

PACIFIC PREMIER BANCORP INC

Form 10-Q

November 06, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-22193

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or  
organization)

33-0743196

(I.R.S Employer Identification No.)

17901 VON KARMAN AVENUE, SUITE 1200, IRVINE, CALIFORNIA 92614

(Address of principal executive offices and zip code)

(949) 864-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act).

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

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

The number of shares outstanding of the registrant's common stock as of November 6, 2014 was 16,894,216.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
FORM 10-Q  
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FOR THE QUARTER ENDED SEPTEMBER 30, 2014

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

PACIFIC PREMIER BANCORP, INC. AND  
SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL  
CONDITION  
(dollars in thousands, except share data)

|   | September<br>30,<br>2014<br>(Unaudited) | December<br>31,<br>2013<br>(Audited) | September<br>30,<br>2013<br>(Unaudited) |
|---|---|--------------------------------------|---|
| ASSETS                                      |   |                                      |   |
| Cash and due from<br>banks                  | \$103,356                               | \$126,787                            | \$61,393                                |
| Federal funds sold                          | 275                                     | 26                                   | 26                                      |
| Cash and cash<br>equivalents                | 103,631                                 | 126,813                              | 61,419                                  |
| Investment securities<br>available for sale | 282,202                                 | 256,089                              | 282,846                                 |
| FHLB and other stock,<br>at cost            | 18,643                                  | 15,450                               | 10,827                                  |
| Loans held for sale,<br>net                 | -                                       | 3,147                                | 3,176                                   |
| Loans held for<br>investment                | 1,548,004                               | 1,240,123                            | 1,138,969                               |
| Allowance for loan<br>losses                | (10,767 )                               | (8,200 )                             | (7,994 )                                |
| Loans held for<br>investment, net           | 1,537,237                               | 1,231,923                            | 1,130,975                               |

|  |                    |                    |                    |
|--|--------------------|--------------------|--------------------|
| Accrued interest receivable  | 6,762              | 6,254              | 5,629              |
| Other real estate owned  | 752                | 1,186              | 1,186              |
| Premises and equipment   | 9,402              | 9,864              | 9,829              |
| Deferred income taxes  | 10,721             | 8,477              | 9,029              |
| Bank owned life insurance  | 26,642             | 24,051             | 23,862             |
| Intangible assets  | 5,867              | 6,628              | 6,881              |
| Goodwill   | 22,950             | 17,428             | 17,428             |
| Other assets   | 9,439              | 6,877              | 5,933              |
| <b>TOTAL ASSETS</b>  | <b>\$2,034,248</b> | <b>\$1,714,187</b> | <b>\$1,569,020</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                    |                    |                    |
| <b>LIABILITIES:</b>  |                    |                    |                    |
| <b>Deposit accounts:</b>   |                    |                    |                    |
| Noninterest bearing  | \$425,166          | \$366,755          | \$363,606          |
| Interest bearing   | 1,118,300          | 939,531            | 920,528            |
| Total deposits   | 1,543,466          | 1,306,286          | 1,284,134          |
| FHLB advances and other borrowings   | 195,561            | 204,091            | 86,474             |
| Subordinated debentures  | 70,310             | 10,310             | 10,310             |
| Accrued expenses and other liabilities   | 27,054             | 18,274             | 16,948             |
| <b>TOTAL LIABILITIES</b>   | <b>1,836,391</b>   | <b>1,538,961</b>   | <b>1,397,866</b>   |
| <b>STOCKHOLDERS' EQUITY:</b>   |                    |                    |                    |
| Common stock, \$.01 par value; 25,000,000 shares authorized; 17,069,216 shares at September 30, 2014, 16,656,279 shares at December 31, 2013, and 16,641,991 shares at September 30, 2013 issued and outstanding | 171                | 166                | 166                |
| Additional paid-in capital   | 150,062            | 143,322            | 143,014            |
| Retained earnings  | 47,540             | 34,815             | 30,611             |
| Accumulated other comprehensive income (loss), net of tax (benefit) of \$59 at September 30, 2014, (\$2,152) at December 31, 2013, and (\$1,843)   | 84                 | (3,077 )           | (2,637 )           |

|   |             |             |             |
|---|-------------|-------------|-------------|
| at September 30, 2013                               |             |             |             |
| TOTAL<br>STOCKHOLDERS'<br>EQUITY                    | 197,857     | 175,226     | 171,154     |
| TOTAL LIABILITIES<br>AND<br>STOCKHOLDERS'<br>EQUITY | \$2,034,248 | \$1,714,187 | \$1,569,020 |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(dollars in thousands, except per share data)  
(unaudited)

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September<br>30, 2014 | September<br>30, 2013 | September<br>30, 2014 | September<br>30, 2013 |
| <b>INTEREST<br/>INCOME</b>  |                       |                       |                       |                       |
| Loans   | \$19,550              | \$14,420              | \$54,057              | \$41,504              |
| Investment securities<br>and other<br>interest-earning<br>assets        | 1,484                 | 1,954                 | 4,230                 | 4,041                 |
| <b>Total interest income</b>  | <b>21,034</b>         | <b>16,374</b>         | <b>58,287</b>         | <b>45,545</b>         |
| <b>INTEREST<br/>EXPENSE</b>   |                       |                       |                       |                       |
| Deposits  | 1,317                 | 1,045                 | 3,589                 | 3,097                 |
| FHLB advances and<br>other borrowings                                   | 294                   | 244                   | 792                   | 722                   |
| Subordinated<br>debentures  | 403                   | 77                    | 553                   | 230                   |
| Total interest<br>expense   | 2,014                 | 1,366                 | 4,934                 | 4,049                 |
| <b>NET INTEREST<br/>INCOME BEFORE<br/>PROVISION FOR<br/>LOAN LOSSES</b> | <b>19,020</b>         | <b>15,008</b>         | <b>53,353</b>         | <b>41,496</b>         |
| PROVISION FOR<br>LOAN LOSSES  | 1,284                 | 646                   | 3,263                 | 1,264                 |
| <b>NET INTEREST<br/>INCOME AFTER<br/>PROVISION FOR<br/>LOAN LOSSES</b>  | <b>17,736</b>         | <b>14,362</b>         | <b>50,090</b>         | <b>40,232</b>         |

NONINTEREST  
INCOME

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| Loan servicing fees   | 547   | 237   | 1,685 | 881   |
| Deposit fees  | 412   | 485   | 1,329 | 1,382 |
| Net gain from sales of loans  | 1,775 | 982   | 3,621 | 1,927 |
| Net gain from sales of investment securities                                  | 363   | 305   | 523   | 1,373 |
| Other-than-temporary impairment recovery (loss) on investment securities, net | 5     | 16    | 28    | (19)  |
| Other income  | 1,365 | 296   | 1,804 | 932   |
| Total noninterest income  | 4,467 | 2,321 | 8,990 | 6,476 |

NONINTEREST  
EXPENSE

|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Compensation and benefits               | 7,490  | 5,948  | 20,866 | 16,732 |
| Premises and occupancy                  | 1,723  | 1,600  | 4,877  | 4,222  |
| Data processing and communications      | 420    | 824    | 2,036  | 2,214  |
| Other real estate owned operations, net | 11     | (1)    | 65     | 610    |
| FDIC insurance premiums                 | 257    | 201    | 760    | 537    |
| Legal, audit and professional expense   | 625    | 679    | 1,603  | 1,523  |
| Marketing expense                       | 318    | 307    | 736    | 777    |
| Office and postage expense              | 441    | 375    | 1,155  | 960    |
| Loan expense                            | 258    | 282    | 633    | 714    |
| Deposit expense                         | 747    | 497    | 2,255  | 1,172  |
| Merger related expense                  | -      | -      | 626    | 6,723  |
| Other expense                           | 1,053  | 1,059  | 2,913  | 2,622  |
| Total noninterest expense               | 13,343 | 11,771 | 38,525 | 38,806 |

NET INCOME  
BEFORE INCOME

|            |         |         |          |         |
|------------|---------|---------|----------|---------|
| TAX        | 8,860   | 4,912   | 20,555   | 7,902   |
| INCOME TAX | 3,410   | 1,846   | 7,830    | 3,113   |
| NET INCOME | \$5,450 | \$3,066 | \$12,725 | \$4,789 |

EARNINGS PER  
SHARE

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | \$0.32 | \$0.19 | \$0.75 | \$0.31 |
| Diluted | \$0.31 | \$0.18 | \$0.73 | \$0.29 |

WEIGHTED  
AVERAGE  
SHARES  
OUTSTANDING

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 17,069,216 | 16,640,471 | 17,078,945 | 15,512,508 |
| Diluted | 17,342,882 | 17,482,230 | 17,385,835 | 16,314,701 |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(dollars in thousands)  
(unaudited)

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2014                                | 2013     | 2014                               | 2013     |
| Net income   | \$ 5,450                            | \$ 3,066 | \$ 12,725                          | \$ 4,789 |
| Other comprehensive income (loss), net of tax (benefit):   |                                     |          |                                    |          |
| Unrealized holding gains (losses) on securities arising during the period, net of income taxes (benefits) (1)  | 320                                 | (799 )   | 3,469                              | (2,933)  |
| Reclassification adjustment for net gain on sale of securities included in net income, net of income taxes (2) | (214 )                              | (179 )   | (308 )                             | (809 )   |
| Net unrealized gain (loss) on securities, net of income taxes  | 106                                 | (978 )   | 3,161                              | (3,742)  |
| Comprehensive income   | \$ 5,556                            | \$ 2,088 | \$ 15,886                          | \$ 1,047 |

(1) Income taxes on the unrealized gains (losses) on securities was \$75,000 for the three months ended September 30, 2014, (\$683,000) million for the three months ended September 30, 2013, \$2.2 million for the nine months ending September 30, 2014 and (\$2.6) million for the first nine months ending September 30, 2013.

(2) Income taxes on the reclassification adjustment for net gain on sale of securities included in net income was \$149,000 for the three months ended September 30, 2014, \$126,000 for the three months ended September 30, 2013, \$215,000 for the nine months ending September 30, 2014 and \$564,000 for the nine months ending September 30, 2013.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2013  
(dollars in thousands)  
(unaudited)

|  | Common<br>Stock<br>Shares | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Stockholders'<br>Equity |
|--|---------------------------|-----------------|----------------------------------|-------------------------------------|---|----------------------------------|
| Balance at<br>December 31,<br>2013         | 16,656,279                | \$ 166          | \$ 143,322                       | \$ 34,815                           | \$ (3,077)                                      | \$ 175,226                       |
| Net income                                 |                           |                 |                                  | 12,725                              |   | 12,725                           |
| Other<br>comprehensive<br>income           |                           |                 |                                  |                                     | 3,161   | 3,161                            |
| Share-based<br>compensation<br>expense     |                           |                 | 377                              |                                     |   | 377                              |
| Common stock<br>repurchased<br>and retired | (262,897 )                | (2 )            | (2,755 )                         |                                     |   | (2,757 )                         |
| Common stock<br>issued                     | 562,469                   | 6               | 9,006                            |                                     |   | 9,012                            |
| Stock options<br>exercised                 | 113,365                   | 1               | 112                              |                                     |   | 113                              |
| Balance at<br>September 30,<br>2014        | 17,069,216                | \$ 171          | \$ 150,062                       | \$ 47,540                           | \$ 84   | \$ 197,857                       |
| Balance at<br>December 31,<br>2012         | 13,661,648                | \$ 137          | \$ 107,453                       | \$ 25,822                           | \$ 1,105  | \$ 134,517                       |
| Net income                                 |                           |                 |                                  | 4,789                               |   | 4,789                            |
| Other<br>comprehensive<br>income           |                           |                 |                                  |                                     | (3,742)   | (3,742 )                         |
| Share-based<br>compensation                |                           |                 | 680                              |                                     |   | 680                              |



|                                      |            |        |            |           |             |            |
|--------------------------------------|------------|--------|------------|-----------|-------------|------------|
| expense                              |            |        |            |           |             |            |
| Common stock repurchased and retired | (10,960 )  | -      | (41 )      |           |             | (41 )      |
| Common stock issued                  | 2,972,472  | 29     | 34,895     |           |             | 34,924     |
| Stock options exercised              | 18,831     | -      | 27         |           |             | 27         |
| Balance at September 30, 2013        | 16,641,991 | \$ 166 | \$ 143,014 | \$ 30,611 | \$ (2,637 ) | \$ 171,154 |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND  
SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH  
FLOWS

(in thousands)  
(unaudited)

Nine Months Ended  
September 30,  
2014                      2013

CASH FLOWS  
FROM OPERATING  
ACTIVITIES

|  |           |          |
|--|-----------|----------|
| Net income   | \$ 12,725 | \$ 4,789 |
| Adjustments to net income:   |           |          |
| Depreciation and amortization expense                              | 1,636     | 1,423    |
| Provision for loan losses  | 3,263     | 1,264    |
| Share-based compensation expense                                   | 377       | 680      |
| Loss on sale and disposal of premises and equipment                | 23        | 2        |
| Loss on sale of other real estate owned                            | 17        | 226      |
| Write down of other real estate owned                              | -         | 354      |
| Amortization of premium/discounts on securities held for sale, net | 1,958     | 2,319    |
|  | (1,632 )  | (2,032 ) |

|   |           |           |
|---|-----------|-----------|
| Amortization of loan<br>mark-to-market<br>discount from<br>acquisitions                   |           |           |
| Loss from fair market<br>value adjustment to<br>loans held for sale                       | 180       | -         |
| Gain on sale of<br>investment securities<br>available for sale                            | (523 )    | (1,373 )  |
| Other-than-temporary<br>impairment loss<br>(recovery) on<br>investment securities,<br>net | (28 )     | 19        |
| Gain on sale of loans<br>held for investment  | (3,621 )  | (1,927 )  |
| Recoveries on loans   | 87        | 344       |
| Principal payments<br>from loans held for<br>sale   | 31        | 505       |
| Deferred income tax<br>provision  | (2,244 )  | (2,142 )  |
| Change in accrued<br>expenses and other<br>liabilities, net                               | 2,310     | 5,562     |
| Income from bank<br>owned life insurance,<br>net  | (591 )    | (470 )    |
| Change in accrued<br>interest receivable<br>and other assets, net                         | (3,070 )  | 1,196     |
| Net cash provided by<br>operating activities  | 10,898    | 10,739    |
| <b>CASH FLOWS<br/>FROM INVESTING<br/>ACTIVITIES</b>                                       |           |           |
| Proceeds from sale<br>and principal<br>payments on loans<br>held for investment           | 229,887   | 131,619   |
| Net change in<br>undisbursed loan<br>funds  | 43,436    | 246,814   |
| Purchase and<br>origination of loans<br>held for investment                               | (495,070) | (463,706) |
| Proceeds from sale of<br>other real estate<br>owned                                       | 777       | 1,488     |
|   | 21,535    | 27,528    |

|   |           |           |
|---|-----------|-----------|
| Principal payments on securities available for sale             |           |           |
| Purchase of securities available for sale                       | (129,636) | (98,799 ) |
| Proceeds from sale or maturity of securities available for sale | 91,907    | 212,314   |
| Investment in bank own life insurance                           | (2,000 )  | -         |
| Purchases of premises and equipment                             | (1,123 )  | (3,010 )  |
| Purchase of Federal Reserve Bank stock                          | (1,520 )  | (1,276 )  |
| Redemption (purchase) of FHLB stock                             | (1,673 )  | 2,349     |
| Cash acquired (disbursed) in acquisitions, net                  | (7,793 )  | 138,751   |
| Net cash provided by (used in) investing activities             | (251,273) | 194,072   |
| CASH FLOWS FROM FINANCING ACTIVITIES                            |           |           |
| Net increase (decrease) in deposit accounts                     | 237,180   | (161,359) |
| Proceeds from issuance of subordinated debt                     | 58,804    | -         |
| Repayment of FHLB advances and other borrowings, net            | (76,147 ) | (45,931 ) |
| Proceeds from issuance of common stock, net of issuance cost    | -         | 4,560     |
| Proceeds from exercise of stock options                         | 113       | 27        |
| Repurchase of common stock                                      | (2,757 )  | (41 )     |
| Net cash provided by (used in) financing activities             | 217,193   | (202,744) |
| NET INCREASE (DECREASE) IN                                      | (23,182 ) | 2,067     |

|                            |            |           |
|----------------------------|------------|-----------|
| CASH AND CASH EQUIVALENTS  |            |           |
| CASH AND CASH EQUIVALENTS, |            |           |
| beginning of period        | 126,813    | 59,352    |
| CASH AND CASH EQUIVALENTS, |            |           |
| end of period              | \$ 103,631 | \$ 61,419 |

PACIFIC PREMIER BANCORP, INC. AND  
SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH  
FLOWS (Continued)  
(in thousands)  
(unaudited)

Nine Months Ended  
September 30,  
2014                      2013

SUPPLEMENTAL  
CASH FLOW  
DISCLOSURES

|   |           |           |
|---|-----------|-----------|
| Interest paid   | \$ 4,615  | \$ 4,012  |
| Income taxes paid   | 11,450    | 6,825     |
| Assets acquired<br>(liabilities assumed<br>and capital created)<br>in acquisitions (See<br>Note 4): |           |           |
| Investment securities   | -         | 347,196   |
| FHLB and TIB Stock  | -         | 1,765     |
| Loans   | 78,833    | 68,815    |
| Core deposit<br>intangible  | -         | 4,766     |
| Other real estate<br>owned  | -         | 752       |
| Goodwill  | 5,522     | 18,234    |
| Fixed assets  | 74        | 1,446     |
| Other assets  | 702       | 12,468    |
| Deposits  | -         | (540,725) |
| Other borrowings  | (67,617 ) | (16,905 ) |
| Other liabilities   | (709 )    | (7,199 )  |
| Additional paid-in<br>capital   | (9,012 )  | (29,364 ) |

NONCASH  
INVESTING  
ACTIVITIES  
DURING THE

| PERIOD  |          |        |
|---|----------|--------|
| Transfers from loans<br>to other real estate<br>owned                       | \$ 360   | \$ 244 |
| Investment securities<br>available for sale<br>purchased and not<br>settled | \$ 5,982 | \$ -   |
| Loans held for sale<br>transfer to loans held<br>for investment             | \$ 2,936 | \$ -   |

Accompanying notes are an integral part of these consolidated financial statements.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2014  
(UNAUDITED)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Pacific Premier Bancorp, Inc. (the "Corporation") and its wholly owned subsidiaries, including Pacific Premier Bank (the "Bank") (collectively, the "Company," "we," "our" or "us"). All significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position as of September 30, 2014, December 31, 2013, and September 30, 2013, the results of its operations and comprehensive income for the three and nine months ended September 30, 2014 and 2013 and the changes in stockholders' equity and cash flows for the nine months ended September 30, 2014 and 2013. Operating results or comprehensive income for the three and nine months ended September 30, 2014 are not necessarily indicative of the results or comprehensive income that may be expected for any other interim period or the full year ending December 31, 2014.

Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 (the "2013 Annual Report").

The Company accounts for its investments in its wholly owned special purpose entity, PPBI Trust I, under the equity method whereby the subsidiary's net earnings are recognized in the Company's statement of operations.

Note 2 – Recently Issued Accounting Pronouncements

Accounting Standards Adopted in 2014

In July 2013, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." The provisions of ASU No. 2013-11 require an entity to present an unrecognized tax benefit, or portion thereof, in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, with certain exceptions related to availability. The Company adopted the provisions of ASU No. 2013-11 effective January 1, 2014. The adoption of ASU No. 2013-11 had no impact on the Company's Consolidated Financial Statements.

#### Accounting Standards Pending Adoption

In January 2014, the FASB issued ASU No. 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects." ASU No. 2014-01 permits reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. This new guidance also requires new disclosures for all investors in these projects. ASU No. 2014-01 is effective for interim and annual reporting periods beginning after December 15, 2014. Upon adoption, the guidance must be applied retrospectively to all periods presented. However, entities that use the effective yield method to account for investments in these projects before adoption may continue to do so for these pre-existing investments. The Company currently accounts for such investments using the effective yield method and plans to continue to do so for these pre-existing investments after adopting ASU No. 2014-01 on January 1, 2015. The Company expects investments made after January 1, 2015 to meet the criteria required for the proportional amortization method and plans to make such an accounting policy election. The adoption of ASU No. 2014-01 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In January 2014, the FASB issued ASU No. 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure." The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's Consolidated Financial Statements.

#### Note 3 – Significant Accounting Policies

**Certain Acquired Loans:** As part of business acquisitions, the Bank acquires certain loans that have shown evidence of credit deterioration since origination. These acquired loans are recorded at the allocated fair value, such that there is no carryover of the seller's allowance for loan losses. Such acquired loans are accounted for individually. The Bank estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of the allocated fair value is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded

(non-accretable difference). Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded through the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

**Goodwill and Core Deposit Intangible:** Goodwill is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate the necessity for such impairment tests to be performed. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Core deposit intangible assets arising from whole bank acquisitions are amortized on an accelerated method over their estimated useful lives, which range from 6 to 10 years.

**Use of Estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly subject to change.

#### Note 4 – Acquisitions

The Company accounted for the following transactions under the acquisition method of accounting which requires purchased assets and liabilities assumed to be recorded at their respective fair values at the date of acquisition. The Company determined the fair value of the core deposit intangible, securities and deposits with the assistance of third party valuations. The fair value of other real estate owned (“OREO”) was based on recent appraisals of the properties.

The estimated fair values in these acquisitions are subject to refinement as additional information relative to the closing date fair values become available through the measurement period, which can extend for up to one year after the closing date of the transaction. While additional significant changes to the closing date fair values are not expected, any information relative to the changes in these fair values will be evaluated to determine if such changes are due to events and circumstances that existed as of the acquisition date. During the measurement period, any such changes will be recorded as part of the closing date fair value.

#### Infinity Franchise Holdings Acquisition

On January 30, 2014, the Company completed its acquisition of Infinity Franchise Holdings, LLC (“Infinity Holdings”) and its wholly owned operating subsidiary Infinity Franchise Capital, LLC (“IFC” and together with Infinity Holdings, “IFH”), a national lender to franchisees in the quick service restaurant (“QSR”) industry, and other direct and indirect subsidiaries utilized in its business. The value of the total consideration paid for the IFH acquisition was \$17.4 million, which consisted of \$8.3 million paid in cash and the issuance of 562,469 shares of the Corporation’s stock, which was valued at \$16.02 per share as measured by the 10-day average closing price immediately prior to closing of the transaction.

The acquisition of IFH is expected to further diversify our loan portfolio with commercial and industrial and owner-occupied commercial real estate loans, to deploy excess liquidity into higher yielding assets, to positively impact our net interest margin and to further leverage our strong capital base. The QSR franchisee lending business is a niche market that we believe provides attractive growth opportunities for the Company in the future. IFH had no

delinquent loans or adversely classified assets as of the acquisition date; and the acquisition is expected to be accretive to our 2014 earnings per share.

Goodwill in the amount of \$5.5 million was recognized in the IFH acquisition. Goodwill represents the future economic benefits arising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the combination of the two entities. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of IFH as of January 30, 2014 and the provisional fair value adjustments and amounts recorded by the Company in 2014 under the acquisition method of accounting:

|  | IFH<br>Book<br>Value   | Fair Value<br>Adjustments | Fair<br>Value |
|--|------------------------|---------------------------|---------------|
|  | (dollars in thousands) |                           |               |
| <b>ASSETS</b>                                      |                        |                           |               |
| <b>ACQUIRED</b>                                    |                        |                           |               |
| Cash and cash equivalents                          | \$ 555                 | \$ -                      | \$ 555        |
| Loans, gross                                       | 78,833                 | -                         | 78,833        |
| Deferred loan costs                                | 1,082                  | (1,082 )                  | -             |
| Allowance for loan losses                          | (268 )                 | 268                       | -             |
| Other assets                                       | 776                    | -                         | 776           |
| Total assets acquired                              | \$ 80,978              | \$ (814 )                 | \$ 80,164     |
| <b>LIABILITIES</b>                                 |                        |                           |               |
| <b>ASSUMED</b>                                     |                        |                           |               |
| Bank loan  | \$ 67,617              | \$ -                      | \$ 67,617     |
| Accrued compensation                               | 495                    | -                         | 495           |
| Other liabilities                                  | 214                    | -                         | 214           |
| Total liabilities assumed                          | 68,326                 | -                         | 68,326        |
| Excess of assets acquired over liabilities assumed | \$ 12,652              | \$ (814 )                 | 11,838        |
| Consideration paid                                 |                        |                           | 17,360        |
| Goodwill recognized                                |                        |                           | \$ 5,522      |



## San Diego Trust Bank Acquisition

On June 25, 2013, the Company completed its acquisition of San Diego Trust Bank (“SDTB”) in exchange for consideration valued at \$30.6 million which consisted of \$16.2 million of cash and 1,198,255 shares of the Corporation’s common stock.

