PACIFIC PREMIER BANCORP INC
Form 10-K
April 02, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

or

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

For the transition period from to ..

Commission File No.: 0-22193

Pacific Premier Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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

1600 Sunflower Ave. 2nd Floor, Costa Mesa, California 92626

(714) 431-4000

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

Common Stock, par value $0.01 per share
(Title of class)

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

None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o 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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. x

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes o 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 $57,356,443 and was based upon the last sales price as quoted on The NASDAQ Stock Market as of June 30, 2006, the last business day of the most recently completed 2nd fiscal quarter.

As of March 30, 2007, the Registrant had 5,213,488 shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Overview

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

The statements contained herein that are not historical facts are forward looking statements based on management s current expectations and beliefs concerning future developments and their potential effects on the Company. There can be no assurance that future developments affecting the Company will be the same as those anticipated by management. Actual results may differ from those projected in the forward-looking statements. These forward-looking statements involve risks and uncertainties. These include, but are not limited to, the following risks: (1) changes in the performance of the financial markets, (2) changes in the demand for and market acceptance of the Company s products and services, (3) changes in general economic conditions including interest rates, presence of competitors with greater financial resources, and the impact of competitive projects and pricing, (4) the effect of the Company s policies, (5) the continued availability of adequate funding sources, and (6) various legal, regulatory and litigation risks.

We are a California-based holding company for Pacific Premier Bank, a federally-chartered savings bank. As the Company continues to transition to a commercial business platform, management determined that a California commercial bank charter was better aligned with its strategic plans. Accordingly, management submitted a conversion application in June 2006 to the California Department of Financial Institutions (DFI) and the Federal Deposit Insurance Corporation (FDIC) to convert its existing federal savings bank charter to a California chartered commercial bank. In connection with the charter conversion, the Company will become a bank holding company regulated by the Board of Governors of the Federal Reserve System (Federal Reserve Board). We expect the charter conversion to be completed in the first quarter of 2007.

We conduct business throughout Southern California from our six locations in the counties of Los Angeles, Orange and San Bernardino. We operate five depository branches in the cities of Costa Mesa, Huntington Beach, Los Alamitos, San Bernardino and Seal Beach, a Small Business Administration (SBA) loan production office in Pasadena and our corporate headquarters in Costa Mesa California. In the first quarter of 2007, we opened an additional depository branch in the City of Newport Beach, California.

We provide banking services within our targeted markets in Southern California to businesses, including the owners and employees of those businesses, professionals, real estate investors and non-profit organizations, as well as, consumers in the communities we serve. Through our branches and our web site at www.PPBI.net on the Internet, we offer a broad array of deposit products and services for both commercial businesses, professionals, non-profit organizations, and consumer customers including checking, money market and savings accounts, cash management services, electronic banking, and on-line bill payment. Our employees are compensated to increase low cost deposits through relationship banking. We offer a wide array of loan products, such as commercial business loans, lines of credit, commercial real estate loans, SBA loans, residential home loans, and home equity loans. At December 31, 2006, we had consolidated total assets of $730.9 million, net loans of $605.1 million, total deposits of $339.4 million, consolidated total stockholders equity of $58.0 million, and the Bank was considered a well-capitalized financial institution for regulatory capital purposes.

History

The Bank was founded in 1983 as a state chartered savings and loan and converted to a federally chartered stock savings bank in 1991. From 1983 to 1994, the Bank engaged in traditional community banking activities, consisting primarily of deposit taking and originating one-to-four family home loans. In 1994, the Bank shifted its operating strategy and implemented a nationwide sub-prime focused mortgage banking platform. The Bank expanded its operations to originate and to sell sub-prime residential home loans through asset securitizations and whole loan sales. Lending activities were funded primarily through non-core deposits, such as wholesale and brokered certificates of deposit (CDs), as well as, high rate consumer CDs. In 1998, the Company and Bank began to experience losses. By the third quarter of 2000, the Bank was deemed under-capitalized, was operating under regulatory enforcement agreements and incurring losses primarily due to loan defaults.

The current management team was retained and implemented a new business plan in the fourth quarter of 2000 in order to primarily refocus the Company s business model toward a community bank. We implemented a three phase strategic plan which involved (1) lowering the risk profile of the Bank and re-capitalizing the Company, (2) growing the balance sheet at an accelerated rate through the origination of adjustable rate multi-family loans, thus, returning the Company to profitability, and (3) transforming the institution to a commercial banking business model. The first two phases of our plan were completed in 2002 and 2004, respectively. Phase three of our plan involves the transition to a commercial banking platform and, thus, we are focusing on changing the deposit base to a higher percentage of low cost core deposits and a diversification of the Bank s loan portfolio. We began implementing this phase of our strategic plan in late 2004 through a shift in our corporate focus towards relationship banking.

When we implemented the second phase of our plan in 2002, our lending was focused on multi-family or apartment loans. We began originating these loans in the second quarter of 2002 with a focus on small to medium-sized loans, in the $200,000 to $2.0 million range, as we believe this market was underserved, especially in Southern California. During 2005, we began shifting our focus towards commercial real estate loans, both owner occupied and investor owned, and commercial and industrial (C&I) business loans as part of our strategic transition towards a commercial banking platform. In 2006, we added SBA loans as part of our commercial banking platform. We will continue to originate multi-family loans that satisfy our loan criteria and compliment our business plan.

Operating Strategy

Our goal is to develop the Bank into one of Southern California s top performing commercial banks as an alternative to the large regional and national banks for small businesses, professionals and real estate entrepreneurs for the long term benefit of our shareholders, customers and employees. The following are our operating strategies to achieve our goals:

- *Recruitment of Commercial Bankers*. We began our transition to a commercial banking platform in 2005 by recruiting experienced commercial bankers who possess an established following of customer relationships. These relationships typically include businesses that have both deposit and loan needs, as well as, the personal depository needs of the business owners themselves. Our incentive plans compensate our commercial bankers for the generation and retention of customer relationships as measured by the level of low cost deposits maintained at the Bank. We will continue to recruit experienced bankers to staff our branches and serve our targeted markets.

- *Relationship Banking.* We recognize that customer relationships are built through a series of consistently executed experiences in both routine transactions and higher value interactions. Our commercial bankers are focused on developing long term relationships with business owners, professionals, real estate investors, and non-profit organizations through consistent and frequent contact. Our bankers work closely with our real estate originators to cross-sell clients to ensure we are capturing the entire banking relationship of each customer with which we do business. Our bankers are actively involved in community organizations and events, thus building and capitalizing on the Bank s reputation within our local communities.

- *Growing Core Deposits/Reducing our Wholesale Funding.* The second phase of our strategic plan relied on wholesale borrowings, such as advances from Federal Home Loan Bank (FHLB) System and brokered deposits to fund a large portion of our accelerated growth during that phase. As we transition towards a commercial banking platform, we intend to reduce our reliance on these funding sources over time. We will manage our growth and our concentration in commercial real estate, in part, by selling excess loan production, generally multi-family loans. We also expect to increase the growth of low cost core deposit accounts via the expansion of our branch network, in order to better serve our market area and to attract additional small business customers. We opened two new branches in the cities of Los Alamitos and Costa Mesa in 2006. Additionally, we relocated our Huntington Beach branch to a new facility which will enable us to better serve our existing business clients and to attract additional business in the surrounding area. In the first quarter of 2007, we will open our sixth full service branch in Newport Beach to serve the business owners, professionals, real estate entrepreneurs, non-profit organizations, and consumers of Newport Beach and the surrounding communities.

- *Expansion through de novo branches, organic growth and acquisitions*. We believe that the consolidation in the banking industry has created an opportunity at the community banking level in the areas that we serve. Many bank customers feel displaced by large out-of-market acquirers and are attracted to local institutions that have local decision making capability, more responsive customer service, and more familiarity with the needs in their markets. We intend to continue expanding our franchise in the high growth areas of Orange and Los Angeles Counties, including the previously mentioned branches. Furthermore, as opportunities arise, we will consider expansion into markets contiguous to our own through potential acquisitions and/or de novo branching.

- *Diversifying our Loan Portfolio.* We believe it is important to diversify our loan portfolio and to increase the amount of commercial real estate, C&I loans and SBA loans within our portfolio. As a result, we believe it is essential to be able to offer our customers a wide array of products and services. We provide flexible and structured loan products to meet our customer s needs, which, in turn, provide us the opportunity to become their full service banker. We continually reassess our various product and service offerings to ensure they allow us to achieve our objectives.

- *Change in our Banking Charter.* As we increase the amount of the commercial real estate and C&I loans in our portfolio we will begin to approach the maximum amount of non-residential real estate loans allowed under our current charter (i.e., four times our regulatory capital). Additionally, our charter limits the amount of C&I loans we may invest in up to 20% of our assets, provided that the amounts in excess of 10% of total assets are used for small business loans. Consequently, the Bank and Company have filed applications to change its charter from a federally-chartered savings association whose primary regulator is the Office of Thrift Supervision (OTS) to a California chartered commercial bank whose primary regulator is the DFI. In connection with such a charter change, the Federal Reserve Board would become the primary regulator of the Company. We expect the change in the charter to be completed sometime in the first quarter of 2007.

- *Maintain Excellent Asset Quality*. Our credit and risk management culture has resulted in low levels of nonperforming loans and an overall high credit quality within our loan portfolio. We monitor existing economic trends and conditions that could positively or negatively impact our business. We will continue to adjust our risk management practices to changes in the conditions that impact our business.

- *Premier Customer Service Provider*. We believe it is imperative that the Bank provide a consistent level of quality service which generates customer retention and referrals. All of our employees, through training, understand that each interaction with our customers is an opportunity to exceed their expectations. Our employees incentive compensation is, in part, predicated on achieving a consistently high level of customer satisfaction.

Our executive offices are located at 1600 Sunflower Avenue, 2nd Floor, Costa Mesa, California 92626 and our telephone number is (714) 431-4000. Our internet website address is www.ppbi.net. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and all amendments thereto, from 1998 to present, are available free of charge on our internet website. Also on our website are our Code of Ethics, Insider Trading and Beneficial Ownership forms, and Corporate Governance Guidelines. 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.

Lending Activities

General. In 2006, we continued our efforts to diversify our lending activities as the Bank transitioned toward a commercial banking platform. We focused on increasing C&I, SBA and commercial real estate lending activities in addition to continuing our strong multi-family lending programs. Loans were made primarily to borrowers within our market area and secured by real property and business assets located principally in Southern California. We emphasized relationship lending, and focused on generating retail production by dealing directly with customers. We have and will continue to offer loans up to our legal lending limit, which was $9.7 million as of December 31, 2006. These efforts assisted us in establishing depository relationships with new and existing customers consistent with the Bank s strategic direction. During 2006, we originated $182.4 million in multi-family, $90.8 million in commercial real estate and land loans, and $72.1 million of business loans consisting of $28.4 million of commercial real estate owner-occupied loans, $34.5 million of C&I loans, and $9.2 million of SBA loans and $1.5 million in other loans. At December 31, 2006, we had $607.6 million in total gross loans outstanding.

Sourcing of our Loans. We primarily obtain new multi-family and commercial real estate loans, from established relationships with mortgage brokers operating throughout Southern California. Our commercial bankers work out of our corporate office and are responsible for building and maintaining these relationships. In 2006, we maintained relationships with over 50 brokerage companies of which five could be termed significant. In 2006, the top five brokerage companies accounted for 62.0% of the multi-family and commercial real estate loans originated by the Bank. Within these five brokerage companies, we funded loans with a total of 26 different agents. Our commercial bankers have relationships with these individuals and seek to maintain the relationship regardless of where these agents are employed. Additionally, our bankers seek to establish relationships with other agents within these brokerage companies that have not done business with us in the past.

Direct loan originations in 2006 accounted for 25.9% of our loans, which represented an increase of 134.9% over 2005. These loans were sourced through referrals from our depository branches and by soliciting these loans directly. Our bankers will continue to focus on developing and maintaining relationships with individual investors, accountants, consultants, commercial real estate investment sales and leasing agents, and other banks to further increase the percentage of direct referrals in future periods.

Commercial business loans are sourced by our Business Development Officers and Branch Managers. These bankers call on business owners, accountants, attorneys, consultants, non-profit organizations, and various other referral sources to generate new business banking relationships. Upon securing the business banking relationships, they work with the business owner to offer personal banking products and services to the business owner, their families, and the businesses employees as well. Additionally, our Branch

Managers work closely with our commercial bankers to capture the full banking needs of our multi-family and commercial real estate loan customers.

SBA loans are sourced by our SBA lending office in Pasadena, CA, our web site, brokers, and through direct contact by our Business Development Officers and Branch Managers. As with other business loans, our bankers work to establish full banking relationships with our SBA loan customers.

Interest Rates on Our Loans. We employ a risk-based pricing strategy on all loans we fund. The interest rates we charge on our loans generally vary based on a number of factors, including the degree of credit risk, size, maturity of the loan, borrower/property management/business expertise, and prevailing market rates for similar types of loans. Depending on market conditions at the time the loan is originated, certain loan agreements will include prepayment penalties. All of the multi-family and commercial real estate loans originated in 2006, except for two loans, had a prepayment penalty provision. Most of our loans are adjustable-rate, and 3, 5, 7, or 10 year fixed rate hybrid adjustable-rate loans and are based on one of several interest rate indices. Mostly all of the loans originated by the Bank in 2006 were fixed rate hybrid adjustable-rate loans and had minimum interest rates (floor rates) at which the rate charged may not be reduced further regardless of further reductions in the underlying interest rate index.

Lending Risks on our Loans. The majority of our loans involve larger extensions of credit to a single borrower that are generally viewed as exposing us to a greater risk than one-to-four family residential lending. The liquidation values of the properties securing our multi-family and commercial real estate loans may be adversely affected by risks generally incidental to interests in real property, such as:

- Changes or continued weakness in general or local economic conditions;
- Changes or continued weakness in specific industry segments;
- Declines in real estate values;
- Declines in rental rates;
- Declines in occupancy rates;
- Increases in other operating expenses (including energy costs);
- The availability of refinancing at lower interest rates or better loan terms;
- Changes in governmental rules, regulations and fiscal policies, including rent control ordinances, environmental legislation and taxation;
- Increases in interest rates, real estate and personal property tax rates; and
- Other factors beyond the control of the borrower or the lender.

We attempt to mitigate these risks through sound and prudent underwriting practices, as well as a proactive loan review process and our risk management practices. See Lending Activities - Underwriting and Approval Authority for Our Loans.

