	5,000	(7)
U.S. government agency mortgage-backed securities	40,804	(76)	—	—	40,804	(76)
U.S. government agency collateralized mortgage obligations	107,825	(594)	—	—	107,825	(594)
	—	—	11,461	(1,625)	11,461	(1,625)

Private-label collateralized mortgage obligations											
Municipal securities	2,365	(41	)	—	—		2,365	(41	)
Other domestic debt securities	—	—		7,109	(1,912	)	7,109	(1,912	)
	$174,047	$(720	)	$18,570	$(3,537	)	$192,617	$(4,257	)

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	At December 31, 2011					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. Treasury notes/bills	$10,029	$(4)	$-	$-	$10,029	$(4)
U.S. government agency notes	10,000	(23)	-	-	10,000	(23)
U.S. government agency mortgage-backed securities	40,889	(82)	-	-	40,889	(82)
U.S. government agency collateralized mortgage obligations	99,894	(368)	-	-	99,894	(368)
Private-label collateralized mortgage obligations	-	-	15,853	(2,811)	15,853	(2,811)
Municipal securities	4,039	(60)	-	-	4,039	(60)
Other domestic debt securities	-	-	7,151	(2,239)	7,151	(2,239)
	$164,851	$(537)	$23,004	$(5,050)	$187,855	$(5,587)

Net unrealized holding gains were $607,000 at June 30, 2012 and net unrealized holding losses were $2.5 million at December 31, 2011. As a percentage of securities, at amortized cost, net unrealized holding gains were 0.12 percent and net unrealized holding losses were 0.55 percent at the end of each respective period. Securities are comprised largely of U.S. Treasury bills and notes, and U.S. government agency notes, mortgage-backed securities and collateralized mortgage obligations. On a quarterly basis, we evaluate our individual available-for-sale securities in an unrealized loss position for other-than-temporary impairment. As part of this evaluation, we consider whether we intend to sell each security and whether it is more-likely-than-not that we will be required to sell the security before the anticipated recovery of the security's amortized cost basis. Should a security meet either of these conditions, we recognize an impairment charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities in an unrealized loss position that meet neither of these conditions, we consider whether we expect to recover the entire amortized cost basis of the security by comparing our best estimate, on a present value basis, of the expected future cash flows from the security with the amortized cost basis of the security. If our best estimate of expected future cash flows is less than the amortized cost basis of the security, we recognize an impairment charge to earnings for this estimated credit loss.

The Company will continue to evaluate the securities portfolio for other-than-temporary impairment at each reporting date and can provide no assurance there will not be further other-than-temporary impairments in future periods.

The following table presents the other-than-temporary impairment activity related to credit loss, which is recognized in earnings, and the other-than-temporary impairment activity related to all other factors, which are recognized in other comprehensive income.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
Beginning balance	$3,008	$3,322	$3,643	$2,256
Reduction for securities sold	—	—	(663)	—
Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized	—	—	28	1,066

Ending balance	$3,008	$3,322	$3,008	$3,322

The Company owns one pooled trust preferred security, rated triple-A at purchase, with an amortized cost basis of $4.6 million and an unrealized loss of $1.9 million at June 30, 2012. The gross unrealized loss is mainly due to extraordinarily high investor yield requirements resulting from an illiquid market, causing this security to be valued at a discount to its acquisition cost. One credit rating agency has now rated the security Baa3 while another has rated the security triple-C. The senior tranche owned by the Company has a collateral balance well in excess of the amortized cost basis of the tranche at June 30, 2012. Nineteen of the fifty-six issuers in the security have deferred or defaulted on their interest payments as of June 30, 2012. The Company's analysis determined that approximately half of the issuers would need to default on their interest payments before the senior tranche owned by the Company would be at risk of loss. As the Company's estimated present value of expected cash flows to be collected is in excess of the amortized cost basis, the Company considers the gross unrealized loss on this security to be temporary.

The majority of unrealized losses at June 30, 2012 relate to a type of mortgage-backed security also known as private-label CMOs. As of June 30, 2012, the par value of these securities was $13.0 million and the amortized cost basis, net of other-than-temporary impairment charges, was $11.5 million. At June 30, 2012, the fair value of these securities was $9.8 million, representing 2 percent of our securities portfolio. Gross unrealized losses related to these private-label CMO's were $1.6 million, or 14 percent of the amortized cost basis of these securities as of June 30, 2012.

