FIRST PACTRUST BANCORP INC
Form 10-Q
October 22, 2010

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, 2010

FIRST PACTRUST BANCORP, INC.

(Exact name of registrant as specified in its charter)

000-49806

(Commission File Number)

Maryland

(State of incorporation)

04-3639825

(IRS Employer Identification No.)

610 Bay Boulevard, Chula Vista, California

(Address of Principal Executive Offices)

91910

(ZIP Code)

(619) 691-1519

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its Corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T (p232.405) of this chapter) during the proceeding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the Registrant is a large accelerated filer; an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of accelerated filer and large accelerated filer in Rule 12B-2 of the Exchange Act.

Large accelerated Filer ¨	Accelerated Filer ¨	Non-accelerated Filer ¨	Smaller reporting company x

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

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

As of October 22, 2010 the Registrant had 4,243,884 outstanding shares of common stock.

Table of Contents

FIRST PACTRUST BANCORP, INC.

Form 10-Q Quarterly Report

Index

Table of Contents

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

This report contains certain forward-looking statements within the meaning of Section 27a of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. First PacTrust Bancorp, Inc. (the Company) and Pacific Trust Bank (the Bank) intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, as amended, and are including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company and the Bank, are generally identifiable by use of the words such as believe, expect, intend, anticipate, estimate, project, or similar expressions. The ability Company and the Bank to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations and future prospects of the Company, the Bank, and the Bank s wholly owned subsidiaries include, but are not limited to, changes in: interest rates; the economic health of the local real estate market; general economic conditions; legislative/regulatory provisions; monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; the quality or composition of the loan and securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Bank s market area; and impact of new accounting pronouncements. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Table of Contents

ITEM 1 FINANCIAL STATEMENTS

First PacTrust Bancorp, Inc.

Consolidated Statements of Financial Condition

(In thousands of dollars except share data)

(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Cash and due from banks	$ 37,038	$ 7,132
Federal funds sold		23,580
Interest-bearing deposits	2,870	3,884
Total cash and cash equivalents	39,908	34,596
Securities available-for-sale	71,194	52,304
Federal Home Loan Bank stock, at cost	8,669	9,364
Loans receivable, net of allowance of $17,560 at September 30, 2010 and $13,079 at December 31, 2009	689,079	748,303
Accrued interest receivable	3,647	3,936
Real estate owned, net	7,790	5,680
Premises and equipment, net	4,214	4,294
Bank owned life insurance investment	18,097	17,932
Prepaid FDIC assessment	3,894	5,013
Deferred tax asset	4,828	5,423
Other assets	11,393	7,076
Total assets	$ 862,713	$ 893,921
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest-bearing	$ 15,599	$ 14,021
Interest-bearing	669,189	644,411
Total deposits	684,788	658,432
Advances from Federal Home Loan Bank	75,000	135,000
Accrued expenses and other liabilities	4,058	3,004
Total liabilities	763,846	796,436
SHAREHOLDERS EQUITY		
Preferred stock, $.01 par value per share, $1,000 per share liquidation preference, 5,000,000 shares authorized, 19,300 shares issued and outstanding at September 30, 2010 and December 31, 2009	19,123	19,094
Common stock, $.01 par value per share, 20,000,000 shares authorized; 5,445,000 shares issued and outstanding at September 30, 2010 and December 31, 2009	54	54
Additional paid-in capital	67,870	67,958
Retained earnings	35,587	35,515
Treasury stock, at cost (September 30, 2010 - 1,201,116 shares, December 31, 2009 - 1,200,154 shares)	(25,801)	(25,788)
	(634)	(1,015)

Unearned employee stock ownership plan shares (September 30, 2010 - 52,900 shares, December 31, 2009 - 84,640 shares)				
Accumulated other comprehensive income		2,668		1,667
Total shareholders equity		98,867		97,485
Total liabilities and shareholders equity	$	862,713	$	893,921

See accompanying notes to consolidated financial statements.

4

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Income (Loss)

(In thousands of dollars except per share data)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Interest and dividend income				
Loans, including fees	$ 9,164	$ 10,212	$ 26,967	$ 32,507
Securities	1,410	1,278	4,026	3,093
Dividends and other interest-earning assets	64	25	153	73
Total interest income	10,638	11,515	31,146	35,673
Interest expense				
Deposits	1,907	3,036	6,358	10,201
Federal Home Loan Bank advances	592	1,212	2,285	4,033
Total interest expense	2,499	4,248	8,643	14,234
Net interest income	8,139	7,267	22,503	21,439
Provision for loan losses	781	2,709	8,629	12,395
Net interest income after provision for loan losses	7,358	4,558	13,874	9,044
Noninterest income				
Customer service fees	336	343	995	1,025
Mortgage loan prepayment penalties		11		21
Income from bank owned life insurance	57	95	165	283
Other income	61	3	25	16
Total noninterest income	454	452	1,185	1,345
Noninterest expense				
Salaries and employee benefits	1,614	1,625	4,778	5,012
Occupancy and equipment	437	494	1,386	1,474
Advertising	67	43	227	138
Professional fees	238	128	547	427
Stationery, supplies, and postage	86	86	266	261
Data processing	289	255	858	751
ATM costs	74	91	224	268
FDIC expense	391	337	1,172	1,231
Loan servicing & foreclosure	150	20	916	575
Operating loss on equity investment	82	87	254	261
Valuation allowance for OREO	386		1,414	
(Gain)/Loss on sale of other real estate owned	(259)		61	
Other general and administrative	291	278	927	841
Total noninterest expense	3,846	3,444	13,030	11,239

Income/(loss) before income tax expense/(benefit)	3,966	1,566	2,029	(850)
Income tax expense/(benefit)	934	71	580	(452)
Net income/(loss)	$ 3,032	$ 1,495	$ 1,449	$ (398)
Dividends and discount on preferred stock	$ 251	$ 251	$ 753	$ 752
Net income/(loss) available to common shareholders	2,781	1,244	696	(1,150)
Basic earnings/(loss) per share	$ .66	$ .30	$ .17	$ (.28)
Diluted earnings/(loss) per share	$ .66	$ .30	$ .17	$ (.28)

See accompanying notes to consolidated financial statements.

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Cash Flows

(In thousands of dollars) (Unaudited)

	Nine Months Ended September 30, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 1,449	$ (398)
Adjustments to reconcile net (loss) to net cash provided by operating activities		
Provision for loan losses	8,629	12,395
Net accretion of securities	(1,357)	(1,431)
Depreciation and amortization	283	334
Employee stock ownership plan compensation expense	262	231
Stock option compensation expense	9	39
Stock award compensation expense	18	71
Bank owned life insurance income	(165)	(283)
Operating loss on equity investment	254	261
Impairment of securities		15
Write down of OREO	1,414	
Loss on sale of real estate owned	61	
Loss on sale of property and equipment		2
Deferred income tax (benefit)/expense	595	(1,320)
Interest capitalized on negative amortizing loans		(16)
Net change in:		
Deferred loan costs	324	181
Accrued interest receivable	347	526
Other assets	5,945	(207)
Accrued interest payable and other liabilities	101	6,059
Net cash provided by operating activities	18,169	16,459
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and principal repayments of securities available-for-sale	13,219	7,500
Purchases of securities available-for-sale	(29,110)	(37,572)
Redemption of Federal Home Loan Bank stock	695	
Loan originations and principal collections, net	28,018	(312)
Net decrease in other interest bearing deposits		893
Proceeds from sale of real estate owned	9,525	7,550
Additions to premises and equipment	(203)	(156)
Net cash used in investing activities	22,144	(22,097)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	26,356	38,948
Net change in Federal Home Loan Bank open line		
Repayments of Federal Home Loan Bank advances	(60,000)	(45,000)
Proceeds from Federal Home Loan Bank advances		20,000
Purchase of treasury stock	(3)	(28)
Issuance costs on preferred stock		(13)
Tax loss from RRP shares vesting	(6)	(46)
Dividends paid on preferred stock	(724)	(722)
Dividends paid on common stock	(624)	(1,348)

Net cash provided by financing activities	(35,001)	11,791
Net change in cash and cash equivalents	5,312	6,153
Cash and cash equivalents at beginning of period	34,596	19,237
Cash and cash equivalents at end of period	$ 39,908	$ 25,390
Supplemental disclosures of cash flow information		
Transfers of loans to other real estate owned	12,728	12,827
Due to broker		5,875
Interest paid on deposits and borrowed funds	8,755	14,444
Income taxes paid	2,700	1,100

See accompanying notes to consolidated financial statements.

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Equity

(In thousands of dollars, except share and per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Unearned ESOP	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2009	$ 19,068	54	68,155	38,496	(25,736)	(1,523)	209	98,723
Net loss				(999)				(999)
Change in net unrealized gain/(losses) on securities available-for-sale, net of reclassification and tax effects							1,458	1,458
Total comprehensive income								459
Forfeiture and retirement of stock			7		(7)			
Stock option compensation expense			46					46
ESOP forfeitures used to reduce ESOP contribution			(63)					(63)
Stock awards earned			77					77
Additional issuance costs on preferred stock	(13)							(13)
Amortization of preferred stock discount	39			(39)				
Purchase of 6,922 shares of treasury stock					(45)			(45)
Employee stock ownership plan shares earned			(218)			508		290
Tax benefit/(loss) of RRP shares vesting			(46)					(46)
Dividends declared ($.25 per common share)				(979)				(979)
Preferred stock dividends				(964)				(964)
Balance at December 31, 2009	$ 19,094	$ 54	$ 67,958	$ 35,515	$ (25,788)	$ (1,015)	$ 1,667	$ 97,485
Net income (loss)				1,449				1,449
Change in net unrealized gain/(losses) on securities available-for-sale, net of reclassification and tax effects							1,001	1,001
Total comprehensive income								2,450
Forfeiture and retirement of stock			10		(10)			
Stock option compensation expense			9					9
ESOP forfeitures used to reduce ESOP contribution								

Stock awards earned			18					18
Additional issuance costs on preferred stock								
Amortization of preferred stock discount	29			(29)				
Purchase of 362 shares of treasury stock					(3)			(3)
Employee stock ownership plan shares earned			(119)			381		262
Tax benefit/(loss) of RRP shares vesting			(6)					(6)
Dividends declared ($.15 per common share)				(624)				(624)
Preferred stock dividends				(724)				(724)
Balance at September 30, 2010	$ 19,123	$ 54	$ 67,870	$ 35,587	$ (25,801)	$ (634)	$ 2,668	$ 98,867

See accompanying notes to consolidated financial statements.

Table of Contents

FIRST PACTRUST BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

(Amounts in thousands of dollars, except share and per share data)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of First PacTrust Bancorp, Inc. (the Company) and its wholly owned subsidiary Pacific Trust Bank (the Bank) as of September 30, 2010 and December 31, 2009 and for the three and nine month periods ended September 30, 2010 and September 30, 2009. Significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by U.S. generally accepted accounting principles are not included herein. These interim statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission. The December 31, 2009 balance sheet presented herein has been derived from the audited financial statements included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission, but does not include all of the disclosures required by U.S. generally accepted accounting principles.