We will not extend credit to any one borrower that is in excess of regulatory limits. Pursuant to OTS regulations, loans-to-one borrower cannot exceed 15% of the Bank s unimpaired capital and surplus. At December 31, 2006, the Bank s loans-to-one borrower limit was $9.7 million. See Regulation Federal Savings Institution Regulation Loans-to-One Borrower.

Underwriting and Approval Authority for Our Loans. Our board of directors establishes our lending policies. Each loan must meet minimum underwriting criteria established in our lending policies and must fit within our overall strategies for yield, interest rate risk, and portfolio concentrations. The underwriting and quality control functions are managed through our corporate office. Each loan application is evaluated from a number of underwriting perspectives. For real estate secured loans, these underwriting considerations include property appraised value, loan-to-value, level of debt service coverage utilizing both the actual net operating income and forecasted net operating income, use and condition of the property, as well as, the borrower s liquidity, income, credit history, net worth, and operating experience. For business and SBA loans, underwriting considerations include historic business cash flows, debt service coverage, loan-to-value ratios of underlying collateral, if any, debt to equity ratios, credit history, business experience, history of business, forecasts of operations, business viability, net worth, and liquidity.

Loans secured by real estate are originated on both a non-recourse and full recourse basis. Business loans are generally originated as recourse or with full guarantees from key borrowers or borrower principals. On loans made to entities, such as partnerships, limited liability companies, corporations or trusts, we typically obtain personal guarantees from the appropriate managing members, major shareholders, trustees or other appropriate principals. In 2006, 99% of our income property loans to entities were originated with full recourse and/or personal guarantees from principals of the borrowers.

Upon receipt of a completed loan application from a prospective borrower, a credit report and other required reports are ordered and, if necessary, additional information is requested. Prior to processing and underwriting any loan, we issue a letter of interest based on a preliminary analysis by our bankers, which letter details the terms and conditions on which we will consider the loan request. Upon receipt of the signed letter of interest and a deposit fee, we process and underwrite each loan application and prepare all loan documentation wherein the loan has been approved.

Our credit memorandum, which are prepared by our underwriters, include a description of the transaction and prospective borrower and guarantors, the collateral securing the loan, if any, the proposed uses of loan proceeds and source(s) of repayment, as well as an analysis of the borrower s business and personal financial statements and creditworthiness. The financial statements and creditworthiness of any guarantors are also analyzed. For loans secured by real property, the credit memorandum will include an analysis of the historic operating income of the property. Loans secured by real estate require an independent appraisal conducted by a licensed appraiser. All appraisal reports are appropriately reviewed by our appraisal department. Our board of directors reviews and approves annually the independent list of acceptable appraisers. When appropriate, environmental reports are obtained and reviewed as well.

Following loan approval and prior to funding, our underwriting and processing departments assure that all loan approval terms have been satisfied, that they conform with lending policies (or are properly documented as exceptions with required approvals), and that all required documentation is present and in proper form.

Commercial business loans are subject to Bank guidelines regarding appropriate covenants and periodic monitoring requirements which include but are not limited to:

- Capital and lease expenditures;
- Capital levels;
- Salaries and other withdrawals;
- Working capital levels;
- Debt to net worth ratios;
- Sale of assets;
- Change of management;
- Change of ownership;

- Cash flow requirements;
- Profitability requirements;
- Debt service ratio;
- Collateral coverage ratio;
- Current and quick ratios.

Subject to the above standards, our board of directors delegates authority and responsibility for loan approvals to management up to $1.5 million for all loans secured by real estate and up to $250,000 for loans not secured by real estate. Loan approvals at the management level require the approval of at least two members of our Management Loan Committee, consisting of our President and Chief Executive Officer, Chief Credit Officer, and Chief Banking Officer. All loans in excess of $1.5 million, including total aggregate borrowings in excess of $1.5 million, and any loan in excess of $250,000 not secured by real estate require a majority approval of our board s Credit Committee, which is comprised of three directors, including our President and Chief Executive Officer.

Multi-family Real Estate Lending. We originate and purchase loans secured by multi-family residential properties (five units and greater) located predominantly in Southern California. The majority of loans we fund on multi-family properties are sold in the secondary market. Pursuant to our underwriting policies, 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 1.15:1, based on the qualifying loan interest rate. Loans are made for terms up to 30 years with amortization periods up to 30 years. As of December 31, 2006, we had $357.3 million of multi-family real estate secured loans, constituting 58.8% of our loan portfolio. Multi-family loans originated in 2006 had an average outstanding balance of $1,208,000, loan-to-value of 64.3%, and debt coverage ratio of 1.15:1 at origination.

Commercial Real Estate Lending. We originate and purchase loans secured by commercial real estate, such as retail centers, small office and light industrial buildings, and mixed-use commercial properties located predominantly in Southern California. We will also, from time to time, make a loan secured by a special purpose property, such as a gas station or motel. Pursuant to our underwriting policies, commercial real estate 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 interest rate. Loans are generally made for terms up to fifteen years with amortization periods up to 30 years. As of December 31, 2006, we had $173.5 million of commercial real estate secured loans, constituting 28.6% of our loan portfolio. Commercial real estate loans originated in 2006 had an average balance of $1,138,000, loan-to-value of 64.84% and debt coverage ratio of 1.24:1 at origination.

Commercial Business (C&I) Lending. We originate loans secured by business assets including inventory, receivables, machinery and equipment to businesses located predominantly in our primary market area. In many instances, real estate holdings of the borrower, its principals or loan guarantors are also taken as loan collateral. Loan types include revolving lines of credit, term loans, seasonal loans and loans secured by liquid collateral such as cash deposits or marketable securities. We also issue letters of credit on behalf of our customers, backed by loans or deposits with the Bank. In addition to lending against business assets, our business loan programs include loans for owner-occupied commercial real estate such as retail, office and industrial properties. Owner-occupied real estate is underwritten based on the value of the building and the cash flow of the occupying business. As of December 31, 2006, we had total commitments of $48.1 million in commercial business lines of credit, of which, $30.4 million was disbursed.

Small Business (SBA) Lending. Our SBA Division, which started in the fourth quarter of 2005, was approved to originate loans under the SBA s Preferred Lenders Program (PLP) within its first year of operation when the Bank was named a PLP lender in the third quarter of 2006. The PLP lending status affords the Bank a higher level of delegated credit autonomy, translating to a significantly shorter turnaround time from application to funding, which is critical to our marketing efforts. We originate loans under the SBA s 7(a), 504 and *Express* loan programs, in conformance with SBA underwriting and documentation standards. The guaranteed portion of the 7(a) loans is typically sold on the secondary market. As of December 31, 2006, we had $5.3 million of SBA loans.

One-to-Four Family Loans. The Bank s portfolio of one-to-four family home loans at December 31, 2006 totaled $12.8 million, of which $10.0 million consists of loans secured by first liens on real estate and $2.8 million consists of loans secured by second or junior liens on real estate. In 2006, the Bank originated two new single family loans for $1.5 million.

Loan Servicing. Loan servicing is centralized at our corporate headquarters. Our loan servicing operations are intended to provide prompt customer service and accurate and timely information for account follow-up, financial reporting and loss mitigation. Following the funding of an approved loan, the data is entered into our data processing system, which provides monthly billing statements, tracks payment performance, and effects agreed upon interest rate adjustments. The loan servicing activities include (i) the collection and remittance of mortgage loan payments, (ii) accounting for principal and interest and other collections and expenses, (iii) holding and disbursing escrow or impounding funds for real estate taxes and insurance premiums, (iv) inspecting properties when appropriate, (v) contacting delinquent borrowers, and (vi) acting as fiduciary in foreclosing and disposing of collateral properties.

When payments are not received by their contractual due date, collection efforts are initiated by our loss mitigation personnel. Accounts delinquent more than 15 days are reviewed by our loss mitigation manager and are assigned to our collector to begin the process of collections. Our collector begins by contacting the borrower telephonically and progresses to sending a notice of intention to foreclose within 30 days of delinquency, and we will initiate foreclosure on one-to-four family loans 30 days thereafter and on multi-family and commercial real estate 10 days thereafter if the delinquent payments are not received in full. Our loss mitigation manager conducts an evaluation of all loans 90 days or more past due by obtaining an estimate of value on the underlying collateral. The evaluation may result in our establishing a specific allowance for that loan or charging off the entire loan, but still continuing with collection efforts.

Loan Portfolio Composition. At December 31, 2006, our net loans receivable held for investment totaled $604.3 million and net loans receivable held for sale totaled $795,000. The types of loans that the Bank may originate are subject to federal law, state law, and regulations.

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

	At December 31, 2006		**2005**		**2004**		**2003**		**2002**	
	Amount	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**	**Amount**	**% of Total**
	(dollars in thousands)									
Real estate loans:										
Multi-family	$ 357,275	58.80 %	$ 459,714	75.98 %	$ 394,582	83.67 %	$ 188,939	75.54 %	$ 62,511	38.33 %
Commercial	173,452	28.55 %	123,364	20.39 %	53,937	11.44 %	20,075	8.03 %	22,336	13.69 %
Construction				0.00 %		0.00 %	3,646	1.46 %	8,387	5.14 %
One-to-four family(1)	12,825	2.11 %	16,561	2.74 %	22,347	4.74 %	36,632	14.65 %	68,822	42.20 %
Business loans:										
Commercial owner occupied(2)	35,929	5.91 %	2,062	0.34 %	565	0.12 %	592	0.24 %	714	0.44 %
Commercial and industrial	22,762	3.75 %	3,248	0.54 %	103	0.02 %		0.00 %		0.00 %
SBA	5,312	0.87 %		0.00 %		0.00 %		0.00 %		0.00 %
Other loans	63	0.01 %	27	0.01 %	75	0.01 %	233	0.08 %	327	0.20 %
Total gross loans	607,618	100.00 %	604,976	100.00 %	471,609	100.00 %	250,117	100.00 %	163,097	100.00 %
Less (plus):										
Undisbursed construction loan funds							1,016		2,372	
Deferred loan origination (costs), fees and (premiums) and discounts	(1,024)		(1,467)		(1,371)		(483)		(341)	
Allowance for loan losses	3,543		3,050		2,626		1,984		2,835	
Loans receivable, net	$ 605,099		$ 603,393		$ 470,354		$ 247,600		$ 158,231	

(1) Includes second trust deeds.

(2) Secured by real estate

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Loan Maturity. The following table shows the contractual maturity of the Bank s gross loans for the period indicated. The table does not reflect prepayment assumptions.

	At December 31, 2006 One-to-Four Family (in thousands)	Multi Family	Commercial Real Estate	Commercial Owner Occupied	Commercial Business	SBA	Other Loans	Total Loans Receivable
Amounts due:								
One year or less	$	$	$ 960	$	$ 13,822	$	$ 20	$ 14,802
More than one year to three years	6	2,792	3,846		7,281		799	14,724
More than three years to five years	75		128	212	736		993	2,144
More than five years to 10 years	2,213	9,342	127,825	28,310	923	5,098	22	173,733
More than 10 years to 20 years	2,680	6,927	25,618	6,111		214		41,549
More than 20 years	7,852	338,214	11,798	1,297			1,505	360,666
Total amount due	12,825	357,275	170,175	35,929	22,762	5,312	3,340	607,618
Less (plus):								
Undisbursed loan funds								
Deferred loan origination fees (costs) and discounts	(61)	(1,079)	(56)	21	31	19		(1,125)
Lower of cost or market	101							101
Allowance for loan losses	331	1,405	863	197	675	68	4	3,543
Total loans, net	12,454	356,949	169,368	35,711	22,056	5,225	3,336	605,099
Loans held for sale, net						795		795
Loans held for investment, net	$ 12,454	$ 356,949	$ 169,368	$ 35,711	$ 22,056	$ 4,430	$ 3,336	$ 604,304

The following table sets forth at December 31, 2006, the dollar amount of gross loans receivable contractually due after December 31, 2007, and whether such loans have fixed interest rates or adjustable interest rates.

	Loans Due After December 31, 2007 At December 31, 2006		
	Fixed	Adjustable	Total
	(in thousands)		
Residential			
One-to-four family	$ 6,808	$ 6,017	$ 12,825
Multi-family	11,437	345,838	357,275
Commercial real estate	19,506	149,709	169,215
Commercial owner occupied	8,552	27,377	35,929
Commercial and industrial	1,082	7,808	8,890
SBA		5,312	5,312
Other loans	40	3,281	3,321
Total gross loans receivable	$ 47,425	$ 545,342	$ 592,767

The following table sets forth the Bank s loan originations, purchases, sales, and principal repayments for the periods indicated:

	For the Year Ended December 31,		
	2006	2005	2004
	(in thousands)		
Beginning balance of gross loans	$ 604,976	$ 471,609	$ 250,117
Loans originated:			
Multi-family	182,378	184,757	254,714
Commercial and land	90,840	74,548	43,563
Commercial owner occupied	28,396	12,335	
Commecial and industrial	34,420	3,741	103
SBA	9,230		
Other loans	1,537	1,945	15
Total loans originated	346,801	277,326	298,395
Loans purchased			
Sub total production	346,801	277,326	298,395
Total	951,777	748,935	548,512
Less:			
Principal repayments	138,116	83,754	63,793
Sales of loans	205,268	59,752	12,147
Charge-offs	266	216	400
Transfer to real estate owned	509	237	563
Total gross loans	607,618	604,976	471,609
Ending balance loans held for sale, gross	795	456	587
Ending balance loans held for investment, gross	$ 606,823	$ 604,520	$ 471,022

Delinquencies and Classified Assets. Federal regulations require that the Bank utilize an internal asset classification system to identify and report problem and potential problem assets. The Bank s Internal Asset Review (IAR) Manager has responsibility for identifying and reporting problem assets to the Bank s Internal Asset Review Committee (IARC), which operates pursuant to the board-approved IAR policy. The policy incorporates the regulatory requirements of monitoring and classifying all assets of the Bank. The Bank currently designates or classifies problem and potential problem assets as Special

Mention , Substandard or Loss assets. An asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. All real estate owned (REO) acquired from foreclosure is classified as Substandard . Assets classified as Loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets which do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated Special Mention.

When the Bank classifies an asset, or portions thereof, as Substandard under current OTS policy, the Bank is required to consider establishing a general valuation allowance in an amount deemed prudent by management. The general valuation allowance, which is a regulatory term, represents a loss allowance which has been established to recognize the inherent credit risk associated with lending and investing activities, but which, unlike specific allowances, has not been allocated to particular problem assets. When the Bank classifies one or more assets, or portions thereof, as Loss, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

The Bank s determination as to the classification of its assets and the amount of its valuation allowances are subject to review by the OTS, which can order the establishment of additional general or specific loss allowances or a change in a classification. The OTS, in conjunction with the other federal banking agencies, adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation allowances. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and that management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. While the Bank believes that it has established an adequate allowance for estimated loan losses, there can be no assurance that its regulators, in reviewing the Bank s loan portfolio, will not request the Bank to materially increase its allowance for estimated loan losses, thereby negatively affecting the Bank s financial condition and earnings at that time. Although management believes that an adequate allowance for estimated loan losses has been established, actual losses are dependent upon future events and, as such, further additions to the level of allowances for estimated loan losses may become necessary.

