PACIFIC PREMIER BANCORP INC
Form 10-K
March 01, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

Commission File No.: 0-22193
(Exact name of registrant as specified in its charter)

Delaware	33-0743196
(State of Incorporation)	(I.R.S. Employer Identification No)

17901 Von Karman Avenue, Suite 1200, Irvine, California 92614
(Address of Principal Executive Offices and Zip Code)

Registrant's telephone number, including area code: (949) 864-8000

Securities registered pursuant to Section 12(b) of the Act:

Title of class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None
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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [X] No [__]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [__] No [X]

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [X] No [ ]

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

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

Large accelerated filer [X]		Accelerated filer	[ ]
Non-accelerated filer [ ]	(Do not check if a smaller reporting company)	Smaller reporting company	[ ]
		Emerging growth company	[ ]

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, i.e., persons other than directors and executive officers of the registrant, was approximately $1.8 billion and was based upon the last sales price as quoted on the NASDAQ Stock Market as of June 30, 2018, the last business day of the most recently completed second fiscal quarter.

As of February 22, 2019, the Registrant had 62,496,827 shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K will be found in the Company's definitive proxy statement for its 2019 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, and such information is incorporated herein by this reference.

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PART I

ITEM 1. BUSINESS

Forward-Looking Statements

All references to “we,” “us,” “our,” “Pacific Premier” or the “Company” mean Pacific Premier Bancorp, Inc. and our consolidated subsidiaries, including Pacific Premier Bank, our primary operating subsidiary. All references to the ‘‘Bank’’ refer to Pacific Premier Bank. All references to the “Corporation” refer to Pacific Premier Bancorp, Inc.

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as “may,” “could,” “should,” “will,” “would,” “beli “anticipate,” “estimate,” “expect,” “intend,” “plan” or words or phases of similar meaning. We caution that the forward-lookin statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors, which are in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking statements.

The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

- The strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the “Federal Reserve”);
- Inflation/deflation, interest rate, market and monetary fluctuations;
- The effect of acquisitions we may make, such as our recent acquisition of Grandpoint Capital Inc., including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions, and/or the failure to effectively integrate an acquisition target into our operations;
- The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- The impact of changes in financial services policies, laws and regulations, including those concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;
- The effectiveness of our risk management framework and quantitative models;
- Changes in the level of our nonperforming assets and charge-offs;
- The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the U.S. Securities and Exchange Commission (“SEC”), the Public Company Accounting Oversight Board, the Financial Accounting Standards Board or other accounting standards setters;
- Possible other-than-temporary impairments (“OTTI”) of securities held by us;
- The impact of current governmental efforts to restructure the U.S. financial regulatory system, including any amendments to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”);
- Changes in consumer spending, borrowing and savings habits;
- The effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- Our ability to attract deposits and other sources of liquidity;

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- The possibility that we may reduce or discontinue the payments of dividends on common stock;
- Changes in the financial performance and/or condition of our borrowers;
- Changes in the competitive environment among financial and bank holding companies and other financial service providers;
- Geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;
- Cybersecurity threats and the cost of defending against them, including the costs of compliance with potential legislation to combat cybersecurity at a state, national or global level;
- Unanticipated regulatory or legal proceedings; and
- Our ability to manage the risks involved in the foregoing.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Annual Report on Form 10-K and other reports and registration statements filed by us with the SEC. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We will not update the forward-looking statements to reflect actual results or changes in the factors affecting the forward-looking statements. Forward-looking information and statements should not be viewed as predictions, and should not be the primary basis upon which investors evaluate us. Any investor in our common stock should consider all risks and uncertainties disclosed in our filings with the SEC, all of which are accessible on the SEC's website at http://www.sec.gov.

Overview

We are a California-based bank holding company incorporated in 1997 in the State of Delaware and a registered bank holding company under the Bank Holding Company Act of 1956, as amended ("BHCA"). Our wholly-owned subsidiary, Pacific Premier Bank, is a California state-chartered commercial bank. The Bank was founded in 1983 as a state-chartered thrift and subsequently converted to a federally-chartered thrift in 1991. The Bank converted to a California-chartered commercial bank and became a member of the Federal Reserve System in March of 2007. The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB"), which is a member bank of the Federal Home Loan Bank System. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to the maximum amount currently allowable under federal law. The Bank is currently subject to examination and regulation by the Federal Reserve Bank ("FRB"), the California Department of Business Oversight-Division of Financial Institutions ("DBO"), the Consumer Financial Protection Bureau ("CFPB") and the FDIC.

We are a growth company keenly focused on building shareholder value through consistent earnings and creating franchise value. Our growth is derived both organically and through acquisitions of financial institutions and lines of business that complement commercial business banking strategy. The Bank's primary target market is small and middle market businesses.

We primarily conduct business throughout California from our 44 full-service depository branches in the counties of Orange, Los Angeles, Riverside, San Bernardino, San Diego, San Luis Obispo and Santa Barbara, California as well as markets in Pima and Maricopa Counties, Arizona, Clark County, Nevada and Clark County, Washington.

We provide banking services within our targeted markets to businesses, including the owners and employees of those businesses, professionals, real estate investors and non-profit organizations. Additionally, we provide certain banking services nationwide. We provide customized cash management, electronic banking services and credit facilities to Homeowners' Associations ("HOA") and HOA management companies nationwide. We provide U.S. Small Business Administration ("SBA") loans nationwide, which provide entrepreneurs and small business owners access to loans needed for working capital and continued growth. In addition, we offer loans and

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other services nationwide to experienced owner-operator franchisees in the quick service restaurant ("QSR") industry.

Through our branches and our internet website at www.ppbi.com, we offer a broad array of deposit products and services, including checking, money market and savings accounts, cash management services, electronic banking services, and on-line bill payment. We also offer a wide array of loan products, such as commercial business loans, lines of credit, SBA loans, commercial real estate ("CRE") loans, agribusiness loans, home equity lines of credit, construction loans, farmland and consumer loans. At December 31, 2018, we had consolidated total assets of $11.49 billion, net loans of $8.80 billion, total deposits of $8.66 billion, and consolidated total stockholders' equity of $1.97 billion. At December 31, 2018, the Bank was considered a "well-capitalized" financial institution for regulatory capital purposes.

The Corporation's common stock is traded on the NASDAQ Global Select Market under the ticker symbol "PPBI." There are 150 million authorized shares of the Corporation's common stock, with approximately 62.5 million shares outstanding as of December 31, 2018. The Corporation has an additional 1.0 million authorized shares of preferred stock, none of which has been issued to date.

Our executive offices are located at 17901 Von Karman Avenue, Suite 1200, Irvine, California 92614, and our telephone number is (949) 864-8000. Our internet website address is www.ppbi.com. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and all amendments thereto, that have been filed with the SEC are available free of charge on our website. Also on our website are our Code of Business Conduct and Ethics, Share Ownership and Insider Trading and Disclosure Policy, Corporate Governance Policy and beneficial ownership forms for our executive officers and directors, as well as the charters for our Audit Committee, Compensation Committee, Governance Committee and Enterprise Risk Management Committee. The information contained in our website or in any websites linked by our website is not a part of this Annual Report on Form 10-K.

Recent Acquisition

Grandpoint Capital, Inc. Acquisition — Effective as of July 1, 2018, the Company completed the acquisition of Grandpoint Capital, Inc. ("Grandpoint"), the holding company of Grandpoint Bank, a California-chartered bank headquartered in Los Angeles, California, pursuant to the terms of a definitive agreement entered into by the Corporation and Grandpoint on February 9, 2018. As a result of the Grandpoint acquisition, the Bank acquired approximately $3.05 billion in total assets, $2.40 billion in gross loans and $2.51 billion in total deposits as of the date of the acquisition.

Pursuant to the terms of the definitive agreement, each outstanding share of Grandpoint voting common stock and Grandpoint non-voting common stock was converted into the right to receive 0.4750 shares of the Corporation's common stock. The value of the total transaction consideration was approximately $601.2 million after approximately $28.1 million in aggregate cash consideration payable to holders of Grandpoint share-based compensation awards by Grandpoint. The transaction consideration represented the issuance of 15,758,089 shares of the Corporation's common stock, valued at $38.15 per share, which was the closing price of the Corporation's common stock on June 29, 2018, the last trading day prior to the consummation of the acquisition.

The Grandpoint acquisition was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date, in accordance with Financial Accounting Standards Board ("FASB") ASC Topic 805, Business Combinations. The fair values of the assets acquired and liabilities assumed were determined based on the requirements of FASB ASC Topic 820: Fair Value Measurements and Disclosures. Such fair values are preliminary estimates and subject to refinement for up to one year after the closing date of acquisition as additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. Fair value adjustments will be finalized no later than July 2019.

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The integration and system conversion of Grandpoint was completed in October 2018.

For additional information regarding the acquisition of Grandpoint, see "Note 26. Acquisitions" of the Notes to the Consolidate Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

Our Strategic Plan

Our strategic plan is focused on generating organic growth through our high performing sales culture. Additionally, we seek to grow through mergers and acquisitions of banks and the acquisition of lines of business that complement our business banking strategy.

Our two key operating strategies are summarized as follows:

- Expansion through Organic Growth. Over the past several years, we have developed a high performing sales culture that places a premium on business bankers who have the ability to consistently generate business with new and existing clients. Business unit managers that possess in-depth product knowledge and expertise in their respective lines of business systematically manage the business development efforts through the use of sales and relationship management technology tools.

- Expansion through Acquisitions. Our acquisition strategy is twofold: first, we seek to acquire whole banks within and contiguous to the State of California to expand geographically and/or to consolidate in our existing markets; and second, we seek to acquire lines of business that will complement our existing business banking strategy. We have completed ten acquisitions since 2010, the first two of which were FDIC-assisted transactions and all other bank transactions were open bank, arm's length negotiated transactions: Canyon National Bank ("CNB") (geographic expansion, closed February 2011), Palm Desert National Bank ("PDNB") (in market consolidation, closed April 2012), First Associations Bank ("FAB") (nationwide HOA line of business, closed March 2013), San Diego Trust Bank ("SDTB") (geographic expansion, closed June 2013), Infinity Franchise Holdings, LLC and Infinity Franchise Capital (collectively, "Infinity") (nationwide lender to franchisees in the QSR industry, closed January 2014), Independence Bank ("IDPK") (geographic expansion, closed January 2015), Security Bank of California ("SCAF") (geographic expansion, closed January 2016), Heritage Oaks Bancorp ("HEOP") (geographic expansion, closed April 2017), Plaza Bancorp ("PLZZ") (geographic expansion, closed November 2017) and Grandpoint (geographic expansion, closed July 2018). We intend to continue to pursue acquisitions of open banks and other non-depository businesses that meet our criteria, though there can be no assurances that we will identify or consummate any such acquisitions, or should we do so, that any or all of those acquisitions will produce the intended results.

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Lending Activities

General. In 2018, we maintained our commitment to a high level of credit quality in our lending activities. Our core lending business continues to focus on meeting the financial needs of local businesses and their owners. To that end, the Company offers a full complement of flexible and structured loan products tailored to meet the diverse needs of our small and middle market commercial customers.

During 2018, we made or purchased loans to borrowers secured by real property and business assets located principally in California, our primary market area, as well as in certain markets in the states of Arizona, Nevada, and Washington where we also have depository and lending offices. We made select loans, primarily QSR franchise loans, SBA guaranteed loans and loans to HOAs, throughout the United States. We emphasize relationship lending and focus on generating loans with customers who also maintain full depository relationships with us. These efforts assist us in establishing and expanding depository relationships consistent with the Company's strategic direction. We maintain internal lending limits below our $526.0 million legal lending limit for secured loans and $315.0 million legal lending limit for unsecured loans as of December 31, 2018. At December 31, 2018, the Bank's largest aggregate outstanding balance of loans to one borrower was $131.0 million of secured credit. Historically, we have managed loan concentrations by selling certain loans, primarily commercial non-owner occupied CRE and multi-family residential loan production. We have also focused on selling the guaranteed portion of SBA loans due to the historically attractive premiums in the market, which gains on sale increase our noninterest income. Other types of loan sales remain a strategic option for us.

During 2018, we generated $2.35 billion of new loan commitments and $1.62 billion of new loan funding, including $533.2 million and $201.4 million of commercial and industrial ("C&I") loans, respectively, $283.7 million and $219.5 million of franchise loans, respectively, $315.4 million and $312.8 million of owner occupied CRE loans, respectively, $139.8 million and $137.1 million of SBA loans, respectively, $59.7 million and $38.1 million of agribusiness loans, respectively, $372.3 million and $370.3 million of non-owner occupied CRE loans, respectively, $220.5 million and $209.7 million of multi-family real estate loans, respectively, $46.0 million and $32.4 million of one-to-four family real estate loans, respectively, $326.2 million and $57.6 million of construction loans, respectively, $20.4 million and $16.8 million of farmland loans, respectively, $12.0 million and $10.5 million of land loans, respectively, and $24.0 million and $10.7 million of consumer loans. During the same period, the acquisition of Grandpoint added $2.40 billion of loans in the third quarter of 2018 before fair value adjustments. At December 31, 2018, we had $8.85 billion in total gross loans held for investment outstanding.

Commercial and Industrial Lending. We originate C&I loans secured by business assets including inventory, receivables, and machinery and equipment to businesses located in our primary market areas. Loan types include revolving lines of credit, term loans, seasonal loans and loans secured by liquid collateral such as cash deposits or marketable securities. HOA credit facilities are included in C&I loans. We also issue letters of credit on behalf of our customers, backed by deposits or other collateral with the Company. At December 31, 2018, C&I loans totaled $1.36 billion, constituting 15.4% of our gross loans held for investment. At December 31, 2018, we had commitments to extend additional credit on C&I loans of $1.12 billion.