Interim statements are subject to possible adjustment in connection with the annual audit of the Company for the year ending December 31, 2010. In the opinion of management of the Company, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position and consolidated results of operations for the periods presented.

The results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: The principal business of the Company is the ownership of the Bank. The Bank is a federally chartered stock savings bank and a member of the Federal Home Loan Bank (FHLB) system, which maintains insurance on deposit accounts with the Federal Deposit Insurance Corporation.

The Bank is engaged in the business of retail banking, with operations conducted through its main office and eight branches located in San Diego and Riverside counties. There are no significant concentrations of loans to any one industry or customer. However, the customers ability to repay their loans is dependent on the real estate market and general economic conditions in the area.

The accounting and reporting polices of the Company are based upon U.S. generally accepted accounting principles and conform to predominant practices within the banking industry. Significant accounting policies followed by the Company are presented below.

Use of Estimates in the Preparation of Financial Statements: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. The allowance for loan losses, other real estate owned, realization of deferred tax assets, and the fair value of financial instruments are particularly subject to change.

Accounting for Uncertainty in Income Taxes (ASC 740): A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. The Company has approximately $109 thousand of total gross unrecognized tax benefits at September 30, 2010, which represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods. The

Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. The Company is no longer subject to examination by U.S. Federal taxing authorities for years before 2006 and for all state income taxes through 2005. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company had $0 accrued for interest and penalties at September 30, 2010.

Deferred Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

As a result of adoption, the Company recognized an increase to deferred tax assets of $328 thousand for uncertain tax positions. This amount was accounted for by increasing the beginning balance of retained earnings on the balance sheet. After recording the cumulative effect at the beginning of 2007, the Company had approximately $109 thousand of total gross unrecognized tax benefits. At December 31, 2009, the total gross unrecognized tax benefit remained at $109 thousand. Of this total, $109 thousand represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non classified loans and is based on historical loss experience adjusted for current factors.

Impaired Loans: A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Troubled debt restructurings are also measured at the present value of estimated future cash flows using the loan s effective rate at inception or at the fair value of collateral if repayment is expected solely from the collateral.

Other Real Estate Owned (OREO): Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

New Accounting Pronouncements: The Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) Update No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The disclosures required at period-ends will be effective for the Company for interim and annual reporting periods ending on or after December 15, 2010 while disclosures for activity that occurs during a period will be effective for the Company for interim and annual periods ending on or after December 15, 2011. The FASB issued ASC Update No. 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules Amendments to SEC Paragraphs Pursuant to Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies*, which is effective upon issuance. Management believes adoption of this ASC update will not materially impact the financial statements of the Company.

NOTE 3 EMPLOYEE STOCK COMPENSATION

Stock Options

A Stock Option Plan (SOP) provides for the issuance of options to directors, officers, and employees. The Company adopted the SOP in April of 2003 under the terms of which up to 529,000 shares of the Company s common stock may be awarded. The options become exercisable in equal installments over a five-year period beginning on their one year anniversary after the date of grant. The options expire ten years from the date of grant. As of September 30, 2010, the Company had 473,596 exercisable options outstanding. There were no options granted during the three or nine months ended September 30, 2010. There were no shares forfeited during the three or nine months ended September 30, 2010.

The Black-Scholes option pricing valuation model was used in estimating the fair value of options that have no vesting restrictions. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

The following table represents stock option activity during the three months ended September 30, 2010:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of period July 1, 2010	482,396	$ 18.32		
Granted				
Exercised				
Forfeited or expired				
Outstanding at end of period	482,396	$ 18.32	3.01	$
Options exercisable at end of period September 30, 2010	473,596	$ 18.32	2.93	$

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of our common stock as of the reporting date. ASC 718 and 505 require the recognition of stock based compensation for the number of awards that are ultimately expected to vest. As a result, recognized stock compensation expense was reduced for estimated forfeitures prior to vesting primarily based on historical annual forfeiture rates of approximately 5% for senior management and the board of directors and 45% for all other employees. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances. The Company recorded stock compensation expense of $9 thousand and $39 thousand as salary and employee benefits expense during the nine months ended September 30, 2010 and September 30, 2009 respectively. As of September 30, 2010, there was a total of $16 thousand of total unrecognized compensation costs related to 8,800 nonvested options in the plan.

Options outstanding at September 30, 2010 were as follows:

		Outstanding		Exercisable	
Range of Exercise Prices	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
$17 - $22	458,396	2.92	17.88	450,596	17.89
$25 - $29	24,000	4.68	26.88	23,000	26.81
Outstanding at quarter end	482,396			473,596	

Recognition and Retention Plan

A Recognition and Retention Plan (RRP) provides for the issuance of shares to directors, officers, and employees. Pursuant to its 2003 stock-based incentive plan, the Company granted 220,600 shares of RRP awards since the inception of the plan. There were no shares granted during the nine months ended September 30, 2010. A total of 600 shares were forfeited during the nine months ended September 30, 2010. Compensation expense for RRP awards totaled approximately $18 thousand for the nine months ended September 30, 2010 and $71 thousand for the nine months ended September 30, 2009. As of September 30, 2010, there was a total of $48 thousand unrecognized compensation cost related to 2,780 nonvested RRP awards granted under the plan.

As described in Note 15 of our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, the plan allows for the issuance of RRP awards that may not be sold or otherwise transferred until the restrictions have lapsed. The unearned stock-based compensation related to these awards is being amortized to compensation expense over the vesting period (generally five years). The share-based expense for these awards was determined based on the market price of our stock at the date of grant applied to the total numbers of shares that were anticipated to fully vest and then amortized over the vesting period. ASC 718 and 505 require the recognition of stock based compensation for the number of awards that are ultimately expected to vest. As a result, recognized stock compensation expense was reduced for estimated forfeitures prior to vesting primarily based on historical annual forfeiture rates of approximately 6%. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances.

NOTE 4 EARNINGS/(LOSS) PER SHARE

Basic earnings/(loss) per share were computed by dividing net income/(loss) by the weighted average number of shares outstanding. Diluted earnings/(loss) per share were computed by dividing net income/(loss) by the weighted average number of shares outstanding, adjusted for the dilutive effect of the outstanding stock options and restricted stock awards. Computations for basic and diluted earnings/(loss) per share are provided below.

Table of Contents

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Basic				
Net income/(loss)	$ 3,032	$ 1,495	$ 1,449	$ (398)
Less: Dividends on preferred stock	(241)	(241)	(724)	(722)
Less Imputed dividends	(10)	(10)	(29)	(30)
Net income/(loss) available to common shareholders	$ 2,781	$ 1,244	$ 696	$ (1,150)
Weighted average common shares outstanding	4,202,533	4,162,914	4,191,836	4,152,727
Basic earnings/(loss) per share	$ .66	$ .30	$ .17	$ (.28)
Diluted				
Net income/(loss) available to common shareholders	$ 2,781	$ 1,244	$ 696	$ (1,150)
Weighted average common shares outstanding for basic earnings per common share	4,202,533	4,162,914	4,191,836	4,152,727
Add: Dilutive effects of stock options				
Add: Dilutive effects of stock awards				
Add: Dilutive effects of assumed exercised common stock warrants				
Average shares and dilutive potential common shares	4,202,533	4,162,914	4,191,836	4,152,727
Diluted earnings/(loss) per common share	$ .66	$ .30	$ .17	$ (.28)

All outstanding options and stock awards were not considered in computing diluted earnings per common share for the period ending September 30, 2010 and September 30, 2009, respectively, because they were anti-dilutive. They were anti-dilutive since the exercise prices were greater than the average market price of the common stock.

NOTE 5 FAIR VALUE

Fair Value Hierarchy. ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The topic describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing and asset or liability.

Investment Securities Available for Sale. The fair values of securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). The fair values of the Company s Level 3 securities are by the Company and an independent third-party provider using a discounted cash flow methodology. The methodology uses discount rates that are based upon observed market yields for similar securities. Prepayment speeds are estimated based upon the prepayment history of each bond and a detailed analysis of the underlying collateral. Gross weighted average coupon, geographic concentrations, loan to value, FICO and seasoning are among the different loan attributes that are factored into our prepayment curve. Default rates and severity are estimated based upon geography of the collateral, delinquency, modifications, loan to value ratios, FICO scores, and past performance.

Table of Contents

Impaired Loans. The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

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

Assets and Liabilities Measured on a Recurring and Non-Recurring Basis

Available for sale securities are measured at fair value on a recurring basis, impaired loans and real estate owned are measured at fair value on a non-recurring basis.

		Fair Value Measurements at September 30, 2010 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
Assets				
U.S. government sponsored entities and agency securities (recurring)	$ 5,092	$	$ 5,092	$
Private label residential mortgage-backed securities (recurring)	$ 66,099	$	$	$ 66,099
Federal National Mortgage Association securities (recurring)	$ 3	$	$ 3	$
Impaired loans (non-recurring)	$ 43,169	$	$	$ 43,169
Real estate owned assets (non-recurring)	$ 7,790	$	$	$ 7,790

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended September 30, 2010 and December 31, 2009:

	Investment Securities Available-for-sale
Balance of recurring Level 3 assets at January 1, 2010	$ 47,131
Total gains or losses (realized/unrealized):	$
Included in earnings realized	$
Included in earnings unrealized	$
Included in other comprehensive income	$ 1,698
Purchases	$ 29,086
Sales, issuances and settlements	$ (11,816)
Net transfers in and/or out of Level 3	$
Balance of recurring Level 3 assets at September 30, 2010	$ 66,099

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $43.2 million, net of a valuation allowance of $7.1 million at September 30, 2010, and prior charge-offs in the amount of $6.8 million. During the nine month period ended September 30, 2010, a provision of $3.1 million was made for these loans, net of charge-offs previously provided. At December 31, 2009, impaired loans had a carrying amount of $44.4 million, net of a valuation allowance of $6.5 million and prior charge-offs in the amount of $14.1 million. During the year ended December 31, 2009, a provision of $8.9 million was made for those loans.

Other real estate owned which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of $7.8 million, which is made up of the outstanding balance of $9.9 million, net of a valuation allowance of $2.1 million at September 30, 2010. Of the $2.1 million valuation allowance, $1.7 million is related to the Bank s sole participation construction property and is based on an internal analysis done by management. The Company is a partial owner in this property and was not the lead lender on the original loan related to this construction property. The Company requested that an appraisal be ordered on this

Table of Contents

property immediately upon foreclosure; however, a valid appraisal still has not been received. During the second quarter ended June 30, 2010, the Company updated the internal valuation analysis, in lieu of receipt of a valid appraisal, which resulted in an additional $1.0 million valuation allowance. This valuation allowance will be updated as needed upon receipt of the appraisal. As of September 30, 2010, this asset has been written down to 36% of the original balance.