SDTB was a San Diego, California based state-chartered bank. The acquisition was an opportunity for the Company to acquire a banking network that complemented our existing banking franchise and expanded into a new market area. Additionally, the SDTB acquisition improved the Company’s deposit base by lowering our cost of deposits and providing an opportunity to accelerate future core deposit growth in the San Diego, California, market area.

Goodwill in the amount of \$5.6 million was recognized in the SDTB acquisition. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of SDTB as of June 25, 2013 and the provisional fair value adjustments and amounts recorded by the Company in 2013 under the acquisition method of accounting:

|                                | SDTB<br>Book<br>Value | Fair Value<br>Adjustments | Fair<br>Value |
|--------------------------------|-----------------------|---------------------------|---------------|
| (dollars in thousands)         |                       |                           |               |
| <b>ASSETS<br/>ACQUIRED</b>     |                       |                           |               |
| Cash and cash equivalents      | \$ 30,252             | \$ -                      | \$ 30,252     |
| Investment securities          | 124,960               | (155 )                    | 124,805       |
| Loans, gross                   | 42,945                | (223 )                    | 42,722        |
| Allowance for loan losses      | (1,013 )              | 1,013                     | -             |
| Other real estate owned        | 752                   | -                         | 752           |
| Core deposit intangible        | -                     | 2,836                     | 2,836         |
| Other assets                   | 9,856                 | -                         | 9,856         |
| Total assets acquired          | \$ 207,752            | \$ 3,471                  | \$ 211,223    |
| <b>LIABILITIES<br/>ASSUMED</b> |                       |                           |               |
| Deposits                       | \$ 183,901            | \$ 6                      | \$ 183,907    |
| Deferred tax liability (asset) | (333 )                | 1,507                     | 1,174         |
| Other liabilities              | 1,823                 | (729 )                    | 1,094         |
|                                | 185,391               | 784                       | 186,175       |

|  |           |          |          |
|--|-----------|----------|----------|
| Total liabilities assumed                          |           |          |          |
| Excess of assets acquired over liabilities assumed | \$ 22,361 | \$ 2,687 | 25,048   |
| Consideration paid                                 |           |          | 30,622   |
| Goodwill recognized                                |           |          | \$ 5,574 |

### First Association Bank Acquisition

On March 15, 2013, the Company completed its acquisition of First Association Bank (“FAB”) in exchange for consideration valued as of the closing at \$57.9 million which consisted of \$43.0 million of cash and 1,279,217 shares of the Corporation’s common stock.

FAB was a Dallas, Texas, based bank which specialized in providing commercial banking services to home owner association (“HOA”) management companies throughout the United States. The FAB acquisition was an opportunity for the Company to acquire a highly efficient, consistently profitable and niche-focused business that complimented our banking franchise. Additionally, this acquisition improved the Company’s deposit base by lowering our cost of deposits and providing a platform to accelerate future core deposit growth from HOAs.

Goodwill in the amount of \$11.9 million was recognized in the FAB acquisition. Goodwill recognized in this transaction is not deductible for income tax purposes.

The following table represents the assets acquired and liabilities assumed of FAB as of March 15, 2013, the provisional fair value adjustments and amounts recorded by the Company in 2013 under the acquisition method of accounting:

|   | FAB<br>Book<br>Value | Fair Value<br>Adjustments | Fair<br>Value |
|---|----------------------|---------------------------|---------------|
| ASSETS<br>ACQUIRED (dollars in thousands) |                      |                           |               |
| Cash and cash equivalents                 | \$ 167,663           | \$ -                      | \$ 167,663    |
| Investment securities                     | 219,913              | 2,478                     | 222,391       |
| Loans, gross                              | 26,264               | 158                       | 26,422        |
| Allowance for loan losses                 | (224 )               | 224                       | -             |
| Core deposit intangible                   | -                    | 1,930                     | 1,930         |
| Other assets                              | 5,823                | -                         | 5,823         |

|  |            |          |            |
|--|------------|----------|------------|
| Total assets<br>acquired                                       | \$ 419,439 | \$ 4,790 | \$ 424,229 |
| <b>LIABILITIES<br/>ASSUMED</b>                                 |            |          |            |
| Deposits   | \$ 356,737 | \$ 81    | \$ 356,818 |
| Borrowings   | 16,905     | -        | 16,905     |
| Deferred tax<br>liability                                      | -          | 3,918    | 3,918      |
| Other<br>Liabilities   | 536        | -        | 536        |
| Total<br>liabilities<br>assumed                                | 374,178    | 3,999    | 378,177    |
| Excess of<br>assets<br>acquired over<br>liabilities<br>assumed | \$ 45,261  | \$ 791   | 46,052     |
| Consideration<br>paid  |            |          | 57,906     |
| Goodwill<br>recognized   |            |          | \$ 11,854  |

There were no purchased credit impaired loans acquired from FAB, SDTB or IFH. For loans acquired from FAB, SDTB and IFH, the contractual amounts due, expected cash flows to be collected, interest component and fair value as of the respective acquisition dates were as follows:

Acquired Loans  
FAB      SDTB      IFH  
(dollars in thousands)

|   |           |           |           |
|---|-----------|-----------|-----------|
| Contractual<br>amounts<br>due                       | \$ 32,107 | \$ 47,251 | \$ 98,320 |
| Cash flows<br>not<br>expected to<br>be<br>collected | -         | -         | -         |
| Expected<br>cash flows                              | 32,107    | 47,251    | 98,320    |
| Interest<br>component<br>of expected<br>cash flows  | 5,685     | 4,529     | 19,487    |
| Fair value<br>of acquired<br>loans                  | \$ 26,422 | \$ 42,722 | \$ 78,833 |

In accordance with generally accepted accounting principles, there was no carryover of the allowance for loan losses that had been previously recorded by FAB, SDTB or IFH.

The operating results of the Company for the nine months ending September 30, 2014 include the operating results of FAB, SDTB and IFH since their respective acquisition dates. The following table presents the net interest and other income, net income and earnings per share as if the acquisition of IFH was effective as of January 1, 2014 and as if the acquisitions of FAB and SDTB were effective as of January 1, 2013. There were no material, nonrecurring adjustments to the pro forma net interest and other income, net income and earnings per share presented below:

|                               | Nine months<br>Ended September<br>30, |          |
|-------------------------------|---------------------------------------|----------|
|                               | 2014                                  | 2013     |
| Net interest and other income | \$62,378                              | \$53,232 |
| Net income                    | \$12,344                              | \$5,027  |
| Basic earnings per share      | \$0.72                                | \$0.27   |
| Diluted earnings per share    | \$0.71                                | \$0.26   |

Note 5 – Investment Securities

The amortized cost and estimated fair value of securities were as follows:

|   | September 30, 2014 |                    |                    |                            |
|---|--------------------|--------------------|--------------------|----------------------------|
|   | Amortized<br>Cost  | Unrealized<br>Gain | Unrealized<br>Loss | Estimated<br>Fair<br>Value |
|   | (in thousands)     |                    |                    |                            |
| Investment securities available for sale: |                    |                    |                    |                            |
| Municipal bonds                           | \$97,358           | \$1,495            | \$(268 )           | \$98,585                   |
| Mortgage-backed securities                | 184,701            | 180                | (1,264)            | 183,617                    |

|                                     |           |         |           |           |
|-------------------------------------|-----------|---------|-----------|-----------|
| Total securities available for sale | \$282,059 | \$1,675 | \$(1,532) | \$282,202 |
|-------------------------------------|-----------|---------|-----------|-----------|

| Investment securities available for sale: | December 31, 2013 |                 |                 |                      |
|---|-------------------|-----------------|-----------------|----------------------|
|   | Amortized Cost    | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
|   | (in thousands)    |                 |                 |                      |
| U.S. Treasury                             | \$73              | \$8             | \$-             | \$81                 |
| Municipal bonds                           | 95,388            | 589             | (1,850)         | 94,127               |
| Mortgage-backed securities                | 165,857           | 12              | (3,988)         | 161,881              |
| Total securities available for sale       | \$261,318         | \$609           | \$(5,838)       | \$256,089            |

| Investment securities available for sale: | September 30, 2013 |                 |                 |                      |
|---|--------------------|-----------------|-----------------|----------------------|
|   | Amortized Cost     | Unrealized Gain | Unrealized Loss | Estimated Fair Value |
|   | (in thousands)     |                 |                 |                      |
| U.S. Treasury                             | \$73               | \$9             | \$-             | \$82                 |
| Municipal bonds                           | 95,971             | 709             | (1,795)         | 94,885               |
| Mortgage-backed securities                | 191,282            | 182             | (3,585)         | 187,879              |
| Total securities available for sale       | \$287,326          | \$900           | \$(5,380)       | \$282,846            |

At September 30, 2014, the Company had \$9.2 million in Federal Home Loan Bank (“FHLB”) stock, \$5.4 million in Federal Reserve Bank (“FRB”) stock, and \$4.1 million in other stock, all carried at cost. During the nine months ended September 30, 2014, the FHLB has repurchased \$2.2 million of the Company’s excess FHLB stock through its stock repurchase program.

At September 30, 2014, mortgage-backed securities (“MBS”) with an estimated par value of \$63.4 million and a fair value of \$65.5 million were pledged as collateral for the Bank’s three reverse repurchase agreements which totaled \$28.5 million and HOA reverse repurchase agreements which totaled \$16.1 million.

The table below shows the number, fair value and gross unrealized holding losses of the Company’s investment securities by investment category and length of time that the securities have been in a continuous loss position.

|  | September 30, 2014  |                     | Total |
|--|---------------------|---------------------|-------|
|  | Less than 12 months | 12 months or Longer |       |

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|                            | Number    | Fair Value        | Gross Unrealized Holding Losses | Number    | Fair Value       | Gross Unrealized Holding Losses | Number    | Fair Value        | Gross Unrealized Holding Losses |
|----------------------------|-----------|-------------------|---------------------------------|-----------|------------------|---------------------------------|-----------|-------------------|---------------------------------|
| (dollars in thousands)     |           |                   |                                 |           |                  |                                 |           |                   |                                 |
| Municipal bonds            | 29        | \$ 16,804         | \$(183 )                        | 26        | \$ 10,459        | \$(85 )                         | 55        | \$ 27,263         | \$(268 )                        |
| Mortgage-backed securities | 22        | 85,248            | (256 )                          | 9         | 42,516           | (1,008 )                        | 31        | 127,764           | (1,264)                         |
| <b>Total</b>               | <b>51</b> | <b>\$ 102,052</b> | <b>\$(439 )</b>                 | <b>35</b> | <b>\$ 52,975</b> | <b>\$(1,093 )</b>               | <b>86</b> | <b>\$ 155,027</b> | <b>\$(1,532)</b>                |

|                            | Less than 12 months |                   |                                 | December 31, 2013<br>12 months or Longer |                  |                                 | Total      |                   |                                 |
|----------------------------|---------------------|-------------------|---------------------------------|--|------------------|---------------------------------|------------|-------------------|---------------------------------|
|                            | Number              | Fair Value        | Gross Unrealized Holding Losses | Number                                   | Fair Value       | Gross Unrealized Holding Losses | Number     | Fair Value        | Gross Unrealized Holding Losses |
| (dollars in thousands)     |                     |                   |                                 |  |                  |                                 |            |                   |                                 |
| Municipal bonds            | 133                 | \$ 61,524         | \$(1,850)                       | -  | \$ -             | \$ -                            | 133        | \$ 61,524         | \$(1,850)                       |
| Mortgage-backed securities | 45                  | 140,704           | (3,075)                         | 1  | 12,607           | (913 )                          | 46         | 153,311           | (3,988)                         |
| <b>Total</b>               | <b>178</b>          | <b>\$ 202,228</b> | <b>\$(4,925)</b>                | <b>1</b>                                 | <b>\$ 12,607</b> | <b>\$(913 )</b>                 | <b>179</b> | <b>\$ 214,835</b> | <b>\$(5,838)</b>                |

|                            | Less than 12 months |                   |                                 | September 30, 2013<br>12 months or Longer |                  |                                 | Total      |                   |                                 |
|----------------------------|---------------------|-------------------|---------------------------------|---|------------------|---------------------------------|------------|-------------------|---------------------------------|
|                            | Number              | Fair Value        | Gross Unrealized Holding Losses | Number                                    | Fair Value       | Gross Unrealized Holding Losses | Number     | Fair Value        | Gross Unrealized Holding Losses |
| (dollars in thousands)     |                     |                   |                                 |   |                  |                                 |            |                   |                                 |
| Municipal bonds            | 131                 | \$ 60,183         | \$(1,795)                       | -   | \$ -             | \$ -                            | 131        | \$ 60,183         | \$(1,795)                       |
| Mortgage-backed securities | 39                  | 136,513           | (2,725)                         | 1   | 13,117           | (860 )                          | 40         | 149,630           | (3,585)                         |
| <b>Total</b>               | <b>170</b>          | <b>\$ 196,696</b> | <b>\$(4,520)</b>                | <b>1</b>                                  | <b>\$ 13,117</b> | <b>\$(860 )</b>                 | <b>171</b> | <b>\$ 209,813</b> | <b>\$(5,380)</b>                |

The amortized cost and estimated fair value of investment securities available for sale at September 30, 2014, by contractual maturity are shown in the table below.

|                        | One Year or Less | More than One Year to Five Years | More than Five Years to Ten Years | More than Ten Years | Total          |
|------------------------|------------------|----------------------------------|-----------------------------------|---------------------|----------------|
|                        | Amortized Cost   | Fair Value                       | Amortized Cost                    | Fair Value          | Amortized Cost |
| (dollars in thousands) |                  |                                  |                                   |                     |                |

Investment securities available for sale:

|   |          |          |               |               |               |               |                |                |                |                |
|---|----------|----------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|----------------|
| Municipal bonds                                       | \$-      | \$-      | \$12,828      | \$12,877      | \$41,817      | \$42,379      | \$42,713       | \$43,329       | \$97,358       | \$98,585       |
| Mortgage-backed securities                            | -        | -        | -             | -             | 30,477        | 30,394        | 154,224        | 153,223        | 184,701        | 183,617        |
| <b>Total investment securities available for sale</b> | <b>-</b> | <b>-</b> | <b>12,828</b> | <b>12,877</b> | <b>72,294</b> | <b>72,773</b> | <b>196,937</b> | <b>196,552</b> | <b>282,059</b> | <b>282,202</b> |

Any temporary impairment is a result of the change in market interest rates and not the underlying issuers' ability to repay. The Company has the intent and ability to hold these securities until the temporary impairment is eliminated. Accordingly, the Company has not recognized the temporary impairment in earnings.

Unrealized gains and losses on investment securities available for sale are recognized in stockholders' equity as accumulated other comprehensive income or loss. At September 30, 2014, the Company had accumulated other comprehensive income of \$143,000, or \$84,000 net of tax, compared to accumulated other comprehensive loss of \$5.2 million, or \$3.1 million net of tax, at December 31, 2013.

#### Note 6 – Loans Held for Investment

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

|  | September<br>30, 2014 | December<br>31, 2013 | September<br>30, 2013 |
|--|-----------------------|----------------------|-----------------------|
|  | (in thousands)        |                      |                       |
| <b>Business loans:</b>                 |                       |                      |                       |
| <b>Commercial and industrial</b>       | <b>\$360,700</b>      | <b>\$187,035</b>     | <b>\$173,720</b>      |
| Commercial owner occupied (1)          | 237,996               | 221,089              | 222,162               |
| SBA                                    | 20,482                | 10,659               | 6,455                 |
| Warehouse facilities                   | 108,093               | 87,517               | 49,104                |
| <b>Real estate loans:</b>              |                       |                      |                       |
| Commercial non-owner occupied          | 355,984               | 333,544              | 304,979               |
| Multi-family                           | 262,588               | 233,689              | 218,929               |
| One-to-four family (2)                 | 125,326               | 145,235              | 152,667               |
| Construction                           | 67,118                | 13,040               | 2,835                 |
| Land                                   | 6,103                 | 7,605                | 7,371                 |
| Other loans                            | 3,521                 | 3,839                | 3,793                 |
| Total gross loans (3)                  | 1,547,911             | 1,243,252            | 1,142,015             |
| Less loans held for sale, net          | -                     | 3,147                | 3,176                 |
| Total gross loans held for investment  | 1,547,911             | 1,240,105            | 1,138,839             |
| Deferred loan origination costs/(fees) | 93                    | 18                   | 130                   |

|                                     |             |             |             |
|-------------------------------------|-------------|-------------|-------------|
| and<br>premiums/(discounts),<br>net |             |             |             |
| Allowance for loan<br>losses        | (10,767 )   | (8,200 )    | (7,994 )    |
| Loans held for<br>investment, net   | \$1,537,237 | \$1,231,923 | \$1,130,975 |

- (1) Majority secured by real estate.
- (2) Includes second trust deeds.
- (3) Total gross loans for September 30, 2014 are net of (i) the unaccreted mark-to-market discounts on Canyon National Bank ("Canyon National") loans of \$1.5 million, on Palm Desert National Bank ("Palm Desert National") loans of \$1.7 million, and on SDTB loans of \$145,000 and (ii) the mark-to-market premium on FAB loans of \$31,000.

From time to time, we may purchase or sell loans in order to manage concentrations, maximize interest income, change risk profiles, improve returns and generate liquidity.

The Company makes residential and commercial loans held for investment to customers located primarily in California. Consequently, the underlying collateral for our loans and a borrower's ability to repay may be impacted unfavorably by adverse changes in the economy and real estate market in the region.

Under applicable laws and regulations, the Bank may not make secured loans to one borrower in excess of 25% of the Bank's unimpaired capital plus surplus and likewise in excess of 15% for unsecured loans. These loans-to-one borrower limitations result in a dollar limitation of \$63.2 million for secured loans and \$37.9 million for unsecured loans at September 30, 2014. At September 30, 2014, the Bank's largest aggregate outstanding balance of loans to one borrower was \$34.2 million of secured credit.

#### Purchased Credit Impaired

The following table provides a summary of the Company's investment in purchased credit impaired loans, acquired from Canyon National and Palm Desert National, as of the period indicated:

|                                 | September 30, 2014 |          |       |
|---------------------------------|--------------------|----------|-------|
|                                 | Canyon             | Palm     |       |
|                                 | National           | Desert   | Total |
|                                 | National           | National |       |
|                                 | (in thousands)     |          |       |
| Business<br>loans:              |                    |          |       |
| Commercial<br>and<br>industrial | \$ 92              | \$ -     | \$ 92 |
| Commercial<br>owner             | 555                | -        | 555   |



|             |          |      |          |
|-------------|----------|------|----------|
| occupied    |          |      |          |
| Real estate |          |      |          |
| loans:      |          |      |          |
| Commercial  |          |      |          |
| non-owner   |          |      |          |
| occupied    | 971      | -    | 971      |
| One-to-four |          |      |          |
| family      | -        | 8    | 8        |
| Total       |          |      |          |
| purchase    |          |      |          |
| credit      |          |      |          |
| impaired    | \$ 1,618 | \$ 8 | \$ 1,626 |

On the acquisition date, the amount by which the undiscounted expected cash flows of the purchased credit impaired loans exceed the estimated fair value of the loan is the “accretable yield.” The accretable yield is measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the purchased credit impaired loan. At September 30, 2014, the Company had \$1.6 million of purchased credit impaired loans, none of which were placed on nonaccrual status.

The following table summarizes the accretable yield on the purchased credit impaired for the nine months ended September 30, 2014:

|                                    | Nine Months Ended |          |          |
|------------------------------------|-------------------|----------|----------|
|                                    | September         |          |          |
|                                    | 30,               |          |          |
|                                    | 2014              |          |          |
|                                    | Palm              |          |          |
|                                    | Canyon            | Desert   | Total    |
|                                    | National          | National |          |
|                                    | (in thousands)    |          |          |
| Balance at the beginning of period | \$ 1,623          | \$ 53    | \$ 1,676 |
| Accretion                          | (192 )            | (1 )     | (193 )   |
| Disposals and other                | (17 )             | -        | (17 )    |
| Change in accretable yield         | -                 | -        | -        |
| Balance at the end of period       | \$ 1,414          | \$ 52    | \$ 1,466 |

#### Impaired Loans

The following tables provide a summary of the Company’s investment in impaired loans as of the period indicated:

|  | Impaired Loans                                |                                       |                               |                                  |                               |                                   |                                  |
|--|---|---------------------------------------|-------------------------------|----------------------------------|-------------------------------|-----------------------------------|----------------------------------|
|  | Contractual<br>Unpaid<br>Principal<br>Balance | Contractual<br>Recorded<br>Investment | With<br>Specific<br>Allowance | Without<br>Specific<br>Allowance | Specific<br>Impaired<br>Loans | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|  | (in thousands)                                |                                       |                               |                                  |                               |                                   |                                  |
| September<br>30, 2014                    |   |                                       |                               |                                  |                               |                                   |                                  |
| <b>Business<br/>loans:</b>               |   |                                       |                               |                                  |                               |                                   |                                  |
| Commercial<br>and<br>industrial          | \$ -  | \$ -                                  | \$ -                          | \$ -                             | \$ -                          | \$ 15                             | \$ -                             |
| <b>Commercial<br/>owner<br/>occupied</b> | <b>441</b>                                    | <b>398</b>                            | <b>-</b>                      | <b>398</b>                       | <b>-</b>                      | <b>555</b>                        | <b>41</b>                        |
| SBA                                      | -   | -                                     | -                             | -                                | -                             | 6                                 | -                                |
| <b>Real estate<br/>loans:</b>            |   |                                       |                               |                                  |                               |                                   |                                  |
| Commercial<br>non-owner<br>occupied      | 1,221   | 883                                   | -                             | 883                              | -                             | 924                               | 65                               |
| <b>One-to-four<br/>family</b>            | <b>649</b>                                    | <b>526</b>                            | <b>-</b>                      | <b>526</b>                       | <b>-</b>                      | <b>504</b>                        | <b>18</b>                        |
| Totals                                   | \$ 2,311                                      | \$ 1,807                              | \$ -                          | \$ 1,807                         | \$ -                          | \$ 2,004                          | \$ 124                           |

|  | Impaired Loans                                |                                       |                               |                                  |                               |                                   |                                  |
|--|---|---------------------------------------|-------------------------------|----------------------------------|-------------------------------|-----------------------------------|----------------------------------|
|  | Contractual<br>Unpaid<br>Principal<br>Balance | Contractual<br>Recorded<br>Investment | With<br>Specific<br>Allowance | Without<br>Specific<br>Allowance | Specific<br>Impaired<br>Loans | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|  | (in thousands)                                |                                       |                               |                                  |                               |                                   |                                  |
| December<br>31, 2013                     |   |                                       |                               |                                  |                               |                                   |                                  |
| <b>Business<br/>loans:</b>               |   |                                       |                               |                                  |                               |                                   |                                  |
| Commercial<br>and<br>industrial          | \$ -  | \$ -                                  | \$ -                          | \$ -                             | \$ -                          | \$ 255                            | \$ 17                            |
| <b>Commercial<br/>owner<br/>occupied</b> | <b>872</b>                                    | <b>747</b>                            | <b>-</b>                      | <b>747</b>                       | <b>-</b>                      | <b>177</b>                        | <b>66</b>                        |
| SBA                                      | 246   | 14                                    | -                             | 14                               | -                             | 70                                | 28                               |
| <b>Real estate<br/>loans:</b>            |   |                                       |                               |                                  |                               |                                   |                                  |
| Commercial<br>non-owner                  | 1,202   | 983                                   | 28                            | 955                              | 1                             | 984                               | 68                               |

|              |          |          |        |          |        |          |        |  |
|--------------|----------|----------|--------|----------|--------|----------|--------|--|
| occupied     |          |          |        |          |        |          |        |  |
| Multi-family | -        | -        | -      | -        | -      | 108      | 2      |  |
| One-to-four  |          |          |        |          |        |          |        |  |
| family       | 746      | 683      | 278    | 405      | 104    | 743      | 44     |  |
| Totals       | \$ 3,066 | \$ 2,427 | \$ 306 | \$ 2,121 | \$ 105 | \$ 2,337 | \$ 225 |  |

## Impaired Loans

|              | Contractual    |            | With Specific |           | Specific  |            | Average    | Interest   |
|--------------|----------------|------------|---------------|-----------|-----------|------------|------------|------------|
|              | Unpaid         | Recorded   | Specific      | Without   | Allowance | Impaired   |            |            |
|              | Principal      | Investment | Allowance     | Specific  | for       | Recorded   | Income     | Recognized |
|              | Balance        | Allowance  | Allowance     | Allowance | Loans     | Investment | Recognized |            |
|              | (in thousands) |            |               |           |           |            |            |            |
| September    |                |            |               |           |           |            |            |            |
| 30, 2013     |                |            |               |           |           |            |            |            |
| Business     |                |            |               |           |           |            |            |            |
| loans:       |                |            |               |           |           |            |            |            |
| Commercial   |                |            |               |           |           |            |            |            |
| and          |                |            |               |           |           |            |            |            |
| industrial   | \$ 186         | \$ 68      | \$ -          | \$ 68     | \$ -      | \$ 326     | \$ 71      |            |
| Commercial   |                |            |               |           |           |            |            |            |
| owner        |                |            |               |           |           |            |            |            |
| occupied     | -              | -          | -             | -         | -         | 153        | 18         |            |
| SBA          | 246            | 14         | -             | 14        | -         | 60         | 16         |            |
| Real estate  |                |            |               |           |           |            |            |            |
| loans:       |                |            |               |           |           |            |            |            |
| Commercial   |                |            |               |           |           |            |            |            |
| non-owner    |                |            |               |           |           |            |            |            |
| occupied     | 527            | 437        | -             | 437       | -         | 983        | 157        |            |
| Multi-family | -              | -          | -             | -         | -         | 144        | 2          |            |
| One-to-four  |                |            |               |           |           |            |            |            |
| family       | 701            | 642        | 282           | 360       | 104       | 772        | 154        |            |
| Totals       | \$ 1,660       | \$ 1,161   | \$ 282        | \$ 879    | \$ 104    | \$ 2,438   | \$ 418     |            |

The Company considers a loan to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or it is determined that the likelihood of the Company receiving all scheduled payments, including interest, when due is remote. The Company has no commitments to lend additional funds to debtors whose loans have been impaired.

