

First California Financial Group, Inc.

Form 10-K

March 31, 2009

Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Form 10-K**

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 000-52498

**FIRST CALIFORNIA FINANCIAL GROUP, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Delaware

38-3737811

Edgar Filing: First California Financial Group, Inc. - Form 10-K

(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification Number)

3027 Townsgate Road, Suite 300

Westlake Village, California  
(Address of Principal Executive Offices)

91361  
(Zip Code)

Registrant's telephone number, including area code: (805) 322-9655

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	The Nasdaq Global Select Market
Securities registered pursuant to Section 12(g) of the Exchange Act: None	

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

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

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

Indicate by check mark 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.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

Aggregate market value of common stock held by non-affiliates as of June 30, 2008: \$35,203,158

As of March 17, 2009, there were 11,605,060 shares of Common Stock, \$0.01 par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the registrant's 2009 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

---

**Table of Contents**

**INDEX**

**Part I**

<u>ITEM 1. BUSINESS</u>	1
<u>ITEM 1A. RISK FACTORS</u>	16
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	25
<u>ITEM 2. PROPERTIES</u>	25
<u>ITEM 3. LEGAL PROCEEDINGS</u>	26
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	26

**Part II**

<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	27
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	28
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	29
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	57
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	57
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	96
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	96
<u>ITEM 9B. OTHER INFORMATION</u>	96

**Part III**

<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	97
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	97
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	97
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	97
<u>ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	97

**Part IV**

<u>ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	97
<u>SIGNATURES</u>	
<u>CERTIFICATIONS</u>	

---

**Table of Contents**

**PART I**

**Item 1. Business**  
**Our Business**

As used herein, the term First California Financial Group, First California, FCAL, the Company, our, us, we or similar expression include First California Financial Group, Inc. and First California Bank unless the context indicates otherwise.

*Business of First California Financial Group*

First California is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, or the BHCA. First California's primary function is to coordinate the general policies and activities of its bank subsidiary, First California Bank, or the Bank, as well as to consider from time to time other legally available investment opportunities. SC Financial is an inactive subsidiary of First California.

First California was incorporated under the laws of the State of Delaware on June 7, 2006. The Company was formed as a wholly-owned subsidiary of National Mercantile Bancorp, a California corporation, or National Mercantile, for the purposes of facilitating the mergers of National Mercantile and FCB Bancorp, a California corporation, or FCB. On March 12, 2007, National Mercantile merged with and into First California. Immediately thereafter, the parties completed the previously announced merger of FCB with and into First California. In this document, we refer to the two-step merger of National Mercantile into First California and FCB into First California as the Mergers. As a result of the Mergers, the separate corporate existence of National Mercantile and FCB ceased, and First California succeeded, and assumed all the rights and obligations of, National Mercantile, whose principal assets were the capital stock of two bank subsidiaries, Mercantile National Bank, or Mercantile, and South Bay Bank, N.A., or South Bay, and the rights and obligations of FCB, whose principal assets were the capital stock of First California Bank. On June 18, 2007, First California integrated its bank subsidiaries into First California Bank. All references to the Bank on or before June 18, 2007 refer to the Bank, Mercantile and South Bay.

*Business of First California Bank*

The Bank is a full-service commercial bank headquartered in Westlake Village, California. The Bank is chartered under the laws of the State of California and is subject to supervision by the California Commissioner of Financial Institutions. The Federal Deposit Insurance Corporation, (the FDIC), insures its deposits up to the maximum legal limit.

On January 23, 2009, the Bank assumed the insured, non-brokered deposits of 1st Centennial Bank, totaling approximately \$270 million, from the FDIC. The Bank also purchased approximately \$164 million in cash and cash equivalents, \$89 million of investment securities and \$2 million in consumer loans related to the transaction. In January 2009, the parent company contributed \$15 million of capital to the Bank which in turn paid approximately that sum to the FDIC for the assumption of those deposits and purchase of those assets. The addition of 1st Centennial Bank's six branches expanded First California Bank's operations to 18 full-service branches throughout Southern California and increased total assets to greater than \$1.4 billion.

The Bank's business strategy has been to attract individuals, professionals, and small- to mid-sized business borrowers in our primary service areas by offering a variety of loan products and a full range of banking services coupled with highly personalized service. The Bank's operations are primarily located within the areas commonly known as the 101 corridor stretching from the City of Ventura to Calabasas, California, the Moorpark-Simi Valley corridor, the western San Fernando Valley, the Tri-Cities area of Glendale-Burbank-Pasadena, the South Bay, the Inland Empire, north San Diego County, Century City and other parts of Los Angeles, Orange and Ventura Counties in Southern California. Our lending products include revolving lines of

## **Table of Contents**

credit, term loans, commercial real estate loans, construction loans and consumer and home equity loans, which often contain terms and conditions tailored to meet the specific demands of the market niche in which the borrower operates. Additionally, the Bank provides a wide array of deposit and investment products serving the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Ventura, San Diego, Riverside and San Bernardino counties through traditional business and consumer banking, construction finance, SBA lending, entertainment finance and commercial real estate lending via 18 full-service branch locations.

Business loans, represented by commercial real estate loans, commercial loans and construction loans, comprise the largest portion of the Bank's loan portfolio. Commercial real estate loans rely upon the cash flow originating from the underlying real property. Commercial real estate is a cyclical industry that is affected not only by general economic conditions but also by local supply and demand. Commercial loans rely upon the cash flow originating from the underlying business activity of the enterprise. The manufacture, distribution or sale of goods or sale of services are not only affected by general economic conditions but also by the ability of the enterprise's management to adjust to local supply and demand conditions, maintain good labor, vendor and customer relationships, as well as market and sell their goods or services for a profit. Construction loans provide developers or owners with funds to build or improve properties that will ultimately be sold or leased. Construction loans are generally considered to involve a higher degree of risk than other loan categories because they rely upon the developer's or owner's ability to complete the project within specified cost and time limits.

Consumer loans, a smaller component of the Bank's loan portfolio, are represented by home mortgages and home equity loans and lines of credit that are secured by first or second trust deeds on a borrower's real estate property, typically their principal residence. These loans are dependent on a person's ability to regularly pay the principal and interest due on the loan and, secondarily, on the value of real estate property that serves as collateral for the loan.

The Bank's business strategy also stresses the importance of customer deposit relationships to support its lending activities. Checking deposits, savings deposits and certificates of deposits represent a significant low-cost and stable source of funds. Business customers are offered cash management products, including on-line banking and remote deposit capture, to meet their specific banking needs.

The Bank's goal is to offer its customers a consistently high level of individualized personal service. Accordingly, in order to meet the changing needs of our customers, the Bank is constantly evaluating a variety of options to broaden the services and products it provides. The Bank's strategy in attaining its goals has been to implement and maintain risk management and controls to achieve a safe and sound business policy, employing an aggressive marketing plan which emphasizes relationship banking and the personal touch, offering competitive products and managing growth. The Bank provides convenience through 18 banking offices with ATM access, 24 hour telephone access to account information, on-line banking, courier service and remote deposit capture. The diversity of our delivery systems enables customers to choose the method of banking that is most convenient for them. The Bank trains its staff to recognize each customer, greet them, and be able to address them by name so that they feel as if they have a private banker.

## **Financial and Statistical Disclosure**

Certain of our financial and statistical information is presented within Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 7A. Quantitative and Qualitative Disclosures About Market Risk. This information should be read in conjunction with the consolidated financial statements contained in Item 8. Financial Statements and Supplementary Data.

## **Competition**

The banking business in California, generally, and in the Bank's service areas, specifically, is highly competitive with respect to both loans and deposits and is dominated by a number of major banks that have many

**Table of Contents**

offices operating over wide geographic areas. The Bank competes for deposits and loans principally with these major banks and other financial institutions located in our market areas. Among the advantages that the major banks have over the Bank are their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Many of the major commercial banks operating in the Bank's service areas offer certain services (such as trust and international banking services) that are not offered directly by the Bank and, by virtue of their greater total capitalization, such banks have substantially higher lending limits. Moreover, all banks face increasing competition for loans and deposits from non-bank financial intermediaries such as mortgage companies, insurance companies, credit unions and securities firms.

In November 1999, the President signed the Gramm-Leach-Bliley Act, or the GLB Act, into law, which significantly changed the regulatory structure and oversight of the financial services industry. The GLB Act revised the Bank Holding Company Act of 1956 and repealed the affiliation prohibitions of the Glass-Steagall Act of 1933. Consequently, a qualifying holding company, called a financial holding company, can engage in a full range of financial activities, including banking, insurance, and securities activities, as well as merchant banking and additional activities that are financial in nature or incidental to those financial activities. Expanded financial affiliation opportunities for existing bank holding companies are now permitted. Moreover, various non-bank financial services providers can acquire banks while also offering services like securities underwriting and underwriting and brokering insurance products. The GLB Act also expanded passive investment activities by financial holding companies, permitting investments in any type of company, financial or non-financial, through acquisitions of merchant banking firms and insurance companies.

Given that the traditional distinctions between banks and other providers of financial services have been effectively eliminated, the Bank has faced and will continue to face additional competition from thrift institutions, credit unions, insurance companies and securities firms. Additionally, the Bank's ability to cross-market banking products to existing customers or the customers of affiliated companies may make it more difficult to compete.

In order to compete, the Bank uses to the fullest extent possible the familiarity of its directors and officers with the market area and its residents and businesses and the flexibility that the Bank's independent status will permit. This includes an emphasis on specialized services, local promotional activity, and personal contacts by directors, officers and other employees. The Bank uses advertising, including newspaper ads and direct mail pieces, to inform the community of the services it offers. The Bank also utilizes emerging marketing techniques, such as the Internet, to reach target markets. The Bank also has an active calling program where officers, including commissioned business development officers, contact targeted prospects to solicit both deposit and loan business.

The Bank has developed programs that are specifically addressed to the needs of consumers, professionals and small-to medium-sized businesses. In the event there are customers whose loan demands exceed the Bank's lending limits, it arranges for such loans on a participation basis with other financial institutions and intermediaries. The Bank also assists those customers requiring other services not offered by the Bank to obtain those services from correspondent banks. In addition, the Bank offers ATM services, a night depository, remote deposit capture, courier services, bank-by-mail services, merchant windows, lockbox and direct deposit services.

The Bank's management believes that the Bank's reputation in the communities served and personal service philosophy enhance the ability to compete favorably in attracting and retaining individual, professional and business clients. The Bank also believes that it has an advantage over the larger national and super regional institutions because it is managed by locally-known, well-respected and experienced bankers. Moreover, our larger competitors may not offer adequate personalized banking services, since their emphasis is on large volume and standardized retail products.

## **Table of Contents**

The Bank also faces growing competition from other community banks. These institutions have similar marketing strategies, have also been successful and offer strong evidence regarding the potential success of the community banking sector.

No assurance can be given that ongoing efforts to compete will continue to be successful.

## **Dependence on One or a Few Major Customers; Business Concentrations**

No individual or single group of related accounts is considered material in relation to our total assets or to the assets or deposits of the Bank, or in relation to our overall business. However, approximately 70% of our loan portfolio at December 31, 2008 consisted of real estate-secured loans, including commercial real estate loans, construction loans, home mortgage loans, home equity loans and lines of credit. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Position December 31, 2008 compared with December 31, 2007. Moreover, our business activities are currently focused primarily in Southern California, with the majority of our business concentrated in Ventura, Orange and Los Angeles Counties. Consequently, our results of operations and financial condition are dependent upon the general trends in the Southern California economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in Southern California exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in this region.

## **Internet Banking Services**

The Bank maintains an internet website, which serves as an additional means of providing customer access to a variety of banking services, including 24/7 online banking. The Bank's website address is [www.fcbank.com](http://www.fcbank.com). No information contained on the website is incorporated herein by reference.

## **Employees**

At December 31, 2008, the Bank had 207 full-time equivalent employees. The Bank's employees are not represented by any union or other collective bargaining agreement and the Bank considers its relations with employees to be excellent.

## **Supervision and Regulation**

### *Recent Developments*

In response to the financial crisis affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Through its authority under the EESA, the Treasury announced in October 2008 the Troubled Asset Relief Program Capital Purchase Program (the CPP), a program designed to bolster healthy institutions, like First California, by making \$250 billion of capital available to U.S. financial institutions in the form of preferred stock.

We participated in the CPP in December 2008 so that we could continue to lend and support our current and prospective clients, especially during this unstable economic environment. Under the terms of our participation, we received \$25 million in exchange for the issuance of preferred stock and a warrant to purchase common stock, and became subject to various requirements, including certain restrictions on paying dividends on our common stock and repurchasing our equity securities, unless the Treasury has consented. Additionally, in order to participate in the CPP, we were required to adopt certain standards for executive compensation and corporate governance. These standards generally apply to the Chief Executive Officer, Chief Financial Officer and the three next most highly compensated senior executive officers, and include (1) ensuring that incentive compensation of senior executives does not encourage unnecessary and excessive risks that threaten the value of

## **Table of Contents**

the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) limiting golden parachute payments to certain senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive. To date, First California has complied with these requirements, but the Secretary of the Treasury is empowered under EESA to adopt other standards, with which First California would be required to comply. Additionally, the bank regulatory agencies, Treasury and the Office of Special Inspector General, also created by the EESA, have issued guidance and requests to the financial institutions that participated in the CPP to document their plans and use of CPP funds and their plans for addressing the executive compensation requirements associated with the CPP. First California will respond to such requests accordingly.

In February 2009, the American Recovery and Reinvestment Act of 2009 (the *ARRA*) was enacted. Among other provisions, the *ARRA* amended the EESA and contains requirements imposed on financial institutions like us which have already participated in the CPP. These requirements expand the initial executive compensation restrictions under the CPP to include, among other things, application of the required clawback provision to our top 25 most highly compensated employees, prohibition of certain bonuses to our top five most highly compensated employees, expanded limitations on golden parachute payments to top ten most highly compensated employees, implementation of a company-wide policy regarding excessive and luxury expenditures, and requirement of a shareholder advisory vote on our executive compensation. Under the new *ARRA* requirements, we may early redeem the shares issued to the Treasury under the CPP without any early penalty or requirement to raise new capital, as previously required under the original terms of the CPP. However, until the shares are redeemed and for so long as we continue to participate in the CPP, we will remain subject to these expanded requirements, and any other requirements applicable to CPP participants that may be subsequently adopted.

The EESA also increased FDIC deposit insurance on most accounts from \$100,000 to \$250,000. This increase is currently in place until the end of 2009 and is not covered by deposit insurance premiums paid by the banking industry. The FDIC has recently proposed that Congress extend the \$250,000 limit to 2016. In addition, the FDIC has implemented two temporary programs under the Temporary Liquidity Guaranty Program (*TLGP*) to provide deposit insurance for the full amount of most non-interest bearing transaction accounts through the end of 2009 and to guarantee certain unsecured debt of financial institutions and their holding companies through June 2012. The Bank is participating in the deposit insurance program and has the ability to issue guaranteed debt under the program. The FDIC charges systemic risk special assessments to depository institutions that participate in the *TLGP*. The FDIC has recently proposed that Congress give the FDIC expanded authority to charge fees to the holding companies which benefit directly and indirectly from the FDIC guarantees. See *FDIC Deposit Insurance* below.

### *General*

Banking is a complex, highly regulated industry. The primary goals of the regulatory scheme are to maintain a safe and sound banking system, protect depositors and the FDIC insurance fund, and facilitate the conduct of sound monetary policy. This regulatory scheme is not designed for the benefit of stockholders of the Company or its successors. In furtherance of these goals, Congress and the states have created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the financial services industry. Consequently, the growth and earnings performance of the Company or its successors and the Bank can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes, regulations and the policies of various governmental regulatory authorities, including the Board of Governors of the Federal Reserve System (*FRB*), the FDIC, and the California Department of Financial Institutions (*DFI*) and the United States Department of the Treasury (*Treasury*).



## **Table of Contents**

The commercial banking business is also influenced by the monetary and fiscal policies of the federal government and the policies of the FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States Government securities, by adjusting the required level of reserves for financial intermediaries subject to its reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. Indirectly, such actions may also impact the ability of non-bank financial institutions to compete with the Bank. The nature and impact of any future changes in monetary policies cannot be predicted.

The system of supervision and regulation applicable to financial services businesses governs most aspects of the business of the Company and the Bank, including: (i) the scope of permissible business; (ii) investments; (iii) reserves that must be maintained against deposits; (iv) capital levels that must be maintained; (v) the nature and amount of collateral that may be taken to secure loans; (vi) the establishment of new branches; (vii) mergers and consolidations with other financial institutions; and (viii) the payment of dividends.

From time to time laws or regulations are enacted which have the effect of increasing the cost of doing business, limiting or expanding the scope of permissible activities, or changing the competitive balance between banks and other financial and non-financial institutions. Proposals to change the laws and regulations governing the operations of banks and bank holding companies are frequently made in Congress, in the California legislature and by various bank and other regulatory agencies. Future changes in the laws, regulations or policies that impact the Company or its successors and the Bank cannot necessarily be predicted, but they may have a material effect on the business and earnings of the Company and the Bank.

Set forth below is a summary description of certain of the material laws and regulations that relate to our operations and those of the Bank. The description does not purport to be a complete description of these laws and regulations and is qualified in its entirety by reference to the applicable laws and regulations.

### *Regulation of First California*

As a registered bank holding company, First California and its subsidiaries are subject to the FRB's supervision, regulation and examination under the BHCA. Under the BHCA, we are subject to periodic examination by the FRB. We are also required to file with the FRB periodic reports of our operations and such additional information regarding the Company and its subsidiaries as the FRB may require.

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the FRB's policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB's regulations or both.

First California is required to obtain the FRB's prior approval before acquiring ownership or control of more than 5% of the outstanding shares of any class of voting securities, or substantially all the assets, of any company, including a bank or bank holding company. Further, we are allowed to engage, directly or indirectly, only in banking and other activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Pursuant to the Gramm-Leach-Bliley Act of 1999 ( GLBA ), in order to elect and retain financial holding company status, all depository institution subsidiaries of a bank holding company must be well capitalized, well managed, and, except in limited circumstances, be in satisfactory compliance with the Community Reinvestment Act ( CRA ).

---

**Table of Contents**

First California's securities are registered with the Securities and Exchange Commission ( SEC ) under the Securities Exchange Act of 1934, as amended (the Exchange Act ), and listed on the NASDAQ Global Select Market. As such, First California is subject to the information, proxy solicitation, insider trading, corporate governance, and other requirements and restrictions of the Exchange Act, as well as the Marketplace Rules and other requirements promulgated by the NASDAQ Stock Market, Inc.

First California is subject to the accounting oversight and corporate governance requirements of the Sarbanes-Oxley Act of 2002, including, among other things, required executive certification of financial presentations, increased requirements for board audit committees and their members, and enhanced disclosure of controls and procedures and internal controls over financial reporting.

First California's earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which First California and the Bank conduct business. For example, these include limitations on the ability of the Bank to pay dividends to us and our ability to pay dividends to our stockholders. It is the policy of the FRB that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. Various federal and state statutory provisions limit the amount of dividends that subsidiary banks can pay to their holding companies without regulatory approval. In addition to these explicit limitations, the federal regulatory agencies have general authority to prohibit a banking subsidiary or bank holding company from engaging in an unsafe or unsound banking practice. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice. In addition, as discussed below under Regulation of the Bank , a bank holding company such as the Company is required to maintain minimum ratios of Tier 1 capital and total capital to total risk-weighted assets, as well as a minimum ratio of Tier 1 capital to total adjusted quarterly average assets as defined in such regulations.

Under the terms of the CPP, for so long as any preferred stock issued under the CPP remains outstanding, First California is restricted from paying cash dividends on our common stock, and from making certain repurchases of equity securities, including common stock, without the Treasury's consent until the third anniversary of the Treasury's investment in our preferred stock or until the Treasury has transferred all of the preferred stock it purchased under the CPP to third parties.

*Regulation of the Bank*

The Bank is extensively regulated under both federal and state law. The Bank, as a California state chartered bank which is not a member of the Federal Reserve System, is subject to regulation, supervision, and regular examination by the DFI and the FDIC. The Bank's deposits are insured by the FDIC up to the maximum extent provided by law. The regulations of these agencies govern most aspects of the Bank's business. California law exempts all banks from usury limitations on interest rates. Various consumer laws and regulations also affect the Bank's operations. These laws primarily protect depositors and other customers of the Bank, rather than First California or its stockholders.

Various requirements and restrictions under the laws of the State of California and the United States affect the operations of the Bank. State and federal statutes and regulations relate to many aspects of the Bank's operations, including standards for safety and soundness, reserves against deposits, interest rates payable on deposits and loans, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, fair lending requirements, Community Reinvestment Act activities and loans to affiliates. Further, the Bank is required to maintain certain levels of capital.

**Table of Contents**

*Dividends and Capital Distributions*

Dividends and capital distributions from the Bank constitute the principal source of cash to First California. The Bank is subject to various federal or state statutory and regulatory restrictions on its ability to pay dividends and capital distributions to its shareholder.

Under California law, banks may declare a cash dividend out of their net profits up to the lesser of retained earnings or the net income for the last three fiscal years (less any distributions made to shareholders during such period), or with the prior written approval of the DFI, in an amount not exceeding the greatest of (i) the retained earnings of the Bank, (ii) the net income of the Bank for its last fiscal year or (iii) the net income of the Bank for its current fiscal year. In addition, under federal law, banks are prohibited from paying any dividends if after making such payment they would fail to meet any of the minimum regulatory capital requirements. The federal regulators also have the authority to prohibit state banks from engaging in any business practices which are considered to be unsafe or unsound, and in some circumstances the regulators might prohibit the payment of dividends on that basis even though such payments would otherwise be permissible.

The Bank may from time to time be permitted to make additional capital distributions to its shareholder with the consent of the DFI. It is not anticipated that such consent could be obtained unless the distributing bank were to remain well capitalized following such distribution.

*Regulatory Capital Guidelines.* Each of the Company and the Bank is required to maintain certain levels of capital. The FRB and the FDIC have substantially similar risk-based capital ratio and leverage ratio guidelines for banking organizations. The guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the guidelines, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution's or holding company's capital, in turn, is classified in one of three tiers, depending on type:

Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual stock at the holding company level, minority interests in equity accounts of consolidated subsidiaries, and qualifying trust preferred securities less goodwill, most intangible assets and certain other assets.

Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for possible loan and lease losses, subject to limitations.

Market Risk Capital (Tier 3). Tier 3 capital includes qualifying unsecured subordinated debt.

**Table of Contents**

The following table sets forth the regulatory capital guidelines and the actual capitalization levels for the Bank and the Company as of December 31, 2008 and 2007:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2008 (in thousands)						
Total capital (to risk weighted assets)						
First California Financial Group, Inc.	\$ 147,680	16.62%	\$ 71,102	≥ 8.00%		
First California Bank	109,022	12.27%	71,110	≥ 8.00%	88,888	≥ 10.00%
Tier I capital (to risk weighted assets)						
First California Financial Group, Inc.	139,530	15.70%	35,551	≥ 4.00%		
First California Bank	100,873	11.35%	35,555	≥ 4.00%	53,333	≥ 6.00%
Tier I capital (to average assets)						
First California Financial Group, Inc.	139,530	12.77%	43,699	≥ 4.00%		
First California Bank	100,873	9.26%	43,568	≥ 4.00%	54,460	≥ 5.00%
December 31, 2007						
Total capital (to risk weighted assets)						
First California Financial Group, Inc.	\$ 115,387	13.35%	\$ 69,167	≥ 8.00%		
First California Bank	102,826	11.98%	68,687	≥ 8.00%	85,858	≥ 10.00%
Tier I capital (to risk weighted assets)						
First California Financial Group, Inc.	107,460	12.43%	34,583	≥ 4.00%		
First California Bank	94,899	11.05%	34,343	≥ 4.00%	51,515	≥ 6.00%
Tier I capital (to average assets)						
First California Financial Group, Inc.	107,460	10.42%	41,248	≥ 4.00%		
First California Bank	94,899	9.24%	41,065	≥ 4.00%	51,332	≥ 5.00%

We recognize that a strong capital position is vital to growth, continued profitability, and depositor and investor confidence. Our policy is to maintain sufficient capital at not less than the well-capitalized thresholds established by banking regulators.

*Basel and Basel II Accords.* The current risk-based capital guidelines which apply to First California and the Bank are based upon the 1988 capital accord of the International Basel Committee on Banking Supervision. A new international accord, referred to as Basel II, became mandatory for large or core international banks outside the U.S. in 2008 (total assets of \$250 billion or more or consolidated foreign exposures of \$10 billion or more). Basel II emphasizes internal assessment of credit, market and operational risk, as well as supervisory assessment and market discipline in determining minimum capital requirements. It is optional for other banks, and if adopted, must first be complied with in a parallel run for two years along with the existing Basel I standards. In January 2009, the Basel Committee proposed to reconsider regulatory-capital standards, supervisory and risk-management requirements and additional disclosures to further strengthen the Basel II framework in response to recent worldwide developments. First California is not required to comply with Basel II. First California elected not to apply the Basel II requirements when they became effective.

*Prompt Corrective Action and Other General Enforcement Authority.* The Federal Deposit Insurance Corporation Improvement Act, or FDICIA, requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or

---

**Table of Contents**

more prescribed minimum capital ratios. The federal banking agencies possess broad powers to take prompt corrective action to resolve the problems of insured banks. Each federal banking agency has issued regulations defining five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the regulations, a bank shall be deemed to be:

well capitalized if it has a total risk-based capital ratio of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a leverage capital ratio of 5.0% or more, and is not subject to specified requirements to meet and maintain a specific capital level for any capital measure;

adequately capitalized if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 4.0% or more, and a leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized ;

undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 4.0%, or a leverage capital ratio that is less than 4.0% (3.0% under certain circumstances);

significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0% or a leverage capital ratio that is less than 3.0%; and

critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Banks are prohibited from paying dividends or management fees to controlling persons or entities if, after making the payment, the bank would be undercapitalized, that is, the bank fails to meet the required minimum level for any relevant capital measure. Asset growth and branching restrictions apply to undercapitalized banks. Banks classified as undercapitalized are required to submit acceptable capital plans guaranteed by its holding company, if any. Broad regulatory authority was granted with respect to significantly undercapitalized banks, including forced mergers, growth restrictions, ordering new elections for directors, forcing divestiture by its holding company, if any, requiring management changes, and prohibiting the payment of bonuses to senior management. Even more severe restrictions are applicable to critically undercapitalized banks, those with capital at or less than 2%. Restrictions for these banks include the appointment of a receiver or conservator. All of the federal banking agencies have promulgated substantially similar regulations to implement this system of prompt corrective action.

A bank, based upon its capital levels, that is classified as well capitalized, adequately capitalized or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment. At each successive lower capital category, an insured bank is subject to more restrictions. The federal banking agencies, however, may not treat an institution as critically undercapitalized unless its capital ratios actually warrant such treatment.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential enforcement actions by the federal banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties. The enforcement of such actions through injunctions or restraining orders may be based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

---

**Table of Contents**

The DFI, as the primary regulator for California state-chartered banks, also has a broad range of enforcement measures, from cease and desist powers and the imposition of monetary penalties to the ability to take possession of a bank, including causing its liquidation.

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

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

*Transactions with Affiliates.* Under Sections 23A and 23B of the Federal Reserve Act and the FRB's Regulation W, loans by the Bank to affiliates, investments by them in affiliates' stock, and taking affiliates' stock as collateral for loans to any borrower is limited to 10% of the Bank's capital, in the case of any one affiliate, and is limited to 20% of the Bank's capital, in the case of all affiliates. The Bank's holding company and any subsidiaries it may purchase or organize are deemed to be affiliates of the Bank within the meaning of Section 23A and 23B and Regulation W. In addition, transactions between the Bank and other affiliates must be on terms and conditions that are consistent with safe and sound banking practices; in particular, a bank and its subsidiaries generally may not purchase from an affiliate a low-quality asset, as defined in the Federal Reserve Act. These restrictions also prevent a bank holding company and its other affiliates from borrowing from a banking subsidiary of the bank holding company unless the loans are secured by marketable collateral of designated amounts. The Company or its successors and the Bank are also subject to certain restrictions with respect to engaging in the underwriting, public sale and distribution of securities.

*Loans to Insiders.* Extensions of credit by the Bank to insiders of both the Bank and First California are subject to prohibitions and other restrictions imposed by federal regulations. For purposes of these limits, insiders include directors, executive officers and principal shareholders of the Bank or First California and their related interests. The term related interest means a company controlled by a director, executive officer or principal shareholder of the Bank or First California. The Bank may not extend credit to an insider of the Bank or First California unless the loan is made on substantially the same terms as, and subject to credit underwriting procedures that are no less stringent than, those prevailing at the time for comparable transactions with non-insiders. Under federal banking regulations, the Bank may not extend a loan to insiders in an amount greater than \$500,000 without prior board approval (with any interested person abstaining from participating directly or indirectly in the voting). The federal regulations place additional restrictions on loans to executive officers, and generally prohibit loans to executive officers other than for certain specified purposes. The Bank is required to maintain records regarding insiders and extensions of credit to them.

*Federal Deposit Insurance.* The FDIC insures our customer deposits through the Deposit Insurance Fund (DIF) up to prescribed limits for each depositor. Pursuant to the EESA, the basic limit on federal deposit insurance coverage was temporarily raised from \$100,000 to \$250,000 per depositor. The legislation provides that the basic deposit insurance limit will return to \$100,000 after December 31, 2009.

---

**Table of Contents**

The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating. Effective February 2009, the FDIC adopted a rule to uniformly increase 2009 FDIC deposit assessment rates by 7 to 9 cents for every \$100 of domestic deposits. For banks in Risk Category I, the deposit assessment is now 12 to 16 cents for total qualified deposits compared to 5 to 7 cents in the prior two years. The FDIC also has proposed a special assessment of 20 cents for every \$100 of domestic deposits to restore the DIF reserves, and reserved the right to charge an additional special assessment of up to 10 cents for every \$100 of domestic deposits, should DIF reserves continue to decline.