		Fair Value Measurements at December 31, 2009 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
Assets				
U.S. government sponsored entities and agency securities (recurring)	$ 5,168	$	$ 5,168	$
Private label residential mortgage-backed securities (recurring)	$ 47,131	$	$	$ 47,131
Federal National Mortgage Association securities (recurring)	$ 4	$	$ 4	$
Government National Mortgage Association securities (recurring)	$ 1	$	$ 1	$
Impaired loans (non-recurring)	$ 44,364	$	$	$ 44,364
Real estate owned assets (non-recurring)	$ 5,680	$	$	$ 5,680

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended December 31, 2009:

	Investment Securities Available-for-sale
Balance of recurring Level 3 assets at January 1, 2009	$
Total gains or losses (realized/unrealized):	$
Included in earnings realized	$
Included in earnings unrealized	$
Included in other comprehensive income	$ 2,806
Purchases	$ 40,607
Sales, issuances and settlements	$ 3,718
Net Transfers in and/or out of Level 3	$
Balance of recurring Level 3 assets at December 31, 2009	$ 47,131

Table of Contents

In accordance with ASC 825-10, the carrying amounts and estimated fair values of financial instruments, at September 30, 2010 and December 31, 2009 were as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 39,908	$ 39,908	$ 34,596	$ 34,596
Securities available-for-sale	71,194	71,194	52,304	52,304
FHLB stock	8,669	N/A	9,364	N/A
Loans receivable, net	689,079	700,849	748,303	755,711
Real estate owned, net	7,790	7,790	5,680	5,680
Accrued interest receivable	3,647	3,647	3,936	3,936
Financial liabilities				
Deposits	$ 684,788	$ 687,390	$ 658,432	$ 660,963
Advances from the FHLB	75,000	76,449	135,000	137,578
Accrued interest payable	255	255	367	367

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits in other financial institutions, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material (or is based on the current fees or cost that would be charged to enter into or terminate such arrangements).

NOTE 6 INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale portfolio at September 30, 2010 and the corresponding amounts of unrealized gains and losses therein:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				
Available-for sale				
U.S. government-sponsored entities and agencies	$ 5,063	$ 29	$	$ 5,092
Private label residential mortgage-backed securities	61,594	4,816	(311)	66,099
Federal National Mortgage Association	3			3
Government National Mortgage Association				
Total securities available for sale	$ 66,660	$ 4,845	$ (311)	$ 71,194

The following table summarizes the amortized cost and fair value of the available-for-sale portfolio at December 31, 2009 and the corresponding amounts of unrealized gains and losses therein:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2009				
Available-for sale				
U.S. government-sponsored entities and agencies	$ 5,141	$ 27	$	$ 5,168
Private label residential mortgage-backed securities	44,324	3,188	(381)	47,131
Federal National Mortgage Association	4			4
Government National Mortgage Association	1			1
Total securities available for sale	$ 49,470	$ 3,215	$ (381)	$ 52,304

Table of Contents

The following table summarizes the investment securities with unrealized losses at September 30, 2010 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
U.S. government-sponsored entities and agencies	$	$	$	$	$	$
Private label residential mortgage-backed securities	15,453	(311)			15,453	(311)
Total available-for-sale	$ 15,453	$ (311)	$	$	$ 15,453	$ (311)

There were no sales or calls of securities during the nine months ended September 30, 2010 and 2009.

The following table summarizes the investment securities with unrealized losses at December 31, 2009 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
Private label residential mortgage-backed securities	$ 10,398	$ (381)	$	$	$ 10,398	$ (381)
Total available-for-sale	$ 10,398	$ (381)	$	$	$ 10,398	$ (381)

<u>Other-Than-Temporary Impairment</u>

Management evaluates securities for other-than-temporary impairment (OTTI) on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under Statement of Financial Accounting Standards ASC 320, *Accounting for Certain Investments in Debt and Equity Securities*. However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase below investment grade are evaluated using the model outlined in ASC 325, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transfer in Securitized Financial Assets.*

In determining OTTI under the ASC 320 model, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

The second segment of the portfolio uses the OTTI guidance provided by ASC 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC 325 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss.

If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the

15

Table of Contents

security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

As of September 30, 2010, the Company s security portfolio consisted of twenty eight securities, seven of which were in an unrealized loss position. The majority of unrealized losses are related to the Company s private label residential mortgage-backed and other securities, as discussed below.

The Company s mortgage-backed securities that are in a loss position had a market value of $15.5 million with unrealized losses of approximately $311 thousand at September 30, 2010. These non-agency mortgage-backed securities were rated above investment grade at the time of purchase and are not within the scope of ASC 325. The Company monitors to ensure it has adequate credit support and as of September 30, 2010, the Company believes there is no OTTI and does not have the intent to sell these securities and it is more likely than not that it will not be required to sell the securities before their anticipated recovery.

NOTE 7 LOANS

Loans receivable consists of the following:

	September 30, 2010		December 31, 2009	
	Amount	**Percent**	**Amount**	**Percent**
Real Estate				
One- to four-family	$ 369,956	52.50%	$ 425,125	56.00%
Commercial and multi-family	83,589	11.86	84,870	11.18
Consumer				
Real estate secured-first trust deeds (Green acct)*	211,148	29.96	208,945	27.53
Real estate secured-second trust deeds (Green acct)*	8,714	1.24	8,661	1.14
Other real estate and land secured (Green acct)*	19,720	2.80	19,582	2.58
Green account subtotal	239,582	34.00	237,188	31.25
Other consumer	11,018	1.56	11,370	1.50
Commercial	556	0.08	567	0.07
Total loans	704,701	100.00%	759,120	100.00%
Net deferred loan origination costs	1,938		2,262	
Allowance for loan losses	(17,560)		(13,079)	
Total loans receivable, net	$ 689,079		$ 748,303	

* The Company s Green Account is a first mortgage line of credit with an associated clearing account that allows all types of deposits and withdrawals to be performed, including direct deposit, check, debit card, ATM, ACH debits and credits, and internet banking and bill payment transactions. At 9/30/10, the above totals included $239.6 million of the Company s Green account loans, of which $211.2 million was secured by one-to four- family properties which are first trust deeds, $12.8 million was secured by commercial properties, $8.7 million was secured by second trust deed line of credit, $4.0 million was secured by land and $2.9 million was secured by multi-family properties. At 12/31/09, these totals included $237.2 million of the Company s Green account loans, of which $208.9 million was secured by one-to four-family properties, $14.3 million was secured by commercial properties, $8.7 million was secured by second trust deed line of credit, $2.8 million was secured by multi-family properties and $2.5 million was secured by land. As of September 30, 2010, unfunded commitments related to the Company s Green account loans totaled $34.9 million. The Company continuously monitors payment history and on a

semi-annual basis reevaluates the underlying collateral using a third party service provider. Based on the results of this review, and other factors, the Company may elect to reduce or eliminate the available line of credit as deemed necessary.

At September 30, 2010, the Company had a total of $198.5 million in interest-only mortgage loans and $32.3 million in loans with the potential for negative amortization. At December 31, 2009, the Company had a total of $269.1 million in interest-only mortgage loans and $33.8 million in loans with the potential for negative amortization. The Company no longer originates loans with the potential for negative amortization. The Company continues to originate interest-only loans and growth in those loans is primarily attributable to growth in the Company s Green account loan product which, by its nature, is an interest-only product. Negatively amortizing and interest-only loans pose a potentially higher credit risk because of the lack of principal amortization and potential for negative amortization which could result in a larger amount outstanding. However, management believes the risk is mitigated through the Company s loan terms and underwriting standards.

Table of Contents

Activity in the allowance for loan losses is summarized as follows:

	Nine Months Ended September 30, 2010	Six Months Ended June 30, 2010	Year Ended December 31, 2009
Balance, beginning of period	$ 13,079	$ 13,079	$ 18,286
Provision for loan losses	8,629	7,848	17,296
Total loans charged off	(4,253)	(3,264)	(22,505)
Total recoveries	105	34	2
Balance, end of period	$ 17,560	$ 17,697	$ 13,079

Charge-offs totaling $4.3 million for the nine months ending September 30, 2010 were attributed to numerous one- to four-family loans and four green account loans that were written down to current estimated fair values of the underlying collateral less estimated costs to sell. During the third quarter ended September 30, 2010, non-performing loans totaling $4.0 million were paid in full resulting in the recapture of $0.3 million in previously allocated reserves.

Impaired Loans. The following table sets forth the amount of impaired loans for which there is a related allowance for credit losses determined in accordance with ASC 310-10 and the amount of that allowance and the amount of impaired loans for which there is no allowance for credit losses, at September 30, 2010, June 30, 2010 and December 31, 2009.

	September 30, 2010			June 30, 2010			December 30, 2009		
	Loans	Reserves for Loan Losses	% of Reserves to Loans	Loans	Reserves for Loan Losses	% of Reserves to Loans	Loans	Reserves for Loan Losses	% of Reserves to Loans
Impaired Loans									
Impaired loans with reserves	$ 32,697	$ 7,108	21.74%	$ 31,811	$ 7,313	22.99%	$ 38,137	$ 6,488	17.01%
Impaired loans without reserves	17,580			21,756			12,715		
Total impaired loans	50,277	7,108	14.14%	53,567	7,313	13.65%	$ 50,852	$ 6,488	12.76%

Delinquent Loans. The following table sets forth, in thousands of dollars, our loan delinquencies by type, number, and amount at September 30, 2010, and December 31, 2009. The $10.4 million one- to four- family 60-89 day delinquent loan total is comprised primarily of four loans with principal balances in excess of $1.0 million in which the Company has specific reserves established of $0.4 million.

	Loans Delinquent For:				Total Loans Delinquent 60 days or more	
	60-89 Days		Greater than 90 days			
	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
September 30, 2010						
One- to four-family	10	$ 10,411	19	$ 9,993	29	$ 20,404
Commercial and multi-family real estate			1	1,392	1	1,392
Home equity	2	141			2	141
Real estate secured-first trust deeds (Green acct)			5	3,394	5	3,394
Real estate secured-second trust deeds (Green acct)						
Construction						
Commercial						

Land			4	10,509	4	10,509
Consumer	2	11	2	6	4	17
	14	$ 10,563	31	$ 25,294	45	$ 35,857
Delinquent loans to total gross loans		1.50%		3.59%		5.09%

Table of Contents

	Loans Delinquent For:				Total Loans Delinquent 60 days or more	
	60-89 Days		Greater than 90 days			
	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
December 31, 2009						
One- to four-family	9	$ 11,570	24	$ 18,647	33	$ 30,217
Commercial and multi-family real estate			7	5,107	7	5,107
Home equity	2	77			2	77
Real estate secured-first trust deeds (Green acct)	1	2,498	3	3,536	4	6,034
Real estate secured-second trust deeds (Green acct)						
Construction						
Commercial						
Land			1	1,400	1	1,400
Consumer	4	13	3	9	7	22
	16	$ 14,158	38	$ 28,699	54	$ 42,857
Delinquent loans to total gross loans		1.87%		3.78%		5.65%

Non-performing Assets. The table below, in thousands of dollars, sets forth the amounts and categories of non-performing assets and includes those loans on nonaccrual status, loans that have been restructured resulting in a troubled debt classification and impaired loans. The Company ceases accruing interest, and therefore classifies as nonaccrual, any loan as to which principal or interest has been in default for a period of greater than 90 days, or if repayment in full of interest or principal is not expected. Of the non-performing loan balance, thirty two loans totaling $17.1 million, net of loan loss reserve of $3.4 million, were current as of September 30, 2010 but were still considered impaired.

	September 31, 2010	June 30, 2010	December 31, 2009
Non-performing loans*:*			
One- to four-family	$ 12,143	$ 13,592	$ 20,773
Commercial and multi-family real estate	3,369	2,013	2,017
Home equity			
Real estate secured-first trust deeds (Green acct)	3,394	7,126	4,368
Real estate secured-second trust deeds (Green acct)		47	
Construction			
Commercial			
Land	6,462	6,563	1,400
Consumer	6		20
Total non-performing loans	$ 25,374	$ 29,341	$ 28,578
Troubled debt restructured loans*:*			
One- to four-family	$ 7,955	$ 7,955	$ 7,497
Commercial and Multi-family real estate	8,502	8,502	8,502
Home equity	108	108	
Real estate secured-first trust deeds (Green acct)	2,355	1,808	320
Real estate secured-second trust deeds (Green acct)			
Construction			
Commercial	39	3	
Land	5,948	5,847	5,847
Consumer	3	3	108
Total troubled debt restructured loans	$ 24,910	$ 24,226	$ 22,274
	$ 50,284	$ 53,567	$ 50,852

Total non-performing and troubled debt restructured loans			
Real estate owned, net of a valuation allowance of $2.1 million at September 30, 2010 and $700 thousand at December 31, 2009	7,790	8,342	5,680
Total non-performing assets	$ 58,074	$ 61,909	$ 56,532
Non-performing loans to total loans	7.14%	7.40%	6.70%
Non-performing assets to total assets	6.73%	7.02%	6.32%

18

Table of Contents

Total non-performing loans decreased $600 thousand to $50.3 million at September 30, 2010 compared to $50.9 million at December 31, 2009. Loan loss reserves totaling $7.1 million and $6.5 million have been established for these loans at September 30, 2010 and December 31, 2009, respectively. The Company utilizes estimated current fair values when assessing loan loss provisions for non-performing collateral dependent loans. Troubled debt restructured loans, net of loan loss reserves of $4.5 million totaled $20.4 million at September 30, 2010 and are included in the nonperforming total assets above. These loans were modified in a way that required guideline exceptions beyond the Company s normal scope. Once the borrowers perform pursuant to the modified terms for six consecutive months, the loans will be placed back on accrual status. Income is recognized when received during the six month nonaccrual period. Of the $20.4 million total troubled debt restructured loans at September 30, 2010, $15.4 million are performing in accordance with the terms of the restructuring and $1.8 million have made at least six consecutive payments under the modified terms and have been placed back on accrual status.

NOTE 8 LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Some financial instruments such as loan commitments, credit lines, letters of credit, and overdraft protection are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contact are met, and usually have expiration dates. Commitments may expire without being used. Risk of credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk was as follows at year end:

	Contract Amount			
	September 30, 2010		**December 31, 2009**	
	Fixed Rate	**Variable Rate**	**Fixed Rate**	**Variable Rate**
Financial instruments whose contract amounts represent credit risk				
Commitments to extend credit	$	$ 1,036	$	$
Unused lines of credit	6,211	43,149	5,257	48,644
Standby letters of credit	10	10	10	10

Commitments to make loans are generally made for periods of 30 days or less.

Financial instruments that potentially subject the Bank to concentrations of credit risk include interest-bearing deposit accounts in other financial institutions, and loans. At September 30, 2010 and December 31, 2009, the Bank had deposit accounts with balances totaling approximately $2.9 million and $3.9 million, respectively, in other financial institutions.

NOTE 9 PREFERRED STOCK

On November 21, 2008, as part of the United States Department of the Treasury s (the Treasury) Capital Purchase Program made available to certain financial institutions in the U.S. pursuant to the Emergency Economic Stabilization Act of 2008 (EESA), the Company and the Treasury entered into a Letter Agreement including the Securities Purchase Agreement Standard Terms Incorporated therein (the Purchase Agreement) pursuant to which the Company issued to the Treasury in exchange for aggregate consideration of $19.3 million, (i) 19,300 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $0.01 with a liquidation preference of $1,000 per share (the Series A Preferred Stock), and (ii) a warrant (the Warrant) to purchase up to 280,795 shares (the Warrant Common Stock), of the Company s common stock, par value $0.01 per share, with an exercise price of $10.31 per share.

The proceeds from the Series A Preferred Stock qualifies as Tier 1 capital to the extent that the proceeds are infused into the Bank, and pays cumulative cash dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter.

Table of Contents

The Series A Preferred Stock is non-voting, other than class voting rights on certain matters that could adversely affect the Series A Preferred Stock. The Series A Preferred Stock may be redeemed by the Company at par at any time, subject to Treasury consulting with our primary federal regulator, the OTS. Subject to certain limited exceptions, until November 21, 2011, or such earlier time as all Series A Preferred Stock has been redeemed or transferred by Treasury, the Company will not, without Treasury s consent, be able to increase its dividend rate per share of common stock or repurchase its common stock.

The Warrant is immediately exercisable and has a 10-year term. The Treasury will not exercise voting power with respect to any shares of Warrant Common Stock. Upon receipt of the aggregate consideration from the Treasury on November 21, 2008, the Company allocated $19.3 million proceeds on a pro rata basis to the Series A Preferred Stock and the Warrant based on relative fair values. In estimating the fair value of the Warrant, the Company utilized the Black-Scholes model which includes assumptions regarding the Company s common stock prices, stock price volatility, dividend yield, the risk free interest rate and the estimated life of the Warrant. The fair value of the Series A Preferred Stock was determined using a discounted cash flow methodology and a discount rate of 13.0%. As a result, the Company assigned $193 thousand of the aggregate proceeds to the Warrant and $19.1 million to the Series A Preferred Stock. The value assigned to the Series A Preferred Stock will be amortized up to the $19.3 million liquidation value of the Series A Preferred Stock, with the cost of such amortization being reported as additional preferred stock dividends. This results in a total dividend with a consistent effective yield of 8.41% over a five year period, which is the expected life of the Series A Preferred Stock.

In addition, the Purchase Agreement (i) grants the holders of the Series A Preferred Stock, the Warrant and the Warrant Common Stock certain registration rights, (ii) subjects the Company to certain of the executive compensation limitations included in the EESA and (iii) allows the Treasury to unilaterally amend any of the terms of the Purchase Agreement to the extent required to comply with any changes in applicable federal statutes.

On December 19, 2008, the Company filed a registration statement with the Securities and Exchange Commission (the Commission) for the purpose of registering the Warrant and the Warrant Common Stock in order to permit the sale of such securities by the U.S. Treasury at any time after effectiveness of the registration statement. On February 3, 2009, the registration statement was deemed effective by the Commission.

The Purchase Agreement also subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (the EESA). In this connection, as a condition to the closing of the transaction, the Company s Senior Executive Officers (as defined in the Purchase Agreement) (the Senior Executive Officers), (i), voluntarily waived any claim against the U.S. Treasury or the Company for any changes to such officer s compensation or benefits that are required to comply with the regulation issued by the U.S. Treasury under the TARP Capital Purchase Program and acknowledged that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements as they relate to the period the U.S. Treasury owns the Preferred Stock of the Company; and (ii) entered into a letter with the Company amending the Benefits Plans with respect to such Senior Executive Officers as may be necessary, during the period that the Treasury owns the Preferred Stock of the Company, as necessary to comply with Section 111(b) of the EESA.

NOTE 10 INCOME TAXES

The Company accounts for income taxes by recognizing deferred tax assets and liabilities based upon temporary differences between the financial reporting and tax basis of its assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets when it is more-likely-than-not that a portion or all of the deferred tax assets will not be realized. During the second quarter of 2010, the Company reviewed its analysis of whether a valuation allowance should be recorded against its deferred tax assets. Accounting literature states that a deferred tax asset should be reduced by a valuation allowance if, based on the weight of all available evidence, it is more likely than not (a likelihood of more than 50%) that some portion or the entire deferred tax asset will not be realized. The determination of whether a deferred tax asset is realizable is based on weighting all available evidence, including both positive and negative evidence. In making such judgments, significant weight is given to evidence that can be objectively verified. Although realization is not assured, the Company believes that the realization of the recognized net deferred tax asset at September 30, 2010 is more likely than not based upon available tax planning strategies and expectations as to future taxable income. At September 30, 2010, the Company had a net deferred tax asset of $4.8 million.

NOTE 11 SUBSEQUENT EVENTS

As previously reported by the Company, on July 27, 2010, the Company entered into subscription agreements to sell $60.0 million of common stock to a group of institutional and accredited investors through a private placement. Completion of the sale is subject to approval by the stockholders of the Company and is expected to close in the fourth quarter of 2010.

20

Table of Contents

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion compares the financial condition of First PacTrust Bancorp, Inc. (the Company), at September 30, 2010, to its financial condition at December 31, 2009, and the results of operations for the three months and nine months ended September 30, 2010 to the same periods in 2009. This discussion should be read in conjunction with the interim financial statements and footnotes included herein.

The Company is a community-oriented financial institution deriving substantially all of its revenue from providing banking services to individuals within its market area, primarily San Diego County and portions of Riverside County, CA. The Company s assets consist primarily of loans and investment securities, which are funded by deposits, borrowings and capital. The primary source of revenue is net interest income, the difference between interest income on loans and investments, and interest expense on deposits and borrowed funds. The Company s basic strategy is to maintain and grow net interest income by the retention of its existing customer base and the expansion of its core businesses and branch offices within its current market and surrounding areas. The Company s primary market risk exposure is interest rate risk and credit risk.

Comparison of Financial Condition at September 30, 2010 and December 31, 2009

Assets. The Company s total assets decreased by $31.2 million, or 3.5%, to $862.7 million at September 30, 2010 from $893.9 million at December 31, 2009 primarily as a result of a decline in the loans receivable balance of $59.2 million. The decrease in total assets was partially reduced by an increase in the balance of the available-for-sale securities portfolio in the amount of $18.9 million, an increase in total cash and cash equivalents of $5.3 million, and an increase in OREO of $2.1 million.

Loans. Loans receivable, net of valuation allowances, decreased by $59.2 million, or 7.9%, to $689.1 million at September 30, 2010 from $748.3 million at December 31, 2009. This decrease was the result of net loan principal repayments, charge-offs and foreclosures exceeding loan production during the nine months ended September 30, 2010. For the nine month period ended September 30, 2010 loan originations and advances on the Company s Green account loans totaled $59.0 million compared to $68.7 million for the nine month period ended September 30, 2009. The loan production was primarily attributable to growth in the Company s Green account loan product. Loan demand in general was down due to current economic circumstances and the slowdown of sales of higher-end properties which is the market focus of the Company.

Investments. Securities classified as available-for-sale of $71.2 million at September 30, 2010 increased $18.9 million from December 31, 2009 due to the purchase of $29.1 million of private label mortgage-backed securities during the period.

Cash and cash equivalents. Cash and cash equivalents increased $5.3 million, or 15.4%, to $39.9 million at September 30, 2010 from $34.6 million at December 31, 2009 primarily due to increased deposit activity and the reduction of loan origination activity.

Allowance for Loan Losses. The allowance for loan losses at September 30, 2010 was $17.6 million, which represented 2.5% of the loans outstanding at September 30, 2010, as compared to $13.1 million, or 1.7%, of the loans outstanding at December 31, 2009. Of these allowances, $7.1 million are allocated to non-performing loans and loans subject to troubled debt restructurings with $10.5 million serving as a general reserve for probable loan loss. The increase in the percentage of allowance to loans outstanding was due to increased general reserves and reserves on problem loans during the nine month period ended September 30, 2010.

The Company maintains an allowance for loan losses to absorb probable incurred losses presently inherent in the loan portfolio. The allowance is based on ongoing assessments of the estimated probable losses presently inherent in the loan portfolio. In evaluating the level of the allowance for loan losses, management considers the types of loans and the amount of loans in the loan portfolio, peer group information, historical loss experience, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. The Company currently uses a rolling 12 month history of actual losses incurred, adjusted for current economic conditions and other qualitative factors, combined with a current loan to value analysis to analyze the associated risks in the current loan portfolio. The Company evaluates all impaired loans individually, primarily through the evaluation of collateral values and cash flows.

Management assesses the allowance for loan losses monthly. While management uses available information to recognize losses on loans; future loan loss provisions may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, review the allowance for loan losses and may require the Bank to recognize additional provisions based on their judgment of information available to them at the time of their examination. The allowance for loan losses as of September 30, 2010 was maintained at a level that represented management s best estimate of incurred losses in the loan portfolio to the extent they were both probable and reasonably estimable. See further discussion in subsection entitled Comparison of Operating Results-Provision for Loan Losses.

Table of Contents

Real estate owned assets. At September 30, 2010, OREO acquired in settlement of loans totaled $7.8 million, net of a valuation allowance of $2.1 million, compared to $8.3 million at June 30, 2010 and $5.7 million at December 31, 2009 based on the fair value of the collateral less estimated costs to sell, and consisted of one participation construction property carried at 36% of the original loan balance and five one- to four-family properties. Each of the one- to four- family properties are carried at 90% of the most recent appraised value.

Deposits. Total deposits increased by $26.4 million, or 4.0%, to $684.8 million at September 30, 2010 from $658.4 million at December 31, 2009. Certificates of deposit increased $11.4 million or 2.9% to $408.6 million, money market accounts increased $7.1 million or 8.7% to $88.9 million, savings accounts increased $4.7 million or 3.9% to $126.2 million and checking accounts increased $1.6 million or 3.6% to $45.5 million due to competitive rates offered by the Bank, sales initiatives and ongoing benefits resulting from dislocations in the market.

FHLB Advances. During the period the Company had $60.0 million of long term advances mature resulting in a 44.4% decrease to $75.0 million at September 30, 2010 from $135.0 million at December 31, 2009. The remaining advances bear an average rate of 3.02% of which $55.0 million will mature at various points throughout 2011.

Equity. Equity increased $1.4 million, or 1.4% to $98.9 million at September 30, 2010 from $97.5 million at December 31, 2009. The net increase was primarily due to the total net operating income of $1.4 million, increased unrealized net gains in securities of $1.0 million and ESOP shares earned of $262 thousand. Equity was reduced by the payment of preferred stock dividends in the amount of $724 thousand and the payment of common stock dividends in the amount of $624 thousand.

Comparison of Operating Results for the Three Months Ended September 30, 2010 and 2009

General. Net income for the three months ended September 30, 2010 was $3.0 million, reflecting a $1.5 million increase over the same period of the prior year. The increase resulted from the fluctuations described below.

Interest Income. Interest income decreased by $877 thousand, or 7.6%, to $10.6 million for the three months ended September 30, 2010, from $11.5 million for the three months ended September 30, 2009 as described below.

Interest income on loans decreased $1.0 million, or 10.3% to $9.2 million for the three months ended September 30, 2010 from $10.2 million for the three months ended September 30, 2009. The primary factor for the decrease was a $77.8 million decrease in the average balance of loans receivable from $774.7 million for the three months ended September 30, 2009 to $696.8 million for the three months ended September 30, 2010. This was due to principal repayments, loan charge-offs, and foreclosures exceeding loan production. A $3.0 million increase in the average balance of non-accrual loans on which the Company ceased to accrue interest during the three month period ending September 30, 2010, also contributed to a decline in loan interest income. For the quarter ended September 30, 2010, loans totaling $6.3 million which had been previously listed as non-accrual were either paid off or brought back to accrual status, resulting in the realization of interest income totaling $385 thousand. The realization of this added interest income had the effect of increasing the Average Yield on Loans Receivable from 5.03% to 5.26%, while also increasing the average yield on interest earning assets from 5.19% to 5.40% all for the period ending September 30, 2010.

Average Balances, Net Interest Income, Yields Earned and Rates Paid

The following tables presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. Also presented is the weighted average yield on interest-earning assets, rates paid on interest-bearing liabilities and the resultant spread for the three months September 30, 2010 and September 30, 2009 and the three months ended June 30, 2010 and June 30, 2009. No tax equivalent adjustments were made. All average balances are monthly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield.

	Three Months Ended September 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
INTEREST-EARNING ASSETS						
Loans receivable(1)	$ 696,844	9,164	5.26%	$ 774,675	10,212	5.27%
Securities(2)	67,183	1,410	8.39%	44,937	1,278	11.38%
Other interest-earning assets(3)	24,443	64	1.05%	22,034	25	0.45%
Total interest-earning assets	788,470	10,638	5.40%	841,646	11,515	5.48%
Non-interest earning assets(4)	80,564			50,718		
Total assets	$ 869,034			$ 892,364		
INTEREST-BEARING LIABILITIES						
NOW	$ 57,840	24	0.17%	$ 54,399	52	0.38%
Money market	88,925	138	0.62%	72,944	197	1.08%
Savings	127,782	186	0.58%	126,483	382	1.21%
Certificates of deposit	409,440	1,559	1.52%	380,184	2,405	2.53%
FHLB advances	81,250	592	2.91%	154,050	1,212	3.15%
Total interest-bearing liabilities	765,237	2,499	1.32%	788,060	4,248	2.16%
Non-interest-bearing liabilities	5,950			7,803		
Total liabilities	771,187			795,863		
Equity	97,847			96,501		
Total liabilities and equity	$ 869,034			$ 892,364		
Net interest/spread		$ 8,139	4.08%		$ 7,267	3.32%
Margin(5)			4.13%			3.45%
Ratio of interest-earning assets to interest-bearing liabilities	103.04%			106.80%		

(1) Calculated net of deferred fees and loss reserves.
(2) Calculated based on amortized cost.
(3) Includes FHLB stock at cost and term deposits with other financial institutions.
(4) Includes BOLI investment of $18.1 million.
(5) Net interest income divided by interest-earning assets.

	Three Months Ended June 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
INTEREST-EARNING ASSETS						
Loans receivable(1)	$ 719,032	8,638	4.81%	$ 788,861	10,964	5.56%
Securities(2)	66,641	1,287	7.72%	41,829	1,098	10.50%
Other interest-earning assets(3)	43,514	65	0.60%	16,215	32	0.79%

Total interest-earning assets	829,187	9,990	4.80%	846,905	12,094	5.72%
Non-interest earning assets(4)	64,903			51,069		
Total assets	$ 894,090			$ 897,974		
INTEREST-BEARING LIABILITIES						
NOW	$ 57,403	31	0.22%	$ 54,679	54	0.40%
Money market	86,638	171	0.79%	73,151	212	1.16%
Savings	125,922	245	0.78%	115,102	400	1.39%
Certificates of deposit	415,776	1,713	1.65%	385,601	2,778	2.88%
FHLB advances	105,000	805	3.07%	167,449	1,372	3.28%
Total interest-bearing liabilities	790,739	2,965	1.48%	795,982	4,816	2.44%
Non-interest-bearing liabilities	5,183			5,901		
Total liabilities	795,922			801,883		
Equity	98,168			96,091		
Total liabilities and equity	$ 894,090			$ 897,974		
Net interest/spread		$ 7,025	3.32%		$ 7,278	3.28%
Margin(5)			3.39%			3.44%
Ratio of interest-earning assets to interest-bearing liabilities	104.86%			106.40%		

(1) Calculated net of deferred fees and loss reserves.
(2) Calculated based on amortized cost.
(3) Includes FHLB stock at cost and term deposits with other financial institutions.
(4) Includes BOLI investment of $18.0 million.
(5) Net interest income divided by interest-earning assets.

Table of Contents

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume, which are changes in volume multiplied by the old rate, and (2) changes in rate, which are changes in rate multiplied by the old volume. Changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Three Months Ended September 30, 2010 compared to September 30, 2009		
	Total Change	Change Due To Volume (In thousands)	Change Due To Rate
Income from interest earning assets:			
Loans, gross	$ (1,048)	$ (4,094)	$ 3,046
Securities	132	2,097	(1,965)
Interest-bearing deposits in other financial institutions	39	10	29
Total interest income from interest earning assets	(877)	(1,987)	1,110
Expense on interest bearing liabilities:			
Now	$ (28)	$ 12	$ (40)
Savings	(196)	16	(212)
Money market	(59)	148	(207)
Certificate of Deposit	(846)	693	(1,539)
FHLB Advances	(620)	(2,145)	(1,525
Total interest expense on interest-bearing liabilities	(1,749)	(1,276)	(473)
Net interest income	$ 872	$ (711)	$ 1,583

Interest income on securities increased $132 thousand to $1.4 million for the three months ended September 30, 2010 from $1.3 million for the three months ended September 30, 2009. This increase was due to the purchase of private label mortgage-backed securities during the three month period ending September 30, 2010 totaling $6.3 million.

Interest Expense. Interest expense decreased $1.7 million or 41.2%, to $2.5 million for the three months ended September 30, 2010 from $4.3 million for the three months ended September 30, 2009. Interest expense on deposits decreased $1.1 million, or 37.2%, to $1.9 million for the three months ended September 30, 2010 from $3.0 million for the three months ended September 30, 2009. Although the average balance of deposits increased $50.0 million from $634.0 million for the three months ended September 30, 2009 to $684.0 million for the three months ended September 30, 2010, the Company s cost of deposit decreased 80 basis points to 1.12% from 1.92% from the prior period. This decline in the Company s cost of funds reflects the overall decrease in short term market interest rates as a result of the continued stress in the credit markets.

Table of Contents

Interest expense on Federal Home Loan Bank advances decreased $620 thousand, or 51.2% to $592 thousand for the period ended September 30, 2010 from $1.2 million for the three months ended September 30, 2009. This decrease was due to a reduction in the average balance of advances, as well as a reduction in the average rate paid. The average balance of the Federal Home Loan Bank advances decreased $72.8 million from $154.1 million for the three months ended September 30, 2009 to $81.3 million for the three months ended September 30, 2010 due to the maturity of Federal Home Loan Bank advances during the period. Rates paid on advances also decreased by an average of 23 basis points due to the maturity of higher rate advances.

Net Interest Income. As a result of the combined effect of the factors mentioned above, net interest income before the provision for loan losses increased $872 thousand, or 12.0%, to $8.1 million for the three months ended September 30, 2010 from $7.3 million for the three months ended September 30, 2009. Due to the substantial decline in the Company s cost of funds as a result of the decrease in short term market interest rates, the Company s margins have increased over the prior period with the net interest spread increasing 76 basis points to 4.08%, and the net interest margin increasing 68 basis points to 4.13%.

Provision for Loan Losses. Management assesses the allowance for loan losses on a monthly basis. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral adjusted for estimated selling costs, bank regulatory guidelines, declining property values and prevailing economic conditions. The Company currently uses a rolling 12 month history of actual losses incurred, adjusted for current economic conditions and other qualitative factors, combined with a current loan to value analysis to analyze the associated risks in the current loan portfolio. Management uses available information to recognize loan losses, however, future loan loss provisions may be necessary based on changes in the above mentioned factors. In addition, regulatory agencies, as an integral part of their examination process, review the allowance for loan losses and may require the Bank to recognize additional provisions based on their judgment of information available to them at the time of their examination. The allowance for loan losses as of September 30, 2010 was maintained at a level that represented management s best estimate of incurred losses in the loan portfolio to the extent they were both probable and reasonably estimable. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events change.

Provisions for loan losses are charged to operations at a level required to reflect probable incurred credit losses in the loan portfolio. In this regard, approximately 95% of the Company s loans are to individuals and businesses in southern California. California, in general, and more specifically, San Diego and Riverside Counties, have been among the most distressed real estate markets in the country. A provision for loan losses of $781 thousand was recorded for the three months ended September 30, 2010 compared to a $2.7 million provision for loan losses recorded for the three months ended September 30, 2009. The decrease in the provision was related primarily to the reduction of the non-performing loans and decreased loan balances at September 30, 2010. Non-performing loans decreased $3.3 million and totaled $50.3 million as of September 30, 2010, compared to $53.6 million at June 30, 2010 and $50.9 million at December 31, 2009. Net charge-offs totaled $917 thousand for the current quarter compared to $6.1 million in the prior year s quarter.

Noninterest Income. Noninterest income slightly increased to $454 thousand for the three months ended September 30, 2010 compared to $452 thousand for the same period of the prior year.

Noninterest Expense. Noninterest expense increased $402 thousand, or 11.7%, to $3.8 million for the three months ended September 30, 2010 compared to $3.4 million for the same period of the prior year. This increase was primarily the result of a $386 thousand increase in the valuation allowance for other OREO, a $130 thousand increase in loan servicing and foreclosure expenses and a $110 thousand increase in professional fees. Additionally, noninterest expense was reduced by a gain on sale of other real estate owned asset totaling $259 thousand and a $57 thousand decrease in occupancy and equipment expenses.

An additional valuation allowance of $386 thousand was recorded for OREO for the three months ended September 30, 2010. OREO is recorded at the lower of cost or fair value less estimated costs to sell at the time of foreclosure, however, one property is based on an updated internal analysis done by management as an appraisal has been ordered for this property but has not been received.

Loan servicing and foreclosure expenses increased $130 thousand to $150 thousand for the three months ended September 30, 2010 from $20 thousand for the three months ended September 30, 2009 primarily due to an increase in OREO activity.

Total professional fees increased $110 thousand for the three months ended September 30, 2010 from $128 thousand for the same period in 2009 due to increased consulting fees related to the hiring of a consultant to assist with the planned private placement.

For the three months ended September 30, 2010, the Company recorded a $259 thousand gain on the sale of three properties.

Table of Contents

The occupancy and equipment expenses decreased $57 thousand to $437 thousand for the three months ended September 30, 2010 from $494 thousand for the three months ended September 30, 2009 primarily due to decreased equipment maintenance expenses for the period ending September 30, 2010.

Income Tax Expense/(Benefit). An income tax expense of $934 thousand was recorded for the three months ended September 30, 2010 compared to income tax expense of $71 thousand for the three months ended September 30, 2009. The effective tax rate for the current period was based on projected net income for the year under the guidelines of ASC 740.

Comparison of Operating Results for the Nine Months Ended September 30, 2010 and 2009

General. Net income for the nine months ended September 30, 2010 was $1.4 million, reflecting a $1.8 million increase in net income over the same period of the prior year. The increase resulted from the fluctuations described below.

Interest Income. Interest income decreased by $4.5 million, or 12.7%, to $31.1 million for the nine months ended September 30, 2010, from $35.7 million for the nine months ended September 30, 2009 as described below.

Interest income on loans decreased $5.5 million, or 17.0% to $27.0 million for the nine months ended September 30, 2010 from $32.5 million for the nine months ended September 30, 2009. The primary factor for the decrease was a $69.4 million decrease in the average balance of loans receivable from $787.0 million for the nine months ended September 30, 2009 to $717.6 million for the nine months ended September 30, 2010. This was due to principal repayments, loan charge-offs, and foreclosures exceeding loan production. The decrease in interest income on loans receivable was further impacted by a 50 basis point reduction in the average yield on loans receivable to 5.0% due to a general decline in market interest rates from the prior period. A $4.6 million increase in the average balance of non-accrual loans on which the Company ceased to accrue interest during the nine month period ending September 30, 2010, also contributed to a decline in loan interest income.

Average Balances, Net Interest Income, Yields Earned and Rates Paid

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. Also presented is the weighted average yield on interest-earning assets, rates paid on interest-bearing liabilities and the resultant spread for the nine months ended September 30, 2010 and September 30, 2009 and six months ended June 30, 2010 and June 30 2009. No tax equivalent adjustments were made. All average balances are monthly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield.

	Nine Months Ended September 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
INTEREST-EARNING ASSETS						
Loans receivable(1)	$ 717,574	26,967	5.01%	$ 786,954	32,507	5.51%
Securities(2)	62,336	4,026	8.61%	37,959	3,093	10.86%
Other interest-earning assets(3)	33,240	153	0.61%	20,940	73	0.46%
Total interest-earning assets	813,150	31,146	5.11%	845,853	35,673	5.63%
Non-interest earning assets(4)	70,645			48,705		
Total assets	$ 883,795			$ 894,558		
INTEREST-BEARING LIABILITIES						
NOW	$ 56,910	87	0.20%	$ 54,504	160	0.39%
Money market	86,837	482	0.74%	76,159	634	1.11%

Savings	125,057	673	0.72%	114,572	1,141	1.33%
Certificates of deposit	409,639	5,116	1.67%	381,715	8,266	2.89%
FHLB advances	101,500	2,285	3.00%	163,549	4,033	3.29%
Total interest-bearing liabilities	779,943	8,643	1.48%	790,499	14,234	2.40%
Non-interest-bearing liabilities	5,688			6,751		
Total liabilities	785,631			797,250		
Equity	98,164			97,308		
Total liabilities and equity	$ 883,795			$ 894,558		
Net interest/spread		$ 22,503	3.63%		$ 21,439	3.23%
Margin(5)			3.69%			3.38%
Ratio of interest-earning assets to interest-bearing liabilities	104.26%			107.00%		

(1) Calculated net of deferred fees and loss reserves.
(2) Calculated based on amortized cost.
(3) Includes FHLB stock at cost and term deposits with other financial institutions.
(4) Includes BOLI investment of $18.1 million.
(5) Net interest income divided by interest-earning assets.

Table of Contents

	Six Months Ended June 30, 2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
INTEREST-EARNING ASSETS						
Loans receivable(1)	$ 728,017	17,803	4.89%	$ 793,199	22,295	5.62%
Securities(2)	60,021	2,616	8.72%	34,794	1,815	10.43%
Other interest-earning assets(3)	39,506	89	0.45%	19,725	48	0.49%
Total interest-earning assets	827,544	20,508	4.96%	847,718	24,158	5.70%
Non-interest earning assets(4)	64,356			47,962		
Total assets	$ 891,900			$ 895,680		
INTEREST-BEARING LIABILITIES						
NOW	$ 56,327	63	0.22%	$ 54,448	108	0.40%
Money market	85,635	343	0.80%	76,842	437	1.14%
Savings	123,949	487	0.79%	108,750	759	1.40%
Certificates of deposit	409,660	3,558	1.74%	382,455	5,861	3.06%
FHLB advances	112,857	1,693	3.00%	169,256	2,821	3.33%
Total interest-bearing liabilities	788,428	6,144	1.56%	791,750	9,986	2.52%
Non-interest-bearing liabilities	5,376			6,399		
Total liabilities	793,804			798,149		
Equity	98,096			97,531		
Total liabilities and equity	$ 891,900			$ 895,680		
Net interest/spread		$ 14,364	3.40%		$ 14,172	3.18%
Margin(5)			3.47%			3.34%
Ratio of interest-earning assets to interest-bearing liabilities	104.96%			107.07%		

(1) Calculated net of deferred fees and loss reserves.
(2) Calculated based on amortized cost.
(3) Includes FHLB stock at cost and term deposits with other financial institutions.
(4) Includes BOLI investment of $18.0 million.
(5) Net interest income divided by interest-earning assets.

Table of Contents

Interest income on securities increased $933 thousand to $4.0 million for the nine months ended September 30, 2010 from $3.1 million for the nine months ended September 30, 2009. This increase was due to the purchase of private label mortgage-backed securities during the nine month period ending September 30, 2010 totaling $29.1 million.

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume, which are changes in volume multiplied by the old rate, and (2) changes in rate, which are changes in rate multiplied by the old volume. Changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Nine Months Ended September 30, 2010 compared to September 30, 2009		
	Total Change	Change Due To Volume (In thousands)	Change Due To Rate
Income from interest earning assets:			
Loans, gross	$ (5,540)	$ (3,652)	$ (1,888)
Securities	933	2,233	(1,300)
Interest-bearing deposits in other financial institutions	80	68	12
Total interest income from interest earning assets	(4,527)	(1,351)	(3,176)
Expense on interest bearing liabilities:			
Now	$ (73)	$ 9	$ (82)
Savings	(468)	129	(597)
Money market	(152)	107	(259)
Certificate of Deposit	(3,150)	757	(3,907)
FHLB Advances	(1,748)	(1,879)	131
Total interest expense on interest-bearing liabilities	(5,591)	(877)	(4,714)
Net interest income	$ 1,064	$ (474)	$ 1,538

Interest Expense. Interest expense decreased $5.6 million or 39.3%, to $8.6 million for the nine months ended September 30, 2010 from $14.2 million for the nine months ended September 30, 2009. Interest expense on deposits decreased $3.8 million, or 37.7%, to $6.4 million for the nine months ended September 30, 2010 from $10.2 million for the nine months ended September 30, 2009. Although the average balance of deposits increased $51.5 million from $626.9 million for the nine months ended September 30, 2009 to $678.4 million for the nine months ended September 30, 2010, the Company s overall cost of deposits decreased 92 basis point to 1.25% from 2.17% from the prior period. This decline in the Company s cost of funds reflected the overall decrease in short term market interest rates as a result of the continued stress in the credit markets.

Interest expense on Federal Home Loan Bank advances decreased $1.7 million, or 43.3% to $2.3 million for the period ended September 30, 2010 from $4.0 million for the period ending September 30, 2009. This decrease was due to a reduction in the average balance of advances, as well as a reduction in the average rate paid. The average balance of Federal Home Loan Bank advances decreased $62.0 million from $163.5 million for the nine months ended September 30, 2009 to $101.5 million for the nine months ended September 30, 2010 due to the maturity of Federal Home Loan Bank advances and growth of deposits during the period. Rates paid on advances also decreased by an average of 29 basis points due to the maturity of higher rate advances.

Net Interest Income. As a result of the combined effect of the factors mentioned above, net interest income before the provision for loan losses increased $1.1 million, or 5.0%, to $22.5 million for the nine months ended September 30, 2010 from $21.4 million for the nine months ended

September 30, 2009. Due to the substantial decline in the Company s cost of funds as a result of the decrease in short term market interest rates, the Company s margins increased over the prior period with the net interest spread increasing 40 basis points to 3.63%, and the net interest margin increasing 31 basis points to 3.69%.

Provision for Loan Losses. Management assesses the allowance for loan losses on a monthly basis. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, peer group information, bank regulatory guidelines, declining property values and prevailing economic conditions. The Company currently uses a

Table of Contents

rolling 12 month history of actual losses incurred, adjusted for current economic conditions and other qualitative factors, combined with a current loan to value analysis to analyze the associated risks in the current loan portfolio. Management uses available information to recognize loan losses, however, future loan loss provisions may be necessary based on changes in the above mentioned factors. In addition, regulatory agencies, as an integral part of their examination process, review the allowance for loan losses and may require the Bank to recognize additional provisions based on their judgment of information available to them at the time of their examination. The allowance for loan losses as of September 30, 2010 was maintained at a level that represented management s best estimate of incurred losses in the loan portfolio to the extent they were both probable and reasonably estimable. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events change.

California, in general, and more specifically, San Diego and Riverside Counties, have been among the most distressed real estate markets in the country. A provision for loan losses of $8.6 million was recorded for the nine months ended September 30, 2010 compared to a $12.4 million provision for loan losses recorded for the nine months ended September 30, 2009. The decline in the provision was related primarily to large provisions taken for two impaired construction loans in the prior year s period. Continued elevated provision levels reflect the deteriorated housing markets, continued high levels of unemployment, the overall challenging economic environment, and the resulting increase in the Company s general reserve factors on all loan products during the period. Year-to-date net charge-offs declined $15.4 million, or 79.0% to $4.1 million from $19.5 million at September 30, 2009. The current year net charge-offs consisted primarily of twenty eight one-to four- family loans and seven Green account loan totaling $4.1 million.

Noninterest Income. Noninterest income decreased $160 thousand, or 11.9%, to $1.2 million for the nine months ended September 30, 2010 compared to $1.3 million for the same period of the prior year primarily due to decreased performance of the bank owned life insurance investment as a result of current market conditions as well as a decrease in various customer service fees.

Noninterest Expense. Noninterest expense increased $1.8 million, or 15.9%, to $13.0 million for the nine months ended September 30, 2010 compared to $11.2 million for the same period of the prior year. This increase was primarily the result of a $1.4 million increase in the valuation allowance for OREO, a $341 thousand increase in loan servicing and foreclosure expenses, a $120 thousand increase in professional fees, and a $107 thousand increase in data processing expenses. Additionally, salaries and employee benefit expenses decreased $102 thousand and total occupancy and equipments expenses decreased $88 thousand.

An additional valuation allowance of $1.4 million was recorded for the nine months ended September 30, 2010. OREO is recorded at the lower of cost or fair value less estimated costs to sell at the time of foreclosure, however, one property valuation is based on an updated internal analysis done by management as an appraisal has been ordered for this property but has not been received.

Loan servicing and foreclosure expenses increased $341 thousand to $916 thousand for the nine months ended September 30, 2010 from $575 thousand for the nine months ended September 30, 2009 primarily due to an increase in OREO activity and increased non-performing loans.

Professional fees increased $120 thousand for the nine months ended September 30, 2010 from $427 thousand for the nine months ended September 30, 2009 due to increased consulting fees related to the hiring of a consultant to assist with the planned private placement.

Data processing expenses increased $107 thousand to $858 thousand for the nine months ended September 30, 2010 from $751 thousand for the nine months ended September 30, 2009 primarily due to increased software maintenance expense for the period.

Salaries and employee benefits represented 36.7% and 44.6% of total noninterest expense for the nine months ended September 30, 2010 and September 30, 2009, respectively. Total salaries and employee benefits decreased $102 thousand, or 2.0%, to $4.9 million for the nine months ended September 30, 2010 from $5.0 million for the same period in 2009 primarily due to a reduction of bonus expense accrual for the current period and due to lower stock award and option expenses as a result of a majority of the awards fully vesting by the end of 2009.

Occupancy and equipment expenses decreased $88 thousand to $1.4 million for the nine months ended September 30, 2010 from $1.5 million for the same period in 2009 primarily due to decreased equipment maintenance expense for the period ending September 30, 2010.

Income Tax Expense/(Benefit). An income tax expense of $580 thousand was recorded for the nine months ended September 30, 2010 compared to income tax benefit of $452 thousand for the nine months ended September 30, 2009. The effective tax rate for the current period was based on projected net income for the year under the guidelines of ASC 740.

Liquidity and Commitments

The Bank is required to have enough liquid assets in order to maintain sufficient liquidity to ensure a safe and sound operation. Liquidity may increase or decrease depending upon availability of funds and comparative yields on investments in relation to the return on loans. Historically, the Bank has maintained liquid assets above levels believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. Cash flow projections are regularly reviewed and updated to ensure that adequate liquidity is maintained.

The Bank s liquidity, represented by cash and cash equivalents, is a product of its operating, investing, and financing activities. The Bank s primary sources of funds are deposits, payments and maturities of outstanding loans and investment securities; and other short-term investments and funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions, and competition. In addition, the Bank invests excess funds in interest-earning assets, which provide liquidity to meet lending requirements. The Bank also generates cash through borrowings. The Bank utilizes Federal Home Loan Bank advances to leverage its capital base, to provide funds for its lending activities, as a source of liquidity, and to enhance its interest rate risk management. The Bank also has the ability to obtain brokered certificates of deposit, however, historically has not issued significant amounts. The Bank had no brokered certificates of deposit at September 30, 2010, and has limited future brokered deposit activity to $20.0 million.

Liquidity management is both a daily and long-term function of business management. Any excess liquidity would be invested in federal funds or authorized investments such as mortgage-backed or U.S. Agency securities. On a longer-term basis, the Bank maintains a strategy of investing in various lending products. The Bank uses its sources of funds primarily to meet its ongoing commitments, to pay maturing certificates of deposit and savings withdrawals, to fund loan commitments, and to maintain its portfolio of mortgage-backed securities and investment securities. At September 30, 2010, there were $1.0 million outstanding approved loan origination commitments. At the same date, unused lines of credit were $49.4 million and outstanding letters of credit totaled $20 thousand. One government agency security is schedule to mature in one year or less with a book value of $5.1 million at September 30, 2010. Certificates of deposit scheduled to mature in one year or less at September 30, 2010, totaled $309.6 million. Based on the competitive rates offered and on historical experience, management believes that a significant portion of maturing deposits will remain with the Bank. In addition, the Bank had the ability at September 30, 2010 to borrow an additional $101.1 million from the Federal Home Loan Bank of San Francisco, $87.6 million at the Federal Reserve Bank as well as $8.0 million from Pacific Coast Bankers Bank as additional funding sources to meet commitments and for liquidity purposes. The Bank has Federal Home Loan Bank advances of $55.0 million maturing within the next 12 months. The Bank intends to replace these advances with deposits and new borrowings from the Federal Home Loan Bank or the Federal Reserve Bank, depending on market conditions.

Capital

Consistent with its goals to operate a sound and profitable financial organization, the Bank actively seeks to be a well capitalized institution in accordance with regulatory standards. Total equity of the Bank was $87.7 million at September 30, 2010, or 10.2% of total assets on that date. As of September 30, 2010, the Bank exceeded all capital requirements of the Office of Thrift Supervision and is deemed well-capitalized. The regulatory capital requirements to be considered well capitalized are 5.0%, 6.0%, and 10.0%, respectively. The Bank has committed to maintaining core and risk-based capital ratios of 8.0% and 12.0%, respectively, while the Bank is facing adverse market conditions.

The following table sets forth the Company s capital components:

	September 30, 2010	September 30, 2009	December 31. 2009
Capital components			
Tier 1 Capital	$ 84,114	$ 82,865	$ 81,824
Tier 2 Capital	$ 8,149	$ 6,201	$ 6,591
Total risk-based capital	$ 92,263	$ 89,066	$ 88,415
Risk-weighted assets	$ 651,918	$ 678,362	$ 674,235
Average assets (regulatory purposes)	$ 867,529	$ 891,793	$ 898,728

Table of Contents

				Minimum Regulatory Requirements
Capital ratios				
Total core capital	9.80%	9.27%	9.18%	4.00%
Tier 1 risk-based capital	12.90%	12.22%	12.14%	4.00%
Total risk-based capital	14.15%	13.13%	13.11%	8.00%

Impact of Inflation

The unaudited consolidated financial statements presented herein have been prepared in accordance with U. S. generally accepted accounting principles. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

The Company s primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Company s performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the liquidity and maturities structures of the Company s assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation, as distinct from levels of interest rates, on earnings is in the area of noninterest expense. Such expense items as employee compensation, employee benefits, and occupancy and equipment costs may be subject to increases as a result of inflation. An additional effect of inflation is the possible increase in the dollar value of the collateral securing loans that the Company has made. The Company is unable to determine the extent, if any, to which properties securing our loans have appreciated in dollar value due to inflation.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Bank s interest rate sensitivity is monitored by management through the use of a model that estimates the change in net portfolio value (NPV) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities, and off-balance-sheet contracts. An NPV Ratio, in any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The Sensitivity Measure is the decline in the NPV Ratio, in basis points, caused by a 2% increase or decrease in rates, whichever produces a larger decline. The higher an institution s Sensitivity Measure is, the greater its exposure to interest rate risk is considered to be. The Office of Thrift Supervision (OTS) has incorporated an interest rate risk component into its regulatory capital rule. Under the rule, an institution whose Sensitivity Measure exceeds 200 basis points may be required to deduct an interest rate risk component in calculating its total capital for purposes of the risk-based capital requirement. Increases in interest rates would be expected to have a negative impact on the Bank s operating results. As of June 30, 2010, the latest date for which information is available, the Bank s Sensitivity Measure, as measured by the OTS, resulting from a 1% decrease in interest rates was a decrease of 26 basis points and would result in a $2.4 million decrease in the NPV of the Bank. The Sensitivity Measure is less than the threshold at which the Bank could be required to hold additional risk-based capital under OTS regulations.