The Company reviews loans for impairment when the loan is classified as substandard or worse, delinquent 90 days, or determined by management to be collateral dependent, or when the borrower files bankruptcy or is granted a troubled debt restructuring ("TDR"). Measurement of impairment is based on the loan's expected future cash flows discounted at the loan's effective interest rate, measured by reference to an observable market value, if one exists, or the fair value of the collateral if the loan is deemed collateral dependent. All loans are generally charged-off at such time the loan is classified as a loss. Valuation allowances are determined on a loan-by-loan basis or by aggregating loans with similar risk characteristics.

The following table provides additional detail on the components of impaired loans at the period end indicated:

|                            | September<br>30,<br>2014 | December<br>31,<br>2013 | September<br>30,<br>2013 |
|----------------------------|--------------------------|-------------------------|--------------------------|
|                            | (in thousands)           |                         |                          |
| Nonaccruing<br>loans       | \$1,624                  | \$2,239                 | \$972                    |
| Accruing<br>loans          | 183                      | 188                     | 189                      |
| Total<br>impaired<br>loans | \$1,807                  | \$2,427                 | \$1,161                  |

When loans are placed on nonaccrual status all accrued interest is reversed from earnings. Payments received on nonaccrual loans are generally applied as a reduction to the loan principal balance. If the likelihood of further loss is remote, the Company will recognize interest on a cash basis only. Loans may be returned to accruing status if the Company believes that all remaining principal and interest is fully collectible and there has been at least three months of sustained repayment performance since the loan was placed on nonaccrual.

The Company does not accrue interest on loans 90 days or more past due or when, in the opinion of management, there is reasonable doubt as to the collection of interest. The Company had impaired loans on nonaccrual status of \$1.6 million at September 30, 2014, \$2.2 million at December 31, 2013, and \$972,000 at September 30, 2013. The Company had no loans 90 days or more past due and still accruing at September 30, 2014, December 31, 2013 or September 30, 2013.

The Company had no TDRs during the quarter ended September 30, 2014 and had one immaterial TDR outstanding related to a U.S. Small Business Administration (“SBA”) loan.

#### Concentration of Credit Risk

As of September 30, 2014, the Company’s loan portfolio was collateralized by various forms of real estate and business assets located principally in California. The Company’s loan portfolio contains concentrations of credit in multi-family real estate, commercial non-owner occupied real estate and commercial owner occupied business loans. The Bank maintains policies approved by the Bank’s Board of Directors (the “Bank Board”) that address these concentrations and continues to diversify its loan portfolio through loan originations, purchases and sales to meet approved concentration levels. While management believes that the collateral presently securing these loans is adequate, there can be no assurances that a significant deterioration in the California real estate market or economy would not expose the Company to significantly greater credit risk.

#### Credit Quality and Credit Risk Management

The Company’s credit quality is maintained and credit risk managed in two distinct areas. The first is the loan origination process, wherein the Bank underwrites credit quality and chooses which risks it is willing to accept. The second is in the ongoing oversight of the loan portfolio, where existing credit risk is measured and monitored, and where performance issues are dealt with in a timely and comprehensive fashion.

The Company maintains a comprehensive credit policy which sets forth minimum and maximum tolerances for key elements of loan risk. The policy identifies and sets forth specific guidelines for analyzing each of the loan products

the Company offers from both an individual and portfolio wide basis. The credit policy is reviewed annually by the Bank Board. The Bank's seasoned underwriters ensure all key risk factors are analyzed with nearly all underwriting including a comprehensive global cash flow analysis of the prospective borrowers. The credit approval process mandates multiple-signature approval by the management credit committee for every loan that requires any subjective credit analysis.

Credit risk is managed within the loan portfolio by the Company's Portfolio Management department based on a comprehensive credit and investment review policy. This policy requires a program of financial data collection and analysis, comprehensive loan reviews, property and/or business inspections and monitoring of portfolio concentrations and trends. The Portfolio Management department also monitors asset-based lines of credit, loan covenants and other conditions associated with the Company's business loans as a means to help identify potential credit risk. Individual loans, excluding the homogeneous loan portfolio, are reviewed at least biennially, and in most cases more often, including the assignment of a risk grade.

Risk grades are based on a six-grade Pass scale, along with Special Mention, Substandard, Doubtful and Loss classifications as such classifications are defined by the regulatory agencies. The assignment of risk grades allows the Company to, among other things, identify the risk associated with each credit in the portfolio, and to provide a basis for estimating credit losses inherent in the portfolio. Risk grades are reviewed regularly by the Company's Credit and Investment Review committee, and are reviewed annually by an independent third-party, as well as by regulatory agencies during scheduled examinations.

The following provides brief definitions for risk grades assigned to loans in the portfolio:

- Pass classifications represent assets with a level of credit quality which contain no well-defined deficiency or weakness.
- Special Mention assets do not currently expose the Bank to a sufficient risk to warrant classification in one of the adverse categories, but possess correctable deficiency or potential weaknesses deserving management's close attention.
  - Substandard assets are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. These assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. OREO acquired from foreclosure is also classified as substandard.
- Doubtful credits have all the weaknesses inherent in substandard credits, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loss assets are those that are considered uncollectible and of such little value that their continuance as assets is not warranted. Amounts classified as loss are promptly charged off.

The Portfolio Management department also manages loan performance risks, collections, workouts, bankruptcies and foreclosures. Loan performance risks are mitigated by our portfolio managers acting promptly and assertively to address problem credits when they are identified. Collection efforts are commenced immediately upon non-payment, and the portfolio managers seek to promptly determine the appropriate steps to minimize the Company's risk of loss. When foreclosure will maximize the Company's recovery for a non-performing loan, the portfolio managers will take appropriate action to initiate the foreclosure process.

When a loan is graded as special mention or substandard or doubtful, the Company obtains an updated valuation of the underlying collateral. If the credit in question is also identified as impaired, a valuation allowance, if necessary, is established against such loan or a loss is recognized by a charge to the allowance for loan losses ("ALLL") if management believes that the full amount of the Company's recorded investment in the loan is no longer collectable. The Company typically continues to obtain updated valuations of underlying collateral for special mention and classified loans on an annual basis in order to have the most current indication of fair value. Once a loan

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is identified as impaired, an analysis of the underlying collateral is performed at least quarterly, and corresponding changes in any related valuation allowance are made or balances deemed to be fully uncollectable are charged-off.

The following tables stratify the loan portfolio by the Company's internal risk grading system as well as certain other information concerning the credit quality of the loan portfolio as of the periods indicated:

|                                  | Credit Risk Grades |                    |                 | Total Gross<br>Loans |
|----------------------------------|--------------------|--------------------|-----------------|----------------------|
|                                  | Pass               | Special<br>Mention | Substandard     |                      |
| September<br>30, 2014            | (in thousands)     |                    |                 |                      |
| <b>Business loans:</b>           |                    |                    |                 |                      |
| Commercial and industrial        | \$358,922          | \$-                | \$1,778         | \$360,700            |
| <b>Commercial owner occupied</b> |                    |                    |                 |                      |
| SBA                              | 228,154            | 387                | 9,455           | 237,996              |
| Warehouse facilities             | 20,482             | -                  | -               | 20,482               |
| <b>Real estate loans:</b>        |                    |                    |                 |                      |
| Commercial non-owner occupied    | 108,093            | -                  | -               | 108,093              |
| Multi-family                     | 351,614            | -                  | 4,370           | 355,984              |
| One-to-four family               | 261,574            | 504                | 510             | 262,588              |
| Construction                     | 124,383            | -                  | 943             | 125,326              |
| Land                             | 67,118             | -                  | -               | 67,118               |
| Other loans                      | 6,103              | -                  | -               | 6,103                |
| <b>Totals</b>                    | <b>\$1,529,964</b> | <b>\$891</b>       | <b>\$17,056</b> | <b>\$1,547,911</b>   |

|                                  | Credit Risk Grades |                    |             | Total Gross<br>Loans |
|----------------------------------|--------------------|--------------------|-------------|----------------------|
|                                  | Pass               | Special<br>Mention | Substandard |                      |
| December<br>31, 2013             | (in thousands)     |                    |             |                      |
| <b>Business loans:</b>           |                    |                    |             |                      |
| Commercial and industrial        | \$184,247          | \$12               | \$2,776     | \$187,035            |
| <b>Commercial owner occupied</b> |                    |                    |             |                      |
| SBA                              | 207,872            | 1,217              | 12,000      | 221,089              |
|                                  | 10,659             | -                  | -           | 10,659               |
|                                  | 87,517             | -                  | -           | 87,517               |

|                               |             |         |          |             |
|-------------------------------|-------------|---------|----------|-------------|
| Warehouse facilities          |             |         |          |             |
| Real estate loans:            |             |         |          |             |
| Commercial non-owner occupied | 329,538     | 352     | 3,654    | 333,544     |
| Multi-family                  | 232,661     | 511     | 517      | 233,689     |
| One-to-four family            | 144,152     | -       | 1,083    | 145,235     |
| Construction                  | 13,040      | -       | -        | 13,040      |
| Land                          | 7,605       | -       | -        | 7,605       |
| Other loans                   | 3,834       | -       | 5        | 3,839       |
| Totals                        | \$1,221,125 | \$2,092 | \$20,035 | \$1,243,252 |

|                               |             |                    |                 |                               |
|-------------------------------|-------------|--------------------|-----------------|-------------------------------|
|                               |             | Credit Risk Grades |                 |                               |
|                               |             | Pass               | Special Mention | Total Gross Substandard Loans |
| September 30, 2013            |             | (in thousands)     |                 |                               |
| Business loans:               |             |                    |                 |                               |
| Commercial and industrial     | \$170,840   | \$68               | \$2,812         | \$173,720                     |
| Commercial owner occupied     | 207,519     | 2,632              | 12,011          | 222,162                       |
| SBA                           | 6,455       | -                  | -               | 6,455                         |
| Warehouse facilities          | 49,104      | -                  | -               | 49,104                        |
| Real estate loans:            |             |                    |                 |                               |
| Commercial non-owner occupied | 299,940     | 355                | 4,684           | 304,979                       |
| Multi-family                  | 217,897     | 513                | 519             | 218,929                       |
| One-to-four family            | 151,564     | -                  | 1,103           | 152,667                       |
| Construction                  | 2,835       | -                  | -               | 2,835                         |
| Land                          | 7,371       | -                  | -               | 7,371                         |
| Other loans                   | 3,787       | -                  | 6               | 3,793                         |
| Totals                        | \$1,117,312 | \$3,568            | \$21,135        | \$1,142,015                   |

The following tables set forth delinquencies in the Company's loan portfolio at the dates indicated:

|  |                |               |       |     |       |              |
|--|----------------|---------------|-------|-----|-------|--------------|
|  |                | Days Past Due |       |     |       |              |
|  | Current        | 30-59         | 60-89 | 90+ | Total | Non-Accruing |
|  | (in thousands) |               |       |     |       |              |

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September  
30, 2014

| Business loans:               |                    |             |             |              |                    |                |
|-------------------------------|--------------------|-------------|-------------|--------------|--------------------|----------------|
| Commercial and industrial     | \$360,700          | \$-         | \$-         | \$-          | \$360,700          | \$-            |
| Commercial owner occupied     | 237,996            | -           | -           | -            | 237,996            | 528            |
| SBA                           | 20,439             | -           | 43          | -            | 20,482             | -              |
| Warehouse facilities          | 108,093            | -           | -           | -            | 108,093            | -              |
| Real estate loans:            |                    |             |             |              |                    |                |
| Commercial non-owner occupied | 355,984            | -           | -           | -            | 355,984            | 882            |
| Multi-family                  | 262,588            | -           | -           | -            | 262,588            | -              |
| One-to-four family            | 124,963            | 20          | -           | 343          | 125,326            | 372            |
| Construction                  | 67,118             | -           | -           | -            | 67,118             | -              |
| Land                          | 6,103              | -           | -           | -            | 6,103              | -              |
| Other loans                   | 3,521              | -           | -           | -            | 3,521              | -              |
| <b>Totals</b>                 | <b>\$1,547,505</b> | <b>\$20</b> | <b>\$43</b> | <b>\$343</b> | <b>\$1,547,911</b> | <b>\$1,782</b> |

|                                  | Current   | Days Past Due |       |     | Total     | Non-Accruing |
|----------------------------------|-----------|---------------|-------|-----|-----------|--------------|
|                                  |           | 30-59         | 60-89 | 90+ |           |              |
| December 31, 2013 (in thousands) |           |               |       |     |           |              |
| Business loans:                  |           |               |       |     |           |              |
| Commercial and industrial        | \$187,035 | \$-           | \$-   | \$- | \$187,035 | \$-          |
| Commercial owner occupied        | 219,875   | 768           | -     | 446 | 221,089   | 747          |
| SBA                              | 10,645    | -             | -     | 14  | 10,659    | 14           |
| Warehouse facilities             | 87,517    | -             | -     | -   | 87,517    | -            |
| Real estate loans:               |           |               |       |     |           |              |
| Commercial non-owner occupied    | 332,984   | -             | -     | 560 | 333,544   | 983          |
| Multi-family                     | 233,689   | -             | -     | -   | 233,689   | -            |
| One-to-four family               | 145,041   | 71            | -     | 123 | 145,235   | 507          |
| Construction                     | 13,040    | -             | -     | -   | 13,040    | -            |
| Land                             | 7,605     | -             | -     | -   | 7,605     | -            |



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|               |                    |              |            |                |                    |                |
|---------------|--------------------|--------------|------------|----------------|--------------------|----------------|
| Other loans   | 3,709              | 130          | -          | -              | 3,839              | -              |
| <b>Totals</b> | <b>\$1,241,140</b> | <b>\$969</b> | <b>\$-</b> | <b>\$1,143</b> | <b>\$1,243,252</b> | <b>\$2,251</b> |

|                                      | Days Past Due      |              |              |              | Total              | Non-Accruing   |
|--------------------------------------|--------------------|--------------|--------------|--------------|--------------------|----------------|
|                                      | Current            | 30-59        | 60-89        | 90+          |                    |                |
| September 30, 2013                   | (in thousands)     |              |              |              |                    |                |
| <b>Business loans:</b>               |                    |              |              |              |                    |                |
| Commercial and industrial            | \$173,478          | \$163        | \$79         | \$-          | \$173,720          | \$78           |
| <b>Commercial owner occupied</b>     |                    |              |              |              |                    |                |
| SBA                                  | 6,312              | -            | 129          | 14           | 6,455              | 142            |
| Warehouse facilities                 | 49,104             | -            | -            | -            | 49,104             | -              |
| <b>Real estate loans:</b>            |                    |              |              |              |                    |                |
| <b>Commercial non-owner occupied</b> |                    |              |              |              |                    |                |
| Multi-family                         | 218,929            | -            | -            | -            | 218,929            | -              |
| <b>One-to-four family</b>            |                    |              |              |              |                    |                |
| Construction                         | 2,835              | -            | -            | -            | 2,835              | -              |
| Land                                 | 7,371              | -            | -            | -            | 7,371              | -              |
| Other loans                          | 3,785              | 2            | 6            | -            | 3,793              | -              |
| <b>Totals</b>                        | <b>\$1,140,966</b> | <b>\$724</b> | <b>\$214</b> | <b>\$111</b> | <b>\$1,142,015</b> | <b>\$1,153</b> |

Note 7 – Allowance for Loan Losses

The Company's ALLL covers estimated credit losses on individually evaluated loans that are determined to be impaired as well as estimated credit losses inherent in the remainder of the loan portfolio. The ALLL is prepared using the information provided by the Company's credit and investment review process together with data from peer institutions and economic information gathered from published sources.

The loan portfolio is segmented into groups of loans with similar risk characteristics. Each segment possesses varying degrees of risk based on, among other things, the type of loan, the type of collateral, and the sensitivity of the borrower or industry to changes in external factors such as economic conditions. An estimated loss rate calculated using the Company's actual historical loss rates adjusted for current portfolio trends, economic conditions, and other relevant internal and external factors, is applied to each group's aggregate loan balances.

The following provides a summary of the ALLL calculation for the major segments within the Company's loan portfolio.

Owner Occupied Commercial Real Estate Loans, Commercial and Industrial Loans and SBA Loans

The Company's base ALLL factor for owner occupied commercial real estate loans, commercial business loans and SBA loans is determined by management using the Bank's actual trailing 36 month, trailing 24 month, trailing 12 month and annualized trailing six month charge-off data. Adjustments to those base factors are made for relevant internal and external factors. For owner occupied commercial real estate loans, commercial business loans and SBA loans, those factors include:

- Changes in national, regional and local economic conditions, including trends in real estate values and the interest rate environment,
  - Changes in the nature and volume of the loan portfolio, including new types of lending,
- Changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans, and
  - The existence and effect of concentrations of credit, and changes in the level of such concentrations.

The resulting total ALLL factor is compared for reasonableness against the 10-year average, 15-year average, and trailing 12 month total charge-off data for all Federal Deposit Insurance ("FDIC") insured commercial banks and savings institutions based in California. This factor is applied to balances graded pass-1 through pass-5. For loans risk graded as watch or worse, progressively higher potential loss factors are applied based on management's judgment, taking into consideration the specific characteristics of the Bank's portfolio and analysis of results from a select group of the Company's peers.

#### Multi-Family and Non-Owner Occupied Commercial Real Estate Loans

The Company's base ALLL factor for multi-family and non-owner occupied commercial real estate loans is determined by management using the Bank's actual trailing 36 month, trailing 24 month, trailing 12 month and annualized trailing six month charge-off data. Adjustments to those base factors are made for relevant internal and external factors. For multi-family and non-owner occupied commercial real estate loans, those factors include:

- Changes in national, regional and local economic conditions, including trends in real estate values and the interest rate environment,
- Changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans, and
  - The existence and effect of concentrations of credit, and changes in the level of such concentrations.

The resulting total ALLL factor is compared for reasonableness against the 10-year average, 15-year average, and trailing 12 month total charge-off data for all FDIC-insured commercial banks and savings institutions based in California. This factor is applied to balances graded pass-1 through pass-5. For loans risk graded as watch or worse, progressively higher potential loss factors are applied based on management's judgment, taking into consideration the specific characteristics of the Bank's portfolio and analysis of results from a select group of the Company's peers.

#### One-to-Four Family and Consumer Loans

The Company's base ALLL factor for one-to-four family and consumer loans is determined by management using the Bank's actual trailing 36 month, trailing 24 month, trailing 12 month and annualized trailing six month charge-off data. Adjustments to those base factors are made for relevant internal and external factors. For one-to-four family and consumer loans, those factors include:

- Changes in national, regional and local economic conditions, including trends in real estate values and the interest rate environment, and
- Changes in volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans.

The resulting total ALLL factor is compared for reasonableness against the 10-year average, 15-year average, and trailing 12 month total charge-off data for all FDIC-insured commercial banks and savings institutions based in California. This factor is applied to balances graded pass-1 through pass-5. For loans risk graded as watch or worse, progressively higher potential loss factors are applied based on management's judgment, taking into consideration the specific characteristics of the Bank's portfolio and analysis of results from a select group of the Company's peers.

#### Warehouse Facilities

The Company's warehouse facilities are structured as repurchase facilities, whereby we purchase funded one-to-four family loans on an interim basis. Therefore, the base ALLL factor for warehouse facilities is equal to that for one-to-four family and consumer loans as discussed above. Adjustments to the base factor are made for relevant internal and external factors. Those factors include:

- Changes in national, regional and local economic conditions, including trends in real estate values and the interest rate environment,
  - Changes in the nature and volume of the loan portfolio, including new types of lending, and
  - The existence and effect of concentrations of credit, and changes in the level of such concentrations.

The resulting total ALLL factor is compared for reasonableness against the 10-year average, 15-year average, and trailing 12 month total charge-off data for one-to-four family loans for all FDIC-insured commercial banks and savings institutions based in California. This factor is applied to balances graded pass-1 through pass-5. For loans risk graded as watch or worse, progressively higher potential loss factors are applied based on management's judgment, taking into consideration the specific characteristics of the Bank's portfolio and analysis of results from a select group of the Company's peers.