On October 16, 2008, the FDIC announced the Temporary Liquidity Guarantee Program, or TLGP. The final rule was adopted on November 26, 2008. The FDIC stated that its purpose is to strengthen confidence and encourage liquidity in the banking system through two limited guarantee programs: the Debt Guarantee Program, or DGP, and the Transaction Account Guarantee Program. Insured depository institutions and most U.S. bank holding companies are eligible to participate. Participation in both programs is voluntary and the Bank elected to participate in both parts of the TLGP. The DGP guarantees newly issued senior unsecured debt that is issued on or before June 30, 2009 and matures before June 12, 2012. Institutions participating in the DGP are charged a fee of 50 to 100 basis points for new unsecured issuances based on the term to maturity of the newly issued debt. As of the date of this report, the Bank has not issued any new debt under the DGP. The Transaction Account Guarantee Program guarantees the entire balance of non-interest bearing deposit transaction accounts (defined as transaction accounts bearing interest rates of 50 basis points or less), through December 31, 2009. Institutions participating in the Transaction Account Guarantee Program are charged a 10-basis point fee on the balance of non-interest bearing deposit transaction accounts exceeding the existing deposit insurance limit of \$250,000.

FDIC insurance premiums are expected to increase significantly in 2009 compared to prior years. FDIC insurance expense was \$682,000 and \$164,000 in 2008 and 2007, respectively. With the proposed 20 basis point special assessment included, 2009 FDIC insurance expense is estimated to be approximately \$3.6 million.

*Money Laundering and Currency Controls.* Various federal statutory and regulatory provisions are designed to enhance record-keeping and reporting of currency and foreign transactions. Pursuant to the Bank Secrecy Act, financial institutions must report high levels of currency transactions or face the imposition of civil monetary penalties for reporting violations. The Money Laundering Control Act imposes sanctions, including revocation of federal deposit insurance, for institutions convicted of money laundering.

The International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (IMLAFATA), a part of the USA Patriot Act, authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks and other financial institutions to enhance record-keeping and reporting requirements for certain financial transactions that are of primary money laundering concern. Among its other provisions, IMLAFATA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving individuals and certain foreign banks; and (iii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities.

The Treasury Department's regulations implementing IMLAFATA mandate that federally-insured banks and other financial institutions establish customer identification programs designed to verify the identity of persons opening new accounts, maintain the records used for verification, and determine whether the person appears on any list of known or suspected terrorists or terrorist organizations.

**Table of Contents**

*Community Reinvestment Act and Fair Lending.* The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act, or CRA, activities. The CRA is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal bank regulatory agencies, in examining insured depository institutions, to assess their record of helping to meet the credit needs of their entire community, including low-and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations. The Bank's compliance with the CRA is reviewed and evaluated by the FDIC, which assigns the Bank a publicly available CRA rating at the conclusion of the examination.

The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance-based evaluation system. This system bases CRA ratings on an institution's actual lending service and investment performance rather than the extent to which the institution conducts needs assessments, documents community outreach or complies with other procedural requirements. In connection with its assessment of CRA performance, the FDIC assigns a rating of outstanding, satisfactory, needs to improve or substantial noncompliance. Failure of an institution to receive at least a Satisfactory rating could inhibit such institution or its holding company from undertaking certain activities, including acquisitions.

The Bank had a CRA rating of Satisfactory as of its most recent regulatory examination.

*Sarbanes-Oxley Act.* On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act aims to restore the credibility lost as a result of high profile corporate scandals by addressing, among other issues, corporate governance, auditing and accounting, executive compensation and enhanced and timely disclosure of corporate information. The NASDAQ Stock Market has adopted corporate governance rules intended to allow shareholders to more easily and effectively monitor the performance of companies and directors. The principal provisions of the Sarbanes-Oxley Act, many of which have been interpreted through regulations released in 2003, provide for and include, among other things: (i) the creation of the Public Company Accounting Oversight Board; (ii) auditor independence provisions that restrict non-audit services that accountants may provide to their audit clients; (iii) additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements; (iv) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; (v) an increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with that company's independent auditors; (vi) requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer; (vii) requirements that companies disclose whether at least one member of the audit committee is a financial expert (as such term is defined by the Securities and Exchange Commission, or the SEC) and if not disclosed, why the audit committee does not have a financial expert; (viii) expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods; (ix) a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions on non-preferential terms and in compliance with other bank regulatory requirements; (x) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; (xi) a range of enhanced penalties for fraud and other violations; and (xii) expanded disclosure and certification relating to an issuer's disclosure controls and procedures and internal controls over financial reporting.



## **Table of Contents**

As a result of the Sarbanes-Oxley Act, and its implementing regulations, we have incurred substantial costs to interpret and ensure compliance with the law and its regulations. Future changes in the laws, regulation, or policies that impact us cannot necessarily be predicted and may have a material effect on our business and earnings.

*Environmental Regulation.* Federal, state and local laws and regulations regarding the discharge of harmful materials into the environment may have an impact on the Bank. Since the Bank is not involved in any business that manufactures, uses or transports chemicals, waste, pollutants or toxins that might have a material adverse effect on the environment, the Bank's primary exposure to environmental laws is through its lending activities and through properties or businesses the Bank may own, lease or acquire. Based on a general survey of the Bank's loan portfolio, conversations with local appraisers and the type of lending currently and historically done by the Bank, management is not aware of any potential liability for hazardous waste contamination that would be reasonably likely to have a material adverse effect on the Company or its successors as of the date of this report.

*Safeguarding of Customer Information and Privacy.* The FRB and other bank regulatory agencies have adopted guidelines for safeguarding confidential, personal customer information. These guidelines require financial institutions to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazard to the security or integrity of such information and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Bank has adopted a customer information security program to comply with such requirements.

Federal banking rules also limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide: (i) initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates; (ii) annual notices of their privacy policies to current customers; and (iii) a reasonable method for customers to opt out of disclosures to nonaffiliated third parties. These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. We have implemented our privacy policies in accordance with the law.

In recent years, a number of states have implemented their own versions of privacy laws. For example, in 2003, California adopted standards that are more restrictive than federal law, allowing bank customers the opportunity to bar financial companies from sharing information with their affiliates.

*Patriot Act.* On October 26, 2001, the President signed into law comprehensive anti-terrorism legislation, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, known as the Patriot Act. The Patriot Act was designed to deny terrorists and others the ability to obtain access to the United States financial system, and has significant implications for depository institutions and other businesses involved in the transfer of money. The Patriot Act, as implemented by various federal regulatory agencies, requires financial institutions, including the Bank, to implement new policies and procedures or amend existing policies and procedures with respect to, among other matters, anti-money laundering, compliance, suspicious activity and currency transaction reporting and due diligence on customers. The Patriot Act and its underlying regulations also permit information sharing for counter-terrorist purposes between federal law enforcement agencies and financial institutions, as well as among financial institutions, subject to certain conditions, and require the FRB and other federal banking agencies to evaluate the effectiveness of an applicant in combating money laundering activities when considering applications filed under Section 3 of the BHCA or the Bank Merger Act. The Bank has adopted comprehensive policies and procedures to address the requirements of the Patriot Act. The Bank believes that the ongoing cost of compliance with the Patriot Act is not likely to be material to the Bank.

---

## **Table of Contents**

*Other Aspects of Banking Law.* The Bank is also subject to federal statutory and regulatory provisions covering, among other things, security procedures, insider and affiliated party transactions, management interlocks, electronic funds transfers, funds availability, and truth-in-savings. There are also a variety of federal statutes which regulate acquisitions of control and the formation of bank holding companies.

### ***Impact of Monetary Policies***

Banking is a business that depends on rate differentials. In general, the difference between the interest rate paid by a bank on its deposits and its other borrowings and the interest rate earned on its loans, securities and other interest-earning assets comprises the major source of a Bank's earnings. These rates are highly sensitive to many factors which are beyond the Bank's control and, accordingly, the earnings and growth of the Bank are subject to the influence of economic conditions generally, both domestic and foreign, including inflation, recession, and unemployment; and also to the influence of monetary and fiscal policies of the United States and its agencies, particularly the FRB. The FRB implements national monetary policy, such as seeking to curb inflation and combat recession, by:

Open-market dealings in United States government securities;

Adjusting the required level of reserves for financial institutions subject to reserve requirements; and

Adjusting the discount rate applicable to borrowings by banks which are members of the Federal Reserve System.

The actions of the FRB in these areas influence the growth of bank loans, investments, and deposits and also affect interest rates. The nature and timing of any future changes in the FRB's policies and their impact on the Company and its successors and the Bank cannot be predicted; however, depending on the degree to which our interest-earning assets and interest-bearing liabilities are rate sensitive, increases in rates would have a temporary effect of increasing our net interest margin, while decreases in interest rates would have the opposite effect. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan charge-offs, thus adversely affecting our net income or other operating costs.

### ***Available Information***

We maintain an Internet website at [www.fcalgroup.com](http://www.fcalgroup.com), and a website for First California Bank at [www.fcbank.com](http://www.fcbank.com). At [www.fcalgroup.com](http://www.fcalgroup.com) and via the Investor Relations link at the Bank's website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13 or 15(d) of the Exchange Act are available, free of charge, as soon as reasonably practicable after such forms are electronically filed with, or furnished to, the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room, located at 100 F Street, NE, Washington, D.C. 20549 on official business days during the hours of 10:00 a.m. to 3:00 p.m. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. You may obtain copies of the Company's filings on the SEC site. These documents may also be obtained in print upon request by our shareholders to our Investor Relations Department.

You may contact our Investor Relations Department at First California Financial Group, Inc., 3027 Townsgate Road, Suite 300, Westlake Village, California 91361, telephone number (805) 322-9655.

(All website addresses given in this document are for information only and are not intended to be an active link or to incorporate any website information into this document.)

We have adopted a written code of ethics that applies to all directors, officers and employees of the Company, including our principal executive officer and senior financial officers, in accordance with Section 406

## **Table of Contents**

of the Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission promulgated thereunder. The code of ethics is available on our website at [www.fcalgroup.com](http://www.fcalgroup.com) and also upon request, at no charge. Requests for copies should be directed to: Investor Relations Department, 3027 Townsgate Road, Suite 300, Westlake Village, California 91361, telephone number (805) 322-9655. In the Corporate Governance section of our corporate website we have also posted the charters for our Audit Committee and Compensation Committee.

### **Item 1A. Risk Factors**

Ownership of our common stock involves risks. You should carefully consider the risks described below in addition to the other information set forth herein. Unless otherwise specified, references to we, our and us in this subsection mean First California and its subsidiaries.

#### **Risks Related to Our Business**

*Our business has been and may continue to be adversely affected by current conditions in the financial markets and economic conditions generally.*

The global and U.S. economies are experiencing significantly reduced business activity and consumer spending as a result of, among other factors, disruptions in the capital and credit markets during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. A sustained weakness or weakening in business and economic conditions generally or specifically in the principal markets in which we do business could have one or more of the following adverse effects on our business:

a decrease in the demand for loans or other products and services offered by us;

a decrease in the value of our loans or other assets secured by consumer or commercial real estate;

a decrease to deposit balances due to overall reductions in the accounts of customers;

an impairment of certain intangible assets or investment securities;

a decreased ability to raise additional capital or the terms may not be acceptable to us; or

an increase in the number of borrowers who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to us. An increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs and provision for credit losses.

*Recent and future legislation and regulatory initiatives to address current market and economic conditions may not achieve their intended objectives, including stabilizing the U.S. banking system or reviving the overall economy.*

Recent and future legislative and regulatory initiatives to address current market and economic conditions, such as EESA or the ARRA, may not achieve their intended objectives, including stabilizing the U.S. banking system or reviving the overall economy. EESA was enacted in October 2008 to restore confidence and stabilize the volatility in the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Treasury and banking regulators have implemented, and likely will continue to implement, various programs under this legislation to address capital and liquidity issues in the banking system, including the Troubled Asset Relief Program ( TARP ), the CPP, President Obama's Financial Stability Plan announced in February 2009, and the ARRA. There can be no assurance as to the actual impact that any of the recent, or future, legislative and regulatory initiatives will have on the financial markets and the overall economy. Any failure of

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

these initiatives to help stabilize or improve the financial markets and the economy, and a continuation or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.

---

**Table of Contents**

***Current levels of market volatility are unprecedented.***

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers' underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

***Additional requirements under our regulatory framework, especially those imposed under ARRA, EESA or other legislation intended to strengthen the U.S. financial system, could adversely affect us.***

Recent government efforts to strengthen the U.S. financial system, including the implementation of ARRA, EESA, the FDIC's Temporary Liquidity Guaranty Program (TLGP) and special assessments imposed by the FDIC, subject participants to additional regulatory fees and requirements, including corporate governance requirements, executive compensation restrictions, restrictions on declaring or paying dividends, restrictions on share repurchases, limits on executive compensation tax deductions and prohibitions against golden parachute payments. These requirements, and any other requirements that may be subsequently imposed, may have a material and adverse affect on our business, financial condition, and results of operations.

***Our growth presents certain risks, including a possible decline in credit quality or capital adequacy.***

The asset growth experienced by National Mercantile and FCB in the years prior to the Mergers and by First California after the Mergers presents certain risks. While we believe we have maintained good credit quality notwithstanding such growth, rapid growth is frequently associated with a decline in credit quality. Accordingly, continued asset growth could lead to a decline in credit quality in the future. In addition, continued asset growth could cause a decline in capital adequacy for regulatory purposes, which could in turn cause us to have to raise additional capital in the future to maintain or regain well capitalized status as defined under applicable banking regulations.

***Our performance and growth are dependent on maintaining a high quality of service for our customers, and will be impaired by a decline in our quality of service.***

Our growth will be dependent on maintaining a high quality of service for customers of First California. As a result of the Mergers and the corresponding growth, it may become increasingly difficult to maintain high service quality for our customers. This could cause a decline in our performance and growth with respect to net income, deposits, assets and other benchmarks.

***The fair value of our investment securities can fluctuate due to market conditions out of our control.***

Our investment securities portfolio includes structured asset-backed collateralized mortgage obligations and trust preferred securities that may have some exposure to the subprime market and/or to other categories of distressed assets. At December 31, 2008, gross unrealized losses on our investment portfolio were \$17.7 million. Factors beyond our control can significantly influence the fair value of these securities and can cause potential adverse changes to the fair value of these securities. These factors include but are not limited to rating agency downgrades of the securities, defaults of debt issuers, changes in market interest rates and continued instability in the credit markets. Any of these mentioned factors could cause an other-than-temporary impairment in future periods and result in a realized loss.

***If borrowers and guarantors fail to perform as required by the terms of their loans, we will sustain losses.***

A significant source of risk for First California arises from the possibility that losses will be sustained if our borrowers and guarantors fail to perform in accordance with the terms of their loans and guaranties. This risk

## **Table of Contents**

increases when the economy is weak. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

### ***Our allowance for loan losses may not be adequate to cover actual losses.***

In accordance with accounting principles generally accepted in the United States, we maintain an allowance for loan losses to provide for actual loan and lease losses. Our allowance for loan losses may not be adequate to cover actual loan and lease losses, and future provisions for credit losses could materially and adversely affect our operating results. Our allowance for loan losses is based on prior experience, as well as an evaluation of the risks in the current portfolio. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates that may be beyond our control, and these losses may exceed current estimates. Federal regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. While we believe that our allowance for loan losses is adequate to cover current losses, it is possible that we will further increase the allowance for loan losses or that regulators will require increases. Either of these occurrences could materially and negatively affect our earnings.

### ***The banking business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.***

Changes in the interest rate environment may reduce our profits. It is expected that we will continue to realize income from the differential between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest margin is affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. We may not be able to minimize our interest rate risk. In addition, while an increase in the general level of interest rates may increase our net interest margin and loan yield, it may adversely affect the ability of certain borrowers with variable rate loans to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest margin, asset quality, loan origination volume and overall profitability.

### ***We face strong competition from financial services companies and other companies that offer banking services which could negatively affect our business.***

We conduct our banking operations primarily in Ventura, Los Angeles and Orange Counties, California. Increased competition in these markets may result in reduced loans and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer the same banking services that we offer in our service areas. These competitors include national banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including without limitation, savings and loan institutions, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In particular, competitors include several major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous banking locations and ATMs and conduct extensive promotional and advertising campaigns.

Additionally, banks and other financial institutions with larger capitalizations and financial intermediaries not subject to bank regulatory restrictions have larger lending limits than we have and are thereby able to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain deposits, and range and quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and

## **Table of Contents**

international financial services markets as technological advances enable more companies to provide financial services. We also face competition from out-of-state financial intermediaries that have opened low-end production offices or that solicit deposits in our market areas. If we are unable to attract and retain banking customers, we may be unable to continue to grow our loan and deposit portfolios and our results of operations and financial condition may otherwise be adversely affected.

***Changes in economic conditions, in particular an economic slowdown in Southern California, could materially and negatively affect our business.***

Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. A deterioration in economic conditions, whether caused by national or local concerns, in particular an economic slowdown in Southern California, could result in the following consequences, any of which could hurt our business materially: loan delinquencies may increase; problem assets and foreclosures may increase; demand for our products and services may decrease; low cost or noninterest bearing deposits may decrease; and collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers' borrowing power, and reducing the value of assets and collateral associated with our existing loans. The State of California and certain local governments in our market area continue to face fiscal challenges upon which the long-term impact on the State or the local economy cannot be predicted.

***A significant portion of the Company's loan portfolio consists of construction loans, which have greater risks than loans secured by completed real properties.***

At December 31, 2008, First California had outstanding construction and land development loans in the amount of \$133.1 million, representing 17% of its loan portfolio. These types of loans generally have greater risks than loans on completed homes, multifamily properties and commercial properties. A construction loan generally does not cover the full amount of the construction costs, so the borrower must have adequate funds to pay for the balance of the project. Price increases, delays and unanticipated difficulties can materially increase these costs. Further, even if completed, there is no assurance that the borrower will be able to sell the project on a timely or profitable basis, as these are closely related to real estate market conditions, which can fluctuate substantially between the start and completion of the project. If the borrower defaults prior to completion of the project, the value of the project will likely be less than the outstanding loan, and we could be required to complete construction with our own funds to minimize losses on the project.

***Further disruptions in the real estate market could materially and negatively affect our business.***

There has been a slow-down in the real estate market due to negative economic trends and credit market disruption, the impacts of which are not yet completely known or quantified. At December 31, 2008, approximately 70% of our loans are secured by real estate. Any further downturn in the real estate market could materially and adversely affect our business because a significant portion of our loans is secured by real estate. Our ability to recover on defaulted loans by selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans. An increase in losses on defaulted loans may have a material impact on our financial condition and results of operations, by reducing income, increasing expenses, and leaving less cash available for lending and other activities.

Substantially all real property collateral for the Company is located in Southern California. Real estate values have declined recently, particularly in California. If real estate sales and appreciation continue to weaken, especially in Southern California, the collateral for our loans would provide less security. Real estate values could be affected by, among other things, an economic recession or slowdown, an increase in interest rates, earthquakes, brush fires, flooding and other natural disasters particular to California.

## **Table of Contents**

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

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Given the current disruption in the financial markets and regulatory initiatives that are likely to be proposed by the new administration and Congress, new regulations and laws that may affect us are increasingly likely. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. There are currently proposed laws, rules and regulations that, if adopted, would impact our operations. These proposed laws, rules and regulations, or any other laws, rules or regulations, may be adopted in the future, which could (1) make compliance much more difficult or expensive, (2) restrict our ability to originate, broker or sell loans or accept certain deposits, (3) further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by us, or (4) otherwise adversely affect our business or prospects for business. In addition, it is likely that we will be required to pay significantly higher FDIC premiums in the future because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

Additionally, in order to conduct certain activities, including acquisitions, we are required to obtain regulatory approval. There can be no assurance that any required approvals can be obtained, or obtained without conditions or on a timeframe acceptable to us. For more information, please see the section entitled "Item 1. Business-Supervision and Regulation" above.

### ***We are exposed to risk of environmental liabilities with respect to properties to which we take title.***

In the course of our business, we may own or foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition, liquidity and results of operations could be materially and adversely affected.

### ***Our internal operations are subject to a number of risks.***

We are subject to certain operational risks, including, but not limited to, data processing system failures and errors, customer or employee fraud, security breaches of our computer systems and catastrophic failures resulting from terrorist acts or natural disasters. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks that are insurable, but should such an event occur that is not prevented or detected by our internal controls and uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on our business, financial condition or results of operations.

### ***We face reputation and business risks due to our interactions with business partners, service providers and other third parties.***

We rely on third parties in a variety of ways, including to provide key components of our business infrastructure or to further our business objectives. These third parties may provide services to us and our clients or serve as partners in business activities. We rely on these third parties to fulfill their obligations to us, to accurately inform us of relevant information and to conduct their activities professionally and in a manner that reflects positively on us. Any failure of our business partners, service providers or other third parties to meet their commitments to us or to perform in accordance with our expectations could harm our business and operations, financial performance, strategic growth or reputation.



## **Table of Contents**

### ***We face risks in connection with our strategic undertakings.***

If appropriate opportunities present themselves, we may engage in strategic activities, which may include acquisitions, investments, asset purchases or other business growth initiatives or undertakings. There can be no assurance that we will successfully identify appropriate opportunities, that we will be able to negotiate or finance such activities or that such activities, if undertaken, will be successful.

In order to finance future strategic undertakings, we might obtain additional equity or debt financing. Such financing might not be available on terms favorable to us, or at all. If obtained, equity financing could be dilutive and the incurrence of debt and contingent liabilities could have a material adverse affect on our business, results of operations and financial condition.

Our ability to execute strategic activities successfully will depend on a variety of factors. These factors likely will vary based on the nature of the activity but may include our success in integrating the operations, services, products, personnel and systems of an acquired company into our business, operating effectively with any partner with whom we elect to do business, retaining key employees, achieving anticipated synergies, meeting management's expectations and otherwise realizing the undertaking's anticipated benefits. Our ability to address these matters successfully cannot be assured. In addition, our strategic efforts may divert resources or management's attention from ongoing business operations and may subject us to additional regulatory scrutiny. If we do not successfully execute a strategic undertaking, it could adversely affect our business, financial condition, results of operations, reputation and growth prospects. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in an impairment of goodwill charge to us, which would adversely affect our results of operations.

### ***We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.***

We depend heavily on the services of our President and Chief Executive Officer, C. G. Kum, our Executive Vice President and Chief Financial Officer, Romolo C. Santarosa and a number of other key management personnel. The loss of any of their services or that of other key personnel could materially and adversely affect our future results of operations and financial condition. Our success also depends in part on our ability to attract and retain additional qualified management personnel. Competition for such personnel is strong in the banking industry and we may not be successful in attracting or retaining the personnel we require.

### ***If we are unable to integrate the operations of 1<sup>st</sup> Centennial Bank successfully, our business and earnings may be negatively affected.***

We recently assumed non-brokered deposits of 1<sup>st</sup> Centennial Bank, totaling approximately \$270 million from the FDIC. We also purchased approximately \$164 million in cash and cash equivalents, \$89 million in investment securities and \$2 million in consumer loans related to the transaction. This purchase and assumption transaction with 1<sup>st</sup> Centennial Bank, including the acquisition of 1<sup>st</sup> Centennial Bank's six branches, involves the integration of certain operations of companies that have previously operated independently. Successful integration of operations of 1<sup>st</sup> Centennial Bank will depend primarily on our ability to consolidate operations, systems and procedures and to eliminate redundancies and costs. No assurance can be given that we will be able to integrate their operations without encountering difficulties including, without limitation, the loss of key employees and customers, the disruption of its respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies. If we have difficulties with any of these integrations, it might not achieve the economic benefits we expect to result from the transaction, and this may hurt our business and earnings. In addition, we may experience greater than expected costs or difficulties relating to the integration of the business of 1<sup>st</sup> Centennial Bank.

---

## **Table of Contents**

### ***The imposition of certain restrictions on our executive compensation as a result of our decision to participate in the CPP may have material adverse effects on our business and results of operations***

As a result of our election to participate in the CPP, we must adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the CPP. These standards would generally apply to our Chief Executive Officer, our Chief Financial Officer and the three next most highly compensated executive officers (collectively, the senior executive officers). The standards include: (i) ensuring that incentive compensation for senior executive officers does not encourage unnecessary and excessive risks that threaten the value of our Company and the Bank, (ii) requiring a clawback of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate, (iii) prohibiting golden parachute payments to a senior executive officer, and (iv) our agreement not to deduct for tax purposes compensation paid to a senior executive officer in excess of \$500,000. In particular, the change to the deductibility limit on executive compensation may increase our income tax expense in future periods if compensation to a senior executive officer exceeds \$500,000. In conjunction with its purchase of the series B cumulative perpetual preferred stock, the Treasury acquired a warrant to purchase 599,042 shares of our common stock. A portion of the warrant is immediately exercisable and has a term of 10 years. Therefore, we could potentially be subject to the executive compensation and corporate governance restrictions for a ten-year period as a result of our participation in the CPP.

### ***If we are unable to redeem the Series B Preferred Stock within five years, the cost of this capital to us will increase substantially.***

If we are unable to redeem the series B cumulative perpetual preferred stock prior to February 15, 2014, the cost of this capital to us will increase substantially on that date, from 5.0% per annum (approximately \$1.25 million annually) to 9.0% per annum (approximately \$2.25 million annually). Depending on our financial condition at the time, this increase in the annual dividend rate on the series B cumulative perpetual preferred stock could have a material negative effect on our liquidity.

## **Risks Related to Our Common Stock**

### ***Certain preferences and rights of preferred stockholders of First California may negatively affect the rights of holders of First California common stock.***

First California's certificate of incorporation authorizes its Board of Directors to issue up to 2,500,000 shares of preferred stock and to determine the rights, preferences, powers and restrictions granted or imposed upon any series of preferred stock without prior shareholder approval. The preferred stock that may be authorized could have preference over holders of First California common stock with respect to dividends and other distributions upon the liquidation or dissolution of First California. If First California's Board of Directors authorizes the issuance of additional series of preferred shares having a voting preference over common stock, such issuances may inhibit or delay the approval of measures supported by holders of common stock that require shareholder approval and consequently may make it difficult and expensive for a third party to pursue a tender offer, change in control or takeover attempt that is opposed by our management and Board of Directors. Accordingly, such issuance could substantially impede the ability of public stockholders to benefit from a change in control or change of our management and Board of Directors and, as a result, may adversely affect the market price of our common stock and the stockholders' ability to realize any potential change of control premium.

Currently, in the event of a voluntary or involuntary liquidation or dissolution, holders of series A convertible perpetual preferred stock of First California are entitled to receive a liquidation preference of \$1,000 plus an amount equal to 8.5% per annum of the \$1,000, which is deemed to have commenced accrual on December 10, 2001. Also, holders of series B cumulative perpetual preferred stock of First California are entitled to receive a liquidation preference of \$1,000 plus an accrued amount equal to 5.0% per annum of the \$1,000, if

---

## **Table of Contents**

any. These amounts are payable out of the assets of First California before any distribution to holders of common stock. If the number of preferred shares having a similar liquidation preference increases, the chance that holders of common stock may receive a smaller distribution upon liquidation or dissolution may be higher.

***Certain restrictions will affect our ability to declare or pay dividends and repurchase our shares as a result of our decision to participate in the CPP.***

As a result of our participation in the CPP, our ability to declare or pay dividends on any of our common stock has been limited. Specifically, we are not able to declare dividend payments on our common, junior preferred or *pari passu* preferred stock if we are in arrears on the dividends on our series B cumulative perpetual preferred stock. Further, we are not permitted to increase dividends on our common stock without the Treasury's approval until the third anniversary of the investment unless the series B cumulative perpetual preferred stock has been redeemed or transferred. In addition, our ability to repurchase our shares has been restricted. The Treasury's consent generally will be required for us to make any stock repurchases until the third anniversary of the investment by the Treasury unless the series B cumulative perpetual preferred stock has been redeemed or transferred. Further, common, junior preferred or *pari passu* preferred stock may not be repurchased if we are in arrears on the series B cumulative perpetual preferred stock dividends to the Treasury.

***Our ability to pay dividends to holders of our Common Stock and holders of Series B Preferred Stock may be restricted under the terms of indentures governing the trust preferred securities we have issued.***

Our ability to pay dividends to our stockholders is restricted in specified circumstances under indentures governing the trust preferred securities we have issued, and we may issue additional securities with similar restrictions in the future. See Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities-Dividends in Part II of this Annual Report on Form 10-K for more information on these restrictions. We cannot assure you that we will meet the criteria specified under these agreements in the future, in which case we may not be able to pay dividends on our Common Stock or on our series B cumulative perpetual preferred stock even if we were to choose to do so.

***The price of our Common Stock may fluctuate significantly, and this may make it difficult for you to resell the Common Stock when you want to or at prices you find attractive.***

We cannot predict how our Common Stock will trade in the future. The market value of our Common Stock will likely continue to fluctuate in response to a number of factors including the following, most of which are beyond our control, as well as the other factors described in this RISK FACTORS section:

actual or anticipated quarterly fluctuations in our operating and financial results;

developments related to investigations, proceedings or litigation that involve us;

changes in financial estimates and recommendations by financial analysts;

dispositions, acquisitions and financings;

actions of our current stockholders, including sales of our Common Stock by existing stockholders and our directors and executive officers;

fluctuations in the stock price and operating results of our competitors;

regulatory developments; and

developments related to the financial services industry.

***Only a limited trading market exists for our common stock, which could lead to significant price volatility.***

Our common stock was designated for quotation on the NASDAQ Global Select Market in March 2007 under the trading symbol **FCAL** and trading volumes since that time have been modest. The limited trading

---

**Table of Contents**

market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue or that stockholders will be able to sell their shares.

*A holder with as little as a 5% interest in First California could, under certain circumstances, be subject to regulation as a Bank Holding Company.*

Any entity (including a group composed of natural persons) owning 25% or more of the outstanding First California common stock, or 5% or more if such holder otherwise exercises a controlling influence over First California, may be subject to regulation as a bank holding company in accordance with the Bank Holding Company Act of 1956, as amended, or the BHCA. In addition, (i) any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve Board under the BHCA to acquire or retain 5% or more of the outstanding First California common stock and (ii) any person other than a bank holding company may be required to obtain the approval of the Federal Reserve Board under the Change in Bank Control Act to acquire or retain 10% or more of the outstanding First California common stock. Becoming a bank holding company imposes certain statutory and regulatory restrictions and burdens, and might require the holder to divest all or a portion of the holder's investment in First California. In addition, because a bank holding company is required to provide managerial and financial strength for its bank subsidiary, such a holder may be required to divest investments that may be deemed incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

*Concentrated ownership of our common stock creates a risk of sudden changes in our share price.*

As of March 17, 2009, First California's directors, executive officers and other affiliates of First California owned approximately 49.5% of First California's outstanding voting stock (not including vested option shares). As a result, if all of these stockholders were to take a common position, they would be able to significantly affect the election of directors as well as the outcome of most corporate actions requiring stockholder approval, such as the approval of mergers or other business combinations. Such concentration may also have the effect of delaying or preventing a change in control of First California. In some situations, the interests of First California's directors and executive officers may be different from other stockholders.

Investors who purchase our common stock may be subject to certain risks due to the concentrated ownership of our common stock. The sale by any of our large stockholders of a significant portion of that stockholder's holdings could have a material adverse effect on the market price of our common stock. Furthermore, the registration of any significant amount of additional shares of our common stock may have the immediate effect of increasing the public float of our common stock, and, in addition, a group of our large stockholders can also demand that we register their shares under certain circumstances. Any such increase in the number of our publicly registered shares may cause the market price of our common stock to decline or fluctuate significantly.

*We do not expect to pay dividends on our common stock in the foreseeable future.*

We have never paid a cash dividend on our common stock and we do not expect to pay a cash dividend in the foreseeable future. We presently intend to retain earnings and increase capital in furtherance of our overall business objectives. We will periodically review our dividend policy in view of the operating performance of the company, and may declare dividends in the future if such payments are deemed appropriate.

In addition, our ability to pay any dividends to our stockholders is subject to the restrictions set forth under Delaware law. Our ability to pay dividends to our stockholders is also restricted in specified circumstances under indentures governing the trust preferred securities we have issued, is restricted as a condition to the Company's participation in the CPP stabilization program and we may issue additional securities with similar restrictions in the future. See Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer

## **Table of Contents**

Purchases of Equity Securities Dividends in Part II of this Annual Report for more information on these restrictions. We cannot assure you that we will meet the criteria specified under Delaware law or under these agreements in the future, in which case we may not be able to pay dividends on our common stock even if we were to choose to do so.

*There may be future sales of additional Common Stock or preferred stock or other dilution of our equity, which may adversely affect the market price of our Common Stock or the series B Preferred Stock.*

We are not restricted from issuing additional Common Stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, Common Stock or preferred stock or any substantially similar securities. The market value of our Common Stock could decline as a result of sales by us of a large number of shares of Common Stock or preferred stock or similar securities in the market or the perception that such sales could occur.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

The Bank owns its former executive offices located at 1100 Paseo Camarillo, Camarillo, California. The building has approximately 5,100 square feet of space and adequate parking facilities.

The Bank leases approximately 5,931 square feet of space located at 730 Paseo Camarillo, Camarillo, California. The Bank vacated this property upon the moving of the Company's headquarters in the 3rd quarter of 2008. The lease expires July 31, 2009.

The Bank also leases approximately 13,880 square feet of space for administrative functions which are located at 1880 Century Park East, Los Angeles, California. The lease term expires in April 2014. Approximately half of this space is sublet through the lease expiration in 2014.

The Bank leases approximately 21,901 square feet of space at Westlake Park Place, 3027 Townsgate Road, Westlake Village, California to serve as the Company's administrative headquarters. The lease term expires in 2018.

The Bank owns its main branch located at 1150 Paseo Camarillo, Camarillo, California. The building has approximately 9,032 square feet of space and adequate parking facilities.

The Bank owns its Irvine Branch Office located at 19752 MacArthur Blvd., Irvine, California 92612. The building has approximately 21,000 square feet of space and adequate parking facilities.

The Bank also owns its Torrance Branch located at 2200 Sepulveda Blvd., Torrance, California.

The Bank leases approximately 1,491 square feet of space for its Anaheim Hills Branch Office located at 168 S. Fairmont Boulevard, Suite O, Anaheim Hills, California. The lease term commenced on March 7, 1995, and the Bank exercised its option to renew for three years, commencing on July 16, 2006 through July 15, 2009.

The Bank leases approximately 1,880 square feet of space for its Century City Branch Office located at 1880 Century Park East, Los Angeles, California. The lease will expire in June 2014.

The Bank leases approximately 1,555 square feet of space located at 3070 Bristol Street, Suite 160, Costa Mesa, California. This facility was vacated in 2007 and the employees and equipment relocated to the Irvine branch. The lease term expires in February 2009.

**Table of Contents**

The Bank leases approximately 3,100 square feet of space for its former El Segundo Branch Office located at 1960 E. Grand Avenue, El Segundo, California. This location was closed in 2008 and the Bank is attempting to sublease this space. The lease term expires in February 2011.

The Bank leases approximately 1,650 square feet of space for its Encino Branch Office located at 16661 Ventura Boulevard, Encino, California. The lease term will expire in May 2009.

The Bank leases approximately 3,000 square feet of space for its Glendale Branch Office located at 505 North Brand Boulevard, Glendale, California. The lease has an initial term of five years and will expire in November, 2013.

The Bank also leases approximately 1,672 square feet of space for its Oxnard Branch Office located at 300 Esplanade Drive, Suite 102, Oxnard, California. The lease will expire in April, 2010.

The Bank also leases approximately 3,478 square feet of space for its former Sherman Oaks Loan Production Office located at 13245 Riverside Dr. Suite 540, Sherman Oaks, California. The lease term is for five years and commenced on March 1, 2006. This Bank vacated this facility upon the opening of the new company headquarters in the third quarter of 2008. The space has been subleased through the lease expiration date of March 2011.

The Bank also leases approximately 5,000 square feet of space for its Simi Valley Branch Office located at Simi Valley Towne Center, Simi Valley, California. The lease term commenced in January 2006 and is for 20 years.

The Bank also leases approximately 3,850 square feet of space for its Thousand Oaks Branch Office located at 11 E. Hillcrest Drive, Suite A, Thousand Oaks, California. The lease term commenced in October 2003 and is for 10 years with two 5-year renewal options.

The Bank also leases approximately 4,000 square feet of space for its Westlake Village Branch Office located at 32111 Agoura Road, Westlake Village, California. The lease term commenced in September 2004 and is for 5 years with one 5-year renewal option.

Subsequent to year end, the Bank plans to lease space for the six new branch offices assumed from the FDIC as receiver for 1st Centennial Bank in Redlands, Palm Desert, Brea, Irwindale, Temecula and Escondido. The lease terms have not been finalized.

The Bank believes that its premises will be adequate for present and anticipated needs. The Bank also believes that it has adequate insurance to cover its premises.

**Item 3. *Legal Proceedings***

The nature of First California's business causes it to be involved in ordinary routine legal proceedings from time to time. Although the ultimate outcome and amount of liability, if any, with respect to these legal proceedings to which we are currently a party cannot presently be ascertained with certainty, in the opinion of management, based upon information currently available to us, any resulting liability is not likely to have a material adverse affect on the Company's consolidated financial condition, results of operations or cash flow.

**Item 4. *Submission of Matters to a Vote of Security Holders***

None.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The common stock of First California began trading on the NASDAQ Global Select Market under the symbol FCAL on March 13, 2007. Prior to that time, the common stock of National Mercantile, First California's predecessor, traded on the NASDAQ Capital Market under the symbol MBLA. The information in the following table indicates the high and low sales prices for National Mercantile's common stock from January 1, 2007 to March 12, 2007 and for First California's common stock from March 13, 2007 to December 31, 2008, as reported by NASDAQ. Because of the limited market for National Mercantile's common stock before March 13, 2007 and First California's common stock after that time, these prices may not be indicative of the fair market value of the common stock. The information does not include transactions for which no public records are available. The trading prices in such transactions may be higher or lower than the prices reported below.

	Common Stock	
	High	Low
<b>2007</b>		
First Quarter	\$ 13.94	\$ 12.60
Second Quarter	13.75	11.32
Third Quarter	12.25	9.34
Fourth Quarter	10.49	7.00
<b>2008</b>		
First Quarter	\$ 9.25	\$ 7.11
Second Quarter	9.15	5.50
Third Quarter	9.00	5.17
Fourth Quarter	8.60	4.71

At March 17, 2009, First California had 418 stockholders of record for its common stock. The number of beneficial owners for the common stock is higher, as many people hold their shares in street name.

**Dividends**

From its inception and until the completion of the Mergers in March 2007, First California was a business combination shell company, conducting no operations or owning or leasing any real estate or other property. Accordingly, First California did not pay any dividends to its sole stockholder, National Mercantile, prior to the Mergers, nor has First California paid any dividends to its common stockholders since the completion of the Mergers. Our common stockholders are entitled to receive dividends when and as declared by our Board of Directors, out of funds legally available therefore, subject to the restrictions set forth in the Delaware General Corporation Law, or the DGCL. The DGCL provides that a corporation may declare and pay dividends out of any surplus, and, if it has no surplus, out of any net profits for the fiscal year in which the dividend was declared or for the preceding fiscal year (provided that the payment will not reduce capital to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets). In addition, First California may not pay dividends on its capital stock if it is in default or has elected to defer payments of interest under its junior subordinated debentures. The Company cannot declare or pay a dividend on its common stock without the consent of the Treasury until the third anniversary of the date of the CPP investment, or December 19, 2011, unless prior to such third anniversary the senior preferred stock series B is redeemed in whole or the Treasury has transferred all of the senior preferred stock series B to third parties.



**Table of Contents**

We do not currently expect to pay a cash dividend to our common stockholders in the foreseeable future. We presently intend to retain earnings and increase capital in furtherance of our overall business objectives. We will periodically review our dividend policy in view of the operating performance of the company, and may declare dividends in the future if such payments are deemed appropriate.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth as of December 31, 2008 information regarding outstanding options and the number of shares available for future option grants under all of our equity compensation plans. All equity plans of FCB Bancorp, in addition to those of National Mercantile Bancorp and all outstanding option awards were assumed by First California in connection with the Mergers.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by shareholders (1)	641,797	\$ 8.89	907,287
Equity compensation plans not approved by shareholders	N/A	N/A	N/A
<b>Total</b>	<b>641,797</b>	<b>\$ 8.89</b>	<b>907,287</b>

(1) Includes the First California 2007 Omnibus Equity Incentive Plan, FCFG FCB 2005 Stock Option Plan, FCFG 2005 NMB Stock Incentive Plan, FCFG Amended 1996 NMB Stock Incentive Plan, FCFG 1994 NMB Stock Option Plan.

**Recent Sales of Unregistered Securities**

On December 19, 2008, the Company sold and issued 25,000 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series B, with a liquidation preference of \$1,000 per share par value \$0.01 per share and a ten-year Warrant to purchase initially up to 599,042 of the Company's common stock to the United States Department of the Treasury pursuant to the Company's participation in the CPP. The terms of this issuance, the terms of exercise of the Warrant and the use of proceeds were disclosed in a Current Report on Form 8-K, as filed with the Securities and Exchange Commission on December 22, 2008, as amended on December 23, 2008.

**Issuer Purchases of Equity Securities**

There were no shares repurchased by the Company during the fourth quarter of 2008.

**Item 6. Selected Financial Data**

Not applicable.

**Table of Contents**

**Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***  
**Forward-Looking Statements**

This discussion contains certain forward-looking information about us, which statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond our control. We caution readers that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

revenues are lower than expected;

credit quality deterioration which could cause an increase in the provision for loan losses;

competitive pressure among depository institutions increases significantly;

changes in consumer spending, borrowings and savings habits;

our ability to successfully integrate acquired entities or to achieve expected synergies and operating efficiencies within expected time-frames or at all;

the integration of acquired businesses costs more, takes longer or is less successful than expected;

technological changes;

the cost of additional capital is more than expected;

a change in the interest rate environment reduces interest margins;

asset/liability repricing risks and liquidity risks;

general economic conditions, particularly those affecting real estate values, either nationally or in the market areas in which we do or anticipate doing business, are less favorable than expected;

a slowdown in construction activity;

the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq and other conflicts;

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

legislative or regulatory requirements or changes adversely affecting our business;

the effects of and changes in monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board;

the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;

inflation, interest rate, securities market and monetary fluctuations;

recent volatility in the credit or equity markets and its effect on the general economy;

the costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews;

regulatory approvals for announced or future acquisitions cannot be obtained on the terms expected or on the anticipated schedule;  
and

our success at managing the risks involved in the foregoing items.

If any of these risks or uncertainties materializes, or if any of the assumptions underlying such forward-looking statements proves to be incorrect, our results could differ materially from those expressed in, implied or

## **Table of Contents**

projected by, such forward-looking statements. For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see Risk Factors under Part I, Item 1A in this report. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Annual Report on Form 10-K. Forward-looking statements speak only as of the date on which such statements are made. We assume no obligation to update such forward-looking statements to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

### **Overview**

The following discussion is designed to provide a better understanding of significant trends related to the consolidated results of operations and financial condition of First California and its wholly-owned subsidiaries. When we say we, our or us, we mean First California and its consolidated subsidiaries after the Mergers. This discussion and information is derived from our audited consolidated financial statements and related notes for the two years ended December 31, 2008 and 2007. You should read this discussion in conjunction with those consolidated financial statements.

We were a wholly-owned subsidiary of National Mercantile Bancorp, or National Mercantile, formed to facilitate the reincorporation merger with National Mercantile and the merger with FCB Bancorp, or FCB. Accordingly, our historical balance sheet and results of operations before the Mergers are the same historical information of National Mercantile. We accounted for the FCB merger using the purchase method of accounting; accordingly, our balance sheet includes the estimates of the fair value of the assets acquired and liabilities assumed from FCB. Our results of operations for the twelve months ended December 31, 2007 include the operations of FCB from the date of acquisition.

### **Critical Accounting Policies**

The discussion and analysis of our consolidated results of operations and financial condition are based upon our audited consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these consolidated financial statements. Accounting estimates are deemed critical when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period and would materially affect our consolidated financial statements as of or for the periods presented. We believe that our estimates and assumptions are reasonable; however, actual results may differ significantly from these estimates and assumptions which could have a material effect on the carrying value of assets and liabilities at the balance sheet dates and on our results of operations for the reporting periods. The accounting policies that involve significant estimates and assumptions by us, which may have a material effect on the carrying value of certain assets and liabilities, are considered critical accounting policies. We have identified our policies for the allowance for loan losses, deferred tax assets, derivative instruments and hedging and assessments of impairment as critical accounting policies.

#### *Allowance for loan losses*

The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when we believe that the collectibility of principal is unlikely. The allowance is an amount that we believe will be adequate to absorb probable losses on existing loans and leases that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Various regulatory agencies, as a regular part of their examination process, periodically review our

---

**Table of Contents**

allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was \$8,048,000 at December 31, 2008 and \$7,828,000 at December 31, 2007.

*Deferred income taxes*

Deferred tax assets are recognized subject to our judgment that realization is more-likely-than-not. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. The information used by us to make this estimate is described later in this section and in the notes to the financial statements. There were net deferred tax assets of \$2,572,000 at December 31, 2008 and net deferred tax liabilities of \$2,535,000 at December 31, 2007. There was no valuation allowance as of December 31, 2008 or December 31, 2007.

*Derivative instruments and hedging*

An estimate of the effectiveness of derivative instruments in off-setting changes in fair value or cash flows of hedged items is required to determine the extent to which earnings are affected. We had no remaining derivative instruments at December 31, 2008 and our hedges were considered effective at December 31, 2007.

*Assessments of impairment*

Goodwill arises from business combinations and represents the value attributable to the unidentifiable intangible elements in our acquired businesses. Goodwill is initially recorded at fair value and is subsequently evaluated at least annually for impairment in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. We perform this annual test as of December 31 of each year. Evaluations are also performed on a more frequent basis if events or circumstances indicate impairment could have taken place. Such events could include, among others, a significant adverse change in the business climate, an adverse action by a regulator, a significant decrease in the market capitalization of the Company, an unanticipated change in the competitive environment, and a decision to change the operations or dispose of a significant business unit or product line.

The first step in this evaluation process is to determine if a potential impairment exists and, if the results of this exercise demonstrate potential impairment we next embark on a second step to determine the amount of impairment loss, if any. The computations required in these two exercises requires us to make a number of estimates and assumptions. In completing the first step, we determine the fair value of the Company. In determining the fair value, we calculate the value using a combination of three separate methods: the trading multiple of comparable publicly traded financial institutions; the acquisition premium of comparable acquisitions of financial institutions; and the discounted present value of our estimates of future cash flows. Critical assumptions that are used as part of these calculations include:

selection of comparable publicly traded companies, based upon location, size and business composition;

selection of market comparable acquisition transactions, based on location, size, business composition, and date of the transaction;

the discount rate applied to future earnings, based upon an estimate of the cost of capital;

the potential future earnings of the Company; and

the relative weight given to the valuations derived by the three methods described

If the first step indicates a potential impairment, we next determine or estimate the implied fair value of the goodwill. This process estimates the fair value of the Company's individual assets and liabilities in the same manner as if a purchase of the Company were taking place. To do this, we must determine the fair value of the assets, liabilities and identifiable intangible assets of the Company based upon the best available information. We estimate the fair market value of all of the tangible assets, identifiable intangible assets and liabilities of the Company in

accordance with the principals of SFAS 157. Loans, deposits with maturities, and debt are valued

---

**Table of Contents**

using assumptions regarding future cash flows, appropriate discount rates and other estimates, such as credit and market liquidity assumptions, to comply with SFAS 157. Deposits with no maturities are valued at book value. Owned properties are appraised, while for furniture, fixtures and equipment it is assumed book value approximates fair market value. Identifiable intangible assets such as core deposit intangibles and trade name intangibles are also identified and valued. If the implied fair value of goodwill calculated in this exercise is less than the carrying amount of goodwill, an impairment is indicated and the carrying value of goodwill is written down to its estimated fair value.

Effective December 31, 2008, we performed our annual goodwill impairment evaluation. Upon completion of the first step of the evaluation process, we concluded that potential impairment of goodwill existed. The second step was completed with the assistance of an independent valuation firm and our internal valuation resources and resulted in our conclusion that goodwill was not impaired at December 31, 2008.

We also review our securities on an ongoing basis for the presence of other-than-temporary impairment, with formal reviews performed quarterly. Other-than-temporary losses on an individual security is recognized as a realized loss through earnings when it is probable that we will not collect all of the contractual cash flows of that security or we are unable to hold the security to recovery.

Our other-than-temporary impairment evaluation process conforms to the rules contained in SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, FSP FAS 115-1 and FAS 124-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, EITF 99-20 *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets*, FSP No. EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20* and FSP 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset is not Active*. These rules require us to take into consideration current market conditions, fair value in relationship to cost, extent and nature of change in fair value, issuer rating changes and trends, current analysts evaluations, all available information relevant to the collectability of debt securities, our ability and intent to hold the security until a recovery of fair value, which may be maturity, and other factors when evaluating for the existence of other-than-temporary impairment in our securities. At December 31, 2008 we evaluated the unrealized loss in our securities portfolio and concluded that there was no other-than-temporary impairment.

**Results of Operations for the two years ended December 31, 2008**

Net income for the year ended December 31, 2008 was \$6.4 million or 54 cents per diluted common share compared with net income of \$7.1 million or 66 cents per diluted common share in 2007. Net income for 2007 was affected by the Mergers completed in the first quarter of 2007. Our 2007 net income includes nine months and 19 days of combined results as well as the effect of merger-related gains and charges.

*Net interest income*

Net interest income is the difference between interest earned on assets and interest incurred on liabilities. Taxable-equivalent net interest income is the largest component of First California's revenue. By its nature, net interest income is especially vulnerable to changes in the mix and amounts of interest-earning assets and interest-bearing liabilities. In addition, changes in the interest rates and yields associated with these assets and liabilities significantly impact net interest income. See **Interest Rate Risk** on page 56 for further discussion of how we manage the portfolios of interest-earning assets and interest-bearing liabilities and associated risk.

Net interest income for 2008 was \$40.8 million compared with \$40.2 million last year. Average interest-earning assets for 2008 were \$1.01 billion, up 16 percent from \$873 million last year. The yield on average interest-earning assets for 2008 declined to 6.26% from 7.57%. The decline in the yield outpaced the benefit from growth in average interest-earning assets which resulted in a decline in interest income of \$2.5 million.

**Table of Contents**

The increase in average interest-earning assets was supported by an increase in average interest-bearing liabilities, principally time certificates of deposits and FHLB advances. Average interest-bearing liabilities increased to \$789.2 million from \$642.6 million, up 23 percent from last year. The rate paid on average interest-bearing liabilities fell to 2.85% from 3.97% last year. The decline in the rate paid outpaced the added expense of more interest-bearing liabilities resulting in a reduction in interest expense of \$3.1 million. Together, the decline in interest expense exceeded the decline in interest income resulting in a 1 percent increase in net interest income for 2008.

The net interest margin (on a taxable equivalent basis) was 4.08% in 2008 compared with 4.64% in 2007. The decreased net interest margin for 2008 compared to 2007 resulted primarily from loan yields decreasing more and faster than deposit rates and a decline in the percentage relationship of noninterest-bearing demand deposits to total interest-bearing liabilities.

Throughout 2008, the FRB lowered the federal funds rate seven times by approximately 400 basis points. In contrast, our net interest margin declined 56 basis points for the 2008 year. A decrease in interest rates generally has a more immediate impact on our variable rate loans. Marketplace deposit rates generally respond more slowly to changes in interest rates and limit our ability to reduce rates quickly. Our interest rate risk management practices are designed to create stability in our net interest margin; however, we anticipate that our net interest margin will continue to experience downward pressure due to marketplace deposit rates.



**Table of Contents**

The following table presents the average balances, the amount of interest earned or incurred and the applicable taxable equivalent yields for interest-earning assets and the costs of interest-bearing liabilities that generate net interest income:

**Average Balance Sheet and Analysis of Net Interest Income**

	December 31, 2008			Year Ended December 31, 2007			December 31, 2006		
	Average Amount	Interest Income/ Expense	Weighted Average Yield/ Rate	Average Amount	Interest Income/ Expense	Weighted Average Yield/ Rate	Average Amount	Interest Income/ Expense	Weighted Average Yield/ Rate
<b>Assets:</b>									
Federal funds sold and securities purchased under agreements to resell	\$ 2,715	\$ 28	1.05%	\$ 2,056	\$ 99	4.83%	\$ 1,661	\$ 86	5.18%
Due from banks-interest-bearing	59	2	2.56%	11,329	26	0.23%	2,538	131	5.16%
Securities available-for-sale	221,623	11,684	5.44%	176,259	9,236	5.40%	96,104	5,087	5.29%
Securities held-to-maturity			%				2,307	96	4.16%
Loans (1) (2)	785,371	51,521	6.56%	683,074	56,389	8.26%	351,882	30,100	8.55%
<b>Total interest earning assets</b>	<b>1,009,768</b>	<b>63,235</b>	<b>6.26%</b>	<b>872,718</b>	<b>65,750</b>	<b>7.57%</b>	<b>454,492</b>	<b>35,500</b>	<b>7.81%</b>
Noninterest earning assets:									
Cash and due from banks demand	19,170			3,798			14,066		
Other assets	118,030			78,150			22,879		
Allowance for loan losses and net unrealized gain/loss on securities available-for-sale	(12,131)			(7,630)			(5,933)		
<b>Total assets</b>	<b>\$ 1,134,837</b>			<b>\$ 947,036</b>			<b>\$ 485,504</b>		
<b>Liabilities and shareholders equity:</b>									
Interest-bearing deposits:									
Checking	\$ 47,526	215	0.45%	\$ 39,186	328	0.84%	\$ 30,737	\$ 221	0.72%
Money market and savings	204,351	3,627	1.77%	223,509	7,185	3.21%	124,319	3,439	2.77%
Time certificates of deposit:									
\$100,000 or more	209,483	5,939	2.84%	165,319	7,076	4.28%	83,993	3,600	4.29%
Under \$100,000	106,851	3,616	3.38%	82,796	3,732	4.51%	23,708	838	3.53%
<b>Total time certificates of deposit</b>	<b>316,334</b>	<b>9,555</b>	<b>3.02%</b>	<b>248,115</b>	<b>10,808</b>	<b>4.36%</b>	<b>107,701</b>	<b>4,438</b>	<b>4.12%</b>
<b>Total interest-bearing deposits</b>	<b>568,211</b>	<b>13,397</b>	<b>2.36%</b>	<b>510,810</b>	<b>18,321</b>	<b>3.59%</b>	<b>262,757</b>	<b>8,098</b>	<b>3.08%</b>
FHLB advances	148,748	5,583	3.75%	61,704	3,003	4.87%	13,991	700	5.00%
Junior subordinated debentures	26,675	1,755	6.58%	25,057	1,676	6.69%	15,464	1,546	10.00%
Federal funds purchased and securities sold under agreements to repurchase	45,676	1,718	3.76%	45,000	2,506	5.57%	33,108	1,808	5.46%
<b>Total interest-bearing liabilities</b>	<b>789,310</b>	<b>22,453</b>	<b>2.84%</b>	<b>642,571</b>	<b>25,506</b>	<b>3.97%</b>	<b>325,320</b>	<b>12,152</b>	<b>3.74%</b>
Noninterest-bearing liabilities:									
Noninterest-bearing demand deposits	190,939			193,630			114,701		
Other liabilities	15,901			9,235			4,728		
Shareholders equity	138,687			101,498			40,755		
<b>Total liabilities and shareholders equity</b>	<b>\$ 1,134,837</b>			<b>\$ 946,934</b>			<b>\$ 485,504</b>		
<b>Net interest income</b>		<b>\$ 40,782</b>			<b>\$ 40,244</b>			<b>\$ 23,348</b>	

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

Net interest margin (tax equivalent)	4.08%	4.64%	5.14%
--------------------------------------	-------	-------	-------

- (1) The average balance of nonperforming loans has been included in loans.
- (2) Yields and amounts earned on loans include loan fees of \$0.8 million, \$3.0 million and \$1.8 million for the years ended December 31, 2008, 2007 and 2006, respectively.

**Table of Contents**

Net interest income is affected by changes in the level and mix of average earning assets and average interest-bearing funds. The changes between periods in these balances are referred to as balance changes. The effect on net interest income from changes in average balances is measured by multiplying the change in the average balance between the current period and the prior period by the prior period average rate. Net interest income is also affected by changes in the average rate earned or paid on earning assets and interest-bearing funds and these are referred to as rate changes. The effect on net interest income from changes in average rates is measured by multiplying the change in the average rate between the current period and the prior period by the prior period average balance. Changes attributable to both rate and volume are allocated on a pro rata basis to the change in average volume and the change in average rate.

**Increase (Decrease) in Net Interest Income/Expense Due to Change in Average Volume and Average Rate (1)**

	2008 vs 2007		Net Increase (Decrease)	2007 vs 2006		Net Increase (Decrease)
	(Decrease) due to: Volume	Rate		(Decrease) due to: Volume	Rate	
(Dollars in thousands)						
<b>Interest Income:</b>						
Federal funds sold	\$ 32	\$ (103)	\$ (71)	\$ 19	\$ (6)	\$ 13
Due from banks interest-bearing	(26)	2	(24)	20	(125)	(105)
Securities available-for-sale	2,732	(284)	2,448	4,200	(51)	4,149
Securities held-to-maturity				(96)		(96)
Loans (2)	8,483	(13,351)	(4,868)	27,341	(1,052)	26,289
<b>Total interest-earning assets</b>	<b>11,221</b>	<b>(13,736)</b>	<b>(2,515)</b>	<b>31,484</b>	<b>(1,234)</b>	<b>30,250</b>
<b>Interest Expense:</b>						
<b>Interest-bearing deposits:</b>						
Checking	70	(183)	(113)	70	37	107
Money market and savings	(615)	(2,943)	(3,558)	3,189	557	3,746
<b>Time certificates of deposit:</b>						
\$100,000 or more	1,890	(3,027)	(1,137)	1,836	(1,704)	132
Under \$100,000	1,087	(1,203)	(116)	5,050	1,188	6,238
<b>Total time certificates of deposit</b>	<b>2,977</b>	<b>(4,230)</b>	<b>(1,253)</b>	<b>6,886</b>	<b>(516)</b>	<b>6,370</b>
<b>Total interest-bearing deposits</b>	<b>2,432</b>	<b>(7,356)</b>	<b>(4,924)</b>	<b>10,145</b>	<b>78</b>	<b>10,223</b>
FHLB advances	4,241	(1,661)	2,580	2,383	(80)	2,303
Junior subordinated debentures	109	(30)	79	959	(829)	130
Federal funds purchased and securities sold under agreements to repurchase	38	(826)	(788)	649	49	698
<b>Total interest-bearing liabilities</b>	<b>6,820</b>	<b>(9,873)</b>	<b>(3,053)</b>	<b>14,136</b>	<b>(782)</b>	<b>13,354</b>
<b>Net interest income</b>	<b>\$ 4,401</b>	<b>\$ (3,863)</b>	<b>\$ 538</b>	<b>\$ 17,348</b>	<b>\$ (452)</b>	<b>\$ 16,896</b>

- (1) The change in interest income or interest expense that is attributable to both changes in average balance and average rate has been allocated to the changes due to (i) average balance and (ii) average rate in proportion to the relationship of the absolute amounts of changes in each.
- (2) Table does not include interest income that would have been earned on nonaccrual loans.

## **Table of Contents**

### ***Provision for loan losses***

We have experienced positive asset quality measures low levels of delinquencies, low levels of nonaccrual loans, and low levels of net charge-offs for an extended period of time. As a result, there was no provision for loan losses for the year ended December 31, 2007. However, due to the current economic climate, increased charge-offs and our ongoing evaluation of credit quality in our loan portfolio, we recorded a provision for loan losses of \$1,150,000 for the year ended December 31, 2008.

Increased provisions for loan losses may be required in the future based on loan growth, the effect changes in economic conditions, such as inflation, unemployment, market interest rate levels, and real estate values may have on the ability of our borrowers to repay their loans, and other negative conditions specific to our borrowers' businesses.

### ***Noninterest income***

Noninterest income was \$5.4 million for 2008 compared with \$8.0 million for 2007.

Service charges on deposit accounts were \$2.8 million for 2008, up 77 percent from \$1.6 million for 2007. The increase in deposit activity fees in 2008 was due primarily to an increase in customers utilizing fee-generating services such as cash management and on-line banking services and a smaller percentage of fees waived.

Earnings on cash surrender value of life insurance were \$424,000 in 2008 compared to \$343,000 for 2007. The increase in earnings reflects a higher average cash surrender value during 2008 as compared to 2007.

Due to decreased demand in the secondary markets, the staffing in our Commercial Mortgage Division was reduced in the first quarter of 2008 and loan sale activity and loan commissions from brokered loans declined in 2008 versus 2007. Commercial and multifamily mortgages originated and sold in 2008 totaled approximately \$19.9 million. Gains from these sales were \$17,000. Commercial and multifamily mortgages originated and sold in 2007 totaled approximately \$76.1 million. Gains from these sales were \$1.7 million. Loan commissions on brokered commercial and multifamily mortgages were \$207,500 in 2008 compared to \$224,000 in 2007. We do not expect the demand in the secondary markets will increase in the near term. Similarly, due to decreased demand in the SBA secondary markets, we reduced the staffing in our SBA department in the first quarter of 2009. SBA loans originated and sold in 2008 and 2007 totaled approximately \$3.8 million and \$2.1 million. Gains from these sales were \$158,000 and \$98,000, respectively. Loan commissions on SBA 504 loans were \$69,500 and \$185,000 for 2008 and 2007. We do not expect the demand in the SBA secondary markets will increase in the near term.

