BANC OF CALIFORNIA, INC.
Form 10-K
March 17, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2013

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 001-35522

BANC OF CALIFORNIA, INC.

(Exact name of registrant as specified in its charter)

Maryland	**04-3639825**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
18500 Von Karman Ave, Suite 1100, Irvine, California	**92612**
(Address of principal executive offices)	**(Zip Code)**

(Registrant s telephone number, including area code) (949) 236-5211

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	The NASDAQ Stock Market LLC
Depositary Shares each representing a 1/40th Interest in a share of 8.00% Non-Cumulative Perpetual Preferred Stock, Series C	The NASDAQ Stock Market LLC
7.50% Senior Notes Due April 15, 2020	The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ¨ NO x

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the closing price of such stock on the NASDAQ Stock Market LLC as of June 30, 2013, was $200.9 million. (The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant.) As of March 3, 2014, the registrant had outstanding 19,689,430 shares of voting common stock and 590,068 shares of Class B non-voting common stock.

DOCUMENTS INCORPORATED BY REFERENCE

PART III of Form 10-K Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held in 2014.

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BANC OF CALIFORNIA, INC.

FORM 10-K

December 31, 2013

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PART I

Forward-looking Statements

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

Factors that could cause actual results to differ materially from the results anticipated or projected include, but are not limited to, the following:

i. risks that the Company s recently completed acquisitions of The Private Bank of California (PBOC), The Palisades Group, and CS Financial and/or the recent merger of the Company s subsidiary banks may disrupt current plans and operations, the potential difficulties in customer and employee retention as a result of the transaction and the amount of the costs, fees, expenses and charges related to the transaction;

ii. The possibility that the changing of the Bank s charter to a national bank charter or its name to Banc of California could cause customer reaction that negatively impacts the bank;

iii. a worsening of current economic conditions, as well as turmoil in the financial markets;

iv. the credit risks of lending activities, which may be affected by deterioration in real estate markets and the financial condition of borrowers, may lead to increased loan and lease delinquencies, losses and nonperforming assets in our loan and lease portfolio, and may result in our allowance for loan and lease losses not being adequate to cover actual losses and require us to materially increase our loan and lease loss reserves;

v. the quality and composition of our securities portfolio;

vi. changes in general economic conditions, either nationally or in our market areas;

vii. continuation of the historically low short-term interest rate environment, changes in the levels of general interest rates, and the relative differences between short- and long-term interest rates, deposit interest rates, our net interest margin and funding sources;

viii. fluctuations in the demand for loans and leases, the number of unsold homes and other properties and fluctuations in commercial and residential real estate values in our market area;

ix. results of examinations of us by regulatory authorities and the possibility that any such regulatory authority may, among other things, require us to increase our allowance for loan and lease losses, write-down asset values, increase our capital levels, or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings;

x. legislative or regulatory changes that adversely affect our business, including changes in regulatory capital or other rules;

xi. our ability to control operating costs and expenses;

xii. staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges;

xiii. errors in our estimates in determining fair value of certain of our assets, which may result in significant declines in valuation;

xiv. the network and computer systems on which we depend could fail or experience a security breach;

xv. our ability to attract and retain key members of our senior management team;

xvi. costs and effects of litigation, including settlements and judgments;

xvii. increased competitive pressures among financial services companies;

xviii. changes in consumer spending, borrowing and saving habits;

xix. adverse changes in the securities markets;

xx. earthquake, fire or other natural disasters affecting the condition of real estate collateral;

xxi. the availability of resources to address changes in laws, rules or regulations or to respond to regulatory actions;

xxii. inability of key third-party providers to perform their obligations to us;

xxiii. changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board or their application to our business, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods;

xxiv. war or terrorist activities; and

xxv. other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described in this report and from time to time in other documents that we file with or furnish to the SEC, including, without limitation, the risks described under Item 1A. Risk Factors presented elsewhere in this report.

The Company undertakes no obligation to update any such statement to reflect circumstances or events that occur after the date on which the forward-looking statement is made, except as required by law.