The following tables summarize the allocation of the ALLL as well as the activity in the ALLL attributed to various segments in the loan portfolio as of and for the three months ended for the periods indicated:

|                       | Commercial and industrial | Commercial owner occupied | SBA   | Warehouse | Commercial non-owner occupied | Multi-family | One-to-four family | Construction | Land  | Other loans | Total    |
|-----------------------|---------------------------|---------------------------|-------|-----------|-------------------------------|--------------|--------------------|--------------|-------|-------------|----------|
|                       | (dollars in thousands)    |                           |       |           |                               |              |                    |              |       |             |          |
| December 31,          | \$1,968                   | \$1,818                   | \$151 | \$392     | \$1,658                       | \$817        | \$1,099            | \$136        | \$127 | \$34        | \$8,200  |
| Charge-offs           | (223 )                    | -                         | -     | -         | (365 )                        | -            | (195 )             | -            | -     | -           | (783 )   |
| Provisions            | 33                        | -                         | 4     | -         | -                             | -            | 32                 | -            | -     | 18          | 87       |
| Net change for period | 1,597                     | 38                        | 290   | 102       | 608                           | 194          | (121 )             | 639          | (55 ) | (29 )       | 3,266    |
| December 30,          | \$3,375                   | \$1,856                   | \$445 | \$494     | \$1,901                       | \$1,011      | \$815              | \$775        | \$72  | \$23        | \$10,772 |

|         | Commercial and industrial |           | Commercial owner occupied |           | SBA       |           | Warehouse |          | Commercial non-owner occupied |         | Multi-family |      | One-to-four family |     | Construction |     | Land |      | Other loans |     | Total |     |      |
|---------|---------------------------|-----------|---------------------------|-----------|-----------|-----------|-----------|----------|-------------------------------|---------|--------------|------|--------------------|-----|--------------|-----|------|------|-------------|-----|-------|-----|------|
|         | (dollars in thousands)    |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| of      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ce      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed to:  |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ally    |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| l loans | \$-                       | \$-       | \$-                       | \$-       | \$-       | \$-       | \$-       | \$-      | \$-                           | \$-     | \$-          | \$-  | \$-                | \$- | \$-          | \$- | \$-  | \$-  | \$-         | \$- | \$-   | \$- |      |
| n       | 3,375                     | 1,856     | 445                       | 494       | 1,901     | 1,011     | 815       | 775      | 72                            | 23      | 10,7         |      |                    |     |              |     |      |      |             |     |       |     |      |
| ally    |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed for  |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ent     | -                         | 398       | -                         | -         | 883       | -         | 526       | -        | -                             | -       | 1,80         |      |                    |     |              |     |      |      |             |     |       |     |      |
| to      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ns      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ally    |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed for  |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ent     | 0.00                      | %         | 0.00                      | %         | 0.00      | %         | 0.00      | %        | 0.00                          | %       | 0.00         | %    | 0.00               | %   | 0.00         | %   | 0.00 | %    | 0.00        | %   | 0.00  | %   | 0.00 |
| ely     |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed for  |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ent     | \$360,700                 | \$237,598 | \$20,482                  | \$108,093 | \$355,101 | \$262,588 | \$124,800 | \$67,118 | \$6,103                       | \$3,521 | \$1,54       |      |                    |     |              |     |      |      |             |     |       |     |      |
| to      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ns      |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ely     |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ed for  |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ent     | 0.94                      | %         | 0.78                      | %         | 2.17      | %         | 0.46      | %        | 0.54                          | %       | 0.39         | %    | 0.65               | %   | 1.15         | %   | 1.18 | %    | 0.65        | %   | 0.70  |     |      |
| ross    | \$360,700                 | \$237,996 | \$20,482                  | \$108,093 | \$355,984 | \$262,588 | \$125,326 | \$67,118 | \$6,103                       | \$3,521 | \$1,54       |      |                    |     |              |     |      |      |             |     |       |     |      |
| ce to   |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| ns      | 0.94                      | %         | 0.78                      | %         | 2.17      | %         | 0.46      | %        | 0.53                          | %       | 0.39         | %    | 0.65               | %   | 1.15         | %   | 1.18 | %    | 0.65        | %   | 0.70  |     |      |
|         |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
|         |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
|         |                           |           |                           |           |           |           |           |          |                               |         |              |      |                    |     |              |     |      |      |             |     |       |     |      |
| er 31,  | \$1,310                   | \$1,512   | \$79                      | \$1,544   | \$1,459   | \$1,145   | \$862     | \$-      | \$31                          | \$52    | \$7,99       |      |                    |     |              |     |      |      |             |     |       |     |      |
| offs    | (291                      | )         | (163                      | )         | (16       | )         | -         | (757     | )                             | (101    | )            | (273 | )                  | -   | -            | (7  | )    | (1,6 |             |     |       |     |      |
| ies     | 107                       | -         | 51                        | -         | -         | -         | 45        | -        | -                             | 141     | 344          |      |                    |     |              |     |      |      |             |     |       |     |      |
|         | 1,675                     | 170       | (64                       | )         | (1,319    | )         | 701       | (538     | )                             | 540     | 121          | 116  | (138               | )   | 1,26         |     |      |      |             |     |       |     |      |

|                                  |           |           |         |          |           |           |           |         |         |         |        |  |  |  |  |  |  |  |  |  |  |  |
|----------------------------------|-----------|-----------|---------|----------|-----------|-----------|-----------|---------|---------|---------|--------|--|--|--|--|--|--|--|--|--|--|--|
| ns for<br>(on in)<br>es          |           |           |         |          |           |           |           |         |         |         |        |  |  |  |  |  |  |  |  |  |  |  |
| er 30,                           | \$2,801   | \$1,519   | \$50    | \$225    | \$1,403   | \$506     | \$1,174   | \$121   | \$147   | \$48    | \$7,99 |  |  |  |  |  |  |  |  |  |  |  |
| of<br>ce<br>d to:                |           |           |         |          |           |           |           |         |         |         |        |  |  |  |  |  |  |  |  |  |  |  |
| ally<br>d<br>l loans             | \$-       | \$-       | \$-     | \$-      | \$-       | \$-       | \$104     | \$-     | \$-     | \$-     | \$104  |  |  |  |  |  |  |  |  |  |  |  |
| n                                | 2,801     | 1,519     | 50      | 225      | 1,403     | 506       | 1,070     | 121     | 147     | 48      | 7,89   |  |  |  |  |  |  |  |  |  |  |  |
| ally<br>d for<br>ent             | 68        | -         | 14      | -        | 437       | -         | 642       | -       | -       | -       | 1,16   |  |  |  |  |  |  |  |  |  |  |  |
| to<br>ns<br>ally<br>d for<br>ent | 0.00      | % 0.00    | % 0.00  | % 0.00   | % 0.00    | % 0.00    | % 16.20   | % 0.00  | % 0.00  | % 0.00  | % 8.96 |  |  |  |  |  |  |  |  |  |  |  |
| ely<br>d for<br>ent              | \$173,652 | \$222,162 | \$6,441 | \$49,104 | \$304,542 | \$218,929 | \$152,025 | \$2,835 | \$7,371 | \$3,793 | \$1,14 |  |  |  |  |  |  |  |  |  |  |  |
| to<br>ns<br>ely<br>d for<br>ent  | 1.61      | % 0.68    | % 0.78  | % 0.46   | % 0.46    | % 0.23    | % 0.70    | % 4.27  | % 1.99  | % 1.27  | % 0.69 |  |  |  |  |  |  |  |  |  |  |  |
| oss                              | \$173,720 | \$222,162 | \$6,455 | \$49,104 | \$304,979 | \$218,929 | \$152,667 | \$2,835 | \$7,371 | \$3,793 | \$1,14 |  |  |  |  |  |  |  |  |  |  |  |
| ce to<br>ns                      | 1.61      | % 0.68    | % 0.77  | % 0.46   | % 0.46    | % 0.23    | % 0.77    | % 4.27  | % 1.99  | % 1.27  | % 0.70 |  |  |  |  |  |  |  |  |  |  |  |

Note 8 – Subordinated Debentures

In August 2014, the Corporation issued \$60 million in aggregate principal amount of 5.75% Subordinated Notes Due 2024 (the “Notes”) in a private placement transaction to institutional accredited investors (the “Private Placement”). The Corporation contributed \$40 million of net proceeds from the Private Placement to the Bank to support general corporate purposes. The Notes will bear interest at an annual fixed rate of 5.75%, with the first interest payment on

the Notes occurring on March 3, 2015, and interest will be paid semiannually each March 3 and September 3 until September 3, 2024.

In connection with the Private Placement, the Corporation obtained ratings from Kroll Bond Rating Agency (“KBRA”). KBRA assigned investment grade ratings of BBB+ and BBB for the Corporation's senior secured debt and subordinated debt, respectively, and a senior deposit rating of A- for the Bank.

In March 2004, the Corporation issued \$10.3 million of Floating Rate Junior Subordinated Deferrable Interest Debentures (the “Subordinated Debentures”) to PPBI Trust I, which funded the payment of \$10.0 million of Floating Rate Trust Preferred Securities (“Trust Preferred Securities”) issued by PPBI Trust I in March 2004. The net proceeds from the offering of Trust Preferred Securities were contributed as capital to the Bank to support further growth. Interest is payable quarterly on the Subordinated Debentures at three-month LIBOR plus 2.75% per annum, for an effective rate of 2.98% per annum as of September 30, 2014.

The Corporation is not allowed to consolidate PPBI Trust I into the Company’s consolidated financial statements. The resulting effect on the Company’s consolidated financial statements is to report only the Subordinated Debentures as a component of the Company’s liabilities.

#### Note 9 – Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing net income or loss available to common stockholders by the weighted average number of common shares outstanding for the period, excluding common shares in treasury. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted from the issuance of common stock that would then share in earnings and excludes common shares in treasury. Stock options exercisable for shares of common stock are excluded from the computation of diluted earnings per share if they are anti-dilutive due to their exercise price exceeding the average market price during the period.

The impact of stock options which are anti-dilutive are excluded from the computations of diluted earnings per share. The dilutive impact of these securities could be included in future computations of diluted earnings per share if the market price of the common stock increases. The following table sets forth the number of stock options excluded for the periods indicated:

|                        | Three Months Ended<br>September 30,<br>2014 |        | Nine Months Ended<br>September 30,<br>2014 |        |
|------------------------|---|--------|--|--------|
|                        | 2013  | 2014   | 2013                                       | 2014   |
| Stock options excluded | 689,774                                     | 13,744 | 635,489                                    | 53,310 |

The following tables set forth the Company’s unaudited earnings per share calculations for the periods indicated:

|            | Three Months Ended September 30, |                        |                        |                        |
|------------|----------------------------------|------------------------|------------------------|------------------------|
|            | 2014                             |                        | 2013                   |                        |
|            | Per<br>Share<br>Amount           | Per<br>Share<br>Amount | Per<br>Share<br>Amount | Per<br>Share<br>Amount |
| Net Income | Shares                           | Net Income             | Shares                 | Net Income             |

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(dollars in thousands, except per share data)

|  |          |            |         |          |            |         |
|--|----------|------------|---------|----------|------------|---------|
| Net income   | \$ 5,450 |            |         | \$ 3,066 |            |         |
| Basic income available to common stockholders                            | 5,450    | 17,069,216 | \$ 0.32 | 3,066    | 16,640,471 | \$ 0.19 |
| Effect of dilutive stock options   | -        | 273,666    |         | -        | 841,759    |         |
| Diluted income available to common stockholders plus assumed conversions | \$ 5,450 | 17,342,882 | \$ 0.31 | \$ 3,066 | 17,482,230 | \$ 0.18 |

|  | Nine Months Ended September 30, |            |                  |            |            |                  |
|--|---------------------------------|------------|------------------|------------|------------|------------------|
|  | 2014                            | 2013       |                  | 2013       |            |                  |
|  | Net Income                      | Shares     | Per Share Amount | Net Income | Shares     | Per Share Amount |
| (dollars in thousands, except per share data)                            |                                 |            |                  |            |            |                  |
| Net income   | \$ 12,725                       |            |                  | \$ 4,789   |            |                  |
| Basic income available to common stockholders                            | 12,725                          | 17,078,945 | \$ 0.75          | 4,789      | 15,512,508 | \$ 0.31          |
| Effect of dilutive stock options   | -                               | 306,890    |                  | -          | 802,193    |                  |
| Diluted income available to common stockholders plus assumed conversions | \$ 12,725                       | 17,385,835 | \$ 0.73          | \$ 4,789   | 16,314,701 | \$ 0.29          |

Note 10 – Fair Value of Financial Instruments

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Financial instruments are considered Level 1 when the valuation is based on quoted prices in active markets for identical assets or liabilities. Level 2 financial instruments are valued using quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or models using inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques, and at least one significant model assumption or input is unobservable and when determination of the fair value requires significant management judgment or estimation.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented. The following methods and assumptions were used by the Company to estimate the fair value of its financial instruments at September 30, 2014, December 31, 2013 and September 30, 2013:

**Cash and due from banks** – The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

**Securities Available for Sale** – Where possible, the Company utilizes quoted market prices to measure debt and equity securities; such items are classified as Level 1 in the hierarchy and include equity securities, US government bonds and securities issued by federally sponsored agencies. When quoted market prices for identical assets are unavailable or the market for the asset is not sufficiently active, varying valuation techniques are used. Common inputs in valuing these assets include, among others, benchmark yields, issuer spreads, forward mortgage-backed securities trade prices and recently reported trades. Such assets are classified as Level 2 in the hierarchy and typically include private label mortgage-backed securities and corporate bonds. Pricing on these securities are provided to the Company by a pricing service vendor. In the Level 3 category, the Company classifies securities that reflect other-than-temporary impairments (“OTTI”) based on a discounted cash flow of the security or a determination of fair value that requires significant management judgment or consideration.

**FHLB, FRB, Other Stock** – The carrying value approximates the fair value based upon the redemption provisions of the stock and are classified as Level 1.

**Loans Held for Sale** - The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted price exists, the fair value of a loan is determined using quoted prices for a similar asset or assets, adjusted for the specific attributes of that loan. Loans held for sale are classified as Level 2.

**Loans Held for Investment**— The fair value of loans, other than loans on nonaccrual status, was estimated by discounting the remaining contractual cash flows using the estimated current rate at which similar loans would be made to borrowers with similar credit risk characteristics and for the same remaining maturities, reduced by deferred net loan origination fees and the allocable portion of the allowance for loan losses. Accordingly, in determining the estimated current rate for discounting purposes, no adjustment has been made for any change in borrowers' credit risks since the origination of such loans. Rather, the allocable portion of the allowance for loan losses is considered to provide for such changes in estimating fair value. As a result, this fair value is not necessarily the value which would be derived using an exit price. These loans are included within Level 3 of the fair value hierarchy. The carrying amount of accrued interest receivable approximates its fair value as a Level 1 classification.

**OREO** – OREO assets are recorded at the fair value less estimated costs to sell at the time of foreclosure. The fair value of OREO assets is generally based on recent real estate appraisals adjusted for estimated selling costs. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

**Accrued Interest Receivable/Payable** – The carrying amount approximates fair value and is classified as Level 1.

**Deposit Accounts**— The fair values estimated for demand deposits (interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts) resulting in a Level 1 classification. Fair values for fixed-rate certificates



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of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits in a Level 2 classification. The carrying amount of accrued interest payable approximates its fair value as a Level 1 classification.

FHLB Advances and Other Borrowings— For these instruments, the fair value of short term borrowings is estimated to be the carrying amount and is classified as Level 1. The fair value of long term borrowings and debentures is determined using rates currently available for similar borrowings or debentures with similar credit risk and for the remaining maturities and are classified as Level 2. The carrying amount of accrued interest payable approximates its fair value as a Level 1 classification.

Subordinated Debentures – The fair value of subordinated debentures is estimated by discounting the balance by the current three-month LIBOR rate plus the current market spread. The fair value is determined based on the maturity date as the Company does not currently have intentions to call the debenture and is classified as Level 2.

Off-Balance Sheet Commitments and Standby Letters of Credit – The majority of the Bank’s commitments to extend credit carry current market interest rates if converted to loans. Because these commitments are generally unassignable by either the Bank or the borrower, they only have value to the Bank and the borrower. The notional amount disclosed for off-balance sheet commitments and standby letters of credit is the amount available to be drawn down on all lines and letters of credit. The cost to assume is calculated at 10% of the notional amount and is classified as Level 2.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company’s entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The fair value estimates presented herein are based on pertinent information available to management as of the periods indicated.

|   | Carrying<br>Amount | At September 30, 2014 |         |           | Estimated<br>Fair Value |
|---|--------------------|-----------------------|---------|-----------|-------------------------|
|   |                    | Level 1               | Level 2 | Level 3   |                         |
| (in thousands)  |                    |                       |         |           |                         |
| Assets:   |                    |                       |         |           |                         |
| Cash and cash<br>equivalents                                  | \$ 103,631         | \$ 103,631            | \$ -    | \$ -      | \$ 103,631              |
| Securities<br>available for<br>sale                           | 282,202            | -                     | 282,202 | -         | 282,202                 |
| Federal<br>Reserve<br>Bank, TIB<br>and FHLB<br>stock, at cost | 18,643             | 18,643                | -       | -         | 18,643                  |
| Loans held<br>for<br>investment,                              | 1,537,237          | -                     | -       | 1,521,466 | 1,521,466               |

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|   |                 |           |          |         |                        |
|---|-----------------|-----------|----------|---------|------------------------|
| Accrued interest receivable                                 | 6,762           | 6,762     | -        | -       | 6,762                  |
| Other real estate owned                                     | 752             | -         | -        | 752     | 752                    |
| <b>Liabilities:</b>   |                 |           |          |         |                        |
| Deposit accounts  | 1,543,466       | 1,157,972 | 371,574  | -       | 1,529,546              |
| FHLB advances   | 150,000         | 149,999   | -        | -       | 149,999                |
| Other borrowings  | 45,561          | -         | 46,095   | -       | 46,095                 |
| Subordinated debentures                                     | 70,310          | -         | 34,142   | -       | 34,142                 |
| Accrued interest payable                                    | 177             | 177       | -        | -       | 177                    |
|   |                 |           |          |         | Cost to Cede or Assume |
|   | Notional Amount | Level 1   | Level 2  | Level 3 |                        |
| Off-balance sheet commitments and standby letters of credit | \$328,708       | \$-       | \$32,871 | \$-     | \$32,871               |

At December 31, 2013

|  | Carrying Amount | Level 1   | Level 2 | Level 3   | Estimated Fair Value |
|--|-----------------|-----------|---------|-----------|----------------------|
|  | (in thousands)  |           |         |           |                      |
| <b>Assets:</b>                               |                 |           |         |           |                      |
| Cash and cash equivalents                    | \$126,813       | \$126,813 | \$-     | \$-       | \$126,813            |
| Securities available for sale                | 256,089         | -         | 256,089 | -         | 256,089              |
| Federal Reserve Bank and FHLB stock, at cost | 15,450          | 15,450    | -       | -         | 15,450               |
| Loans held for sale, net                     | 3,147           | -         | 3,147   | -         | 3,147                |
| Loans held for investment, net               | 1,231,923       | -         | -       | 1,230,316 | 1,230,316            |
| Accrued interest                             | 6,254           | 6,254     | -       | -         | 6,254                |

receivable

|                         |       |   |   |       |       |
|-------------------------|-------|---|---|-------|-------|
| Other real estate owned | 1,186 | - | - | 1,186 | 1,186 |
|-------------------------|-------|---|---|-------|-------|

Liabilities:

|                  |           |         |         |   |           |
|------------------|-----------|---------|---------|---|-----------|
| Deposit accounts | 1,306,286 | 991,630 | 301,007 | - | 1,292,637 |
|------------------|-----------|---------|---------|---|-----------|

FHLB

|          |         |         |   |   |         |
|----------|---------|---------|---|---|---------|
| advances | 156,000 | 156,000 | - | - | 156,000 |
|----------|---------|---------|---|---|---------|

Other

|            |        |   |        |   |        |
|------------|--------|---|--------|---|--------|
| borrowings | 48,091 | - | 49,058 | - | 49,058 |
|------------|--------|---|--------|---|--------|

Subordinated

|            |        |   |       |   |       |
|------------|--------|---|-------|---|-------|
| debentures | 10,310 | - | 4,696 | - | 4,696 |
|------------|--------|---|-------|---|-------|

Accrued

|                  |     |     |   |   |     |
|------------------|-----|-----|---|---|-----|
| interest payable | 166 | 166 | - | - | 166 |
|------------------|-----|-----|---|---|-----|

|   | Notional<br>Amount | Level 1 | Level 2  | Level 3 | Cost to<br>Cede<br>or Assume |
|---|--------------------|---------|----------|---------|------------------------------|
| Off-balance sheet commitments and standby letters of credit | \$337,181          | \$-     | \$33,718 | \$-     | \$33,718                     |

At September 30, 2013

|                | Carrying<br>Amount | Level 1 | Level 2 | Level 3 | Estimated<br>Fair Value |
|----------------|--------------------|---------|---------|---------|-------------------------|
| (in thousands) |                    |         |         |         |                         |

Assets:

|                           |          |          |     |     |          |
|---------------------------|----------|----------|-----|-----|----------|
| Cash and cash equivalents | \$61,419 | \$61,419 | \$- | \$- | \$61,419 |
|---------------------------|----------|----------|-----|-----|----------|

Securities

|                    |         |   |         |   |         |
|--------------------|---------|---|---------|---|---------|
| available for sale | 282,846 | - | 282,846 | - | 282,846 |
|--------------------|---------|---|---------|---|---------|

Federal Reserve Bank and FHLB

|                |        |        |   |   |        |
|----------------|--------|--------|---|---|--------|
| stock, at cost | 10,827 | 10,827 | - | - | 10,827 |
|----------------|--------|--------|---|---|--------|

Loans held

|               |       |   |       |   |       |
|---------------|-------|---|-------|---|-------|
| for sale, net | 3,176 | - | 3,176 | - | 3,176 |
|---------------|-------|---|-------|---|-------|

Loans held

|                     |           |   |   |           |           |
|---------------------|-----------|---|---|-----------|-----------|
| for investment, net | 1,130,975 | - | - | 1,225,352 | 1,225,352 |
|---------------------|-----------|---|---|-----------|-----------|

Accrued

|                     |       |       |   |   |       |
|---------------------|-------|-------|---|---|-------|
| interest receivable | 5,629 | 5,629 | - | - | 5,629 |
|---------------------|-------|-------|---|---|-------|

Other real

|              |       |   |   |       |       |
|--------------|-------|---|---|-------|-------|
| estate owned | 1,186 | - | - | 1,186 | 1,186 |
|--------------|-------|---|---|-------|-------|

## Liabilities:

|                          |           |         |         |   |           |
|--------------------------|-----------|---------|---------|---|-----------|
| Deposit accounts         | 1,284,134 | 998,217 | 284,403 | - | 1,282,620 |
| FHLB advances            | 35,000    | 35,000  | -       | - | 35,000    |
| Other borrowings         | 51,474    | -       | 53,435  | - | 53,435    |
| Subordinated debentures  | 10,310    | -       | 4,766   | - | 4,766     |
| Accrued interest payable | 195       | 195     | -       | - | 195       |

|   | Notional Amount | Level 1 | Level 2  | Level 3 | Cost to Cede or Assume |
|---|-----------------|---------|----------|---------|------------------------|
| Off-balance sheet commitments and standby letters of credit | \$333,592       | \$-     | \$33,359 | \$-     | \$33,359               |

A loan is considered impaired when it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. Impairment is measured based on the fair value of the underlying collateral or the discounted expected future cash flows. The Company measures impairment on all non-accrual loans for which it has reduced the principal balance to the value of the underlying collateral less the anticipated selling cost. As such, the Company records impaired loans as non-recurring Level 2 when the fair value of the underlying collateral is based on an observable market price or current appraised value. When current market prices are not available or the Company determines that the fair value of the underlying collateral is further impaired below appraised values, the Company records impaired loans as Level 3. At September 30, 2014, substantially all the Company's impaired loans were evaluated based on the fair value of their underlying collateral based upon the most recent appraisal available to management.

The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following fair value hierarchy table presents information about the Company's financial instruments measured at fair value on a recurring basis at the dates indicated:

| September 30, 2014     |         |         |            |  |
|------------------------|---------|---------|------------|--|
| Fair Value Measurement |         |         |            |  |
| Using                  |         |         |            |  |
| Level 1                | Level 2 | Level 3 | Securities |  |
| 1                      |         | 3       | at         |  |

|   | Fair Value     |            |      |            |
|---|----------------|------------|------|------------|
|   | (in thousands) |            |      |            |
| Investment securities available for sale: |                |            |      |            |
| Municipal bonds                           | \$ -           | \$ 98,585  | \$ - | \$ 98,585  |
| Mortgage-backed securities                | -              | 183,617    | -    | 183,617    |
| Total securities available for sale       | \$ -           | \$ 282,202 | \$ - | \$ 282,202 |

|   | September 30, 2013<br>Fair Value Measurement<br>Using |            |            |                | Securities<br>at<br>Fair<br>Value |
|---|---|------------|------------|----------------|-----------------------------------|
|   | Level<br>1  | Level 2    | Level<br>3 | (in thousands) |                                   |
| Investment securities available for sale: |   |            |            |                |                                   |
| U.S. Treasury                             | \$ -  | \$ 82      | \$ -       | \$ 82          |                                   |
| Municipal bonds                           | -   | 94,885     | -          | 94,885         |                                   |
| Mortgage-backed securities                | -   | 187,879    | -          | 187,879        |                                   |
| Total securities available for sale       | \$ -  | \$ 282,846 | \$ -       | \$ 282,846     |                                   |

The following table provides a summary of the changes in balance sheet carrying values associated with Level 3 financial instruments during the three months ended for the periods indicated:

|  | Nine<br>Months<br>Ended<br>September<br>30,<br>2013 |
|--|---|
| Balance, beginning of period                 | \$952   |
| Total gains or (losses) realized/unrealized: |   |
| Included in earnings (or changes in net      | 194   |

|  |         |
|--|---------|
| assets)                                |         |
| Included in other comprehensive income | (140 )  |
| Purchases, issuances, and settlements  | (1,077) |
| Transfer in and/or out of Level 3      | 71      |
| Balance, end of period                 | \$-     |

The fair value of impaired loans was determined using Level 3 assumptions, and represents impaired loan balances for which a specific reserve has been established or on which a write down has been taken. Generally, the Company obtains third party appraisals (or property evaluations) and/or collateral audits in conjunction with internal analyses based on historical experience on its impaired loans and other real estate owned to determine fair value. In determining the net realizable value of the underlying collateral for impaired loans, the Company will then discount the valuation to cover both market price fluctuations and selling costs the Company expected would be incurred in the event of foreclosure. In addition to the discounts taken, the Company's calculation of net realizable value considered any other senior liens in place on the underlying collateral.