Noninterest income also includes a recognized pre-tax gain of \$2.4 million from the sale of the bank charters of Mercantile and South Bay to United Central Bank and The Independent Bankers Bank, respectively, during the second quarter of 2007.

Other income includes gains from non-hedge derivatives of \$1,042,000 in 2008 versus \$224,000 in 2007. The increase in 2008 is due to the decrease in market rates throughout 2008 which produced gains on our interest rate floor contracts. Our last derivative contract expired in December 2008.

**Table of Contents**

The following table presents a summary of noninterest income:

	<b>For the years ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in thousands)</b>	
Service charges on deposit accounts	\$ 2,756	\$ 1,557
Earnings on cash surrender value of life insurance	424	343
Commissions on brokered loans	277	409
Net gain on sale of loans	175	1,790
Net gain (loss) on sale of securities	(22)	89
Net servicing fees	87	58
Gain on sale of bank charters		2,375
Gain on derivatives	1,042	224
Other income	642	1,202
<b>Total noninterest income</b>	<b>\$ 5,381</b>	<b>\$ 8,047</b>

***Noninterest expense***

Noninterest expense for 2008 was \$35.1 million down 5.2 percent from \$37.0 million for 2007. The decrease in 2008 primarily reflects a decrease in merger and integration-related expenses, as well as a loss on the early termination of debt incurred in 2007. A key measure tracked by us is the efficiency ratio. This ratio measures noninterest expense, excluding amortization of intangibles, to the sum of net interest income and noninterest income. Gains or losses from securities transactions are excluded from noninterest income. The efficiency ratio was 73.45 percent for 2008 compared with 63.18 percent for 2007.

The following table presents a summary of noninterest expense:

	<b>For the years ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in thousands)</b>	
Salaries and employee benefits	\$ 18,526	\$ 17,514
Premises and equipment	4,813	4,040
Data processing	1,313	1,047
Legal, audit, and other professional services	1,962	1,353
Printing, stationary, and supplies	691	490
Telephone	752	532
Directors' fees	434	514
Advertising and marketing	1,324	1,029
Postage	199	159
Amortization of intangibles	1,190	1,029
Integration and conversion expenses		5,443
Loss on early termination of debt		1,564
Other expenses	3,901	2,331
<b>Total noninterest expense</b>	<b>\$ 35,105</b>	<b>\$ 37,045</b>

We launched an integration program shortly after the Mergers which combined our three banks under a single brand First California Bank. We recognized integration and conversion pre-tax charges of \$5.44 million in 2007. These charges primarily include \$2.3 million severance for the former chief executive officer, chief financial officer, and chief credit officer of National Mercantile and \$1.8 million to exit National Mercantile technology. In connection with the integration of the banks, we installed the existing First California Bank



## **Table of Contents**

technology in all Mercantile National Bank and South Bay Bank offices and incurred selective staff reductions. We believe the integration program created operating efficiencies and eliminated redundancies.

In January 2007, we elected to redeem all of the \$15.5 million outstanding 10.25% fixed rate junior subordinated debentures due July 25, 2031. The debentures were redeemable at a price of 107.6875% of the principal amount outstanding plus accrued interest. As a result, we incurred a pre-tax charge of \$1.6 million in the first quarter of 2007 which is reflected in our 2007 non-interest expense.

To redeem the July 2031 debentures, we issued \$16.5 million 6.80% fixed/floating rate junior subordinated debentures due March 15, 2037. For the first five years, the interest rate is fixed. Thereafter, the interest rate resets quarterly to the 3-month LIBOR rate plus 1.60%. These debentures are redeemable at par, in whole or in part, any time on or after March 15, 2012. We expect to save in the initial 5-year period approximately \$500,000 per year in pre-tax interest expense from the early redemption of the former and the issuance of the new debentures.

### ***Income taxes***

The provision for income taxes was \$3.5 million for 2008 compared with \$4.2 million for 2007. The effective tax rate was 35.8 percent for 2008 compared with 37.0 percent for 2007.

The combined federal and state statutory rate for 2008 was 42.05 percent and for 2007 was 41.15 percent. The effective tax rates were less than the combined statutory tax rate primarily as a result of excluding from taxable income interest income on municipal securities and the earnings on the cash surrender value of life insurance.

### **Financial Position December 31, 2008 compared with December 31, 2007**

#### ***Lending and credit risk***

We provide a variety of loan and credit-related products and services to meet the needs of borrowers primarily located in the California counties of Ventura, Los Angeles and Orange. Business loans, represented by commercial real estate loans, commercial loans and construction loans comprise the largest portion of the loan portfolio. Consumer or personal loans, represented by home mortgage, home equity and installment loans, comprise a smaller portion of the loan portfolio.

Credit risk is the risk to earnings or capital arising from an obligor's failure to meet the terms of any contract with us or otherwise to perform as agreed. Credit risk is found in all activities in which success depends on counterparty, issuer, or borrower performance. Credit risk is present any time funds are extended, committed, invested, or otherwise exposed through actual or implied contractual agreements, whether reflected on or off the balance sheet.

All categories of loans present credit risk. Major risk factors applicable to all loan categories include changes in international, national and local economic conditions such as interest rates, inflation, unemployment levels, consumer and business confidence, volatility in the stock market and real estate market and the supply and demand for goods and services.

Commercial real estate loans rely upon the cash flow originating from the underlying real property. Commercial real estate is a cyclical industry that is affected not only by general economic conditions but also by local supply and demand. In the office sector, the demand for office space is highly dependent on employment levels. In the retail sector, the demand for retail space and the levels of retail rents are affected by consumer spending and confidence. The industrial sector has exposure to the level of exports, defense spending and inventory levels. Vacancy rates, location and other factors affect the amount of rental income for commercial property. Tenants may relocate, fail to honor their lease or go out of business. In the multifamily residential

## **Table of Contents**

sector, the demand for apartments is heavily influenced by the affordability of ownership housing, employment conditions and the vacancy of existing inventory. Population growth or decline and changing demographics, such as increases in the level of immigrants or retirees, are also factors influencing the multifamily residential sector.

Commercial loans rely upon the cash flow originating from the underlying business activity of the enterprise. The manufacture, distribution or sale of goods or sale of services are not only affected by general economic conditions but also by the ability of the enterprise's management to adjust to local supply and demand conditions, maintain good labor, vendor and customer relationships, as well as market, price and sell their goods or services for a profit. Customer demand for goods and services of the enterprise may change because of competition or obsolescence.

Construction loans provide developers or owners with funds to build or improve properties that will ultimately be sold or leased. Construction loans are generally considered to involve a higher degree of risk than other loan categories because they rely upon the developer's or owner's ability to complete the project within specified cost and time limits. Cost overruns can cause the project cost to exceed the project sales price or exceed the amount of the committed permanent funding. Construction projects also can be delayed for a number of reasons such as poor weather, material or labor shortages, labor difficulties, or substandard work that must be redone to pass inspection.

Home mortgages and home equity loans and lines of credit are secured by first or second trust deeds on a borrower's real estate property, typically their principal residence. These loans are dependent on a person's ability to regularly pay the principal and interest due on the loan and, secondarily, on the value of real estate property that serves as collateral for the loan. Home mortgages are generally considered to involve a lower degree of risk than other loan categories because of the relationship of the loan amount to the value of the residential real estate and a person's reluctance to forego their principal place of residence. Home real estate values however are not only affected by general economic conditions but also on local supply and demand. Installment loans and credit card lines are also dependent on a person's ability to regularly pay principal and interest on a loan; however, these loans generally are not secured by collateral or, if they are secured, the collateral value can rapidly decline as is the case for automobiles. A person's ability to service debt is highly dependent upon their continued employment or financial stability. Job loss, divorce, illness and bankruptcy are just a few of the risks that may affect a person's ability to service their debt.

Since the risks in each category of loan changes based on a number of factors, it is not possible to state whether a particular type of lending carries with it a greater or lesser degree of risk at any specific time in the economic cycle. In a stabilized economic environment, it is generally considered that home mortgage loans have the least risk, followed by home equity loans, multifamily property loans, commercial property loans, commercial loans and lines and finally construction loans. However, this ordering may vary from time to time and the degree of risk from the credits with the least risk to those with the highest risk profile may expand or contract with the general economy.

We manage credit risk through Board approved policies and procedures. These policies are reviewed and approved at least annually by the Directors. Lending policies provide us with a framework for consistent loan underwriting and a basis for sound credit decisions. Lending policies specify, among other things, the parameters for the type or purpose of the loan, the required debt service coverage and the required collateral requirements. Credit limits are also established and certain loans require approval by the Directors' Loan Committee. The Director's Audit Committee also engages a third party to perform a credit review of the loan portfolio to ensure compliance with policies and assist in the evaluation of the credit risk inherent in the loan portfolio.



**Table of Contents****Loans**

Total loans, excluding loans held for sale, increased 5.7 percent to \$788.4 million at December 31, 2008 from \$746.2 million at December 31, 2007. Loan growth is primarily the result of strong commercial and real estate lending in our immediate market areas.

The following table presents the portfolio of loans:

	2008	For the years ended December 31,			2004
		2007	2006	2005	
			(in thousands)		
Commercial mortgage	\$ 302,016	\$ 295,496	\$ 141,741	\$ 121,641	\$ 135,411
Commercial loans and lines of credit	228,958	189,638	105,574	89,261	98,163
Construction and land development	133,054	148,101	82,954	91,783	50,022
Multifamily mortgage	51,607	34,198	17,602	18,663	18,330
Home mortgage	45,202	46,193	8,206	9,970	9,405
Home equity loans and lines of credit	22,568	22,519	2,493	342	
Installment & credit card	5,016	10,034	7,148	6,898	2,516
<b>Total loans</b>	<b>788,421</b>	<b>746,179</b>	<b>365,718</b>	<b>338,558</b>	<b>313,847</b>
Allowance for loan losses	(8,048)	(7,828)	(4,740)	(4,468)	(3,511)
<b>Loans, net</b>	<b>\$ 780,373</b>	<b>\$ 738,351</b>	<b>\$ 360,978</b>	<b>\$ 334,090</b>	<b>\$ 310,336</b>
<b>Loans held-for-sale</b>	<b>\$ 31,401</b>	<b>\$ 11,454</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>

The loan categories above are derived from bank regulatory reporting standards for loans secured by real estate; however, a portion of the mortgage loans above are loans that we consider to be commercial loans for which we have taken real estate collateral as additional support or from an abundance of caution. In these instances we are not looking to the real property as its primary source of repayment, but rather as a secondary or tertiary source of repayment.

**Table of Contents**

Commercial mortgage loans, the largest segment of our portfolio, were 38 percent of total loans at December 31, 2008, down from 40 percent at December 31, 2007. We had approximately 323 commercial mortgage loans with an average balance of \$938,000. Commercial mortgage loans are collateralized by many different commercial property types. Our top three categories have been office, industrial and retail. In addition, most of our commercial property lending is in Los Angeles, Orange and Ventura counties. The following is a table of our commercial mortgage lending by county.

Commercial mortgage loans by region/county	At December 31, 2008	At December 31, 2007
	(in thousands)	
<b>Southern California</b>		
Los Angeles	\$ 154,669	\$ 151,075
Orange	31,808	27,589
Ventura	87,770	95,397
Riverside	8,549	7,165
San Bernardino	9,834	5,858
Santa Barbara	236	240
San Diego	2,966	3,692
<b>Total Southern California</b>	<b>295,832</b>	<b>291,016</b>
<b>Northern California</b>		
Alameda	342	342
Contra Costa	434	1,262
Fresno	2,512	849
Kern	1,115	1,177
Madera	561	562
Placer	635	
Solano	285	288
Tulare	300	
<b>Total Northern California</b>	<b>6,184</b>	<b>4,480</b>
<b>Total commercial mortgage</b>	<b>\$ 302,016</b>	<b>\$ 295,496</b>

The following table shows the distribution of our commercial mortgage loans by property type at December 31, 2008.

Commercial mortgage loans by property type	At December 31, 2008
	(In thousands)
Industrial/warehouse	\$ 60,171
Office	59,183
Retail	57,799
Medical	15,174
Hotel	14,522
Restaurant	11,636
Assisted living	11,478
Self storage	10,081
Mixed use	9,334
All other	52,638

Total	\$ 302,016
-------	------------

**Table of Contents**

Commercial mortgage loans are underwritten with policy guidelines of a maximum loan-to-value of 70 percent and a minimum debt service coverage ratio of 1.25. These criteria may become more stringent depending on the type of property. At December 31, 2008, the weighted-average loan-to-value was 59 percent and debt service coverage ratio was 1.29 for our commercial mortgage loan portfolio. We focus on cash flow; consequently, regardless the value of the collateral, the commercial real estate project must provide sufficient cash flow, or alternatively the principals must supplement the project with other cash flow, to service the debt. We generally require the principals to guarantee the loan. We also stress-test commercial mortgage loans to determine the potential affect changes in interest rates, vacancy rates, and lease or rent rates would have on the cash flow of the project. Additionally, at least on an annual basis, we require updates on the cash flow of the project and, where practicable, we visit the properties.

Commercial loans represent the next largest category of loans and were 29 percent of total loans at December 31, 2008, up from 25 percent at December 31, 2007. We had approximately 796 commercial loans with an average balance of \$288,000. Commercial loans are made for the purpose of providing working capital, equipment purchases and business expansion. Commercial loans may be unsecured or secured by assets such as equipment, inventory, accounts receivables, and real property. Personal guarantees of the business owner may also be present. Additionally, these loans may also have partial guarantees from the U.S. Small Business Administration ( SBA ) or other federal or state agencies. The commercial loan portfolio is made up of broadly diversified business sectors with the largest sectors in real estate/construction, finance and insurance, healthcare, manufacturing and professional services. Below is a table of our commercial loans by business sector.

Commercial loans by industry/sector	At	At
	December 31, 2008	December 31, 2007
	(in thousands)	
Services	\$ 56,298	\$ 38,748
Information	55,510	43,440
Real Estate	54,200	46,450
Trade	24,865	22,295
Healthcare	13,731	13,087
Manufacturing	10,620	16,644
Transportation and Warehouse	8,796	8,974
Other	4,938	
<b>Total commercial loans</b>	<b>\$ 228,958</b>	<b>\$ 189,638</b>

Commercial loans are underwritten with maturities not to exceed seven years and we generally require the loan to be fully amortized within the term of the loan. Traditional working capital lines are underwritten for a 12 month period and have a 30-day out-of-debt requirement. Accounts receivable and inventory financing revolving lines of credit have an annual maturity date, a maximum advance rate, and an annual field audit for lines of \$200,000 or more. Field audits are performed by third-party vendors. The maximum advance rate for accounts receivable is 75 percent and the maximum advance rate for eligible inventory is 25 percent.

**Table of Contents**

Construction loans were 17 percent of total loans at December 31, 2008 and 20 percent at December 31, 2007. At December 31, 2008 we had approximately 49 projects with an average commitment of \$3,442,000. Construction loans represent single-family, multi-family and commercial building projects as well as land development loans. At December 31, 2008, 23 percent of these loans, or \$30.5 million, represent single-family residential construction projects, 29 percent were multi-family residential construction projects, 35 percent were commercial projects and 13 percent were land development projects. Construction loans are typically short term, with maturities ranging from 12 to 18 months. For commercial projects, we have a maximum loan-to-value requirement of 70 percent of the Federal Institutions Reform Recovery and Enforcement Act ( FIRREA ) conforming appraised value. For residential projects, the maximum loan-to-value ranges from 80 percent on loans under \$500,000 to 70 percent on loans of \$1,000,000 or more. We require the borrower to provide in cash at least 20 percent of the cost of the project. At the borrower's expense, we use a third party vendor for funds control, lien releases and inspections. In addition, we regularly monitor the marketplace and the economy for evidence of deterioration in real estate values. Below is a table of our construction loans by county.

Construction loans by county	At December 31, 2008		At December 31, 2007	
	Commitment	Outstanding	Commitment	Outstanding
	(in thousands)			
Los Angeles	\$ 91,254	\$ 66,390	\$ 109,780	\$ 78,142
Orange	8,550	3,650	8,042	3,103
Ventura	56,101	50,290	53,055	37,152
Monterey			4,690	4,191
Riverside	2,984	2,958	6,873	5,227
San Bernardino	414	417	4,624	567
San Diego	736	738	752	736
Santa Barbara	8,611	8,611	21,055	18,983
<b>Total construction</b>	<b>\$ 168,650</b>	<b>\$ 133,054</b>	<b>\$ 208,871</b>	<b>\$ 148,101</b>

We are mindful of the recent developments in our marketplace and have supplemented our regular monitoring practices by updating project appraisals, re-evaluating estimated project marketing time and re-evaluating the sufficiency of the original loan commitment to absorb interest charges (i.e., interest reserves). We are also re-evaluating the project sponsor, where applicable, to successfully complete other projects funded by other institutions. In circumstances where the interest reserve was not sufficient the project sponsor has made payments to us from their general resources or the project sponsor placed with us the proceeds from a portion of the project sale. In addition, where supported by a current appraisal, loan-to-value requirements, and the ability of the project sponsor, we increased the project commitment. While we believe that our monitoring practices are adequate we cannot assure you that there will not be further delinquencies, lengthened project marketing time or declines in real estate values.

**Table of Contents**

Multifamily residential mortgage loans were 7 percent of total loans at December 31, 2008 up from 5 percent at December 31, 2007. We had approximately 68 multifamily loans with an average balance of \$755,000. Multifamily mortgage loans are collateralized by apartments mostly located in our tri-county market area. Multifamily mortgage loans are underwritten in a fashion similar to commercial mortgage loans described above. Below is a table of our multifamily mortgage loans by county.

Multi-family mortgage loans by region/county	At	At
	December 31, 2008	December 31, 2007
	(in thousands)	
<b>Southern California</b>		
Los Angeles	\$ 15,574	\$ 12,028
Orange	17,774	11,806
Ventura	3,842	3,295
Riverside		880
San Bernardino	3,925	2,861
San Diego	3,016	565
Total	44,131	31,435
<b>Northern California</b>		
Alameda	806	
Calaveras	1,387	1,409
Fresno	256	261
Mendocino		403
Merced	681	690
Monterey	388	
Mono	235	
San Francisco	1,363	
San Luis Obispo	504	
Santa Clara	711	
Santa Cruz	1,145	
Total	7,476	2,763
Total multifamily mortgage	\$ 51,607	\$ 34,198

The table below illustrates the distribution of our loan portfolio by loan size at December 31, 2008. All loans are distributed by loan balance outstanding except construction loans are distributed by loan commitment. At year-end 2008, nearly one-third of our loans were less than \$1 million; three-quarters of our loans were less than \$5 million. We believe the high number of smaller-balance loans aids in the mitigation of credit risk; however, a prolonged and deep recession can affect a greater number of borrowers.

Loan distribution by size	December 31, 2008					
	Less than \$500,000	\$500,000 to \$999,999	\$1,000,000 to \$2,999,999	\$3,000,000 to \$4,999,999	\$5,000,000 to \$9,999,999	\$10,000,000 to \$22,000,000
Commercial mortgage	12%	14%	36%	14%	15%	9%
Commercial loans and lines of credit	25%	10%	29%	16%	10%	10%
Construction and land development	2%	5%	13%	21%	41%	18%
Multifamily mortgage	15%	34%	39%	0%	12%	0%
Home mortgage	34%	30%	22%	0%	14%	0%
Home equity loans and lines of credit	44%	17%	39%	0%	0%	0%
Installment & credit card	85%	15%	0%	0%	0%	0%

Edgar Filing: First California Financial Group, Inc. - Form 10-K

Totals	17%	14%	30%	14%	17%	8%
		44				

**Table of Contents**

The following table presents the scheduled maturities of fixed and adjustable rate loans:

	December 31, 2008			Total
	One year or less	After one year to five years (in thousands)	After five years	
<b>Fixed rate loans</b>				
Commercial mortgage	\$ 28,173	\$ 60,913	\$ 35,881	\$ 124,967
Multifamily mortgage	713	2,012	11,533	14,258
Commercial loans and lines	54,640	35,365	6,591	96,596
Construction	6,902			6,902
Home mortgage	4,434	8,803	10,713	23,950
Home equity loans	1,612	3,762	1,153	6,527
Installment & credit card	619	841	52	1,512
<b>Total fixed rate loan maturities</b>	<b>97,093</b>	<b>111,696</b>	<b>65,923</b>	<b>274,712</b>
<b>Adjustable rate loans</b>				
Commercial mortgage	28,705	43,961	103,887	176,553
Multifamily mortgage	1,617	2,432	33,799	37,848
Commercial loans and lines	86,575	31,390	14,421	132,386
Construction	104,003	22,149		126,152
Home equity loans	4,449	2,696	8,870	16,015
Home mortgage	591	152	20,509	21,252
Installment & credit card	2,438	4	1,061	3,503
<b>Total adjustable rate loan maturities</b>	<b>228,378</b>	<b>102,784</b>	<b>182,547</b>	<b>513,709</b>
<b>Total maturities</b>	<b>\$ 325,471</b>	<b>\$ 214,480</b>	<b>\$ 248,470</b>	<b>\$ 788,421</b>

**Allowance for Loan Losses**

We maintain an allowance for loan losses to provide for inherent losses in the loan portfolio. Additions to the allowance are established through a provision charged to expense. All loans which are judged to be uncollectible are charged against the allowance while any recoveries are credited to the allowance. It is our policy to charge-off any known losses at the time of determination. Any unsecured loan more than 90 days delinquent in payment of principal or interest and not in the process of collection is charged-off in total. Secured loans are evaluated on a case by case basis to determine the ultimate loss potential to us subsequent to the liquidation of collateral. In those cases where we are inadequately protected, a charge off will be made to reduce the loan balance to a level equal to the liquidation value of the collateral.

Our loan policy provides procedures designed to evaluate and assess the risk factors associated with our loan portfolio, to enable us to assess such risk factors prior to granting new loans and to evaluate the sufficiency of the allowance for loan losses. We conduct an assessment of the allowance on a monthly basis and undertake a more critical evaluation quarterly. At the time of the monthly review, the Board of Directors will examine and formally approve the adequacy of the allowance. The quarterly evaluation includes an assessment of the following factors: any external loan review and any regulatory examination, estimated probable loss exposure on each pool of loans, concentrations of credit, value of collateral, the level of delinquency and non-accruals, trends in the portfolio volume, effects of any changes in the lending policies and procedures, changes in lending personnel, present economic conditions at the local, state and national level, the amount of undisbursed off-balance sheet commitments, and a migration analysis of historical losses and recoveries for the prior eight quarters.



**Table of Contents**

Our evaluation of the adequacy of the allowance for loan losses includes a review of individual loans to identify specific probable losses and also assigns estimated loss factors to specific groups or types of loans to calculate possible losses. A component of our allowance for loan losses represents an estimate for the amount of accrued and unpaid interest which may be uncollectible on loans which are placed into non-accrual status. The allocated allowance is a result of these quantitative considerations. Our evaluation also considers subjective factors such as changes in local and regional economic and business conditions, financial improvement or deterioration in business sectors and industries, changes in lending practices, changes in personnel, changes in the volume and level of past due and nonaccrual loans and concentrations of credit. The unallocated allowance is a result of these qualitative considerations.

Third-party reviews of our loan portfolio, stress tests, concentration monitoring, risk-grading of individual loans and the classification of our loans into pass, special mention, substandard, doubtful and loss categories are all techniques we utilize to identify potential problem loans and determine the adequacy of our allowance for loan losses.

In 2007, we considered, among other things, the increase in loans outstanding as a result of the recent Mergers, our positive asset quality measures, our experience in originating, underwriting and servicing real estate loans in a larger three county area over the past year, the depth and competency of our personnel, and the economic outlook and uncertainties of the real estate market, particularly in California, which in the second half of 2007, began to experience rapid and significant deterioration. As a result of our positive asset quality measures and controls, there was no provision in 2007.

During 2008, we have experienced higher levels of nonaccrual loans and loans past due 90 days or more and still accruing. Nonaccrual loans increased 48% to \$8.5 million at December 31, 2008 from \$5.7 million at December 31, 2007. Further, we have also experienced higher levels of charged-off loans. Net loan charge-offs increased to \$930,000 in 2008 compared to \$466,000 in 2007, an increase of 100%. While these amounts have increased from prior years, we believe these are consistent with, if not more favorable, than industry trends. Based upon the foregoing, we recorded a provision for loan losses of \$1,150,000 for the twelve months ended December 31, 2008.

The ratio of the allowance for loan losses to loans was 1.02 percent at December 31, 2008 compared with 1.05 percent at December 31, 2007. Even though the amount of nonaccrual loans has increased in 2008, most of these loans are real estate secured and the fair value of the underlying collateral, less estimated costs to sell, is greater than the loan balances and has not caused a large increase to the allowance for loan losses. While we believe that our allowance for credit losses was adequate at December 31, 2008 and December 31, 2007, the determination of the allowance is a highly judgmental process and we cannot assure you that we will not further increase or decrease the allowance or that bank regulators will not require us to increase or decrease the allowance in the future.

The following table presents activity in the allowance for loan losses:

	For the years ended December 31,				
	2008	2007	2006	2005	2004
	(in thousands)				
Beginning balance	\$ 7,828	\$ 4,740	\$ 4,468	\$ 3,511	\$ 3,635
Balance acquired in purchase		3,554			
Provision (credit) for loan losses	1,150		248	(84)	220
Loans charged-off	(1,075)	(567)	(55)	(10)	(57)
Transfer to undisbursed commitment			62	(165)	(417)
Recoveries on loans charged-off	145	101	17	1,216	130
Ending balance	\$ 8,048	\$ 7,828	\$ 4,740	\$ 4,468	\$ 3,511
Allowance to loans	1.02%	1.05%	1.30%	1.32%	1.25%

**Table of Contents**

The reserve for unfunded commitments was \$102,000 at December 31, 2008 compared with \$99,000 at December 31, 2007. There have been no charges to the reserve since its inception. The reserve for unfunded commitments is included among other liabilities on the balance sheet.

The following table presents the allocation of the allowance for loan losses to each loan category and the percentage relationship of loans in each category to total loans:

	For the years ended December 31,									
	2008		2007		2006		2005		2004	
	Allocation of the allowance by loan category	Percent of Loans in Category to Total Loans	Allocation of the allowance by loan category	Percent of Loans in Category to Total Loans	Allocation of the allowance by loan category	Percent of Loans in Category to Total Loans	Allocation of the allowance by loan category	Percent of Loans in Category to Total Loans	Allocation of the allowance by loan category	Percent of Loans in Category to Total Loans
	(in thousands)									
Commercial mortgage	\$ 2,309	38%	\$ 2,788	40%	\$ 1,545	39%	\$ 1,600	36%	\$ 1,516	43%
Multifamily mortgage	389	7%	157	5%	265	5%	247	6%	204	6%
Commercial loans	2,328	29%	1,903	25%	1,384	29%	1,177	26%	1,097	31%
Construction loans	1,986	17%	1,766	20%	1,252	23%	1,211	27%	561	16%
Home equity loans	172	3%	65	3%		1%		%		%
Home mortgage	334	6%	450	6%	132	2%	138	3%	105	3%
Installment and credit card	40	%	349	1%	162	1%	95	2%	28	1%
Subtotal	7,558		7,478		4,740		4,468		3,511	
Unallocated	490	%	350	%		%		%		%
Total	\$ 8,048	100%	\$ 7,828	100%	\$ 4,740	100%	\$ 4,468	100%	\$ 3,511	100%

The allocation presented above should not be interpreted as an indication that charges to the allowance will be incurred in these amounts or proportions. The amounts attributed to each loan category are based on the analysis described above.

The following table presents past due and nonaccrual loans. We had no restructured loans for the periods presented.

	For the years ended December 31,				
	2008	2007	2006	2005	2004
	(in thousands)				
Accruing loans past due 30 to 89 days	\$ 2,644	\$ 4,746	\$	\$	\$ 106
Accruing loans past due 90 days or more	\$ 429	\$ 2,848	\$	\$	\$ 1,804
Nonaccrual loans	\$ 8,475	\$ 5,720	\$	\$ 319	\$ 18
Ratios:					
Accruing loans past due 90 days or more to average loans	0.05%	0.42%			0.64%
Nonaccrual loans to average loans	1.08%	0.84%		0.10%	0.01%
Interest foregone on nonaccrual loans:					
Foregone interest	\$ 543	\$ 339	\$ 28	\$ 11	\$ 12

At December 31, 2008 the largest nonaccrual loan is a \$5.7 million matured land loan which is in the process of foreclosure. The other six nonaccrual loans are all under \$1 million individually and consist of four single family residential mortgage loans, one land loan and one SBA loan.

**Investing, funding and liquidity risk**

Liquidity risk is the risk to earnings or capital arising from the inability to meet obligations when they come due without incurring unacceptable losses. Liquidity risk includes the inability to manage unplanned decreases or changes in funding sources as well as the failure to recognize or address changes in market conditions that affect the ability to liquidate assets quickly and with minimal loss in value.



## **Table of Contents**

We manage bank liquidity risk through Board approved policies and procedures. These policies are reviewed and approved at least annually by the Directors. Liquidity risk policies provide us with a framework for consistent evaluation of risk and establish risk tolerance parameters. Management's Asset and Liability Committee meets regularly to evaluate liquidity risk, review and establish deposit interest rates, review loan and deposit in-flows and out-flows and reports quarterly to the Directors' Balance Sheet Management Committee on compliance with policies. The Directors' Audit Committee also engages a third party to perform a review of management's asset and liability practices to ensure compliance with policies.

We enjoy a large base of core deposits (representing checking, savings and small balance certificates of deposit). At December 31, 2008, core deposits totaled \$602.1 million. At December 31, 2007 core deposits totaled \$556.3 million. Core deposits represent a significant low-cost source of funds that support our lending activities and represent a key part of our funding strategy. We seek and stress the importance of both loan and deposit relationships with customers in our business plans.

Alternative funding sources include large balance certificates of deposits, federal funds purchased from other institutions, securities sold under agreements to repurchase and borrowings. Total alternative funds used at December 31, 2008 and December 31, 2007 were \$382.5 million and \$373.7 million, respectively.