Item 1. Business

General

Banc of California, Inc. is a financial holding company and the parent of Banc of California, National Association, a national bank (the Bank), the Palisades Group, LLC, an SEC-registered investment advisor (TPG), and PTB Property Holdings, LLC, an entity formed to hold real estate, cash and fixed income investments (PTB). Prior to October 11, 2013, Banc of California, Inc. was a multi-bank holding company with two banking subsidiaries, Pacific Trust Bank, a federal savings bank (PacTrust Bank or Pacific Trust Bank) and The Private Bank of California

(Beach Business Bank prior to July 1, 2013). On October 11, 2013, Banc of California, Inc. became a one-bank holding company when Pacific Trust Bank converted from a federal savings bank to a national bank and changed its name to Banc of California, National Association, and immediately thereafter The Private Bank of California was merged into Banc of California, National Association. On January 17 2014, Banc of California, Inc. became a financial holding company. Unless the context indicates otherwise, references to the Bank prior to October 11, 2013 mean Pacific Trust Bank and The Private Bank of California (Beach Business Bank prior to July 1, 2013), collectively, and references to the Bank on or after October 11, 2013 refer to Banc of California, National Association. Unless the context indicates otherwise, all references to Banc of California, Inc. refer to Banc of California, Inc. excluding its consolidated subsidiaries and all references to the Company, we, us or o refer to Banc of California, Inc. including its consolidated subsidiaries.

The Company was incorporated under Maryland law in March 2002, and in July 2013, the Company changed its name to Banc of California, Inc. and, as noted above, in October 2013, the Company s subsidiary banks merged to form a single, national bank subsidiary under the name Banc of California, National

Association. The Bank has one wholly owned subsidiary, CS Financial, Inc., which was acquired on October 31, 2013. See Recent Transactions CS Financial Acquisition.

Banc of California, Inc. is subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board or FRB), and the Bank is subject to regulation primarily by the Office of the Comptroller of the Currency (OCC). As a financial holding company, Banc of California, Inc. may engage in activities permissible for bank holding companies and may engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature, primarily securities, insurance and merchant banking activities. See Regulation and Supervision.

Banc of California, Inc. is not an operating company and its assets primarily consist of the outstanding stock of the Bank as well as the outstanding membership interests of TPG and PTB. From time to time, Banc of California, Inc. has purchased impaired loans and leases, investments and other real estate owned (OREO) from the Bank to assure the Bank s safety and soundness. Banc of California, Inc. has no significant liabilities at the holding company level other than $82.3 million in its 7.50 percent Senior Notes due April 15, 2020 (Senior Notes) and related interest payments, compensation of its executive employees and directors, as well as expenses related to strategic initiatives. Banc of California, Inc. also utilizes the support staff and offices of the Bank and pays the Bank for these services. If Banc of California, Inc. expands or changes its business in the future, it may hire additional employees of its own.

The Bank offers a variety of financial services to meet the banking and financial needs of the communities we serve. The Bank is headquartered in Orange County, California and as of December 31, 2013, the Bank operated 15 branches in San Diego, Orange, and Los Angeles Counties in California and 68 producing mortgage loan production offices in California, Arizona, Oregon, Montana, Virginia and Washington.

The principal business of the Bank consists of attracting retail deposits from the general public and investing these funds primarily in commercial, consumer and real estate secured loans. The Bank solicits deposits in its market area and, to a lesser extent, from institutional depositors nationwide and may accept brokered deposits.

The Bank s deposit product and service offerings include checking, savings, money market, certificates of deposit, retirement accounts as well as mobile, online, cash and treasury management, card payment services, remote deposit, ACH origination, employer/employee retirement planning, telephone banking, automated bill payment, electronic statements, safe deposit boxes, direct deposit and wire transfers. Bank customers also have the ability to access their accounts through a nationwide network of over 30,000 surcharge-free ATMs.

The principal executive offices of the Company are located at 18500 Von Karman Avenue, Suite 1100, California, and its telephone number is (949) 236-5211. Banc of California, Inc. s voting common stock, the depository shares each representing a 1/40th interest in a share of its 8.00 percent Non-Cumulative Perpetual Preferred Stock, Series C, and its Senior Notes are listed on the NASDAQ Stock Market under the symbols BANC, BANCP and BANCL, respectively.

The reports, proxy statements and other information that Banc of California, Inc. files with the SEC, as well as news releases, are available free of charge through the Company s Internet site at http://www.bancofcal.com. This information can be found on the BANC OF CALIFORNIA, INC. News or Investor relations pages of our Internet site. The annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed and furnished pursuant to Section 13(a) of the Exchange Act are available as soon as reasonably practicable after they have been filed or furnished to the SEC. Reference to the Company s Internet address is not intended to incorporate any of the information contained on our Internet site into this document.

Strategy

The Company is committed to building the top full-service bank serving California s diverse private businesses, entrepreneurs, and homeowners, and investing in and growing complementary businesses that enhance shareholder value.