The following table provides a summary of the financial instruments the Company measures at fair value on a non-recurring basis as of the periods indicated:

|                                     | September 30, 2014 |         |          |                      |
|-------------------------------------|--------------------|---------|----------|----------------------|
|                                     | Fair Value         |         |          |                      |
|                                     | Measurement Using  |         |          |                      |
|                                     | Level 1            | Level 2 | Level 3  | Assets at Fair Value |
|                                     | (in thousands)     |         |          |                      |
| Assets                              |                    |         |          |                      |
| Collateral dependent impaired loans | \$ -               | \$ -    | \$ 1,241 | \$ 1,241             |
| Other real estate owned             | -                  | -       | 752      | 752                  |
| Total assets                        | \$ -               | \$ -    | \$ 1,993 | \$ 1,993             |

|  | September 30, 2013 |         |         |           |
|--|--------------------|---------|---------|-----------|
|  | Fair Value         |         |         |           |
|  | Measurement Using  |         |         |           |
|  | Level 1            | Level 2 | Level 3 | Assets at |
|  |                    |         |         |           |

|                                     | (in thousands) |             |                 | Fair Value      |
|-------------------------------------|----------------|-------------|-----------------|-----------------|
| Assets                              |                |             |                 |                 |
| Collateral dependent impaired loans | \$ -           | \$ -        | \$ 150          | \$ 150          |
| Other real estate owned             | -              | -           | 1,186           | 1,186           |
| <b>Total assets</b>                 | <b>\$ -</b>    | <b>\$ -</b> | <b>\$ 1,336</b> | <b>\$ 1,336</b> |

The following table presents quantitative information about level 3 of fair value measurements for financial instruments measured at fair value on a non-recurring basis for the periods indicated:

|                                      | September 30, 2014 |                      |   |                 |                        |                     |  |
|--------------------------------------|--------------------|----------------------|---|-----------------|------------------------|---------------------|--|
|                                      | Fair Value         | Valuation Techniques | Unobservable Inputs   | Rate            | Range Maturity (years) | Unobservable Inputs |  |
| Collateral dependent impaired loans: |                    |                      |   |                 |                        |                     |  |
| Business loans:                      |                    |                      |   |                 |                        |                     |  |
| Commercial owner occupied            | \$ 398             | Collateral valuation | Management adjustment to reflect current conditions and selling costs | 6.75 %          | 8                      | 0-10 %              |  |
| Real estate loans:                   |                    |                      |   |                 |                        |                     |  |
| Commercial non-owner occupied        | 500                | Collateral valuation | Management adjustment to reflect current conditions and selling costs | 7.00 %          | 13                     | 0-15 %              |  |
| One-to-four family                   | 343                | Collateral valuation | Management adjustment to reflect current conditions and selling costs | 4.50 %<br>15.00 | 6 -<br>23              | 0-10 %              |  |

| costs                                     |          |                      |   |    |    |        |
|---|----------|----------------------|---|----|----|--------|
| Total collateral dependent impaired loans | \$ 1,241 |                      |   |    |    |        |
| Other real estate owned                   |          |                      |   |    |    |        |
|   |          |                      | Management adjustment to reflect current conditions and selling costs |    |    |        |
| Land                                      | \$ 752   | Collateral valuation |   | -- | -- | 0-10 % |
| Total other real estate owned             | \$ 752   |                      |   |    |    |        |

September 30, 2013

|                                      | Fair Value | Valuation Techniques | Unobservable Inputs   | Rate      | Range Maturity (years) | Unobservable Inputs |
|--------------------------------------|------------|----------------------|---|-----------|------------------------|---------------------|
| Collateral dependent impaired loans: |            |                      |   |           |                        |                     |
| Business loans:                      |            |                      |   |           |                        |                     |
|                                      |            |                      | Management adjustment to reflect current conditions and selling costs |           |                        |                     |
| Commercial and industrial            | \$ 68      | Collateral valuation |   | 6.00 %    | 1                      | 0-10 %              |
|                                      |            |                      | Management adjustment to reflect current conditions and selling costs |           |                        |                     |
| SBA                                  | 14         | Collateral valuation |   | 6.00 %    | 8                      | 0-20 %              |
|                                      |            |                      | Management adjustment to reflect current conditions and selling costs | 6.62%     | 11                     |                     |
| One-to-four family                   | 68         | Collateral valuation |   | - 11.50 % | - 23                   | 0-10 %              |



|   |          |                      |   |    |    |        |
|---|----------|----------------------|---|----|----|--------|
| Total collateral dependent impaired loans | \$ 150   |                      |   |    |    |        |
| Other real estate owned                   |          |                      |   |    |    |        |
|   |          | Collateral valuation | Management adjustment to reflect current conditions and selling costs | -- | -- | 0-10 % |
| Land                                      | \$ 1,186 |                      |   |    |    |        |
| Total other real estate owned             | \$ 1,186 |                      |   |    |    |        |

#### Note 11 – Pending Acquisition of Independence Bank

On October 21, 2014, the Company entered into an Agreement and Plan of Reorganization (the “Merger Agreement”) to acquire Independence Bank (OTCQB: IDPK), a Newport Beach, California based state-chartered bank pursuant to which the Bank will acquire Independence Bank. At September 30, 2014, Independence Bank had \$426.2 million in total assets, \$341.1 million in gross loans and \$358.3 million in total deposits at September 30, 2014. Independence Bank has six branches located in Orange County and Riverside County.

On the date of the Merger Agreement, the aggregate merger consideration was estimated at approximately \$71.5 million, based on a \$14.73 closing price of the Company’s common stock on October 21, 2014. Under the terms of the Merger Agreement, holders of Independence Bank common stock, stock options and warrants will receive aggregate cash consideration of \$7.2 million and, using the Company’s October 21, 2014 closing price, the aggregate stock consideration is currently estimated at \$64.3 million. Assuming such Company stock price, the Independence Bank shareholders will own approximately 20.4% of the combined company. Independence Bank shareholders will have a choice between electing to receive \$13.75 per share in cash or 0.9259 of a share of the Company’s common stock for each share of Independence Bank or a combination thereof, subject to the overall requirement that 10% of the aggregate consideration will be in the form of cash and 90% will be in the form of the Company’s common stock. The number of shares of the Company’s common stock to be issued to Independence Bank shareholders is based on a fixed exchange ratio, provided that the Company’s stock price remains between \$13.365 and \$16.335 as measured by the 10-day average closing price up to and including the fifth trading day prior to closing of the transaction. The value of the stock portion of consideration will fluctuate based on the value of the Company’s common stock. To the extent the average closing price of the Company’s common stock is outside this price range, then the exchange ratio will adjust to reflect the increase or decrease of the Company’s common stock that is outside of this range.

The transaction is expected to close late in the first quarter of 2015, subject to satisfaction of customary closing conditions, including regulatory approvals and approval of Independence Bank and the Company’s shareholders. Directors and executive officers of Independence Bank have entered into agreements with the Company and Independence Bank whereby they committed to vote their shares of Independence Bank common stock in favor of the acquisition. For additional information about the proposed acquisition of Independence Bank, see the Company’s Current Report on Form 8-K filed with the SEC on October 22, 2014 and the Merger Agreement which is filed as an exhibit to the Current Report on Form 8-K.

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

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains information and statements that are considered "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, 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 phrases of similar meaning. We caution that 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 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 the SDTB, FAB and IFH acquisitions, the proposed acquisition of Independence Bank and other acquisitions we have made or may make, if any, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;
- The effect if Associations, Inc. or its homeowners association, or HOA, management companies lose some or all of their HOA customers, fall into financial or legal difficulty or elect to reduce the amount of HOA customers that are directed to us;
  - Changes in the level of our nonperforming assets and charge-offs;
-

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The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the SEC, the Public Company Accounting Oversight Board, the FASB or other accounting standards setters;

- Possible OTTI of securities held by us;
- 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 Quarterly Report on Form 10-Q and other reports and registration statements filed by us with the SEC. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We will not update the forward-looking information and statements to reflect actual results or changes in the factors affecting the forward-looking information and statements. For information on the factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see “Risk Factors” under Part I, Item 1A of our 2013 Annual Report.

Forward-looking information and statements should not be viewed as predictions, and should not be the primary basis upon which investors evaluate us. Any investor in our common stock should consider all risks and uncertainties disclosed in our filings with the SEC, all of which are accessible on the SEC’s website at <http://www.sec.gov>.

### GENERAL

This discussion should be read in conjunction with our Management Discussion and Analysis of Financial Condition and Results of Operations included in our 2013 Annual Report, plus the unaudited consolidated financial statements and the notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q. The results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results expected for the year ending December 31, 2014.

The Corporation is a California-based bank holding company incorporated in the state of Delaware and registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (“BHCA”). Our wholly owned subsidiary, Pacific Premier Bank, is a California state-chartered commercial bank. As a bank holding company, the Corporation is subject to regulation and supervision by the Federal Reserve. We are required to file with the Federal

Reserve quarterly and annual reports and such additional information as the Federal Reserve may require pursuant to the BHCA. The Federal Reserve may conduct examinations of bank holding companies, such as the Corporation, and its subsidiaries. The Corporation is also a bank holding company within the meaning of the California Financial Code. As such, the Corporation and its subsidiaries are subject to examination by, and may be required to file reports with, the California Department of Business Oversight-Division of Financial Institutions (“DBO”).

A bank holding company, such as the Corporation, is required to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so absent such a policy. The Federal Reserve, under the BHCA, has the authority to require a bank holding company to terminate any activity or to relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve’s determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

As a California state-chartered commercial bank which is a member of the Federal Reserve, the Bank is subject to supervision, periodic examination and regulation by the DBO and the Federal Reserve. The Bank’s deposits are insured by the FDIC through the Deposit Insurance Fund. In general terms, insurance coverage is up to \$250,000 per depositor for all deposit accounts. As a result of this deposit insurance function, the FDIC also has certain supervisory authority and powers over the Bank. If, as a result of an examination of the Bank, the regulators should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of the Bank’s operations are unsatisfactory or that the Bank or our management is violating or has violated any law or regulation, various remedies are available to the regulators. Such remedies include the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict growth, to assess civil monetary penalties, to remove officers and directors and ultimately to request the FDIC to terminate the Bank’s deposit insurance. As a California-chartered commercial bank, the Bank is also subject to certain provisions of California law.

We provide banking services within our targeted markets in California to businesses, including the owners and employees of those businesses, professionals, real estate investors and non-profit organizations, as well as consumers in the communities we serve. Additionally, through our HOA Banking and Lending and Franchise Capital units we can provide customized cash management, electronic banking services and credit facilities to HOAs, HOA management companies and QSR franchise owners nationwide. At September 30, 2014, the Bank operated 13 full-service depository branches in California located in the cities of Encinitas, Huntington Beach, Irvine, Los Alamitos, Newport Beach, Palm Springs, Palm Desert, Point Loma, San Bernardino, San Diego and Seal Beach. Our corporate headquarters are located in Irvine, California. Through our branches and our web site at [www.ppbi.com](http://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 variety of loan products, including commercial business loans, lines of credit, commercial real estate loans, SBA loans, residential home loans, and home equity loans. The Bank funds its lending and investment activities with retail deposits obtained through its branches, advances from the FHLB, lines of credit, and wholesale and brokered certificates of deposits.

Our principal source of income is the net spread between interest earned on loans and investments and the interest costs associated with deposits and borrowings used to finance the loan and investment portfolios. Additionally, the Bank generates fee income from loan and investment sales and various products and services offered to both depository and loan customers.

#### CRITICAL ACCOUNTING POLICIES

Management has established various accounting policies that govern the application of U.S. GAAP in the preparation of our financial statements. Our significant accounting policies are described in the Notes to the Consolidated

Financial Statements in our 2013 Annual Report. There have been no significant changes to our Critical Accounting Policies as described in our 2013 Annual Report.

Certain accounting policies require management to make estimates and assumptions which have a material impact on the carrying value of certain assets and liabilities; management considers these to be critical accounting policies. The estimates and assumptions management uses are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at balance sheet dates and our results of operations for future reporting periods.

We consider the ALLL to be a critical accounting policy that requires judicious estimates and assumptions in the preparation of our financial statements that is particularly susceptible to significant change. For further information, see "Allowances for Loan Losses" discussed in Note 6 to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q and in our 2013 Annual Report.

### IFH ACQUISITION

On January 30, 2014, the Company acquired IFH, a national lender to franchisees in the QSR industry, and other direct and indirect subsidiaries utilized in its business, pursuant to the terms of a definitive agreement entered into by the Corporation, the Bank and Infinity on November 15, 2013. As a result of the IFH acquisition, the Bank acquired and recorded at the acquisition date assets with a fair value of approximately \$80.2 million, including \$78.8 million in loans. Also as a result of the IFH acquisition, the Bank recorded equity of \$9.0 million in connection with the Corporation's stock issued to IFH shareholders as part of the acquisition consideration and assumed at acquisition date liabilities with a fair value of approximately \$68.3 million, including a \$67.6 million credit facility that was paid off in conjunction with the closing of the acquisition.

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.

The acquisition of IFH has diversified our loan portfolio with commercial and industrial and owner-occupied commercial real estate loans, permitting us to deploy excess liquidity into higher yielding assets. The QSR franchisee lending business is a niche market that provides attractive growth opportunities for the Company in the future. IFH had no delinquent loans or adversely classified assets as of the acquisition date.

### SDTB ACQUISITION

Effective June 25, 2013, the Company acquired SDTB, a San Diego, California, based state-chartered bank, pursuant to the terms of a definitive agreement entered into by the Corporation, the Bank and SDTB on March 6, 2013. As a result of the SDTB acquisition, the Bank acquired and recorded at the acquisition date assets with a fair value of approximately \$211.2 million, including:

- \$124.8 million in investment securities;
- \$42.7 million of gross loans;
- \$30.3 million of cash and cash equivalents;
- \$5.6 million in goodwill;
- \$5.8 million in bank owned life insurance;

- \$4.1 million of other types of assets; and
- \$2.8 million of a core deposit intangible.

Also as a result of the SDTB acquisition, the Bank recorded equity of \$14.4 million in connection with the Corporation's stock issued to SDTB shareholders as part of the acquisition consideration and assumed at acquisition date liabilities with a fair value of approximately \$186.2 million, including:

- \$178.8 million in deposit transaction accounts;
- \$5.1 million in retail certificates of deposit;
- \$1.2 million in deferred tax liability; and
- \$1.1 million other liabilities.

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.

#### FAB ACQUISITION

Effective March 15, 2013, the Company acquired FAB, a Dallas, Texas, based Texas-chartered bank, pursuant to the terms of a definitive agreement entered into by the Bank and the FAB on October 15, 2012. As a result of the FAB acquisition, the Bank acquired and recorded at the acquisition date assets with a fair value of approximately \$424.2 million, including:

- \$222.4 million in investment securities;
- \$167.7 million of cash and cash equivalents;
  - \$26.4 million of gross loans;
  - \$11.9 million in goodwill;
- \$5.8 million of other types of assets; and
- \$1.9 million of a core deposit intangible.

Also as a result of the FAB acquisition, the Bank recorded equity of \$14.9 million in connection with the Corporation's stock issued to FAB shareholders as part of the acquisition consideration and assumed at acquisition date liabilities with a fair value of approximately \$378.2 million, including:

- \$329.5 million in deposit transaction accounts;
- \$17.4 million in retail certificates of deposit;
  - \$9.9 million in wholesale deposits;
  - \$16.9 million in other borrowings;

- \$3.9 million in deferred tax liability; and
- \$536,000 of other liabilities.

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.

## RESULTS OF OPERATIONS

In the third quarter of 2014, we reported net income of \$5.5 million, or \$0.31 per diluted share, compared with net income for the third quarter of 2013 of \$3.1 million or \$0.18 per diluted share. For the three months ended September 30, 2014, the Company's return on average assets was 1.14% and return on average equity was 11.25%, compared with a return on average assets of 0.78% and a return on average equity of minus 7.29% for the three months ended September 30, 2013.

For the first nine months of 2014, the Company recorded net income of \$12.7 million, or \$0.73 per diluted share. This compares with net income of \$4.8 million or \$0.29 per diluted share for the first nine months of 2013. For the nine months ended September 30, 2014, the Company's return on average assets was 0.96% and return on average equity was 8.98%, compared with a return on average assets of 0.46% and a return on average equity of 4.09% for the nine months ended September 30, 2013.

Prior period comparisons for the year-to-date results are impacted by one-time merger-related expenses totaling \$626,000 associated with the acquisition of IFH in the first quarter of 2014, \$5.0 million associated with the acquisition of SDTB in the second quarter of 2013 and \$1.7 million associated with the acquisition of FAB in the first quarter of 2013. Excluding one-time merger-related expenses during these reporting periods, the Company's adjusted net income for the first nine months of 2014 was \$13.1 million, or \$0.75 per diluted share, compared to an adjusted net income of \$9.2 million, or \$0.57 per diluted share, for the first nine months of 2013.

### Net Interest Income

Our earnings are derived predominately from net interest income, which is the difference between the interest income earned on interest-earning assets, primarily loans and securities, and the interest expense incurred on interest-bearing liabilities, primarily deposits and borrowings. The spread between the yield on interest-earning assets and the cost of interest-bearing liabilities and the relative dollar amounts of these assets and liabilities principally affect net interest income.

Net interest income for the third quarter of 2014 increased \$4.0 million or 26.7%, compared to the third quarter of 2013. The increase in net interest income was primarily related to an increase in interest-earning assets of \$305.7 million, primarily related to our organic loan growth and loans acquired as part of the IFH acquisition. Also contributing to the increase in net interest income was an increase in the net interest margin of 21 basis points, primarily related to a higher yield on interest-earning assets of 30 basis points, as we deployed liquidity received from our acquisitions of FAB and SDTB to increase the level of higher yielding loans within interest-earning assets. The decrease in loan yield was impacted by existing loans repricing at lower interest rates and the repayment of higher yielding loans during the third quarter of 2014 when compared to the prior year third quarter. Partially offsetting the higher yield on interest-earning assets was an increase in the cost of interest-bearing liabilities by 10 basis points. During the third quarter of 2014, borrowing costs were impacted by our offering of \$60.0 million in aggregate principal amount of 5.75% subordinated notes completed at the end of August 2014 and by partially replacing overnight FHLB borrowings with 18 month and two year fixed rate advances for the purpose of extending the maturity of our borrowings to support our interest rate risk management strategies.

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For the first nine months of 2014, net interest income totaled \$53.4 million, up \$11.9 million or 28.6%, compared to the net interest income for the first nine months of 2013. The increase reflected an increase in interest-earning assets of \$340.9 million while the net interest margin increased 11 basis points to 4.23%. The increase in interest-earning assets was primarily related to the acquisitions of FAB, SDTB and IFH along with our organic loan growth. The increase in net interest margin included an increase in the yield on interest-earning assets of 9 basis points, which resulted from an improved mix in higher yielding loans realized from leveraging the liquidity received from our acquisitions and a decrease in the cost of interest-bearing liabilities of 2 basis points from an improved mix of lower costing transaction accounts.

The following tables present for the periods indicated the average dollar amounts from selected balance sheet categories calculated from daily average balances and the total dollar amount, including adjustments to yields and costs, of:

- Interest income earned from average interest-earning assets and the resultant yields; and
- Interest expense incurred from average interest-bearing liabilities and resultant costs, expressed as rates.

The tables below set forth our net interest income, net interest rate spread and net interest rate margin for the periods indicated. The net interest rate margin reflects the relative level of interest-earning assets to interest-bearing liabilities and equals our net interest rate spread divided by average interest-earning assets for the periods indicated.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
STATISTICAL INFORMATION

|                                   | Three Months Ended<br>September 30, 2014 |                     |                       |   | Average Balance Sheet<br>Three Months Ended<br>June 30, 2014 |                     |                       |   | Three Months Ended<br>September 30, 2013 |                     |                       |   |
|-----------------------------------|--|---------------------|-----------------------|---|--|---------------------|-----------------------|---|--|---------------------|-----------------------|---|
|                                   | Average<br>Balance                       | Average<br>Interest | Average<br>Yield/Cost | % | Average<br>Balance   | Average<br>Interest | Average<br>Yield/Cost | % | Average<br>Balance                       | Average<br>Interest | Average<br>Yield/Cost | % |
| (dollars in thousands)            |  |                     |                       |   |  |                     |                       |   |  |                     |                       |   |
| <b>Assets</b>                     |  |                     |                       |   |  |                     |                       |   |  |                     |                       |   |
| <b>Interest-earning assets:</b>   |  |                     |                       |   |  |                     |                       |   |  |                     |                       |   |
| Cash and cash equivalents         | \$70,009                                 | \$26                | 0.15                  | % | \$79,600   | \$37                | 0.19                  | % | \$126,503                                | \$64                | 0.20                  | % |
| Federal funds sold                | 275                                      | -                   | -                     |   | 276  | -                   | -                     |   | 26                                       | -                   | -                     |   |
| Investment securities             | 272,692                                  | 1,458               | 2.14                  |   | 225,294  | 1,272               | 2.26                  |   | 346,737                                  | 1,890               | 2.18                  |   |
| Loans receivable, net (1)         | 1,477,896                                | 19,550              | 5.25                  |   | 1,362,030  | 17,922              | 5.28                  |   | 1,041,871                                | 14,420              | 5.49                  |   |
| Total interest-earning assets     | 1,820,872                                | 21,034              | 4.59                  | % | 1,667,200  | 19,231              | 4.63                  | % | 1,515,137                                | 16,374              | 4.29                  | % |
| Noninterest-earning assets        | 88,656                                   |                     |                       |   | 84,845   |                     |                       |   | 61,873                                   |                     |                       |   |
| Total assets                      | \$1,909,528                              |                     |                       |   | \$1,752,045  |                     |                       |   | \$1,577,010                              |                     |                       |   |
| <b>Liabilities and Equity</b>     |  |                     |                       |   |  |                     |                       |   |  |                     |                       |   |
| <b>Interest-bearing deposits:</b> |  |                     |                       |   |  |                     |                       |   |  |                     |                       |   |
| Interest checking                 | \$134,819                                | \$40                | 0.12                  | % | \$134,051  | \$39                | 0.12                  | % | \$109,775                                | \$38                | 0.14                  | % |



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|  |                  |              |               |                  |              |               |                  |              |               |
|--|------------------|--------------|---------------|------------------|--------------|---------------|------------------|--------------|---------------|
| Money market   | 477,111          | 381          | 0.32          | 456,466          | 343          | 0.30          | 445,717          | 313          | 0.28          |
| Savings  | 74,790           | 27           | 0.14          | 74,406           | 27           | 0.15          | 80,298           | 31           | 0.15          |
| Time   | 380,904          | 869          | 0.91          | 359,446          | 794          | 0.89          | 316,931          | 663          | 0.83          |
| <b>Total interest-bearing deposits</b>                           | <b>1,067,624</b> | <b>1,317</b> | <b>0.49</b>   | <b>1,024,369</b> | <b>1,203</b> | <b>0.47</b>   | <b>952,721</b>   | <b>1,045</b> | <b>0.44</b>   |
| FHLB advances and other borrowings                               | 177,689          | 294          | 0.66          | 103,813          | 255          | 0.99          | 66,284           | 244          | 1.46          |
| Subordinated debentures  | 31,832           | 403          | 5.02          | 10,310           | 75           | 2.92          | 10,310           | 77           | 2.96          |
| Total borrowings   | 209,521          | 697          | 1.32          | 114,123          | 330          | 1.16          | 76,594           | 321          | 1.66          |
| <b>Total interest-bearing liabilities</b>                        | <b>1,277,145</b> | <b>2,014</b> | <b>0.63 %</b> | <b>1,138,492</b> | <b>1,533</b> | <b>0.54 %</b> | <b>1,029,315</b> | <b>1,366</b> | <b>0.53 %</b> |
| Noninterest-bearing deposits                                     | 418,129          |              |               | 408,318          |              |               | 362,442          |              |               |
| Other liabilities  | 20,410           |              |               | 15,562           |              |               | 16,974           |              |               |
| Total liabilities  | 1,715,684        |              |               | 1,562,372        |              |               | 1,408,731        |              |               |
| Stockholders' equity   | 193,844          |              |               | 189,673          |              |               | 168,279          |              |               |
| Total liabilities and equity                                     | \$1,909,528      |              |               | \$1,752,045      |              |               | \$1,577,010      |              |               |
| Net interest income  | \$19,020         |              |               | \$17,698         |              |               | \$15,008         |              |               |
| Net interest rate spread (2)                                     |                  |              | 3.96 %        |                  |              | 4.09 %        |                  |              | 3.76 %        |
| Net interest margin (3)  |                  |              | 4.14 %        |                  |              | 4.26 %        |                  |              | 3.93 %        |
| Ratio of interest-earning assets to interest-bearing liabilities |                  |              | 142.57 %      |                  |              | 146.44 %      |                  |              | 147.20 %      |

(1) Average balance includes loans held for sale and nonperforming loans and is net of deferred loan origination fees, unamortized discounts and premiums, and allowance for loan losses.

(2) Represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(3) Represents net interest income divided by average interest-earning assets.

PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARIES  
STATISTICAL INFORMATION

|                           | Average Balance Sheet                   |                                |   |                                |
|---------------------------|---|--------------------------------|---|--------------------------------|
|                           | Nine Months Ended<br>September 30, 2014 |                                | Nine Months Ended<br>September 30, 2013 |                                |
|                           | Average<br>Balance                      | Average<br>Interest Yield/Cost | Average<br>Balance                      | Average<br>Interest Yield/Cost |
| (dollars in thousands)    |   |                                |   |                                |
| Assets                    |   |                                |   |                                |
| Interest-earning assets:  |   |                                |   |                                |
| Cash and cash equivalents | \$73,316                                | \$91 0.17 %                    | \$103,592                               | \$161 0.21 %                   |
| Federal funds sold        | 248                                     | - -                            | 26                                      | - -                            |
|                           | 247,383                                 | 4,139 2.23                     | 261,300                                 | 3,880 1.98                     |

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|  |             |          |        |   |             |          |        |   |
|--|-------------|----------|--------|---|-------------|----------|--------|---|
| Investment securities  |             |          |        |   |             |          |        |   |
| Loans receivable, net (1)  | 1,365,595   | 54,057   | 5.29   |   | 980,695     | 41,504   | 5.66   |   |
| Total interest-earning assets                                    | 1,686,542   | 58,287   | 4.62   | % | 1,345,613   | 45,545   | 4.53   | % |
| Noninterest-earning assets                                       | 86,873      |          |        |   | 41,957      |          |        |   |
| Total assets   | \$1,773,415 |          |        |   | \$1,387,570 |          |        |   |
| Liabilities and Equity   |             |          |        |   |             |          |        |   |
| Interest-bearing deposits:                                       |             |          |        |   |             |          |        |   |
| Interest checking  | \$135,499   | \$118    | 0.12   | % | \$86,505    | \$75     | 0.12   | % |
| Money market   | 456,409     | 1,037    | 0.30   |   | 347,349     | 711      | 0.27   |   |
| Savings  | 75,029      | 82       | 0.15   |   | 79,433      | 95       | 0.16   |   |
| Time   | 356,649     | 2,352    | 0.88   |   | 335,935     | 2,216    | 0.88   |   |
| Total interest-bearing deposits                                  | 1,023,586   | 3,589    | 0.47   |   | 849,222     | 3,097    | 0.49   |   |
| FHLB advances and other borrowings                               | 122,513     | 792      | 0.86   |   | 54,146      | 722      | 1.78   |   |
| Subordinated debentures  | 17,563      | 553      | 4.21   |   | 10,310      | 230      | 2.98   |   |
| Total borrowings   | 140,076     | 1,345    | 1.28   |   | 64,456      | 952      | 1.97   |   |
| Total interest-bearing liabilities                               | 1,163,662   | 4,934    | 0.57   | % | 913,678     | 4,049    | 0.59   | % |
| Noninterest-bearing deposits                                     | 405,424     |          |        |   | 307,714     |          |        |   |
| Other liabilities  | 15,412      |          |        |   | 10,189      |          |        |   |
| Total liabilities  | 1,584,498   |          |        |   | 1,231,581   |          |        |   |
| Stockholders' equity   | 188,917     |          |        |   | 155,989     |          |        |   |
| Total liabilities and equity                                     | \$1,773,415 |          |        |   | \$1,387,570 |          |        |   |
| Net interest income  |             | \$53,353 |        |   |             | \$41,496 |        |   |
| Net interest rate spread (2)                                     |             |          | 4.05   | % |             |          | 3.94   | % |
| Net interest margin (3)  |             |          | 4.23   | % |             |          | 4.12   | % |
| Ratio of interest-earning assets to interest-bearing liabilities |             |          | 144.93 | % |             |          | 147.27 | % |

(1) Average balance includes loans held for sale and nonperforming loans and is net of deferred loan origination fees, unamortized discounts and premiums, and allowance for loan losses.

(2) Represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(3) Represents net interest income divided by average interest-earning assets.

Changes in our net interest income are a function of changes in both volumes and rates of interest-earning assets and interest-bearing liabilities. The following table presents the impact the volume and rate changes have had on our net interest income for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, we have provided information on changes to our net interest income with respect to:

- Changes in interest rates (changes in interest rates multiplied by prior volume);
- Changes in volume (changes in volume multiplied by prior rate); and
- The net change or the combined impact of volume and rate changes allocated proportionately to changes in volume and changes in interest rates.

|                                     | Three Months Ended<br>September 30, 2014<br>Compared to<br>Three Months Ended<br>September 30, 2013 |          |          | Nine Months Ended September<br>30, 2014<br>Compared to<br>Nine Months Ended September<br>30, 2013 |           |           |
|-------------------------------------|---|----------|----------|---|-----------|-----------|
|                                     | Increase (decrease) due to  |          |          | Increase (decrease) due to  |           |           |
|                                     | Rate  | Volume   | Net      | Rate  | Volume    | Net       |
|                                     | (in thousands)  |          |          |   |           |           |
| <b>Interest-earning assets</b>      |   |          |          |   |           |           |
| Cash and cash equivalents           | \$ (14 )  | \$ (24 ) | \$ (38 ) | \$ (28 )  | \$ (42 )  | \$ (70 )  |
| Investment securities               | (34 )   | (398 )   | (432 )   | 473   | (214 )    | 259       |
| Loans receivable, net               | (651)   | 5,781    | 5,130    | (2,800)   | 15,353    | 12,553    |
| Total interest-earning assets       | \$ (699)  | \$ 5,359 | \$ 4,660 | \$ (2,355)  | \$ 15,097 | \$ 12,742 |
| <b>Interest-bearing liabilities</b> |   |          |          |   |           |           |
| Interest checking                   | \$ (6 )   | \$ 8     | \$ 2     | \$ -  | \$ 43     | \$ 43     |
| Money market                        | 46  | 22       | 68       | 84  | 242       | 326       |
| Savings                             | (2 )  | (2 )     | (4 )     | (7 )  | (6 )      | (13 )     |
| Time                                | 66  | 140      | 206      | -   | 136       | 136       |
| FHLB advances and other borrowings  | (190)   | 240      | 50       | (510 )  | 580       | 70        |
| Subordinated debentures             | 82  | 244      | 326      | 119   | 204       | 323       |
| Total interest-bearing liabilities  | \$ (4 )   | \$ 652   | \$ 648   | \$ (314 )   | \$ 1,199  | \$ 885    |

## liabilities

## Change in net

|                 |          |          |          |            |           |           |
|-----------------|----------|----------|----------|------------|-----------|-----------|
| interest income | \$ (695) | \$ 4,707 | \$ 4,012 | \$ (2,041) | \$ 13,898 | \$ 11,857 |
|-----------------|----------|----------|----------|------------|-----------|-----------|

## Provision for Loan Losses

We recorded a \$1.3 million provision for loan losses during the third quarter of 2014, up from \$646,000 for the third quarter of 2013. The increase in the provision for loan losses in the third quarter of 2014 was attributable to the growth in our loan portfolio. In the third quarter of 2014, we had net loan charge-offs of \$250,000, compared to net loan charge-offs of \$646,000 in the third quarter of 2013.

For the first nine months of 2014, we recorded a \$3.3 million provision for loan losses, up from \$1.3 million recorded for the first nine months of 2013. The \$2.0 million increase in the provision for loan losses was primarily attributable to the organic growth in our loan portfolio. Net loan charge-offs amounted to \$696,000 for the first nine months of 2014, down from \$1.3 million for the first nine months of 2013. Substantially all of the charge-offs in 2014 were attributable to loans that we acquired from our Federal Deposit Insurance Corporation (“FDIC”)-assisted transactions.

For purchased credit impaired loans, charge-offs are recorded when there is a decrease in the estimated cash flows of the credit from original cash flow estimates. Purchased credit impaired loans were recorded at their estimated fair value, which incorporated our estimated expected cash flows until the ultimate resolution of these credits. To the extent actual or projected cash flows are less than originally estimated, additional provisions for loan losses or charge-offs will be recognized into earnings or against the allowance, if applicable. To the extent actual or projected cash flows are more than originally estimated, the increase in cash flows is prospectively recognized in loan interest income. Due to the accounting rules associated with our purchased credit impaired loans, each quarter we are required to re-estimate cash flows which could cause volatility in our reported net interest margin and provision for loans losses. During the third quarters of 2014 and 2013, there were no charge-offs associated with purchased credit impaired loans.

Our Loss Mitigation Department continues collection efforts on loans previously written down and/or charged-off to maximize potential recoveries. See “Allowance for Loan Losses” discussed below in this Quarterly Report on Form 10-Q.

## Noninterest Income

Noninterest income for the third quarter of 2014 was \$4.5 million, up \$2.1 million or 92.5% from the third quarter of 2013. The increase was primarily related to the following:

- A \$1.0 million increase in other income. During the third quarter of 2014, we received \$1.1 million in settlement proceeds related to properties received from our FDIC-assisted acquisitions.
- A \$793,000 increase in net gain from sale of loans. During the third quarter of 2014, sales included \$14.6 million in U.S. Small Business Administration (“SBA”) loans at an overall premium of 11% and \$10.5 million of commercial non-owner occupied loans at an overall premium of 2%. That compares with sales of \$7.8 million in SBA loans at an overall premium of 12% and a \$3.7 million in commercial non-owner occupied loans at an overall premium of 2% in the third quarter of 2013.
- A \$310,000 increase in loan servicing fees. During the third quarter of 2014, we experienced higher prepayment fees, which was the primary contributor to the increase.

For the first nine months of 2014, noninterest income totaled \$9.0 million, up from \$6.5 million for the first nine months of 2013. The increase of \$2.5 million or 38.8% was primarily related to higher net gain from sale of loans of \$1.7 million, other income of \$872,000 and loan servicing fees of \$804,000, partially offset by a lower net gain from sale of investment securities of \$850,000. The increase in other income was primarily associated with a \$1.1 million settlement proceeds related to properties received from our FDIC-assisted acquisitions, partially offset by a nonrecurring \$180,000 market value loss related to loans held for sale both of which were recorded in the first nine months of 2014. The increase in loan servicing fees primarily related to a \$500,000 loan fee associated with the assumption of an existing loan coupled with higher prepayment fees.

#### Noninterest Expense

Noninterest expense totaled \$13.3 million for the third quarter of 2014, up \$1.6 million or 13.4% from the third quarter of 2013. The increase was primarily related to a \$1.5 million increase in compensation and benefits costs, a \$250,000 increase in deposit expenses and a \$123,000 increase in premises and occupancy expense, all of which was primarily associated with our organic and acquisition growth. Partially offsetting these increases was a \$404,000 decrease in data processing and communications expense, primarily as a result of renegotiated core system contracts.

For the first nine months of 2014, noninterest expense totaled \$38.5 million, down \$281,000 or 0.7% from the first nine months of 2013. The decrease was primarily related to a \$6.1 million decrease in one-time merger-related expenses and a decrease of \$545,000 in expenses related to other real estate owned operations, partially offset by increases of \$4.1 million in compensation and benefits, \$1.1 million in deposit expenses, \$655,000 in premises and occupancy expense, \$291,000 in other expense, and \$223,000 in FDIC insurance premiums. The increases in expenses were primarily due to costs associated with our acquisitions and expansion of our lending platform to increase loan production and sales.

The Company's efficiency ratio was 56.57% for the third quarter of 2014, compared to 67.72% for the third quarter of 2013. The efficiency ratio in the current quarter was impacted from higher other income that included the \$1.1 million in settlement proceeds related to properties received from our FDIC-assisted acquisitions that accounted for 2.69 percentage points of the ratio. The improvement in the current quarter efficiency ratio was primarily the result of net interest income and noninterest income increasing more rapidly than noninterest expense. For the third quarter of 2014, the Company's noninterest expense to average asset ratio was 2.80%, compared to 2.99% for the third quarter of 2013.

#### Income Taxes

For the third quarter of 2014, our effective tax rate was 38.49%, compared with 37.58% for the third quarter of 2013. For the first nine months of 2014, our effective tax rate was 38.09%, compared to 39.40% for the first nine months of 2013.

#### FINANCIAL CONDITION

At September 30, 2014, assets totaled \$2.0 billion, up \$320.1 million or 18.7% from December 31, 2013 and \$465.2 million or 29.7% from September 30, 2013.

The increase in assets since year-end 2013 was primarily related to loans held for investment of \$307.9 million associated with organic loan growth and the acquisition of IFH, which added assets at the acquisition date of \$80.2 million, and investment securities available for sale of \$26.1 million. Partially offsetting those increases was a decrease in cash and cash equivalents of \$23.2 million.

The increase in assets from September 30, 2013 was primarily related to increases in loans held for investment of \$409.0 million, cash and cash equivalents of \$42.2 million and FHLB and other stock investments of \$7.8

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million. The increase in loans held for investment was attributable to organic loan growth and the acquisition of IFH, while the increase in cash was related to an increase in our size and to fund organic loan growth.

Loans

Net loans held for investment totaled \$1.54 billion at September 30, 2014, an increase of \$305.3 million or 24.8% from December 31, 2013 and an increase of \$406.3 million or 35.9% from September 30, 2013.

The increase in loans from December 31, 2013 included increases in commercial and industrial (“C&I”) loans of \$173.7 million, which included \$78.8 million of total loans acquired from IFH at the acquisition date, as well as increases in real estate loans of \$84.0 million, warehouse facility loans of \$20.6 million, commercial owner occupied loans of \$16.9 million and SBA loans of \$9.8 million.

The increase in loan balances since September 30, 2013 was primarily related to increases in C&I loans of \$187.0 million, real estate loans of \$130.3 million, warehouse facilities loans of \$59.0 million, commercial owner occupied loans of \$15.8 million and SBA loans of \$14.0 million. Included in the C&I loan increase were the franchise loans acquired from IFH.

The following table sets forth the composition of our loan portfolio in dollar amounts, as a percentage of the portfolio and gives the weighted average interest rate by loan category at the dates indicated:

|  | September 30, 2014 |                  |                                | December 31, 2013 |                  |                                | September 30, 2013 |                  |                                |
|--|--------------------|------------------|--------------------------------|-------------------|------------------|--------------------------------|--------------------|------------------|--------------------------------|
|  | Amount             | Percent of Total | Weighted Average Interest Rate | Amount            | Percent of Total | Weighted Average Interest Rate | Amount             | Percent of Total | Weighted Average Interest Rate |
| (dollars in thousands)                       |                    |                  |                                |                   |                  |                                |                    |                  |                                |
| <b>Business loans:</b>                       |                    |                  |                                |                   |                  |                                |                    |                  |                                |
| Commercial and industrial                    | \$360,700          | 23.3 %           | 5.35 %                         | \$187,035         | 15.0 %           | 5.01 %                         | \$173,720          | 15.2 %           | 5.07 %                         |
| Commercial owner occupied (1)                | 237,996            | 15.4 %           | 5.13 %                         | 221,089           | 17.8 %           | 5.33 %                         | 222,162            | 19.5 %           | 5.41 %                         |
| SBA  | 20,482             | 1.3 %            | 5.69 %                         | 10,659            | 0.9 %            | 5.92 %                         | 6,455              | 0.6 %            | 6.02 %                         |
| Warehouse facilities                         | 108,093            | 7.0 %            | 4.03 %                         | 87,517            | 7.0 %            | 4.07 %                         | 49,104             | 4.3 %            | 4.10 %                         |
| <b>Real estate loans:</b>                    |                    |                  |                                |                   |                  |                                |                    |                  |                                |
| Commercial non-owner occupied                | 355,984            | 23.0 %           | 5.13 %                         | 333,544           | 26.9 %           | 5.33 %                         | 304,979            | 26.7 %           | 5.41 %                         |
| Multi-family                                 | 262,588            | 17.0 %           | 4.56 %                         | 233,689           | 18.8 %           | 4.82 %                         | 218,929            | 19.2 %           | 4.91 %                         |
| One-to-four family (2)                       | 125,326            | 8.1 %            | 4.36 %                         | 145,235           | 11.7 %           | 4.43 %                         | 152,667            | 13.4 %           | 4.46 %                         |
| Construction                                 | 67,118             | 4.3 %            | 5.18 %                         | 13,040            | 1.0 %            | 5.18 %                         | 2,835              | 0.2 %            | 5.84 %                         |
| Land   | 6,103              | 0.4 %            | 4.51 %                         | 7,605             | 0.6 %            | 4.73 %                         | 7,371              | 0.6 %            | 4.72 %                         |
| Other loans                                  | 3,521              | 0.2 %            | 5.73 %                         | 3,839             | 0.3 %            | 5.82 %                         | 3,793              | 0.3 %            | 5.96 %                         |
| <b>Total gross loans (3)</b>                 | <b>1,547,911</b>   | <b>100.0 %</b>   | <b>4.93 %</b>                  | <b>1,243,252</b>  | <b>100.0 %</b>   | <b>4.95 %</b>                  | <b>1,142,015</b>   | <b>100.0 %</b>   | <b>5.05 %</b>                  |
| Less loans held for sale                     | -                  |                  |                                | 3,147             |                  |                                | 3,176              |                  |                                |
| <b>Total gross loans held for investment</b> | <b>1,547,911</b>   |                  |                                | <b>1,240,105</b>  |                  |                                | <b>1,138,839</b>   |                  |                                |
| Deferred loan origination costs/(fees) and   | 93                 |                  |                                | 18                |                  |                                | 130                |                  |                                |

premiums/(discounts),  
net

|                                |              |              |              |
|--------------------------------|--------------|--------------|--------------|
| Allowance for loan losses      | (10,767 )    | (8,200 )     | (7,994 )     |
| Loans held for investment, net | \$ 1,537,237 | \$ 1,231,923 | \$ 1,130,975 |

(1) Majority secured by real estate.

(2) Includes second trust deeds.

(3) Total gross loans for September 30, 2014 are net of (i) the unaccreted mark-to-market discounts on Canyon National loans of \$1.5 million, on Palm Desert National loans of \$1.7 million, and on SDTB loans of \$145,000 and (ii) the mark-to-market premium on FAB loans of \$31,000.

The increase in gross loans held for investment of \$405.9 million or 35.5% from the year-ago third quarter was primarily related to increases from organic growth, loans acquired from IFH of \$78.8 million, and loan purchases. Total gross loans increased \$304.7 million since December 31, 2013 through diversified loan production which included loan originations of \$429.8 million, loans acquired from IFH of \$78.8 million and loans purchased of \$144.1 million, partially offset by loan repayments of \$178.7 million, loan sales of \$47.6 million and an increase in undisbursed loan funds of \$43.4 million. The weighted average loan portfolio rate at September 30, 2014 was 4.93%, compared to 4.95% at December 31, 2013 and 5.05% at September 30, 2013.

The following table sets forth loan originations, purchases, sales and principal repayments relating to our gross loans for the periods indicated:

|                               | Nine Months Ended  |                    |
|-------------------------------|--------------------|--------------------|
|                               | September 30, 2014 | September 30, 2013 |
|                               | (in thousands)     |                    |
| Beginning balance gross loans | \$ 1,243,252       | \$ 986,194         |
| Loans originated:             |                    |                    |
| Business loans:               |                    |                    |
| Commercial and industrial     | 196,171            | 60,792             |
| Commercial owner occupied (1) | 14,002             | 40,931             |
| SBA                           | 43,604             | 6,548              |
| Warehouse facilities          | 5,150              | 74,860             |
| Real estate loans:            |                    |                    |
| Commercial non-owner occupied | 63,362             | 76,555             |

|  |             |             |
|--|-------------|-------------|
| Multi-family   | 16,104      | 46,659      |
| One-to-four family (2)                               | 2,220       | 1,580       |
| Construction loans                                   | 88,988      | 5,650       |
| Other loans  | 241         | 2,803       |
| Total loans originated                               | 429,842     | 316,378     |
| Loans purchased:                                     |             |             |
| Business loans:                                      |             |             |
| Commercial and industrial                            | 69,543      | 30,084      |
| Commercial owner occupied                            | 18,651      | 42,835      |
| Real estate loans:                                   |             |             |
| Commercial non-owner occupied                        | 12,965      | 16,763      |
| Multi-family   | 42,902      | 43,231      |
| One-to-four family                                   | -           | 78,673      |
| Construction   | -           | 1,399       |
| Land   | -           | 2,770       |
| Other loans  | -           | 716         |
| Total loans purchased                                | 144,061     | 216,471     |
| Total loan production                                | 573,903     | 532,849     |
| Principal repayments                                 | (178,674 )  | (111,475 )  |
| Sales of loans                                       | (47,623 )   | (18,722 )   |
| Change in undisbursed loan funds, net                | (43,436 )   | (246,814 )  |
| Charge-offs  | (783 )      | (1,608 )    |
| Change in mark-to-market discounts from acquisitions | 1,632       | 2,587       |
| Transfer to other real estate owned                  | (360 )      | (996 )      |
| Net increase in gross loans                          | 304,659     | 155,821     |
| Ending balance gross loans                           | \$1,547,911 | \$1,142,015 |

(1) Majority secured by real



estate.  
 (2) Includes  
 second trust  
 deeds.

The following table sets forth the weighted average interest rates, weighted average number of months to reprice and the periods to repricing for our gross loan portfolio at the date indicated:

| Periods to Repricing     | Number of Loans | September 30, 2014               |                                |                                    |
|--------------------------|-----------------|----------------------------------|--------------------------------|------------------------------------|
|                          |                 | Amount<br>(dollars in thousands) | Weighted Average Interest Rate | Weighted Average Months to Reprice |
| 1 Year and less          | 1,042           | \$ 534,428                       | 4.98 %                         | 1.13                               |
| Over 1 Year to 3 Years   | 152             | 171,117                          | 4.53 %                         | 29.93                              |
| Over 3 Years to 5 Years  | 319             | 405,329                          | 4.74 %                         | 48.80                              |
| Over 5 Years to 7 Years  | 62              | 127,381                          | 4.67 %                         | 96.83                              |
| Over 7 Years to 10 Years | 16              | 14,928                           | 4.70 %                         | 106.46                             |
| Total adjustable         | 1,591           | 1,253,183                        | 4.81 %                         | 28.78                              |
| Fixed                    | 894             | 294,728                          | 5.49 %                         |                                    |
| Total                    | 2,485           | \$ 1,547,911                     | 4.93 %                         |                                    |

Delinquent Loans. When a borrower fails to make required payments on a loan and does not cure the delinquency within 30 days, we normally record a notice of default and, after providing the required notices to the borrower, commence foreclosure proceedings. If the loan is not reinstated within the time permitted by law, we may sell the property at a foreclosure sale. At these foreclosure sales, we generally acquire title to the property. At September 30, 2014, loans delinquent 30 or more days as a percentage of total gross loans was 0.03%, down from 0.17% at December 31, 2013 and 0.09% at September 30, 2013.

The following table sets forth delinquencies in the Company's loan portfolio at the dates indicated:

| 30 - 59 Days |                   | 60 - 89 Days |                   | 90 Days or More (1) |                   | Total      |                   |
|--------------|-------------------|--------------|-------------------|---------------------|-------------------|------------|-------------------|
| # of Loans   | Principal Balance | # of Loans   | Principal Balance | # of Loans          | Principal Balance | # of Loans | Principal Balance |
|              |                   |              |                   |                     |                   |            |                   |

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|                                       | of<br>Loans |               | of<br>Loans<br>(dollars in thousands) |              | of<br>Loans |                 | of<br>Loans |                 |
|---------------------------------------|-------------|---------------|---------------------------------------|--------------|-------------|-----------------|-------------|-----------------|
| <b>At September 30, 2014</b>          |             |               |                                       |              |             |                 |             |                 |
| Business loans:                       |             |               |                                       |              |             |                 |             |                 |
| SBA                                   | -           | -             | 1                                     | 43           | -           | -               | 1           | 43              |
| Real estate loans:                    |             |               |                                       |              |             |                 |             |                 |
| One-to-four family                    | 1           | 20            | -                                     | -            | 6           | 343             | 7           | 363             |
| <b>Total</b>                          | <b>1</b>    | <b>\$ 20</b>  | <b>1</b>                              | <b>\$ 43</b> | <b>6</b>    | <b>\$ 343</b>   | <b>8</b>    | <b>\$ 406</b>   |
| Delinquent loans to total gross loans |             |               |                                       |              |             |                 |             |                 |
|                                       |             | 0.00 %        |                                       | 0.00 %       |             | 0.02 %          |             | 0.03 %          |
| <b>At December 31, 2013</b>           |             |               |                                       |              |             |                 |             |                 |
| Business loans:                       |             |               |                                       |              |             |                 |             |                 |
| Commercial owner occupied             |             |               |                                       |              |             |                 |             |                 |
|                                       | 2           | \$ 768        | -                                     | \$ -         | 1           | \$ 446          | 3           | \$ 1,214        |
| SBA                                   | -           | -             | -                                     | -            | 1           | 14              | 1           | 14              |
| Real estate loans:                    |             |               |                                       |              |             |                 |             |                 |
| Commercial non-owner occupied         |             |               |                                       |              |             |                 |             |                 |
|                                       | -           | -             | -                                     | -            | 2           | 560             | 2           | 560             |
| One-to-four family                    | 3           | 71            | -                                     | -            | 4           | 123             | 7           | 194             |
| Other                                 | 3           | 130           | -                                     | -            | -           | -               | 3           | 130             |
| <b>Total</b>                          | <b>8</b>    | <b>\$ 969</b> | <b>-</b>                              | <b>\$ -</b>  | <b>8</b>    | <b>\$ 1,143</b> | <b>16</b>   | <b>\$ 2,112</b> |
| Delinquent loans to total gross loans |             |               |                                       |              |             |                 |             |                 |
|                                       |             | 0.08 %        |                                       | 0.00 %       |             | 0.09 %          |             | 0.17 %          |
| <b>At September 30, 2013</b>          |             |               |                                       |              |             |                 |             |                 |
| Business loans:                       |             |               |                                       |              |             |                 |             |                 |
| Commercial and industrial             |             |               |                                       |              |             |                 |             |                 |
|                                       | 1           | \$ 163        | 2                                     | \$ 79        | -           | \$ -            | 3           | \$ 242          |
| SBA                                   | -           | -             | 1                                     | 129          | 1           | 14              | 2           | 143             |
| Real estate loans:                    |             |               |                                       |              |             |                 |             |                 |
| Commercial non-owner occupied         |             |               |                                       |              |             |                 |             |                 |
|                                       | 2           | 559           | -                                     | -            | -           | -               | 2           | 559             |

|                                       |   |        |   |        |   |        |    |          |
|---------------------------------------|---|--------|---|--------|---|--------|----|----------|
| One-to-four family                    | - | -      | - | -      | 3 | 97     | 3  | 97       |
| Other                                 | 1 | 2      | 1 | 6      | - | -      | 2  | 8        |
| Total                                 | 4 | \$ 724 | 4 | \$ 214 | 4 | \$ 111 | 12 | \$ 1,049 |
| Delinquent loans to total gross loans |   | 0.06 % |   | 0.02 % |   | 0.01 % |    | 0.09 %   |

(1) All loans that are delinquent 90 days or more are on nonaccrual status and reported as part of nonperforming loans.