The Bank s IARC reviews the IAR Manager s recommendations for classifying the Bank s assets quarterly and reports the results of its review to the board of directors. The Bank classifies assets and establishes both a general allowance and specific allowance in accordance with the board-approved Allowance for Loan Losses policy. The following table sets forth information concerning substandard assets, REO and total classified assets at December 31, 2006 for the Company:

	At December 31, 2006					
	Total Substandard Assets		REO		Total Substandard Assets and REO	
	Gross Balance	# of Loans	Gross Balance	# of Properties	Gross Balance	# of Assets
	(dollars in thousands)					
Residential:						
One-to-four family	$ 703	14	$ 138	8	$ 841	22
Multi-family						
Commercial Real Estate						
Commercial Owner Occupied						
Commercial Business						
SBA						
Other loans						
Specific Allowance	(60)				(60)	
Total Substandard Assets	$ 643	14	$ 138	8	$ 781	22

At December 31, 2006, the Company had $1.0 million of Special Mention assets, $781,000 of Substandard assets, and $166,000 assets classified as Loss that are offset by a specific allowance of the same amount. The difference between the specific allowance in the above table and the total specific allowance is the specific allowance on accounts that were Substandard at one time and are currently classified either as Special Mention or as Pass.

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The following table sets forth delinquencies in the Company s loan portfolio as of the dates indicated:

	60-89 Days		90 Days or More	
	# of Loans	Principal Balance of Loans	# of Loans	Principal Balance of Loans
	(dollars in thousands)			
At December 31, 2006				
Multi-family		$		$
Commercial real estate				
Commercial owner occupied				
Commercial and industrial				
SBA				
One-to-four family and other loans	4	182	13	634
Total	4	$ 182	13	$ 634
Delinquent loans to				
total gross loans		0.03 %		0.10 %
At December 31, 2005				
Multi-family		$		$
Commercial real estate				
Commercial owner occupied				
Commercial and industrial				
SBA				
One-to-four family and other loans	2	157	33	1,687
Total	2	$ 157	33	$ 1,687
Delinquent loans to				
total gross loans		0.03 %		0.28 %
At December 31, 2004				
Multi-family		$		$
Commercial real estate				
Construction				
One-to-four family and other loans	11	525	38	2,371
Total	11	$ 525	38	$ 2,371
Delinquent loans to				
total gross loans		0.11 %		0.50 %
At December 31, 2003				
Multi-family		$		$
Commercial real estate				
Construction				
One-to-four family and other loans	2	46	45	2,730
Total	2	$ 46	45	$ 2,730
Delinquent loans to				
total gross loans		0.02 %		1.09 %
At December 31, 2002				
Multi-family		$		$
Commercial real estate				
Construction and land				
One-to-four family and other loans	17	929	91	5,205
Total	17	$ 929	91	$ 5,205
Delinquent loans to				
total gross loans		0.57 %		3.19 %

Nonperforming Assets. At December 31, 2006 and 2005, respectively, we had $712,000 and $1.7 million of net nonperforming assets, respectively, which included $574,000 and $1.5 million of net nonperforming loans, respectively. Our current policy is not to accrue interest on loans 90 days or more past due. Our nonperforming assets consist of loans made prior to December 31, 2000 and secured by one-to-four family residences. The decrease in nonperforming assets in 2006 is primarily due to increases in housing prices since the loans were made which allowed delinquent customers to refinance or sell their homes and our continuing foreclosure efforts.

Real estate owned (REO) was $138,000 (consisting of eight properties) at December 31, 2006, compared to $211,000 (consisting of eight properties) at December 31, 2005. Properties acquired through or in lieu of foreclosure are initially recorded at the lower of fair value less cost to sell, or the balance of the loan at the date of foreclosure through a charge to the allowance for loan losses. The Bank generally obtains an appraisal and/or a market evaluation on all REO at the time of possession. After foreclosure, valuations are periodically performed by management as needed due to changing market conditions or factors specifically attributable to the properties condition. If the carrying value of the property exceeds its fair value less estimated cost to sell, a charge to operations is recorded. The decline in REO over the periods represented reflects the improvements in asset quality and sales of REO properties.

The following tables set forth information concerning nonperforming loans and REO at the periods indicated:

	At December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(dollars in thousands)				
Nonperforming assets(1)					
Real Estate:					
One-to-four family	$ 634	$ 1,687	$ 2,371	$ 2,729	$ 5,203
Multi-family					
Commercial and land					
Business loans:					
Commercial owner occupied					
Commercial and industrial					
SBA					
Other loans				1	2
Total nonaccrual loans	634	1,687	2,371	2,730	5,205
Foreclosures in process				43	425
Specific allowance	(60)	(185)	(244)	(299)	(627)
Total nonperforming loans, net	574	1,502	2,127	2,474	5,003
Foreclosed real estate owned(2)	138	211	351	979	2,427
Total nonperforming assets, net(3)	$ 712	$ 1,713	$ 2,478	$ 3,453	$ 7,430
Restructured loans(4)	$	$	$	$	$
Allowance for loan losses as a percent of gross loans receivable(5)	0.58 %	0.50 %	0.56 %	0.79 %	1.74 %
Allowance for loan losses as a percent of total nonperforming loans, gross	558.83 %	180.79 %	110.77 %	71.55 %	50.35 %
Nonperforming loans, net of specific allowances, as a percent of gross loans receivable	0.09 %	0.25 %	0.45 %	0.99 %	3.07 %
Nonperforming assets, net of specific allowances, as a percent of total assets	0.10 %	0.24 %	0.46 %	1.12 %	3.12 %

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(1) During the years ended December 31, 2006, 2005, 2004, 2003, and 2002, approximately $41,000, $75,000, $131,000, $299,000, and $313,000, respectively, of interest income related to these loans was included in net income. Additional interest income of approximately $106,000, $310,000, $317,000, $406,000, and $708,000 million, respectively, would have been recorded for the years ended December 31, 2006, 2005, 2004, 2003, and 2002 if these loans had been paid in accordance with their original terms and had been outstanding throughout the applicable period then ended or, if not outstanding throughout the applicable period then ended, since origination.

(2) Foreclosed REO balances are shown net of related loss allowances.

(3) Nonperforming assets consist of nonperforming loans and REO. Nonperforming loans consisted of all loans 90 days or more past due and foreclosures in process less than 90 days and still accruing interest.

(4) A restructured loan is one wherein the terms of the loan were renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrower. We did not include in interest income any interest on restructured loans during the periods presented.

(5) Gross loans include loans receivable held for investment and held for sale.

Allowance for Loan Losses. We maintain an allowance for loan losses to absorb losses inherent in the loans held for investment portfolio. Loans held for sale are carried at the lower of cost or estimated market value. Net unrealized losses, if any, are recognized in a lower of cost or market valuation allowance by charges to operations. The allowance is based on ongoing, quarterly assessments of probable estimated losses inherent in our loan portfolio. The allowance is increased by a provision for loan losses which is charged to expense and reduced by charge-offs, net of recoveries.

As of December 31, 2006, the allowance for loan losses totaled $3.5 million, compared to $3.1 million at December 31, 2005 and $2.6 million at December 31, 2004. The December 31, 2006 allowance for loan losses, as a percent of nonperforming loans and gross loans, was 558.8% and 0.58%, respectively, compared with 180.8% and 0.50% at December 31, 2005, and 110.8% and 0.56% at December 31, 2004. The specific allowance amount included in the allowance for loan losses totaled $166,000, $291,000 and $345,000, as of December 31, 2006, 2005 and 2004, respectively.

The Bank s methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowance for identified problem loans and the unallocated allowance. The formula allowance is calculated by applying loss factors to all loans held for investment.

The loan loss factors for the multi-family loan portfolio are based primarily upon the charge-off data for all FDIC insured commercial banks and savings institutions in the state of California for the past 14¾ years, a peer analysis of other financial institutions engaged in similar lending activities, a quantitative and qualitative analysis of the portfolio and management s past experience with such loan types. Management believes the utilization of industry-wide historic loss data of multi-family loans is more reflective of potential losses due to the fact that the Bank has not had a loss or a delinquency on any of its multi-family loans since it began originating these loan types in the second quarter of 2002. The industry s average annual charge-off loss experience over the last 14¾ years (1992-2006Q3) was 35.6 basis points. During the past 10 year (1996Q4-2006Q3) period, the charge-off rate for multi-family loans for California was 2.9 basis points. However, the Bank used the data for the longer period as a starting point in developing the multi-family loan loss factors. Management has adopted a tiered system that establishes the highest loss factors for loans with a loan-to-value (LTV) ratio greater than 65% at origination and with less than 12 months of payment history (seasoning). Loans that possess a LTV ratio less than 65% at origination and a satisfactory payment history for the past 13 months or more are considered to have less credit risk

and, therefore, are assigned a lower loss factor. The tiered system has four categories to address the unique characteristics of the Bank s multi-family loan portfolio and are reviewed and updated quarterly.

The loss factors for the commercial real estate loan portfolio are developed and applied in a similar manner as the multi-family loan portfolio and thus considers the industry s charge-off data in the state of California, a peer analysis of other financial institutions engaged in similar lending activities, a quantitative and qualitative analysis of the portfolio and management s past experience with such loan types. The industry s average annual charge-off over the last 14¾ years was 33.2 basis points and was reduced to 3.6 basis points for the past 10 year period. Management also considers the past loss experience related to Southern California commercial real estate in establishing loan loss factors for the commercial real estate portfolio.

The loan loss factors for the commercial business loan portfolio is based primarily upon the thrift industry s nationwide and West Region historic charge-off data, a peer analysis of other financial institutions engaged in similar lending activities, a quantitative and qualitative analysis of the portfolio and management s past experience with such loan types. Since this portfolio is relatively unseasoned, the Bank s loss experience is nonexistent and, therefore, management relies upon available recent industry data to support the loss factor for this portfolio. The Bank s IAR Department has reviewed and analyzed the charge-off data for commercial business loans in the state of California over a period of 14¾ years (1992-2006Q3). The data represents commercial business loan charge-offs for all FDIC insured commercial banks and savings institutions in the state of California. Based upon this analysis, the IAR Department has determined that for this period, the average annual charge-off rate was 83 basis points. Management will continue to analyze and evaluate the adequacy of the loss factors for this loan portfolio segment on a quarterly basis.

For the homogeneous single-family residential loan portfolio, the loss factors were developed by the Bank s IAR Department using a loss migration analysis over the prior one year period to determine the percentage of loans from a particular classification category that flows through to a realized loss. The formula allowance is calculated based upon the developed loss factors and is assigned to the homogeneous single-family residential loan portfolio by geographic regions, loan pool type and classification.

Specific allowances are established for certain loans where management has identified significant conditions or circumstances related to a credit that management believes indicates the probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. Furthermore, on all one-to-four family loans secured by first and second deeds of trust that are 90 days or more past due, a market evaluation which includes adjusting the value for the location of the collateral and the Bank s historical loss experience for that location is completed. A specific allowance is determined based on the valuation of the collateral underlying the loan and is calculated by subtracting the current market value less estimated selling and holding costs from the loan balance.

The IARC meets monthly to review and monitor conditions in the portfolio and to determine the appropriate allowance for loan losses based on the recommendation of the IAR Department and the analysis performed. To the extent that any of these conditions are evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, the IARC s estimate of the effect of such condition may be reflected as a specific allowance applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, the IARC s evaluation of the probable loss related to such condition is reflected in the unallocated allowance. By assessing the probable estimated losses inherent in the loan portfolios on a quarterly basis, the Bank is able to adjust specific and inherent loss estimates based upon more recent information that has become available.

The following table sets forth activity in the Bank s allowance for loan losses for the periods indicated:

	As of and For the Year Ended December 31, 2006	2005	2004	2003	2002
	(dollars in thousands)				
Balances:					
Average net loans outstanding during the period	$ 607,439	$ 546,426	$ 351,968	$ 184,460	$ 152,738
Total loans outstanding at end of the period	607,618	604,976	471,609	250,117	163,097
Allowance for Loan Losses:					
Balance at beginning of period	3,050	2,626	1,984	2,835	4,364
Provision for loan losses	531	349	705	655	1,133
Charge-offs:					
Real Estate:					
One-to-four family	266	211	252	1,612	1,908
Multi-family					
Commercial and land					
Construction					386
Business loans:					
Commercial owner occupied					
Commercial and industrial					
SBA					
Other loans		5	148	388	820
Total charge-offs	266	216	400	2,000	3,114
Recoveries :					
Real Estate:					
One-to-four family	225	191	122	197	295
Multi-family					
Commercial and land					
Construction		74			
Business loans:					
Commercial owner occupied					
Commercial and industrial					
SBA					
Other loans	3	26	215	297	157
Total recoveries	228	291	337	494	452
Net loan charge-offs	38	(75)	63	1,506	2,662
Balance at end of period	$ 3,543	$ 3,050	$ 2,626	$ 1,984	$ 2,835
Ratios:					
Net charge-offs to average net loans	0.01 %	(0.01)%	0.02 %	0.82 %	1.74 %
Allowance for loan losses to gross loans at end of period	0.58 %	0.50 %	0.56 %	0.79 %	1.74 %
Allowance for loan losses to total nonperforming loans	558.83 %	180.79 %	110.77 %	71.55 %	50.35 %

The following table sets forth the Bank s allowance for loan losses and the percent of gross loans to total gross loans in each of the categories listed at the dates indicated:

Balance at End of Period Applicable to	As of December 31, 2006 Amount (dollars in thousands)	% of Loans in Category to Total Loans	2005 Amount	% of Loans in Category to Total Loans	2004 Amount	% of Loans in Category to Total Loans
Real Estate:						
Residential:						
One-to-four family	$ 331	2.11 %	$ 554	2.74 %	$ 661	4.74 %
Multi-family	1,405	58.80 %	1,746	75.98 %	1,643	83.67 %
Commercial real estate	881	28.55 %	627	20.39 %	271	11.44 %
Commercial owner occupied	179	5.91 %	10	0.34 %	1	0.12 %
Commercial and industrial	478	3.75 %	110	0.54 %	3	0.02 %
SBA	68	0.87 %		0.00 %		0.00 %
Other Loans	4	0.01 %	3	0.01 %	11	0.01 %
Unallocated	197				36	
Total	$ 3,543	100.00 %	$ 3,050	100.00 %	$ 2,626	100.00 %