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Our overall strategy is comprised of specific growth and operating objectives. The key elements of that strategy are:

Growth Strategies

Build California s Bank

Extend branch footprint throughout attractive markets in California

Enhance suite of simple, fair products to meet needs of small businesses, entrepreneurs, homeowners including Residential Lending, Commercial Real Estate Lending, Private Banking, Entertainment Banking, Small / Middle Market Lending, C&I and SBA Lending, Multi-Family Lending

The Company successfully completed two bank acquisitions in 2012 and one bank acquisition in 2013, each of which included a team of local commercial lending officers which has given us a greater network and far greater capacity to attract commercial and private banking relationships. The Company will seek to continue to develop its commercial lending activities through strategic lift outs of lending teams in various geographic markets that have particular business niches and specialty.

The Company has successfully attracted and launched several new loan origination groups through acquisitions and the new hire process. These include the acquisition of The Palisades Group and CS Financial as well as the hiring and launch of our Financial Institutions Bank (which has a product offerings such as securities backed lines of credit, insurance backed lines of credit and financial advisor acquisition financing), our multi-family and CRE lending teams, and equipment finance teams. We will seek to continue to diversify our lending capabilities through our hiring and M&A process.

Develop simple, fair deposit products: checking, CD, analysis and cash management

Implement a robust CRA plan focused on integrating with and investing in our communities

Invest in Complementary Financial Services Businesses

The Company seeks to invest in and grow mutually complementary financial services businesses either as part of its subsidiary bank or through other non-bank subsidiaries. In 2013, these efforts resulted in the acquisition of The Palisades Group (an asset management and investment advisory businesses focused on whole loans, which became a wholly owned subsidiary of the Company) and CS Financial (a private mortgage bank serving high net worth borrowers throughout California, which became a wholly owned subsidiary of the Bank).

Continue as a public company with a common stock that is quoted and traded on a national stock market. In addition to providing access to growth capital in a diversified approach, such as common or preferred stock and debt, we believe a public currency provides flexibility in structuring acquisitions and will allow us to attract and retain qualified management through equity-based compensation.

Operating Strategies

Achieve appropriate scale and profitability for each line of business.

Execute its focused value proposition and marketing to become California s Bank.

Enhance the Company s risk management functions by proactively managing sound procedures and committing experienced human resources to this effort. We seek (i) to identify risks in all functions of our business, including credit, operations and asset and liability management, (ii) to evaluate such risks and their trends and (iii) to adopt strategies to manage such risks based upon our evaluations.

Maintain and improve asset quality through prudent loan underwriting standards and credit risk management practices.

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Actively manage interest rate and market risks by closely matching the volume and maturity of our interest sensitive assets to our interest sensitive liabilities in order to mitigate adverse effects of rapid changes in interest rates on either side of our balance sheet.

Expand lending, to California s private businesses, entrepreneurs and homeowners, which commonly are associated with deposits that are a lower cost and/or more stable funding source.

Share the success of the Company with employees aligned with shareholders by establishing the Employee Equity Ownership Plan effective October 15, 2013 to make every employee a shareholder, subject to vesting, as of their 90th day of employment.

Recent Transactions

CS Financial Acquisition

Effective October 31, 2013, the Company acquired CS Financial, Inc. (CS Financial), which became a wholly owned subsidiary of the Bank. CS Financial specializes in higher balance residential mortgage loans that serve the Bank s high net worth individual, entrepreneur and family office clients, and the Bank believes the acquisition of CS Financial will increase its origination of such loan products.

The CS Financial acquisition was accounted for under GAAP guidance for business combinations. The purchased assets, including identifiable intangible assets and assumed liabilities were recorded at their estimated fair values as of October 31, 2013. Because of the short time period between acquisition date and December 31, 2013, the Company used significant estimates and assumptions to value the identifiable assets acquired and liabilities assumed. The closing date valuations related to loans, premises, equipment, capital leases, other intangible assets, other assets, and assumed liabilities are considered preliminary and could differ significantly when finalized.

For additional information regarding this transaction, see Notes 2 and 25 of the notes to consolidated financial statements contained in Item 8 of this report.

Branch Sales

Effective October 4, 2013, the Company completed the sale of eight branches to AmericanWest Bank, a Washington state chartered bank (AWB). The transaction provided for the transfer of deposits of $464.3 million and its related assets to AWB in exchange for a deposit premium of 2.3 percent applied to certain deposit balances transferred. Certain other assets related to the branches included the real estate for three of the branch locations and certain overdraft and other credit facilities related to the deposit accounts. The branches were located in San Diego, Riverside and Los Angeles Counties. The sale was done to reshape the Bank s branch network to focus on serving small-to-mid sized businesses and high net worth families throughout Los Angeles, Orange and San Diego counties.

For additional information regarding this transaction, see Note 2 of the notes to consolidated financial statements contained in Item 8 of this report.

The Palisades Group, LLC Acquisition

Effective September 10, 2013, the Company acquired The Palisades Group, LLC (Palisades), a Delaware limited liability company and a registered investment adviser under the Investment Advisers Act of 1940, pursuant to the terms of the Amended and Restated Units Purchase Agreement dated as of November 30, 2012, amended and restated as of August 12, 2013. Palisades provides financial advisory and asset management services to third parties, including the Bank, with respect to the purchase, sale and management of residential mortgage loans.

The Palisades acquisition was accounted for under GAAP guidance for business combinations. The assets and liabilities were recorded at their estimated fair values as of the September 10, 2013 acquisition date. No goodwill was recognized.

For additional information regarding this transaction, see Notes 2 and 25 of the notes to consolidated financial statements contained in Item 8 of this report.

The Private Bank of California Acquisition

Effective July 1, 2013, the Company completed its acquisition of The Private Bank of California (PBOC) pursuant to the terms of the Agreement and Plan of Merger, dated as of August 21, 2012, as amended (the Merger Agreement), by and between the Company, Beach Business Bank (Beach) (then a separate subsidiary bank of the Company) and PBOC. PBOC merged with and into Beach, with Beach continuing as the surviving entity in the merger and a wholly owned subsidiary of the Company, and changing its name to The Private Bank of California. As noted above, on October 11, 2013, The Private Bank of California was merged with the Company s other wholly owned banking subsidiary, Banc of California, National Association (formerly Pacific Trust Bank.)

Pursuant to the terms of the Merger Agreement, the Company paid aggregate merger consideration of (1) 2,082,654 shares of Company common stock (valued at $28.3 million based on the $13.58 per share closing price of Company common stock on July 1, 2013), and (2) $25.3 million in cash. Additionally, the Company paid out $2.7 million for certain outstanding options to acquire PBOC common stock in accordance with the merger agreement and converted outstanding PBOC stock options to the Company s stock options with an assumed fair value of approximately $30 thousand. On the basis of the number of shares of PBOC common stock issued and outstanding immediately prior to the completion of the Merger, each outstanding share of PBOC common stock was converted into the right to receive $6.52 in cash and 0.5379 shares of Company common stock.

In addition, upon completion of the acquisition, each share of preferred stock issued by PBOC as part of the Small Business Lending Fund (SBLF) program of the United States Department of Treasury (10,000 shares in the aggregate with a liquidation preference amount of $1,000 per share) was converted automatically into one substantially identical share of preferred stock of the Company. The terms of the preferred stock issued by the Company in exchange for the PBOC preferred stock are substantially identical to the preferred stock previously issued by the Company as part of its own participation in the SBLF program (32,000 shares in aggregate with a liquidation preference amount of $1,000 per share).

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

In accordance with GAAP guidance for business combinations, the Company has expensed approximately $2.6 million of direct acquisition costs and recorded $15.0 million of goodwill and $10.4 million of other intangible assets. The other intangible assets are primarily related to core deposits and are being amortized on an accelerated basis over 2-7 years. Loans that were acquired from PBOC that were considered credit-impaired were written down at the acquisition date in accordance with purchase accounting to fair value. In addition, the allowance for loan losses for all PBOC loans was not carried over to the Company s allowance for loan and lease losses. A full valuation allowance for the deferred tax asset was recorded as well. For tax purposes purchase accounting adjustments, including goodwill are all nontaxable and/or non-deductible. Certain valuations related to assumed liabilities are considered preliminary and could differ significantly when finalized.

Gateway Bancorp Acquisition

Effective August 18, 2012, the Company acquired Gateway Bancorp, the holding company of Gateway Business Bank (Gateway) pursuant to the terms of the Stock Purchase Agreement (the Purchase Agreement) dated June 3, 2011, as amended on November 28, 2011, February 24, 2012, June 30, 2012, and July 31, 2012. The acquisition was accomplished by the Company s purchase of all of the outstanding stock of Gateway Bancorp for $15.4 million in cash.

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

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

Beach Business Bank Acquisition

Effective July 1, 2012, the Company acquired Beach Business Bank pursuant to the terms of the Agreement and Plan of Merger (the Beach Merger Agreement) dated August 30, 2011, as amended October 31, 2011. At the effective time of the transaction, a newly formed and wholly owned subsidiary of the Company (Merger Sub) merged with and into Beach (the Merger), with Beach continuing as the surviving entity in the Merger and a wholly owned subsidiary of the Company. Pursuant and subject to the terms of the Beach Merger Agreement, each outstanding share of Beach common stock (other than specified shares owned by the Company, Merger Sub or Beach, and other than in the case of shares in respect of, or underlying, certain Beach options and other equity awards, which were treated as set forth in the Beach Merger Agreement) was converted into the right to receive $9.21415 in cash and one warrant. Each warrant entitled the holder to purchase 0.33 of a share of Company common stock at an exercise price of $14.00 per share for a period of one year. All of the warrants expired on June 30, 2013 without being exercised. The aggregate cash consideration paid to Beach shareholders in the Merger was approximately $39.1 million. In addition, Beach shareholders received in aggregate warrants to purchase the equivalent of 1,401,959 shares of the Company s common stock with an estimated fair value of $1.0 million.

Beach (re-named The Private Bank of California effective July 1, 2013 and merged with Pacific Trust Bank on October 11, 2013 to form the Bank) operated branches in Manhattan Beach, Long Beach, and Costa Mesa, California. Beach also has a division named The Doctors Bank®, which serves physicians and dentists nationwide. Additionally, Beach provided loans to small businesses based on Small Business Administration (SBA) lending programs, which the Bank continues to provide. Beach s consolidated assets and equity (unaudited) as of June 30, 2012 totaled $311.9 million and $33.3 million, respectively. The acquired assets and liabilities were recorded at fair value at the date of acquisition.

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

Lending Activities

Governance

The Company conducts its lending activities under a system of risk governance controls. A key element of our risk governance structure is our risk appetite framework and risk appetite statement. The risk appetite framework adopted by the Company and the Bank has been developed in conjunction with the Company s strategic and capital plans. The strategic and capital plans articulate the Board approved balance sheet and loan concentration targets and the appropriate level of capital to properly manage our risks.

The risk appetite framework provides the overall approach, including policies, processes, controls, and systems through which the risk appetite is established, communicated, and monitored. The risk appetite framework utilizes a risk assessment process to identify inherent risks across the Company, gauge the effectiveness of our internal controls, and establish tolerances for residual risk in each of the regulatory risk categories: credit, market (interest rate and price risks), liquidity, operational, compliance, strategic, and reputational. Each risk category is assigned risk ratings with a target overall residual risk rating for the organization. The risk appetite framework includes a risk appetite statement, risk limits, and an outline of roles and responsibilities of those overseeing the implementation and monitoring of the framework. The risk appetite statement is an expression of the maximum level of risk that we are prepared to accept in order to achieve our business objectives. Defining, communicating, and monitoring risk appetite is fundamental to a safe and sound control environment and a risk-focused culture. The Board of Directors establishes the Company s strategic objectives and approves the Company s risk appetite statement, which is developed in collaboration with the chief executive officer, chief risk officer, general counsel, chief financial officer, and business unit leaders. The executive team translates the Board approved strategic objectives and the risk appetite statement into targets and constraints for business lines and legal entities to follow.

The risk appetite framework is supported by an enterprise risk management program. Enterprise risk management at the Company integrates all risk efforts under one common framework. Key elements of enterprise risk management that are intended to support prudent lending activities include:

Policies Loan policy articulates the credit culture of our lending business and provides clarity around encouraged and discouraged lending activities. Additional policies cover key business segments of the portfolio, for example Commercial Real Estate Policy, and other important aspects supporting our lending activities, for example appraisal, risk ratings, fair lending, etc.

Credit Approval Authorities all material credit exposures of the Bank are approved by a credit risk management group that is independent of the business units. Above this threshold, credit approvals are made by the chief credit officer or an executive management committee of the Bank. The enterprise risk committee of the Board reviews/approves material loan pool purchases/divestitures and any other transactions as appropriate.

Concentration Policy and Guidelines To mitigate and manage the risk within the Company s loan portfolio, the Board of Directors established certain concentration guidelines which it expects to review and revise from time to time as appropriate. It is anticipated that these guidelines will be reviewed regularly and may change at any time including pursuant to quarterly or annual reviews. For instance, the Company s Board expects to review the concentration guidelines when considering material strategic initiatives such as acquisitions and new product launches. The Company has developed policies relating to the appropriate actions to be taken should management seek to increase the concentration guidelines or exceed the guideline maximum, including for good reason. These concentration guidelines are not meant to be restrictive limits, but are intended to aid management and the Board to ensure that the Bank s loan concentrations are consistent with the Board s risk appetite.

Stress Testing the Bank has developed a stress test policy and stress testing methodology as a tool to evaluate our loan portfolio, capital levels and strategic plan with the objective of ensuring that our loan portfolio and balance sheet concentrations are consistent with the Board approved risk appetite and strategic and capital plans.

Loan Portfolio Management the Bank has an internal asset review committee that formally reviews the loan portfolio on a regular basis. Risk rating trends, loan portfolio performance, including delinquency status, and the resolution of problem assets are reviewed and evaluated.

Commercial Real Estate Loan Pricing, Multi-Family Loan Pricing and Residential Loan Pricing Regular discussions occur between Treasury, Capital Markets, Credit and Risk Management and the Business units with regard to the pricing of our loan products. These committees meet to ensure that the Bank is pricing its products appropriately to meet our strategic and capital plans while ensuring an appropriate return for shareholders.

General

The Company offers a number of different commercial and consumer loan products, including commercial and industrial loans, commercial real estate loans, multi-family loans, SBA guaranteed business loans, construction and renovation loans, lease financing, one-to-four family residential (single family residential and SFR) mortgage loans, warehouse loans, asset or security backed loans, home equity lines of credit (HELOCs), consumer and business lines of credit, home equity loans and other consumer loans.

Legal lending limits are calculated in conformance with OCC regulations, which prohibit a national bank from lending to any one individual or entity or its related interests on any amount that exceeds 15 percent of the bank s capital and surplus, plus an additional 10 percent of the bank s capital and surplus, if the amount that exceeds the bank s 15 percent general limit is fully secured by readily marketable collateral. At December 31, 2013, the Bank s authorized legal lending limits for loans to one borrower were $54.1 million for unsecured loans plus an additional $36.1 million for specific secured loans.

Commercial and Industrial Loans

Commercial and industrial loans are made to finance operations, provide working capital, or to finance the purchase of assets, equipment or inventory. A borrower s cash flow from operations is generally the primary source of repayment. Accordingly, our policies provide specific guidelines regarding debt coverage and other important financial ratios. Commercial and industrial loans include lines of credit and commercial term loans. Lines of credit are extended to businesses or individuals based on the financial strength and integrity of the borrower and guarantor(s) and generally are collateralized by short-term assets such as accounts receivable, inventory, equipment or real estate and have a maturity of one year or less. Commercial term loans are typically made to finance the acquisition of fixed assets or refinance short-term debt originally used to purchase fixed assets. Commercial term loans generally have terms of one to five years. They may be collateralized by the asset being acquired or other available assets.

Commercial and industrial loans include short-term secured and unsecured business and commercial loans with maturities typically ranging up to 5 years (up to 10 years if a SBA loan), accounts receivable financing typically for 1-5 years (up to 10 years if a SBA loan), and equipment leases up to 6 years. The interest rates on these loans generally are adjustable and usually are indexed to The Wall Street Journal s prime rate or LIBOR and will vary based on market conditions and be commensurate to the credit risk. Where it can be negotiated, loans are written with a floor rate of interest. Generally, lines of credit are granted for no more than a 12-month period.

Commercial and industrial loans, including accounts receivable and inventory financing, generally are made to businesses that have been in operation for at least 5 years or less if a SBA loan, including start-ups. To qualify for such loans, prospective borrowers generally must have debt-to-net worth ratios not exceeding 3-to-1, operating cash flow sufficient to demonstrate the ability to pay obligations as they become due, and good payment histories as evidenced by credit reports. We attempt to control our risk by generally requiring loan-to-value (LTV) ratios of not more than 80 percent and by closely and regularly monitoring the amount and value of the collateral in order to maintain that ratio.

The Company s commercial and industrial business lending policy includes credit file documentation and analysis of the borrower s background, capacity to repay the loan, the adequacy of the borrower s capital and collateral as well as an evaluation of other conditions affecting the borrower. Analysis of the borrower s past, present and future cash flows is also an important aspect of our credit analysis. In order to mitigate the risk of borrower default, we generally require collateral to support the credit or, in the case of loans made to businesses, personal guarantees from their owners, or both. In addition, all such loans must have well-defined primary and secondary sources of repayment. Nonetheless, these loans are believed to carry higher credit risk than traditional single-family home loans.

Commercial and industrial loans are typically made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial and industrial loans may be substantially dependent on the success of the business itself (which, in turn, is often dependent in part upon general economic conditions). The Company s commercial business loans are usually, but not always, secured by business assets. However, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. See Asset Quality Non-Performing Assets in Item 7.

Commercial and industrial loan growth also assists in the growth of our deposits because many commercial loan borrowers establish noninterest-bearing (demand) and interest-bearing transaction deposit accounts and banking services relationships with us. Those deposit accounts help us to reduce our overall cost of funds and those banking services relationships provide us with a source of non-interest income.

At December 31, 2013 and 2012, commercial and industrial loans totaled $287.8 million or 11.8 percent and $80.4 million or 6.4 percent, respectively, of the total gross loans. This increase was due mainly to the acquisition of PBOC as well as loan originations in 2013.

Commercial Real Estate Lending and Multi-Family Real Estate Lending

Commercial real estate and multi-family real estate loans are secured primarily by multi-family dwellings, industrial/warehouse buildings, anchored and non-anchored retail centers, office buildings and hospitality properties, on a limited basis, primarily located in the Company s market area, and throughout the West Coast. At December 31, 2013, commercial real estate and multi-family real estate loans totaled $529.9 million, or 21.7 percent, and $141.6 million, or 5.8 percent, respectively, of the Company s total gross loans, as compared to $338.9 million, or 27.1 percent, and $115.1 million, or 9.2 percent, respectively, of the Company s total gross loans, at December 31, 2012. This increase was due mainly to the acquisition of PBOC as well as loan originations in 2013.

The Company s loans secured by multi-family and commercial real estate are originated with either a fixed or adjustable interest rate. The interest rate on adjustable-rate loans is based on a variety of indices, generally determined through negotiation with the borrower. Loan-to-value ratios on these loans typically do not exceed 75 percent of the appraised value of the property securing the loan. These loans typically require monthly payments, may contain balloon payments and have maximum maturities of 30 years.

Loans secured by multi-family and commercial real estate are underwritten based on the income producing potential of the property and the financial strength of the borrower/sponsor. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt. The Company generally requires an assignment of rents or leases in order to be assured that the cash flow from the project will be used to repay the debt. Appraisals on properties securing multi-family and commercial real estate loans are performed by independent state licensed fee appraisers approved by management. See Loan and Lease Originations, Purchases, Sales and Repayments In item 7. The Company may require the borrower to maintain a tax or insurance escrow account for loans secured by multi-family and commercial real estate. In order to monitor the adequacy of cash flows on income-producing properties, the borrower is generally required to provide periodic financial information.

Loans secured by multi-family and commercial real estate properties generally involve a greater degree of credit risk than one-to-four family residential mortgage loans. These loans typically involve large balances to single borrowers or groups of related borrowers.

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Because payments on loans secured by multi-family and commercial real estate properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower s ability to repay the loan may be impaired. See Asset Quality Non-Performing Assets in Item 7.

Small Business Administration Loans

The Company provides numerous SBA loan products, primarily through the Bank. Beach Business Bank (which was acquired by the Company in 2012, re-named The Private Bank of California on July 1, 2013 and merged with and into the Bank on October 11, 2013) had approval to access the Preferred Lenders Program (PLP) within the SBA. After the October 11, 2013 subsidiary bank merger, the Bank received PLP status within the SBA effective as of February 3, 2014. The Bank s PLP status generally gives it the authority to make the final credit decision and have most servicing and liquidation authority.

The Company provides the following SBA products:

7(a) These loans provide the Bank with a guarantee from the SBA of the United States Government for up to 85 percent of the loan amount for loans up to $150,000 and 75 percent of the loan amount for loans of more than $150,000, with a maximum loan amount of $5 million. These are term loans that can be used for a variety of purposes including expansion, renovation, new construction, and equipment purchases. Depending on collateral, these loans can have terms ranging from 7 to 25 years. The guaranteed portion of these loans is often sold into the secondary market.

Cap Lines In general, also guaranteed up to 75 percent and typically used for working capital purposes, secured by accounts receivable and/or inventory. These lines are generally allowed for up to $5 million and can be issued with maturities of up to 5 years.

504 Loans These are real estate loans in which the lender can advance up to 90 percent of the purchase price; retain 50 percent as a first trust deed; and, have a Certified Development Company (CDC) retain the 2nd position for 40 percent of the total cost. CDC s are licensed by the SBA. Required equity of the borrower is 10 percent. Terms of the first trust deed are typically similar to market rates for conventional real estate loans, while the CDC establishes rates and terms for the second trust deed loan.

SBA Express These loans offer a 50 percent guaranty by the SBA and are up to a maximum of $350,000 (although the SBA temporarily increased the maximum limit to $1 million on October 8, 2010 for a period of one year). These loans are typically revolving lines and have maturities of up to 7 years.

SBA lending is subject to federal legislation that can affect the availability and funding of the program. This dependence on legislative funding might cause future limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

The Company s portfolio of SBA loans is subject to certain risks, including, but not limited to: (i) the effects of economic downturns on the Southern California economy; (ii) interest rate increases; (iii) deterioration of the value of the underlying collateral; and, (iv) deterioration of a borrower s or guarantors financial capabilities. We attempt to reduce the exposure of these risks through: (a) reviewing each loan request and renewal individually; (b) adhering to written loan policies; (c) adhering to SBA policies and regulations; (e) obtaining independent third party appraisals; and (f) obtaining external independent credit reviews. SBA loans normally require monthly installment payments of principal and interest and therefore are continually monitored for past due conditions. In general, the Company receives and reviews financial statements and other documents of borrowing customers on an ongoing basis during the term of the relationship and responds to any deterioration identified.

At December 31, 2013, SBA loans totaled $27.4 million or 1.1 percent of total gross loans compared to $36.1 million or 2.9 percent of total gross loans at December 31, 2012.

Construction Lending

Our construction lending primarily relates to one-to-four family residential properties. The Company may in the future originate or purchase loans or participations in construction and rehabilitation loans on residential, multi-family and/or commercial real estate properties. The Company had $24.9 million in construction loans at December 31, 2013, or 1.0 percent of total gross loans compared to $6.6 million or 0.5 percent of total gross loans at December 31, 2012. The increase was due mainly to the acquisition of $16.7 million construction loans in the PBOC acquisition.

Lease Financing

Commercial equipment leasing and financing was introduced as a product in the third quarter of 2012 to meet the needs of small and medium sized businesses for growth through investments in commercial equipment. The Company provides full payout capital leases and equipment finance agreements for essential use equipment to small and medium sized business nationally. The terms are 1 to 7 years in length and generally provide more flexibility to meet the equipment obsolescence needs of small and medium sized businesses than traditional business loans.

Commercial equipment leases are secured by the business assets being financed. The Company also obtains a commercial guaranty of the business and generally a personal guaranty of the owner(s) of the business. As of December 31, 2013, the Company had $31.9 million in commercial equipment leases outstanding, or 1.3 percent of total loans and leases, an increase of $20.7 million, or 185.2 percent, from $11.2 million, or 0.9 percent of total loans and leases at December 31, 2012.

Real Estate 1-4 Family First Mortgages Loans

The Company originates loans secured by first mortgages on one-to-four family residences throughout California and the United States.

The Company offers a variety of loan products catering to the specific needs of borrowers, including fixed rate and adjustable rate mortgages with either 30-year or 15-year terms. The Company offers conventional mortgages eligible for sale to Fannie Mae or Freddie Mac, government insured Federal Housing Administration (FHA) and Veteran Affairs (VA) mortgages, and jumbo loans where the loan amount exceeds Fannie Mae or Freddie Mac limits.

The Company s residential lending activity includes both a direct-to-consumer retail residential lending business and a wholesale and correspondent mortgage business. In the retail business, Company loan officers are located either in our call center in Irvine, Bank branches in San Diego, Orange, and Los Angeles Counties, or loan production offices throughout California and in Arizona, Oregon, Montana, Virginia and Washington, and originate mortgage loans directly to consumers. The wholesale mortgage business originates residential mortgage loans submitted to the Company by outside mortgage brokers for underwriting and funding. The correspondent mortgage business acquires residential mortgage loans originated by outside mortgage bankers. The Company does not originate loans defined as high cost by state or federal regulators.

The Company also purchases closed residential mortgage loans from other banks or mortgage bankers through its correspondent subsidiary. Purchased loans are underwritten by the Bank prior to purchase and contain representations and warranties from the seller concerning the accuracy of the credit file and compliance with regulations.

A majority of residential mortgage loans originated by the Company are made to finance the purchase or the refinance of existing loans on owner-occupied homes with a smaller percentage used to finance non-owner occupied homes. A majority of the Company s loan originations for the held for investment portfolio are collateralized by real properties located in Southern California; however the Bank originates loans held for sale collateralized by real properties located throughout the United States.

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The Company generally underwrites one-to-four family residential mortgage loans based on the applicant s income and credit history and the appraised value of the subject property. Generally, the Company requires private mortgage insurance for conventional loans with a loan to value greate