The gross unrealized losses associated with these securities were primarily due to extraordinarily high investor yield requirements resulting from an extremely illiquid market, significant uncertainty about the future condition of the mortgage market and the economy, and continued deterioration in the credit performance of loan collateral underlying these securities, causing these securities to be valued at significant discounts to their acquisition cost. Two private-label CMOs had credit agency ratings of less than investment grade at June 30, 2012. We performed discounted cash flow analyses for these two securities using the current month, last three month and last twelve month historical prepayment speed, the cumulative default rate and the loss severity rate to determine if there was other-than-temporary impairment as of June 30, 2012. Based upon this analysis, we determined that neither of the two private-label CMO's had further other-than-temporary impairment than what had been previously recognized. We had previously recognized an other-than-temporary loss of $1.6 million on these two securities in prior periods. We do not intend to sell these securities and we do not believe it likely that we will be required to sell these securities before the anticipated recovery of the remaining amortized cost basis. If current conditions in the mortgage markets and general business conditions continue to deteriorate, the fair value of our private-label CMOs may decline further and we may experience further impairment losses. For the three months ended June 30, 2012 and 2011, we did not recognize an impairment loss on securities. For the six months ended June 30, 2012, we recognized a $28,000 impairment on a $1 million community development-related equity investment. We had previously recognized a credit loss of $433,000 on this investment in prior periods. For the six months ended June 30, 2011, we recognized a credit loss of $1.1 million related to our private-label CMO securities.

The amortized cost and estimated fair value of securities by contractual maturities are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	At June 30, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due in one year or less	$41,268	$41,270
Due after one year through five years	42,629	42,783
Due after five years through ten years	115,528	117,312
Due after ten years	322,181	320,848
Total	$521,606	$522,213

NOTE 5 – NON-COVERED LOANS AND ALLOWANCE FOR NON-COVERED LOAN LOSSES

The loans not acquired in the SLTB and WCB acquisitions and which are not covered by the related shared-loss agreements with the FDIC are referred to as non-covered loans. The non-covered loan portfolio by type consists of the following:

(in thousands)	At June 30, 2012	At December 31, 2011
Commercial mortgage	$ 430,489	$ 393,376
Multifamily	215,509	187,333
Commercial loans and lines	171,413	180,421
Home mortgage	155,559	106,350
Home equity loans and lines of credit	34,402	28,645
Construction and land	28,100	35,082
Installment and credit card	4,393	4,896
Total loans	1,039,865	936,103
Allowance for loan losses	(18,344)	(17,747)
Loans, net	$ 1,021,521	$ 918,356

At June 30, 2012, loans with a balance of $742.1 million were pledged as security for Federal Home Loan Bank, or FHLB, advances. Loan balances include net deferred loan costs of $6.2 million and $3.4 million at June 30, 2012 and December 31, 2011, respectively.

Most of the Company's lending activity is with customers located in Los Angeles, Orange, Ventura, Riverside, San Bernardino, San Diego and San Luis Obispo Counties and most loans are secured by or dependent on real estate. Although the Company has no significant exposure to any individual customer, economic conditions, particularly the recent sustained decline in real estate values in Southern California, could adversely affect customers and their ability to satisfy their obligations under their loan agreements.

Changes in the allowance for non-covered loan losses were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Beginning balance	$18,154	$18,666	$17,747	$17,033
Provision for loan losses	500	500	1,000	3,000
Loans charged-off	(408)	(1,134)	(626)	(2,027)
Recoveries on loans charged-off	98	274	223	300
Ending balance	$18,344	$18,306	$18,344	$18,306

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the six months ended June 30, 2012. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								
Beginning balance	$ 6,091	$ 6,221	$ 2,886	$ 814	$1,274	$390	$ 71	$17,747
Charge-offs	(10)	(479)	–	–	(103)	–	(34)	(626)
Recoveries	2	213	–	–	3	–	5	223
Provision	(642)	1,161	47	(356)	687	28	75	1,000
Ending balance	$ 5,441	$ 7,116	$ 2,933	$ 458	$1,861	$418	$ 117	$18,344
Ending balance; individually evaluated for impairment	$ 62	$ 5,162	$ 141	$ 10	$157	$–	$ 75	$5,607
Ending balance; collectively evaluated for	5,379	1,954	2,792	448	1,704	418	42	12,737

impairment								
Non-covered loan balances:								
Ending balance	$ 430,489	$ 171,413	$ 215,509	$ 28,100	$155,559	$34,402	$ 4,393	$1,039,865
Ending balance; individually evaluated for impairment	$ 675	$ 20,016	$ 1,515	$ 196	$1,386	$–	$ 180	$23,968
Ending balance; collectively evaluated for impairment	$ 429,814	$ 151,397	$ 213,994	$ 27,904	$154,173	$34,402	$ 4,213	$1,015,897

The following table details activity in the allowance for non-covered loan losses by portfolio segment for the six months ended June 30, 2011. Allocation of a portion of the allowance to one segment of the loan portfolio does not preclude its availability to absorb losses in other segments.