Balance at End of Period Applicable to	As of December 31, 2003 Amount (dollars in thousands)	% of Loans in Category to Total Loans	2002 Amount	% of Loans in Category to Total Loans
Real Estate:				
Residential:				
One-to-four family	$ 843	14.65 %	$ 2,205	42.20 %
Multi-family	812	75.54 %	316	38.33 %
Commercial real estate	105	8.03 %	121	13.69 %
Construction and land	41	1.46 %	92	5.14 %
Commercial business		0.24 %		0.44 %
Other Loans	15	0.08 %	16	0.20 %
Unallocated	168		85	
Total	$ 1,984	100.00 %	$ 2,835	100.00 %

The following table sets forth the allowance for loan losses amounts calculated by the categories listed for the periods set forth in the table:

Balance at End of Period Applicable to	As of December 31, 2006 Amount	% of Allowance to Total	2005 Amount	% of Allowance to Total	2004 Amount	% of Allowance to Total
	(dollars in thousands)					
Formula allowance	$ 3,180	89.7 %	$ 2,759	90.5 %	$ 2,245	85.5 %
Specific allowance	166	4.7 %	291	9.5 %	345	13.1 %
Unallocated allowance	197	5.6 %		0.0 %	36	1.4 %
Total	$ 3,543	100.0 %	$ 3,050	100.0 %	$ 2,626	100.0 %

Balance at End of Period Applicable to	As of December 31, 2003 Amount	% of Allowance to Total	2002 Amount	% of Allowance to Total
	(dollars in thousands)			
Formula allowance	$ 1,386	69.9 %	$ 2,015	71.1 %
Specific allowance	430	21.7 %	735	25.9 %
Unallocated allowance	168	8.5 %	85	3.0 %
Total	$ 1,984	100.0 %	$ 2,835	100.0 %

Investment Activities

Our investment policy as established by our board of directors attempts to provide and maintain liquidity, generate a favorable return on investments without incurring undue interest rate and credit risk, and complement our lending activities. Specifically, our policies limit investments to U.S. government securities, federal agency-backed securities, non-government guaranteed securities, municipal bonds, corporate bonds and mutual funds comprised of the above.

Our investment securities portfolio amounted to $77.1million at December 31, 2006, as compared to $49.8 million at December 31, 2005. As of December 31, 2006, the portfolio consisted of $35.1 million of mortgage-backed securities, $26.7 million of mutual funds, and $15.3 million of FHLB stock. The increase in securities in 2006 is primarily due to the purchase of $26.8 million of mortgage backed securities and $1.4 million in FHLB stock.

At December 31, 2006, our securities portfolio includes $32.9 million of mortgage-backed securities which are guaranteed by Freddie Mac and a $2.1 million private-issue mortgage-backed security that are accounted for as available for sale. The mutual fund investments are comprised of two separate funds under the Shay Asset Management Funds, with $16.9 million invested in the Adjustable Rate Mortgage (ARM) Fund and $9.8 million in the Intermediate Fund. The ARM Fund invests in U.S. government agency adjustable-rate mortgage-backed securities, fixed and floating-rate collateralized mortgage obligations and investment grade corporate debt instruments. The Intermediate Fund invests in mortgage-backed securities, U.S. government notes and U.S. government agency debentures. We may increase or decrease our investment in mortgage-backed securities and mutual funds in the future depending on our liquidity needs and market opportunities.

The following table sets forth certain information regarding the carrying and fair values of the Company s securities at the dates indicated:

	2006 Amortized Cost (in thousands)	Carrying Value	2005 Amortized Cost	Carrying Value
Available for sale:				
Mortgage-backed securities	$ 35,271	$ 35,081	$ 9,171	$ 9,059
Mutual funds	27,719	26,735	27,719	26,791
Total securities available for sale	62,990	61,816	36,890	35,850
Held to maturity:				
FHLB Stock	15,328	15,328	13,945	13,945
Total securities held to maturity	15,328	15,328	13,945	13,945
Total securities	$ 78,318	$ 77,144	$ 50,835	$ 49,795

The table below sets forth certain information regarding the carrying value, weighted average yields and contractual maturities of the Company s securities as of December 31, 2006.

	At December 31, 2006									
	One Year or Less		More than One to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value (dollars in thousands)	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Available for sale:										
Mortgage-backed securities	$		$		$		$ 35,081	5.03 %	$ 35,081	5.03 %
Mutual Funds	26,735	4.72 %							26,735	4.72 %
Total available for sale	$ 26,735	4.72 %	$		$		$ 35,081	5.03 %	$ 61,816	4.90 %
Held to maturity:										
FHLB Stock	$ 15,328	5.33 %	$		$		$		$ 15,328	5.33 %
Total held to maturity	$ 15,328	5.33 %	$		$		$		$ 15,328	5.33 %
Total securities	$ 42,063	4.94 %	$		$		$ 35,081	5.03 %	$ 77,144	4.98 %

Sources of Funds

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

Deposits. Deposits represent our primary source of funds for our lending and investing activities. The Bank offers a variety of deposit accounts with a range of interest rates and terms. The deposit accounts are offered through our five branch network in Southern California, which increased to six branches with the opening of a de novo branch located in the City of Newport Beach in the first quarter of 2007. The Bank s deposits consist of passbook savings, checking accounts, money market accounts and certificates of deposit. Total deposits at December 31, 2006 were $339.4 million, as compared to $327.9 million at December 31, 2005. For the year ended December 31, 2006, certificates of deposit constituted 71.7% of total average deposits. The terms of the fixed-rate certificates of deposit offered by the Bank vary from 3 months to 5 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. The flow of deposits is influenced significantly by general economic conditions,

changes in money market rates, prevailing interest rates and competition. At December 31, 2006, the Bank had $228.3 million of certificate of deposit accounts maturing in one year or less.

The Bank relies primarily on customer service, business development efforts, 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 Bank s ability to attract and retain deposits. Additionally, the Bank will utilize both wholesale and brokered deposits to supplement its generation of deposits from businesses and consumers. During 2006, the Bank reduced the amount of broker deposits by $21.1 million to $35.5 million at December 31, 2006.

The following table presents the deposit activity of the Bank for the years ended December 31:

	2006	2005	2004
	(in thousands)		
Net (withdrawals) deposits	$ 424	$ 30,914	$ 61,976
Interest credited on deposit accounts	11,089	8,135	5,464
Total increase in deposit accounts	$ 11,513	$ 39,049	$ 67,440

At December 31, 2006, the Bank had $130.3 million in certificate accounts in amounts of $100,000 or more maturing as follows:

Maturity Period	Amount	Weighted Average Rate
	(dollars in thousands)	
Three months or less	$ 73,391	5.06 %
Over three months through 6 months	34,136	5.22 %
Over 6 months through 12 months	16,996	5.01 %
Over 12 months	5,804	4.21 %
Total	$ 130,326	5.06 %

The following table sets forth the distribution of the Bank s average deposit accounts for the periods indicated and the weighted average interest rates on each category of deposits presented:

	For the Year Ended December 31, 2006			2005			2004		
	Average Balance	% of Total Average Deposits	Weighted Average Rate	Average Balance	% of Total Average Deposits	Weighted Average Rate	Average Balance	% of Total Average Deposits	Weighted Average Rate
	(dollars in thousands)								
Passbook accounts	$ 2,600	0.81 %	0.55 %	$ 3,613	1.19 %	0.24 %	$ 3,682	1.40 %	0.32 %
Money market accounts	39,128	12.13 %	3.44 %	33,905	11.12 %	2.57 %	28,013	10.66 %	1.69 %
Checking accounts	49,441	15.32 %	0.63 %	42,755	14.02 %	1.19 %	42,123	16.02 %	0.78 %
Sub-total	91,169	28.26 %	1.83 %	80,273	26.33 %	1.48 %	73,818	28.08 %	1.10 %
Certificate of deposit accounts:									
Three months or less	9,072	2.81 %	4.89 %	12,580	4.13 %	3.30 %	487	0.19 %	1.64 %
Four through 12 months	163,802	50.79 %	4.55 %	109,580	35.96 %	3.14 %	97,654	37.15 %	2.05 %
13 through 36 months	43,093	13.36 %	3.75 %	85,210	27.95 %	2.97 %	74,823	28.47 %	2.58 %
37 months or greater	15,453	4.79 %	4.39 %	17,176	5.63 %	4.44 %	16,057	6.11 %	4.50 %
Total certificate of deposit accounts	231,420	71.74 %	4.40 %	224,546	73.67 %	3.18 %	189,021	71.92 %	2.47 %
Total average deposits	$ 322,589	100.00 %	3.67 %	$ 304,819	100.00 %	2.73 %	$ 262,839	100.00 %	2.10 %

The following table presents, by various rate categories, the amount of certificate of deposit accounts outstanding at the date indicated and the periods to maturity of the certificate of deposit accounts outstanding at December 31, 2006:

	Period to Maturity from December 31, 2006						
	Less than One Year (in thousands)	One to Two Years	Two to Three Years	Three to Four Years	Four to Five Years	More than Five Years	Total
Certificate of deposit accounts							
0.50 to 2.00%	$	$	$	$	$ 1	$ 5	$ 6
2.01 to 3.00%	390	16	14	7	25	135	587
3.01 to 4.00%	17,532	4,259	1,068	94	57	23	23,033
4.01 to 5.00%	63,969	4,129	2,250	674	47	5	71,074
5.01 to 6.00%	145,996	343	201	123	164	497	147,324
6.01 to 7.00%	6	77	37	15	34	22	191
7.01 to 8.00%	357	112	4				473
Total	$ 228,250	$ 8,936	$ 3,574	$ 913	$ 328	$ 687	$ 242,688

FHLB Advances. The FHLB system functions as a source of credit to financial institutions that are members. Advances are secured by certain real estate loans, investment securities and the capital stock of the FHLB owned by the Bank. Subject to the FHLB s advance policies and requirements, these advances can be requested for any business purpose in which the Bank is authorized to engage. In granting advances, the FHLB considers a member s creditworthiness and other relevant factors. The Bank is allowed to have advances totaling 45% of its assets, equating to a credit line of $318.1 million as of December 31, 2006. At December 31, 2006, the Bank had FHLB advances outstanding totaling $300.3 million of which eight were term advances totaling $280.0 million with a weighted average interest rate of 5.21% and a weighted average remaining maturity of 1.6 years.

Borrowings. The Bank has established a credit facility, secured by mutual funds pledged to Pershing LLC. The Bank is able to borrow up to 70% of the valuation of the pledged mutual funds at a cost of the current federal funds rate plus 75 basis points. At December 31, 2006, the Bank had borrowed $1.0 million against the line. The Bank maintains lines of credit totaling $30.0 million with four correspondent banks to purchase federal funds as business needs dictate. Federal funds purchased are short-term in nature and utilized to meet short term funding needs. As of December 31, 2006, we had an outstanding federal funds purchased balance with our correspondent banks of $5.0 million that matured on January 2, 2007. Additionally, the Bank has a $100.0 million credit facility with Salomon Brothers. At December 31, 2006, there were $10.0 million borrowings against this line.

Debentures. On March 25, 2004 the Company issued $10,310,000 of Floating Rate Junior Subordinated Deferrable Interest Debentures (the Debt Securities) to PPBI Trust I, a statutory trust created under the laws of the State of Delaware. The Debt Securities are subordinated to effectively all borrowings of the Company and are due and payable on April 7, 2034. Interest is payable quarterly on the Debt Securities at three-month LIBOR plus 2.75% for an effective rate of 8.12% as of December 31, 2006.

The following table sets forth certain information regarding the Company s borrowed funds at or for the years ended on the dates indicated:

	At or For Year Ended December 31,		
	2006	2005	2004
	(dollars in thousands)		
FHLB advances			
Average balance outstanding	$ 297,441	$ 234,243	$ 95,601
Maximum amount outstanding at any month-end during the year	319,200	296,835	178,000
Balance outstanding at end of year	300,300	296,835	178,000
Weighted average interest rate during the year	4.79 %	3.12 %	1.99 %
Debentures			
Average balance outstanding	$ 10,310	$ 10,310	$ 7,939
Maximum amount outstanding at any month-end during the year	10,310	10,310	10,310
Balance outstanding at end of year	10,310	10,310	10,310
Weighted average interest rate during the year	7.77 %	6.03 %	4.28 %
Other borrowings and lines of credit			
Average balance outstanding	$ 1,833	$ 9,870	$ 6,657
Maximum amount outstanding at any month-end during the year	16,191	35,500	18,400
Balance outstanding at end of year	16,191	11,000	18,400
Weighted average interest rate during the year	5.86 %	3.16 %	1.50 %
Total borrowings			
Average balance outstanding	$ 309,584	$ 254,423	$ 110,197
Maximum amount outstanding at any month-end during the year	345,701	342,645	206,710
Balance outstanding at end of year	326,801	318,145	206,710
Weighted average interest rate during the year	4.89 %	3.24 %	2.12 %

Subsidiaries

As of December 31, 2006, we had two subsidiaries, the Bank, which did not have any subsidiaries at December 31, 2006, and PPBI Trust I, which has been deconsolidated for reporting purposes.

Personnel

As of December 31, 2006, we had 104 full-time employees and 5 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

The banking business in California, in general, and specifically in our market areas, is highly competitive with respect to virtually all products and services. The industry continues to consolidate, and unregulated competitors have entered banking markets with 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. These competitive trends are likely to continue.

The banking business is largely 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 major banks operating in the area offer certain services that we do not offer directly but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, such banks also have substantially higher lending limits than the Bank s.

In addition to other savings banks, our competitors include commercial banks, credit unions, and numerous non-banking institutions, such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, 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 financial services markets. 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, mail, home computer, 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.

In order to compete with these other institutions, the Company primarily relies on local promotional activities, personal relationships established by officers, directors and employees of the Company and specialized services tailored to meet the individual needs of the Company s customers.

REGULATION

General

The Company, as a savings and loan holding company, is required to file certain reports with, and otherwise comply with the rules and regulations of the OTS under the Home Owners Loan Act, as amended (the HOLA). In addition, the activities of savings institutions, such as the Bank, are governed by the HOLA and the Federal Deposit Insurance Act (FDI Act). Upon completion of the Bank s charter conversion to a California chartered commercial bank in 2007, the Bank will be regulated by the DFI and the FDIC. In addition, the Company will become a bank holding company subject to regulation by the Federal Reserve Board.

The Bank, a federally chartered savings bank, is subject to extensive regulation, examination and supervision by the OTS, as its primary federal regulator, and the Federal Deposit Insurance Corporation (FDIC), as the deposit insurer. The Bank is a member of the Federal Home Loan Bank System and its deposit accounts are insured up to applicable limits by the FDIC. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions, such as mergers with, or acquisitions of, other savings institutions. The OTS and/or the FDIC conduct periodic examinations to test the Bank s safety and soundness and compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the OTS, the FDIC or Congress, could have a material adverse impact on the Company, the Bank and their operations. Certain of the regulatory requirements applicable to the Bank and to the Company are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on the Bank and the Company.

Holding Company Regulation

The Company is a nondiversified unitary savings and loan holding company within the meaning of the HOLA. As a unitary savings and loan holding company, the Company generally is not restricted under existing laws as to the types of business activities in which it may engage, provided that the Bank continues to be a qualified thrift lender (QTL). See Federal Savings Institution Regulation--QTL Test. Upon any non-supervisory acquisition by the Company of another savings institution or savings bank that meets the QTL test and is deemed to be a savings institution by the OTS, the Company would become a multiple savings and loan holding company (if the acquired institution is held as a separate subsidiary) and would be subject to extensive limitations on the types of business activities in which it could engage. The HOLA limits the activities of a multiple savings and loan holding company and its non-insured institution subsidiaries primarily to activities permissible for bank holding companies under the Bank Holding Company Act (BHC Act), subject to the prior approval of the OTS, and certain activities authorized by OTS regulation, and no multiple savings and loan holding company may acquire more than 5% of the voting stock of a company engaged in impermissible activities.

The HOLA prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of the voting stock of another savings institution or holding company thereof, without prior written approval of the OTS or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources and future prospects of the company and institution involved the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisition. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Although savings and loan holding companies are not subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions, HOLA does prescribe such restrictions on subsidiary savings institutions as described below. The Bank must notify the OTS 30 days before declaring any dividend to the Company and, under certain circumstances, receive OTS approval of such dividend. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OTS and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Federal Savings Institution Regulation

Capital Requirements. The OTS capital regulations require savings institutions to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage (core) capital ratio and an 8% risk-based capital ratio. Core capital is defined as common stockholders equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus, and minority interests in equity accounts of consolidated subsidiaries less intangibles other than certain mortgage servicing rights and credit card relationships. The OTS regulations require that, in meeting the tangible, leverage (core) and risk-based capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities that are not permissible for a national bank.

The risk-based capital standard for savings institutions requires the maintenance of total capital (which is defined as core capital and supplementary capital) to risk-weighted assets to be at least 8%. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% or higher if deemed appropriate, as assigned by the OTS capital regulation based on the risks the OTS believes are inherent in the type of asset. The components of core capital are equivalent to those discussed earlier under the 4% leverage standard. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock and, within specified limits, the allowance for loan and lease losses. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

Prompt Corrective Action Regulations. Under the OTS prompt corrective action regulations, the OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization. Generally, a savings institution that has a total risk-based capital ratio of 10%, a Tier 1 risk-based capital ratio of 6% and a leverage ratio of 5% is considered to be well-capitalized, and a savings institution that has a total risk-based capital ratio of 8%, a Tier 1 risk-based capital ratio of 4% and a leverage ratio of 4% is considered to be adequately capitalized . A saving institution that has a total risk-based capital of less than 8% or a leverage ratio or a Tier 1 capital ratio that is less than 4% is considered to be undercapitalized . A savings institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio less than 3% or a leverage ratio less than 3% is considered to be significantly undercapitalized and a savings institution that has a tangible capital to asset ratio equal to or less than 2% is deemed to be critically undercapitalized . Numerous mandatory supervisory actions become immediately applicable to the institution depending upon its category, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The OTS could also take any one of a number of discretionary supervisory actions, including requiring a capital plan, the issuance of a capital directive and the replacement of senior executive officers and directors.

The following table presents the Bank s capital position at December 31, 2006:

	Actual Amount (dollars in thousands)	Ratio	To be adequately capitalized Amount	Ratio	To be well capitalized Amount	Ratio
At December 31, 2006						
Total Capital (to risk-weighted assets)	$ 64,124	11.55 %	$ 44,407	8.00 %	$ 55,508	10.00 %
Tier 1 Capital (to adjusted tangible assets)	60,747	8.38 %	29,012	4.00 %	36,265	5.00 %
Tangible Capital (to tangible assets)	60,747	8.38 %	N.A.	N.A.	N.A.	N.A.
Tier 1 Capital (to risk-weighted assets)	60,747	10.94 %	22,203	4.00 %	33,305	6.00 %

Insurance of Accounts and Regulation by the FDIC. The Bank is a member of the Deposit Insurance Fund (DIF), which is administered by the FDIC. Deposits are insured up to the applicable limits by the FDIC. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the Insurance Fund. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving the OTS an opportunity to take such action, and may terminate an institution s deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

In February 2006, the Federal Deposit Insurance Reform Act (Reform Act) was enacted. The new law merged the old BIF and SAIF into the single Deposit Insurance Fund, increased deposit insurance coverage for IRAs to $250,000, provides for the further increase of deposit insurance on all accounts by indexing the coverage to the rate of inflation, authorizes the FDIC to set the reserve ratio of the combined DIF at a level between 1.15% and 1.50%, and permits the FDIC to establish assessments to be paid by insured banks to maintain the minimum ratios.

In November 2006, the FDIC adopted final regulations to implement the Reform Act. The final regulations include the annual assessment rates that will take effect at the beginning of 2007. The new assessment rates for nearly all banks will vary between five and seven cents for every $100 of domestic deposits. Applied to the Bank s assessment base of approximately $326.7 million, this translates to an annual deposit premium estimated to be between $163,000 and $229,000. Most banks have not been required to pay any deposit insurance premiums since 1995. We have not paid any deposit insurance premiums since 2004. As part of the Reform Act, Congress provided credits to institutions that paid high premiums in the past to bolster the FDIC s insurance reserves. As a result, according to the FDIC, the majority of banks will have assessment credits to initially offset all or most of their premiums in 2007. The preliminary assessment credit for the Bank was calculated at $123,000. The assessment credit will not be recognized up front, but recognized on a go-forward basis only to the extent the credit is used to reduce future deposit premiums that would otherwise be due. Accordingly, we expect the reinstitution of deposit premiums by the FDIC will not have a material effect on our financial condition, results of operations or cash flows in 2007. The level of annual deposit premiums is dependent on the amount of the Bank s deposit assessment base. However, assuming our deposit base remains at approximately $326.7 million in 2008, our annual deposit premiums will increase by approximately $163,000 to $229,000 per year, which will result in higher general and administrative expenses.

The Bank, as a former member of the SAIF, also pays, in addition to its normal deposit insurance premium, assessments towards the retirement of the Financing Corporation Bonds (known as FICO Bonds) issued in the 1980s to assist in the recovery of the savings and loan industry. These assessments will continue until the FICO Bonds mature in 2017. The annual rate (as of the first quarter of 2007) for all insured institutions is $0.122 for every $1,000 in domestic deposits. These assessments are revised quarterly and will continue until the bonds mature in the year 2017. For the year ended December 31, 2006, assessments for the FICO payments was $41,000.

Loans-to-One Borrower. Under the HOLA, savings institutions are generally subject to the limits on loans-to-one borrower applicable to national banks. Generally, savings institutions may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent; equal to 10% of unimpaired capital and surplus, if such loan is secured by readily marketable collateral, which is defined to include certain financial instruments and bullion. At December 31, 2006, the Bank s limit on loans-to-one borrower was $9.7 million. At December 31, 2006, the Bank s largest aggregate outstanding balance of loans-to-one borrower was $8.7 million.

QTL Test. The HOLA requires savings institutions to meet a QTL test. Under the QTL test, a savings association is required to maintain at least 65% of its portfolio assets (total assets less: (i) specified liquid assets up to 20% of total assets; (ii) intangibles, including goodwill; and (iii) the value of property used to conduct business) in certain qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities and, to a certain extent, education loans, credit card loans and small business loans) in at least 9 months out of each 12 month period.

A savings association that fails the QTL test must convert to a bank charter or operate under certain restrictions. As of December 31, 2006, the Bank maintained 70.7% of its portfolio assets in qualified thrift investments and, therefore, met the QTL test.

Limitation on Capital Distributions. OTS regulations impose limitations upon all capital distributions by savings institutions, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital. The rule establishes three tiers of institutions, which are based primarily on an institution s capital level. An institution that exceeds all fully phased-in capital requirements before and after a proposed capital distribution (Tier 1 Bank) and has not been advised by the OTS that it is in need of more than normal supervision, could, after prior notice but without obtaining approval of the OTS, make capital distributions during a calendar year equal to the greater of (i) 100% of its net earnings to date during the calendar year plus the amount that would reduce by one-half its surplus capital ratio (the excess capital over its fully phased-in capital requirements) at the beginning of the calendar year or (ii) 75% of its net income for the previous four quarters. Any additional capital distributions would require prior regulatory approval. In the event the Bank s capital fell below its regulatory requirements or the OTS notified it that it was in need of more than normal supervision, the Bank s ability to make capital distributions could be restricted. In addition, the OTS could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the OTS determines that such distribution would constitute an unsafe or unsound practice.

Liquidity. The Financial Regulatory Relief and Economic Efficiency Act of 2000 repealed the statutory liquidity requirement for savings association, citing the requirement as unnecessary. In light of this action, the OTS repealed its liquidity regulations and replaced them with a general requirement that thrifts continue to maintain sufficient liquidity to ensure safe and sound operations. The Bank s average liquidity ratio for the year ended December 31, 2006 was 7.15%.

Branching. OTS regulations permit nationwide branching by federally chartered savings institutions to the extent allowed by federal statute. This permits federal savings institutions to establish interstate networks and to geographically diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings institutions.

Transactions with Related Parties. The Bank s authority to engage in transactions with related parties or affiliates (e.g., any company that controls or is under common control with an institution, including the Company, is limited by Sections 23A and 23B of the Federal Reserve Act (FRA). Section 23A restricts the aggregate amount of covered transactions with any individual affiliate to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings 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 Board 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. We are considered to be an affiliate of the Bank.

Enforcement. Under the FDI Act, the OTS has primary enforcement responsibility over savings institutions and has the authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal

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enforcement action may range from the issuance of a capital directive or cease and desist order, to removal of officers and/or directors, to institution of receivership, or conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to $25,000 per day, or even $1.0 million per day in especially egregious cases. Under the FDI Act, the FDIC has the authority to recommend to the Director of the OTS enforcement action to be taken with respect to a particular savings institution. If action is not taken by the Director, the FDIC has authority to terminate the Bank s deposit insurance. Federal law also establishes criminal penalties for certain violations.

Standards for Safety and Soundness. The FDI Act requires each federal banking agency to prescribe for all insured depository institutions standards relating to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, and compensation, fees, benefits and such other operational and managerial standards as the agency deems appropriate. The federal banking agencies have adopted final regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness (Guidelines) to implement these safety and soundness standards. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the Guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard, as required by FDI Act.

Federal Reserve System. The Federal Reserve Board regulations require savings institutions to maintain noninterest earning reserves against their transaction accounts (primarily NOW and regular checking accounts). At December 31, 2006, the Bank maintained compliance with the foregoing requirements.

Community Reinvestment Act and the Fair Lending Laws. Savings associations have a responsibility under the Community Reinvestment Act and related regulations of the OTS to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution s failure to comply with the provisions of the Community Reinvestment Act could, as a minimum, result in regulatory restrictions on its activities and the denial of applications. In addition, an institution s failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in the OTS, other federal regulatory agencies and/or the Department of Justice taking enforcement actions against the institution. Based on its last Community Reinvestment Act examination conducted in November 2005, the Bank received an outstanding rating with respect to its performance pursuant to the Community Reinvestment Act.

Financial Services Modernization Legislation. In November 1999, the Gramm-Leach-Bliley Act of 1999 (the GLB) was enacted. The GLB repeals provisions of the Glass-Steagall Act which restricted the affiliation of Federal Reserve member banks with firms engaged principally in specified securities activities, and which restricted officer, director or employee interlocks between a member bank and any company or person primarily engaged in specified securities activities.

In addition, the GLB also contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers by revising and expanding the BHC Act framework to permit a holding company to engage in a full range of financial activities through a new entity known as a financial holding company. Financial activities is broadly defined to include not only banking, insurance and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB provides that no company may acquire control of an insured savings association unless that company engages, and continues to engage, only in the financial activities permissible for a financial holding company, unless the company is grandfathered as a unitary savings and loan holding company. The Financial Institution Modernization Act grandfathers any company that was a unitary savings and loan holding company on May 4, 1999 or became a unitary savings and loan holding company pursuant to an application pending on that date.

To the extent that the GLB permits banks, securities firms and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLB is intended to grant to community banks powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies already possess. Nevertheless, the GLB may have the result of increasing the amount of competition that we face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than we have.

USA Patriot Act of 2001. On October 26, 2001, President Bush signed the USA Patriot Act of 2001 (the Patriot Act). Enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. on September 11, 2001, the Patriot Act is intended to strengthen U.S. law enforcement s and the intelligence communities ability to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Act on financial institutions of all kinds is significant and wide ranging. The Act contains sweeping anti-money laundering and financial transparency laws and requires various regulations, including:

- due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons;

- standards for verifying customer identification at account opening; and

- rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 (SOA) was enacted to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities Exchange Commission under the Securities Exchange Act of 1934, as amended (the Exchange Act), including us.

The SOA includes additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of specified issues by the Securities and Exchange Commission (SEC) and the Comptroller General. The SEC has promulgated regulations to implement various provisions of the SOA, including additional disclosure requirements and certifications in periodic filings under the Exchange Act. We have revised our internal policies and Exchange Act disclosures to comply with these new requirements.

Federal and State Taxation

The Company 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 Bank has not been audited by the IRS. For its 2006 taxable year, the Bank is subject to a maximum federal and state income tax rate of 34% and 10.84%, respectively.

ITEM 1A. RISK FACTORS

Risk Factors

You should carefully consider the following risk factors and all other information contained in this Annual Report on Form 10-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe are immaterial also may impair our business. If any of the events described in the following risk factors occur, our business, results of operations and financial condition could be materially adversely affected.

Our multi-family residential and commercial real estate loans are relatively unseasoned, and defaults on such loans would adversely affect our financial condition and results of operations.

At December 31, 2006, our multi-family residential loans amounted to $357.3 million, or 58.8% of our total loans. At December 31, 2006, our commercial real estate loans amounted to $205.6 million, or 33.8% of our total loans. Our multi-family residential and commercial real estate loan portfolios consist primarily of loans originated after June 30, 2002 and are, consequently, relatively unseasoned. In addition, such loans originated after June 30, 2002 have an average loan balance as of December 31, 2006 of $837,000 in the case of multi-family loans and $1.2 million in the case of commercial real estate loans, so that a default on a multi-family or commercial real estate loan may have a greater impact on us than a default on a single-family residential loan which is generally smaller in size. Further, the payment on multi-family and commercial real estate loans is typically dependent on the successful operation of the project, which is affected by the supply and demand for multi-family residential units and commercial property within the relevant market. If the market for multi-family units and commercial property experiences a decline in demand, multi-family and commercial borrowers may suffer losses on their projects and be unable to repay their loans. Defaults on these loans would negatively affect our financial condition, results of operations and financial prospects.

We may be unable to successfully compete in our industry.

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 mortgage companies that make loans in our primary market areas. We also face substantial competition in attracting deposits from other banking institutions, money market and mutual funds, credit unions and other investment vehicles. In addition banks with larger capitalizations and non-bank financial institutions that are not governed by bank regulatory restrictions have large lending limits and are better able to serve the needs of larger customers. Many of these financial institutions are also significantly larger and have greater financial resources than we have, and 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 that we originate and the quality of service that we provide to our borrowers. 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 origination of multi-family and commercial real estate loans is dependent on the mortgage brokers who refer these loans to us.

Our primary method of originating multi-family and commercial real estate loans is through referrals by mortgage brokers. During 2006, five mortgage brokers have referred to us approximately 62.0% of all the multi-family and commercial real estate loans we originated. Although we have in-house account managers who have the responsibility of developing relationships with additional mortgage brokers which may refer us the types of loans we target, should we not be successful in developing relationships with additional mortgage brokers and should we lose referrals from one or more mortgage brokers on whom we depend for a large percentage of our multi-family and commercial real estate loans, our loan originations could be substantially less than we anticipate, thus reducing our anticipated income from these loans.

Interest rate fluctuations, 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 on interest-earning assets, such as loans and investments, and interest expense 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 Board or otherwise, may have a significant effect on net interest income. The assets and liabilities may react differently to changes in overall market rates or conditions. Moreover, in periods of rising interest rates, financial institutions typically originate fewer mortgage loans adversely affecting our interest income on loans. 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.

We may experience loan losses in excess of our allowance for loan losses.

We try to limit the risk that borrowers will fail to repay loans by carefully underwriting the loans, nevertheless losses can and do occur. We create an allowance for estimated loan losses in our accounting records, based on estimates of the following:

- industry historical losses as reported by the FDIC;
- historical experience with our loans;
- evaluation of economic conditions;
- regular reviews of the quality mix and size of the overall loan portfolio;
- regular reviews of delinquencies; and
- the quality of the collateral underlying our loans.

We maintain an allowance for loan losses at a level that we believe is adequate to absorb any specifically identified losses, as well as, any other losses inherent in our loan portfolio. However, changes in economic, operating and other conditions, including 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 OTS, as part of its supervisory function, periodically reviews our allowance for loan losses. Such 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 allowance required by the OTS could also adversely affect our financial condition and results of operations.

Upon exercise of the Warrant, shareholders will experience significant dilution in their shares of common stock.

In 2002, a warrant (the Warrant) was issued in conjunction with a private placement. The holder of the Warrant has the right to purchase 1,166,400 shares of our common stock at an exercise price of $0.75 per share, which shares, once exercised, would represent approximately 17.4% of our issued and outstanding shares as of December 31, 2006. The Warrant is currently exercisable for an aggregate of 1,166,400 shares of our common stock. The trading price of our common stock has been significantly higher than $0.75 per share for the last three fiscal years and at December 31, 2006, the closing price of our common stock was $12.18 per share. Upon exercise of the Warrant, existing shareholders will experience significant dilution of the shares of our common stock that they hold.

Adverse outcomes of litigation against us could harm our business and results of operations.

We are currently involved in litigation involving the prior management s origination and sale of subprime mortgages, as well as, other actions arising in the ordinary course of our business. A significant judgment against us in connection with any pending or future litigation could harm our business and results of operations.

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

A substantial majority of our assets and deposits are generated in Southern California. As a result, poor economic conditions in Southern 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. Further, a downturn in the Southern California real estate market could hurt our business. Our business activities and credit exposure are concentrated in Southern California. A downturn in the Southern California real estate market could hurt our business because the vast majority of our loans are secured by real estate located within Southern California. As of December 31, 2006, approximately 93.9% of our loan portfolio consisted of loans secured by real estate located in California, the substantial majority of which are located in Southern California. If there is a significant decline in real estate values, especially in Southern California, the collateral for our loans will 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. Real estate values in Southern California could be affected by, among other things, earthquakes and other natural disasters particular to Southern California.

We do not expect to pay cash dividends in the foreseeable future.

We do not intend to pay cash dividends on our common stock in the foreseeable future. Instead, we intend to reinvest our earnings in our business. In addition, in order to pay cash dividends to our shareholders, we would most likely need to obtain funds from the Bank. The Bank s ability, in turn, to pay dividends to us is limited by federal banking law. It is possible, depending on the financial condition of the Bank and other factors, that the OTS could assert that payment of dividends by the Bank is an unsafe or unsound practice.

Federal law imposes conditions on the ability to acquire control of our common stock at specified threshold percentages, which could discourage a change in control.

Acquisition of control of a federal savings bank or its holding company requires advance approval by the OTS. Under federal law, the acquisition of more than 10% of our common stock would result in a rebuttable presumption of control and the ownership of more than 25% of our voting stock would result in conclusive control. Depending on the circumstances, the foregoing requirements may prevent or restrict a change in control of us.

Our business may be adversely affected by the highly regulated environment in which we operate.

We are subject to extensive federal and state legislation, regulation and supervision. Recently enacted, proposed and future legislation and regulations have had and are expected to continue to have a significant impact on the financial services industry. Some of the legislative and regulatory changes may benefit us. However, other changes could increase our costs of doing business or reduce our ability to compete in certain markets.

Anti-takeover defenses may delay or prevent future transactions

Our Certificate of Incorporation and Bylaws, among other things:

- divide the board of directors into three classes with directors of each class serving for a staggered three year period;
- provides that our directors must fill vacancies on the board;
- permit the issuance, without shareholder approval, of shares of preferred stock having rights and preferences determined by the board of directors;
- provide that stockholders holding 80% of our issued and outstanding shares must vote to approve certain business combinations and other transactions involving holders of more than 10% of our common stock or our affiliates;
- provide that stockholders holding 80% of our issued and outstanding shares must vote to remove directors for cause; and
- provide that record holders of our common stock who beneficially own in excess of 10% of our common stock are not entitled to vote shares held by them in excess of 10% of our common stock.

In addition, Steven R. Gardner, our President and Chief Executive Officer, has an employment agreement which provides that, in the event of a change of control in which Mr. Gardner s employment is terminated, Mr. Gardner will be entitled to severance payments equal to two times his annual base salary plus an amount equal to his incentive bonus for the previous year. Also, the Bank has Salary Continuation Agreements with Mr. Gardner and John Shindler, our Chief Financial Officer, that provides that if their employment is terminated within 12 months of a change in control they would receive the present value of their benefits which is approximately $1.5 million and $740,000, respectively.

These provisions in our certificate of incorporation, by-laws and Mr. Gardner s employment agreement could make the removal of incumbent directors more difficult and time-consuming and may have the effect of discouraging a tender offer or other takeover attempts not previously approved by our board of directors.

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 President and Chief Executive Officer, who developed and implemented our new business strategy. The loss of Mr. Gardner could have a negative impact on the success of our new business strategy. In addition, we rely upon the services of John Shindler, our Executive Vice President and Chief Financial Officer, Eddie Wilcox, our Executive Vice President and Chief Banking Officer, 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. We do not maintain key-man life insurance on any employee other than Messrs Gardner and Shindler, nor have we entered into an employment agreement with any other employee other than Mr. Gardner. Mr. Gardner entered into a three year employment agreement with both the Company and Bank on January 5, 2004 which automatically extended for an additional year on October 7, 2006.

Potential acquisitions may disrupt our business and dilute stockholder value.

We have evaluated merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions. 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 an acquisition could have a material adverse effect on our financial condition and results of operations.

We may seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. We do not currently have any specific plans, arrangements or understandings regarding such expansion. 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 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;
- Difficulty and expense of integrating the operations and personnel 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;
- Potential changes in banking or tax laws or regulations that may affect the target company.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Location	Leased or Owned	Original Year Leased or Acquired	Date of Lease Expiration	Net Book Value of Property or Leasehold Improvements at December 31, 2006
Corporate Headquarters: 1600 Sunflower Ave(a) Costa Mesa, CA 92626	Owned	2002	N.A.	$ 4,906,000
Branch Office: 1598 E Highland Avenue San Bernardino, CA 92404	Leased	1986	2015	$ 69,000
Branch Office: 19011 Magnolia Avenue Huntington Beach CA 92646	Owned (b)	2005	2023	$ 1,500,000
Branch Office: 13928 Seal Beach Blvd. Seal Beach, CA 90740	Leased	1999	2012	$ 7,000
Branch Office: 4957 Katella Avenue, Suite B Los Alamitos, CA 90720	Leased	2005	2015	$ 387,000
Branch Office: 4667 MacArthur Blvd. Newport Beach, CA 92660	Leased	2005	2016	$ 2,000
Branch Office: 201 South Lake Avenue, Suite 602 Pasadena, CA 91101	Leased	2005	2007	$

(a) We lease to two tenants approximately 9,735 square feet of the 36,159 square feet of our corporate headquarters for $15,423 per month.

(b) The building is owned, but the land is leased on a long-term basis.

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.

ITEM 3. LEGAL PROCEEDINGS

In February 2004, the Bank was named in a class action lawsuit titled, James Baker v. Century Financial, et al , alleging various violations of Missouri s Second Mortgage Loans Act by charging and receiving fees and costs that were either wholly prohibited by or in excess of that allowed by the Act relating to origination fees, interest rates, and other charges. The class action lawsuit was filed in the Circuit Court of Clay County, Missouri. The complaint seeks restitution of all improperly collected charges and interest plus the right to rescind the mortgage loans or a right to offset any illegal collected charges and interest against the principal amounts due on the loans. In March of 2005, the Bank s motion for dismissal due to limitations was denied by the trial court without comment. Our motion to dismiss due to federal preemption of state law because the Bank is a federal savings bank was denied in August 2006. The Bank has answered the Plaintiffs complaint and the lawsuit is in the early stages of discovery. The Bank intends to appeal the trial court s ruling on the limitations in the form of a motion for summary judgment after discovery is completed.

In October 2005, the Bank and the Company were added to a lawsuit titled, DLJ Mortgage Capital, Inc. (DLJ) vs. Attorneys Title Guaranty Fund, Inc. and William Mansell, et al, for alleged defaults and breaches of warranty under a loan sale agreement between DLJ and the Company. The lawsuit was filed in the District Court of Salt Lake County, Utah. The complaint seeks restitution of the principal balance, interest, and late charges totaling $1.5 million as of the date of the complaint. The action is relates to a fraudulent loan, which the Bank purchased in 1999 from an unaffiliated mortgage company and then sold to DLJ in February 2000.

In August 2006, DLJ filed a motion for partial summary judgment against the Company and the Bank which the Company and the Bank are opposing. We expect a ruling on such motion in the second quarter of 2007. The Company and the Bank believe that they have numerous defenses to such complaint, including that any losses should be covered by the applicable title insurance with respect to the loan. While the Company and the Bank intend to vigorously defend this matter no assurance can be given that the Company and the Bank will be successful with respect to its defense of the complaint or that the Company and the Bank ultimately will not be required to pay all or a portion of the specific damages. In any event, Management does not believe that the resolution of the lawsuit will have a material adverse affect on the Company s consolidated financial condition or results of operation.

The Company and the Bank are not involved in any other 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 or the Bank.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

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

PRICE RANGE BY QUARTERS

The common stock of the Company has been publicly traded since 1997 and is currently traded on the NASDAQ Global Market under the symbol PPBI. However, until recently, trading in the common stock has not been extensive and such trades cannot be characterized as constituting an active trading market.

As of March 5, 2007, there were approximately 1,260 holders of record of the common stock. The following table summarizes the range of the high and low closing sale prices per share of our common stock as quoted by the Nasdaq Global Market for the periods indicated.

	Sale Price of Common Stock	
	High	**Low**
2005		
First Quarter	$ 13.42	$ 10.48
Second Quarter	$ 11.14	$ 9.70
Third Quarter	$ 13.16	$ 10.69
Fourth Quarter	$ 12.95	$ 10.58
2006		
First Quarter	$ 12.45	$ 11.63
Second Quarter	$ 12.03	$ 11.12
Third Quarter	$ 12.33	$ 10.79
Fourth Quarter	$ 12.69	$ 11.46

Stock Performance Graph. The graph below compares the performance of the common stock with that of the Nasdaq Composite Index (U.S. Companies) and the Nasdaq Bank Stocks Index from December 31, 2001 through December 31, 2006. The graph is based on the investment of $100 in the common stock at its closing price on December 31, 2001. The Company has not paid any dividends on its common stock.

Total Return Analysis	**12/31/2001**	**12/31/2002**	**12/31/2003**	**12/31/2004**	**12/30/2005**	**12/29/2006**
Pacific Premier Bancorp, Inc.	$ 100.00	$ 259.02	$ 540.98	$ 646.83	$ 575.61	$ 594.15
Nasdaq Bank Stocks Index	$ 100.00	$ 102.37	$ 131.69	$ 150.71	$ 147.23	$ 165.24
Nasdaq Composite Index	$ 100.00	$ 69.13	$ 103.36	$ 112.49	$ 114.88	$ 126.21

DIVIDENDS

It is our policy to retain earnings, if any, to provide funds for use in our business. We have never declared or paid dividends on our common stock and do not anticipate declaring or paying any cash dividends in the foreseeable future.

Our ability to pay a dividend on the common stock will depend upon, among other things, future earnings, operating and financial condition, capital requirements, general business conditions and the receipt of regulatory approvals. In addition, our ability to pay dividends at any time may be limited by the Bank s ability to pay dividends to the Company. The OTS regulations require that the Bank must give prior notice to the OTS before making any dividend declaration. Further, if the OTS should decide that to pay a dividend would place the Bank in an unsafe or unsound financial condition, it can prohibit the payment of dividends.

ISSUER PURCHASES OF EQUITY SECURITIES

In 2005, the Company s Board of Directors authorized the Management of the Company to repurchase up to 61,500 shares, or 1.17% of the Company s issued and outstanding common stock, to be done in accordance with Rule 10b-18 of the Exchange Act. At December 31, 2006, the Company had purchased 34,300 shares pursuant to that authorization. The following table summarizes purchase activity for the year of 2006:

Month of Purchase	Total Number of shares purchased/ returned	Average price paid per share	Total number of shares repurchased as part of the publicly announced program	Maximum number of shares that may yet be purchased under the program
Jan-06		$		29,950
Feb-06				29,950
Mar-06				29,950
Apr-06				29,950
May-06	750	11.32	750	29,200
Jun-06			0	29,200
Jul-06			0	29,200
Aug-06			0	29,200
Sep-06	2,000	11.46	2,000	27,200
Oct-06				27,200
Nov-06				27,200
Dec-06				27,200
Total/Average	2,750	$ 11.42	2,750	27,200

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data presented below is derived from the audited consolidated financial statements of the Company and should be read in conjunction with the Consolidated Financial Statements presented elsewhere herein (dollars in thousands, except ratios and per share data):

	As of and For the Years Ended December 31,				
	2006	2005	2004	2003	2002
Operating Data:					
Interest income	$ 44,128	$ 33,707	$ 23,223	$ 17,248	$ 18,872
Interest expense	27,003	16,571	7,817	7,657	8,910
Net interest income	17,125	17,136	15,406	9,591	9,962
Provision for loan losses	531	349	705	655	1,133
Net interest income after provision for loans losses	16,594	16,787	14,701	8,936	8,829
Net gains (losses) from loan sales	3,697	590	105	328	(261)
Other noninterest income	2,818	3,540	4,141	1,987	2,130
Noninterest expense	15,231	12,260	11,234	9,783	10,165
Income before income tax provision (benefit)	7,878	8,657	7,713	1,468	533
Income tax provision (benefit)(1)	450	1,436	972	(597)	(2,345)
Net income	$ 7,428	$ 7,221	$ 6,741	$ 2,065	$ 2,878

	As of and For the Years Ended December 31,				
	2006	2005	2004	2003	2002
Share Data:					
Net income per share:					
Basic	$ 1.41	$ 1.37	$ 1.28	$ 0.96	$ 2.16
Diluted	$ 1.11	$ 1.08	$ 1.02	$ 0.61	$ 1.16
Weighted average common shares outstanding:					
Basic	5,261,897	5,256,906	5,256,334	2,161,314	1,333,572
Diluted	6,684,915	6,658,240	6,622,735	3,399,376	2,476,648
Book value per share (basic)	$ 11.03	$ 9.67	$ 8.37	$ 7.10	$ 8.72
Book value per share (diluted)	$ 9.16	$ 8.09	$ 7.08	$ 5.98	$ 4.98
Selected Balance Sheet Data:					
Total assets	$ 730,874	$ 702,696	$ 543,124	$ 309,368	$ 238,278
Participation Contract				5,977	4,869
Securities and FHLB stock	77,144	49,795	44,844	42,275	58,243
Loans held for sale, net(2)	795	456	532	804	1,866
Loans held for investment, net(2)	604,304	602,937	469,822	246,796	156,365
Allowance for loan losses	3,543	3,050	2,626	1,984	2,835
Mortgage servicing rights			12	29	51
Total deposits	339,449	327,936	288,887	221,447	191,170
Borrowings	316,491	318,145	206,710	48,600	32,940
Total stockholders equity	58,038	50,542	44,028	37,332	11,623
Performance Ratios:(3)					
Return on average assets(4)	1.07 %	1.18 %	1.61 %	0.82 %	1.18 %
Return on average equity(5)	13.47 %	15.17 %	16.37 %	12.43 %	30.70 %
Average equity to average assets	7.94 %	7.78 %	9.86 %	6.59 %	3.85 %
Equity to total assets at end of period	7.98 %	7.20 %	8.11 %	12.07 %	4.88 %
Average interest rate spread(6)	2.39 %	2.70 %	3.66 %	4.02 %	4.44 %
Net interest margin(7)	2.58 %	2.88 %	3.82 %	4.06 %	4.37 %
Efficiency ratio(8)	64.26 %	57.72 %	57.21 %	81.20 %	85.19 %
Average interest-earning assets to average interest-bearing liabilities	104.83 %	106.41 %	108.02 %	101.16 %	98.45 %
Capital Ratios(9):					
Tier 1 capital to adjusted total assets	8.38 %	7.79 %	9.09 %	8.93 %	7.03 %
Tier 1 capital to total risk-weighted assets	10.94 %	11.21 %	13.00 %	12.49 %	11.29 %
Total capital to total risk-weighted assets	11.55 %	11.78 %	13.59 %	13.21 %	12.54 %
Asset Quality Ratios:					
Nonperforming loans, net, to total loans(10)	0.09 %	0.25 %	0.45 %	0.99 %	3.07 %
Nonperforming assets, net as a percent of total assets(11)	0.10 %	0.24 %	0.46 %	1.12 %	3.12 %
Net charge-offs to average total loans	0.01 %	(0.01)%	0.02 %	0.82 %	1.74 %
Allowance for loan losses to total loans at period end	0.58 %	0.50 %	0.56 %	0.79 %	1.74 %
Allowance for loan losses as a percent of nonperforming loans at period end(10)	558.83 %	180.79 %	110.77 %	71.55 %	50.35 %

(1) In the years ended December 31, 2006, December 31, 2005 and December 31, 2004, we reversed $2.4 million, $1.6 million, and $1.6 million, respectively, of our deferred tax valuation allowance due to our improved financial outlook.

(2) Loans are net of the allowance for loan losses and deferred fees.

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(3) All average balances consist of average daily balances.

(4) Net income divided by total average assets.

(5) Net income divided by average stockholders equity.

(6) Represents the weighted average yield on interest-earning assets less the weighted average cost of interest-bearing liabilities.

(7) Represents net interest income as a percent of average interest-earning assets.

(8) Represents the ratio of noninterest expense less (gain) loss on foreclosed real estate to the sum of net interest income before provision for loan losses and total noninterest income.

(9) Calculated with respect to the Bank.

(10) Nonperforming loans consist of loans past due 90 days or more and foreclosures in process less than 90 days and still accruing interest.

(11) Nonperforming assets consist of nonperforming loans (see footnote 10 above) and foreclosed real estate owned.

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

Summary

Our principal business is attracting deposits from small 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. In 2007, the Bank expects to fund substantially all of the loans that it originates or purchases through deposits, FHLB advances 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 Bank s market area. The Bank s ability to originate and purchase loans is influenced by the general level of product available. The Bank s results of operations are also affected by the Bank s provision for loan losses and the level of operating expenses. The Bank s operating expenses primarily consist of employee compensation and benefits, premises and occupancy 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

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. The Company s significant accounting policies are described in the Notes 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 balance sheet dates and the Company s results of operations for future reporting periods.

We believe that the allowance for loan losses and the valuation allowance on deferred taxes are the critical accounting policies that require estimates and assumptions in the preparation of the Company s financial statements that are most susceptible to significant change. For further information, see Business Allowances for Loan Losses and Note 1 to the Consolidated Financial Statements.

Average Balance Sheet. The following tables set forth certain information relating to the Company for the years ended December 31, 2006, 2005, and 2004. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are measured on a daily basis. The yields and costs include fees, which are considered adjustments to yields.

	For the Year Ended December 31,								
	2006			2005			2004		
	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(1)	$ 602	$ 126	20.93 %	$ 509	$ 53	10.41 %	$ 4,096	$ 57	1.39 %
Federal funds sold	1,123	54	4.84 %	575	20	3.50 %	621	7	1.13 %
Participation Contract			0.00 %			0.00 %	2,367	1,965	83.02 %
Investment securities(2)	53,519	2,654	4.96 %	47,564	1,924	4.05 %	43,896	1,475	3.36 %
Loans receivable, net(3)	607,439	41,294	6.80 %	546,426	31,710	5.80 %	351,968	19,719	5.60 %
Total interest-earning assets	662,683	44,128	6.66 %	595,074	33,707	5.66 %	402,948	23,223	5.76 %
Noninterest-earning assets	31,893			16,967			14,630		
Total assets	$ 694,576			$ 612,041			$ 417,578		
Liabilities and Equity:									
Interest-bearing liabilities:									
Transaction accounts	$ 91,169	1,669	1.83 %	$ 80,273	1,185	1.48 %	$ 73,818	812	1.10 %
Certificate accounts	231,420	10,185	4.40 %	224,546	7,148	3.18 %	189,021	4,670	2.47 %
Total interest-bearing deposits	322,589	11,854	3.67 %	304,819	8,333	2.73 %	262,839	5,482	2.09 %
FHLB advances and other borrowings	299,274	14,348	4.79 %	244,113	7,616	3.12 %	102,258	1,995	1.95 %
Subordinated debentures	10,310	801	7.77 %	10,310	622	6.03 %	7,939	340	4.28 %
Total interest-bearing liabilities	632,173	27,003	4.27 %	559,242	16,571	2.96 %	373,036	7,817	2.10 %
							110,197		
Noninterest-bearing liabilities	7,253			5,187			3,358		
Total liabilities	639,426			564,429			376,394		
Stockholders equity	55,150			47,612			41,184		
Total liabilities and equity	$ 694,576			$ 612,041			$ 417,578		
Net interest income		$ 17,125			$ 17,136			$ 15,406	
Net interest rate spread(4)			2.39 %			2.70 %			3.66 %
Net interest margin(5)			2.58 %			2.88 %			3.82 %
Ratio of interest-earning assets to interest-bearing liabilities			104.83 %			106.41 %			108.02 %

(1) Includes interest on float from cash disbursements.

(2) Includes unamortized discounts and premiums.

(3) Amount is net of deferred loan origination fees, unamortized discounts, premiums and allowance for estimated loan losses and includes loans held for sale and nonperforming loans. Loan fees were approximately $1.1 million, $1.6 million, and $1.6 million for the years ended December 31, 2006, 2005, and 2004, respectively.

(4) Net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(5) Net interest margin represents net interest income divided by average interest-earning assets.

Rate Volume Analysis. The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net

change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Year Ended December 31, 2006 Compared to Year Ended December 31, 2005 Increase (decrease) due to			Year Ended December 31, 2005 Compared to Year Ended December 31, 2004 Increase (decrease) due to		
	Average Volume (in thousands)	Average Rate	Net	Average Volume	Average Rate	Net
Interest-earning assets:						
Cash and cash equivalents	$ 11	$ 62	$ 73	$ (88)	$ 84	$ (4)
Federal funds sold	25	9	34		13	13
Investment securities	260	470	730	131	318	449
Participation Contract				(1,965)		(1,965)
Loans receivable, net	3,780	5,804	9,584	11,261	730	11,991
Total interest-earning assets	4,076	6,345	10,421	9,339	1,145	10,484
Interest-bearing liabilities:						
Transaction accounts	175	309	484	76	297	373
Certificate accounts	208	2,829	3,037	978	1,500	2,478
FHLB advances and other borrowings	1,996	4,736	6,732	3,926	1,695	5,621
Subordinated debentures		179	179	119	163	282
Total interest-bearing liabilities	2,379	8,053	10,432	5,099	3,655	8,754
Changes in net interest income	$ 1,697	$ (1,708)	$ (11)	$ 4,240	$ (2,510)	$ 1,730

Comparison of Operating Results for the Year Ended December 31, 2006 and December 31, 2005

General: For the year ended December 31, 2006, the Company reported net income of $7.4 million or $1.11 per diluted share, compared with net income of $7.2 million or $1.08 per diluted share for the same period in 2005. The $207,000 increase in net income in 2006 compared to 2005 was primarily the result of increases in total interest income of $10.4 million, total noninterest income of $2.4 million and the reversal of its valuation allowance for deferred taxes of $2.4 million, which was partially offset by increases in total interest expense of $10.4 million and noninterest expense of $3.0 million.

Interest Income: Interest income for the year ended December 31, 2006 was $44.1 million, compared to $33.7 million for the year ended December 31, 2005. The increase of $10.4 million, or 30.9%, is primarily due to interest income on loans receivable increasing $9.6 million to $41.3 million for the year ended December 31, 2006 from $31.7 million for the year ended December 31, 2005. The increase in interest income on loans was primarily the result of an increase in the average loan balance of $61.0 million from $546.5 million in 2005 to $607.4 million in 2006 combined with a 100 basis points increase in the average yield on said loans from 5.80% for 2005 to 6.80% for 2006. The increase in loan yield is primarily due to the re-pricing of our short-term adjustable-rate income property loans and the origination of higher yielding loans during 2006.

Interest Expense: Interest expense for the year ended December 31, 2006 was $27.0 million, compared to $16.6 million for the year ended December 31, 2005. The $10.4 million increase, or 63.0%, primarily reflects an increase in the average balance of deposits and FHLB advances and other borrowings of $17.8 million and $55.2 million, respectively, during the year, combined with a 131 basis points increase in the average cost of interest-bearing liabilities that was due to a higher interest rate environment.

Net Interest Income: Our primary source of revenue is net interest income, which is the difference between interest income on earning assets and interest expense on interest-bearing liabilities. Net interest income and net interest margin are affected by several factors including (1) the level of, and the

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relationship between, the dollar amount of interest-earning assets and interest-bearing liabilities, (2) the relationship between repricing or maturity of our variable-rate and fixed-rate loans and securities, and our deposits and borrowings, and (3) the magnitude of our non-interest earning assets, including non-accrual loans and foreclosed real estate.

Net interest income before provision for loan losses was $17.1 million for each of the years ended December 31, 2006 and 2005.

Provision for Loan Losses: The provision for loan losses increased to $531,000 for the year ended December 31, 2006 from $349,000 for the year ended December 31, 2005. The increase in the current year provision for loan losses was primarily due to the overall shift in our loan portfolio mix toward more commercial real estate, business and SBA loans, which was partially offset by a decrease in our nonperforming loans by 58.4% from $1.7 million in 2005 to $712,000 in 2006, Net charge-offs increased $113,000 in 2006 from a net recoveries of $75,000 in 2005 to $38,000 in net charge-off in 2006. Total net loans receivable in 2006 increased $1.7 million, or 2.8%, over 2005.

Noninterest Income: Noninterest income was $6.5 million for the year ended December 31, 2006, compared to $4.1 million for the year ended December 31, 2005. The $2.4 million increase, or 57.7%, was primarily due to an increase in gains from loan sales of $3.1 million in 2006 compared to 2005. Partially offsetting the increase from the gains on loan sales was a decrease in other income from the sale and collection of charged-off loans related to the Participation Contract. During 2006 and 2005, the Company collected $171,000 and $1.0 million, respectively, in recoveries on the collection of charged-off loans associated with the Participation Contract.

Noninterest Expense: Noninterest expense for the year ended December 31, 2006 was $15.2 million compared to $12.3 million for the year ended December 31, 2005. The $2.9 million increase, or 24.2%, in noninterest expense was principally due to increases in compensation and benefits of $1.6 million and premises and occupancy of $805,000. These increases are reflective of the Bank s investments in its strategic expansion through de novo branching and the addition of experienced business bankers to staff its new locations. The number of employees at the Bank grew from 89 at December 31, 2005 to 106 at December 31, 2006. A large portion of the increases in compensation and benefits, $996,000, and premises and occupancy expense, $478,000, for the year ended December 31, 2006 compared to the prior year, is associated with the Bank s depository branches in the cities of Costa Mesa and Los Alamitos that opened in 2006 and Newport Beach (scheduled to open in the first quarter of 2007), and the SBA loan production office in Pasadena, which opened in January 2006.

Income Taxes: The provision for income taxes decreased to $450,000 for the year ended December 31, 2006 compared to a provision of $1.4 million for the year ended December 31, 2005. The Company had income before income taxes of $7.9 million for the year ended December 31, 2006 compared to income before income taxes of $8.7 million for the year ended December 31, 2005. In 2006, the Company eliminated its remaining valuation allowance for deferred taxes which reduced its provision by $2.4 million. In 2005, the Company reduced its valuation allowance for deferred taxes by $1.6 million. The elimination of the deferred tax valuation allowance is due to management s forecast of taxable earnings, based on assumptions regarding the Company s growth in the near future.

Comparison of Operating Results for the Year Ended December 31, 2005 and December 31, 2004

General: For the year ended December 31, 2005, the Company reported net income of $7.2 million or $1.08 per diluted share, compared with net income of $6.7 million or $1.02 per diluted share for the same period in 2004. The $480,000 increase in net income was primarily the result of increases in net interest income of $2.1 million which was partially offset by increases in noninterest expense and provision for income tax of $1.0 million and $464,000, respectively.

Interest Income: Interest income for the year ended December 31, 2005 was $33.7 million, compared to $23.2 million for the year ended December 31, 2004. The increase of $10.5 million, or 45.1%, is primarily due to an increase of $194.5 million in the average balance of our loans receivable, which was partially offset by no interest income from the Participation Contract in 2005 compared to $2.0 million in 2004. The three residuals that made up the Participation Contract were either sold or terminated during 2004. Interest income on loans receivable increased $12.0 million to $31.7 million for the year ended December 31, 2005 from $19.7 million for the year ended December 31, 2004. The increase in interest income on loans was primarily the result of an increase in the average loan balance from $352.0 million in 2004 to $546.5 million in 2005 combined with a 20 basis points increase in the average yield on loans. The increase in loan yield is primarily due to the re-pricing of our short-term adjustable-rate income property loans.

Interest Expense: Interest expense for the year ended December 31, 2005 was $16.6 million, compared to $7.8 million for the year ended December 31, 2004. The $8.8 million increase, or 112.0%, primarily reflects an increase in the average balance of deposits and FHLB advances and other borrowings of $42.0 million and $141.9 million, respectively, during the year, combined with an 86 basis points increase in the average cost of interest-bearing liabilities that was due to a higher interest rate environment.

Net Interest Income: Net interest income before provision for loan losses was $17.1 million for the year ended December 31, 2005, compared to $15.4 million for the year ended December 31, 2004. The $1.7 million increase, or 11.2%, in net interest income before provision for loan losses is primarily due to the $10.5 million increase in the Company s interest income which is predominately attributable to a 55.3% increase in average loans outstanding of $194.5 million, over the prior year period, which was partially offset by a decline in net interest margin of 0.94%. The average cost of interest-bearing liabilities for the Company increased to 2.96% during the year ended 2005, compared with 2.10% during the same period in 2004. The Company s yield on average earning assets was 5.66% for the year ended December 31, 2005, compared with 5.76% for the same period in 2004. Total interest income increased $10.5 million, or 45.1%, while total interest expense increased by $8.8 million, or 112.0%.

Provision for Loan Losses: The provision for loan losses decreased to $349,000 for the year ended December 31, 2005 from $705,000 for the year ended December 31, 2004. The current year provision for loan losses was primarily due to the growth in our loan portfolio. Nonperforming loans decreased by 28.8% from $2.4 million in 2004 to $1.7 million in 2005, with a corresponding decrease in net charge-offs from $63,000 in 2004 to recoveries of $75,000 in 2005. Total loans receivable in 2005 increased $133.5 million, or 28.3%, over 2004.

Noninterest Income: Noninterest income was $4.1 million for the year ended December 31, 2005, compared to $4.2 million for the year ended December 31, 2004. The $116,000 decrease, or 2.7%, was primarily due to a reduction of income associated with the Participation Contract of $1.4 million partially offset by an increase in prepayment penalties of $882,000 and gains on loan sales of $485,000. In 2004, the Participation Contract generated $2.4 million gain from the sale or termination of the three residual interest components and $141,000 from recoveries on the collection of charged-off loans associated with the Participation Contract. During 2005, the Company collected $1.0 million in recoveries on the collection of charged-off loans associated with the Participation Contract.

Noninterest Expense: Noninterest expense for the year ended December 31, 2005 was $12.3 million compared to $11.2 million for the year ended December 31, 2004. The $1.1 million increase, or 9.1%, in noninterest expense was principally due to increases in compensation and benefits of $762,000 and premises and occupancy of $166,000. The increase in compensation and benefits was primarily due to an increase in the number of employees from 80 full-time employees at December 31, 2004 to 87 full-time employees at December 31, 2005.

Income Taxes: The provision for income taxes increased to a tax provision of $1.4 million for the year ended December 31, 2005 compared to a provision of $972,000 for the year ended December 31, 2004. The Company had income before income taxes of $8.7 million for the year ended December 31, 2005 compared to income before income taxes of $7.7 million for the year ended December 31, 2004. The Company increased the deferred tax asset by reducing its deferred tax valuation allowance by $1.6 million and $1.4 million in 2005 and 2004, respectively. The decrease in the deferred tax valuation allowance is due to management s forecast of taxable earnings, based on assumptions regarding the Company s growth in the near future. As the Company achieves continuous taxable income and if the earning projections show that the Company will have the ability to use its net operating loss carry-forwards, then all or part of the remaining valuation allowance for deferred taxes of $2.4 million will be eliminated.

Comparison of Financial Condition at December 31, 2006 and December 31, 2005

Total assets of the Company were $731.1 million as of December 31, 2006, compared to $702.7 million as of December 31, 2005. The $28.4 million, or 4.0%, increase in total assets is primarily due to the purchase of $10.0 million of Bank Owned Life Insurance (BOLI) at the end of March 2006, and an increase in securities available for sale of $26.0 million, partially offset by a decrease in federal funds sold of $14.0 million.

Total liabilities of the Company were $672.8 million at December 31, 2006 compared to $652.2 million at December 31, 2005. The $20.6 million increase, or 3.2%, was primarily due to increases of $8.7 million in other borrowings and $11.5 million in deposits. Total deposits at December 31, 2006 were $339.4 million compared to $327.9 million at December 31, 2005. In addition, FHLB advances and other borrowings increased by $3.5 million and $5.2 million, respectively, as of December 31, 2006 compared to the prior year-end.

At December 31, 2006 and 2005, our stockholders equity amounted to $58.3 million and $50.6 million, respectively. The increase in stockholders equity was due primarily to $7.4 million of net income for the year ended December 31, 2006.

Liquidity

Our primary sources of funds are principal and interest payments on loans, deposits and FHLB advances. While maturities and scheduled amortization of loans are a predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. We seek to maintain a level of liquid assets to ensure a safe and sound operation. Our average liquidity ratios were 7.20%, 6.32% and 13.70% for the years ended December 31, 2006, 2005 and 2004, respectively. The liquidity ratio is calculated by dividing the sum of cash balances plus unpledged securities by the sum of deposits that mature in one year or less plus transaction accounts and FHLB advances. Our liquidity is monitored daily.

We believe the level of liquid assets is sufficient to meet current and anticipated funding needs. Liquid assets of the Bank (which are comprised of cash and unpledged investments) represent approximately 9.2% of total assets at December 31, 2006, 9.9% of total assets at December 31, 2005 and 6.2% of total assets at December 31, 2004. At December 31, 2006, the Bank had four unsecured lines of credit with other correspondent banks totaling $30.0 million to purchase federal funds as business needs dictate. The

Bank had $5.0 million on these lines at year end. Also, in March 2004, the Bank established a $100.0 million credit facility which is secured by investments pledged to Salomon Brothers. We also have a line of credit with FHLB allowing us to borrow up to 45% of the Bank s total assets as of September 30, 2006 or $318.1 million, $300.3 million of which was outstanding as of such date. The FHLB advance line is collateralized by eligible loan collateral. At December 31, 2006, we had approximately $480.2 million of loans pledged to secure FHLB borrowings.

We had commitments for capital expenditures of $910,000 at December 31, 2006 related to the construction of our branch located in Newport Beach, California, that opened in the first quarter of 2007. At December 31, 2006, we had $685,000 in outstanding commitments to originate or purchase loans compared to $2.2 million and $8.1 million at December 31, 2005 and 2004, respectively.

The Bank s loan to deposit and borrowing ratio was 91.9%, 94.5% and 96.4% as of December 31, 2006, 2005 and 2004, respectively. Certificates of deposit, which are scheduled to mature in one year or less from December 31, 2006, totaled $228.3 million. We expect to retain a substantial portion of the maturing certificates of deposit at maturity.

Capital Resources

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can trigger certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

At December 31, 2006 and 2005, the Bank s leverage capital amounted to $60.7 million and $54.4 million, respectively, and its risk-based capital amounted to $64.1 million and $57.1 million, respectively. As a result, the Bank exceeded the capital levels required to be considered well capitalized at that date. Pursuant to regulatory guidelines under prompt corrective action rules, a bank must have total risk-based capital of 10% or greater, Tier 1 risk-based capital of 6% or greater and a leverage ratio of 5% or greater to be considered well capitalized. At December 31, 2006, the Bank s total risk-based capital, Tier 1 risk-based capital and leverage ratios were 11.55%, 10.94%, and 8.38%, respectively.

Contractual Obligations and Commitments

The Company enters into contractual obligations in the normal course of business as a source of funds for its asset growth and to meet required capital needs. The following schedule summarizes our contractual obligations as of December 31, 2006:

		Payment Due by Period			
	Total (in thousands)	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Contractual Obligations:					
FHLB borrowings	$ 300,300	$ 150,300	$ 150,000	$	$
Other borrowings	16,191	16,191			
Certificates of deposit	242,688	228,250	8,936	3,574	1,928
Operating leases	6,596	625	1,224	1,271	3,476
Total contractual cash obligations	$ 565,775	$ 395,366	$ 160,160	$ 4,845	$ 5,404

The following table summarizes our contractual commitments with off-balance sheet risk as of December 31, 2006:

	2006 **(in thousands)**
Other unused commitments:	
Loans to originate	$ 685
Home equity lines of credit	510
Commercial lines of credit	17,690
Commercial letters of credit	8
Standby letters of credit	165

Impact of Inflation and Changing Prices

Our consolidated financial statements and related data presented in this annual report on Form 10-K have been prepared in accordance with accounting principles generally accepted in the United States which require the measurement of financial position and operating results in terms of historical dollar amounts (except with respect to securities classified as available for sale which are carried at market value) without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike most industrial companies, substantially all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same magnitude as the price of goods and services.

Impact of New Accounting Standards

In December 2004, the FASB SFAS No. 123R which is a revision to SFAS No. 123, and which addresses the accounting for transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. This statement eliminates the ability to account for share-based compensation transactions using Accounting Principles Board Opinion (APB) No. 25 (APB No. 25), and generally requires instead that such transactions be accounted for using a fair-value-based method. The statement does not change the accounting in SFAS No. 123, for transactions in which an enterprise exchanges its equity instruments for services of parties other than employees or the accounting for employee stock ownership plans, which are subject to SOP 93-6.

The phase-in period for this statement, as amended April 14, 2005 by the SEC, began in the first quarter of 2006. Based on the SEC s phase-in period, we adopted SFAS No. 123R on January 1, 2006 and account for share-based compensation based on this new pronouncement. We compute compensation expense for stock options using the Black-Scholes valuation model and utilize the modified prospective method under SFAS No. 123R.

In March 2005, the SEC issued SAB No. 107, which provided interpretative guidance on SFAS No. 123R valuation method assumptions used in valuation models and the interaction of SFAS No. 123R with existing guidance.

In May 2005, FASB issued SFAS No. 154. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154, effective January 1, 2006, did not have a material impact on our financial condition or operating results.

In February 2006, FASB issued SFAS No. 155, an amendment of SFAS No. 133 and SFAS No. 140. The provisions of this statement allow financial instruments that have embedded derivatives to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. The new statement also amends SFAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The provisions of this standard are effective as of the beginning of our fiscal year 2007. We do not expect the adoption of SFAS No. 155 to have a material impact on our financial condition or operating results.

In March 2006, FASB issued SFAS No. 156. The provisions of this statement require mortgage servicing rights to be initially valued at fair value. SFAS No. 156 also allows servicers to choose one of the following measurement methods subsequent to the initial fair value measurement: (1) the fair-value-measurement method , which measures servicing rights at fair value at each reporting date, with changes in fair value reported in earnings or (2) the amortization method , which allows continued amortization of servicing rights over the period of estimated net servicing income or loss, consistent with the existing requirements of SFAS No. 140. The provisions of this standard are effective as of the beginning of our fiscal year 2007. We currently use the amortization method to account for our servicing rights, and we expect to continue this practice after implementing SFAS No. 156. We do not expect the adoption of SFAS No. 156 to have a material impact on our financial condition or operating results.

In June 2006, the FASB issued FIN No. 48. This interpretation clarifies the accounting for uncertainty in income taxes in an entity s financial statements, in accordance with FASB Statement No. 109, *Accounting for Income Taxes* by prescribing the minimum recognition threshold a tax position must meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We do not expect FIN No. 48, which is effective for fiscal years beginning after December 15, 2006, to have a material impact on our financial condition or operating results.

In September 2006, the FASB issued SFAS No. 157, a standard that provides enhanced guidance for using fair value to measure assets and liabilities. The standard also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair