IMPERIAL CAPITAL BANCORP, INC.
Form 10-Q
November 09, 2007

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2007

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 1-33199

IMPERIAL CAPITAL BANCORP, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	95-4596322 (IRS Employer Identification No.)
888 Prospect St., Suite 110, La Jolla, California (Address of Principal Executive Offices)	92037 (Zip Code)

(858) 551-0511
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" in Rule 12b-2 of the Exchange Act. Large Accelerated Filer £ Accelerated Filer R Non-Accelerated Filer £
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No R.
Number of shares of common stock of the registrant: 5,420,760 outstanding as of November 2, 2007.

IMPERIAL CAPITAL BANCORP, INC.
FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007

TABLE OF CONTENTS

Forward Looking Statements

"Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995: This Form 10-Q contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to, changes in economic conditions in our market areas, changes in policies by regulatory agencies, the impact of competitive loan products, loan demand risks, the quality or composition of our loan or investment portfolios, increased costs from pursuing the national expansion of our real estate lending platform and operational challenges inherent in implementing this expansion strategy, fluctuations in interest rates and changes in the relative differences between short and long-term interest rates, levels of non-performing assets and other loans of concern, and operating results, the economic impact of any terrorist actions on our loan originations and loan repayments and other risks detailed from time to time in our filings with the Securities and Exchange Commission. We caution readers not to place undue reliance on forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for 2007 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us.

As used throughout this report, the terms “we”, “our”, “us”, or the “Company” refer to Imperial Capital Bancorp, Inc. and its consolidated subsidiaries.

Table of Contents

PART I – FINANCIAL INFORMATION

IMPERIAL CAPITAL BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30, 2007 (unaudited)	December 31, 2006
	(in thousands, except share data)	
Assets		
Cash and cash equivalents	$ 12,102	$ 30,448
Investment securities available-for-sale, at fair value	116,205	99,527
Investment securities held-to-maturity, at amortized cost	165,045	193,512
Stock in Federal Home Loan Bank	50,938	48,984
Loans, net (net of allowance for loan losses of $44,665 and $46,049 as of September 30, 2007 and December 31, 2006, respectively)	3,134,321	2,973,368
Interest receivable	21,203	20,753
Other real estate and other assets owned, net	18,333	6,729
Premises and equipment, net	8,583	7,851
Deferred income taxes	11,269	11,513
Goodwill	3,118	3,118
Other assets	20,993	19,707
Total assets	$ 3,562,110	$ 3,415,510
Liabilities and Shareholders' Equity		
Liabilities:		
Deposit accounts	$ 2,184,397	$ 2,059,405
Federal Home Loan Bank advances and other borrowings	1,029,447	1,010,000
Accounts payable and other liabilities	34,361	38,168
Junior subordinated debentures	86,600	86,600
Total liabilities	3,334,805	3,194,173
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, 5,000,000 shares authorized, none issued	—	—
Contributed capital - common stock, $.01 par value; 20,000,000 shares authorized, 9,138,256 and 9,065,672 issued as of September 30, 2007 and December 31, 2006, respectively	84,805	82,073
Retained earnings	255,684	243,823
Accumulated other comprehensive income, net	428	35
	340,917	325,931
Less treasury stock, at cost 3,993,869 and 3,803,969 shares as of September 30, 2007 and December 31, 2006, respectively	(113,612)	(104,594)

Total shareholders' equity	227,305	221,337
Total liabilities and shareholders' equity	$ 3,562,110	$ 3,415,510

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

IMPERIAL CAPITAL BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
	(in thousands, except per share data)			
Interest income:				
Loans, including fees	$ 58,450	$ 53,605	$ 175,677	$ 151,824
Cash and investment securities	4,249	5,525	13,337	14,494
Total interest income	62,699	59,130	189,014	166,318
Interest expense:				
Deposit accounts	28,479	23,088	82,552	60,059
Federal Home Loan Bank advances and other borrowings	11,440	9,648	33,710	28,987
Junior subordinated debentures	2,102	2,104	6,268	6,088
Total interest expense	42,021	34,840	122,530	95,134
Net interest income before provision for loan losses	20,678	24,290	66,484	71,184
Provision for loan losses	5,266	1,500	6,516	3,750
Net interest income after provision for loan losses	15,412	22,790	59,968	67,434
Non-interest income:				
Late and collection fees	309	208	848	692
Other	640	370	1,660	1,210
Total non-interest income	949	578	2,508	1,902
Non-interest expense:				
Compensation and benefits	5,967	5,435	17,205	16,530
Occupancy and equipment	1,987	1,886	5,928	5,568
Other	5,301	4,153	14,446	13,246
Total general and administrative	13,255	11,474	37,579	35,344
Real estate and other assets owned expense, net	199	287	557	216
Total non-interest expense	13,454	11,761	38,136	35,560
Income before provision for income taxes	2,907	11,607	24,340	33,776