Franchise Lending. We originate loans to franchises in the QSR industry nationwide, including financing for equipment, real estate, new store development, remodeling, refinancing, acquisition and partnership restructuring. At December 31, 2018, franchise loans totaled $765.4 million, constituting 8.7% of our gross loans held for investment.

Commercial Owner-Occupied Business Lending. We originate and purchase loans secured by owner-occupied CRE, such as small office and light industrial buildings, and mixed-use commercial properties located in our primary market areas. We also make loans secured by special purpose properties, such as gas stations and churches. Pursuant to our underwriting policies, owner-occupied CRE loans may be made in amounts of up to 80% of the lesser of the appraised value or the purchase price of the collateral property. Loans are generally made for terms up to 25 years with amortization periods up to 25 years. At December 31, 2018, we had $1.68 billion of owner-occupied CRE secured loans, constituting 19.0% of our gross loans held for investment.

SBA Lending. We are approved to originate loans under the SBA's Preferred Lenders Program ("PLP"). The PLP lending status affords us a higher level of delegated credit autonomy, translating to a significantly shorter time-line from application to funding, which is critical to our marketing efforts. We originate loans nationwide under the SBA's 7(a), SBAExpress, International Trade and 504 loan programs, in conformity with SBA underwriting and documentation standards. The guaranteed portion of the 7(a) loans is typically sold on the secondary market. At December 31, 2018, we had $193.9 million of SBA loans, constituting 2.2% of our gross loans held for investment.

Agribusiness and Farmland. We originate loans to the agricultural community to fund seasonal production and longer term investments in land, buildings, equipment, crops and livestock. Agribusiness loans are for the purpose of financing agricultural production, specifically crops and livestock. Farmland loans include all land known to be used or usable for agricultural purposes, such as crop and livestock production, and is secured by the land and improvements thereon. At December 31, 2018, agribusiness loans totaled $138.5 million, constituting 1.6% of our gross loans held for investment. At December 31, 2018, we had $150.5 million of farmland loans, constituting 1.7% of our gross loans held for investment.

Commercial Non-Owner Occupied Real Estate Lending. We originate and purchase loans that are secured by CRE, such as retail centers, small office and light industrial buildings, and mixed-use commercial properties located in our primary market areas that are not occupied by the borrower. We also make loans secured by special purpose properties, such as hotels and self-storage facilities. Pursuant to our underwriting practices, non-owner occupied CRE loans may be made in amounts up to 75% of the lesser of the appraised value or the purchase price of the collateral property. We consider the net operating income of the property and typically require a stabilized debt service coverage ratio of at least 1.20:1, based on the qualifying loan interest rate. Loans are generally made for terms from 10 years up to 25 years, with amortization periods up to 25 years. At December 31, 2018, we had $2.00 billion of non-owner occupied CRE secured loans, constituting 22.6% of our gross loans held for investment.

Multi-family Residential Lending. We originate and purchase loans secured by multi-family residential properties (five units and greater) located in our primary market areas. Pursuant to our underwriting practices, multi-family residential loans may be made in an amount up to 75% of the lesser of the appraised value or the purchase price of the collateral property. In addition, we generally require a stabilized minimum debt service coverage ratio of at least 1.15:1, based on the qualifying loan interest rate. Loans are made for terms of up to 30 years with amortization periods up to 30 years. At December 31, 2018, we had $1.54 billion of multi-family real estate secured loans, constituting 17.4% of our gross loans held for investment.

One-to-Four Family Real Estate Lending. Although we do not originate traditional consumer single family residential mortgages, we have acquired single family residential mortgages through our bank acquisitions. Our portfolio of one-to-four family loans at December 31, 2018 totaled $356.3 million, constituting 4.0% of our gross loans held for investment, of which $306.3 million consists of loans secured by first liens on real estate and $50.0 million consists of loans secured by second or junior liens on real estate.

Construction Lending. We originate loans for the construction of 1-4 family homes, multi-family residences and CRE properties in our market areas. We concentrate our1-4 family construction lending on single homes and small infill projects in established neighborhoods where there is not abundant land available for development. Multi-family and commercial construction loans are made to experienced developers for projects with strong market demand. Pursuant to our underwriting practices, construction loans may be made in an amount up to the lesser of 80% of the completed value of or 85% of the cost to build the collateral property. Loans are made solely for the term of construction, generally less than 24 months. We require that the owner's equity is injected prior to the funding of the loan. At December 31, 2018, construction loans totaled $523.6 million, constituting 5.9% of our gross loans, and we had commitments to extend additional construction credit of $420.7 million.

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Land Loans. We occasionally originate land loans located in our primary market areas for the purpose of facilitating the ultimate construction of a home or commercial building. We do not originate loans to facilitate the holding of land for speculative purposes. At December 31, 2018, land loans totaled $46.6 million, constituting 0.5% of our gross loans.

Consumer Loans. We originate a limited number of consumer loans, generally for existing banking customers only, which consist primarily of small balance personal unsecured loans and savings account secured loans. Before we make a consumer loan, we assess the applicant's ability to repay the loan and, if applicable, the value of the collateral securing the loan. At December 31, 2018, we had $89.4 million in consumer loans, which represented less than 1.0% of our gross loans.

Sources of Funds

General. Deposits, loan repayments and prepayments, and cash flows generated from operations and borrowings are the primary sources of the Company's funds for use in lending, investing and other general purposes.

Deposits. Deposits represent our primary source of funds for our lending and investing activities. The Company offers a variety of deposit accounts with a range of interest rates and terms. The deposit accounts are offered through our 44 full depository branch network in California and Nevada, including our Irvine, California branch, which serves our nationwide HOA Banking unit located in Dallas, Texas. The Company's deposits consist of checking accounts, money market accounts, passbook savings, and certificates of deposit. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. The terms of the fixed-rate certificates of deposit offered by the Company vary from three months to five years. Specific terms of an individual account vary according to the type of account, the minimum balance required, the time period funds must remain on deposit and the interest rate, among other factors. Total deposits at December 31, 2018 were $8.66 billion, compared to $6.09 billion at December 31, 2017. At December 31, 2018, certificates of deposit constituted 16.3% of total deposits, compared to 17.8% at December 31, 2017. At December 31, 2018, we had $1.11 billion of certificate of deposit accounts maturing in one year or less.

We primarily rely on customer service, sales and marketing efforts, business development, cross selling of deposit products to loan customers, and long-standing relationships with customers to attract and retain local deposits. However, market interest rates and rates offered by competing financial institutions significantly affect the Company's ability to attract and retain deposits. Additionally, from time to time, we will utilize both wholesale and brokered deposits to supplement our generation of deposits from businesses and consumers. At December 31, 2018, we had $401.6 million in brokered deposits that were raised to supplement and diversify our deposit funding and support our interest rate risk management strategies. The brokered deposits had a weighted average maturity of 5 months and an all-in cost of 233 basis points.

Subsidiaries

The Bank, a California state-chartered commercial bank, is a wholly-owned, consolidated subsidiary of the Corporation. The Corporation also has four unconsolidated Delaware statutory trust subsidiaries, PPBI Statutory Trust I, Heritage Oaks Capital Trust II, Mission Community Capital Trust I and Santa Lucia Bancorp (CA) Capital Trust, and one unconsolidated Connecticut statutory trust subsidiary, First Commerce Bancorp Statutory Trust I. All are used as business trusts in connection with the issuance of trust-preferred securities. These business trusts are described in more detail in "Note 13. Subordinated Debentures" in Item 8 of this Form 10-K.

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Personnel

As of December 31, 2018, we had 1,016 full-time employees and 14 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be satisfactory.

Competition

We consider our Bank to be a community bank focused on the commercial banking business, with our primary market encompassing California. To a lesser extent, we also compete in several broader regional and national markets through our HOA Banking, SBA, Franchise Lending and CRE and multi-family lines of business.

The banking business is highly competitive with respect to virtually all products and services. The industry continues to consolidate, and unregulated competitors in the banking markets have focused products targeted at highly profitable customer segments. Many largely unregulated competitors are able to compete across geographic boundaries and provide customers increasing access to meaningful alternatives to nearly all significant banking services and products.

The banking business is dominated by a relatively small number of major banks with many offices operating over a wide geographical area. These banks have, among other advantages, the ability to finance wide-ranging and effective advertising campaigns, and to allocate their resources to regions of highest yield and demand. Many of the national or super-regional banks operating in our primary market area offer certain services that we do not offer directly but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, the national or super-regional banks also have significantly higher lending limits than us.

In addition to other local community banks, our competitors include commercial banks, savings banks, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms and investment banking firms. Increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal financial software. Strong competition for deposit and loan products affects the rates of those products, as well as the terms on which they are offered to customers. Mergers between financial institutions have placed additional pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues to remain competitive.

Technological innovations have also resulted in increased competition in the financial services market. Such innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously were considered traditional banking products. In addition, many customers now expect a choice of delivery systems and channels, including telephone, mobile phones, mail, home computers, ATMs, self-service branches, and/or in-store branches. The sources of competition in such products include commercial banks, as well as credit unions, brokerage firms, money market and other mutual funds, asset management groups, finance and insurance companies, internet-only financial intermediaries and mortgage banking firms.

We work to anticipate and adapt to competitive conditions, whether developing and marketing innovative products and services, adopting or developing new technologies that differentiate our products and services, or providing highly personalized banking services. We strive to distinguish ourselves from other community banks and financial services providers in our marketplace by providing a high level of service to enhance customer loyalty and to attract and retain business. However, no assurances can be given that our efforts to compete in our market areas will continue to be successful.

Supervision and Regulation

General. Bank holding companies, such as the Corporation, and banks, such as the Bank, are subject to extensive regulation and supervision by federal and state regulators. Various requirements and restrictions under state and federal law affect our operations, including reserves against deposits, ownership of deposit accounts, loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices and capital requirements. The following is a summary of certain statutes and rules applicable to us. This summary is qualified in its entirety by reference to the particular statute and regulatory provision referred to below and is not intended to be an exhaustive description of all applicable statutes and regulations.

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

Under changes made by the Dodd-Frank Act, a bank holding company must act as a source of financial and managerial strength to each of its subsidiary banks and to commit resources to support each such subsidiary bank. In order to fulfill its obligations as a source of strength, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank. In addition, the Federal Reserve may charge the bank holding company with engaging in unsafe and unsound practices if the bank holding company fails to commit resources to a subsidiary bank or if it undertakes actions that the Federal Reserve believes might jeopardize the bank holding company’s ability to commit resources to such subsidiary bank. The Federal Reserve also has the authority to require a bank holding company to terminate any activity or to relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve’s determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

The CFPB is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets, such as the Bank, which is our subsidiary depository institution. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The CFPB has issued regulatory guidance and has proposed, or will be proposing, regulations on issues that directly relate to our business. Although it is difficult to predict the full extent to which the CFPB’s final rules impact the operations and financial condition of the Bank, such rules may have a material impact on the Bank’s compliance costs, compliance risk and fee income.

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

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ultimately, request the FDIC terminate the Bank's deposit insurance. As a California-chartered commercial bank, the Bank is also subject to certain provisions of California law.

Legislative and regulatory initiatives, which necessarily impact the regulation of the financial services industry, are introduced from time-to-time. We cannot predict whether or when potential legislation or new regulations will be enacted, and if enacted, the effect that new legislation or any implemented regulations and supervisory policies would have on our financial condition and results of operations. Moreover, bank regulatory agencies can be more aggressive in responding to concerns and trends identified in examinations, which could result in an increased issuance of enforcement actions to financial institutions requiring action to address credit quality, liquidity and risk management and capital adequacy, as well as other safety and soundness concerns.

Dodd-Frank Act

The Dodd-Frank Act, which was signed into law in July 2010, implemented far-reaching changes across the financial regulatory landscape, including provisions that, among other things, repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts, and increased the authority of the Federal Reserve to examine bank holding companies, such as the Corporation, and their non-bank subsidiaries.

Many aspects of the Dodd-Frank Act continue to be subject to rulemaking and have yet to take full effect, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry generally. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

In 2017, both the U.S. House of Representatives and the U.S. Senate introduced legislation that would repeal or modify provisions of the Dodd-Frank Act and significantly impact financial services regulation. In May 2018, certain provisions of these bills were signed into law as part of the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Economic Growth Act") and repealed or modified significant portions of the Dodd-Frank Act. Specifically, the Economic Growth Act delayed implementation of rules related to the Home Mortgage Disclosure Act, reformed and simplified certain Volcker Rule requirements, and raised the threshold for applying enhanced prudential standards to bank holding companies with total consolidated assets equal to or greater than $50 billion to those with total consolidated assets equal to or greater than $250 billion. While recent federal legislation, including the Economic Growth Act, has scaled back portions of the Dodd-Frank Act, uncertainty about the timing and scope of such changes, as well as the cost of complying with a new regulatory regime, remains.

Activities of Bank Holding Companies. The activities of bank holding companies are generally limited to the business of banking, managing or controlling banks, and other activities that the Federal Reserve has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies that qualify and register as "financial holding companies" are also able to engage in certain additional financial activities, such as merchant banking, and securities and insurance underwriting, subject to limitations set forth in federal law. We are not at this date a "financial holding company."

The BHCA requires a bank holding company to obtain prior approval of the Federal Reserve before: (i) taking any action that causes a bank to become a controlled subsidiary of the bank holding company; (ii) acquiring direct or indirect ownership or control of voting shares of any bank or bank holding company, if the acquisition results in the acquiring bank holding company having control of more than 5% of the outstanding shares of any class of voting securities of such bank or bank holding company, unless such bank or bank holding company is majority-owned by the acquiring bank holding company before the acquisition; (iii) acquiring all or substantially all the assets of a bank;

or (iv) merging or consolidating with another bank holding company.

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Permissible Activities of the Bank. Because California permits commercial banks chartered by the state to engage in any activity permissible for national banks, the Bank can form subsidiaries to engage in activates "closely related to banking" or "nonbanking" activities and expanded financial activities. However, to form a financial subsidiary, the Bank must be well capitalized and would be subject to the same capital deduction, risk management and affiliate transaction rules as applicable to national banks. Generally, a financial subsidiary is permitted to engage in activities that are "financial in nature" or incidental thereto, even though they are not permissible for the national bank to conduct directly within the bank. The definition of "financial in nature" includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance (other than credit life insurance), issue annuities or engage in real estate development, investment or merchant banking.

Incentive Compensation. Federal banking agencies have issued guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. In accordance with the Dodd-Frank Act, the federal banking agencies prohibit incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions (generally institutions that have over $1 billion in assets) and are deemed to be excessive, or that may lead to material losses.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The scope and content of the U.S. banking regulators' policies on executive compensation may continue to evolve in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Company's ability to hire, retain and motivate its key employees.

Capital Requirements. Bank holding companies and banks are subject to various regulatory capital requirements administered by state and federal agencies. These agencies may establish higher minimum requirements if, for example, a banking organization previously has received special attention or has a high susceptibility to interest rate risk. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items. Under the Dodd-Frank Act, the Federal Reserve must apply consolidated capital requirements to depository institution holding companies that are no less stringent than those currently applied to depository institutions. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

Under federal regulations, bank holding companies and banks must meet certain risk-based capital requirements. Effective as of January 1, 2015, the Basel III final capital framework, among other things, (i) introduces as a new capital measure “Common Equity Tier 1” (“CET1”), (ii) specifies that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of

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capital and (iv) expands the scope of the adjustments as compared to existing regulations. Beginning January 1, 2016, financial institutions are required to maintain a minimum capital conservation buffer to avoid restrictions on capital distributions such as dividends and equity repurchases and other payments such as discretionary bonuses to executive officers. The minimum capital conservation buffer is phased in over a four year transition period with minimum buffers of 0.625%, 1.25%, 1.875%, and 2.50% during 2016, 2017, 2018 and 2019, respectively.

As fully phased-in on January 1, 2019, Basel III subjects banks to the following risk-based capital requirements:

- a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer”;
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer, or 8.5%;
- a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer, or 10.5%; and
- a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures.

The Basel III final framework provides for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Basel III also includes, as part of the definition of CET1 capital, a requirement that banking institutions include the amount of Additional Other Comprehensive Income (“AOCI”), which primarily consists of unrealized gains and losses on available for sale securities, which are not required to be treated as other-than-temporary impairment, net of tax) in calculating regulatory capital. Banking institutions had the option to opt out of including AOCI in CET1 capital if they elected to do so in their first regulatory report following January 1, 2015. As permitted by Basel III, the Company and the Bank have elected to exclude AOCI from CET1.

The Dodd-Frank Act excludes trust preferred securities issued after May 19, 2010, from being included in Tier 1 capital, unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued prior to that date will continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, such as the Corporation. The trust preferred securities issued by our unconsolidated subsidiary capital trusts qualify as Tier 1 capital up to a maximum limit of 25% of total Tier 1 capital. Any additional portion of our trust preferred securities would qualify as “Tier 2 capital.”

In addition, goodwill and most intangible assets are deducted from Tier 1 capital. For purposes of applicable total risk-based capital regulatory guidelines, Tier 2 capital (sometimes referred to as “supplementary capital”) is defined to include, subject to limitations: perpetual preferred stock not included in Tier 1 capital, intermediate-term preferred stock and any related surplus, certain hybrid capital instruments, perpetual debt and mandatory convertible debt securities, allowances for loan and lease losses, and intermediate-term subordinated debt instruments. The maximum amount of qualifying Tier 2 capital is 100% of qualifying Tier 1 capital. For purposes of determining total capital under federal guidelines, total capital equals Tier 1 capital, plus qualifying Tier 2 capital, minus investments in unconsolidated subsidiaries, reciprocal holdings of bank holding company capital securities, and deferred tax assets and other deductions.

We had outstanding subordinated debentures in the aggregate principal amount of $110.3 million. Of this amount, $25.8 million is attributable to subordinated debentures issued to statutory trusts in connection with prior issuances of trust-preferred securities, $25.0 million of which qualifies as Tier 1 capital and $875,000 of which qualifies as Tier 2 capital, and $84.5 million is attributable to outstanding subordinated notes, all of which qualifies as Tier 2 capital.

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Basel III changed the manner of calculating risk-weighted assets. New methodologies for determining risk-weighted assets in the general capital rules are included, including revisions to recognition of credit risk mitigation, including a greater recognition of financial collateral and a wider range of eligible guarantors. They also include risk weighting of equity exposures and past due loans; and higher (greater than 100%) risk weighting for certain commercial real estate exposures that have higher credit risk profiles, including higher loan to value and equity components. In particular, loans categorized as “high-volatility commercial real estate” loans (“HVCRE loans”) are required to be assigned a 150% risk weighting, and require additional capital support. HVCRE loans are defined to include any credit facility that finances or has financed the acquisition, development or construction of real property, unless it finances: 1-4 family residential properties; certain community development investments; agricultural land used or usable for, and whose value is based on, agricultural use; or commercial real estate projects in which: (i) the loan to value is less than the applicable maximum supervisory loan to value ratio established by the bank regulatory agencies; (ii) the borrower has contributed cash or unencumbered readily marketable assets, or has paid development expenses out of pocket, equal to at least 15% of the appraised “as completed” value; (iii) the borrower contributes its 15% before the bank advances any funds; and (iv) the capital contributed by the borrower, and any funds internally generated by the project, is contractually required to remain in the project until the facility is converted to permanent financing, sold or paid in full.

In addition to the uniform risk-based capital guidelines and regulatory capital ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios. Future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect our ability to grow and could restrict the amount of profits, if any, available for the payment of dividends.

In addition, the Dodd-Frank Act requires the federal banking agencies to adopt capital requirements that address the risks that the activities of an institution poses to the institution and the public and private stakeholders, including risks arising from certain enumerated activities.

Basel III became applicable to the Corporation and the Bank on January 1, 2015. Overall, the Corporation believes that implementation of the Basel III Rule has not had and will not have a material adverse effect on the Corporation’s or the Bank’s capital ratios, earnings, shareholder’s equity, or its ability to pay dividends, effect stock repurchases or pay discretionary bonuses to executive officers.

In September 2017, the federal bank regulators proposed to revise and simplify the capital treatment for certain deferred tax assets, mortgage servicing assets, investments in non-consolidated financial entities and minority interests for banking organizations, such as the Corporation and the Bank, that are not subject to the advanced approaches requirements. In November 2017, the federal banking regulators revised the Basel III Rules to extend the current transitional treatment of these items for non-advanced approaches banking organizations until the September 2017 proposal is finalized. The September 2017 proposal would also change the capital treatment of certain commercial real estate loans under the standardized approach, which we use to calculate our capital ratios.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as “Basel IV”). Among other things, these standards revise the Basel Committee’s standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain “unconditionally cancellable commitments,” such as unused credit card lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Corporation or the Bank. The impact of Basel IV on us will depend on the manner in which it is implemented by the federal bank regulators.

In 2018, the federal bank regulatory agencies issued a variety of proposals and made statements concerning regulatory capital standards. These proposals touched on such areas as commercial real estate exposure, credit loss allowances under generally accepted accounting principles, capital requirements for covered swap

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entities, among others. Public statements by key agency officials have also suggested a revisiting of capital policy and supervisory approaches on a going-forward basis. We will be assessing the impact on us of these new regulations and supervisory approaches as they are proposed and implemented.

Prompt Corrective Action Regulations. The federal banking regulators are required to take “prompt corrective action” with respect to capital-deficient institutions. Federal banking regulations define, for each capital category, the levels at which institutions are “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” Under regulations effective through December 31, 2018, the Bank was “well capitalized,” which means it had a common equity Tier 1 capital ratio of 6.5% or higher; a Tier I risk-based capital ratio of 8.0% or higher; a total risk-based capital ratio of 10.0% or higher; a leverage ratio of 5.0% or higher; and was not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure.

As noted above, Basel III integrates the capital requirements into the prompt corrective action category definitions. The following capital requirements have applied to the Corporation since January 1, 2015.

Capital Category	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Common Equity Tier 1 (CET1) Capital Ratio	Leverage Ratio	Tangible Equity to Assets	Supplemental Leverage Ratio
Well Capitalized	10% or greater	8% or greater	6.5% or greater	5% or greater	n/a	n/a
Adequately Capitalized	8% or greater	6% or greater	4.5% or greater	4% or greater	n/a	3% or greater
Undercapitalized	Less than 8%	Less than 6%	Less than 4.5%	Less than 4%	n/a	Less than 3%
Significantly Undercapitalized	Less than 6%	Less than 4%	Less than 3%	Less than 3%	n/a	n/a
Critically Undercapitalized	n/a	n/a	n/a	n/a	Less than 2%	n/a

As of December 31, 2018, the Bank was “well capitalized” according to the guidelines as generally discussed above. As of December 31, 2018, the Corporation had a consolidated ratio of 12.39% of total capital to risk-weighted assets, a consolidated ratio of 11.13% of Tier 1 capital to risk-weighted assets and a consolidated ratio of 10.88% of common equity Tier 1 capital, and the Bank had a ratio of 12.28% of total capital to risk-weighted assets, a ratio of 11.87% of common equity Tier 1 capital and a ratio of 11.87% of Tier 1 capital to risk-weighted assets.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. An institution’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the institution’s overall financial condition or prospects for other purposes.

In the event an institution becomes “undercapitalized,” it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary’s compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution’s holding company is entitled to a priority of payment in bankruptcy. The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution’s assets at the time it became undercapitalized or the amount necessary to cause the institution to be “adequately capitalized.” The bank regulators have greater power in situations where an institution becomes “significantly” or “critically” undercapitalized or fails to submit a capital restoration plan. In addition to requiring undercapitalized institutions to submit a capital restoration plan, bank regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch

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establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution's capital decreases, the regulators' enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management, and other restrictions. A regulator has limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

In addition to the federal regulatory capital requirements described above, the DBO has authority to take possession of the business and properties of a bank in the event that the tangible stockholders' equity of a bank is less than the greater of (i) 4% of the bank's total assets or (ii) $1.0 million.

Dividends. It is the Federal Reserve's policy that bank holding companies, such as the Corporation, should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also the Federal Reserve's policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. Prior to 2019, we never declared or paid dividends on our common stock. On January 28, 2019 the Corporation's board of directors declared a $0.22 per share dividend, payable on March 1, 2019 to shareholders of record on February 15, 2019. The Corporation anticipates that it will continue to pay quarterly cash dividends in the future, although there can be no assurance that payment of such dividends will continue or that they will not be reduced. The payment and amount of future dividends remain within the discretion of the Corporation's board of directors and will depend on the Corporation's operating results and financial condition, regulatory limitations, tax considerations, and other factors. Interest on deposits will be paid prior to payment of dividends on the Corporation's common stock.

The Bank's ability to pay dividends to the Corporation is subject to restrictions set forth in the Financial Code. The Financial Code provides that a bank may not make a cash distribution to its stockholders in excess of the lesser of a bank's (1) retained earnings; or (2) net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the stockholders of the bank during such period. However, a bank may, with the approval of the DBO, make a distribution to its stockholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that bank regulators determine that the stockholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the regulators may order the bank to refrain from making a proposed distribution. The payment of dividends could, depending on the financial condition of a bank, be deemed to constitute an unsafe or unsound practice. Under the foregoing provision of the Financial Code, the amount available for distribution from the Bank to the Corporation was approximately $245.7 million at December 31, 2018.

Approval of the Federal Reserve is required for payment of any dividend by a state chartered bank that is a member of the Federal Reserve, such as the Bank, if the total of all dividends declared by the bank in any calendar year would exceed the total of its retained net income for that year combined with its retained net income for the preceding two years. In addition, a state member bank may not pay a dividend in an amount greater than its undivided profits without regulatory and stockholder approval. The Bank is also prohibited under federal law from paying any dividend that would cause it to become undercapitalized.

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FDIC Insurance of Certain Accounts and Regulation by the FDIC. The Bank is an FDIC insured financial institution whereby the FDIC provides deposit insurance for a certain maximum dollar amount per customer. The Bank, as is true for all FDIC insured banks, is subject to deposit insurance assessments as determined by the FDIC.

Under the FDIC's risk-based deposit premium assessment system, the assessment rates for an insured depository institution are determined by an assessment rate calculator, which is based on a number of elements that measure the risk each institution poses to the Deposit Insurance Fund. As a result of the Dodd-Frank Act, the calculated assessment rate is applied to average consolidated assets less the average tangible equity of the insured depository institution during the assessment period to determine the dollar amount of the quarterly assessment. Under the current system, premiums are assessed quarterly and could increase if, for example, criticized loans and leases and/or other higher risk assets increase or balance sheet liquidity decreases. In addition, the FDIC can impose special assessments in certain instances. Deposit insurance assessments fund the DIF. In 2010, the FDIC adopted its DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% of total deposits by September 30, 2020, and the FDIC's final rule with respect to this became effective July 1, 2016. Insured institutions with assets over $10 billion, such as the Bank, are responsible for funding the increase. Based on the current FDIC insurance assessment methodology, our FDIC insurance premium expense was $3.0 million for 2018, $2.2 million for 2017 and $1.5 million in 2016.