**Allowance for Loan Losses.** The ALLL represents an estimate of probable losses inherent in our loan portfolio and is determined by applying a systematically derived loss factor to individual segments of the loan portfolio. The adequacy and appropriateness of the ALLL and the individual loss factors are reviewed each quarter by management.

The loss factor for each segment of our loan portfolio is generally based on our actual historical loss rate experience with emphasis on recent past periods to account for current economic conditions and supplemented by management judgment for certain segments where we lack loss history experience. We also consider historical charge-off rates for the last 10 and 15 years for commercial banks and savings institutions headquartered in California as collected and reported by the FDIC. The loss factor is adjusted by qualitative adjustment factors to arrive at a final loss factor for each loan portfolio segment. For additional information regarding the qualitative adjustments, please see "Allowances for Loan Losses" discussed in our 2013 Annual Report. The qualitative factors allow management to assess current trends within our loan portfolio and the economic environment to incorporate their effect when calculating the ALLL. The final loss factors are applied to pass graded loans within our loan portfolio. Higher factors are applied to loans graded below pass, including classified and criticized assets.

No assurance can be given that we will not, in any particular period, sustain loan losses that exceed the amount reserved, or that subsequent evaluation of our loan portfolio, in light of the prevailing factors, including economic conditions which may adversely affect our market area or other circumstances, will not require significant increases in the loan loss allowance. In addition, regulatory agencies, as an integral part of their examination process, periodically review our ALLL and may require us to recognize additional provisions to increase the allowance or take charge-offs in anticipation of future losses.

Our ALLL at September 30, 2014 was \$10.8 million, up from \$8.2 million at December 31, 2013 and \$8.0 million at September 30, 2013. At September 30, 2014, given the composition of our loan portfolio, the ALLL was considered adequate to cover estimated losses inherent in the loan portfolio. Should any of the factors considered by management in evaluating the appropriate level of the ALLL change, the Company's estimate of probable loan losses could also change, which could affect the level of future provisions for loan losses.

The following table sets forth the Company's ALLL and its corresponding percentage of the loan category balance and the percent of loan balance to total gross loans in each of the loan categories listed for the periods indicated:

| Balance at End of | September 30, 2014 |                         | December 31, 2013 |                         | September 30, 2013 |                         |
|-------------------|--------------------|-------------------------|-------------------|-------------------------|--------------------|-------------------------|
|                   | as a % of          | Category to             | as a % of         | Category to             | as a % of          | Category to             |
|                   |                    | % of Allowance Loans in |                   | % of Allowance Loans in |                    | % of Allowance Loans in |

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| Period<br>Applicable<br>to           | Category<br>Amount | Total<br>Total | Total<br>Loans | Category<br>Amount | Total<br>Total | Total<br>Loans | Category<br>Amount | Total<br>Total | Total<br>Loans |
|--------------------------------------|--------------------|----------------|----------------|--------------------|----------------|----------------|--------------------|----------------|----------------|
| (dollars in thousands)               |                    |                |                |                    |                |                |                    |                |                |
| <b>Business loans:</b>               |                    |                |                |                    |                |                |                    |                |                |
| Commercial and industrial            | \$3,375            | 0.94 %         | 23.3 %         | \$1,968            | 1.05 %         | 15.0 %         | \$2,801            | 1.61 %         | 15.2 %         |
| <b>Commercial owner occupied</b>     |                    |                |                |                    |                |                |                    |                |                |
| SBA                                  | 1,856              | 0.78 %         | 15.4 %         | 1,818              | 0.82 %         | 17.8 %         | 1,519              | 0.68 %         | 19.5 %         |
| Warehouse facilities                 | 445                | 2.17 %         | 1.3 %          | 151                | 1.42 %         | 0.9 %          | 50                 | 0.77 %         | 0.6 %          |
| <b>Real estate loans:</b>            |                    |                |                |                    |                |                |                    |                |                |
| <b>Commercial non-owner occupied</b> |                    |                |                |                    |                |                |                    |                |                |
| Multi-family                         | 1,901              | 0.53 %         | 23.0 %         | 1,658              | 0.50 %         | 26.9 %         | 1,403              | 0.46 %         | 26.7 %         |
| One-to-four family                   | 1,011              | 0.39 %         | 17.0 %         | 817                | 0.35 %         | 18.8 %         | 506                | 0.23 %         | 19.2 %         |
| Construction                         | 815                | 0.65 %         | 8.1 %          | 1,099              | 0.76 %         | 11.7 %         | 1,174              | 0.77 %         | 13.4 %         |
| Land                                 | 775                | 1.15 %         | 4.3 %          | 136                | 1.04 %         | 1.0 %          | 121                | 4.27 %         | 0.2 %          |
| Other Loans                          | 72                 | 1.18 %         | 0.4 %          | 127                | 1.67 %         | 0.6 %          | 147                | 1.99 %         | 0.6 %          |
| <b>Total</b>                         | <b>\$10,767</b>    | <b>0.70 %</b>  | <b>100.0 %</b> | <b>\$8,200</b>     | <b>0.66 %</b>  | <b>100.0 %</b> | <b>\$7,994</b>     | <b>0.70 %</b>  | <b>100.0 %</b> |

The ALLL as a percent of nonaccrual loans was 604.2% at September 30, 2014, up from 364.3% at December 31, 2013, but down from 693.3% at September 30, 2013. At September 30, 2014, the ratio of ALLL to total gross loans was 0.70%, up from 0.66% at December 31, 2013, and equal to the ratio at September 30, 2013. Our ratio of ALLL plus the remaining unamortized credit discount on the loans acquired to total gross loans was 0.85% at September 30, 2014, down from 0.93% at December 31, 2013 and 1.06% at September 30, 2013.

The following table sets forth the activity within the Company's ALLL in each of the loan categories listed for the periods indicated:

|                                    | Three Months<br>Ended<br>September 30,<br>2014 |         | Nine Months<br>Ended<br>September 30,<br>2013 |         |
|------------------------------------|--|---------|---|---------|
| Balance,<br>beginning of<br>period | \$9,733  | \$7,994 | \$8,200                                       | \$7,994 |
| Provision for<br>loan losses       | 1,284  | 646     | 3,263   | 1,264   |
| <b>Charge-offs:</b>                |  |         |   |         |

|   |          |         |          |          |  |  |  |
|---|----------|---------|----------|----------|--|--|--|
| Business loans:   |          |         |          |          |  |  |  |
| Commercial and industrial                                 | (99 )    | (233 )  | (223 )   | (291 )   |  |  |  |
| Commercial owner occupied                                 | -        | (163 )  | -        | (163 )   |  |  |  |
| SBA   | -        | (11 )   | -        | (16 )    |  |  |  |
| Real estate:  |          |         |          |          |  |  |  |
| Commercial non-owner occupied                             | -        | -       | (365 )   | (757 )   |  |  |  |
| Multi-family  | -        | (90 )   | -        | (101 )   |  |  |  |
| One-to-four family  | (183 )   | (263 )  | (195 )   | (273 )   |  |  |  |
| Other loans   | -        | (1 )    | -        | (7 )     |  |  |  |
| Total charge-offs   | (282 )   | (761 )  | (783 )   | (1,608 ) |  |  |  |
| Recoveries :  |          |         |          |          |  |  |  |
| Business loans:   |          |         |          |          |  |  |  |
| Commercial and industrial                                 | 12       | 86      | 33       | 107      |  |  |  |
| SBA   | 1        | 7       | 4        | 51       |  |  |  |
| Real estate:  |          |         |          |          |  |  |  |
| One-to-four family  | 2        | 1       | 32       | 45       |  |  |  |
| Other loans   | 17       | 21      | 18       | 141      |  |  |  |
| Total recoveries  | 32       | 115     | 87       | 344      |  |  |  |
| Net loan charge-offs                                      | (250 )   | (646 )  | (696 )   | (1,264 ) |  |  |  |
| Balance at end of period                                  | \$10,767 | \$7,994 | \$10,767 | \$7,994  |  |  |  |
| Ratios:   |          |         |          |          |  |  |  |
| Net charge-offs (recoveries) to average total loans, net  | 0.07 %   | 0.25 %  | 0.07 %   | 0.17 %   |  |  |  |
| Allowance for loan losses to gross loans at end of period | 0.70 %   | 0.70 %  | 0.70 %   | 0.70 %   |  |  |  |

## Investment Securities

We primarily use our investment portfolio for liquidity purposes and to support our interest rate risk management strategies. Investment securities available for sale totaled \$282.2 million at September 30, 2014, up \$26.1 million or 10.2% from December 31, 2013, but down \$644,000 or 0.2% from September 30, 2013. The increase in securities available for sale from December 31, 2013 was primarily related to purchases of \$135.6 million and an increase in unrealized value on these securities of \$5.4 million, partially offset by sales of \$91.4 million and principal pay downs of \$21.5 million. The purchase of investment securities was primarily due to investing excess liquidity, while the sales were made to help fund loan production and to improve our interest-earning asset mix by redeploying investment funds into loans. At September 30, 2014, the end of period yield on investment securities was 1.97%, down from 2.21% at December 31, 2013, and 2.12% from September 30, 2013.

The following tables set forth the amortized cost, unrealized gains and losses, and estimated fair value of our investment securities portfolio at the dates indicated:

|   | September 30, 2014 |            |            | Estimated |
|---|--------------------|------------|------------|-----------|
|   | Amortized          | Unrealized | Unrealized | Fair      |
|   | Cost               | Gain       | Loss       | Value     |
|   | (in thousands)     |            |            |           |
| Investment securities available for sale: |                    |            |            |           |
| Municipal bonds                           | \$97,358           | \$1,495    | \$(268)    | \$98,585  |
| Mortgage-backed securities                | 184,701            | 180        | (1,264)    | 183,617   |
| Total securities available for sale       | \$282,059          | \$1,675    | \$(1,532)  | \$282,202 |

|   | December 31, 2013 |            |            | Estimated |
|---|-------------------|------------|------------|-----------|
|   | Amortized         | Unrealized | Unrealized | Fair      |
|   | Cost              | Gain       | Loss       | Value     |
|   | (in thousands)    |            |            |           |
| Investment securities available for sale: |                   |            |            |           |
| U.S. Treasury                             | \$73              | \$8        | \$-        | \$81      |
| Municipal bonds                           | 95,388            | 589        | (1,850)    | 94,127    |
| Mortgage-backed securities                | 165,857           | 12         | (3,988)    | 161,881   |
| Total securities available for sale       | \$261,318         | \$609      | \$(5,838)  | \$256,089 |

|  | September 30, 2013 |            |           |
|--|--------------------|------------|-----------|
|  | Unrealized         | Unrealized | Estimated |

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|   | Amortized<br>Cost | Gain  | Loss      | Fair<br>Value |
|---|-------------------|-------|-----------|---------------|
|   | (in thousands)    |       |           |               |
| Investment securities available for sale: |                   |       |           |               |
| U.S. Treasury                             | \$73              | \$9   | \$-       | \$82          |
| Municipal bonds                           | 95,971            | 709   | (1,795)   | 94,885        |
| Mortgage-backed securities                | 191,282           | 182   | (3,585)   | 187,879       |
| Total securities available for sale       | \$287,326         | \$900 | \$(5,380) | \$282,846     |

The following table sets forth the fair values and weighted average yields on our investment securities available for sale portfolio by contractual maturity at the date indicated:

|  | September 30, 2014     |                        |                             |                        |                    |                        |                     |                        |            |                        |
|--|------------------------|------------------------|-----------------------------|------------------------|--------------------|------------------------|---------------------|------------------------|------------|------------------------|
|  | One Year or Less       |                        | More than One to Five Years |                        | Years to Ten Years |                        | More than Ten Years |                        | Total      |                        |
|  | Fair Value             | Weighted Average Yield | Fair Value                  | Weighted Average Yield | Fair Value         | Weighted Average Yield | Fair Value          | Weighted Average Yield | Fair Value | Weighted Average Yield |
|  | (dollars in thousands) |                        |                             |                        |                    |                        |                     |                        |            |                        |
| Investment securities available for sale:      |                        |                        |                             |                        |                    |                        |                     |                        |            |                        |
| Municipal bonds                                | \$-                    | 0.00 %                 | \$12,877                    | 1.19 %                 | \$42,379           | 1.93 %                 | \$43,329            | 2.52 %                 | \$98,585   | 2.09 %                 |
| Mortgage-backed securities                     | -                      | 0.00 %                 | -                           | 0.00 %                 | 30,394             | 1.73 %                 | 153,223             | 1.86 %                 | 183,617    | 1.84 %                 |
| Total investment securities available for sale | -                      | 0.00 %                 | 12,877                      | 1.19 %                 | 72,773             | 1.85 %                 | 196,552             | 2.00 %                 | 282,202    | 1.92 %                 |
| Stock:   |                        |                        |                             |                        |                    |                        |                     |                        |            |                        |
| FHLB   | 9,156                  | 0.00 %                 | -                           | 0.00 %                 | -                  | 0.00 %                 | -                   | 0.00 %                 | 9,156      | 0.00 %                 |
| Federal Reserve Bank and other                 | 9,487                  | 5.39 %                 | -                           | 0.00 %                 | -                  | 0.00 %                 | -                   | 0.00 %                 | 9,487      | 5.39 %                 |
| Total stock                                    | 18,643                 | 2.74 %                 | -                           | 0.00 %                 | -                  | 0.00 %                 | -                   | 0.00 %                 | 18,643     | 2.74 %                 |
| Total securities                               | \$18,643               | 2.74 %                 | \$12,877                    | 1.19 %                 | \$72,773           | 1.85 %                 | \$196,552           | 2.00 %                 | \$300,845  | 1.97 %                 |

Each quarter, we review individual securities classified as available for sale to determine whether a decline in fair value below the amortized cost basis is other-than-temporary. If it is probable that we will be unable to collect all amounts due according to the contractual terms of the debt security, an OTTI write down is recorded against the security and a loss recognized.

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In determining if a security has an OTTI loss, we review downgrades in credit ratings and the length of time and extent that the fair value has been less than the cost of the security. We estimate OTTI losses on a security primarily through:

- An evaluation of the present value of estimated cash flows from the security using the current yield to accrete beneficial interest and including assumptions in the prepayment rate, default rate, delinquencies, loss severity and percentage of nonperforming assets;
  - An evaluation of the estimated payback period to recover principal;
- An analysis of the credit support available in the underlying security to absorb losses; and
- A review of the financial condition and near term prospects of the issuer.

During the quarter ended September 30, 2014, there were OTTI recoveries of \$5,000, compared to a net \$16,000 OTTI charge during the same period last year.

Securities with OTTI credit losses recognized in noninterest income and associated OTTI non-credit losses recognized in accumulated other comprehensive loss during the periods indicated were as follows:

| Rating  | Number | Three Months Ended<br>September 30, 2014 |                 |   | Three Months Ended<br>September 30, 2013 |                 |   |      |
|---------|--------|--|-----------------|---|--|-----------------|---|------|
|         |        | Fair Value                               | Loss (Recovery) | Non Credit Gain in Accumulated OTTI Other Comprehensive Income (AOCI) | Fair Value                               | Loss (Recovery) | Non Credit Gain in Accumulated OTTI Other Comprehensive Income (AOCI) |      |
| C       | -      | \$ -                                     | \$ -            | \$ -  | 7  | \$ -            | \$ 11   | \$ - |
| D       | -      | -  | -               | -   | 5  | -               | 5   | -    |
| Various | 12     | -  | (5 )            | -   | -  | -               | -   | -    |
| Total   | 12     | \$ -                                     | \$ (5 )         | \$ -  | 12                                       | \$ -            | \$ 16   | \$ - |

| Rating | Number | Nine Months Ended<br>September 30, 2014 |                 |   | Nine Months Ended<br>September 30, 2013 |                 |   |      |
|--------|--------|---|-----------------|---|---|-----------------|---|------|
|        |        | Fair Value                              | Loss (Recovery) | Non Credit Gain in Accumulated OTTI Other Comprehensive Income (AOCI) | Fair Value                              | Loss (Recovery) | Non Credit Gain in Accumulated OTTI Other Comprehensive Income (AOCI) |      |
| Caa2   | -      | \$ -                                    | \$ -            | \$ -  | 1                                       | \$ -            | \$ (11 )  | \$ - |
| C      | -      | -                                       | -               | -   | 7                                       | -               | 11  | -    |
| D      | -      | -                                       | -               | -   | 7                                       | -               | (19 )   | -    |



|              |           |             |                |             |           |             |                |             |
|--------------|-----------|-------------|----------------|-------------|-----------|-------------|----------------|-------------|
| Various      | 13        | -           | (28)           | -           | -         | -           | -              | -           |
| <b>Total</b> | <b>13</b> | <b>\$ -</b> | <b>\$ (28)</b> | <b>\$ -</b> | <b>15</b> | <b>\$ -</b> | <b>\$ (19)</b> | <b>\$ -</b> |

There was no OTTI credit loss for any single debt security for the nine months ended September 30, 2014, compared to the largest OTTI credit loss for any single debt security of \$32,000 for the nine months ended September 30, 2013.

#### Nonperforming Assets

Nonperforming assets consist of loans on which we have ceased accruing interest (nonaccrual loans), restructured loans and OREO. It is our general policy to account for a loan as nonaccrual when the loan becomes 90 days delinquent or when collection of interest appears doubtful.

At September 30, 2014, nonperforming assets totaled \$2.5 million or 0.12% of total assets, down from \$3.4 million or 0.20% of total assets at December 31, 2013, but up from \$2.3 million or 0.15% of total assets at September 30, 2013. At September 30, 2014, nonperforming loans decreased \$469,000 and OREO decreased \$434,000 from December 31, 2013 and nonperforming loans increased \$629,000 and OREO decreased \$434,000 from September 30, 2013.

The following table sets forth our composition of nonperforming assets at the dates indicated:

|                                     | September<br>30,<br>2014 | December<br>31,<br>2013 | September<br>30,<br>2013 |
|-------------------------------------|--------------------------|-------------------------|--------------------------|
| (dollars in thousands)              |                          |                         |                          |
| Nonperforming<br>assets             |                          |                         |                          |
| <b>Business loans:</b>              |                          |                         |                          |
| Commercial<br>and industrial        | \$ -                     | \$ -                    | \$ 78                    |
| Commercial<br>owner<br>occupied     | 528                      | 747                     | -                        |
| SBA                                 | -                        | 14                      | 142                      |
| <b>Real estate:</b>                 |                          |                         |                          |
| Commercial<br>non-owner<br>occupied | 882                      | 983                     | 437                      |
| One-to-four<br>family               | 372                      | 507                     | 496                      |
| Total<br>nonaccrual<br>loans        | 1,782                    | 2,251                   | 1,153                    |
| <b>Other real<br/>estate owned:</b> |                          |                         |                          |
| Commercial<br>owner<br>occupied     | -                        | -                       | 245                      |
| Land                                | 752                      | 1,186                   | 941                      |
|                                     | 752                      | 1,186                   | 1,186                    |

|   |           |          |          |  |
|---|-----------|----------|----------|--|
| Total other real estate owned                                       |           |          |          |  |
| Total nonperforming assets, net                                     | \$ 2,534  | \$ 3,437 | \$ 2,339 |  |
| Allowance for loan losses   | \$ 10,767 | \$ 8,200 | \$ 7,994 |  |
| Allowance for loan losses as a percent of total nonperforming loans | 604.21 %  | 364.28 % | 693.32 % |  |
| Nonperforming loans as a percent of gross loans                     | 0.12 %    | 0.18 %   | 0.10 %   |  |
| Nonperforming assets as a percent of total assets                   | 0.12 %    | 0.20 %   | 0.15 %   |  |

#### Liabilities and Stockholders' Equity

Total liabilities were \$1.8 billion at September 30, 2014, compared to \$1.5 billion at December 31, 2013 and \$1.4 billion at September 30, 2013. The increase of \$297.4 million or 19.3% from the year ended December 31, 2013 was predominately related to increases in deposits of \$237.2 million and subordinated debentures of \$60.0 million. The increase of \$438.5 million from September 30, 2013 was primarily due to an increase in deposits of \$259.3 million, FHLB advances and other borrowings of \$109.1 million and subordinated debentures of \$60.0 million.

Deposits. At September 30, 2014, total deposits were \$1.54 billion, up \$237.2 million or 18.2% from December 31, 2013 and up \$259.3 million or 20.2% from September 30, 2013.

The increase in deposits since year-end 2013 included increases in certificates of deposit of \$109.4 million, money market deposits of \$61.1 million, noninterest bearing checking deposits of \$58.4 million and interest-bearing checking deposits of \$9.3 million. After not having held brokered deposits for several years, during the third quarter of 2014, the Company added \$50.3 million in brokered deposits that have an average maturity of 18 months and a weighted average interest rate of 0.65% which lengthens the overall maturity of the Company's liabilities and supports its interest rate risk management strategies.

The increase in deposits from the year-ago third quarter included increases in certificates of deposit of \$138.0 million, including the above mentioned \$50.3 million raised in brokered deposits, noninterest bearing checking of \$61.6 million, money market of \$41.8 million and interest-bearing checking of \$23.5 million, partially offset by a decrease in savings of \$ 5.5 million.

The total weighted average cost of deposits at September 30, 2014 was 0.36%, up from 0.33% at December 31, 2013, and up from 0.30% at September 30, 2013.

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At September 30, 2014, our gross loan to deposit ratio was 100.3%, up from 95.2% at December 31, 2013 and 88.9% at September 30, 2013.

The following table sets forth the distribution of the Company's deposit accounts at the dates indicated and the weighted average interest rates on each category of deposits presented:

|                                 | September 30, 2014 |                     |                       | December 31, 2013 |                     |                       | September 30, 2013 |                     |                       |
|---------------------------------|--------------------|---------------------|-----------------------|-------------------|---------------------|-----------------------|--------------------|---------------------|-----------------------|
|                                 | Balance            | % of Total Deposits | Weighted Average Rate | Balance           | % of Total Deposits | Weighted Average Rate | Balance            | % of Total Deposits | Weighted Average Rate |
| (dollars in thousands)          |                    |                     |                       |                   |                     |                       |                    |                     |                       |
| Noninterest bearing checking    | \$425,166          | 27.5 %              | 0.00%                 | \$366,755         | 28.1 %              | 0.00%                 | \$363,606          | 28.3 %              | 0.00%                 |
| Interest-bearing deposits:      |                    |                     |                       |                   |                     |                       |                    |                     |                       |
| Checking                        | 130,221            | 8.4 %               | 0.12%                 | 120,886           | 9.3 %               | 0.11%                 | 106,740            | 8.3 %               | 0.11%                 |
| Money market                    | 488,677            | 31.7 %              | 0.31%                 | 427,577           | 32.7 %              | 0.29%                 | 446,885            | 34.8 %              | 0.29%                 |
| Savings                         | 75,373             | 4.9 %               | 0.14%                 | 76,412            | 5.8 %               | 0.14%                 | 80,867             | 6.3 %               | 0.15%                 |
| Time deposit accounts:          |                    |                     |                       |                   |                     |                       |                    |                     |                       |
| Less than 1.00%                 | 191,892            | 12.4 %              | 0.60%                 | 120,583           | 9.2 %               | 0.39%                 | 152,820            | 11.9 %              | 0.42%                 |
| 1.00-1.99                       | 219,583            | 14.2 %              | 1.06%                 | 181,046           | 13.9 %              | 1.06%                 | 119,450            | 9.3 %               | 1.09%                 |
| 2.00-2.99                       | 11,105             | 0.7 %               | 2.85%                 | 11,503            | 0.8 %               | 2.83%                 | 12,037             | 0.9 %               | 2.82%                 |
| 3.00-3.99                       | 706                | 0.1 %               | 3.20%                 | 795               | 0.1 %               | 3.28%                 | 874                | 0.1 %               | 3.29%                 |
| 4.00-4.99                       | 3                  | 0.0 %               | 4.93%                 | 2                 | 0.0 %               | 4.93%                 | 142                | 0.0 %               | 4.30%                 |
| 5.00 and greater                | 740                | 0.1 %               | 5.24%                 | 727               | 0.1 %               | 5.25%                 | 713                | 0.1 %               | 5.26%                 |
| Total time deposit accounts     | 424,029            | 27.5 %              | 0.91%                 | 314,656           | 24.1 %              | 0.88%                 | 286,036            | 22.3 %              | 0.82%                 |
| Total interest-bearing deposits | 1,118,300          | 72.5 %              | 0.50%                 | 939,531           | 71.9 %              | 0.45%                 | 920,528            | 71.7 %              | 0.42%                 |
| Total deposits                  | \$1,543,466        | 100.0 %             | 0.36%                 | \$1,306,286       | 100.0 %             | 0.33%                 | \$1,284,134        | 100.0 %             | 0.30%                 |

Borrowings. At September 30, 2014, total borrowings amounted to \$265.9 million, up \$51.5 million or 24.0% from December 31, 2013 and up \$169.1 million or 174.7% from September 30, 2013.