In addition, we have lines of credit with other financial institutions providing for federal funds facilities up to a maximum of \$31.0 million. The lines of credit support short-term liquidity needs and cannot be used for more than 30 consecutive days. These lines are unsecured, have no formal maturity date and can be revoked at any time by the granting institutions. There were no borrowings under these lines of credit at December 31, 2008 and 2007. We also have a \$10.2 million secured borrowing facility with the Federal Reserve Bank of San Francisco which had no balance outstanding at December 31, 2008. In addition, we had approximately \$55.0 million of available borrowing capacity on the bank's secured FHLB borrowing facility at December 31, 2008.

The primary sources of liquidity for the Company, on a stand-alone basis, include the dividends from our bank subsidiary and, historically, our ability to issue equity and debt instruments. The ability of the Company to obtain funds for its cash requirements, including payments on the junior subordinated debentures underlying our outstanding trust preferred securities and dividends on our series B preferred stock, is largely dependent upon the Bank's earnings. First California Bank is subject to restrictions under certain federal and state laws and regulations which limit its ability to transfer funds to the Company through intercompany loans, advances or cash dividends. Dividends paid by California state banks, such as First California Bank, are regulated by the DFI under its general supervisory authority as it relates to a bank's capital requirements. A California state bank may declare a dividend without the approval of the DFI as long as the total dividends declared in a calendar year do not exceed either the retained earnings or the total of net profits for three previous fiscal years less any dividends paid during such period. During the twelve months ended December 31, 2008, we received \$3.0 million in dividends from our bank subsidiary. The amount of dividends available for payment by our remaining bank subsidiary to the holding company at January 1, 2009 was \$14.9 million without prior approval from bank regulators. The Company has \$36.7 million in cash on deposit with its bank subsidiary.

## ***Securities***

Securities are classified as available-for-sale for accounting purposes and, as such, are recorded at their fair, or market, values in the balance sheet. Fair values are based on quoted market prices. Changes in the fair value of securities (that is, unrealized holding gains or losses) are reported as other comprehensive income, net of tax and carried as accumulated comprehensive income or loss within shareholders' equity until realized.

**Table of Contents**

The following table presents securities, at amortized cost, by maturity distribution and weighted average yield (tax equivalent):

	For the year ended December 31, 2008				Total
	One year or less	After one year to five years	After five years to ten years (in thousands)	Over ten years	
<b>Maturity distribution</b>					
U.S. government agency notes	\$ 2,000	\$	\$	\$	\$ 2,000
U.S. government agency mortgage-backed securities		61,076	53,352	14,632	129,060
Collateralized mortgage obligations		29,667	9,510	23,941	63,118
Municipal securities	296	2,547	9,793	4,691	17,327
Other domestic debt securities				4,941	4,941
<b>Total</b>	<b>\$ 2,296</b>	<b>\$ 93,290</b>	<b>\$ 72,655</b>	<b>\$ 48,205</b>	<b>\$ 216,446</b>
<b>Weighted average yield</b>					
U.S. government agency notes	5.00%				5.00%
U.S. government agency mortgage-backed securities		5.09%	5.31%	5.34%	5.21%
Collateralized mortgage obligations		5.42%	5.33%	5.76%	5.53%
Municipal securities	7.24%	5.49%	5.65%	5.96%	5.74%
Other domestic debt securities				3.76%	3.76%
<b>Total</b>	<b>5.29%</b>	<b>5.21%</b>	<b>5.36%</b>	<b>5.45%</b>	<b>5.31%</b>

Securities, at amortized cost, decreased by \$14.2 million, or 6 percent, from \$230.7 million at December 31, 2007 to \$216.4 million at December 31, 2008 primarily through principal paydowns, maturities and called securities.

Net unrealized holding gains or (losses) at December 31, 2008 and 2007 were (\$13,984,000) and \$444,000, respectively. As a percentage of securities, at amortized cost, unrealized holding gains or (losses) were (6.46) percent and 0.19 percent at the end of each respective period. Securities are comprised largely of U.S. Government Agency obligations, mortgage-backed securities and California municipal general obligation bonds. We perform regular analyses on the investment securities available-for-sale portfolio to determine if any securities are other-than-temporarily impaired. If it is probable that we will be unable to collect all amounts due according to the contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment is considered to have occurred. When an other-than-temporary impairment occurs, the cost basis of the security is written down to its fair value (as the new cost basis) and the write down is accounted for as a realized loss. Other-than-temporary declines in fair value are assessed based on the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, the long-term financial outlook of the issuer and our ability and intent on holding the securities until the fair values recover.

The majority of unrealized losses in the available-for-sale securities portfolio at December 31, 2008 is related to a type of mortgage-backed security also known as collateralized mortgage obligations ( CMO s ). As of December 31, 2008, the fair value of these securities totaled \$47.9 million, representing 24 percent of our securities portfolio. The \$47.9 million is comprised of \$9.2 million of agency CMO s and \$38.7 million of private label CMO s. Gross unrealized losses related to these securities amounted to \$15.5 million, or 25 percent of the aggregate amortized cost basis of these securities as of December 31, 2008. These unrealized losses are caused by a severe disruption in the market for these securities and historically wide market spreads resulting

**Table of Contents**

from instability in the residential real estate and credit markets. All of these securities had credit rating agency grades of triple-A upon purchase and various rating agencies have reaffirmed these securities' investment grade status at December 31, 2008, except one. With the exception of one security, described below, the issuers of these securities have not, to our knowledge, established any cause for default on these securities and the performance of the underlying collateral is within expected parameters. One CMO with an amortized cost basis of \$8.3 million has an unrealized loss of \$3.5 million as of December 31, 2008. This security is rated triple-C by one rating agency as of December 31, 2008. The current delinquency and default rates of the collateral for this security are above original expectations at the time of purchase. We performed a discounted cash flow analysis using the historical prepayment speed of this security, the cumulative default rate over the last 12 months and the loss severity rate over the last 12 months to determine if there was other-than-temporary impairment of this security as of December 31, 2008. This discounted cash flow analysis resulted in no shortfall of contractual cash flows to the tranche of this security owned by us. As we have the ability and intention to hold this security for a sufficient amount of time, during which the fair value may recover to cost or the security matures, we do not deem this security to be other-than-temporarily impaired at December 31, 2008.

We also own one pooled trust preferred security with an amortized cost basis of \$5.0 million and an unrealized loss of \$2.0 million at December 31, 2008. This unrealized loss is primarily caused by a severe disruption in the market for these securities and no active market for this type of security. The security has an investment rating of triple-A by various rating agencies and is supported by a significant collateral margin at December 31, 2008. There is very little default experience within this security and there is no evidence of a shortage of contractual cash flows to the tranche of the security owned by us. As we have the ability and intention to hold this security for a sufficient amount of time, during which the fair value may recover to cost or the security matures, we do not deem this security to be other-than-temporarily impaired at December 31, 2008.

The remainder of our securities portfolio consists mainly of agency mortgage-backed securities and various municipal securities. A few of these securities have been in a continuous unrealized loss position for twelve months or longer as of December 31, 2008. All of these securities had credit rating agency grades of triple-A upon purchase and various rating agencies have reaffirmed these securities' long-term investment grade status of triple-B or better at December 31, 2008. The unrealized losses for these securities are not material as the largest individual unrealized loss is \$25,900 and the aggregate gross unrealized losses for these securities total \$169,000. The issuers of these securities have not, to our knowledge, established any cause for default on these securities. These securities have fluctuated in value since their purchase date as market interest rates have fluctuated. However, we have the ability and the intention to hold these securities for a sufficient amount of time, during which their fair values may recover to cost or the securities may mature. As such, we do not deem these securities to be other-than-temporarily impaired at December 31, 2008.

We will continue to evaluate our securities portfolio for other-than-temporary impairment at each reporting date and we can provide no assurance that there will not be an other-than-temporary impairment in future periods.

**Table of Contents****Deposits**

The following tables present the average balance and the average rate paid on each deposit category for the periods indicated:

	For the years ended December 31,					
	2008		2007		2006	
	Balance	Rate	Balance (in thousands)	Rate	Balance	Rate
<b>Core deposits</b>						
Noninterest bearing demand deposits	\$ 190,939		\$ 193,630		\$ 114,701	
Interest checking	47,526	0.45%	39,186	0.84%	30,737	0.72%
Savings accounts	204,351	1.77%	223,508	3.21%	124,319	2.77%
Time deposits less than \$100,000	106,851	3.38%	82,796	4.51%	23,708	3.53%
<b>Total core deposits</b>	<b>549,667</b>	<b>1.36%</b>	<b>539,120</b>	<b>2.09%</b>	<b>293,465</b>	<b>1.53%</b>
<b>Noncore deposits</b>						
Time deposits of \$100,000 or more	209,483	2.84%	165,319	4.28%	83,993	4.29%
<b>Total core and noncore deposits</b>	<b>\$ 759,150</b>		<b>\$ 704,439</b>		<b>\$ 377,458</b>	

Large balance certificates of deposits (that is, balances of \$100,000 or more) totaled \$215.5 million at December 31, 2008. Large balance certificates of deposits were \$204.8 million at December 31, 2007. A portion of these large balance time deposits represent time deposits placed by the State Treasurer of California with the Bank. The time deposit program is one element of a pooled investment account managed by the State Treasurer for the benefit of the State of California and all participating local agencies. The pooled investment account has approximately \$63 billion of investments of which approximately \$8 billion represented time deposits placed at various financial institutions. At December 31, 2008, State of California time deposits placed with us, with original maturities of three and six months, were \$110.0 million. We believe that the State Treasurer will continue this program; we also believe that we have the ability to establish large balance certificates of deposit rates that will enable us to attract, replace, or retain those deposits accepted in our local market area if it becomes necessary under a modified funding strategy. The remainder represents time deposits accepted from customers in our market area.

We use brokered CDs, which are classified as time certificates of deposits less than \$100,000, to supplement our liquidity and achieve other asset liability management objectives (see the discussion under Net Interest Income). Brokered deposits are wholesale certificates of deposit placed by rate sensitive customers that do not have any other significant relationship with us. Professionals operating under established investment criteria manage most wholesale funds and the brokered deposits are typically in amounts that are within the FDIC deposit insurance limit. As a result, these funds are generally very sensitive to credit risk and interest rates, and pose greater liquidity risk to a bank. They may refuse to renew the certificates of deposit at maturity if higher rates are available elsewhere or if they perceive that creditworthiness is deteriorating. At December 31, 2008 we had total brokered deposits of \$98.2 million of which \$79.0 million had maturities within 12 months.

**Table of Contents**

The following table presents the maturity of large balance certificates of deposits for the periods indicated:

	2008		For the Years Ending December 31, 2007		2006	
	Amount	Percentage	Amount (in thousands)	Percentage	Amount	Percentage
Three months or less	\$ 149,810	63%	\$ 129,528	63%	\$ 46,819	59%
Over three months through six months	20,912	12%	24,879	12%	5,122	6%
Over six months through one year	25,807	21%	42,474	21%	23,218	29%
Over one year	18,984	4%	7,876	4%	4,921	6%
<b>Total</b>	<b>\$ 215,513</b>	<b>100%</b>	<b>\$ 204,757</b>	<b>100%</b>	<b>\$ 80,080</b>	<b>100%</b>

**Borrowings**

Borrowings are comprised of federal funds purchased from other financial institutions, FHLB advances and securities sold under agreements to repurchase. At December 31, 2008, we had \$167.0 million of borrowings outstanding, of which \$45.0 million was comprised of securities sold under agreements to repurchase and \$122.0 million of FHLB advances. For our FHLB advances, the following table presents the amounts and weighted average interest rates outstanding.

	Year Ended December 31, 2008		Year Ended December 31, 2007	
	Federal Home Loan Bank Advances	Weighted average interest rate (in thousands)	Federal Home Loan Bank Advances	Weighted average interest rate
Amount outstanding at end of period	\$ 122,000	3.88%	\$ 123,901	4.19%
Maximum amount outstanding at any month-end during the period	\$ 196,463	3.29%	\$ 123,901	4.19%
Average amount outstanding during the period	\$ 148,748	3.75%	\$ 61,704	4.87%

The following table presents the maturities of FHLB advances at December 31, 2008.

	Amount	Maturity Year (in thousands)	Weighted Average Interest Rate
Term advances	\$ 28,500	2009	3.72%
Term advances	40,000	2010	3.82%
Term advances	11,000	2011	3.42%
Term advances	17,500	2012	4.12%
Term advances	17,500	2014	4.24%
Term advances	7,500	2017	4.07%
	<b>\$ 122,000</b>		



**Table of Contents**

The following table presents the maturities of securities sold under agreements to repurchase at December 31, 2008.

<b>Amount</b>	<b>Maturity Year (in thousands)</b>	<b>Weighted Average Interest Rate</b>
\$ 15,000	2011	3.64%
20,000	2013	3.60%
10,000	2014	3.72%

\$ 45,000

***Junior Subordinated Debentures***

At December 31, 2008, we had an aggregate of \$26.8 million of junior subordinated debentures outstanding. The terms of these junior subordinated debentures are discussed in Note #9 to our audited financial statements included in Item 8. Financial Statements and Supplementary Data of this Report.

As of December 31, 2008, the weighted average interest rate being paid on our junior subordinated debentures was 6.55%. At December 31, 2008, our annual interest payments with respect to our outstanding junior subordinated debentures amounted to \$1.8 million in the aggregate, based on the applicable interest rate during the year.

***Capital resources***

We have 1,000 issued shares of preferred stock series A, \$0.01 par value, with a liquidation preference of \$1,000 per share. Redemption of the preferred stock series A is at the Company's option subject to certain restrictions imposed by our preferred stock series B. The redemption amount is computed at the per share liquidation preference plus unpaid dividends at a rate of 8.5%. Each holder of preferred stock series A has the right, exercisable at the option of the holder, to convert all or some of such holder's series A shares into common stock. The number of shares of common stock to be issued upon conversion of each share of preferred stock series A shall be determined by dividing the sum of each share's liquidation preference plus unpaid dividend by the conversion factor of 5.63 per share. As of December 31, 2008, the number of common shares which would be issued upon conversion of the preferred stock series A is 280,450.

On December 19, 2008, we participated in the U.S. Treasury Capital Purchase Program, under which we received \$25 million in exchange for issuing 25,000 preferred stock series B shares and a warrant to purchase common stock to the Treasury. As a participant in CPP, we are subject to various restrictions and requirements, such as restrictions on our stock repurchases and payment of dividends, and other requirements relating to our executive compensation and corporate governance practices. Moreover, under legislation such as the ARRA, we may early redeem the shares issued to the Treasury under the CPP without any early penalty or requirement to raise new capital, as previously required under the original terms of the CPP. The preferred stock series B qualifies as Tier 1 capital, and holders are entitled to receive cumulative cash dividends at a rate of 5 percent per year for the first five years and 9 percent per year thereafter, on a liquidation preference of \$1,000 per share. Dividends are payable quarterly in arrears on each of February 15, May 15, August 15, and November 15, if, as and when declared by our Board of Directors, out of assets legally available for payment. The common stock warrant entitles the Treasury to purchase 599,042 shares of our common stock at an initial exercise price of \$6.26 for a term of ten years. We recorded the total \$25 million of the preferred stock series B and the warrant at their relative fair values of \$22.7 million and \$2.3 million, respectively. The difference from the par amount of the preferred shares is accreted to preferred stock over five years using the interest method.

The Company is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on a

**Table of Contents**

company's financial statements. Under capital adequacy guidelines, bank holding companies must meet specific capital guidelines that involve quantitative measures of the company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2008, that the Company meets all capital adequacy requirements to which it is subject.

The following tables present the capital amounts and ratios of the Company with a comparison to the minimum ratios for the periods indicated:

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
(in thousands)				
December 31, 2008				
Total capital (to risk weighted assets)	\$ 147,680	16.62%	\$ 71,102	≥ 8.00%
Tier I capital (to risk weighted assets)	\$ 139,530	15.70%	\$ 35,551	≥ 4.00%
Tier I capital (to average assets)	\$ 139,530	12.77%	\$ 43,699	≥ 4.00%

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
(in thousands)				
December 31, 2007				
Total capital (to risk weighted assets)	\$ 115,387	13.35%	\$ 69,167	≥ 8.00%
Tier I capital (to risk weighted assets)	\$ 107,460	12.43%	\$ 34,583	≥ 4.00%
Tier I capital (to average assets)	\$ 107,460	10.42%	\$ 41,248	≥ 4.00%

The Bank is also subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on a company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks 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. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2007, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum Total risk-

**Table of Contents**

based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the table below. There are no conditions or events since December 31, 2008 that management believes may have changed the Bank's category.

The following tables present the capital amounts and ratios of the Bank with a comparison to the minimum ratios for the periods indicated:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount (in thousands)	Ratio	Amount	Ratio
December 31, 2008						
Total capital (to risk weighted assets)	\$ 109,022	12.27%	\$ 71,110	≥ 8.00%	\$ 88,888	≥ 10.00%
Tier I capital (to risk weighted assets)	\$ 100,873	11.35%	\$ 35,555	≥ 4.00%	\$ 53,333	≥ 6.00%
Tier I capital (to average assets)	\$ 100,873	9.26%	\$ 43,568	≥ 4.00%	\$ 54,460	≥ 5.00%

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount (in thousands)	Ratio	Amount	Ratio
December 31, 2007						
Total capital (to risk weighted assets)	\$ 102,826	11.98%	\$ 68,687	≥ 8.00%	\$ 85,858	≥ 10.00%
Tier I capital (to risk weighted assets)	\$ 94,899	11.05%	\$ 34,343	≥ 4.00%	\$ 51,515	≥ 6.00%
Tier I capital (to average assets)	\$ 94,899	9.24%	\$ 41,065	≥ 4.00%	\$ 51,332	≥ 5.00%

We recognize that a strong capital position is vital to growth, continued profitability, and depositor and investor confidence. Our policy is to maintain sufficient capital at not less than the well-capitalized thresholds established by banking regulators.

We announced on November 7, 2007 that our board of directors authorized a repurchase of up to \$5 million of the Company's common stock until November 2008. Effective August 31, 2008, the board of directors terminated the stock repurchase program due to current market conditions. The Company repurchased 344,660 shares for \$3,040,000 while the repurchase program was active.

**Table of Contents****Commitments, contingent liabilities, contractual obligations and off-balance sheet arrangements**

In the normal course of business, we make commitments to extend credit or issue letters of credit to customers. We generally do not recognize these commitments in our balance sheet. These commitments do involve, to varying degrees, elements of credit risk; however, we use the same credit policies and procedures as we do for on-balance sheet credit facilities. Commitments to extend credit were \$153.1 million at December 31, 2008 compared with \$198.7 million at December 31, 2007. Commercial and stand-by letters of credit were \$0.4 million and \$2.5 million at December 31, 2008 and December 31, 2007, respectively. The known contractual obligations of the Company at December 31, 2008 are as follows:

	Twelve months and less	After one year but within three years	Payments Due After three years but within five years	After five years	Total
(Dollars in thousands)					
FHLB term advances	\$ 28,500	\$ 51,000	\$ 35,000	\$ 7,500	\$ 122,000
Securities sold under agreements to repurchase		15,000	20,000	10,000	45,000
Salary continuation benefits				384	384
Deferred compensation benefits	206	412	244		842
Severance benefits	265	530	177		972
Junior subordinated debentures				26,701	26,701
Operating lease obligations	1,728	3,244	3,113	6,742	14,827
Total	\$ 30,699	\$ 70,186	\$ 58,393	\$ 51,448	\$ 210,726

We have entered into deferred compensation agreements with several of our key employees. We suspended participation and contributions to these agreements in 2007. Under the agreements, benefits are to be paid in a lump sum or equal monthly installments for a period up to five years upon the employee's termination with the Company or within 30 days of the employee's death.

**Interest rate risk**

Interest rate risk is the risk to earnings or capital arising from movements in interest rates. Interest rate risk arises from differences between the timing of rate changes and the timing of cash flows (re-pricing risk), from changing the rate relationships among different yield curves affecting bank activities (basis risk), from changing rate relationships across the spectrum of maturities (yield curve risk), and from interest-related options embedded in loans and products (options risk).

We manage interest rate risk through Board approved policies and procedures. These policies are reviewed and approved at least annually by the Directors. Interest rate risk policies provide management with a framework for consistent evaluation of risk and establish risk tolerance parameters. Management's Asset and Liability Committee meets regularly to evaluate interest rate risk, engages a third party to assist in the measurement and evaluation of risk and reports quarterly to the Directors' Balance Sheet Management Committee on compliance with policies. The Directors' Audit Committee also engages a third party to perform a review of management's asset and liability practices to ensure compliance with policies.

We use simulation modeling techniques that apply alternative interest rate scenarios to periodic forecasts of future business activity and assess the potential changes to net interest income. In our most recent simulation, we estimated that net interest income would decrease approximately 0.1% within a 12-month time horizon for an assumed 100 basis point decrease in prevailing interest rates or increase approximately 1.0% for an assumed 100 basis point increase in prevailing interest rates. In addition, we estimated that net interest income would increase approximately 1.9% within a 12-month time horizon for an assumed 200 basis point increase in prevailing interest rates. These estimated changes were within the policy limits established by the Board.

**Table of Contents**

Our simulation model includes assumptions about anticipated prepayments on mortgage-related instruments, the estimated cash flow on loans and deposits, and our future business activity. These assumptions are inherently uncertain and, as a result, our modeling techniques cannot precisely estimate the effect of changes in net interest income. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes, cash flow and business activity.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Not Applicable.

**Item 8. *Financial Statements and Supplementary Data***

<u>Report of independent registered public accounting firm</u>	58
<u>Consolidated balance sheets as of December 31, 2008 and December 31, 2007</u>	59
<u>Consolidated statements of operations for the years ended December 31, 2008 and 2007</u>	60
<u>Consolidated statements of comprehensive income (loss) for the years ended December 31, 2008 and 2007</u>	61
<u>Consolidated statements of changes in shareholders' equity for the years ended December 31, 2008 and 2007</u>	62
<u>Consolidated statements of cash flows for the years ended December 31, 2008 and 2007</u>	63
<u>Notes to consolidated financial statements</u>	64

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors of First California Financial Group, Inc. and Subsidiaries:

We have audited the accompanying consolidated balance sheets of First California Financial Group, Inc. and Subsidiaries (the Company) as of December 31, 2008 and 2007 and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders equity and cash flows for each of the years in the two-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of First California Financial Group, Inc. and Subsidiaries as of December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ MOSS ADAMS LLP

Los Angeles, CA

March 30, 2009

**Table of Contents****FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES****Consolidated Balance Sheets**

	December 31, 2008	December 31, 2007
	(in thousands, except share data)	
<b>ASSETS</b>		
Cash and due from banks	\$ 13,712	\$ 17,413
Federal funds sold	35,415	255
Securities available-for-sale, at fair value	202,462	231,095
Loans held-for-sale	31,401	11,454
Loans, net	780,373	738,351
Premises and equipment, net	20,693	18,626
Goodwill	50,098	50,216
Other intangibles, net	8,452	9,642
Deferred tax assets, net	2,572	
Cash surrender value of life insurance	11,355	10,931
Accrued interest receivable and other assets	21,512	20,859
<b>Total assets</b>	<b>\$ 1,178,045</b>	<b>\$ 1,108,842</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Noninterest checking	\$ 189,011	\$ 197,262
Interest checking	22,577	53,312
Savings and money market	198,606	229,236
Certificates of deposit, under \$100,000	191,888	76,513
Certificates of deposit, \$100,000 and over	215,513	204,757
Total deposits	817,595	761,080
Securities sold under agreements to repurchase	45,000	45,000
Federal Home Loan Bank advances	122,000	123,901
Junior subordinated debentures	26,701	26,648
Deferred tax liabilities, net		2,535
Accrued interest payable and other liabilities	7,826	12,811
Total liabilities	1,019,122	971,975
<b>Commitments and Contingencies (Note 19)</b>		
Perpetual preferred stock - authorized 2,500,000 shares		
Series A - \$0.01 par value, 1,000 shares issued and outstanding as of December 31, 2008 and 2007	1,000	1,000
Series B - \$0.01 par value, 25,000 shares issued and outstanding as of December 31, 2008 and none at December 31, 2007	22,713	
Common stock, \$0.01 par value; authorized 25,000,000 shares; 11,807,624 shares issued at December 31, 2008 and 11,768,999 at December 31, 2007; 11,462,964 and 11,507,020 shares outstanding as of December 31, 2008 and 2007	118	118
Additional paid-in capital	135,603	132,543
Treasury stock, 344,660 and 261,979 shares at cost at December 31, 2008 and 2007	(3,050)	(2,374)
Retained earnings	11,559	5,350
Accumulated other comprehensive income (loss)	(9,020)	230
Total shareholders' equity	158,923	136,867

Edgar Filing: First California Financial Group, Inc. - Form 10-K

<b>Total liabilities and shareholders equity</b>	\$ 1,178,045	\$ 1,108,842
--	--------------	--------------

See accompanying notes to consolidated financial statements.



**Table of Contents****FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Operations**

	<b>For the Year Ended December 31, 2008      2007 (in thousands, except per share data)</b>	
<b>Interest income:</b>		
Interest and fees on loans	\$ 51,521	\$ 56,388
Taxable interest on securities	11,010	8,011
Nontaxable interest on securities	674	1,226
Interest on federal funds sold	30	125
<b>Total interest income</b>	<b>63,235</b>	<b>65,750</b>
<b>Interest expense:</b>		
Interest on deposits	13,397	18,321
Interest on borrowings	7,301	5,509
Interest on junior subordinated debt	1,755	1,676
<b>Total interest expense</b>	<b>22,453</b>	<b>25,506</b>
<b>Net interest income before provision for loan losses</b>	<b>40,782</b>	<b>40,244</b>
Provision for loan losses	1,150	
<b>Net interest income after provision for loan losses</b>	<b>39,632</b>	<b>40,244</b>
<b>Noninterest income:</b>		
Service charges on deposit accounts	2,756	1,557
Earnings on cash surrender value of life insurance	424	343
Commissions on brokered loans	277	409
Net gain on sale of loans	175	1,790
Net gain (loss) on sale of securities	(22)	89
Gain on sale of bank charters		2,375
Trading gains on non-hedge derivatives	1,042	224
Other income	729	1,260
<b>Total noninterest income</b>	<b>5,381</b>	<b>8,047</b>
<b>Noninterest expense:</b>		
Salaries and employee benefits	18,526	17,514
Premises and equipment	4,813	4,040
Data processing	1,313	1,047
Legal, audit, and other professional services	1,962	1,353
Printing, stationary, and supplies	691	490
Telephone	752	532
Directors fees	434	514
Advertising and marketing	1,324	1,029
Postage	199	159
Loss on early termination of debt		1,564
Integration and conversion expenses		5,443
Amortization of intangible assets	1,190	1,029
Other expenses	3,901	2,331
<b>Total noninterest expense</b>	<b>35,105</b>	<b>37,045</b>

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

Income before provision for income taxes	9,908	11,246
Provision for income taxes	3,542	4,158
Net income	\$ 6,366	\$ 7,088
Earnings per share:		
Basic	\$ 0.56	\$ 0.68
Diluted	\$ 0.54	\$ 0.66

See accompanying notes to consolidated financial statements.

**Table of Contents****FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income (Loss)**

	<b>For the Year Ended December 31, 2008      2007 (in thousands)</b>	
<b>Comprehensive income (loss)</b>		
Unrealized holding gains (losses) on securities available-for-sale and derivative financial instruments arising during the period	\$ (14,807)	\$ 2,166
Reclassification adjustments for losses included in net income	135	24
Other comprehensive income (loss), before taxes	(14,672)	2,190
Income tax (expense) benefit related to items of other comprehensive income	5,422	(800)
Other comprehensive income (loss), net of tax	(9,250)	1,390
Net income	6,366	7,088
<b>Total comprehensive income (loss)</b>	<b>\$ (2,884)</b>	<b>\$ 8,478</b>

See accompanying notes to consolidated financial statements.

**Table of Contents****FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Changes in Shareholders' Equity**

	Preferred Stock Series A		Preferred Stock Series B		Common Stock, no par value		Common Stock, \$0.01 par value		Additional Paid in Capital	Treasury Stock		Accumulated Other Comprehensive Retained Earnings (Loss)		Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount		Shares	Amount	Earnings	(Loss)	
Balance at December 31, 2006		\$	1,000	\$ 1,000	5,650,147	\$ 46,967		\$	\$		\$	\$ (1,738)	\$ (1,160)	\$ 45,069
Stock options exercised							243,766	2	1,842					1,844
Exchange of stock as a result of merger	1,000	\$ 1,000	(1,000)	\$ (1,000)	(5,650,147)	(46,967)	5,650,147	57	46,910					
Common stock issued in connection with FCB Bancorp							5,868,586	59	83,527					83,586
Stock-based compensation cost									264					264
Issuance of restricted stock							6,500							
Purchase of treasury stock							(261,979)			261,979	(2,374)			(2,374)
Comprehensive income:														
Unrealized holding gain during the period, net													1,390	1,390
Net income												7,088		7,088
Comprehensive income														8,478
Balance at December 31, 2007	1,000	\$ 1,000		\$		\$	11,507,020	\$ 118	\$ 132,543	261,979	\$ (2,374)	\$ 5,350	\$ 230	\$ 136,867
Stock options exercised							15,063		86					86
Issuance of restricted stock							23,562							
Issuance of preferred stock and warrant			25,000	22,713					2,287					25,000
Adjustment to reflect change in accounting principle for post-retirement benefits									(46)			(157)		(203)
Stock-based compensation cost									733					733
							(82,681)			82,681	(676)			(676)

Edgar Filing: First California Financial Group, Inc. - Form 10-K

Purchase of treasury stock		
Comprehensive loss:		
Unrealized holding loss during the period, net	(9,250)	(9,250)
Net income	6,366	6,366

Comprehensive loss		(2,884)
--------------------	--	---------

Balance at December 31, 2008	1,000	\$ 1,000	25,000	\$ 22,713	\$	11,462,964	\$ 118	\$ 135,603	344,660	\$ (3,050)	\$ 11,559	\$ (9,020)	\$ 158,923
------------------------------	-------	----------	--------	-----------	----	------------	--------	------------	---------	------------	-----------	------------	------------

See accompanying notes to consolidated financial statements.