Provision for income taxes		1,193		4,759		9,851		13,850
NET INCOME	$	1,714	$	6,848	$	14,489	$	19,926
Basic earnings per share	$	0.31	$	1.24	$	2.64	$	3.58
Diluted earnings per share	$	0.31	$	1.20	$	2.58	$	3.49
Dividends declared per share of common stock	$	0.16	$	0.15	$	0.48	$	0.45

See accompanying notes to the unaudited consolidated financial statements.

Table of Contents

IMPERIAL CAPITAL BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Nine Months Ended September 30, 2007	2006
	(in thousands)	
Cash Flows From Operating Activities:		
Net Income	$ 14,489	$ 19,926
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,823	2,008
Amortization of premium on purchased loans	3,986	3,233
Accretion of deferred loan origination fees, net of costs	(1,967)	(2,235)
Provision for loan losses	6,516	3,750
Other, net	71	(1,476)
Increase in interest receivable	(450)	(2,143)
(Increase) decrease in other assets	(1,286)	468
(Decrease) increase in accounts payable and other liabilities	(3,804)	1,884
Net cash provided by operating activities	19,378	25,415
Cash Flows From Investing Activities:		
Purchases of investment securities available-for-sale	(77,195)	(22,703)
Proceeds from maturity and calls of investment securities available-for-sale	62,006	23,246
Purchases of investment securities held-to-maturity	—	(7,771)
Proceeds from the maturity and redemption of investment securities held-to-maturity	28,441	37,836
Purchase of stock in Federal Home Loan Bank	—	(2,724)
Purchase of loans	(47,343)	(347,328)
Other (increases) decreases in loans, net	(136,474)	141,427
Cash paid for capital expenditures	(2,555)	(2,453)
Net cash used in investing activities	(173,120)	(180,470)
Cash Flows From Financing Activities:		
Proceeds and excess tax benefits from exercise of employee stock options	2,488	2,167
Cash paid to acquire treasury stock	(9,018)	(9,179)
Cash paid for dividends	(2,513)	(1,582)
Increase in deposit accounts	124,992	211,142
Net proceeds from short-term borrowings	46,502	21,795
Proceeds from long-term borrowings	142,000	89,869
Repayments of long-term borrowings	(169,055)	(111,487)
Net cash provided by financing activities	135,396	202,725
Net (decrease) increase in cash and cash equivalents	(18,346)	47,670
Cash and cash equivalents at beginning of period	30,448	93,747

Cash and cash equivalents at end of period	$	12,102	$	141,417
Supplemental Cash Flow Information:				
Cash paid during the period for interest	$	124,536	$	89,769
Cash paid during the period for income taxes	$	11,702	$	14,329
Non-Cash Investing and Financing Transactions:				
Loans transferred to other real estate and other assets owned	$	14,330	$	3,499
Cash dividends declared but not yet paid	$	829	$	789

See accompanying notes to the unaudited consolidated financial statements.

IMPERIAL CAPITAL BANCORP, INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

The unaudited consolidated financial statements of Imperial Capital Bancorp, Inc. (formerly ITLA Capital Corporation) and subsidiaries (the "Company") included herein reflect all normal recurring adjustments which are, in the opinion of management, necessary to present fairly the results of operations and financial position of the Company, as of the dates and for the interim periods indicated. The unaudited consolidated financial statements include the accounts of Imperial Capital Bancorp, Inc. and its wholly-owned subsidiaries, Imperial Capital Bank (the "Bank") and Imperial Capital Real Estate Investment Trust ("Imperial Capital REIT").

All intercompany transactions and balances have been eliminated. Certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Certain amounts in prior periods have been reclassified to conform to the presentation in the current periods. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of the results of operations for the remainder of the year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2006.

NOTE 2 – ACCOUNTING FOR STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment", which requires the recognition of the expense related to the fair value of stock-based compensation awards within the consolidated statement of income. The Company elected the modified prospective transition method as permitted by SFAS No. 123(R), and accordingly, results from prior periods were not restated. