

HANMI FINANCIAL CORP
Form 10-Q
November 09, 2018

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2018

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: 000-30421

HANMI FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware 95-4788120
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

3660 Wilshire Boulevard, Penthouse Suite A 90010
Los Angeles, California
(Address of Principal Executive Offices) (Zip Code)
(213) 382-2200

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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 No

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 5, 2018, there were 31,780,321 outstanding shares of the Registrant's Common Stock.

Hanmi Financial Corporation and Subsidiaries
Quarterly Report on Form 10-Q
Three and Nine Months Ended September 30, 2018
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Part I — Financial Information

Item 1. Financial Statements

Hanmi Financial Corporation and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

	(Unaudited) September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	\$ 159,617	\$ 153,826
Securities available for sale, at fair value (amortized cost of \$588,097 as of September 30, 2018 and \$581,992 as of December 31, 2017)	572,236	578,804
Loans held for sale, at the lower of cost or fair value	4,455	6,394
Loans and leases receivable, net of allowance for loan and lease losses of \$31,676 as of September 30, 2018 and \$31,043 as of December 31, 2017	4,551,207	4,273,415
Accrued interest receivable	13,646	12,770
Premises and equipment, net	28,552	26,655
Customers' liability on acceptances	1,265	803
Servicing assets	8,878	10,218
Goodwill and other intangible assets, net	12,273	12,544
Federal Home Loan Bank ("FHLB") stock, at cost	16,385	16,385
Bank-owned life insurance	51,372	50,554
Prepaid expenses and other assets	67,156	68,117
Total assets	\$5,487,042	\$5,210,485
Liabilities and stockholders' equity		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 1,313,777	\$ 1,312,274
Interest-bearing	3,300,645	3,036,380
Total deposits	4,614,422	4,348,654
Accrued interest payable	8,153	5,309
Bank's liability on acceptances	1,265	803
Borrowings	160,000	150,000
Subordinated debentures	117,670	117,270
Accrued expenses and other liabilities	17,784	25,972
Total liabilities	4,919,294	4,648,008
Stockholders' equity:		
Common stock, \$0.001 par value; authorized 62,500,000 shares; issued 33,188,833 shares (32,087,236 shares outstanding) as of September 30, 2018 and issued 33,083,133 shares (32,431,627 shares outstanding) as of December 31, 2017	33	33
Additional paid-in capital	568,861	565,627
Accumulated other comprehensive loss, net of tax benefit of \$4,566 as of September 30, 2018 and \$1,319 as of December 31, 2017	(11,295)	(1,869)
Retained earnings	93,768	70,575
Less: treasury stock, at cost; 1,101,597 shares as of September 30, 2018 and 651,506 shares as of December 31, 2017	(83,619)	(71,889)
Total stockholders' equity	567,748	562,477
Total liabilities and stockholders' equity	\$5,487,042	\$5,210,485

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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Hanmi Financial Corporation and Subsidiaries
 Consolidated Statements of Income (Unaudited)
 (in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest and dividend income:				
Interest and fees on loans and leases	\$56,361	\$ 50,265	\$161,643	\$143,614
Interest on securities	3,238	3,188	9,541	8,657
Dividends on FHLB stock	286	286	858	943
Interest on deposits in other banks	151	123	398	323
Total interest and dividend income	60,036	53,862	172,440	153,537
Interest expense:				
Interest on deposits	11,694	7,071	28,944	18,687
Interest on borrowings	1,264	198	2,959	714
Interest on subordinated debentures	1,749	1,667	5,170	3,677
Total interest expense	14,707	8,936	37,073	23,078
Net interest income before provision for loan and lease losses	45,329	44,926	135,367	130,459
Loan and lease loss provision	200	269	949	611
Net interest income after provision for loan and lease losses	45,129	44,657	134,418	129,848
Noninterest income:				
Service charges on deposit accounts	2,513	2,678	7,352	7,667
Trade finance and other service charges and fees	1,128	1,133	3,449	3,449
Gain on sales of Small Business Administration ("SBA") loans	1,114	2,546	3,970	6,678
Disposition gains on Purchased Credit Impaired ("PCI") loans	21	979	166	1,702
Net gain (loss) on sales of securities	19	267	(341) 1,473
Other operating income	1,420	1,213	3,624	4,764
Total noninterest income	6,215	8,816	18,220	25,733
Noninterest expense:				
Salaries and employee benefits	17,436	16,947	53,590	50,674
Occupancy and equipment	3,685	3,883	11,839	11,743
Data processing	1,745	1,779	4,976	5,148
Professional fees	1,626	1,210	4,210	3,912
Supplies and communications	805	755	2,206	2,135
Advertising and promotion	814	1,147	2,724	2,964
Merger and integration costs (income)	466	—	846	(40
Other operating expenses	2,431	2,939	7,883	8,307
Total noninterest expense	29,008	28,660	88,274	84,843
Income before income tax expense	22,336	24,813	64,364	70,738
Income tax expense	6,255	9,890	17,880	27,576
Net income	\$16,081	\$ 14,923	\$46,484	\$43,162
Basic earnings per share	\$0.50	\$ 0.46	\$1.44	\$1.34
Diluted earnings per share	\$0.50	\$ 0.46	\$1.43	\$1.33
Weighted-average shares outstanding:				
Basic	32,155,133	32,095,286	32,171,558	32,058,705
Diluted	32,275,273	32,255,814	32,306,041	32,230,319

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

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Hanmi Financial Corporation and Subsidiaries
 Consolidated Statements of Comprehensive Income (Unaudited)
 (in thousands)

	Three Months		Nine Months	
	Ended September		Ended September	
	30,	30,	30,	2017
	2018	2017	2018	2017
Net income	\$16,081	\$14,923	\$46,484	\$43,162
Other comprehensive (loss) income, net of tax:				
Unrealized (loss) gain on securities:				
Unrealized holding (loss) gain arising during period	(2,750)	529	(13,115)	6,059
Less: reclassification adjustment for net gain included in net income	(19)	(267)	(87)	(1,473)
Income tax benefit (expense) related to items of other comprehensive income	798	(109)	3,793	(1,902)
Other comprehensive (loss) income, net of tax	(1,971)	153	(9,409)	2,684
Comprehensive income	\$14,110	\$15,076	\$37,075	\$45,846

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Hanmi Financial Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

(in thousands, except share data)

	Common Stock - Number of Shares			Stockholders' Equity					Total Stockholders' Equity
	Shares Issued	Treasury Shares	Shares Outstanding	Common Stock	Additional Paid-in Capital	Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock, at Cost	
Balance at January 1, 2017	32,946,197	(615,450)	32,330,747	\$33	\$562,446	\$ (2,394)	\$41,726	\$(70,786)	\$ 531,025
Stock options exercised	22,125	—	22,125	—	270	—	—	—	270
Restricted stock awards, net of forfeitures	90,844	—	90,844	—	—	—	—	—	—
Share-based compensation expense	—	—	—	—	2,071	—	—	—	2,071
Restricted stock surrendered due to employee tax liability	—	(30,634)	(30,634)	—	—	—	—	(935)	(935)
Cash dividends declared	—	—	—	—	—	—	(19,030)	—	(19,030)
Net income	—	—	—	—	—	—	43,162	—	43,162
Change in unrealized gain (loss) on securities available for sale, net of income taxes	—	—	—	—	—	2,684	—	—	2,684
Balance at September 30, 2017	33,059,166	(646,084)	32,413,082	\$33	\$564,787	\$ 290	\$65,858	\$(71,721)	\$ 559,247
Balance at January 1, 2018	33,083,133	(651,506)	32,431,627	\$33	\$565,627	\$ (1,869)	\$70,575	\$(71,889)	\$ 562,477
Adjustments related to adoption of new accounting standards:									
ASU 2016-01 (See Notes 1 and 2)	—	—	—	—	—	382	(382)	—	—
ASU 2018-02	—	—	—	—	—	(399)	399	—	—

(See Notes 1
and 5)

Adjusted balance at January 1, 2018	33,083,133	(651,506)	32,431,627	\$33	\$565,627	\$(1,886)	\$70,592	\$(71,889)	\$562,477
Stock options exercised	25,750	—	25,750	—	570	—	—	—	570
Restricted stock awards, net of forfeitures	79,950	—	79,950	—	—	—	—	—	—
Share-based compensation expense	—	—	—	—	2,664	—	—	—	2,664
Restricted stock surrendered due to employee tax liability	—	(20,533)	(20,533)	—	—	—	—	(607)	(607)
Repurchase of common stock	—	(429,558)	(429,558)	—	—	—	—	(11,123)	(11,123)
Cash dividends declared	—	—	—	—	—	—	(23,308)	—	(23,308)
Net income	—	—	—	—	—	—	46,484	—	46,484
Change in unrealized loss on securities available for sale, net of income taxes	—	—	—	—	—	(9,409)	—	—	(9,409)
Balance at September 30, 2018	33,188,833	(1,101,597)	32,087,236	\$33	\$568,861	\$(11,295)	\$93,768	\$(83,619)	\$567,748

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Hanmi Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$46,484	\$43,162
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,510	9,353
Share-based compensation expense	2,664	2,071
Loan and lease loss provision	949	611
Loss (gain) on sales of securities	341	(1,473)
Gain on sales of SBA loans	(3,970)	(6,678)
Disposition gains on PCI loans	(166)	(1,702)
Origination of SBA loans held for sale	(56,244)	(81,716)
Proceeds from sales of SBA loans	63,057	92,715
Change in accrued interest receivable	(876)	(1,111)
Change in bank-owned life insurance	(818)	(828)
Change in prepaid expenses and other assets	3,223	1,829
Change in accrued interest payable	2,844	1,504
Change in accrued expenses and other liabilities	(7,069)	(1,914)
Net cash provided by operating activities	58,929	55,823
Cash flows from investing activities:		
Proceeds from matured, called and repayment of securities	79,309	51,117
Proceeds from sales of securities available for sale	34,751	70,333
Proceeds from sales of other real estate owned ("OREO")	1,902	5,710
Change in loans and leases receivable, excluding purchases	(214,670)	(191,594)
Purchases of securities	(124,964)	(201,398)
Purchases of premises and equipment	(3,800)	(147)
Purchases of loans receivable	(66,966)	(161,253)
Net cash used in investing activities	(294,438)	(427,232)
Cash flows from financing activities:		
Change in deposits	265,768	489,273
Change in overnight FHLB borrowings	10,000	(205,000)
Issuance of subordinated debentures	—	97,735
Proceeds from exercise of stock options	570	270
Cash paid for treasury shares acquired in respect of share-based compensation	(607)	(935)
Repurchase of common stock	(11,123)	—
Cash dividends paid	(23,308)	(19,030)
Net cash provided by financing activities	241,300	362,313
Net increase (decrease) in cash and cash equivalents	5,791	(9,096)
Cash and cash equivalents at beginning of year	153,826	147,235
Cash and cash equivalents at end of period	\$159,617	\$138,139
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	\$34,229	\$23,078
Income taxes	\$13,553	\$25,146

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Non-cash activities:

Transfer of loans receivable to other real estate owned	\$938	\$143
Income tax benefit (expense) related to items in other comprehensive income	\$3,793	\$(1,902)
Change in unrealized loss (gain) in accumulated other comprehensive income	\$13,115	\$(6,059)
Cash dividends declared	\$(23,308)	\$(19,030)
See Accompanying Notes to Consolidated Financial Statements (Unaudited)		

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Hanmi Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)
Nine Months Ended September 30, 2018 and 2017
Note 1 — Organization and Basis of Presentation

Hanmi Financial Corporation (“Hanmi Financial,” the “Company,” “we,” “us” or “our”) is a bank holding company whose subsidiary is Hanmi Bank (the “Bank”). Our primary operations are related to traditional banking activities, including the acceptance of deposits and the lending and investing of money through the operation of the Bank.

In August 2018, the Company's Board of Directors adopted a stock repurchase program. Under this repurchase program, the Company may repurchase up to 5% of its outstanding shares or approximately 1.6 million shares of its common stock. The program permits shares to be repurchased in open market or private transactions, through block trades, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The repurchase program may be suspended, terminated or modified at any time for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, and other factors deemed appropriate. These factors may also affect the timing and amount of share repurchases. The repurchase program does not obligate the Company to purchase any particular number of shares. During the three months ended September 30, 2018, the Company repurchased 429,558 shares of common stock at a cost of \$11.1 million under this program.

In management’s opinion, the accompanying unaudited consolidated financial statements of Hanmi Financial and its subsidiaries reflect all adjustments of a normal and recurring nature that are necessary for a fair presentation of the results for the interim period ended September 30, 2018, but are not necessarily indicative of the results that will be reported for the entire year or any other interim period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted. The aforementioned unaudited consolidated financial statements are prepared in conformity with GAAP and in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. The interim information should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “2017 Annual Report on Form 10-K”).

The preparation of interim consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Material estimates subject to change include, among other items, the determination of allowance for loan and lease losses and various other assets and liabilities measured at fair value. Actual results could differ from those estimates.

Descriptions of our significant accounting policies are included in Note 1 - Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements in our 2017 Annual Report on Form 10-K.

Effective January 1, 2018, the Company adopted Accounting Standards Update (“ASU”) 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825) and ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (Topic 220). Summaries of ASU 2016-01 and 2018-02 and the impact of their adoption are included in Notes 2 and 5 to the Consolidated Financial Statements, respectively. In addition to other provisions, ASU 2016-01 requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. Beginning with the quarter ended March 31, 2018, the Company measured the fair value of certain financial instruments, included in Note 10 to the Consolidated Financial Statements, using an exit price notion.

The Company also adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606), as of January 1, 2018, as required. ASU 2014-09 replaces existing revenue recognition guidance for contracts to provide goods or services to customers and amends existing guidance related to recognition of gains and losses on the sale of certain nonfinancial assets such as real estate. See Note 14 to the Consolidated Financial Statements for the impact of the adoption of this new standard on the Company's consolidated financial statements.

Note 2 — Securities

The following is a summary of securities available for sale as of September 30, 2018 and December 31, 2017:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
(in thousands)				
September 30, 2018				
Mortgage-backed securities ⁽¹⁾	\$308,054	\$ 51	\$ 9,719	\$298,386
Collateralized mortgage obligations ⁽¹⁾	121,541	6	3,892	117,655
U.S. government agency securities	7,499	—	147	7,352
Municipal bonds-tax exempt	111,328	9	2,059	109,278
U.S. treasury securities	39,675	—	110	39,565
Total securities available for sale	\$588,097	\$ 66	\$ 15,927	\$572,236
December 31, 2017				
Mortgage-backed securities ⁽¹⁾	\$306,166	\$ 145	\$ 2,702	\$303,609
Collateralized mortgage obligations ⁽¹⁾	119,658	8	1,898	117,768
U.S. government agency securities	7,499	—	85	7,414
Municipal bonds-tax exempt	125,601	1,943	69	127,475
U.S. treasury securities	152	—	—	152
Mutual funds	22,916	—	530	22,386
Total securities available for sale	\$581,992	\$ 2,096	\$ 5,284	\$578,804

⁽¹⁾ Collateralized by residential mortgages and guaranteed by U.S. government sponsored entities.

The amortized cost and estimated fair value of securities as of September 30, 2018, by contractual or expected maturity, are shown below. Collateralized mortgage obligations are included in the table shown below based on their expected maturities. All other securities are included based on their contractual maturities.

	Available for Sale	
	Amortized Cost	Estimated Fair Value
(in thousands)		
Within one year	\$18,067	\$18,027
Over one year through five years	116,744	114,401
Over five years through ten years	228,679	222,171
Over ten years	224,607	217,637
Total	\$588,097	\$572,236

Gross unrealized losses on securities available for sale, the estimated fair value of the related securities and the number of securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of September 30, 2018 and December 31, 2017:

	Holding Period			Total			Gross Unrealized Loss	Estimated Fair Value	Number of Securities
	Less Than 12 Months	12 Months or More		Less Than 12 Months	12 Months or More				
	Gross Unrealized Loss	Estimated Fair Value	Number of Securities	Gross Unrealized Loss	Estimated Fair Value	Number of Securities	Gross Unrealized Loss	Estimated Fair Value	Number of Securities
	(in thousands, except number of securities)								
September 30, 2018									
Mortgage-backed securities	\$2,484	\$109,384	44	\$7,235	\$183,568	72	\$9,719	\$292,952	116
Collateralized mortgage obligations	453	26,235	7	3,439	89,706	47	3,892	115,941	54
U.S. government agency securities	—	—	—	147	7,352	3	147	7,352	3
Municipal bonds-tax exempt	1,811	98,667	43	248	7,034	4	2,059	105,701	47
U.S. treasury securities	110	39,565	5	—	—	—	110	39,565	5
Total	\$4,858	\$273,851	99	\$11,069	\$287,660	126	\$15,927	\$561,511	225
December 31, 2017									
Mortgage-backed securities	\$1,855	\$197,621	66	\$847	\$56,998	25	\$2,702	\$254,619	91
Collateralized mortgage obligations	773	65,726	20	1,125	49,986	32	1,898	115,712	52
U.S. government agency securities	15	1,484	1	70	5,930	2	85	7,414	3
Municipal bonds-tax exempt	48	11,541	6	21	2,737	2	69	14,278	8
Mutual funds	—	—	—	530	22,382	6	530	22,382	6
Total	\$2,691	\$276,372	93	\$2,593	\$138,033	67	\$5,284	\$414,405	160

All individual securities that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2018 and December 31, 2017 included securities with issuers which have not established any cause for default on these securities. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated.

The Company does not intend to sell these securities and it is more likely than not that we will not be required to sell the securities before the recovery of their amortized cost basis. Interest payments have been made as scheduled, and management believes this will continue in the future and that the securities will be repaid in full as scheduled. Therefore, in management's opinion, all securities that have been in a continuous unrealized loss position for the past 12 months or longer as of September 30, 2018 and December 31, 2017 were not other-than-temporarily impaired, and therefore, no impairment charges as of September 30, 2018 and December 31, 2017 were warranted.

Realized gains and losses on sales of securities and proceeds from sales of securities were as follows for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
	(in thousands)			
Gross realized gains on sales of securities	\$19	\$267	\$87	\$1,473

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Gross realized losses on sales of securities	—	—	(957)	—
Net realized (losses) gains on sales of securities	\$19	\$267	\$(870)	\$1,473

Proceeds from sales of securities	\$3,426	\$17,644	\$34,751	\$70,333
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In January 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825). This new guidance, among other provisions, amends accounting related to the classification and measurement of investments in equity securities. We adopted this guidance, as

required, in the first quarter of 2018. ASU 2016-01 requires the amounts reported in accumulated other comprehensive income for equity securities that exist as of the date of adoption previously classified as available-for-sale be reclassified to retained earnings. The Company reduced the balance of securities by \$529,000 as of January 1, 2018, representing the loss related to all of our mutual fund equity securities, which resulted in a net reduction of retained earnings of \$382,000 and an increase of \$147,000 in net deferred tax assets based on the transition requirements of this standard.

For the three months ended September 30, 2018 and 2017, there was a \$19,000 and \$267,000 net gain in earnings resulting from the sale of securities, respectively. Net unrealized gains of \$21,000 and \$227,000 related to these sold securities had previously been recorded in accumulated other comprehensive income as of the beginning of the period in 2018 and 2017, respectively.

During the nine months ended September 30, 2018, there was \$87,000 in gains included in earnings resulting from sale of securities which had \$116,000 in previously recorded unrealized gains in accumulated other comprehensive income. Additionally, during the nine months ended September 30, 2018, we sold all of our mutual fund equity securities with gross realized losses of \$957,000. The Company recorded a \$428,000 net loss in earnings resulting from the sale of these securities in the three months ended March 31, 2018. The remaining loss of \$529,000 related to these sold securities was recorded as a transition adjustment upon adoption of ASU 2016-01 as of the beginning of the period as described in the preceding paragraph. There was a \$1.5 million net gain in earnings resulting from sales of securities during the nine months ended September 30, 2017, that had previously been recorded as net unrealized gains of \$971,000 in comprehensive income.

Securities available for sale with market values of \$29.7 million and \$130.1 million as of September 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

Note 3 — Loans and leases

Loans and Leases Receivable, Net

Loans and leases receivable consisted of the following as of the dates indicated:

	September 30, 2018	December 31, 2017
	(in thousands)	
Real estate loans:		
Commercial property		
Retail	\$924,007	\$915,273
Hospitality	809,287	681,325
Other ⁽¹⁾	1,474,406	1,417,273
Total commercial property loans	3,207,700	3,013,871
Construction	67,682	55,190
Residential property	516,968	521,853
Total real estate loans	3,792,350	3,590,914
Commercial and industrial loans:		
Commercial term	186,249	182,685
Commercial lines of credit	178,570	181,894
International loans	31,564	34,622
Total commercial and industrial loans	396,383	399,201
Leases receivable	379,455	297,284
Consumer loans ⁽²⁾	14,695	17,059
Loans and leases receivable	4,582,883	4,304,458
Allowance for loan and lease losses	(31,676)	(31,043)
Loans and leases receivable, net	\$4,551,207	\$4,273,415

(1) Includes, among other types, mixed-use, apartment, office, industrial, gas stations, faith-based facilities and warehouse; all other property types represent less than one percent of total loans and leases receivable.

(2) Consumer loans include home equity lines of credit of \$10.9 million and \$14.2 million as of September 30, 2018 and December 31, 2017, respectively.

Accrued interest on loans and leases receivable was \$11.2 million and \$10.2 million at September 30, 2018 and December 31, 2017, respectively. At September 30, 2018 and December 31, 2017, loans receivable of \$1.1 billion were pledged to secure borrowing facilities from the FHLB.

Loans Held for Sale

The following is the activity for SBA loans held for sale for the three months ended September 30, 2018 and 2017:

	SBA Loans Held for Sale		
	Real Estate	Commercial and Industrial	Total
	(in thousands)		
September 30, 2018			
Balance at beginning of period	\$2,785	\$ 2,564	\$5,349
Originations	5,408	13,469	18,877
Sales	(6,453)	(13,299)	(19,752)
Principal payoffs and amortization	(3)	(16)	(19)
Balance at end of period	\$1,737	\$ 2,718	\$4,455
September 30, 2017			
Balance at beginning of period	\$8,817	\$ 2,132	\$10,949
Originations	16,326	11,723	28,049
Sales	(20,593)	(11,926)	(32,519)
Principal payoffs and amortization	(4)	(6)	(10)
Balance at end of period	\$4,546	\$ 1,923	\$6,469

The following is the activity for SBA loans held for sale for the nine months ended September 30, 2018 and 2017:

	SBA Loans Held for Sale		
	Real Estate	Commercial and Industrial	Total
	(in thousands)		
September 30, 2018			
Balance at beginning of period	\$3,746	\$ 2,648	\$6,394
Originations	25,996	30,248	56,244
Sales	(28,000)	(30,043)	(58,043)
Principal payoffs and amortization	(5)	(135)	(140)
Balance at end of period	\$1,737	\$ 2,718	\$4,455
September 30, 2017			
Balance at beginning of period	\$7,410	\$ 1,906	\$9,316
Originations	51,090	30,626	81,716
Sales	(53,930)	(30,586)	(84,516)
Principal payoffs and amortization	(24)	(23)	(47)
Balance at end of period	\$4,546	\$ 1,923	\$6,469

Allowance for Loan and Lease Losses

Activity in the allowance for loan and lease losses was as follows for the periods indicated:

	As of and for the Three Months Ended September 30, 2018		As of and for the Nine Months Ended September 30, 2017	
	2018	2017	2018	2017
	(in thousands)			
Allowance for loan and lease losses:				
Balance at beginning of period	\$31,818	\$33,758	\$31,043	\$32,429
Charge-offs	(1,246)	(2,405)	(3,535)	\$(3,256)
Recoveries on loans and leases previously charged off	904	871	3,219	\$2,709
Net charge-offs	(342)	(1,534)	(316)	(547)
Loan and lease loss provision	200	268	949	\$610
Balance at end of period	\$31,676	\$32,492	\$31,676	\$32,492

Management believes the allowance for loan and lease losses is appropriate to provide for probable losses inherent in the loan and lease portfolio. However, the allowance is an estimate that is inherently uncertain and depends on the outcome of future events. Management's estimates are based on previous loss experience; size, growth and composition of the loan and lease portfolio; the value of collateral; and current economic conditions. Our lending is concentrated generally in real estate loans, commercial loans and leases and SBA loans to small and middle market businesses primarily in California, Texas, Illinois and New York.

The following table details the information on the allowance for loan and lease losses by portfolio segment as of and for the three months ended September 30, 2018 and 2017:

	Real Estate	Commercial Leases and Industrial Receivable	Consumer	Unallocated	Total	
	(In thousands)					
As of and for the Three Months Ended September 30, 2018						
Allowance for loan and lease losses on loans and leases:						
Beginning balance	\$17,916	\$7,120	6,649	\$109	\$24	\$31,818
Charge-offs	(220)	(232)	(794)	—	—	(1,246)
Recoveries on loans and leases previously charged off	577	237	90	—	—	904
Loan and lease loss provision (income)	(184)	(38)	446	—	(24)	200
Ending balance	\$18,089	\$7,087	\$6,391	\$109	\$—	\$31,676
Individually evaluated for impairment	\$2,428	\$631	\$1,763	\$—	\$—	\$4,822
Collectively evaluated for impairment	\$15,661	\$6,456	\$4,628	\$109	\$—	\$26,854
Loans and leases receivable:						
Individually evaluated for impairment	\$3,792,350	\$396,383	\$379,455	\$14,695	\$—	\$4,582,883
Collectively evaluated for impairment	\$20,596	\$3,767	\$5,093	\$881	\$—	\$30,337
Collectively evaluated for impairment	\$3,771,754	\$392,616	\$374,362	\$13,814	\$—	\$4,552,546

	Real Estate	Commercial Leases and Industrial Receivable	Leases	Consumer	Unallocated	Total
	(In thousands)					
As of and for the Three Months Ended September 30, 2017						
Allowance for loan and lease losses on loans and leases:						
Beginning balance	\$23,433	\$ 7,020	2,033	\$95	\$ 1,177	\$33,758
Charge-offs	(146)	(1,976)	(283)	—	—	(2,405)
Recoveries on loans and leases previously charged off	343	308	220	—	—	871
Loan and lease loss provision (income)	(3,293)	1,183	2,867	(30)	(459)	268
Ending balance	\$20,337	\$ 6,535	\$4,837	\$ 65	\$ 718	\$32,492
Individually evaluated for impairment	\$3,882	\$ 531	\$2,008	\$—	\$ —	\$6,421
Collectively evaluated for impairment	\$ 16,455	\$ 6,004	\$2,829	\$ 65	\$ 718	\$26,071
Loans and leases receivable:	\$3,539,558	\$ 364,456	\$272,271	\$ 19,070	\$ —	\$4,195,355
Individually evaluated for impairment	\$ 19,466	\$ 3,610	\$3,378	\$ 1,045	\$ —	\$27,499
Collectively evaluated for impairment	\$3,520,092	\$ 360,846	\$268,893	\$ 18,025	\$ —	\$4,167,856

The following table details the information on the allowance for loan and lease losses by portfolio segment as of and for the nine months ended September 30, 2018 and 2017:

	Real Estate	Commercial Leases and Industrial Receivable	Leases	Consumer	Unallocated	Total
	(In thousands)					
As of and for the Nine Months Ended September 30, 2018						
Allowance for loan and lease losses on loans and leases:						
Beginning balance	\$17,012	\$ 7,400	6,279	\$ 122	\$ 230	\$31,043
Charge-offs	(1,249)	(597)	(1,689)	—	—	(3,535)
Recoveries on loans and leases previously charged off	1,833	1,170	214	2	—	3,219
Loan and lease loss provision (income)	493	(886)	1,587	(15)	(230)	949
Ending balance	\$18,089	\$ 7,087	\$6,391	\$ 109	\$ —	\$31,676
Individually evaluated for impairment	\$2,428	\$ 631	\$1,763	\$—	\$ —	\$4,822
Collectively evaluated for impairment	\$ 15,661	\$ 6,456	\$4,628	\$ 109	\$ —	\$26,854
Loans and leases receivable:	\$3,792,350	\$ 396,383	\$379,455	\$ 14,695	\$ —	\$4,582,883
Individually evaluated for impairment	\$20,596	\$ 3,767	\$5,093	\$ 881	\$ —	\$30,337
Collectively evaluated for impairment	\$3,771,754	\$ 392,616	\$374,362	\$ 13,814	\$ —	\$4,552,546

	Real Estate	Commercial Leases and Industrial Receivable	Leases	Consumer	Unallocated	Total
	(In thousands)					
As of and for the Nine Months Ended September 30, 2017						
Allowance for loan and lease losses on loans and leases:						
Beginning balance	\$26,134	\$ 5,623	307	\$ 199	\$ 166	\$32,429
Charge-offs	(289) (2,017) (950) —	—	(3,256
Recoveries on loans and leases previously charged off	1,434	1,021	239	15	—	2,709
Loan and lease loss provision (income)	(6,942) 1,908	5,241	(149) 552	610
Ending balance	\$20,337	\$ 6,535	\$4,837	\$ 65	\$ 718	\$32,492
Individually evaluated for impairment	\$3,882	\$ 531	\$2,008	\$—	\$ —	\$6,421
Collectively evaluated for impairment	\$16,455	\$ 6,004	\$2,829	\$ 65	\$ 718	\$26,071
Loans and leases receivable:	\$3,539,558	\$ 364,456	\$272,271	\$19,070	\$ —	\$4,195,355
Individually evaluated for impairment	\$19,466	\$ 3,610	\$3,378	\$1,045	\$ —	\$27,499
Collectively evaluated for impairment	\$3,520,092	\$ 360,846	\$268,893	\$18,025	\$ —	\$4,167,856

Loan and Lease Quality Indicators

As part of the on-going monitoring of the credit quality of our loan and lease portfolio, we utilize an internal loan and lease grading system to identify credit risk and assign an appropriate grade, from 0 to 8, for each loan or lease in our loan and lease portfolio. Third party loan reviews are performed throughout the year. Additional adjustments are made when determined to be necessary. The loan and lease grade definitions are as follows:

Pass and Pass-Watch: Pass and pass-watch loans and leases, grades 0-4, are in compliance in all respects with the Bank's credit policy and regulatory requirements, and do not exhibit any potential or defined weaknesses as defined under Special Mention, Substandard or Doubtful. This category is the strongest level of the Bank's loan and lease grading system. It incorporates all performing loans and leases with no credit weaknesses. It includes cash and stock/security secured loans or other investment grade loans.

Special Mention: A special mention credit, grade 5, has potential weaknesses that deserve management's close attention. If not corrected, these potential weaknesses may result in deterioration of the repayment prospects of the debt and result in a Substandard classification. Loans and leases that have significant actual, not potential, weaknesses are considered more severely classified.

Substandard: A substandard credit, grade 6, has a well-defined weakness that jeopardizes the liquidation of the debt. A credit graded Substandard is not protected by the sound worth and paying capacity of the borrower, or of the value and type of collateral pledged. With a Substandard loan or lease, there is a distinct possibility that the Bank will sustain some loss if the weaknesses or deficiencies are not corrected.

Doubtful: A doubtful credit, grade 7, is one that has critical weaknesses that would make the collection or liquidation of the full amount due improbable. However, there may be pending events which may work to strengthen the credit, and therefore the amount or timing of a possible loss cannot be determined at the current time.

Loss: A loan or lease classified as loss, grade 8, is considered uncollectible and of such little value that its continuance as an active bank asset is not warranted. This classification does not mean that the loan or lease has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be possible in the future. Loans and leases classified as loss are charged off in a timely manner.

Under regulatory guidance, loans and leases graded special mention or worse are considered criticized loans and leases, and loans and leases graded substandard or worse are considered classified loans and leases.

As of September 30, 2018 and December 31, 2017, pass/pass-watch, special mention and classified loans and leases, disaggregated by loan class, were as follows:

	Pass/Pass- Watch	Special Mention	Classified	Total
(In thousands)				
September 30, 2018				
Real estate loans:				
Commercial property				
Retail	\$917,990	\$ 9	\$ 6,008	\$924,007