Transactions with Related Parties. Depository institutions are subject to the restrictions contained in the Federal Reserve Act (the "FRA") with respect to loans to directors, executive officers and principal stockholders. Under the FRA, loans to directors, executive officers and stockholders who own more than 10% of a depository institution and certain affiliated entities of any of the foregoing, may not exceed, together with all other outstanding loans to such person and affiliated entities, the institution's loans-to-one-borrower limit as discussed in the above section. Federal regulations also prohibit loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who own more than 10% of an institution, and their respective affiliates, unless such loans are approved in advance by a majority of the board of directors of the institution. Any "interested" director may not participate in the voting. The proscribed loan amount, which includes all other outstanding loans to such person, as to which such prior board of director approval is required, is the greater of $25,000 or 5% of capital and surplus up to $500,000. The Federal Reserve also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to non-executive employees of the bank and must not involve more than the normal risk of repayment. There are additional limits on the amount a bank can loan to an executive officer.

Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under Sections 23A and 23B of the FRA. Section 23A restricts the aggregate amount of covered transactions with any individual affiliate to 10% of the capital and surplus of the financial institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the institution's capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A and the purchase of low quality assets from affiliates are generally prohibited. Section 23B generally provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. The Federal Reserve has promulgated Regulation W, which codifies prior interpretations under Sections 23A and 23B of the FRA and provides interpretive guidance with respect to affiliate transactions. Affiliates of a bank include, among other entities, a bank's holding company and companies that are under common control with the bank. The Corporation is considered to be an affiliate of the Bank.

The Dodd-Frank Act generally enhanced the restrictions on transactions with affiliates under Section 23A and 23B of the FRA, including an expansion of the definition of "covered transactions" and an increase in the amount of time for which collateral requirements regarding covered credit transactions must be satisfied. Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and

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the expansion of the types of transactions subject to the various limits, including derivatives transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution’s board of directors.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) asset growth; (v) earnings; and (vi) compensation, fees and benefits.

In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and for evaluating and monitoring earnings to ensure that earnings are sufficient for the maintenance of adequate capital and reserves. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets; (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses; (iii) compare problem asset totals to capital; (iv) take appropriate corrective action to resolve problem assets; (v) consider the size and potential risks of material asset concentrations; and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk.

Loans to One Borrower. Under California law, our ability to make aggregate secured and unsecured loans-to-one-borrower is limited to 25% and 15%, respectively, of unimpaired capital and surplus. At December 31, 2018, the Bank’s limit on aggregate secured loans-to-one-borrower was $526.0 million and unsecured loans-to-one borrower was $315.0 million. The Bank has established internal loan limits, which are lower than the legal lending limits for a California bank.

Community Reinvestment Act and the Fair Lending Laws. The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act (“CRA”) activities. The CRA generally requires the federal banking regulators to evaluate the record of a financial institution in meeting the credit needs of their local communities, including low and moderate income neighborhoods. In addition to substantial penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities. A bank’s compliance with its CRA obligations is based on a performance-based evaluation system, which bases CRA ratings on an institution’s lending, service and investment performance, resulting in a rating by the appropriate bank regulator of “outstanding,” “satisfactory,” “needs to improve” or “substantial noncompliance.” Based on its last CRA examination, the Bank received a “satisfactory” rating.

Bank Secrecy Act and Money Laundering Control Act. In 1970, Congress passed the Currency and Foreign Transactions Reporting Act, otherwise known as the Bank Secrecy Act (the “BSA”), which established requirements for recordkeeping and reporting by banks and other financial institutions. The BSA was designed to help identify the source, volume and movement of currency and other monetary instruments into and out of the U.S. in order to help detect and prevent money laundering connected with drug trafficking, terrorism and other criminal activities. The primary tool used to implement BSA requirements is the filing of Suspicious Activity Reports. Today, the BSA requires that all banking institutions develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with certain recordkeeping and reporting requirements regarding both domestic and international currency transactions. These programs must, at a minimum, provide for a system of internal controls to assure ongoing compliance, provide for independent testing of such systems and compliance, designate individuals responsible for such compliance and provide appropriate personnel training.

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USA Patriot Act. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the USA Patriot Act or the Patriot Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum standards specified by the act, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers. The costs or other effects of the compliance burdens imposed by the Patriot Act or future anti-terrorist, homeland security or anti-money laundering legislation or regulation cannot be predicted with certainty.

Consumer Laws and Regulations. The Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. These laws include, among others: Truth in Lending Act; Truth in Savings Act; Electronic Funds Transfer Act; Expedited Funds Availability Act; Equal Credit Opportunity Act; Fair and Accurate Credit Transactions Act; Fair Housing Act; Fair Credit Reporting Act; Fair Debt Collection Act; Home Mortgage Disclosure Act; Real Estate Settlement Procedures Act; laws regarding unfair and deceptive acts and practices; and usury laws. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations. Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those listed above. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission rights, action by state and local attorneys general, and civil or criminal liability.

Pursuant to the Dodd-Frank Act, the CFPB has broad authority to regulate and supervise the retail consumer financial products and services activities of banks and various non-bank providers. The CFPB has authority to promulgate regulations, issue orders, guidance and policy statements, conduct examinations and bring enforcement actions with regard to consumer financial products and services. With assets exceeding $10.0 billion at December 31, 2018, the Bank is subject to examination for consumer compliance by the CFPB. The creation of the CFPB by the Dodd-Frank Act has led to, and is likely to continue to lead to, enhanced and strengthened enforcement of consumer financial protection laws.

In addition, federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution’s policies and procedures regarding the handling of customers’ nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, a financial institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure.

Federal and State Taxation

The Corporation and the Bank report their income on a consolidated basis using the accrual method of accounting, and are subject to federal income taxation in the same manner as other corporations with some exceptions. The Company has not been audited by the Internal Revenue Service (“IRS”). For its 2018, the Company was subject to a maximum federal income tax rate of 21.00% and California state income tax rate of 10.84%. For its 2017 and 2016 tax years, the Company was subject to a maximum federal income tax rate of 35.00% and California state income tax rate of 10.84%.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law. The Tax Act includes a number of provisions that impact us, including the following:

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- Tax Rate. The Tax Act replaces the graduated corporate income tax rates applicable under prior law, which imposed a maximum corporate income tax rate of 35%, with a reduced 21% flat corporate income tax rate. Although the reduced corporate income tax rate generally should be favorable to us, resulting in increased earnings and capital, it decreased the value of our existing deferred tax assets. Accounting principles generally accepted in the United States ("U.S. GAAP") requires that the impact of the provisions of the Tax Act be accounted for in the period of enactment. Accordingly, the total incremental income tax expense recorded by the Corporation related to the Tax Act was $3.4 million.

- FDIC Insurance Premiums. The Tax Act prohibits taxpayers with consolidated assets over $50 billion from deducting any FDIC insurance premiums and prohibits taxpayers with consolidated assets between $10 and $50 billion from deducting the portion of their FDIC premiums equal to the ratio, expressed as a percentage, that (i) the taxpayer's total consolidated assets over $10 billion, as of the close of the taxable year, bears to (ii) $40 billion. As such, a portion of the Bank's FDIC insurance premiums were deemed not deductible for the year ended December 31, 2018 as we completed the acquisition of Grandpoint with $3.05 billion in total assets during 2018 and our total consolidated assets reached $11.49 billion at December 31, 2018.

- Employee Compensation. A "publicly held corporation" is not permitted to deduct compensation in excess of $1 million per year paid to certain employees. The Tax Act eliminates certain exceptions to the $1 million limit applicable under prior law related to performance-based compensation (for example, equity grants and cash bonuses paid only on the attainment of performance goals). As a result, our ability to deduct certain compensation paid to our most highly compensated employees is now limited.

- Business Asset Expensing. The Tax Act allows taxpayers to immediately expense the entire cost (instead of only 50%, as under prior law) of certain depreciable tangible property and real property improvements acquired and placed in service after September 27, 2017 and before January 1, 2023 (with an additional year for certain property). This 100% "bonus" depreciation is phased out proportionately for property placed in service on or after January 1, 2023 and before January 1, 2027 (with an additional year for certain property).

- Interest Expense. The Tax Act limits a taxpayer's annual deduction of business interest expense to the sum of (i) business interest income, and (ii) 30% of "adjusted taxable income," defined as a business's taxable income without taking into account business interest income or expense, net operating losses, and, for 2018 through 2021, depreciation, amortization and depletion. Because we generate significant amounts of net interest income, we do not expect to be impacted by this limitation.

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ITEM 1A. RISK FACTORS

Ownership of our common stock involves certain risks. The risks and uncertainties described below are not the only ones we face. You should carefully consider the risks described below, as well as all other information contained in this Annual Report on Form 10-K. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of these risks actually occurs, our business, financial condition or results of operations could be materially, adversely affected.

Risks Related to Our Business

The economic environment could pose significant challenges for the Company and could adversely affect our financial condition and results of operations.

Our financial condition and results of operations are dependent on the U.S. economy, generally, and markets we serve, specifically. We primarily serve markets in California, though certain of our products and services are offered nationwide. Although the U.S. economy continues a gradual expansion following the severe recession that ended in 2009, the duration and magnitude of the continued expansion is uncertain. Financial stress on borrowers as a result of an uncertain future economic environment could have an adverse effect on the Company’s borrowers and their ability to repay their loans, which could adversely affect the Company’s business, financial condition and results of operations. A weakening of these conditions in the markets in which we operate would likely have an adverse effect on us and others in the financial institutions industry. For example, deterioration in economic conditions in our markets could drive losses beyond that which is provided for in our allowance for loan losses (“ALLL”). We may also face the following risks in connection with these events:

- Economic conditions that negatively affect real estate values and the job market may result, in the deterioration of the credit quality of our loan portfolio, and such deterioration in credit quality could have a negative impact on our business.
- A decrease in the demand for loans and other products and services offered by us.
- A decrease in deposit balances, including low-cost and non-interest bearing deposits, due to overall reductions in the accounts of customers.
- A decrease in the value of our loans or other assets secured by commercial or residential real estate.
- A decrease in net interest income derived from our lending and deposit gathering activities.
- Sustained weakness in our markets may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities.
- The processes we use to estimate ALLL and reserves may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation.
- Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite customers become less predictive of future charge-offs.

As these conditions or similar ones exist or worsen, we could experience adverse effects on our business, financial condition and results of operations.

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Our business is subject to various lending and other economic risks that could adversely impact our results of operations and financial condition.

There can be no assurance that the economic conditions that impact the financial services industry, and the capital, credit and real estate markets generally, will not deteriorate in the near or long term, in which case, we could experience losses and write-downs of assets, and could face capital and liquidity constraints or other business challenges. If economic conditions were to deteriorate, particularly within our geographic regions, it could result in the following additional consequences, any of which could have a material adverse effect on our business, results of operations and financial condition:

- Loan delinquencies may increase causing increases in our provision for loan losses and ALLL and decreases to our capital.
- Collateral for loans, especially real estate, may decline in value, in turn reducing a customer’s borrowing power, and reducing the value of assets and collateral associated with our loans held for investment.
- Consumer confidence levels may decline and cause adverse changes in payment patterns, resulting in increased delinquencies and default rates on loans and other credit facilities and decreased demand for our products and services.
- Performance of the underlying loans in mortgage backed securities may deteriorate to potentially cause OTTI markdowns to our investment portfolio.

Adverse economic conditions in California may cause us to suffer higher default rates on our loans and reduce the value of the assets we hold as collateral.

Our business activities and credit exposure are concentrated in California. Difficult economic conditions, including state and local government deficits, in California may cause us to incur losses associated with higher default rates and decreased collateral values in our loan portfolio. In addition, demand for our products and services may decline. Declines in the California real estate market could hurt our business, because the majority of our loans are secured by real estate located within California. As of December 31, 2018, approximately 59% of the aggregate outstanding principal of our loans was secured by real estate were located in California. If real estate values were to decline in California, the collateral for our loans would provide less security. As a result, our ability to recover on defaulted loans by selling the underlying real estate would be diminished, and we would be more likely to suffer losses on defaulted loans.

Changes in U.S trade policies and other factors beyond the Company’s control may adversely impact our business, financial condition and results of operations.

Following the U.S. presidential election in 2016, there have been changes to U.S. trade policies, legislation, treaties and tariffs, including trade policies and tariffs affecting China and retaliatory tariffs by China. Tariffs, retaliatory tariffs or other trade restrictions on products and materials that our customers import or export, including among others, agricultural and technological products, could cause the prices of our customers’ products to increase which could reduce demand for such products, or reduce our customer margins, and adversely impact their revenues, financial results and ability to service debt; this, in turn, could adversely affect our financial condition and results of operations. In addition, to the extent changes in the political environment have a negative impact on us or on the markets in which we operate, our business, results of operations and financial condition could be materially and adversely impacted in the future. A trade war or other governmental action related to tariffs or international trade agreements or policies has the potential to negatively impact our and our customers’ costs, demand for our customers’ products, and the U.S. economy or certain sectors thereof and, thus, adversely impact our business, financial condition and results of operations.

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We may suffer losses in our loan portfolio in excess of our allowance for loan losses.

Our total nonperforming assets amounted to $5.0 million, or 0.04% of our total assets, at December 31, 2018, an increase from $3.6 million or 0.04% at December 31, 2017. We had $1.0 million of net loan charge-offs for 2018, unchanged from $1.0 million in 2017. Our provision for loan losses was $8.2 million in 2018, a decrease from $8.6 million in 2017. If increases in our nonperforming assets occur in the future, our net loan charge-offs and/or provision for loan losses may also increase which may have an adverse effect upon our future results of operations and capital.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices generally include analysis of a borrower’s prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and liquid asset verifications. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our ALLL. Our allowance for probable incurred losses is based on analysis of the following:

- Historical experience with our loans;
- Industry historical losses as reported by the FDIC;
- Evaluation of economic conditions;
- Regular reviews of the quality, mix and size of the overall loan portfolio;
- Regular reviews of delinquencies;
- The quality of the collateral underlying our loans; and
- The effect of external factors, such as competition, legal developments and regulatory requirements.

Although we maintain an ALLL at a level that we believe is adequate to absorb probable incurred losses inherent in our loan portfolio, changes in economic, operating and other conditions, including a sharp decline in real estate values and changes in interest rates, which are beyond our control, may cause our actual loan losses to exceed our current allowance estimates. If the actual loan losses exceed the amount reserved, it will adversely affect our financial condition and results of operations.

In addition, the Federal Reserve and the DBO, as part of their supervisory function, periodically review our ALLL. Either agency may require us to increase our provision for loan losses or to recognize further loan losses, based on their judgments, which may be different from those of our management. Any increase in the ALLL required by them could also adversely affect our financial condition and results of operations.

Risks related to specific segments of our loan portfolio may result in losses that could affect our results of operations and financial condition.

General economic conditions and local economic conditions, changes in governmental rules, regulations and fiscal policies, and increases in interest rates and tax rates affect our entire loan portfolio. In addition, lending risks vary by the type of loan extended.

In our C&I and SBA lending activities, collectability of loans may be adversely affected by risks generally related to small and middle market businesses, such as:

- Changes or weaknesses in specific industry segments, including weakness affecting the business’ customer base;
- Changes in consumer behavior and a business’ personnel;
- Increases in supplier costs and operating costs that cannot be passed along to customers; and
- Changes in competition.

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In our investor real estate and construction loans, payment performance and the liquidation values of collateral properties may be adversely affected by risks generally incidental to interests in real property (for investor real estate and CRE construction loans) or risks generally related to consumers (for single family residence construction loans), such as:

- Declines in real estate values, rental rates and occupancy rates;
- Increases in other operating expenses (including energy costs);
- Demand for the type of property or high-end home in question; and
- The availability of property financing.

In our HOA and consumer loans, collectability of the loans may be adversely affected by risks generally related to consumers, such as:

- Changes in consumer behavior and changes or weakness in employment and wage income;
- Declines in real estate values or rental rates;
- Increases in association operating expenses; and
- The availability of property financing.

In our agribusiness and farmland loans, collectability of the loans may be adversely affected by risks generally related to agriculture production and farmlands, such as:

- The cyclical nature of the agriculture industry;
- Fluctuating commodity prices;
- Changing climatic conditions, including drought conditions, which adversely impact agricultural customers' operating costs, crop yields and crop quality and could impact such customers' ability to repay loans;
- The imposition of tariffs and retaliatory tariffs or other trade restrictions on agricultural products and materials that our clients import or export; and
- Increases in operating expenses and changes in real estate values.

Our level of credit risk could increase due to our focus on commercial lending and the concentration on small and middle market business customers, who can have heightened vulnerability to economic conditions.

As of December 31, 2018, our commercial real estate loans amounted to \$3.7 billion, or 42.2% of our total loan portfolio, and our commercial business loans amounted to \$4.1 billion, or 46.8% of our total loan portfolio. At such date, our largest outstanding commercial business loan was \$53.2 million, our largest multiple borrower relationship was \$131 million and our largest outstanding CRE loan was \$94.1 million. CRE and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. CRE and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Company's commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

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Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

Nonperforming assets adversely affect our net income in various ways. We generally do not record interest income on nonperforming loans or other real estate owned ("OREO"), which adversely affects our income. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience future increases in nonperforming assets.

Changes in accounting policies, standards, and interpretations could materially affect how the Company reports its financial condition and results of operations.

From time to time, the FASB and the SEC change the financial accounting and reporting standards that govern the preparation of the Company's financial statements. These changes can materially impact how the Company records and reports its financial condition and results of operations.
In June 2016, the FASB issued Accounting Standards Update ("ASU") 2016-13, Measurement of Credit Losses on Financial Instruments. The ASU introduces a new revenue model based on current expected credit losses ("CECL") rather than incurred losses. The CECL model will apply to most debt instruments, including loan receivables and loan commitments.
Under the CECL model, the Company would recognize an impairment allowance equal to its current estimate of expected life of loan losses for financial instruments as of the end of the reporting period. Measuring expected life of loan losses will likely be a significant challenge for all entities, including the Company. Additionally, the allowance for credit loss("ACL") measured under a CECL model could differ materially from the allowance for loan losses ("ALLL") measured under the Company's incurred loss model. To initially apply the CECL amendments, for most debt instruments, the Company would record a cumulative-effect adjustment to its statement of financial condition as of the beginning of the first reporting period in which the guidance is effective (a modified retrospective approach). The amendments in ASU 2016-13 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, and are required to be adopted through a modified retrospective approach, with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the ASU is effective. The implementation of CECL may require us to increase our loan loss allowance, decreasing our reported income, and may introduce additional volatility into our reported earnings.
On December 21, 2018, federal bank regulatory agencies approved a final rule, effective as of April 1, 2019, modifying their regulatory capital rules and providing an option to phase in over a three-year period the initial regulatory capital effects of the CECL methodology. The Company is currently evaluating the magnitude of the one-time cumulative adjustment to its allowance and of the ongoing impact of the CECL model on its loan loss allowance and results of operations, together with the final rule that becomes effective as of April 1, 2019, to determine if the phase-in option will be elected.

Changes in monetary policy may have a material effect on our results of operations.

Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but also our ability to originate loans and deposits. Historically, there has been an inverse correlation between the demand for loans and interest rates. Loan origination volume usually declines during periods of rising or high interest rates and increases during periods of declining or low interest rates. Changes in interest rates also have a significant impact on the carrying value of certain of our assets, including loans, real estate and investment securities, on our balance sheet. We may incur debt in the future and that debt may also be sensitive to interest rates.

Further, federal monetary policy significantly affects credit conditions for us, as well as for our borrowers, particularly as implemented by the Federal Reserve, primarily through open market operations in U.S. government securities, the discount rate for bank borrowings and reserve requirements. A material change in any of these conditions could have a material impact on us or our borrowers, and therefore on our results of operations.

Interest rate changes, increases or decreases, which are out of our control, could harm profitability.

Our profitability depends to a large extent upon net interest income, which is the difference between interest income and dividends we earn on interest-earning assets, such as loans and investments, and interest expense we pay on interest-bearing liabilities, such as deposits and borrowings. Any change in general market interest rates, whether as a result of changes in the monetary policy of the Federal Reserve or otherwise, may have a significant effect on net interest income.

In response to improving economic conditions, the Federal Reserve Board's Open Market Committee has slowly increased its federal funds rate target from a range of 0.00% - 0.25%, that was in effect for several years, to the current target range of 2.25% - 2.50%, that was in effect at December 31, 2018. Moreover, since December 2015, the Federal Reserve has removed reserves from the banking system, which also puts upward pressure on market rates of interest. In addition, the prohibition restricting depository institutions from paying interest on demand deposits, such as checking accounts, was repealed as part of the Dodd-Frank Act.

Our assets and liabilities may react differently to changes in overall interest rates or conditions. In general, higher interest rates are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Further, if interest rates decline, our loans may be refinanced at lower rates or paid off and our investments may be prepaid earlier than expected. If that occurs, we may have to redeploy the loan or investment proceeds into lower yielding assets, which might also decrease our income. Also, as many of our loans currently have interest rate floors, a rise in rates may increase the cost of our deposits while the rates on the loans remain at their floors, which could decrease our net interest income. Accordingly, changes in levels of market interest rates could materially and adversely affect our financial condition, loan origination volumes, net interest margin, results of operations and profitability.

The Company's sensitivity to changes in interest rates is low in a rising interest rate environment based on the current profile of the Company's loan portfolio and low-cost and no-cost deposits. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Management of Market Risk." At December 31, 2018, we had $526.1 million in interest-bearing demand deposits. In addition, at December 31, 2018, we had $3.23 billion in money market and savings deposits. If the interest rates on our loans increase comparably faster than the interest rate on our interest- bearing demand deposits and money market and savings deposits, our core deposit balances may decrease as customers use those funds to repay higher cost loans. In addition, if we need to offer additional interest-bearing demand deposit products or higher interest rates on our current interest-bearing demand, money market or savings deposit accounts in order to maintain current customers or attract new customers, our interest expense will increase, perhaps materially. Furthermore, if we fail to offer competitive rates sufficient to retain these accounts, our core deposits may be reduced, which would

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require us to seek alternative funding sources or risk slowing our future asset growth. In these circumstances, our net interest income may decrease, which may adversely affect our financial condition and results of operations.

As interest rates rise, our existing borrowers who have adjustable rate loans may see their loan payments increase and, as a result, may experience difficulty repaying those loans, which in turn could lead to higher losses for us. Increasing delinquencies, non-accrual loans and defaults lead to higher loan loss provisions, and potentially greater eventual losses that would lower our current profitability and capital ratios.

Conditions in the financial markets may limit our access to additional funding to meet our liquidity needs.

Liquidity is essential to our business, as we must maintain sufficient funds to respond to the needs of depositors and borrowers. An inability to raise funds through deposits, repurchase agreements, federal funds purchased, FHLB advances, the sale or pledging as collateral of loans and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities, or on terms attractive to us, could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could negatively affect our access to liquidity sources include a reduction in our credit ratings, if any, an increase in costs of capital in financial capital markets, negative operating results, a decrease in the level of our business activity due to a market downturn, a decrease in depositor or investor confidence or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole.

Our ability to obtain funding from the FHLB or through its overnight federal funds lines with other banks could be negatively affected if we experienced a substantial deterioration in the Company’s financial condition or if such funding became restricted due to deterioration in the financial markets. While the Company has a contingency funds management plan to address such a situation if it were to occur (such plan includes deposit promotions, the sale of securities and the curtailment of loan growth, if necessary), a significant decrease in our ability to borrow funds could adversely affect our liquidity.

As a commercial banking institution, we compete with our market peers in, among other things, attracting, maintaining and increasing customer deposits. We are currently part of a highly competitive local deposit market, in which our competitors are offering ever increasing deposit rates in order to attract new deposits. Given our large proportion of non-maturity deposits, we could experience significant and acute deposit outflows if our offered deposit rates do not remain competitive in our primary market. Such outflows could adversely affect our liquidity.

Further, depending on these competitive factors and the interest rate environment, lower cost deposits may need to be replaced with higher cost funding, resulting in a decrease in net interest income and net income. While these events could have a material impact on our results, we expect, in the ordinary course of business, that these deposits will fluctuate and believes the Company is capable of mitigating this risk, as well as the risk of losing one of these depositors, through additional liquidity, and business generation in the future. However, should a significant number of these customers leave the Bank, it could have a material adverse impact on the Bank and the Company.

The primary source of the Company’s liquidity from which, among other things, dividends may be paid is the receipt of dividends from the Bank.

We recently initiated the paying of a quarterly cash dividend on our common stock. Our ability to pay cash dividends to our shareholders is dependent upon receiving dividends from the Bank. The Bank’s ability to pay dividends to us is subject to restrictions set forth in the Financial Code. The Financial Code provides that a bank may not make a cash distribution to its stockholders in excess of the lesser of (1) a bank’s retained earnings and (2) a bank’s net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a

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bank may, with the approval of the DBO, make a distribution to its stockholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that banking regulators determine that the stockholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the regulators may order the bank to refrain from making a proposed distribution.

Approval of the Federal Reserve is required for payment of any dividend by a state chartered bank that is a member of the Federal Reserve System, such as the Bank, if the total of all dividends declared by the Bank in any calendar year would exceed the total of its retained net income for that year combined with its retained net income for the preceding two years. In addition, a state member bank may not pay a dividend in an amount greater than its undivided profits without regulatory and stockholder approval. The Bank is also prohibited under federal law from paying any dividend that would cause it to become undercapitalized.

We may reduce or discontinue the payment of dividends on common stock.

Our shareholders are only entitled to receive such dividends as our Board may declare out of funds legally available for such payments. Although we have only recently begun to declare cash dividends on our common stock, we are not required to do so and may reduce or eliminate our common stock dividend in the future. Our ability to pay dividends to our stockholders is subject to the restrictions set forth in Delaware law, by the Federal Reserve, and by certain covenants contained in our subordinated debentures. Notification to the Federal Reserve is also required prior to our declaring and paying a cash dividend to our shareholders during any period in which our quarterly and/or cumulative twelve-month net earnings are insufficient to fund the dividend amount, among other requirements. We may not pay a dividend if the Federal Reserve objects or until such time as we receive approval from the Federal Reserve or we no longer need to provide notice under applicable regulations. In addition, we may be restricted by applicable law or regulation or actions taken by our regulators, now or in the future, from paying dividends to our shareholders. We cannot provide assurance that we will continue paying dividends on our common stock at current levels or at all. A reduction or discontinuance of dividends on our common stock could have a material adverse effect on our business, including the market price of our common stock.

The financial condition of other financial institutions could negatively affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional customers. Many of these transactions expose us to credit risk in the event of a default by a counterparty or customer. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

We are dependent on our key personnel.

Our future operating results depend in large part on the continued services of our key personnel, including Steven R. Gardner, our Chairman, President and Chief Executive Officer, who developed and implemented our business strategy. The loss of Mr. Gardner could have a negative impact on the success of our business strategy. In addition, we rely upon the services of Edward Wilcox, President and Chief Operating Officer of the Bank, and Ronald Nicolas, Chief Financial Officer of the Corporation and the Bank, and our ability to attract and retain highly skilled personnel. We cannot assure you that we will be able to continue to attract and retain the qualified personnel necessary for the development of our business. The unexpected loss of services of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel. In addition, recent regulatory proposals and guidance relating to compensation may negatively impact our ability to retain and attract skilled personnel.

Security breaches and other disruptions, whether in our systems or those of our contracted partners, could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including our proprietary business information and personally identifiable information of our customers and employees in our data centers and on our networks. The secure maintenance and transmission of this information is critical to our operations. Although we devote significant resources to maintain and regularly update our systems and processes that are designed to protect the security of our computer systems, software, networks and other technology assets, as well as the confidentiality, integrity and availability of information belonging to us and our customers, there is no assurance that all of our security measures will provide absolute security.

Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Like many financial institutions, we can be subject to attempts to infiltrate the security of our websites or other systems which can involve sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disrupt service, sabotage systems or cause other damage, including through the introduction of computer viruses or malware, cyberattacks and other means. We can be targeted by individuals and groups using malicious code and viruses, and can be exposed to distributed denial-of-service attacks with the objective of disrupting on-line banking services. Despite efforts to ensure the security and integrity of our systems, it is possible that we may not be able to anticipate, detect or recognize threats to our systems or to implement effective preventive measures against all security breaches of these types inside or outside our business, especially because the techniques used frequently are not recognized until launched, and because cyberattacks can originate from a wide variety of sources, including individuals or groups who are or may be involved in organized crime, hostile foreign governments or linked to terrorist organizations. These risks may increase in the future as our web-based product offerings grow or we expand internal usage of web-based applications.

In addition, we outsource a significant portion of our data processing to certain third-party providers. If any of these third-party providers encounters difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel. We do not have direct control over the systems of these vendors and third-party providers and, were they to suffer a breach, our sensitive data, including customer information, could be accessed, publicly disclosed, lost or stolen

A successful penetration or circumvention of the security of our systems or the systems of another market participant, our vendors or third party providers, which we refer to generally as a data breach, could cause serious negative consequences, including significant disruption of our operations, misappropriation of

confidential information, or damage to computers or systems, and may result in violations of applicable privacy and other laws, financial loss, loss of confidence, customer dissatisfaction, significant litigation exposure and harm to our reputation, all of which could have a material adverse effect on our business, financial condition, results of operations, and future prospects.

Any such data breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, including regulatory mandates specific to the financial services industry, and regulatory penalties, disrupt our operations and the services we provide to customers, damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our business, revenues and competitive position.

We devote significant resources to protecting our and our customers' information. To the extent that the expenses associated with these and future protective measures increase, our non-interest expenses may increase overall, which could adversely affect our results of operations. In addition, we maintain cyber risk insurance coverage in amounts that we believe are reasonable based upon the scope of our activities. However, this insurance coverage may not be sufficient to cover all of our losses from future data breaches of our systems or the systems of another market participant or our vendors or third party providers. If our cyber risk insurance is insufficient with respect to covering all of the losses resulting from any such future data breach, our financial condition and results of operations could be adversely affected.

Our controls, processes and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls over financial reporting, disclosure controls, processes and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls, processes and procedures or failure to comply with regulations related to controls, processes and procedures could necessitate changes in those controls, processes and procedures, which may increase our compliance costs, divert management attention from our business or subject us to regulatory actions and increased regulatory scrutiny. Any of these could have a material adverse effect on our business, results of operations, reputation and financial condition.

A natural disaster or recurring energy shortage, especially in California, could harm our business.

We are based in Irvine, California and, at December 31, 2018, approximately 59% of the aggregate outstanding principal of our loans was secured by real estate located in California. In addition, the computer systems that operate our Internet websites and some of their back-up systems are located in Irvine and San Diego, California. Historically, California has been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as earthquakes, wildfires, floods and mudslides. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our information technology structure and websites, which could prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, which is comprised substantially of real estate loans. Uninsured or underinsured disasters may reduce borrowers' ability to repay mortgage loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted loans. California has also experienced energy shortages, which, if they recur, could impair the value of the real estate in those areas affected. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters or energy shortages in California could have a material adverse effect on our business prospects, financial condition and results of operations.

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Environmental liabilities with respect to properties on which we take title may have a material effect on our results of operations.

Although we perform limited environmental due diligence in conjunction with originating loans secured by properties we believe have environmental risk, we could be subject to environmental liabilities on real estate properties we foreclose upon and take title to in the normal course of our business. In connection with environmental contamination, we may be held liable to governmental entities or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties, or we may be required to investigate or clean-up hazardous or toxic substances at a property. The investigation or remediation costs associated with such activities could be substantial. Furthermore, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination even if we were the former owner of a contaminated site. The incurrence of a significant environmental liability could adversely affect our business, financial condition and results of operations. These risks are present even though we perform environmental due diligence on our collateral properties. Such diligence may not reflect all current risks or threats, and unforeseen or unpredictable future events may cause a change in the environmental risk profile of a property after a loan has been made.

We may be unable to successfully compete with financial services companies and other companies that offer banking services.

We face direct competition from a significant number of financial institutions, many with a state-wide or regional presence, and in some cases, a national presence, in both originating loans and attracting deposits. Competition in originating loans comes primarily from other banks and finance companies, and more recently, financial technology (or “fintech”) companies, that make loans in our primary market areas. In addition banks with larger capitalizations and non-bank financial institutions that are not governed by bank regulatory restrictions have larger lending limits and are better able to serve the needs of larger customers. Many of these financial institutions are also significantly larger than us, have greater financial resources than we have, have established customer bases and name recognition. We compete for loans principally on the basis of interest rates and loan fees, the types of loans we offer and the quality of service that we provide to our borrowers. We also face substantial competition in attracting deposits from other banking institutions, money market and mutual funds, credit unions and other investment vehicles. Our ability to attract and retain deposits requires that we provide customers with competitive investment opportunities with respect to rate of return, liquidity, risk and other factors. To effectively compete, we may have to pay higher rates of interest to attract deposits, resulting in reduced profitability. In addition, we rely upon local promotional activities, personal relationships established by our officers, directors and employees and specialized services tailored to meet the individual needs of our customers in order to compete. If we are not able to effectively compete in our market area, our profitability may be negatively affected.

Our ability to attract and maintain customer and investor relationships depends largely on our reputation.

Damage to our reputation could undermine the confidence of our current and potential customers and investors in our ability to provide high-quality financial services. Such damage could also impair the confidence of our counterparties and vendors and ultimately affect our ability to effect transactions. Maintenance of our reputation depends not only on our success in maintaining our service-focused culture and controlling and mitigating the various risks described in this report, but also on our success in identifying and appropriately addressing issues that may arise in areas such as potential conflicts of interest, anti-money laundering, customer personal information and privacy issues, customer and other third-party fraud, record-keeping, technology-related issues including but not limited to cyber fraud, regulatory investigations and any litigation that may arise from the failure or perceived failure to comply with legal and regulatory requirements. Maintaining our reputation also depends on our ability to successfully prevent third parties from infringing on our brands and associated trademarks and our other intellectual property. Defense of our reputation, trademarks and other intellectual property, including through litigation, could result in costs that could have a material adverse effect on our business, financial condition, or results of operations.

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We are subject to extensive regulation, which could adversely affect our business.

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Federal and state banking regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations. Additionally, in order to conduct certain activities, including acquisitions, we are required to obtain regulatory approval. There can be no assurance that any required approvals can be obtained, or obtained without conditions or on a timeframe acceptable to us.

Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. Regulations affecting banks and other financial institutions, such as the Dodd-Frank Act, are continuously reviewed and change frequently. For instance, the Dodd-Frank Act has changed the bank regulatory framework, created an independent consumer protection bureau that has assumed the consumer protection responsibilities of the various federal banking agencies, and established more stringent capital standards for banks and bank holding companies. The ultimate effect of such changes cannot be predicted. Because our business is highly regulated, compliance with such regulations and laws may increase our costs and limit our ability to pursue business opportunities. There can be no assurance that laws, rules and regulations will not be proposed or adopted in the future, which could (i) make compliance much more difficult or expensive, (ii) restrict our ability to originate, modify, broker or sell loans or accept certain deposits, (iii) restrict our ability to foreclose on property securing loans, (iv) further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by us, or (v) otherwise materially and adversely affect our business or prospects for business. These risks could affect our deposit funding and the performance and value of our loan and investment securities portfolios, which could negatively affect our financial performance and financial condition.

While recent federal legislation has scaled back portions of the Dodd-Frank Act and the current administration in the United States may further roll back or modify certain of the regulations adopted since the financial crisis, including those adopted under the Dodd-Frank Act, uncertainty about the timing and scope of any such changes as well as the cost of complying with a new regulatory regime, may negatively impact our business, at least in the short-term, even if the long-term impact of any such changes are positive for our business.

We are subject to heightened regulatory requirements as our total assets exceed $10 billion.

With the acquisition of Grandpoint on July 1, 2018, our total assets exceeded $10 billion during the quarter ended September 30, 2018. The Dodd-Frank Act and its implementing regulations impose various additional requirements on bank holding companies with $10 billion or more in total assets, including a more frequent and enhanced regulatory examination regime. In addition, banks, including ours, with $10 billion or more in total assets are primarily examined by the CFPB with respect to various federal consumer financial protection laws and regulations, with the Federal Reserve maintaining supervision over some consumer related regulations. Previously, the Federal Reserve has been primarily responsible for examining our Bank’s compliance with consumer protection laws. As a relatively new agency with evolving regulations and practices, there is some uncertainty as to how the CFPB examination and regulatory authority might impact our business.

One key Dodd-Frank Act requirement applicable to banks with $10 billion or more in total assets has been compulsory stress testing (Dodd-Frank Act Stress Test or “DFAST”). The Economic Growth, Regulatory Relief, and Consumer Protection Act, signed into law on May 24, 2018, increased the asset threshold at which company-run stress tests are required from $10 billion to $250 billion. The elimination of DFAST has not eliminated the expectation of the regulatory agencies that we will conduct enhanced capital stress testing. However, standards establishing the framework surrounding such expectations have not been announced. The

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unknown nature and extent of future stress testing requirements creates uncertainty with respect to the impact of those requirements on our business.

Compliance with stress testing requirements may necessitate that we hire additional compliance or other personnel, design and implement additional internal controls, or incur other significant expenses, any of which could have a material adverse effect on our business, financial condition or results of operations

Federal and state regulatory agencies periodically conduct examinations of our business, including compliance with laws and regulations, and our failure to comply with any supervisory actions to which we are or become subject as a result of such examinations may adversely affect us.

Federal and state regulatory agencies, including the Federal Reserve, the DBO and the FDIC, periodically conduct examinations of our business, including compliance with laws and regulations. If, as a result of an examination, a regulatory agency were to determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that the Company or its management was in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance. If we become subject to such regulatory actions, our business, results of operations and reputation may be negatively impacted.

Changes in the value of goodwill and intangible assets could reduce our earnings.

When the Company acquires a business, a substantial portion of the purchase price of the acquisition is allocated to goodwill and other identifiable intangible assets. The amount of the purchase price, which is allocated to goodwill and other intangible assets is determined by the excess of the purchase price over the fair value of the net identifiable assets acquired. As of December 31, 2018, the Company had approximately $909.3 million of goodwill and intangible assets, which includes goodwill of approximately $808.7 million resulting from the acquisitions the Company has consummated since 2011. The Company accounts for goodwill and intangible assets in accordance with U.S. GAAP, which, in general, requires that goodwill not be amortized, but rather that it is tested for impairment at least annually at the reporting unit level. In testing for impairment of goodwill and intangible assets, the Company first performs a qualitative assessment of goodwill and intangible assets which considers the impact that various relevant economic, industry, market and company specific factors may have on the value of the Company. The Company’s qualitative assessment considers known positive and negative as well as any mitigating events and circumstances associated with each relevant factor that may be deemed to have an impact on the value of the Company. Should the Company’s qualitative assessment indicate the value of goodwill and intangible assets could be impaired, a quantitative assessment is then performed to determine if there is impairment. This assessment involves determining the fair value of the reporting unit (which in our case is the Company) and comparing that determination of fair value to the carrying value of the Company in order to quantify the amount of possible impairment. The estimation of fair values involves a high degree of judgment and subjectivity in the assumptions used. Changes in the local and national economy, the federal and state legislative and regulatory environments for financial institutions, the stock market, interest rates and other external factors (such as natural disasters or significant world events) may occur from time to time, often with great unpredictability, and may materially impact the fair value of publicly traded financial institutions and result in an impairment charge at a future date. If we were to conclude that a future write-down of our goodwill or intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, results of operations or financial condition.

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Recent and potential future acquisitions may disrupt our business.

We have consummated ten acquisitions since 2010. Most recently, on July 1, 2018, we completed the acquisition of Grandpoint, the holding company of Grandpoint Bank, a California state-chartered bank with $3.2 billion in total assets. The success of the Grandpoint acquisition or any future acquisition we may consummate will depend on, among other things, our ability to realize the anticipated revenue enhancements and efficiencies and to combine the businesses of Pacific Premier with Grandpoint or the target institution, as the case may be, in a manner that does not materially disrupt the existing customer relationships of Grandpoint or the target institution, as the case may be, or result in decreased revenues resulting from any loss of customers, and that permits growth opportunities to occur. If we are not able to successfully achieve these objectives, the anticipated benefits of the subject acquisition may not be realized fully or at all or may take longer to realize than expected.

It is possible that the ongoing Grandpoint integration process or the integration process associated with any future acquisition could result in the loss of key employees, the disruption of ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the acquisitions. Integration efforts could also divert management attention and resources. These integration matters could have an adverse effect on the combined company.

Potential future acquisitions may dilute stockholder value.

We continue to evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions on an ongoing basis. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our stock’s tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from recent or future acquisitions could have a material adverse effect on our financial condition and results of operations.

We cannot say with any certainty that we will be able to consummate, or if consummated, successfully integrate future acquisitions or that we will not incur disruptions or unexpected expenses in integrating such acquisitions. In attempting to make such future acquisitions, we anticipate competing with other financial institutions, many of which have greater financial and operational resources. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- Potential exposure to unknown or contingent liabilities of the target company;
- Exposure to potential asset quality issues of the target company;
- Potential disruption to our business;
- Potential diversion of management’s time and attention;
- The possible loss of key employees and customers of the target company;
- Difficulty in estimating the value of the target company; and
- Potential changes in banking or tax laws or regulations that may affect the target company.

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The tax reform legislation enacted in late 2017 could negatively affect our financial condition and results of operations.

In late 2017, the U.S. Congress passed significant legislation reforming the Internal Revenue Code known as the Tax Cuts and Jobs Act of 2017 (the “Tax Act”). In connection with the preparation of our consolidated financial statements for the fiscal year ended December 31, 2018, we completed the process of determining the accounting for the income tax effect of the Tax Act under ASC Topic 740, Income Taxes, as disclosed in the related notes to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 and subsequent filings made by us with the SEC. Although the Company has generally benefited from the legislation’s reduction in the federal corporate income tax rate, a tax rate reduction has broader implications for the Company’s operations as the new rates could cause positive or negative impacts on loan demand and on the Company’s pricing models, municipal bonds, tax credits and CRA investments and capital market transactions. Additionally, the interest deduction limitation implemented by the new tax law could make some businesses and industries less inclined to borrow, potentially reducing demand for the Company’s commercial loan products.

Technical corrections or other forthcoming guidance could change how we interpret provisions of the Tax Act, which may impact our effective tax rate and could affect our deferred tax assets, tax positions and/or our tax liabilities. The ultimate overall impact of any tax reform on our business, customers and shareholders is uncertain and could be adverse.

Changes in the fair value of our investment securities may reduce our stockholders’ equity and net income.

At December 31, 2018, $1.10 billion of our securities were classified as available-for-sale. At such date, the aggregate net unrealized loss on our available-for-sale securities was $7.9 million. We increase or decrease stockholders’ equity by the amount of change from the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of our available-for-sale securities portfolio, net of the related tax, under the category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders’ equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the case of equity securities, which have no stated maturity, the declines in fair value may or may not be recovered over time.

At December 31, 2018, we had stock holdings in the FHLB of San Francisco totaling $19.6 million, $51.5 million in FRB stock, and $37.7 million in other stock, all carried at cost. The stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. For the year ended December 31, 2018, we did not recognize an impairment charge related to our stock holdings. There can be no assurance that future negative changes to the financial condition of the issuers may require us to recognize an impairment charge with respect to such stock holdings.

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Risks Related to Ownership of Our Common Stock

The price of our common stock, like many of our peers, has fluctuated significantly over the recent past and may fluctuate significantly in the future, which may make it difficult for you to resell your shares of common stock at times or at prices you find attractive.

Stock price volatility may make it difficult for holders of our common stock to resell their common stock when desired and at desirable prices. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Inaccurate management decisions regarding the fair value of assets and liabilities acquired which could materially affect our financial condition;
- Natural disasters, fires, and severe weather;
- Internal controls may fail;
- Reliance on other companies to provide key components of our business processes;
- Meeting capital adequacy standards and the need to raise additional capital in the future if needed, including through future sales of our common stock;
- Actual or anticipated variations in quarterly results of operations;
- Recommendations by securities analysts;
- Failure of securities analysts to cover, or continue to cover, us;
- Operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions in the current economic downturn;
- Perceptions in the marketplace regarding us and/or our competitors;
- Departure of our management team or other key personnel;
- Cyber security breaches of the company or contracted partners;
- New technology used, or services offered, by competitors;
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- Existing or increased regulatory and compliance requirements, changes or proposed changes in laws or regulations, or differing interpretations thereof affecting our business, or enforcement of these laws and regulations;
- Litigation and governmental investigations;
- Changes in government regulations; and
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results as evidenced by the current volatility and disruption of capital and credit markets.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The Company’s headquarters are located in Irvine, California at 17901 Von Karman Avenue. As of December 31, 2018, our properties included 19 administrative offices and 44 branches. We owned 13 properties and leased the remaining properties throughout Orange, Los Angeles, Riverside, San Bernardino, San Diego, San Luis Obispo and Santa Barbara Counties, California as well as Pima and Maricopa Counties, Arizona, Clark County, Nevada and Clark County, Washington. The lease terms are not individually material and range from month-to-month to ten years from inception date.

All of our existing facilities are considered to be adequate for our present and anticipated future use. In the opinion of management, all properties are adequately covered by insurance.

For additional information regarding properties of the Company, see Note 7. Premises and Equipment of the Notes to the Consolidate Financial Statements contained in “Item 8. Financial Statements and Supplementary.”

ITEM 3. LEGAL PROCEEDINGS

The Company is not involved in any material pending legal proceedings other than legal proceedings occurring in the ordinary course of business. Management believes that none of these legal proceedings, individually or in the aggregate, will have a material adverse impact on the results of operations or financial condition of the Company

ITEM 4. MINE SAFETY DISCLOSURES

None.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Shareholder Information

The common stock of the Corporation has been publicly traded since 1997 and is currently traded on the NASDAQ Global Market under the symbol PPBI. As of February 22, 2019, there were approximately 12,729 holders of record of our common stock.

Equity Compensation Plan Information

The following table provides information as of December 31, 2018, with respect to options and RSUs outstanding and shares available for future awards under the Company's active equity incentive plans.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders:			
Pacific Premier Bancorp, Inc. 2004 Long-term Incentive Plan	40,105	$ 13.80	—
Pacific Premier Bancorp, Inc. Amended and Restated 2012 Stock Long-term Incentive Plan	578,063	14.88	3,272,558
Heritage Oaks Bancorp, Inc. 2005 Equity Incentive Plan	35,950	17.87	—
Heritage Oaks Bancorp, Inc. 2015 Equity Incentive Plan	27,815	21.63	652,866
Equity compensation plans not approved by security holders	—	—	—
Total Equity Compensation plans	681,933	15.26	3,925,424

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Stock Performance Graph. The graph below compares the performance of our common stock with that of the NASDAQ Composite Index (U.S. companies) and the NASDAQ Bank Stocks Index from December 31, 2013 through December 31, 2018. The graph is based on an investment of $100 in our common stock at its closing price on December 31, 2013. The Corporation has not paid any dividends on its common stock.

Total Return to Stockholders
(Assumes $100 investment on 12/31/2013)

Total Return Analysis	12/31/2013	12/31/2014	12/31/2015	12/30/2016	12/29/2017	12/31/2018
Pacific Premier Bancorp, Inc.	$ 100.00	$ 110.10	$ 135.01	$ 224.59	$ 254.13	$ 162.13
NASDAQ Composite Index	100.00	113.40	119.89	128.89	165.29	158.87
NASDAQ Bank Stocks Index	100.00	102.84	109.65	148.06	153.26	125.82

Dividends

In January 2019, we announced the initiation of a quarterly cash dividend. We had not previously declared or paid dividends on our common stock. On January 28, 2019, the Corporation’s board of directors declared a $0.22 per share cash dividend, payable on March 1, 2019 to shareholders of record on February 15, 2019. The Corporation anticipates continuing a regular quarterly cash dividend thereafter targeting a 35% initial payout ratio. However, we have no obligation to pay dividends and we may change our dividend policy at any time without notice to our shareholders. Any future determination to pay dividends to holders of our common stock will depend on our results of operations, financial condition, capital requirements, banking regulations, contractual restrictions and any other factors that our board of directors may deem relevant.

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Our ability to pay dividends on our common stock is dependent on the Bank's ability to pay dividends to the Corporation. Various statutory provisions restrict the amount of dividends that the Bank can pay without regulatory approval. For information on the statutory and regulatory limitations on the ability of the Corporation to pay dividends to its stockholders and on the Bank to pay dividends to the Corporation, see "Item 1. Business-Supervision and Regulation—Dividends" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity."

Unregistered Sales of Equity Securities and Use of Proceeds

On October 26, 2018, the Corporation's board of directors approved its third stock repurchase program. Under the third stock repurchase program, the Corporation is authorized to repurchase up to $100 million of its common stock. The program may be limited or terminated at any time without prior notice. The Company did not repurchase any shares under the recently approved stock repurchase program. The stock repurchase program is intended to replace and supersede the Company's prior stock repurchase program, which was approved in June 2012 and authorized the repurchase of up to 1,000,000 shares of the Company's common stock. An aggregate of 237,455 shares were repurchased under that program.
The following table provides information with respect to purchases made by or on behalf of us or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the fourth quarter of 2018.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2018 to October 31, 2018	—	—	—	$100,000,000
November 1, 2018 to November 30, 2018	—	—	—	100,000,000
December 1, 2018 to December 31, 2018	—	—	—	100,000,000
Total	—		—	

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain of our consolidated financial and statistical information at or for each of the years presented. This data should be read in conjunction with our audited consolidated financial statements as of December 31, 2018 and 2017, and for each of the years in the three-year period ended December 31, 2018 and related Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data."

	For the Years Ended December 31,				
	2018	2017	2016	2015	2014
Operating Data	(dollars in thousands, except per share data)				
Interest income	$448,423	$270,005	$166,605	$118,356	$81,339
Interest expense	55,712	22,503	13,530	12,057	7,704
Net interest income	392,711	247,502	153,075	106,299	73,635
Provision for credit losses	8,253	8,432	9,296	6,631	4,739
Net interest income after provision for credit losses	384,458	239,070	143,779	99,668	68,896
Net gains from loan sales	10,759	12,468	9,539	7,970	6,300
Other noninterest income	20,268	18,646	10,063	6,418	7,077
Noninterest expense	249,905	167,958	98,063	73,332	54,938
Income before income tax	165,580	102,226	65,318	40,724	27,335
Income tax	42,240	42,126	25,215	15,209	10,719
Net income	$123,340	$60,100	$40,103	$25,515	$16,616
Share Data					
Net income per share:					
Basic	$2.29	$1.59	$1.49	$1.21	$0.97
Diluted	2.26	1.56	1.46	1.19	0.96
Weighted average common shares outstanding:					
Basic	53,963,047	37,705,556	26,931,634	21,156,668	17,046,660
Diluted	54,613,057	38,511,261	27,439,159	21,488,698	17,343,977
Book value per share (basic)	$31.52	$26.86	$16.54	$13.86	$11.81
Book value per share (diluted)	31.38	26.73	16.78	13.78	11.73
Selected Balance Sheet Data					
Total assets	$11,487,387	$8,024,501	$4,036,311	$2,789,599	$2,037,731
Securities and FHLB stock	1,257,251	871,601	426,832	312,207	218,705
Loans held for sale, net	5,719	23,426	7,711	8,565	—
Loans held for investment, net	8,800,746	6,167,288	3,220,317	2,336,998	1,616,422
Allowance for loan losses	36,072	28,936	21,296	17,317	12,200
Total deposits	8,658,351	6,085,886	3,145,581	2,195,123	1,630,826
Total borrowings	777,994	641,410	397,354	265,388	185,787
Total stockholders' equity	1,969,697	1,241,996	459,740	298,980	199,592
Performance Ratios					
Return on average assets	1.26 %	0.99 %	1.11 %	0.97 %	0.91 %
Return on average equity	7.71	6.75	9.30	9.31	8.76
Average equity to average assets	16.33	14.62	11.97	10.45	10.38
Equity to total assets at end of period	17.15	15.48	11.39	10.72	9.79
Average interest rate spread	4.00	4.18	4.22	4.01	4.01
Net interest margin	4.44	4.43	4.48	4.25	4.21

Efficiency ratio [1]	51.6		50.9		53.6		55.9		61.3	
Average interest-earnings assets to average interest-bearing deposits and borrowings	169.84		164.66		166.42		149.17		145.45	
Pacific Premier Bank Capital Ratios										
Tier 1 leverage ratio	11.06	%	11.59	%	10.94	%	11.41	%	11.29	%
Common equity tier 1 risk-weighted capital ratio	11.87		11.77		11.65		12.35	%	N/A	
Tier 1 capital to total risk-weighted assets	11.87		11.77		11.65		12.35		12.72	
Total capital to total risk-weighted assets	12.28		12.22		12.29		13.07		13.45	
Pacific Premier Bancorp, Inc. Capital Ratios										
Tier 1 leverage ratio	10.38	%	10.61	%	9.78	%	9.52	%	9.18	%
Common equity tier 1 risk-weighted capital ratio	10.88		10.48		10.12		9.91	%	N/A	
Tier 1 capital to total risk-weighted assets	11.13		10.78		10.41		10.28		10.30	
Total capital to total risk-weighted assets	12.39		12.46		12.72		13.43		14.46	
Asset Quality Ratios										
Nonperforming loans to loans held for investment	0.05	%	0.05	%	0.04	%	0.18	%	0.09	%
Nonperforming assets as a percent of total assets	0.04		0.04		0.04		0.18		0.12	
Net charge-offs to average total loans, net	0.01		0.02		0.17		0.06		0.05	
Allowance for loan losses to loans held for investment at period end	0.41		0.47		0.66		0.74		0.75	
Allowance for loan losses as a percent of nonperforming loans, gross at period end	743		881		1,866		436		845	

[1] Represents the ratio of noninterest expense less other real estate owned operations, core deposit intangible amortization and merger related expense to the sum of net interest income before provision for credit losses and total noninterest income less gains/(loss) on sale of securities, other-than-temporary impairment recovery/(loss) on investment securities, gain on acquisitions and gain/(loss) from other real estate owned.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations is intended to provide a better understanding of the significant changes in trends relating to the Company's financial condition, results of operation, liquidity and capital resources. This section should be read in conjunction with the disclosures regarding "Forward-Looking Statements" set forth in "Item I. Business-Forward Looking Statements", as well as the discussion set forth in "Item 8. Financial Statements and Supplementary Data," including the notes to consolidated financial statements.

Acquisition of Grandpoint

Effective July 1, 2018, we completed our acquisition of Grandpoint pursuant to an agreement and plan of reorganization dated as of February 9, 2018 by and between the Corporation and Grandpoint. Prior to the acquisition, Grandpoint was headquartered in Los Angeles, California and operated 14 regional offices in Southern California. As a result of the acquisition, the Bank acquired approximately$3.05 billion in total assets, $2.40 billion in gross loans and $2.51 billion in total deposits as of the date of the acquisition.

In connection with the consummation of the acquisition, the Corporation issued approximately 15,758,089 shares of its common stock valued at $38.15 per share, which was the closing price for the Corporation's common stock on June 29, 2018, which was the last trading day prior to the consummation of the merger. The value of the total transaction consideration was approximately $601.2 million after approximately $28.1 million in aggregate cash consideration payable to holders of Grandpoint share-based compensation awards by Grandpoint.

Goodwill in the amount of $313.0 million was recognized in the Grandpoint acquisition. Goodwill represents the future economic benefits rising from net assets acquired that are not individually identified and separately recognized and is attributable to synergies expected to be derived from the combination of the two entities. Goodwill recognized in this transaction is not deductible for income tax purposes.

Grandpoint acquisition was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date, in accordance with FASB ASC Topic 805, Business Combinations. The fair values of the assets acquired and liabilities assumed were determined based on the requirements of FASB ASC Topic 820: Fair Value Measurements and Disclosures. Such fair values are preliminary estimates and subject to refinement for up to one year after the closing date of acquisition as additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. Fair value adjustments will be finalized no later than July 2019.

Summary

Our principal business is attracting deposits from small and middle market businesses and consumers and investing those deposits, together with funds generated from operations and borrowings, primarily in commercial business loans and various types of commercial real estate loans. The Company expects to fund substantially all of the loans that it originates or purchases through deposits, FHLB advances and other borrowings and internally generated funds. Deposit flows and cost of funds are influenced by prevailing market rates of interest primarily on competing investments, account maturities and the levels of savings in the Company's market area. The Company generates the majority of its revenues from interest income on loans that it originates and purchases, income from investment in securities and service charges on customer accounts. The Company's revenues are partially offset by interest expense paid on deposits and borrowings, the provision for loan losses and noninterest expenses, such as operating expenses. The Company's operating expenses primarily consist of employee compensation and benefit expenses, premises and occupancy expenses, data processing and communication

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expenses and other general expenses. The Company's results of operations are also affected by prevailing economic conditions, competition, government policies and other actions of regulatory agencies.

Critical Accounting Policies and Estimates

We have established various accounting policies that govern the application of accounting principles generally accepted in the United States of America in the preparation of the Company's financial statements in Item 8 hereof. The Company's significant accounting policies are described in Note 1 to the Consolidated Financial Statements. Certain accounting policies require management to make estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities; management considers these to be critical accounting policies. The estimates and assumptions management uses are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at consolidated statements of financial condition dates and the Company's results of operations for future reporting periods.

Allowance for Loan Losses

We consider the determination of ALLL to be among our critical accounting policies,requiring judicious estimates and assumptions in the preparation of the Company's financial statements and being particularly susceptible to significant change. The Company maintains an ALLL at a level deemed appropriate by management to provide for known or probable incurred losses in the portfolio at the consolidated statements of financial condition date. The Company has implemented and adheres to an internal loan review system and loss allowance methodology designed to provide for the detection of problem loans and maintenance of an adequate allowance to cover loan losses. Management's determination of the adequacy of ALLL is based on an evaluation of the composition of the portfolio, actual loss experience, industry charge-off experience on loans, current economic conditions, and other relevant factors in the areas in which the Company's lending and real estate activities are based. These factors may affect the borrowers' ability to pay and the value of the underlying collateral. The allowance is calculated by applying loss factors to loans held for investment according to loan type and loan credit classification. The loss factors are evaluated on a quarterly basis and established based primarily upon the Bank's historical loss experience and, to a lesser extent, the industry charge-off experience. Various regulatory agencies, as an integral part of their examination process, periodically review the Company's ALLL. Such agencies may require the Bank to recognize additions to the allowance based on judgments different from those of management. In the opinion of management, and in accordance with the credit loss allowance methodology, the present allowance is considered adequate to absorb estimable and probable credit losses. Additions and reductions to the allowance are reflected in current operations. Charge-offs to the allowance are made when specific loans (or portions thereof) are considered uncollectible or are transferred to OREO and the fair value of the property is less than the loan's recorded investment. Recoveries are credited to the allowance.

Although management uses the best information available to make these estimates, future adjustments to the allowance may be necessary due to economic, operating, regulatory and other conditions that may be beyond the Company's control. For further information on the ALLL, see Notes 1 and 5 to the Consolidated Financial Statements in Item 8 hereof.

Business Combinations

We account for acquisitions under the acquisition method. All identifiable assets acquired and liabilities assumed are recorded at fair value. Any excess of the purchase price over the fair value of net assets and other identifiable intangible assets acquired is recorded as goodwill. Identifiable intangible assets include core deposit intangibles, which have a definite life. Core deposit intangibles ("CDI") are subsequently amortized over the estimated life up to 10 years and are tested for impairment annually. Goodwill generated from business combinations is deemed to have an indefinite life and is not subject to amortization, and instead is tested for impairment at least annually.

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As part of the estimation of fair value, we review each loan or loan pool acquired to determine whether there is evidence of deterioration in credit quality since inception and if it is probable that the Company will be unable to collect all amounts due under the contractual loan agreements. We consider expected prepayments and estimated cash flows including principal and interest payments at the date of acquisition. If a loan is determined to be a purchased credit impaired (“PCI”) loan, the amount in excess of the estimated future cash flows is not accreted into earnings (non-accretable difference). The amount in excess of the estimated future cash flows over the book value of the loan is accreted into interest income over the remaining life of the loan (accretable yield). The Company records these loans on the acquisition date at their net realizable value. Thus, an allowance for estimated future losses is not established on the acquisition date. Losses or a reduction in cash flow, which arise subsequent to the date of acquisition are reflected as a charge through the provision for loan losses. An increase in the expected cash flows adjusts the level of the accretable yield recognized on a prospective basis over the remaining life of the loan.

Income Taxes

Deferred tax assets and liabilities are recorded for the expected future tax consequences of events that have been recognized in the Company’s financial statements or tax returns using the asset liability method. In estimating future tax consequences, all expected future events other than enactments of changes in the tax laws or rates are considered. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are to be recognized for temporary differences that will result in deductible amounts in future years and for tax carryforwards if, in the opinion of management, it is more likely than not that the deferred tax assets will be realized. See also Note 14 of the Consolidated Financial Statements in Item 8 hereof.

Fair Value of Financial Instruments

We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Investment securities available-for-sale are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a non-recurring basis, such as impaired loans and OREO. These non-recurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write-downs of individual assets. During the first quarter of 2018, the Company adopted ASU 2016-01 and measures the fair value of financial instruments reported at amortized cost on the consolidated statement of financial condition using the exit price notion. Further, we include in Note 18 to the Consolidated Financial Statements information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. Additionally, for financial instruments not recorded at fair value we disclose the estimate of their fair value.

Operating Results

Overview. The comparability of financial information is affected by our acquisitions. On July 1, 2018, the Company completed the acquisition of Grandpoint.

Non-GAAP Measurements

The Company uses certain non-GAAP financial measures to provide meaningful supplemental information regarding the Company’s operational performance and to enhance investors’ overall understanding of such financial performance. However, these non-GAAP financial measures are supplemental and are not a substitute for an analysis based on GAAP measures and may not be comparable to non-GAAP financial measures that may be presented by other companies. The non-GAAP measures used in this Form 10-K include the following:

- Tangible common equity: Total stockholders’ equity is reduced by the amount of intangible assets, including goodwill.

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- Tangible common equity amounts and ratios, tangible assets and tangible book value per share: Given that the use of these measures is prevalent among banking regulators, investors and analysts, we disclose them in addition to equity-to-assets ratio, total assets and book value per share, respectively.

The following tables provide reconciliations of the non-GAAP measures with financial measures defined by GAAP:

	For the Years ended December 31,		
	2018	2017	2016
	(dollars in thousands)		
Total stockholders' equity	$1,969,697	$1,241,996	$459,740
Less: Intangible assets	909,282	536,343	111,941
Tangible common equity	$1,060,415	$705,653	$347,799
Total assets	$11,487,387	$8,024,501	$4,036,311
Less: Intangible assets	909,282	536,343	111,941
Tangible assets	$10,578,105	$7,488,158	$3,924,370
Common Equity ratio	17.15 %	15.48 %	11.39 %
Less: Intangible equity ratio	7.13	6.06	2.53
Tangible common equity ratio	10.02 %	9.42 %	8.86 %
Basic shares outstanding	62,480,755	46,245,050	27,798,283
Book value per share	$31.52	$26.86	$16.54
Less: Intangible book value per share	14.55	11.60	4.03
Tangible book value per share	$16.97	$15.26	$12.51

Net Interest Income. Our primary source of revenue is net interest income, which is the difference between the interest earned on loans, investment securities, and interest earning balances with financial institutions ("interest-earning assets") and the interest paid on deposits and borrowings ("interest-bearing liabilities"). Net interest margin is net interest income expressed as a percentage of average interest earning assets. Net interest income is affected by changes in both interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities.

For 2018, net interest income totaled $392.7 million, an increase of $145.2 million or 59% from 2017. The increase reflected an increase in average interest-earning assets of $3.25 billion, primarily due to the acquisition of Grandpoint on July 1, 2018 and PLZZ on November 1, 2017, which at acquisition added $2.40 billion and $1.06 billion of loans, respectively, and organic loan growth from new loan originations of $1.62 billion in 2018, partially offset by an increase in interest-bearing liabilities of $1.81 billion and loan paydowns of $1.28 billion. Net interest margin increased 1 basis point to 4.44% from 2017, primarily due to the yield on interest-earning assets' increasing 23 basis points and a higher level of increases in the balances of interest-earning assets relative to interest-bearing liabilities, offset by a 41 basis point increase in the cost of interest-bearing liabilities.

For 2017, net interest income totaled $247.5 million, an increase of $94.4 million or 62% from 2016. The increase reflected an increase in average interest-earning assets of $2.17 billion, primarily due to the acquisitions of HEOP and PLZZ in the second and fourth quarter of 2017, respectively. Net interest margin decreased 5 basis points to 4.43% from 2016, primarily due to yield on interest-earning assets decreasing 4 basis points and a slight increase in cost of funds.

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

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

The table also sets forth our net interest income, net interest rate spread and net interest rate margin for the periods indicated. The net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities. The net interest rate margin reflects the ratio of net interest income as a percentage of interest-earning assets for the year.

	For the Years Ended December 31,								
	2018			2017			2016		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
	(dollars in thousands)								
Assets									
Interest-earning assets:									
Cash and cash equivalents	$221,236	$2,123	0.96 %	$140,402	$842	0.60 %	$180,185	$762	0.42 %
Investment securities	1,087,835	30,890	2.84	718,564	18,136	2.52	334,283	7,908	2.37
Loans receivable, net [(1)]	7,527,004	415,410	5.52	4,724,808	251,027	5.31	2,900,379	157,935	5.45
Total interest-earning assets	8,836,075	448,423	5.07 %	5,583,774	270,005	4.84 %	3,414,847	166,605	4.88 %
Noninterest-earning assets	958,842			511,109			186,564		
Total assets	$9,794,917			$6,094,883			$3,601,411		
Liabilities and Equity									
Interest-bearing deposits:									
Interest checking	$438,698	$1,167	0.27 %	$293,450	$365	0.12 %	$176,508	$203	0.11 %
Money market	2,624,106	19,567	0.75	1,701,209	6,720	0.40	1,003,861	3,638	0.36
Savings	241,686	357	0.15	189,408	251	0.13	98,224	151	0.15
Retail certificates of deposit	897,033	10,937	1.22	556,121	3,390	0.61	416,232	3,084	0.74