**Table of Contents****FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

	<b>For the Year Ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in thousands)</b>	
Net income	\$ 6,366	\$ 7,088
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization of premises and equipment	1,425	1,450
Provision for loan losses	1,150	
Stock-based compensation costs	733	264
Realized net gains on sales of securities and loans	(153)	
(Gain) loss on settlement of derivatives	113	(224)
Accretion of net discounts on securities available-for-sale	(311)	(734)
FHLB stock dividends	(410)	(259)
Amortization of core deposit intangibles and trade name	1,190	1,029
Loss on disposal of premises and equipment	172	
Gain on sale of bank charters		(2,375)
Gain on sale of other real estate owned	(10)	
Loss on early termination of debt		1,564
Amortization of premium on loans purchased		30
Origination of loans held for sale	(42,955)	(80,393)
Proceeds from sale and payments received from loans held for sale	23,183	68,939
Increase in cash surrender value of life insurance	(424)	(343)
(Increase) decrease in deferred tax assets/liabilities, net	(5,107)	4,198
(Increase) decrease in accrued interest receivable and other assets	4,071	(1,526)
Increase (decrease) in accrued interest payable and other liabilities	(2,680)	2,118
<b>Net cash provided by (used in) operating activities</b>	<b>(13,647)</b>	<b>826</b>
Purchases of securities available-for-sale	(30,758)	(82,623)
Proceeds from repayments, sales and maturities of securities available-for-sale	45,197	37,704
Proceeds from redemption of Federal Home Loan Bank stock	1,581	4,935
Purchases of Federal Home Loan Bank and other restricted stock	(4,136)	(3,511)
Net change in federal funds sold	(35,160)	(525)
Loan originations and principal collections, net	(42,580)	(15,323)
Proceeds received for sale of bank charters		2,375
Purchases of premises and equipment	(3,493)	(631)
Proceeds from sale of other real estate owned	218	
Net cash and cash equivalents received in acquisition		6,760
<b>Net cash used in investing activities</b>	<b>(69,131)</b>	<b>(50,839)</b>
Net increase (decrease) in noninterest-bearing deposits	(8,251)	3,175
Net increase (decrease) in interest-bearing deposits	64,766	(17,509)
Net increase (decrease) in FHLB advances and other borrowings	(1,848)	68,981
Issuance of Junior Subordinated Debentures		16,495
Redemption of Junior Subordinated Debentures		(16,624)
Proceeds from exercise of stock options	86	1,844
Purchases of treasury stock	(676)	(2,374)
Issuance of preferred stock and warrant	25,000	
<b>Net cash provided by financing activities</b>	<b>79,077</b>	<b>53,988</b>
Change in cash and due from banks	(3,701)	3,975
Cash and due from banks, beginning of period	17,413	13,438

Edgar Filing: First California Financial Group, Inc. - Form 10-K

<b>Cash and due from banks, end of period</b>	\$ 13,712	\$ 17,413
<i>Supplemental cash flow information:</i>		
Cash paid for interest	\$ 19,472	\$ 25,575
Cash paid for income taxes	7,218	608
<i>Supplemental disclosure of noncash items:</i>		
Unrealized gain (loss) on securities available-for-sale, net of tax effect	\$ (9,250)	\$ 662
Loans transferred to other real estate owned	338	
Unrealized gain on cash flow hedges, net of tax effect		606
Issuance of common stock for purchase accounting acquisition		82,982

See accompanying notes to consolidated financial statements.

---

**Table of Contents**

**FIRST CALIFORNIA FINANCIAL GROUP, INC.**

**Notes to Consolidated Financial Statements**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and nature of operations** First California Financial Group, Inc., or First California or the Company, was incorporated under the laws of the State of Delaware on June 7, 2006. The Company was formed as a wholly-owned subsidiary of National Mercantile Bancorp, a California corporation, or National Mercantile, for the purposes of effecting the merger and capital stock exchange with National Mercantile and acquisition of FCB Bancorp, a California corporation, or FCB.

On June 15, 2006, First California, FCB and National Mercantile entered into an Agreement and Plan of Merger, or the Merger Agreement, providing for the merger of National Mercantile and FCB with and into the newly formed holding company, First California, and the conversion of each share of National Mercantile common stock into the right to receive one share of First California common stock and the conversion of each share of FCB common stock into the right to receive 1.7904 shares of First California common stock. In addition, the Merger Agreement provided for the conversion of each share of National Mercantile series B convertible perpetual preferred stock into the right to receive one share of series A convertible perpetual preferred stock, \$0.01 par value per share, or First California Preferred Stock, of First California. The merger and acquisition were approved by both National Mercantile and FCB shareholders and regulators.

On March 12, 2007, First California completed the merger and capital stock exchange with National Mercantile and acquisition of FCB pursuant to the Merger Agreement as described above. Concurrent with the merger and acquisition, the number of common shares authorized of First California was increased to 25,000,000 shares and First California authorized the issuance of 2,500,000 shares of preferred stock of which 1,000 shares were designated as series A convertible perpetual preferred stock. In addition, each share of National Mercantile series B convertible perpetual preferred stock was exchanged for one share of series A convertible perpetual preferred stock of First California. As a result of these transactions, First California issued an aggregate of 11,518,733 shares of First California common stock to former National Mercantile and FCB shareholders and 1,000 shares of First California preferred stock to former shareholders of National Mercantile series B convertible preferred stock. First California paid cash of \$1,800 in lieu of fractional shares of First California common stock issued in connection with the acquisition of FCB.

Upon completion of the merger of National Mercantile into its wholly-owned subsidiary First California and the acquisition of FCB by First California, the separate corporate existence of National Mercantile and FCB ceased, and First California succeeded and assumed all the rights and obligations of National Mercantile and FCB. First California assumed all rights and obligations of National Mercantile, whose principal assets were the capital stock of two bank subsidiaries: Mercantile National Bank, or Mercantile, and South Bay Bank, N.A., or South Bay. As a result of the acquisition of FCB, First California acquired all the rights and obligations of FCB, whose principal assets consisted of the capital stock of First California Bank, or the Bank.

On June 19, 2007, First California completed the integration of Mercantile, South Bay and First California Bank. As contemplated by the Merger Agreement, the Bank purchased substantially all the assets and assumed substantially all the liabilities of Mercantile and South Bay, sold the bank charters of Mercantile and South Bay to United Central Bank and The Independent Bankers Bank, respectively, and recognized a gain of \$2.4 million during the second quarter of 2007.

Subsequent to year-end, on January 23, 2009, the Bank assumed the insured, non-brokered deposits of 1<sup>st</sup> Centennial Bank, totaling approximately \$270 million, from the FDIC. The Bank also purchased approximately \$164 million in cash and cash equivalents, \$89 million in investment securities and \$2 million in consumer loans related to the transaction. The addition of 1<sup>st</sup> Centennial's six branches expanded the Bank's operations to 18 full-service branches throughout Southern California. The Bank also received the exclusive option for 30 days to (i) purchase loans at book value, (ii) put back to the FDIC certain assets purchased and/or



## **Table of Contents**

liabilities assumed and (iii) for 90 days received the exclusive option to purchase/lease the branch locations and related furniture and equipment of 1<sup>st</sup> Centennial Bank at fair market value.

The Company serves the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Ventura, San Diego, Riverside and San Bernardino counties through traditional business and consumer banking to construction finance, SBA lending, entertainment finance and commercial real estate lending via 18 full-service branch locations.

**Basis of presentation and consolidation** The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry. The consolidated financial statements include, in conformity with generally accepted accounting principles, the accounts of the Company, its bank subsidiary and SC Financial. SC Financial is an inactive subsidiary of First California. The Company has not consolidated the accounts of the First California Capital Trust I and FCB Statutory Trust I in its consolidated financial statements in accordance with FASB Interpretation No. 46R. As a result, the junior subordinated debentures issued by the Company to the Trusts are reflected on the Company's consolidated balance sheet as junior subordinated debentures. Results of operations for the twelve months ended December 31, 2007 includes operations of FCB from the date of acquisition. The Company's historical balance sheet and results of operations before the merger and acquisition are the same as the historical information of National Mercantile. All material intercompany transactions have been eliminated.

**Reclassifications** Certain reclassifications have been made to the 2007 consolidated financial statements to conform with current year presentation.

**Management's estimates and assumptions** The preparation of the consolidated financial statements, in conformity with generally accepted accounting principles, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by us primarily involve the calculation of the allowance for loan losses, the carrying amount of deferred tax assets, the assessments of impairment related to goodwill and investment securities and the effectiveness of derivative instruments in offsetting changes in fair value or cash flows of hedged items.

**Cash and due from banks** Cash and due from banks include amounts the Company is required to maintain to meet certain average reserve and compensating balance requirements of the Federal Reserve Bank of San Francisco. As of December 31, 2008 and 2007, the Company had met all reserve requirements. At December 31, 2008, the Company had cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Company places these deposits with large, well-capitalized financial institutions, management believes the risk of loss to be minimal.

**Securities** Securities are classified as available-for-sale if the instrument may be sold in response to such factors as (1) changes in market interest rates and related changes in the prepayment risk, (2) need for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Unrealized holding gains and losses, net of taxes, on securities available-for-sale are reported as other comprehensive income and carried as accumulated comprehensive income or loss within shareholders' equity until realized. Fair values for securities are based on quoted market prices. Realized gains and losses on the sale of securities available-for-sale are determined using the specific-identification method.

Premiums and discounts on available-for-sale securities are recognized in interest income using the effective interest method over the period to maturity.

The fair values of securities are evaluated according to SFAS No. 157, *Fair Value Measurements*. Declines in the fair value of individual securities available-for-sale below their cost that are other-than-temporary result in

## **Table of Contents**

write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. At each financial statement date, management assesses each security to determine if securities are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends.

**Loans, net of allowance for loan losses and net deferred loan fees/costs** Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and net deferred loan fees/costs. Interest on loans is calculated by the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees net of certain direct origination costs are capitalized and recognized as an adjustment of the yield over the life of the related loan.

The Company does not accrue interest on loans for which payment in full of principal and interest is not expected, or which payment of principal or interest has been in default 90 days or more, unless the loan is well-secured and in the process of collection. Nonaccrual loans are considered impaired loans. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of collateral if the loan is collateral dependent. When it is doubtful the full principal and interest due on a loan will be collected, interest accrual is discontinued. Interest income is subsequently recognized only to the extent cash payments are received or when the loan is removed from nonaccrual status. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for evaluation of impairment.

The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when management believes that the collectibility of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Various regulatory agencies, as a regular part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations.

**Premises and equipment** Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed by the straight-line and accelerated methods over the estimated useful lives of the assets, which range from 3 to 7 years for furniture and equipment, and 10 to 39 years for building premises. Leasehold improvements are amortized over the estimated life of the lease or life of the asset, whichever is shorter. Maintenance and repairs are expensed as incurred, while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

**Goodwill and other intangible assets** The Company has goodwill, which represents the excess of purchase price over the fair value of net assets acquired in business combinations. In accordance with generally accepted accounting principles, goodwill is not amortized and is reviewed for impairment on an annual basis or on an interim basis if an event occurs or circumstances change that would reduce the fair value of the acquired business below its carrying value. Other intangible assets consist of tradename and core deposit intangibles. Tradename, which represents the fair value of the First California Bank name, is amortized using the straight-line method over a period of ten years. Core deposit intangibles, which represent the fair value of depositor relationships resulting from deposit liabilities assumed in acquisitions, are amortized using the straight-line method over the projected useful lives of the deposits. Core deposit and trade name intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment of goodwill and other intangibles is permanently recognized by writing down the asset to the extent that the carrying value exceeds the estimated fair value.

---

**Table of Contents**

**Other real estate owned and repossessed assets** Other real estate owned and repossessed assets, acquired through foreclosure, deeds in lieu of foreclosure or repossession, is carried at the lower of cost or estimated net realizable value. When property is acquired, any excess of the loan balance over its estimated net realizable value is charged to the allowance for loan losses. Subsequent write-downs to net realizable value, if any, or any disposition gains or losses are included in noninterest income and expense in the statements of income. The Company possessed other real estate owned and repossessed assets of \$327,000 and \$197,000 at December 31, 2008 and 2007, respectively.

**Federal funds purchased and securities sold under repurchase agreements** The Company borrows federal funds purchased as part of its short-term financing strategy. Federal funds purchased are generally overnight borrowings and mature within one to three business days from the transaction date.

The Company sells securities under repurchase agreements. These transactions are accounted for as collateralized financing transactions and recorded at the amounts at which the securities were sold. The Company has provided collateral related to these agreements and may have to provide additional collateral to the counterparty, as necessary, if the fair value of the collateral fluctuates below required levels.

**Federal Home Loan Bank stock and other non-marketable securities** Federal Home Loan Bank stock represents the Company's investment in the Federal Home Loan Bank San Francisco ( FHLB ) stock and is carried at cost because it can only be redeemed at par value. The Company's investment in FHLB stock is included in accrued interest receivable and other assets in the consolidated balance sheets and was \$8,421,000 and \$6,034,000 at December 31, 2008 and 2007, respectively. As a member of the FHLB system, the Company is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets or FHLB advances. The Company may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB. The Company also has stock investments in other companies for CRA and other bank-related purposes. These stock investments were \$1,354,000 at December 31, 2008 and \$776,000 at December 31, 2007 and are carried at par value which reasonably approximates its fair value. The Company reviews our investments accounted for under the cost method at least quarterly for possible other-than-temporary impairment. This review typically includes an analysis of facts and circumstances of each investment, the expectations of the investment's future cash flows and capital needs, and trends in the investment's business and cash flows. The Company reduces the investment value when declines in value are considered to be other-than-temporary. The Company recognizes the estimated loss as a loss on investment securities, a component of noninterest income.

**Junior subordinated debentures** The Company has two statutory business trusts that are wholly-owned subsidiaries of the Company. In private placement transactions, the trusts issued fixed rate capital securities representing undivided preferred beneficial interests in the assets of the trusts. The Company is the owner of all the beneficial interests represented by the common securities of the trusts. The purpose of issuing the capital securities was to provide the Company with a cost-effective means of obtaining Tier I capital under regulatory capital rules.

**Income taxes** The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), on January 1, 2007. FIN 48 prescribes a comprehensive model and provides guidance for accounting and disclosure for uncertainty in tax provisions and for the recognition and measurement related to the accounting for income taxes. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The Company had no unrecognized tax benefits or uncertain tax positions which required an adjustment to the January 1, 2007 beginning balance of retained earnings. The Company had no unrecognized tax benefits or uncertain tax positions at December 31, 2008 and December 31, 2007.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in income tax expense. During the years ended December 31, 2008 and 2007, the Company recognized no interest and penalties

## **Table of Contents**

in income tax expense. The Company files income tax returns in the U.S. federal jurisdiction and in California. The Company is no longer subject to U.S. federal and California income tax examinations by tax authorities for years before 2005 and 2004, respectively.

Deferred income tax assets and liabilities are determined based on the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred tax assets are recognized subject to management's judgment that realization is more-likely-than-not. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. There was no valuation allowance at December 31, 2008 or December 31, 2007.

**Derivative instruments and hedging** An estimate of the effectiveness of derivative instruments in off-setting changes in fair value or cash flows of hedged items is required to determine the extent to which earnings are affected. A portion of the Company's interest rate swap instruments were deemed effective during 2008 and 2007, thus income was booked, to the extent determined to be ineffective, to the income statement as required under hedge accounting. At December 31, 2008 and 2007, there were no gains and gains of \$629,000, respectively, recorded in accumulated other comprehensive income. During 2008 and 2007 the interest rate floor was deemed to be ineffective and the net gains of \$1,042,000 and \$165,000 were recognized in earnings as required by hedge accounting. At December 31, 2008 there were no remaining derivative instruments as the final contract expired in December 2008.

**Off-balance sheet financial instruments** In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit, commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The Company maintains a reserve for off-balance sheet items, included as an accrued liability. The reserve is an amount that management believes will be adequate to absorb possible losses associated with off-balance sheet credit risk. The evaluations take into consideration such factors as changes in the nature and volume of the commitments to extend credit and undisbursed balances of existing lines of credit and letters of credit.

**Stock-based compensation** Stock-based compensation generally includes grants of stock options and restricted stock to employees and nonemployee directors. We account for stock-based payments, including stock options, in accordance with SFAS No. 123(R), *Share-Based Payment*, and recognize them in the statement of income based on their fair values. The fair value of stock options are being measured using a lattice option pricing model while the fair value of restricted stock awards are based on the quoted price of our common stock on the date of grant. See Note 15 Stock-Based Compensation for additional information.

**Advertising** Advertising costs are charged to expense during the year in which they are incurred. Advertising expenses were \$256,000 and \$148,000 for the years ended December 31, 2008 and 2007, respectively.

**Earnings per share** Basic earnings per common share is computed by dividing net income available to shareholders by the weighted average number of common shares outstanding (excluding unvested restricted stock) during the period, after giving retroactive effect to stock dividends and splits. Diluted earnings per common share is calculated by adjusting net earnings and average outstanding common shares, assuming conversion of all potentially dilutive common stock equivalents, which include stock options and restricted shares using the treasury stock method. Diluted earnings per common share exclude common stock equivalents whose effect is antidilutive.

---

**Table of Contents**

**Fair value of financial instruments** Estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data and to develop the estimates of fair value. Accordingly, the estimates of fair value in the financial statements are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on the estimated fair value amounts.

**Recently issued accounting pronouncements** In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements*, which provides a single definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands required disclosures about fair value measurements. We adopted SFAS No. 157 effective January 1, 2008 on a prospective basis. The adoption of SFAS No. 157 had no impact on either the Company's financial condition or operating results.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115*, was effective for us on January 1, 2008. SFAS No. 159 would allow the Company a one-time irrevocable election to measure certain financial assets and liabilities on the balance sheet at fair value and report the unrealized gains and losses on the elected items in earnings at each subsequent reporting date. Upon adoption, we did not choose to measure any of our financial instruments at fair value and accordingly SFAS No. 159 had no impact on either the Company's financial condition or operating results.

In December 2007, SFAS No. 141R, *Business Combinations*, was issued and is effective for us on January 1, 2009. SFAS No. 141R changes the way acquisitions are accounted for in the following ways: (1) the measurement date for consideration transferred, including equity securities, is the date when control is obtained, generally the closing date; previously, equity securities issued in a business combination were measured at the combination's announcement date; (2) acquisition and restructuring costs are generally expensed as incurred rather than being considered part of the cost of the business combination; (3) contractual contingencies are measured on the closing date at fair value with adjustments to such fair value recorded in earnings when new information is obtained; and (4) contingent consideration is measured at its fair value on the closing date with subsequent adjustments based on changes in fair value. Management is currently evaluating the impact this Statement may have on the Company's financial statements as they relate to future acquisitions.

In December 2007, SFAS No. 160, *Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* was issued. SFAS No. 160 requires entities to report noncontrolling (minority) interests as a component of shareholders' equity on the balance sheet; include all earnings of a consolidated subsidiary in consolidated results of operations; and treat all transactions between an entity and noncontrolling interest as equity transactions between the parties. SFAS No. 160 is effective for the Company's fiscal year beginning 2009 and adoption is prospective only; however, presentation and disclosure requirements described above must be applied retrospectively. The Company does not currently have any noncontrolling (minority) interests and does not expect this Statement to have an impact on either the Company's financial condition or operating results.

In June 2008, the FASB issued FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, or FSP EITF 03-6-1. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities and are included in the two-class method of computing basic and diluted earnings per share. We are currently assessing the impact this FSP may have, if any, on earnings per share amounts and disclosures.

**NOTE 2 MERGER**

On March 12, 2007, First California completed the acquisition of 100% of the outstanding common stock of FCB for a purchase price of \$84.9 million pursuant to the Merger Agreement as described in Note 1 above. FCB

**Table of Contents**

was the parent company of the Bank. At the date of acquisition, the Bank became a wholly-owned subsidiary of the Company. As provided by the Merger Agreement, each share of the then issued and outstanding shares of common stock of FCB was exchanged for 1.7904 shares of the Company's common stock. Upon completion of the acquisition, the Company issued approximately 5.9 million shares of common stock to former shareholders of FCB representing an approximate 49.9% interest in the Company. The fair value of \$14.14 for each of the Company's common shares issued to complete the acquisition of FCB on March 12, 2007 was based on the average of the quoted market price per share of National Mercantile's common stock for a period of three days before, the day of and three days after the announcement of the merger and acquisition on June 15, 2006.

In addition, FCB had 160,100 employee stock options outstanding at the acquisition date. On the acquisition date, the Company exchanged the FCB stock options for options to purchase shares of the Company's common stock which resulted in the Company granting a total of 286,643 stock options with a weighted average exercise price of \$10.33 per share to former FCB employees and executives. The fair value of the stock options of \$1.4 million is included in the purchase price.

Under the purchase method of accounting, the assets and liabilities of FCB were recorded at their respective fair values at March 12, 2007. The Company has based the allocation of purchase price above on an estimate of the fair values of the assets acquired and the liabilities assumed. Valuations of certain assets and liabilities of FCB were performed with the assistance of independent valuation consultants. Based on the ending FCB tangible equity of \$32.3 million and an aggregate purchase price of \$84.9 million, the merger resulted in total intangible assets of \$56.5 million. Of the total intangible assets \$5.5 million was allocated to core deposit intangibles, \$4.0 million to tradename and \$47.0 million to goodwill. None of the intangible assets are tax deductible; however, deferred income tax liabilities of \$3.8 million were recorded as a result of the acquisition. The deferred income tax liabilities will be reflected as an income tax benefit in the consolidated statement of income in proportion to and over the amortization periods of the related core deposit intangible and tradename assets. The core deposit intangible asset and tradename are being amortized over an estimated useful life of 10 years. The statement of net assets acquired at fair value on March 12, 2007, and the computation of the purchase price and goodwill related to the acquisition of FCB are presented below.

**Statement of Net Assets Acquired at Fair Value**

	(in thousands)
<b>Assets Acquired</b>	
Cash and due from banks	\$ 8,148
Federal funds sold	780
Securities	83,853
Loans, net	362,482
Premises and equipment, net	10,284
Goodwill	47,019
Other assets	31,890
<b>Total assets acquired</b>	<b>544,456</b>
<b>Liabilities Assumed</b>	
Deposits	394,800
Borrowings	44,657
Junior subordinated debt	10,110
Other liabilities	9,965
<b>Total liabilities assumed</b>	<b>459,532</b>
<b>Net Assets Acquired over Liabilities Assumed</b>	<b>\$ 84,924</b>

**Table of Contents****Purchase Price and Goodwill**

	(in thousands, except share and per share amounts)
<b>Purchase Price</b>	
Number of shares of Company stock issued for FCB stock	5,868,586
Price of the Company's stock on the date of Merger Agreement	\$ 14.14
Total stock consideration	\$ 82,982
Fair value of FCB's stock options converted to Company stock options at acquisition date	1,408
Less: Fair value of unvested options related to future service periods	(804)
Total common stock issued and stock options assumed	83,586
Direct costs of the acquisition	1,338
Total purchase price and acquisition costs	84,924
<b>Allocation of Purchase Price</b>	
FCB's equity	\$ 49,444
Less: Intangible assets derecognized	(17,152)
Adjustments to reflect assets acquired and liabilities assumed at fair value:	
Loans	(2,489)
Core deposit intangibles	5,488
Other assets	6,983
Deferred tax liabilities	(3,508)
Deposits	(624)
Borrowings	(37)
Subordinated debt	(200)
Fair value of net assets acquired	37,905
Estimated goodwill arising from acquisition	\$ 47,019

The results of operations for FCB have been included in the Company's consolidated financial statements as of the acquisition date.

**NOTE 3 SECURITIES**

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities available-for-sale at December 31, 2008 and 2007, are summarized as follows:

	For the year ended December 31, 2008			Estimated
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
U.S. government agency notes	\$ 2,000	\$ 20	\$	\$ 2,020
U.S. government agency mortgage-backed securities	129,060	3,197	(46)	132,211
Collateralized mortgage obligations	63,118	278	(15,498)	47,898
Municipal securities	17,327	220	(123)	17,424
Other domestic debt securities	4,941		(2,032)	2,909
Securities available-for-sale	\$ 216,446	\$ 3,715	\$ (17,699)	\$ 202,462





**Table of Contents**

	For the year ended December 31, 2007			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
	(in thousands)			
U.S. Treasury notes	\$ 526	\$ 3	\$	\$ 529
U.S. government agency notes	14,499	137	(1)	14,635
U.S. government agency mortgage-backed securities	121,155	626	(258)	121,523
Collateralized mortgage obligations	70,910	377	(518)	70,769
Municipal securities	18,598	105	(14)	18,689
Other domestic debt securities	4,963		(13)	4,950
<b>Securities available-for-sale</b>	<b>\$ 230,651</b>	<b>\$ 1,248</b>	<b>\$ (804)</b>	<b>\$ 231,095</b>

At December 31, 2008, and December 31, 2007, there were no securities held-to-maturity.

Securities available-for-sale that were in an unrealized loss position at December 31, 2008 and 2007 are presented in the following tables aggregated by investment category and length of time the individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to the fluctuation in market interest rates since purchase and temporary disruption in the credit markets as well as the Company's intent and ability to hold them until fair values recover.

	Less Than 12 Months		At December 31, 2008 Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. agency mortgage-backed securities	\$ 3,611	\$ (46)	\$	\$	\$ 3,611	\$ (46)
Collateralized mortgage obligations	52,583	(15,210)	3,078	(288)	55,661	(15,498)
Municipal securities	7,360	(121)	173	(2)	7,533	(123)
Other domestic debt securities			4,941	(2,032)	4,941	(2,032)
	<b>\$ 63,554</b>	<b>\$ (15,377)</b>	<b>\$ 8,192</b>	<b>\$ (2,322)</b>	<b>\$ 71,746</b>	<b>\$ (17,699)</b>

	Less Than 12 Months		At December 31, 2007 Greater Than 12 Months		Total	
	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses	Amortized Cost	Unrealized Losses
	(in thousands)					
U.S. agency notes	\$ 1,999	\$ (1)	\$	\$	\$ 1,999	\$ (1)
U.S. agency mortgage-backed securities	12,643	(106)	15,956	(152)	28,599	(258)
Collateralized mortgage obligations	26,672	(330)	12,153	(188)	38,825	(518)
Municipal securities	2,670	(14)			2,670	(14)
Other domestic debt securities	4,950	(13)			4,950	(13)
	<b>\$ 48,934</b>	<b>\$ (464)</b>	<b>\$ 28,109</b>	<b>\$ (340)</b>	<b>\$ 77,043</b>	<b>\$ (804)</b>

At December 31, 2008, there were four securities that have been in a continuous unrealized loss position for 12 months or more and fifty-six securities that have been in a continuous unrealized loss position for less than 12 months. At December 31, 2007, there were thirty-eight securities that have been in a continuous unrealized loss position for 12 months or more and two securities that have been in a continuous unrealized loss position for less than 12 months.



**Table of Contents**

Regular analyses are performed on the securities available-for-sale portfolio to determine if any securities are other-than-temporarily impaired. If it is probable that we will be unable to collect all amounts due according to the contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment is considered to have occurred. When an other-than-temporary impairment occurs, the cost basis of the security is written down to its fair value (as the new cost basis) and the write down is accounted for as a realized loss. Other-than-temporary declines in fair value are assessed based on the duration the security has been in a continuous unrealized loss position, the severity of the decline in value, the rating of the security, the long-term financial outlook of the issuer and our ability and intent on holding the securities until the fair values recover. Management concluded that there were no securities with an other-than-temporary impairment at December 31, 2008. We will continue to evaluate our securities portfolio for other-than-temporary impairment at each reporting date and we can provide no assurance that there will not be an other-than-temporary impairment in future periods.

Proceeds from the sale of securities and realized losses for the year ended December 31, 2008 amounted to \$1,007,000 and \$22,000, respectively. Proceeds from sale of securities and realized gains for the year ended December 31, 2007 amounted to \$6,157,000 and \$89,000, respectively.

The amortized cost and estimated fair value of securities by contractual maturities are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>At December 31, 2008</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(in thousands)</b>	
Due in one year or less	\$ 2,567	\$ 2,589
Due after one year through five years	93,462	89,910
Due after five years through ten years	72,286	72,179
Due after ten years	48,131	37,784
	<b>\$ 216,446</b>	<b>\$ 202,462</b>

For the purpose of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted average contractual maturities of underlying collateral. Mortgage-backed securities may mature earlier than their weighted average contractual maturities because of principal prepayments.

As of December 31, 2008, securities with an estimated fair value of \$192.7 million have been pledged to secure public and other deposits, as required by law, and to secure borrowing facilities with the FHLB and the Federal Reserve Bank of San Francisco.

**Table of Contents****NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES**

The loan portfolio consists of the following:

	At December 31, 2008                      2007 (in thousands)	
Commercial mortgage	\$ 302,016	\$ 295,496
Commercial loans and lines of credit	228,958	189,638
Construction and land development	133,054	148,101
Multifamily mortgage	51,607	34,198
Home mortgage	45,202	46,193
Home equity loans and lines of credit	22,568	22,519
Installment and credit card	5,016	10,034
Total loans	788,421	746,179
Allowance for loan losses	(8,048)	(7,828)
Loans, net	\$ 780,373	\$ 738,351
Loans held-for-sale	\$ 31,401	\$ 11,454

As of December 31, 2008, loans with a carrying value of \$354.0 million were pledged to secure FHLB advances. Loan balances include net deferred loan fees and costs of \$1,772,000 and \$2,656,000 as of December 31, 2008 and 2007, respectively.

Most of the Company's lending activity is with customers located in Los Angeles, Orange and Ventura Counties and most loans are secured by or dependent on real estate. Although the Company has no significant exposure to any individual customer, the economic condition, particularly the recent decline in real estate values in Southern California could adversely affect customers and their ability to satisfy their obligations under their loan agreements.

Nonaccrual loans are those loans for which management has discontinued accrual of interest because reasonable doubt exists as to the full and timely collection of either principal or interest. There were seven nonaccrual loans totaling \$8.5 million at December 31, 2008. There was one nonaccrual loan of \$5.7 million as of December 31, 2007. The allowance for loan losses maintained for nonaccrual loans was \$0.6 million and none at December 31, 2008 and 2007, respectively. Had these loans performed according to their original terms, additional interest income of \$543,000 and \$339,000 would have been recognized in 2008 and 2007, respectively.

Due to the small average loan size and nature of our loan portfolio, impaired loans are determined by periodic evaluation on an individual loan basis. The average investment in impaired loans was \$16.6 million and \$4.1 million in 2008 and 2007, respectively. Impaired loans were \$34.5 million and \$8.2 million at December 31, 2008 and 2007, respectively. Of the \$34.5 million of impaired loans at December 31, 2008, \$2.0 million had specific reserves totaling \$0.6 million.

**Table of Contents**

Changes in the allowance for loan losses were as follows:

	For the Years Ended December 31,	
	2008	2007
	(in thousands)	
Beginning balance	\$ 7,828	\$ 4,740
Balance acquired in purchase		3,554
Provision for loan losses	1,150	
Loans charged-off	(1,075)	(567)
Recoveries on loans previously charged-off	145	101
Ending balance	\$ 8,048	\$ 7,828

**NOTE 5 PREMISES AND EQUIPMENT**

The major classifications of premises and equipment are summarized as follows:

	2008	2007
	(Dollars in thousands)	
Land	\$ 4,792	\$ 4,792
Buildings	11,973	11,784
Leasehold improvements	5,879	4,079
Furniture, fixtures and equipment	15,176	13,673
	37,820	34,328
Less accumulated amortization and depreciation	(17,127)	(15,702)
	\$ 20,693	\$ 18,626

Depreciation and amortization expense was \$1,425,000 and \$1,450,000 in 2008 and 2007, respectively.

**NOTE 6 GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill of \$50.1 million at December 31, 2008 includes \$46.9 million, representing the excess of the purchase price over the fair values of assets acquired and liabilities assumed in the acquisition of FCB. At December 31, 2007, goodwill was \$50.2 million. The decrease in goodwill of \$117,000 was the result of final purchase price allocations recorded in the first quarter of 2008. No impairment loss was recognized for the periods ended December 31, 2008 and December 31, 2007.

Other intangible assets and related accumulated amortization is as follows:

	For the year ended December 31,	
	2008	2007
	(in thousands)	
Core deposit intangibles	\$ 7,788	\$ 7,788
Trade name	4,000	4,000
	11,788	11,788

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

Less accumulated amortization	(3,336)	(2,146)
	\$ 8,452	\$ 9,642

Core deposit intangibles, net of accumulated amortization, were \$5.2 million at December 31, 2008 and \$6.0 million at December 31, 2007. Amortization expense was \$790,000 and \$708,000 for the years ended December 31, 2008 and 2007, respectively.

**Table of Contents**

Trade name, net of accumulated amortization, was \$3.3 million at December 31, 2008 and \$3.7 million at December 31, 2007 representing the fair value of the Bank name recorded as part of the acquisition of FCB. Amortization expense for the years ended December 31, 2008 and 2007 was \$400,000 and \$321,000, respectively.

Amortization expense of other intangibles for 2008 and 2007 was \$1,190,000 and \$1,029,000, respectively. Estimated amortization expense for the next 5 years and thereafter is expected to be as follows:

Year	Amount (in thousands)
2009	\$ 1,190
2010	1,190
2011	1,190
2012	1,190
2013	1,190
Thereafter	2,502
	<b>\$ 8,452</b>

**NOTE 7 CERTIFICATES OF DEPOSIT**

At December 31, 2008, the scheduled maturities for all certificates of deposit are as follows:

Year	Under \$100,000	\$100,000 and Over (in thousands)	Total
2009	\$ 159,051	\$ 196,529	\$ 355,580
2010	29,676	13,397	43,073
2011	1,427	2,451	3,878
2012	316	1,865	2,181
2013 and later	1,418	1,271	2,689
	<b>\$ 191,888</b>	<b>\$ 215,513</b>	<b>\$ 407,401</b>

**NOTE 8 LINES OF CREDIT AND BORROWED FUNDS**

The Bank has lines of credit with three financial institutions providing for federal funds facilities up to a maximum of \$31.0 million. The lines of credit support short-term liquidity and cannot be used for more than 30 consecutive business days, depending on the lending institution. These lines are unsecured, have no formal maturity date, and can be revoked at any time by the granting institution. There were no borrowings outstanding under these agreements at December 31, 2008 and 2007.

As a state nonmember bank, the Bank also has a secured borrowing facility of \$10.2 million with the Federal Reserve Bank of San Francisco. At December 31, 2008 and 2007, there were no borrowings outstanding under these agreements.

**Table of Contents**

The Bank, as a member of the FHLB, has entered into credit arrangements with the FHLB, with maximum available borrowings of approximately \$214.5 million at December 31, 2008. Borrowings under the credit arrangements are collateralized by FHLB stock as well as loans or other instruments which may be pledged. The Bank's borrowing capacity is determined based on the estimated market value of certain eligible loans and securities pledged as collateral, however, the FHLB has a blanket lien against the Bank's entire loan portfolio as collateral for borrowings. As of December 31, 2008, borrowings outstanding with the FHLB were as follows:

	Amount	Maturity Year (in thousands)	Weighted Average Interest Rate
Overnight advances	\$		
Term advances	28,500	2009	3.72%
Term advances	40,000	2010	3.82%
Term advances	11,000	2011	3.42%
Term advances	17,500	2012	4.12%
Term advances	17,500	2014	4.24%
Term advances	7,500	2017	4.07%

\$ 122,000

As of December 31, 2008, \$7.5 million of our FHLB advances are ten-year putable advances with a weighted average rate of 4.1%, \$17.5 million are seven-year putable advances with a weighted average rate of 4.2%, \$17.5 million are five-year putable advances with a weighted average rate of 4.1%, and \$17.5 million are three-year putable advances with a weighted average rate of 4.1%.

The following tables show other borrowed funds for the dates and periods shown (in thousands):

	2008			
	Year-end		Average	
	Balance	Rate	Balance	Rate
Securities sold under repurchase agreements	\$ 45,000	3.64%	\$ 45,000	3.77%

	2007			
	Year-end		Average	
	Balance	Rate	Balance	Rate
Securities sold under repurchase agreements	\$ 45,000	3.97%	\$ 45,000	5.57%

The maximum amount of overnight borrowings outstanding at any month-end during 2008 and 2007 was \$59.6 million and \$53.5 million, respectively.

The Company had \$56.0 million of unused borrowing capacity from the FHLB at December 31, 2008 based upon pledged securities and loans.

**NOTE 9 JUNIOR SUBORDINATED DEBENTURES**

In December 2005 and January 2007 the Company, or an acquired company, issued junior subordinated debentures to the Trusts. These junior subordinated debentures are effectively subordinated to all of our borrowings. The Company also owns the common stock of each of the Trusts. The balance of the equity of the Trusts is comprised of mandatorily redeemable preferred securities and is included in accrued interest receivable and other assets on our Consolidated Balance Sheets.



**Table of Contents**

As of December 31, 2008 and 2007 we had \$26.8 million in junior subordinated debentures outstanding from two issuances of trust preferred securities. Junior subordinated debentures as of December 31, 2008 consisted of the following:

	Interest Rate	Maturity Date	As of December 31, 2008	
			Effective Interest Rate	Balance
FCB Statutory Trust I	Fixed until Dec. 2010	December 15, 2035	6.15%	\$ 10,310
First California Capital Trust I	Fixed until Jan. 2012	March 15, 2037	6.80%	16,495
			6.55%	\$ 26,805

The book balance of FCB Statutory Trust I, net of purchase accounting adjustment, is \$10,206,000 at December 31, 2008, and the total junior subordinated debt on the consolidated balance sheet is \$26,701,000 at December 31, 2008.

Under FIN 46(R), the Company does not consolidate the Trusts into the consolidated financial statements. Prior to the issuance of FIN 46(R), holding companies typically consolidated these entities.

On March 1, 2005, the FRB adopted a final rule that allows the continued inclusion of trust preferred securities in the Tier 1 capital of holding companies, subject to stricter quantitative limits and qualitative standards. Under the final ruling, qualifying mandatory preferred securities may be included in Tier 1 capital, subject to a limit of 25 percent of all core capital. Amounts of restricted core capital elements in excess of this limit generally may be included in Tier 2 capital. The qualitative limits become effective March 31, 2011, after a six-year transition period. As of December 31, 2008, junior subordinated debentures are included in Tier 1 capital for regulatory capital purposes. There is no expected impact to regulatory capital upon the effective date of this ruling.

**NOTE 10 DERIVATIVES**

The Company holds fixed rate and variable rate financial assets that are funded by fixed rate and variable rate liabilities. Consequently, they are subject to the effects of changes in interest rates. In response to this, the Company has developed an interest rate risk management policy with the objective of mitigating financial exposure to changing interest rates. These exposures are managed, in part, with the use of derivatives but only to the extent necessary to meet the overall goal of minimizing interest rate risk.

Derivatives are accounted for according to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. This standard requires that all derivative instruments be recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. To qualify for hedge accounting, the details of the hedging relationship must be formally documented at inception of the arrangement, including the risk management objective, hedging strategy, hedged item, specific risks that are being hedged, the derivative instrument and how effectiveness is being assessed. The derivative must be highly effective in offsetting either changes in fair value or cash flows, as appropriate, for the risk being hedged. Effectiveness is evaluated on a retrospective and prospective basis. If a hedge relationship becomes ineffective or the forecasted transaction becomes no longer probable, it no longer qualifies as a hedge. Any excess gains or losses attributable to such ineffectiveness, as well as subsequent changes in the fair value of the derivative, are recognized in earnings.

**Table of Contents**

A summary of our derivative instruments at December 31, 2008 and 2007 follows:

**Derivative Financial Instruments and Hedging Activities**

	December 31, 2008		December 31, 2007	
	Notional Amount	Fair Value	Notional Amount	Fair Value
(Dollars in thousands)				
Cash flow hedges:				
Interest rate swaps	\$	\$	\$ 50,000	\$ 180
Non-hedge derivatives:				
Interest rate floors	\$	\$	\$ 50,000	\$ 124

Cash flow hedges use derivatives that are entered into to manage the risk associated with the variability of expected future cash flows of variable-rate loans. The Company's cash flow hedges include certain interest rate swaps used to manage the interest rate risk associated with its significant volume of adjustable rate loans. At December 31, 2008 and 2007, zero and gains of \$629,000, respectively, were recorded in accumulated other comprehensive income. During 2007, a portion of the interest rate swap was deemed to be ineffective and the related net gain of \$165,000 was reclassified from accumulated other comprehensive income and recognized in earnings as required by hedge accounting. During 2008, income of \$1.0 million was recognized in earnings related to the ineffective portion of the interest rate swap. All remaining interest rate swap contracts were terminated in 2008.

Non-hedge derivatives are interest rate floors that do not meet the strict criteria for hedge accounting treatment. The Company uses derivatives to hedge exposures when it makes economic sense to do so, including circumstances in which the hedging relationship does not qualify for hedge accounting. Derivatives not designated as hedges are marked-to-market through earnings. The last remaining interest rate floor contract expired in December 2008.

**NOTE 11 INCOME TAXES**

The components of the provision for income taxes consisted of the following for the years shown:

	2008	2007
(Dollars in thousands)		
Current taxes:		
Federal	\$ 2,399	\$ 3,125
State	809	1,087
Total current taxes	3,208	4,212
Deferred taxes:		
Federal	154	(101)
State	180	47
Total deferred taxes	334	(54)
Total provision for income taxes	\$ 3,542	\$ 4,158

**Table of Contents**

A reconciliation of the amounts computed by applying the federal statutory rate of 35% for 2008 and 34% for 2007 to the income before the provision for income taxes and the effective tax rate are as follows:

	2008		2007	
	Amount	Rate	Amount	Rate
Provision for income taxes at statutory rate	\$ 3,468	35.0%	\$ 3,823	34.0%
Increase (reduction) in taxes resulting from:				
State taxes, net of federal tax benefit	660	6.7%	742	6.6%
Permanent differences	(196)	(2.0)%	(338)	(3.0)%
Other	(390)	(3.9)%	(69)	(0.6)%
	\$ 3,542	35.8%	\$ 4,158	37.0%

The major components of the net deferred tax asset (liabilities) at December 31, 2008 and 2007 are as follows:

	2008	2007
	(Dollars in thousands)	
Deferred tax assets:		
Securities available-for-sale	\$ 5,880	\$ 439
Accrued expenses	1,441	610
Nonaccrual interest	342	22
Loan fees		255
Allowance for loan losses	1,428	2,008
Securities acquired in business combination		51
State taxes	356	320
Integration and conversion costs		1,558
Other	757	611
Total deferred tax assets	10,204	5,874
Deferred tax liabilities:		
Depreciation	(2,084)	(2,030)
FHLB stock dividend	(571)	(400)
Loan premium amortization	(11)	(44)
Deferred loan costs	(1,260)	(677)
Core deposit intangibles	(2,180)	(2,038)
Trade name	(1,374)	(1,644)
Acquisition and reorganization costs		(220)
Other	(152)	(1,356)
Total deferred tax liabilities	(7,632)	(8,409)
Net deferred tax asset (liability)	\$ 2,572	\$ (2,535)

The Company establishes a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of December 31, 2008 and 2007, the Company believes that it is more-likely-than-not that we will have sufficient taxable earnings to realize its deferred tax assets and has not provided an allowance.

**NOTE 12 SHAREHOLDERS EQUITY**

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

The Company has 1,000 issued shares of preferred stock series A, \$0.01 par value, with a liquidation preference of \$1,000 per share. Redemption of the preferred stock series A is at the Company's option subject to

**Table of Contents**

certain restrictions imposed by our preferred stock series B. The redemption amount is computed at the per share liquidation preference plus unpaid dividends at a rate of 8.5%. Each holder of preferred stock series A has the right, exercisable at the option of the holder, to convert all or some of such holder's series A shares into common stock. The number of shares of common stock to be issued upon conversion of each share of preferred stock series A shall be determined by dividing the sum of each share's liquidation preference plus unpaid dividend by the conversion factor of 5.63 per share. As of December 31, 2008, the number of common shares which would be issued upon conversion of the preferred stock series A is 280,450.

On December 19, 2008, the Company participated in the U.S. Treasury Capital Purchase Program (CPP), under which the Company received \$25 million in exchange for issuing 25,000 preferred stock series B shares and a warrant to purchase common stock to the Treasury. As a participant in CPP, the Company is subject to various restrictions and requirements, such as restrictions on stock repurchases and payment of dividends, and other requirements relating to executive compensation and corporate governance practices. Moreover, under legislation such as the American Recovery and Reinvestment Act of 2009, the Company may early redeem the shares issued to the Treasury under the CPP without any early penalty or requirement to raise new capital, as previously required under the original terms of the CPP. The preferred stock series B qualifies as Tier 1 capital, and holders are entitled to receive cumulative cash dividends at a rate of 5 percent per year for the first five years and 9 percent per year thereafter, on a liquidation preference of \$1,000 per share. Dividends are payable quarterly in arrears on each of February 15, May 15, August 15, and November 15, if, as and when declared by the Company's Board of Directors, out of assets legally available for payment. The common stock warrant entitles the Treasury to purchase 599,042 shares of our common stock at an initial exercise price of \$6.26 for a term of ten years. The Company recorded the total \$25 million of the preferred stock series B and the warrant at their relative fair values of \$22.7 million and \$2.3 million, respectively. The difference from the par amount of the preferred shares is accreted to preferred stock over five years using the interest method.

On November 7, 2007, the Company's Board of Directors authorized a new stock repurchase program to buy back up to \$5.0 million of the Company's common stock until November 2008. The stock repurchase program was cancelled by the board of directors on August 31, 2008 due to current market conditions. During 2008, we repurchased 81,520 shares at a weighted average per share cost of \$8.37. During the fourth quarter of 2007, the Company repurchased 261,979 shares at a weighted average per share cost of \$9.00.

**NOTE 13 EARNINGS PER SHARE**

The number of shares outstanding at December 31, 2008 and 2007 was 11,462,964 and 11,507,020, respectively. On March 12, 2007, the number of shares of First California common stock outstanding increased by 5,868,586 as a result of the merger. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if common shares were issued pursuant to the exercise of common stock options under the Company's stock option plans. The dilutive calculation excludes 532,861 and 105,833 weighted average options outstanding for the years ended December 31, 2008 and 2007, respectively, for which the exercise price exceeded the average market price of the Company's common stock during these periods.

**Table of Contents**

The following table illustrates the computations of basic and diluted earnings per share for the periods indicated:

	Net Income	Weighted Average Shares	Per Share Amount
	(Dollars in thousands, except share and per share data)		
<i>For the year ended December 31, 2008:</i>			
Basic earnings per share	\$ 6,366	11,457,231	\$ 0.56
Effect of dilutive securities:			
Warrants		3,516	
Restricted stock		4,135	
Options		106,287	
Convertible preferred stock		272,880	
Diluted earnings per share	\$ 6,366	11,844,049	\$ 0.54
<i>For the year ended December 31, 2007:</i>			
Basic earnings per share	\$ 7,088	10,467,619	\$ 0.68
Effect of dilutive securities:			
Convertible preferred stock		264,075	
Diluted earnings per share	\$ 7,088	10,731,694	\$ 0.66

**NOTE 14 EMPLOYEE BENEFITS**

The Company has adopted a 401(k) savings investment plan which allows employees to defer certain amounts of compensation for income tax purposes under Section 401(k) of the Internal Revenue Code. Essentially all eligible employees may elect to defer and contribute up to statutory limits. The Company may, at its discretion, make matching contributions, the total of which may not exceed 15% of eligible compensation. For the years ending December 31, 2008 and 2007, the Company made matching contributions of approximately \$259,000 and \$243,000, respectively, to the plan.

As part of the merger and acquisition, the Company acquired life insurance to support life insurance benefits for several key employees and salary continuation benefits for certain executives. As of December 31, 2008 and 2007, the cash surrender value of the life insurance was \$11.4 million and \$10.9 million, respectively. As of December 31, 2008 and 2007, the Company recognized a liability for salary continuation benefits of \$384,000 and \$559,000, respectively. Payments under the salary continuation plan commence when the respective executive reaches the age of 65 and continue for a period up to 20 years. For the years ending December 31, 2008 and 2007, salary continuation expense was approximately (\$175,000) and \$123,000, respectively. The 2008 expense reflects the reversal of a previously accrued liability for an executive who terminated their employment prior to vesting in the salary continuation benefit.

The Company has entered into deferred compensation agreements with several of its key employees. Under the agreement, benefits are to be paid in a lump sum or equal monthly installments for a period up to five years upon the employee's termination with the Company or within 30 days of the employee's death. The Company also has deferred compensation arising through deferred severance payments to two former executives. As of December 31, 2008 and 2007, a liability of \$1,814,000 and \$2,409,000, respectively, for deferred compensation, including deferred severance was included in other liabilities in the accompanying consolidated balance sheets.

The Company has established and sponsors an irrevocable trust commonly referred to as a Rabbi Trust related to severance payments due to a former executive. The trust assets are consolidated in the Company's balance sheets in other assets and the associated liability is included in other liabilities. The asset and liability balances related to this trust as of December 31, 2008 and 2007 were \$972,000 and \$1,237,000, respectively.

**Table of Contents****NOTE 15 STOCK-BASED COMPENSATION**

**Stock Incentive Plans** In June 2007, the Company's board of directors approved the First California 2007 Omnibus Equity Incentive Plan, or the Plan. The Plan authorizes the issuance of awards for up to 1,000,000 shares of the Company's common stock in the form of incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards.

The Company issues restricted stock to employees and directors under share-based compensation plans. For the years ended December 31, 2008 and 2007, stock-based compensation expense relating to restricted stock awards was \$124,000 and \$26,000, respectively. A summary of non-vested restricted stock shares as of December 31, 2007 and changes during the year ended December 31, 2008, is presented below:

Non-Vested Shares	No. of Shares	Weighted Average Price
Outstanding, December 31, 2007	6,500	\$ 11.00
Granted	23,562	8.02
Vested	(3,250)	11.00
Forfeited		
Expired		
Outstanding, December 31, 2008	26,812	\$ 8.38

Of the total shares of restricted stock granted in 2008, 17,062 shares were granted to outside directors. The weighted average fair values of restricted stock awards granted during the years ended December 31, 2008 and 2007 were \$8.02 and \$11.00, respectively. As of December 31, 2008 and 2007, total unrecognized compensation cost related to restricted stock awards amounted to \$114,000 and \$57,000, respectively. This cost is expected to be recognized over a remaining period of 2.2 years.

The activity of stock options for the year ended December 31, 2008 is as shown:

	No. of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (Dollars in thousands)
Outstanding, December 31, 2007	628,706	\$ 10.40	5.55	\$ 2,310
Granted	180,000	7.35		
Exercised	(15,063)	5.78		
Forfeited/Expired	(151,846)	9.67		
Outstanding, December 31, 2008	641,797	8.89	5.25	2,463
Exercisable, December 31, 2008	228,026	\$ 8.11	4.28	\$ 542

**Table of Contents**

The activity of stock options for the year, net of merger and acquisition activity and assumption of existing option plans, ended December 31, 2007 is as shown:

	No. of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (Dollars in thousands)
Outstanding, December 31, 2006	492,355	\$ 8.28	6.0	\$ 2,691
Granted/Assumed	395,399	11.32		
Exercised	(243,766)	7.56		
Forfeited/Expired	(15,282)	10.70		
Outstanding, December 31, 2007	628,706	10.40	5.55	2,310
Exercisable, December 31, 2007	229,662	\$ 8.77	5.85	\$ 812

The estimated per share weighted average grant date fair value of options granted during the year ended December 31, 2008 and 2007 was \$3.14 and \$4.35, respectively. The total proceeds from options exercised during the year ended December 31, 2008 was \$86,000 and the total fair value of the shares granted during 2008 was \$564,000. At December 31, 2008, there was \$1,089,160 of total unrecognized compensation cost related to nonvested share-based compensation awards granted under the share-based compensation plans. The cost is expected to be recognized over a weighted-average period of 3.4 years.

Under the fair value method, stock option compensation expense is measured on the date of grant using an option-pricing model. Upon adoption of SFAS No. 123R, the fair values of the stock options were estimated using a lattice option pricing model. For the years ended December 31, 2008 and 2007, share-based compensation expense was \$733,000 and \$264,000, respectively.

The Company uses the lattice binomial model formula to determine the fair value of stock options using the following estimates and assumptions. The expected volatility assumption used in the lattice option pricing model is based upon the weekly historical volatility of the Company's stock price using a blend of the unweighted standard deviation of closing price with a weighted mean reversion formula. The risk-free interest rate assumption for the expected term of the share options and is based upon the U.S. Treasury implied forward yield curve at the time of the grant. The dividend yield assumption is based upon the Company's capital planning model. The fair value of the option at the grant date also follows.

	2008 Grants	2007 Grants
Expected option term	7.1 years	7.5 years
Expected volatility	33.0%	31.8%
Expected dividend yield	0%	0%
Risk-free interest rate	4.35%	4.05%
Stock option fair value	\$ 3.14	\$ 4.35

**NOTE 16 TRANSACTIONS WITH RELATED PARTIES**

Certain directors, executive officers, and principal shareholders are customers of and have had banking transactions with the Company, and the Company expects to have such transactions in the future. All loans and commitments to loan included in such transactions were made in compliance with applicable laws on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectibility or present any other unfavorable features. There is one extension of credit to a related party at December 31, 2008 and 2007.





**Table of Contents**

The outstanding balance of the loan to the related party was \$2,000 and \$32,000 at December 31, 2008 and 2007, respectively. Deposits of related parties held by the Company at December 31, 2008 amounted to approximately \$1,649,000.

**NOTE 17 CONCENTRATIONS OF CREDIT RISK**

The Company maintains balances in correspondent bank accounts which may at times exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to financial strength of correspondent banks. The Company has not experienced any losses in such accounts.

Substantially all of the Company's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Company's market areas, primarily Ventura, Orange and Los Angeles County, California. Many of such customers are also depositors of the Company. The concentrations of credit by type of loan are set forth in Note 4. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers as of December 31, 2008. The Company's loan policies require the extension of credit to any single borrower or group of related borrowers between \$2.0 million and \$5.0 million to be approved by the officer loan committee and credit in excess of \$5.0 million to be approved by the director loan committee.

The Bank's investment in municipal securities of \$17.4 million, or 8.6% of our securities portfolio, represents general obligations and revenue bonds of local agencies mainly within the state of California.

**NOTE 18 FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

In the normal course of business to meet the financing needs of its customers, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit written, is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company may or may not require collateral or other security to support financial instruments with credit risk, depending on its loan underwriting guidelines.

The following summarizes the Company's outstanding commitments:

	2008	2007
	(in thousands)	
Financial instruments whose contract amounts contain credit risk:		
Commitments to extend credit	\$ 153,077	\$ 198,657
Commercial and standby letters of credit	444	2,501
	\$ 153,521	\$ 201,158

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon an extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

**Table of Contents**

Letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

As of December 31, 2008 and 2007, the Company maintained a reserve for unfunded commitments of \$102,000 and \$99,000, respectively. The reserve is included in accrued interest payable and other liabilities on the balance sheets.

**Guarantees** As successor to all the rights and obligations of National Mercantile and FCB, the Company has unconditionally guaranteed, on a subordinated basis, all distributions and payments under the First California Trust s and FCB Statutory Trust I s capital securities upon liquidation, redemption, or otherwise, but only to the extent either the First California Trust or the FCB Statutory Trust I, as the case may be, fails to pay such distributions under the fixed/floating rate deferrable interest debentures such trust holds from the Company. See Junior Subordinated Debentures under Note 9 above.

**NOTE 19 COMMITMENTS AND CONTINGENCIES**

In the normal course of business, we make commitments to extend credit or issue letters of credit to customers. We generally do not recognize these commitments in our balance sheet. These commitments do involve, to varying degrees, elements of credit risk; however, we use the same credit policies and procedures as we do for on-balance sheet credit facilities. Commitments to extend credit were \$153.1 million at December 31, 2008 compared with \$198.7 million at December 31, 2007. Commercial and stand-by letters of credit were \$0.4 million and \$2.5 million at December 31, 2008 and December 31, 2007, respectively.

The Company has entered into deferred compensation agreements with several of its key employees. Under the agreement, benefits are to be paid in a lump sum or equal monthly installments for a period up to five years upon the employee s termination with the Company or within 30 days of the employee s death. The Company also has deferred compensation arising through deferred severance payments to two former executives.

Rental expense on operating leases included in occupancy expense in the consolidated statements of operations was \$1,660,000 in 2008 and \$1,432,000 in 2007. Estimated operating lease commitments for the next 5 years and thereafter is as follows:

Year	Amount (in thousands)
2009	\$ 1,728
2010	1,644
2011	1,600
2012	1,579
2013	1,534
Thereafter	6,742
	<b>\$ 14,827</b>

**NOTE 20 REGULATORY MATTERS**

The Company is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on a company s financial statements. Under capital adequacy guidelines, bank holding companies must meet specific

**Table of Contents**

capital guidelines that involve quantitative measures of the company's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2008, that the Company meets all capital adequacy requirements to which it is subject.

As discussed further in Note 12, the preferred shares and warrant to purchase common stock issued to the U.S. Treasury under the CPP qualify as Tier 1 capital.

The following tables present the capital amounts and ratios of the Company with a comparison to the minimum ratios for the periods indicated:

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio (in thousands)	Amount	Ratio
December 31, 2008				
Total capital (to risk weighted assets)	\$ 147,680	16.62%	\$ 71,102	≥ 8.00%
Tier I capital (to risk weighted assets)	\$ 139,530	15.70%	\$ 35,551	≥ 4.00%
Tier I capital (to average assets)	\$ 139,530	12.77%	\$ 43,699	≥ 4.00%

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio (in thousands)	Amount	Ratio
December 31, 2007				
Total capital (to risk weighted assets)	\$ 115,387	13.35%	\$ 69,167	≥ 8.00%
Tier I capital (to risk weighted assets)	\$ 107,460	12.43%	\$ 34,583	≥ 4.00%
Tier I capital (to average assets)	\$ 107,460	10.42%	\$ 41,248	≥ 4.00%

Common stockholders are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available therefore, subject to the restrictions set forth in the Delaware General Corporation Law, or the DGCL. The DGCL provides that a corporation may declare and pay dividends out of any surplus, and, if it has no surplus, out of any net profits for the fiscal year in which the dividend was declared or for the preceding fiscal year (provided that the payment will not reduce capital to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets). In addition, First California may not pay dividends on its capital stock if it is in default or has elected to defer payments of interest under its junior subordinated debentures. The Company cannot declare or pay a dividend on its common stock without the consent of the Treasury until the third anniversary of the date of the CPP investment, or December 19, 2011, unless prior to such third anniversary the senior preferred stock series B is redeemed in whole or the Treasury has transferred all of the senior preferred stock series B to third parties.

The Bank, and its predecessors, South Bay Bank and Mercantile National Bank were also subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum

**Table of Contents**

requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on a company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks 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. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2008, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2008, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum Total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the table below. There are no conditions or events since December 31, 2008 that management believes may have changed the Bank's category.

The following tables present the capital amounts and ratios of the Bank with a comparison to the minimum ratios for the periods indicated:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)						
December 31, 2008						
Total capital (to risk weighted assets)	\$ 109,022	12.27%	\$ 71,110	≥ 8.00%	\$ 88,888	≥ 10.00%
Tier I capital (to risk weighted assets)	\$ 100,873	11.35%	\$ 35,555	≥ 4.00%	\$ 53,333	≥ 6.00%
Tier I capital (to average assets)	\$ 100,873	9.26%	\$ 43,568	≥ 4.00%	\$ 54,460	≥ 5.00%

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)						
December 31, 2007						
Total capital (to risk weighted assets)	\$ 102,826	11.98%	\$ 68,687	≥ 8.00%	\$ 85,858	≥ 10.00%
Tier I capital (to risk weighted assets)	\$ 94,899	11.05%	\$ 34,343	≥ 4.00%	\$ 51,515	≥ 6.00%
Tier I capital (to average assets)	\$ 94,899	9.24%	\$ 41,065	≥ 4.00%	\$ 51,332	≥ 5.00%

The Bank is subject to various federal or state statutory and regulatory restrictions on its ability to pay dividends and capital distributions to its shareholder.

Under California law, banks may declare a cash dividend out of their net profits up to the lesser of retained earnings or the net income for the last three fiscal years (less any distributions made to shareholders during such period), or with the prior written approval of the DFI, in an amount not exceeding the greatest of (i) the retained earnings of the Bank, (ii) the net income of the Bank for its last fiscal year or (iii) the net income of the Bank for

## **Table of Contents**

its current fiscal year. In addition, under federal law, banks are prohibited from paying any dividends if after making such payment they would fail to meet any of the minimum regulatory capital requirements. The federal regulators also have the authority to prohibit state banks from engaging in any business practices which are considered to be unsafe or unsound, and in some circumstances the regulators might prohibit the payment of dividends on that basis even though such payments would otherwise be permissible.

The Bank may from time to time be permitted to make additional capital distributions to its shareholder with the consent of the DFI. It is not anticipated that such consent could be obtained unless the distributing bank were to remain well capitalized following such distribution.

### **NOTE 21 FAIR VALUE OF FINANCIAL INSTRUMENTS**

The Company adopted SFAS No. 157 effective January 1, 2008. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurement. This standard applies to all financial assets and liabilities that are being measured and reported at fair value on a recurring and non-recurring basis. Upon adoption of SFAS No. 157, there was no cumulative effect adjustment to beginning retained earnings and no impact on the financial statements in the first quarter of 2008.

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following table presents information about the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2008 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) for identical instruments that are highly liquid, observable and actively traded in over-the-counter markets. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable and can be corroborated by market data. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The Company uses fair value to measure certain assets and liabilities on a recurring basis when fair value is the primary measure for accounting. This is done primarily for available-for-sale securities and derivatives. Fair value is used on a nonrecurring basis to measure certain assets when applying lower of cost or market accounting or when adjusting carrying values, such as for loans held-for-sale, impaired loans, and other real estate owned. Fair value is also used when evaluating impairment on certain assets, including securities, goodwill, core deposit and other intangibles, and for annual disclosures required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*.

**Table of Contents**

The following tables present information on the assets measured and recorded at fair value on a recurring and nonrecurring basis at and for the year ended December 31, 2008.

	Financial Assets Measured at Fair Value on a Recurring Basis at December 31, 2008, Using			
	Fair value at December 31, 2008	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
Available-for-sale securities	\$ 202,462	\$	\$ 202,462	\$
Total assets measured at fair value	\$ 202,462	\$	\$ 202,462	\$

	Financial Assets Measured at Fair Value on a Non-Recurring Basis at December 31, 2008, Using			
	Fair value at December 31, 2008	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(in thousands)			
Impaired loans	\$ 1,438	\$	\$	\$ 1,438
Total assets measured at fair value	\$ 1,438	\$	\$	\$ 1,438

The following methods were used to estimate the fair value of each class of financial instrument above:

**Available for sale securities** Fair values for investment securities are obtained from a third-party pricing service for identical or comparable assets. The market valuations include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair value.

**Impaired loans** Impaired loans are measured and recorded at fair value on a nonrecurring basis. The impaired loans shown are collateral dependent and, accordingly, we measure impaired loans based on the fair value of such collateral. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* ( SFAS No. 107 ), requires that we disclose estimated fair values for our financial instruments. Fair value estimates, methods and assumptions, set forth below for our financial instruments, are made solely to comply with the requirements of SFAS No. 107. The following describes the methods and assumptions used in estimating the fair values of financial instruments, excluding financial instruments already recorded at fair value as described above in our SFAS No. 157 disclosures.

**Cash and cash equivalents** The carrying amounts of cash and federal funds sold approximate their fair value.

## Edgar Filing: First California Financial Group, Inc. - Form 10-K

**Loans** Loans are not measured at fair value on a recurring basis. Therefore, the following valuation discussion relates to estimating the fair value to be disclosed under SFAS No. 107. Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type and further segmented into fixed and adjustable rate interest terms and by credit risk categories. The fair values of loans is then estimated by discounting scheduled cash flows through the estimated maturity using estimated market prepayment speeds and estimated market discount rates that reflect the credit and interest rate risk inherent in the loans. Loans, other than those held-for-sale, are not normally purchased and sold by the Company, and there are no active trading markets for much of this portfolio.



**Table of Contents**

**Deposits** The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts and fixed-term certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Federal Home Loan Bank advances and other borrowings** The fair value of the FHLB advances and other borrowings is estimated using a discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

**Junior subordinated debentures** The fair value of the debentures is estimated using a discounted cash flow analysis based on current incremental borrowing rates for similar types of borrowing arrangements.

**Off-balance sheet instruments** Off-balance sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

The following table estimates fair values and the related carrying amounts of the Company's financial instruments:

	For the years ended December 31,			
	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
<b>Financial assets:</b>				
Cash, due from banks, and federal funds sold	\$ 49,127	\$ 49,127	\$ 17,668	\$ 17,668
Securities available-for-sale	202,462	202,462	231,095	231,095
FHLB and other stock	9,775	9,775	6,810	6,810
Loans, net	780,373	726,605	738,351	755,203
Interest rate swaps			180	180
Non-hedge derivatives			124	124
<b>Financial liabilities:</b>				
Demand deposits, money market and savings	\$ 410,194	\$ 410,194	\$ 479,810	\$ 479,810
Time certificates of deposit	407,401	411,107	281,270	281,144
FHLB advances and other borrowings	167,000	171,064	168,901	166,166
Junior subordinated debentures	26,701	12,042	26,648	22,611

These fair value disclosures represent the Company's best estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of the various instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

**Table of Contents**

**NOTE 22 SUBSEQUENT EVENTS**

On January 16, 2009, the Company filed a universal shelf registration statement on Form S-3 with the SEC. On March 2, 2009, the Company filed Amendment No. 1 to the universal shelf registration statement on Form S-3 filed with the SEC on January 16, 2009. The shelf registration statement was declared effective March 3, 2009. The Company filed the shelf registration statement on Form S-3 with the SEC to register shares of the Company's common stock issuable under the warrant related to the Company's participation in the CPP and to register an indeterminate number of shares of our common stock that may be issued by us at various times and at indeterminate prices, with a total offering price not to exceed \$25 million.

On January 23, 2009, the Bank assumed the insured, non-brokered deposits of 1<sup>st</sup> Centennial Bank, totaling approximately \$270 million, from the FDIC. The Bank also purchased approximately \$164 million in cash and cash equivalents, \$89 million in investment securities and \$2 million in consumer loans related to the transaction. In January 2009, the parent company contributed \$15 million of capital to the Bank who in turn paid approximately that sum to the FDIC for the assumption of those deposits and purchase of those assets. The addition of 1<sup>st</sup> Centennial's six branches expanded First California Bank's operations to 18 full-service branches throughout Southern California and increased total assets to greater than \$1.4 billion.

On February 17, 2009, the Company paid \$0.2 million in Series B Preferred Stock cash dividends. The dividend was declared by the Company's Board of Directors on January 28, 2009 and was payable to shareholders of record as of January 28, 2009.

On February 27, 2009, the FDIC adopted an interim rule setting a special assessment of 20 basis points for every \$100 of domestic deposits to restore the DIF reserves. This special assessment, as proposed, would be assessed in June 2009 and payable in September 2009. If this interim rule is adopted as currently proposed, this would significantly increase the Company's noninterest expense in 2009.

**Table of Contents****NOTE 23 PARENT COMPANY ONLY FINANCIAL INFORMATION**

The following financial information presents the condensed balance sheet of the Company on a parent-only basis as of December 31, 2008 and 2007, and the related condensed statements of operations and cash flows for each of the years in the two-year period ended December 31, 2008.

**Balance Sheet**

	December 31,	
	2008	2007
	(Dollars in thousands)	
Cash and due from banks	\$ 36,684	\$ 6,765
Investment in subsidiary bank	146,967	150,904
Other assets	5,707	10,308
<b>Total assets</b>	<b>\$ 189,358</b>	<b>\$ 167,977</b>
Junior subordinated debentures	\$ 26,701	\$ 26,648
Other liabilities	3,734	4,462
<b>Total liabilities</b>	<b>30,435</b>	<b>31,110</b>
Shareholders' equity:		
Preferred stock	23,713	1,000
Common stock	118	118
Additional paid-in-capital	135,603	132,543
Treasury stock	(3,050)	(2,374)
Retained earnings	11,559	5,350
Accumulated other comprehensive income (loss)	(9,020)	230
<b>Total shareholders' equity</b>	<b>158,923</b>	<b>136,867</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 189,358</b>	<b>\$ 167,977</b>

**Statements of Operations**

	Year ended	
	December 31,	
	2008	2007
	(Dollars in thousands)	
Interest income	\$ 248	\$ 320
Interest expense	1,755	1,680
<b>Net interest expense</b>	<b>(1,507)</b>	<b>(1,360)</b>
Other operating income		(2,554)
Other operating expense	2,299	5,459
<b>Loss before equity in net income of subsidiaries</b>	<b>(3,806)</b>	<b>(4,265)</b>
Equity in net income of subsidiaries	8,469	9,442
<b>Income before income tax benefit</b>	<b>4,663</b>	<b>5,177</b>
Income tax benefit	(1,703)	(1,911)

Net income

\$ 6,366

\$ 7,088

**Table of Contents****Statements of Cash Flow**

	<b>Year ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Dollars in thousands)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 6,366	\$ 7,088
<b>Adjustment to reconcile net income to net cash provided by operating activities:</b>		
Equity in net income of subsidiaries, net	(8,469)	(9,442)
Stock-based compensation costs	733	264
Loss on early termination of debt		1,564
Gain from sale of charters		(2,374)
Net (decrease) increase in other assets and other liabilities	3,879	(5,851)
<b>Net cash provided (used) in operations</b>	<b>2,509</b>	<b>(8,751)</b>
<b>Cash flows from investing activities:</b>		
Net cash and cash equivalents received in acquisition		6,760
Proceeds received for sale of Bank charters		2,375
Sales and maturities of available-for-sale securities		1,950
<b>Net cash provided by (used in) investing activities</b>		<b>11,085</b>
<b>Cash flows from financing activities:</b>		
Distribution from subsidiaries	3,000	3,000
Proceeds from exercise of stock options	86	1,844
Issuance of Junior Subordinated Debentures		16,495
Redemption of Junior Subordinated Debentures		(16,624)
Issuance of preferred stock and warrants	25,000	
Purchases of treasury stock	(676)	(2,374)
<b>Net cash provided by financing activities</b>	<b>27,410</b>	<b>2,341</b>
<b>Net increase in cash and cash equivalents</b>	<b>29,919</b>	<b>4,675</b>
Cash and cash equivalents, beginning of the year	6,765	2,090
<b>Cash and cash equivalents, end of the year</b>	<b>\$ 36,684</b>	<b>\$ 6,765</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$ 1,755	\$ 1,373
Cash (received) paid for income taxes, net	\$ (7,816)	\$ 608

**Table of Contents****NOTE 24 QUARTERLY FINANCIAL DATA (Unaudited)**

The following tables present the unaudited quarterly financial data for the years ended December 31, 2008 and 2007:

	2008 Quarters				2007 Quarters			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
	(in thousands, except per share data)							
Net interest income	\$ 9,836	\$ 10,348	\$ 10,335	\$ 10,263	\$ 10,658	\$ 10,954	\$ 11,710	\$ 6,922
Service charges, fees & other income	1,332	1,042	536	2,043	886	858	824	680
Loan commissions & sales	69	143	185	54	586	540	816	257
Gains (loss) on sales of securities	(9)	(13)			224			
Operating expenses	9,696	8,339	8,757	8,314	8,217	8,601	7,499	10,351
Provision for loan losses	200	300	200	450				
Income (loss) before income tax	1,332	2,881	2,099	3,596	4,137	3,751	5,851	(2,492)
Income tax provision (benefit)	200	1,120	815	1,407	1,475	1,340	2,741	(1,397)
Net income (loss)	\$ 1,132	\$ 1,761	\$ 1,284	\$ 2,189	\$ 2,662	\$ 2,411	\$ 3,110	\$ (1,095)
Net earnings (loss) per share:								
Basic	\$ 0.10	\$ 0.15	\$ 0.11	\$ 0.19	\$ 0.23	\$ 0.21	\$ 0.27	\$ (0.16)
Diluted	\$ 0.10	\$ 0.15	\$ 0.11	\$ 0.19	\$ 0.22	\$ 0.20	\$ 0.25	\$ (0.15)

---

**Table of Contents**

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosures***

None.

**Item 9A(T). *Controls and Procedures***

(a) *Evaluation of Disclosure Controls and Procedures:* An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this report. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as currently in effect are effective.

(b) *Management's Annual Report on Internal Control over Financial Reporting:* The management of First California Financial Group, Inc., or First California or the Company, including its consolidated subsidiaries, is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with U.S. generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management maintains a comprehensive system of controls intended to ensure that transactions are executed in accordance with management's authorization, assets are safeguarded, and financial records are reliable. Management also takes steps to see that information and communication flows are effective and to monitor performance, including performance of internal control procedures.

As of December 31, 2008, First California management assessed the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2008, is effective.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements should they occur. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the control procedures may deteriorate.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

(c) *Changes in Internal Controls:* There was no change in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. *Other Information***

None.

**Table of Contents**

**PART III**

**Item 10. *Directors, Executive Officers and Corporate Governance***

Information required by this Item will appear in the proxy statement to be delivered to our stockholders in connection with the 2009 annual meeting of stockholders, or the 2009 Proxy Statement, and such information is herein incorporated by reference to the 2009 Proxy Statement.

**Item 11. *Executive Compensation***

Information required by this Item will appear in the 2009 Proxy Statement, and such information is herein incorporated by reference to the 2009 Proxy Statement.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information required by this Item will appear in the 2009 Proxy Statement, and such information is herein incorporated by reference to the 2009 Proxy Statement.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information required by this Item will appear in the 2009 Proxy Statement, and such information is herein incorporated by reference to the 2009 Proxy Statement.

**Item 14. *Principal Accountant Fees and Services***

Information required by this Item will appear in the 2009 Proxy Statement, and such information is herein incorporated by reference to the 2009 Proxy Statement.

**PART IV**

**Item 15. *Exhibits, Financial Statement Schedules***

(a)(1) The following consolidated financial statements of First California Financial Group, Inc. are filed as part of this Annual Report.

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2008 and 2007

Consolidated Statements of Operations for each of the two years in the period ended December 31, 2008

Consolidated Statements of Comprehensive Income (Loss) for each of the two years in the period ended December 31, 2008

Consolidated Statements of Changes in Shareholders' Equity for each of the two years ended in the period ended December 31, 2008

Consolidated Statements of Cash Flows for each of the two years in the period ended December 31, 2008

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

Financial statement schedules other than those listed above have been omitted because they are either not applicable or the information is otherwise included.





**Table of Contents**

(a)(3) Exhibits. The following is a list of exhibits filed as a part of this Annual Report.

Exhibit Number	Exhibit Title
2.1	Agreement and Plan of Merger, dated as of June 15, 2006, by and among First California Financial Group, Inc., FCB Bancorp and National Mercantile Bancorp (Appendix A to the Joint Proxy Statement-Prospectus filed on February 21, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
3.1	Amended and Restated Certificate of Incorporation of First California Financial Group, Inc. (Exhibit 3.1 to Form 10-Q filed on August 13, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
3.2	Amended and Restated By-Laws of First California Financial Group, Inc. (Exhibit 3.2 to Form 10-Q filed on August 13, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
3.3	Certificate of Designations with respect to the Preferred Stock Series B, issued on December 19, 2008 (Exhibit 3.1 to Form 8-K filed on December 22, 2008 by First California Financial Group, Inc. and incorporated herein by this reference).
4.1	Indenture, dated as of July 16, 2001, governing Junior Subordinated Debt Securities between National Mercantile Bancorp, as Issuer, and the Bank of New York, as Trustee, (Exhibit 10.3 to Form 10-Q filed on December 21, 2001 by National Mercantile and incorporated herein by this reference).
4.2	Indenture, dated as of September 30, 2005, governing Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures due 2035, between FCB Bancorp, as Issuer, and Wilmington Trust Company, as Trustee (Exhibit 4.1 to Form 8-K filed on October 27, 2005 by FCB Bancorp and incorporated herein by this reference).
4.3	First Supplemental Indenture, dated as of March 12, 2007, by and between First California Financial Group, Inc., as Successor to FCB Bancorp, and Wilmington Trust Company, as Trustee (Exhibit 4.3 to Form 10-K filed on April 2, 2007 by First California Financial Group, Inc. and incorporated here by this reference).
4.4	Indenture for Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures, dated as of January 25, 2007 (Exhibit 10.4 to Form 8-K filed on January 20, 2006 by National Mercantile and incorporated herein by this reference).
4.5	First Supplemental Indenture, dated as of March 12, 2007, by and between First California Financial Group, Inc., as Successor to National Mercantile, and Wilmington Trust Company, as Trustee (Exhibit 4.5 to Form 10-K filed on April 2, 2007 by First California Financial Group, Inc. and incorporated here by this reference).
4.6	Specimen of Common Stock Certificate. (Exhibit 4.3 to Form S-8 filed on March 19, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
4.7	Form of Capital Security Certificate evidencing the capital securities of First California Capital Trust I (Exhibit 4.1 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
4.8	Form of Common Security Certificate evidencing common securities of First California Capital Trust I (Exhibit 4.3 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
4.9	Form of National Mercantile Bancorp Fixed/Floating Rate Junior Subordinated Deferrable Interest Debenture due 2037 (Exhibit 4.2 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).

**Table of Contents**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
4.10	Warrant to purchase up to 599,042 shares of Common Stock, issued on December 19, 2008 (Exhibit 4.2 to Form 8-K filed on December 22, 2008 by First California Financial Group, Inc. and incorporated herein by this reference).
4.11	Form of Certificate for the Fixed Rate Cumulative Perpetual Preferred Stock, Series B (Exhibit 4.3 to the Registration Statement on Form S-3 filed on January 16, 2009 by First California Financial Group, Inc. and incorporated herein by this reference).
10.1*	Employment Agreement, dated January 1, 1999, between National Mercantile Bancorp and Scott A. Montgomery (Exhibit 10.1 to Form S-4/A filed on December 5, 2006 by First California Financial Group, Inc. and incorporated herein by this reference).
10.2*	Letter dated June 15, 2006 amending Employment Agreement between National Mercantile Bancorp and Scott A. Montgomery (Exhibit 10.1 to Form 8-K filed on June 21, 2006 by National Mercantile and incorporated herein by this reference).
10.3*	Employment Agreement, dated June 15, 2006, between First California Financial Group, Inc. and C. G. Kum (Exhibit 99.2 to Form 8-K filed on June 21, 2006 by FCB Bancorp and incorporated herein by this reference).
10.4*	First California Financial Group, Inc. 2005 NMB Stock Incentive Plan (formerly known as the National Mercantile Bancorp 2005 Stock Incentive Plan) (Exhibit 4.1 to Form S-8 filed on May 25, 2005 by National Mercantile and incorporated herein by this reference).
10.5*	Amendment No. 1 to First California Financial Group, Inc. 2005 NMB Stock Incentive Plan (formerly known as the National Mercantile Bancorp 2005 Stock Incentive Plan) (Exhibit 10.7 to Form S-8 filed on March 19, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
10.6*	Form of Stock Option Agreement under First California Financial Group, Inc. 2005 NMB Stock Incentive Plan (formerly known as the National Mercantile 2005 Stock Incentive Plan) (Exhibit 10.1 to Form S-8 filed on May 25, 2005 by National Mercantile and incorporated herein by this reference).
10.7*	Form of Non-Qualified Stock Option Agreement under the First California Financial Group, Inc. 2005 NMB Stock Incentive Plan (formerly known as the National Mercantile 2005 Stock Incentive Plan) (Exhibit 10.2 to Form S-8 filed on May 25, 2005 by National Mercantile and incorporated herein by this reference).
10.8*	First California Financial Group, Inc. 1994 NMB Stock Option Plan (formerly known as National Mercantile Bancorp 1994 Stock Option Plan) (Exhibit 10.7 to Form S-4 filed on October 23, 2006 by First California Financial Group, Inc. and incorporated herein by this reference).
10.9*	Amendment No. 1 to First California Financial Group, Inc. 1994 NMB Stock Option Plan (formerly known as the National Mercantile Bancorp 1994 Stock Option Plan) (Exhibit 10.4 to Form S-8 filed on March 19, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
10.10*	Form of Stock Option Agreement under the First California Financial Group, Inc. 1994 NMB Stock Option Plan (formerly known as the National Mercantile Bancorp 1994 Stock Option Plan) (Exhibit 10.8 to Form S-4 filed on October 23, 2006 by First California Financial Group, Inc. and incorporated herein by this reference).
10.11*	First California Financial Group, Inc. FCB 2005 Stock Option Plan (formerly known as the FCB Bancorp 2005 Stock Option Plan) (Exhibit 10.1 to Form S-4/A filed on September 1, 2005 by FCB Bancorp and incorporated herein by this reference).
10.12*	Amendment No. 1 to First California Financial Group, Inc. FCB 2005 Stock Option Plan (formerly known as the FCB Bancorp 2005 Stock Option Plan) (Exhibit 10.2 to Form S-8 filed on March 19, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).

**Table of Contents**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
10.13*	First California 2007 Omnibus Equity Incentive Plan (Appendix B to the Proxy Statement filed on May 30, 2007 in connection with the 2007 annual meeting of stockholders and incorporated herein by this reference).
10.14	Registration Rights Agreement, dated June 15, 2006, by and between First California Financial Group, Inc. and the Stockholders party thereto (Exhibit 10.10 to Form S-4 filed on October 23, 2006 by First California Financial Group, Inc. and incorporated herein by this reference).
10.15	Amended and Restated Declaration of Trust of National Mercantile Capital Trust I, dated as of June 27, 2001 (Exhibit 10.11 to Form S-4/A filed on January 11, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
10.16	Guarantee Agreement of National Mercantile Bancorp for trust preferred securities dated July 16, 2001 (Exhibit 10.12 to Form S-4/A filed on January 11, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
10.17*	Second Amended and Restated Severance Agreement, dated as of June 15, 2006, by and between National Mercantile Bancorp and David Brown (Exhibit 10.3 to Form 8-K filed on June 21, 2006 by National Mercantile and incorporated herein by this reference).
10.18*	Second Amended and Restated Severance Agreement, dated as of June 15, 2006, by and between National Mercantile Bancorp and Robert W. Bartlett (Exhibit 10.2 to Form 8-K filed on June 21, 2006 by National Mercantile and incorporated herein by this reference).
10.19	Lease, dated as of November 12, 2003, between Century Park and Mercantile National Bank relating to Suite 800 offices at 1880 Century Park East, Los Angeles, California (Exhibit 10.10 to Form 10-KSB filed on March 30, 2004 by National Mercantile and incorporated herein by this reference).
10.20	Lease, dated as of September 19, 2003, between Metropolitan Life Insurance Company and Mercantile National Bank relating to offices at 3070 Bristol Street, Costa Mesa, California (Exhibit 10.11 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).
10.21	Lease, dated as of November 12, 2003, between Century Park and Mercantile National Bank relating to ground floor offices at 1880 Century Park East, Los Angeles, California (Exhibit 10.12 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).
10.22	Lease, dated as of March 30, 2005, between Brighton Enterprises, LLC and Mercantile National Bank relating to offices at 9601 Wilshire Boulevard, Beverly Hills, California (Exhibit 10.13 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).
10.23	Lease, dated as of September 10, 2004, between Encino Corporate Plaza, LP and Mercantile National Bank relating to offices at 16661 Ventura Boulevard, Encino, California (Exhibit 10.14 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).
10.24*	Mercantile National Bank Deferred Compensation Plan and Form of Agreement (Exhibit 10.15 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).
10.25*	Salary Continuation Agreement, dated March 27, 2003, with Chong Guk Kum (Exhibit 10.4 to Form S-4/A filed on September 1, 2005 by FCB Bancorp and incorporated herein by reference).
10.26*	Split Dollar Agreement, dated March 27, 2003, with Chong Guk Kum (Exhibit 10.5 to Form S-4/A filed on September 1, 2005 by FCB Bancorp and incorporated herein by reference).
10.27*	Salary Continuation Agreement, dated May 11, 2006, with Romolo Santarosa (Exhibit 10.13 to Form 10-Q filed on May 15, 2006 by FCB Bancorp and incorporated herein by reference).
10.28*	Split Dollar Agreement, dated May 11, 2006, with Romolo Santarosa (Exhibit 10.14 to Form 10-Q filed on May 15, 2006 by FCB Bancorp and incorporated herein by reference).

**Table of Contents**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
10.29*	Salary Continuation Agreement, dated March 27, 2003, with Thomas E. Anthony (Exhibit 10.6 to Form S-4/A filed on September 1, 2005 by FCB Bancorp and incorporated herein by reference).
10.30*	Split Dollar Agreement, dated March 27, 2003, with Thomas E. Anthony (Exhibit 10.7 to Form S-4/A filed on September 1, 2005 by FCB Bancorp and incorporated herein by reference).
10.31*	First California Bank Split Dollar Agreement, dated July 31, 2006, with John W. Birchfield (Exhibit 99.1 to Form 8-K filed on August 2, 2006 by FCB Bancorp and incorporated herein by reference).
10.32*	First California Bank Split Dollar Agreement, dated July 31, 2006, with Richard D. Aldridge (Exhibit 99.2 to Form 8-K filed on August 2, 2006 by FCB Bancorp and incorporated herein by reference).
10.33*	409A Amendment to the First California Bank Salary Continuation Agreement for Chong Guk Kum (Exhibit 99.1 to Form 8-K filed on June 7, 2006 by FCB Bancorp and incorporated herein by this reference).
10.34*	409A Amendment to the First California Bank Salary Continuation Agreement for Thomas E. Anthony (Exhibit 99.2 to Form 8-K filed on June 7, 2006 by FCB Bancorp and incorporated herein by this reference).
10.37	Placement Agreement, dated January 24, 2007, among National Mercantile Bancorp, First California Capital Trust I, FTN Financial Capital Markets and Keefe, Bruyette & Woods, Inc. (Exhibit 10.1 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
10.38	Amended and Restated Declaration of Trust among National Mercantile Bancorp, as sponsor, the Administrators named therein, and Wilmington Trust Company, as institutional and Delaware trustee (Exhibit 10.2 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
10.39	Guarantee Agreement between National Mercantile Bancorp and Wilmington Trust Company, as guarantee trustee (Exhibit 10.3 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
10.40	Indenture between National Mercantile Bancorp and Wilmington Trust Company, as indenture trustee (Exhibit 10.4 to Form 8-K filed on January 30, 2007 by National Mercantile and incorporated herein by this reference).
10.41	Amended and Restated Declaration of Trust, dated as of September 30, 2005, by and among Wilmington Trust Company, as Delaware Trustee and as Institutional Trustee, FCB Bancorp, as Sponsor, and C. G. Kum and Romolo Santarosa, as Administrators (Exhibit 4.2 to Form 8-K filed on October 27, 2005 by FCB Bancorp and incorporated herein by this reference).
10.42*	First California Financial Group, Inc. Amended 1996 NMB Stock Incentive Plan (formerly known as the National Mercantile Bancorp Amended 1996 Stock Incentive Plan) (Exhibit 10.6 to Form 10-KSB filed on April 15, 2003 by National Mercantile Bancorp and incorporated herein by this reference).
10.43*	Amendment No. 1 to First California Financial Group, Inc. Amended 1996 NMB Stock Incentive Plan (formerly known as the National Mercantile Bancorp Amended 1996 Stock Incentive Plan) (Exhibit 10.6 to Form S-8 filed on March 19, 2007 by First California Financial Group, Inc. and incorporated herein by this reference).
10.44*	Form of Stock Option Agreement under the First California Financial Group, Inc. Amended 1996 NMB Stock Incentive Plan (formerly known as the National Mercantile Bancorp Amended 1996 Stock Incentive Plan) (Exhibit 10.4 to Form 10-KSB filed on March 31, 2005 by National Mercantile and incorporated herein by this reference).

**Table of Contents**

<b>Exhibit Number</b>	<b>Exhibit Title</b>
10.45	Letter Agreement, dated December 19, 2008, including the Securities Purchase Agreement Standard Terms incorporated by reference therein, between the Company and the U.S. Treasury (Exhibit 10.1 to Form 8-K filed on December 22, 2008 by First California Financial Group, Inc. and incorporated herein by this reference).
10.46*	409A Amendment to the First California Bank Salary Continuation Agreement and Split Dollar Agreement between the Bank and C. G. Kum, dated December 29, 2008 (filed herewith).
10.47*	409A Amendment to the First California Bank Salary Continuation Agreement and Split Dollar Agreement between the Bank and Romolo Santarosa, dated December 29, 2008 (filed herewith).
10.48*	409A Amendment to the First California Bank Salary Continuation Agreement and Split Dollar Agreement between the Bank and Richard Glass, dated December 29, 2008 (filed herewith).
10.49	Lease, dated as of November 23, 2007, between Westlake Plaza Center East, LLC and First California Bank relating to Suite 300 offices at 3027 Townsgate Road, Westlake Village, California (filed herewith).
21	List of Subsidiaries of Registrant.
23.1	Consent of Moss Adams LLP.
24.1	Power of Attorney (included on signature page to this Annual Report on Form 10-K).
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* This exhibit is a management contract or compensatory plan or arrangement.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST CALIFORNIA FINANCIAL GROUP, INC.

Date: March 30, 2009

By: /s/ C. G. KUM  
C. G. Kum

**Director, President and Chief Executive Officer**

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints C. G. Kum and Romolo Santarosa, and each of them severally, his or her true and lawful attorney-in-fact with power of substitution and resubstitution to sign in his or her name, place and stead, in any and all capacities, to do any and all things and execute any and all instruments that such attorney may deem necessary or advisable under the Securities Exchange Act of 1934 and any rules, regulations and requirements of the U.S. Securities and Exchange Commission in connection with this Annual Report on Form 10-K and any and all amendments hereto, as fully for all intents and purposes as he or she might or could do in person, and hereby ratifies and confirms all said attorneys-in-fact and agents, each acting alone, and his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this registration statement has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated:

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ C. G. KUM  <b>C. G. Kum</b>	Director, President and Chief Executive Officer (Principal Executive Officer)	March 30, 2009
/s/ ROMOLO SANTAROSA  <b>Romolo Santarosa</b>	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 30, 2009
/s/ RICHARD D. ALDRIDGE  <b>Richard D. Aldridge</b>	Director	March 30, 2009
/s/ DONALD E. BENSON  <b>Donald E. Benson</b>	Director	March 30, 2009
/s/ JOHN W. BIRCHFIELD  <b>John W. Birchfield</b>	Director	March 30, 2009
/s/ JOSEPH N. COHEN  <b>Joseph N. Cohen</b>	Director	March 30, 2009
/s/ ROBERT E. GIPSON	Chairman of the Board of Directors	March 30, 2009

**Robert E. Gipson**



---

**Table of Contents**

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<i>/s/</i> W. DOUGLAS HILE <b>W. Douglas Hile</b>	Director	March 30, 2009
<i>/s/</i> ANTOINETTE HUBENETTE, M.D. <b>Antoinette Hubenette, M.D.</b>	Director	March 30, 2009
<i>/s/</i> SYBLE R. ROBERTS <b>Syble R. Roberts</b>	Director	March 30, 2009
<i>/s/</i> THOMAS TIGNINO <b>Thomas Tignino</b>	Director	March 30, 2009