On August 29, 2014, the Corporation completed the issuance of \$60 million in aggregate principal amount of 5.75% subordinated notes due September 3, 2024 in a private placement transaction. The net proceeds of the offering were approximately \$59 million and are to be used for general corporate purposes, including, but not limited to, contribution of capital to the Bank to support both organic growth as well as opportunistic acquisitions, should appropriate opportunities arise. Toward the end of the third quarter of 2014, we locked in borrowings from the FHLB of \$25.0 million at 60 basis points for 18 months and \$25.0 million at 84 basis points for 2 years. These borrowings replaced our FHLB overnight borrowings and also lengthen the overall maturity of our liabilities and support our interest rate risk management strategies as well as leverage our balance sheet for future growth. Additionally, during 2014, repurchase agreement debt related to our HOA business decreased \$2.5 million to \$16.1 million. This repurchase agreement debt was offered as a service to certain HOA depositors as added protection for deposit amounts

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above FDIC insurance levels. At September 30, 2014, total borrowings represented 13.1% of total assets and had an end of period weighted average cost of 1.93%, compared with 12.5% of total assets at a weighted average cost of 0.63% at December 31, 2013 and 6.2% of total assets at a weighted average cost of 1.32% at September 30, 2013. At September 30, 2014, total borrowings were comprised of the following:

- Overnight FHLB advances of \$100.0 million at 0.07%;
- Subordinated notes of \$60 million at 5.75% due September 3, 2024. For additional information about the Subordinated notes, see Note 8 to the Consolidated Financial Statements in this report;
- One 18 month fixed FHLB advance of \$25.0 million at 0.60% due March 16, 2016, and one 24 month fixed FHLB advance of \$25.0 million at 0.84% due September 15, 2016;
- Three reverse repurchase agreements totaling \$28.5 million at a weighted average rate of 3.26% with \$10.0 million due in February 2018 and \$18.5 million due in September 2018. These agreements are secured by government sponsored entity MBS securities with a par value of \$34.1 million and a fair value of \$35.5 million;
- HOA reverse repurchase agreements totaling \$16.1 million at a weighted average rate of 0.01% and secured by of government sponsored entity MBS securities with a par value of \$29.3 million and a fair value of \$30.0 million; and
- Subordinated debentures used to fund the issuance of Trust Preferred Securities in 2004 of \$10.3 million at 2.98% due April 7, 2034. For additional information about the Subordinated Debentures and Trust Preferred Securities, see Note 8 to the Consolidated Financial Statements in this report.

The following table sets forth certain information regarding the Company's borrowed funds at the dates indicated:

|                     | September 30,<br>2014  |                             | December 31,<br>2013 |                             | September 30,<br>2013 |                             |
|---------------------|------------------------|-----------------------------|----------------------|-----------------------------|-----------------------|-----------------------------|
|                     | Balance                | Weighted<br>Average<br>Rate | Balance              | Weighted<br>Average<br>Rate | Balance               | Weighted<br>Average<br>Rate |
|                     | (dollars in thousands) |                             |                      |                             |                       |                             |
| <b>FHLB</b>         |                        |                             |                      |                             |                       |                             |
| advances            | \$150,000              | 0.29%                       | \$156,000            | 0.06%                       | \$35,000              | 0.11%                       |
| Reverse             |                        |                             |                      |                             |                       |                             |
| repurchase          |                        |                             |                      |                             |                       |                             |
| agreements          | 45,561                 | 2.09%                       | 48,091               | 1.98%                       | 51,474                | 1.81%                       |
| <b>Subordinated</b> |                        |                             |                      |                             |                       |                             |
| debentures          | 70,310                 | 5.34%                       | 10,310               | 2.99%                       | 10,310                | 3.02%                       |
| <b>Total</b>        |                        |                             |                      |                             |                       |                             |
| borrowings          | \$265,871              | 1.93%                       | \$214,401            | 0.63%                       | \$96,784              | 1.32%                       |
| <b>Weighted</b>     |                        |                             |                      |                             |                       |                             |
| average cost        |                        |                             |                      |                             |                       |                             |
| of                  |                        |                             |                      |                             |                       |                             |
| borrowings          |                        |                             |                      |                             |                       |                             |
| during the          |                        |                             |                      |                             |                       |                             |
| quarter             | 1.32                   | %                           | 1.01                 | %                           | 1.66                  | %                           |
| <b>Borrowings</b>   |                        |                             |                      |                             |                       |                             |
| as a percent        | 13.1                   | %                           | 12.5                 | %                           | 6.2                   | %                           |

of total  
assets

Stockholders' Equity. Total stockholders' equity was \$197.9 million as of September 30, 2014, up from \$175.2 million at December 31, 2013 and \$171.2 million at September 30, 2013. The current year increase of \$22.6 million in stockholders' equity was primarily related to net income for the first nine months of 2014 of \$12.7 million, equity consideration for the acquisition of IFH of \$9.0 million, and favorable change in accumulated other comprehensive income of \$3.2 million, partially offset by the repurchase of the Company's common stock of \$2.8 million. The increase of \$26.7 million from September 30, 2013 was primarily related to net income over the period of \$16.9 million, the Corporation's stock issued to IFH shareholders as part of the acquisition consideration of \$9.0 million for IFH, and a favorable change in accumulated other comprehensive income of \$2.7 million, partially offset by the repurchase of the Company's common stock of \$2.8 million.

Our book value per share increased to \$11.59 at September 30, 2014, up from \$10.52 at December 31, 2013 and \$10.28 at September 30, 2013. At September 30, 2014, the Company's tangible common equity to tangible assets ratio was 8.43%, down from 8.94% at December 31, 2013, and 9.51% at September 30, 2013.

Tangible common equity to tangible assets (the "tangible common equity ratio") is a non-GAAP financial measure derived from GAAP-based amounts. We calculate the tangible common equity ratio by excluding the balance of intangible assets from common shareholders' equity and dividing by tangible assets. We believe that this information is important to shareholders as tangible equity is a measure that is consistent with the calculation of capital for bank regulatory purposes, which excludes intangible assets from the calculation of risk-based ratios.

PACIFIC PREMIER BANCORP, INC. AND  
SUBSIDIARIES  
GAAP Reconciliation  
(dollars in thousands)

|                            | September<br>30,<br>2014 | December<br>31,<br>2013 | September<br>30,<br>2013 |
|----------------------------|--------------------------|-------------------------|--------------------------|
| Total stockholders' equity | \$ 197,857               | \$ 175,226              | \$ 171,154               |
| Less:                      |                          |                         |                          |
| Intangible assets          | (28,817 )                | (24,056 )               | (24,309 )                |
| Tangible common equity     | \$ 169,040               | \$ 151,170              | \$ 146,845               |
| <br>                       |                          |                         |                          |
| Total assets               | \$ 2,034,248             | \$ 1,714,187            | \$ 1,569,020             |
| Less:                      |                          |                         |                          |
| Intangible assets          | (28,817 )                | (24,056 )               | (24,309 )                |
| Tangible assets            | \$ 2,005,431             | \$ 1,690,131            | \$ 1,544,711             |

|                                    |      |   |      |   |      |   |
|------------------------------------|------|---|------|---|------|---|
| Tangible<br>common<br>equity ratio | 8.43 | % | 8.94 | % | 9.51 | % |
|------------------------------------|------|---|------|---|------|---|

## CAPITAL RESOURCES AND LIQUIDITY

Our primary sources of funds are deposits, advances from the FHLB and other borrowings, principal and interest payments on loans, and income from investments. While maturities and scheduled amortization of loans are a predictable source of funds, deposit inflows and outflows as well as loan prepayments are greatly influenced by general interest rates, economic conditions, and competition.

Our primary sources of funds generated during the first nine months of 2014 were from:

- Net increase of \$237.2 million in deposit accounts;
- Proceeds of \$229.9 million from the sale and principal payments on loans held for investment;
  - Proceeds of \$91.9 million from the sale of securities available for sale;
  - Net proceeds from subordinated debt offering of \$58.8 million; and
  - Principal payments of \$21.5 million from securities available for sale.

We used these funds to:

- Purchase and originate loans held for investment of \$495.1 million;
  - Purchase securities available for sale of \$129.6 million;
- Repay FHLB advances and other borrowings of \$76.1 million; and
  - Acquire IFH for cash proceeds of \$7.8 million.

Our most liquid assets are unrestricted cash and short-term investments. The levels of these assets are dependent on our operating, lending and investing activities during any given period. Our liquidity position is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. At September 30, 2014, cash and cash equivalents totaled \$103.6 million and the market value of our investment securities available for sale totaled \$282.2 million. If additional funds are needed, we have additional sources of liquidity that can be accessed, including FHLB advances, Federal Funds lines, the Federal Reserve's lending programs and loan sales. As of September 30, 2014, the maximum amount we could borrow through the FHLB was \$863.1 million, of which \$532.3 million was available for borrowing based on collateral pledged of \$605.0 million in real estate loans. At September 30, 2014, we had \$150.0 million in FHLB borrowings against that available balance. At September 30, 2014, we also had unsecured lines of credit aggregating \$85.3 million, which consisted of \$82.0 million with other financial institutions from which to draw funds and \$3.3 million with the Federal Reserve Bank. At September 30, 2014, \$1.0 million was drawn against these unsecured lines of credit. For the quarter ended September 30, 2014, our average liquidity ratio was 14.69%. The Company regularly models liquidity stress scenarios to ensure that adequate liquidity is available and has contingency funding plans in place which are reviewed and tested on a regular basis.

To the extent that 2014 deposit growth is not sufficient to satisfy our ongoing commitments to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans, or make investments, we may access funds through our FHLB borrowing arrangement, unsecured lines of credit or other sources.

The Bank has a policy in place that permits the purchase of brokered funds, in an amount not to exceed 5% of total deposits, as a secondary source for funding. At September 30, 2014, we had \$50.3 million in brokered time deposits.

The Corporation is a corporate entity separate and apart from the Bank that must provide for its own liquidity. The Corporation's primary sources of liquidity are dividends from the Bank. There are statutory and regulatory provisions

that limit the ability of the Bank to pay dividends to the Corporation. Management believes that such restrictions will not have a material impact on the ability of the Corporation to meet its ongoing cash obligations.

The Corporation has never declared or paid dividends on its common stock and does not anticipate declaring or paying any cash dividends in the foreseeable future. The Corporation's board of directors authorized in June 2012 a stock repurchase plan, which allows the Corporation to proactively manage its capital position and return excess capital to its stockholders. The repurchase plan authorizes the repurchase of up to 1,000,000 shares of the Company's common stock. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. For the nine months ending September 30, 2014, the Company has repurchased 262,897 shares of its common stock for \$2.8 million under the repurchase plan. Also, please see Part II, Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds for additional information.

#### Contractual Obligations and Off-Balance Sheet Commitments

**Contractual Obligations.** The Company enters into contractual obligations in the normal course of business primarily as a source of funds for its asset growth and to meet required capital needs.

The following schedule summarizes maturities and payments due on our obligations and commitments, excluding accrued interest, as of the date indicated:

|                                    | September 30, 2014  |                |                |                         |            |
|------------------------------------|---------------------|----------------|----------------|-------------------------|------------|
|                                    | Less than<br>1 year | 1 - 3<br>years | 3 - 5<br>years | More<br>than 5<br>years | Total      |
|                                    | (in thousands)      |                |                |                         |            |
| Contractual obligations            |                     |                |                |                         |            |
| FHLB advances                      | \$ 100,000          | \$ 50,000      | \$-            | \$-                     | \$ 150,000 |
| Other borrowings                   | 17,061              | -              | 28,500         | -                       | 45,561     |
| Subordinated debentures            | -                   | -              | -              | 70,310                  | 70,310     |
| Certificates of deposit            | 292,968             | 127,527        | 2,926          | 608                     | 424,029    |
| Operating leases                   | 3,025               | 4,981          | 3,387          | 1,106                   | 12,499     |
| Total contractual cash obligations | \$ 413,054          | \$ 182,508     | \$ 34,813      | \$ 72,024               | \$ 702,399 |

**Off-Balance Sheet Commitments.** We utilize off-balance sheet commitments in the normal course of business to meet the financing needs of our customers and to reduce our own exposure to fluctuations in interest rates. These financial instruments include commitments to originate real estate, business and other loans held for investment, undisbursed loan funds, lines and letters of credit, and commitments to purchase loans and investment securities for portfolio. The contract or notional amounts of those instruments reflect the extent of involvement we have in particular classes of financial instruments.

Commitments to originate loans held for investment are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Undisbursed loan funds and unused lines of credit on home equity and commercial loans include committed funds not disbursed. Letters of credit are conditional commitments we issue to guarantee the performance of a customer to a third party. As of September 30, 2014, we had commitments to extend credit on existing lines and letters of credit of \$327.6 million, compared to \$337.2 million at December 31, 2013 and \$333.6 million at September 30, 2013.

The following table summarizes our contractual commitments with off-balance sheet risk by expiration period at the date indicated:

|                             | September 30, 2014  |                |                |                         | Total     |
|-----------------------------|---------------------|----------------|----------------|-------------------------|-----------|
|                             | Less than<br>1 year | 1 - 3<br>years | 3 - 5<br>years | More<br>than 5<br>years |           |
|                             | (in thousands)      |                |                |                         |           |
| Other commitments           |                     |                |                |                         |           |
| Commercial and industrial   | \$69,885            | \$23,700       | \$8,363        | \$56,680                | \$158,628 |
| Warehouse facilities        | -                   | -              | -              | 99,697                  | 99,697    |
| Construction                | 26,799              | 24,682         | -              | -                       | 51,481    |
| Home equity lines of credit | 114                 | 1,680          | 50             | 10,639                  | 12,483    |
| Standby letters of credit   | 4,118               | -              | -              | 20                      | 4,138     |
| All other                   | 1,031               | 530            | 6              | 714                     | 2,281     |
| Total other commitments     | \$101,947           | \$50,592       | \$8,419        | \$167,750               | \$328,708 |

### Regulatory Capital Compliance

The Corporation and the Bank are subject to risk-based capital regulations which quantitatively measure capital against risk-weighted assets, including certain off-balance sheet items. These regulations define the elements of the Tier 1 and Tier 2 components of total capital and establish minimum ratios of 4% for Tier 1 capital and 8% for total capital for capital adequacy purposes. Supplementing these regulations is a leverage requirement. This requirement establishes a minimum leverage ratio (at least 3% or 4%, depending upon an institution's regulatory status) which is calculated by dividing Tier 1 capital by adjusted quarterly average assets (after deducting goodwill). In addition, the Bank is subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") which imposes a number of mandatory supervisory measures. Among other matters, FDICIA established five capital categories, ranging from "well capitalized" to "critically under capitalized." Such classifications are used by regulatory agencies to determine a bank's deposit insurance premium and approval of applications authorizing institutions to increase their asset size or otherwise expand business activities or acquire other institutions. Under FDICIA, a "well capitalized" bank must maintain minimum leverage, Tier 1 and total capital ratios of 5%, 6% and 10%, respectively. The Federal Reserve applies comparable tests for bank holding companies. At September 30, 2014, the Bank and the Corporation,



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respectively, exceeded the requirements for “well capitalized” institutions under the tests pursuant to FDICIA and of the Federal Reserve.

For regulatory capital purposes, subject to applicable limitations, the issuance of \$60 million of subordinated notes during the third quarter of 2014 qualifies as Tier 2 capital for the Company. During August 2014, the Company contributed \$40 million of the proceeds from the offering to the Bank, which enhanced the Bank’s regulatory capital ratios.

The Bank’s and the Company’s capital amounts and ratios are presented in the following table along with the well capitalized requirement at the dates indicated:

|  | Actual    |         | Minimum Required for Capital Adequacy Purposes |        | Required to be Well Capitalized Under Prompt Corrective Action Regulations |         |
|--|-----------|---------|--|--------|--|---------|
|  | Amount    | Ratio   | Amount   | Ratio  | Amount   | Ratio   |
| (dollars in thousands)                                     |           |         |  |        |  |         |
| <b>At September 30, 2014</b>                               |           |         |  |        |  |         |
| <b>Tier 1 Capital (to adjusted tangible assets)</b>        |           |         |  |        |  |         |
| Bank   | \$216,185 | 11.48 % | \$75,302                                       | 4.00 % | \$94,128   | 5.00 %  |
| Consolidated   | 178,727   | 9.50 %  | 75,217   | 4.00 % | N/A  | N/A     |
| <b>Tier 1 Risk-Based Capital (to risk-weighted assets)</b> |           |         |  |        |  |         |
| Bank   | 216,185   | 12.77 % | 67,726   | 4.00 % | 101,589  | 6.00 %  |
| Consolidated   | 178,727   | 10.53 % | 67,914   | 4.00 % | N/A  | N/A     |
| <b>Total Capital (to risk-weighted assets)</b>             |           |         |  |        |  |         |
| Bank   | 227,270   | 13.42 % | 135,452  | 8.00 % | 169,315  | 10.00 % |
| Consolidated   | 249,812   | 14.71 % | 135,828  | 8.00 % | N/A  | N/A     |
| <b>At December 31, 2013</b>                                |           |         |  |        |  |         |
| <b>Tier 1 Capital (to adjusted tangible assets)</b>        |           |         |  |        |  |         |

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|              |           |        |          |       |          |       |
|--------------|-----------|--------|----------|-------|----------|-------|
| Bank         | \$160,473 | 10.03% | \$64,025 | 4.00% | \$80,031 | 5.00% |
| Consolidated | 163,105   | 10.29% | 63,431   | 4.00% | N/A      | N/A   |

Tier 1  
Risk-Based  
Capital (to  
risk-weighted  
assets)

|              |         |        |        |       |        |       |
|--------------|---------|--------|--------|-------|--------|-------|
| Bank         | 160,473 | 12.34% | 52,021 | 4.00% | 78,031 | 6.00% |
| Consolidated | 163,105 | 12.54% | 52,046 | 4.00% | N/A    | N/A   |

Total Capital  
(to  
risk-weighted  
assets)

|              |         |        |         |       |         |        |
|--------------|---------|--------|---------|-------|---------|--------|
| Bank         | 168,673 | 12.97% | 104,042 | 8.00% | 130,052 | 10.00% |
| Consolidated | 171,305 | 13.17% | 104,092 | 8.00% | N/A     | N/A    |

At September  
30, 2013

Tier 1 Capital  
(to adjusted  
tangible  
assets)

|              |           |        |          |       |          |       |
|--------------|-----------|--------|----------|-------|----------|-------|
| Bank         | \$155,832 | 10.02% | \$62,201 | 4.00% | \$77,751 | 5.00% |
| Consolidated | 158,309   | 10.19% | 62,167   | 4.00% | N/A      | N/A   |

Tier 1  
Risk-Based  
Capital (to  
risk-weighted  
assets)

|              |         |        |        |       |        |       |
|--------------|---------|--------|--------|-------|--------|-------|
| Bank         | 155,832 | 13.28% | 46,936 | 4.00% | 70,404 | 6.00% |
| Consolidated | 158,309 | 13.48% | 46,966 | 4.00% | N/A    | N/A   |

Total Capital  
(to  
risk-weighted  
assets)

|              |         |        |        |       |         |        |
|--------------|---------|--------|--------|-------|---------|--------|
| Bank         | 163,827 | 13.96% | 93,873 | 8.00% | 117,341 | 10.00% |
| Consolidated | 166,303 | 14.16% | 93,933 | 8.00% | N/A     | N/A    |

On July 2, 2013, the Federal Reserve issued a final rule implementing a revised regulatory capital framework for U.S. banks in accordance with the Basel III international accord and satisfying related mandates under the Dodd-Frank Act. Under the final rule, minimum capital requirements will increase for both quantity and quality of capital held by banking organizations. The final rule includes a new common equity tier 1 minimum capital requirement of 4.5% of risk-weighted assets and increases the minimum tier 1 capital requirement from 4.0% to 6.0% of risk-weighted assets. The minimum total risk-based capital requirement remains unchanged at 8.0% of total risk-weighted assets. In addition to these minimum capital requirements, the final rule requires banking organizations to hold a buffer of

common equity tier 1 capital in an amount above 2.5% of total risk-weighted assets to avoid restrictions on capital distributions and discretionary bonus payments to executive officers.

The final rule also establishes a standardized approach for determining risk-weighted assets. Under the final rule, risk weights for residential mortgage loans that apply under current capital rules will continue to apply and banking organizations with less than \$15 billion in total assets may continue to include existing trust preferred securities as capital. The final rule allows banking organizations that are not subject to the advanced approaches rule, like us, to make a one-time election not to include most elements of accumulated other comprehensive income in regulatory capital and instead use the existing treatment under current capital rules.

The minimum regulatory capital requirements and compliance with a standardized approach for determining risk-weighted assets of the final rule are effective for us on January 1, 2015. The capital conservation buffer framework transition period begins January 1, 2016, with full implementation effective January 1, 2019. The Company continues to evaluate the impact of the final Basel III capital rules, and based on management's initial review, we expect to exceed all capital requirements under the new rules. We will continue to evaluate and monitor our capital ratios under the new rules prior to the initial implementation date of January 1, 2015.

The final rule also enhances the risk-sensitivity of the advanced approaches risk-based capital rule, including among others, revisions to better address counterparty credit risk and interconnectedness among financial institutions and incorporation of the Federal Reserve's market risk rule into the integrated capital framework. These provisions of the final rule generally apply only to large, internationally active banking organizations or banking organizations with significant trading activity and are not expected to directly impact us.

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

Management believes that there have been no material changes in our quantitative and qualitative information about market risk since December 31, 2013. For a complete discussion of our quantitative and qualitative market risk, see "Item 7A. Quantitative and Qualitative Disclosure About Market Risk" in our 2013 Annual Report.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by our management, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report.

#### Changes in Internal Controls

There have not been any changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter to which this Quarterly Report on Form 10-Q relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II - OTHER INFORMATION

Item 1. legal Proceedings

In February 2004, the Bank was named in a class action lawsuit titled “James Baker v. Century Financial, et al,” alleging various violations of Missouri’s Second Mortgage Loans Act by charging and receiving fees and costs that were either wholly prohibited by or in excess of that allowed by the Act relating to origination fees, interest rates, and other charges. The class action lawsuit was filed in the Circuit Court of Clay County, Missouri. The complaint seeks restitution of all improperly collected charges, interest thereon, the right to rescind the mortgage loans or a right to offset any illegal collected charges and interest against the principal amounts due on the loans and punitive damages. In March 2005, the Bank’s motion for dismissal due to limitations was denied by the trial court without comment. The Bank’s “preemption” motion was denied in August 2006. The Bank has answered the plaintiffs’ complaint and the parties have exchanged and answered initial discovery requests. When the record is more fully developed, the Bank intends to raise the limitations issue again in the form of a motion for summary judgment.

The Company is not involved in any other material pending legal proceedings.

Item 1A. Risk Factors

There were no material changes to the risk factors as previously disclosed under Item 1A of our 2013 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

- |              |   |
|--------------|---|
| 2.1          | Agreement and Plan of Reorganization, dated as of October 21, 2014, among Pacific Premier Bancorp, Inc., Pacific Premier Bank and Independence Bank.(1)                   |
| 4.1          | Issuing and Paying Agency Agreement, dated August 29, 2014, between Pacific Premier Bancorp, Inc. and U.S. Bank National Association, as the issuing and paying agent.(2) |
| 4.2          | Form of Global 5.75% Subordinated Note due 2024.(2)   |
| Exhibit 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended                                     |
| Exhibit 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15(d)-14(a) under the Securities Exchange Act of 1934, as amended                                     |

|                 |  |
|-----------------|--|
| Exhibit 32      | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.INS | XBRL Instance Document   |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document  |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definitions Linkbase Document  |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |

- (1) Incorporated by reference from the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 22, 2014 (File No. 141166781).
- (2) Incorporated by reference from the Corporation's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 2, 2014 (File No. 141076730.)

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### PACIFIC PREMIER BANCORP, INC.,

November 6, 2014  
Date

By: /s/ Steve Gardner  
Steve Gardner  
President and Chief Executive Officer  
(principal executive officer)

November 6, 2014  
Date

By: /s/ Kent J. Smith  
Kent J. Smith  
Executive Vice President and Chief Financial Officer  
(principal financial and accounting officer)

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### Index to Exhibits

|              |  |
|--------------|--|
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|                 |  |
|-----------------|--|
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