(in thousands)	Commercial Mortgage	Commercial	Multifamily	Construction and Land	Home Mortgage	Home Equity	Installment	Total
Allowance for credit losses:								
Beginning balance	$ 6,134	$ 4,934	$ 2,273	$ 1,698	$1,496	$416	$ 82	$17,033
Charge-offs	(312)	(1,192)	(65)	(3)	(367)	–	(88)	(2,027)
Recoveries	–	291	–	4	–	–	5	300
Provision	1,197	1,436	348	(825)	722	10	112	3,000
Ending balance	$ 7,019	$ 5,469	$ 2,556	$ 874	$1,851	$426	$ 111	$18,306
Ending balance; individually evaluated for impairment	$ –	$ 1,827	$ –	$ –	$–	$–	$ 2	$1,829
Ending balance; collectively evaluated for impairment	7,019	3,642	2,556	874	1,851	426	109	16,477
Non-covered loan balances:								
Ending balance	$ 392,312	$ 200,863	$ 134,091	$ 49,325	$107,509	$28,414	$ 6,393	$918,907
Ending balance; individually evaluated for impairment	$ 1,435	$ 11,924	$ 2,078	$ 133	$1,105	$–	$ 5	$16,680
Ending balance; collectively evaluated for impairment	$ 390,877	$ 188,939	$ 132,013	$ 49,192	$106,404	$28,414	$ 6,388	$902,227

Nonaccrual loans are those loans for which management has discontinued accrual of interest because reasonable doubt exists as to the full and timely collection of either principal or interest. Nonaccrual loans are also considered impaired loans. Total non-covered nonaccrual loans totaled $13.5 million at June 30, 2012 as compared to $13.9 million at December 31, 2011. The allowance for loan losses maintained for nonaccrual loans was $3.9 million and $3.1 million at June 30, 2012 and December 31, 2011, respectively. Had these loans performed according to their original terms, additional interest income of $0.3 million and $1.0 million would have been recognized in the six months ended June 30, 2012 and 2011, respectively.

The following table sets forth the amounts and categories of our non-covered non-accrual loans at the dates indicated:

Non-accrual loans	At June 30, 2012	At December 31, 2011
	(Dollars in thousands)	
Aggregate loan amounts		

Multifamily	$795	$ 837
Commercial loans	11,152	11,594
Home mortgage	1,386	1,387
Installment	174	42
Total non-covered nonaccrual loans	$13,507	$ 13,860

Included in non-covered non-accrual loans at June 30, 2012 were twelve restructured loans totaling $2.5 million. The twelve loans consist of three home mortgage loans, eight commercial loans and one multifamily loan. Interest income recognized on these loans was $2,000 for the six months ended June 30, 2012. We had no commitments to lend additional funds to these borrowers.

Included in non-covered non-accrual loans at December 31, 2011 were nine restructured loans totaling $2.8 million. The nine loans consist of one home mortgage loan and eight commercial loans. Interest income recognized on these loans was $34,000 for the twelve months ended December 31, 2011. We had no commitments to lend additional funds to these borrowers.

Credit Quality Indicators

Loans are risk rated based on analysis of the current state of the borrower's credit quality. This analysis of credit quality includes a review of all sources of repayment, the borrower's current financial and liquidity status and all other relevant information. The Company utilizes a ten grade risk rating system, where a higher grade represents a higher level of credit risk. The ten grade risk rating system can be generally classified by the following categories: Pass, Special Mention, Substandard, Doubtful and Loss. The risk ratings reflect the relative strength of the sources of repayment.

Pass loans are generally considered to have sufficient sources of repayment in order to repay the loan in full in accordance with all terms and conditions. These borrowers may have some credit risk that requires monitoring, but full repayment is expected. Special Mention loans are considered to have potential weaknesses that warrant close attention by management. Special Mention is considered a transitory grade and generally, the Company does not have a loan stay graded Special Mention for longer than six months. If any potential weaknesses are resolved, the loan is upgraded to a Pass grade. If negative trends in the borrower's financial status or other information is presented that indicates the repayment sources may become inadequate, the loan is downgraded to a Substandard grade. Substandard loans are considered to have well-defined weaknesses that jeopardize the full and timely repayment of the loan. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. Additionally, when management has assessed a potential for loss but a distinct possibility of loss is not recognizable, the loan is still classified as Substandard. Doubtful loans have insufficient sources of repayment and a high probability of loss. Loss loans are considered to be uncollectible and of such little value that they are no longer considered bankable assets. These internal risk ratings are reviewed continuously and adjusted due to changes in borrower status and likelihood of loan repayment.

The table below presents the non-covered loan portfolio by credit quality indicator as of June 30, 2012.

	Pass	Special Mention	Substandard	Doubtful	Loss	Total
			(in thousands)			
Home mortgage	$152,805	$974	$1,780	$–	$–	$155,559
Commercial mortgage	398,080					