The OTS uses certain assumptions in assessing the interest rate risk of savings associations. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates, and the market values of certain assets under differing interest rate scenarios, among others.

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis used in the forthcoming table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, if interest rates change, expected rates of prepayments on loans and early withdrawals from certificates could deviate significantly from those assumed in calculating the table.

The following table shows the NPV and projected change in the NPV of the Bank at June 30, 2010, the latest date for which information is available, assuming an instantaneous and sustained change in market rates of interest of 100, 200, and 300 basis points. The net portfolio value analysis was unable to produce results for the minus 200 and 300 basis point scenario for the quarter ended June 30, 2010.

Table of Contents

Interest Rate Sensitivity of Net Portfolio Value (NPV)

	Net Portfolio Value			NPV as a % of PV of Assets	
Change in Rates	**$ Amount**	**$ Change**	**% Change**	**NPV Ratio**	**Change**
+ 300 bp	$ 113,246	5,365	5%	12.50%	65bp
+ 200 bp	114,026	6,145	6%	12.53%	68bp
+ 100 bp	112,521	4,640	4%	12.34%	49bp
0 bp	107,881			11.85%	0bp
- 100 bp	105,527	(2,354)	(2)%	11.59%	(26)bp

The Bank does not maintain any securities for trading purposes. The Bank does not currently engage in trading activities or use derivative instruments in a material amount to control interest rate risk. In addition, interest rate risk is the most significant market risk affecting the Bank. Other types of market risk, such as foreign currency exchange risk and commodity price risk, do not arise in the normal course of the Bank s business activities and operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures: An evaluation of the Company s disclosure controls and procedures (as defined in Section 13(a)-15(e) of the Securities Exchange Act of 1934 (the Act)) as of September 30, 2010 was carried out under the supervision and with the participation of the Company s Chief Executive Officer, Principal Financial Officer and other members of the Company s senior management as of the end of the period preceding the filing of this quarterly report. The Company s Chief Executive Officer and Principal Financial Officer concluded that the Company s disclosure controls and procedures as currently in effect are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company s management (including the Chief Executive Officer and Principal Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

There have been no changes in internal controls over financial reporting (as defined in Rule 13a-15(f) under the Activities) that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all errors and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure is met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

The Company intends to continually review and evaluate the design and effectiveness of its disclosure controls and procedures and to improve controls and procedures over time and to correct any deficiencies that may be discovered in the future. The goal is to ensure that senior management has timely access to all material financial and non-financial information concerning the Company s business. While the Company believes that the present design of its disclosure controls and procedures is effective to achieve this goal, future events affecting the Company s business may cause modifications of disclosure controls and procedures.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

There were no changes to the risk factors previously disclosed in the Company s Form 10-K for the year ended December 31, 2009 except as set forth below.

The Dodd-Frank Wall Street Reform and Consumer Protection Act that was enacted on July 21, 2010, provides for, among other things, for new restrictions and an expanded framework of regulatory oversight for financial institutions and their holding companies, including the Company and the Bank. Under the new law, the Bank s primary regulator, the Office of Thrift Supervision, will be eliminated and existing federal thrifts will be subject to regulation and supervision by the Office of Comptroller of the Currency, which currently supervises and regulates all national banks. In addition, beginning in 2011, all financial holding companies, including First PacTrust Bancorp, Inc. will be regulated by the Board of Governors of the Federal Reserve System, including imposing federal capital requirements and may result in additional restrictions on investments and other holding company activities. The law also creates a new consumer financial protection bureau that will have the authority to promulgate rules intended to protect consumers in the financial products and services market. The creation of this independent bureau could result in new regulatory requirements and raise the cost of regulatory compliance. In addition, new regulations mandated by the law could require changes in regulatory capital requirements, loan loss provisioning practices, and compensation practices and require holding companies to serve as a source of strength for their financial institution subsidiaries. Effective July 21, 2011, financial institutions may pay interest on demand deposits, which could increase our interest expense. We cannot determine the full impact of the new law on our business and operations at this time. Any legislative or regulatory changes in the future could adversely affect our operations and financial condition.

In response to the financial crisis of 2008 and early 2009, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the Federal Deposit Insurance Corporation has taken actions to increase insurance coverage on deposit accounts. The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act provides for the creation of a consumer protection division at the Board of Governors of the Federal Reserve System that will have broad authority to issue regulations governing the services and products we provide consumers. This additional regulation could increase our compliance costs and otherwise adversely impact our operations. That legislation also contains provisions that, over time, could result in higher regulatory capital requirements and loan loss provisions for First PacTrust Bancorp, Inc. and Pacific Trust Bank and may increase interest expense due to the ability in July 2011 to pay interest on all demand deposits. There have also been proposals made by members of Congress and others that would reduce the amount delinquent borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution s ability to foreclose on mortgage collateral. Recent regulatory changes impose limits on our ability to change overdraft fees, which may decrease our non-interest income as compared to more recent prior periods. The potential exists for additional federal or state laws and regulations, or changes in policy, affecting lending funding practices and liquidity standards. See How We Are Regulated.

The Company has a significant deferred tax asset and cannot assure that it will be fully realized. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and the tax basis of assets and liabilities computed using enacted tax rates. If we determine that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we are required under generally accepted accounting principles to establish a full or partial valuation allowance. If we determine that a valuation allowance is necessary, we are required to incur a charge to operations. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax asset will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At September 30, 2010, we had a net deferred tax asset of $4.8 million. Although realization is not assured, the Company believes that the realization of the recognized net deferred tax asset at September 30, 2010 is more likely than not based upon available tax planning strategies and expectations as to future taxable income.

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) The following table sets forth information for the three months ended September 30, 2010 with respect to the repurchase of outstanding common stock.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total # of shares Purchased	Average price paid per share	Total # of shares purchased as part of a publicly announced program	Maximum # of shares that may yet be purchased
07/1/10-07/31/10				0
08/1/10-08/31/10				0
09/1/10-09/30/10				0

The Company has terminated the buyback plan in connection with its participation in the TARP Capital Purchase Program, however, future purchases may be made by the Company if they are related to employee stock benefit plans, consistent with past practices.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. RESERVED.

None

ITEM 5. OTHER INFORMATION.

None

ITEM 6. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements: See Part II Item 8. Financial Statements and Supplementary Data

(a)(2) Financial Statement Schedule: All financial statement schedules have been omitted as the information is not required under the related instructions or is not applicable.

(a)(3) Exhibits

Table of Contents

Regulation S-K Exhibit Number	Document	Reference to Prior Filing or Exhibit Number Attached Hereto
2.0	Plan of acquisition, reorganization, arrangement, liquidation or succession	None
3.1	Charter for First PacTrust Bancorp, Inc.	*
3.2	Articles supplementary to the Charter of the Registrant containing the terms of the Registrant s Fixed Rate Cumulative Perpetual Preferred Stock, Series A.	****
3.3	Bylaws of First PacTrust Bancorp, Inc.	*
4.0	Form of Stock Certificate of First PacTrust Bancorp, Inc.	*
4.1	Form of Preferred Stock Certificate of First PacTrust Bancorp, Inc.	****
4.2	Warrant to purchase shares of the Registrant s common stock dated November 21, 2008	****
9.0	Voting Trust Agreement	None
10.1	Severance Agreement with Hans Ganz	***
10.2	Severance Agreement with Melanie Yaptangco, formerly Stewart	***
10.3	Severance Agreement with James P. Sheehy	***
10.4	401(k) Employee Stock Ownership Plan	*
10.5	Registrant s Stock Option and Incentive Plan	**
10.6	Registrant s Recognition and Retention Plan	**
10.7	Named Executive Officers Salary and Bonus Arrangements for 2009 and Director Fee Arrangements for 2009.	*****
10.8	Letter Agreement, including Schedule A, and Securities Purchase Agreement, dated November 21, 2008, between First PacTrust Bancorp, Inc. and United States Department of the Treasury, with respect to the issuance and sale of the Series A Preferred Stock and the warrant.	****
10.9	Form of Compensation Modification Agreement and Waiver, executed by each of Hans R. Ganz, James P. Sheehy, Melanie M. Yaptangco, Regan J. Lauer, Rachel M. Carrillo, and Lisa R. Goodwin.	****
11.0	Statement regarding computation of ratios	None
14.0	Code of Ethics	***
16.0	Letter regarding change in certifying accountant	None
18.0	Letter regarding change in accounting principles	None
21.0	Subsidiaries of the Registrant	*
22.0	Published Report regarding matters submitted to vote of security holders	None
23.0	Consent of Crowe Horwath LLP	None
24.0	Power of Attorney, included in signature pages	None
31.1	Rule 13(a)-14(a) Certification (Chief Executive Officer)	31.1
31.2	Rule 13(a)-14(a) Certification (Chief Financial Officer)	31.2
32.1	Section 1350 of The Sarbanes-Oxley Act Certification (Chief Executive Officer)	32.1

32.2	Section 1350 of The Sarbanes-Oxley Act Certification (Chief Financial Officer)	32.2

* Filed in First PacTrust s Registration Statement on Form S-1. Filed on March 28, 2002. Such information is hereby incorporated by reference.

** Filed as an appendix to the Registrant s definitive proxy statement filed on March 21, 2003. Such previously filed document is incorporated herein by reference in accordance with Item 601 of Regulation S-K.

*** Filed as an Exhibit to the Company s annual report on Form 10-K for the year ended December 31, 2005.

**** Filed as an Exhibit to the Registrant s Current Report on Form 8-K. Filed on November 21, 2008. Such information is hereby incorporated by reference.

***** Included in the Registrant s definitive proxy statement filed on March 23, 2009. Such previously filed document is incorporated herein by reference in accordance with Item 601 of Regulation S-K.

(b) Exhibits Included, see list in (a)(3).

(c) Financial Statement Schedules None

Table of Contents

SIGNATURES

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

	FIRST PACTRUST BANCORP, INC.
Date: October 22, 2010	/s/ Hans R. Ganz Hans R. Ganz President and Chief Executive Officer
Date: October 22, 2010	/s/ Regan Lauer Regan Lauer Senior Vice President/ Controller (Principal Financial and Accounting Officer)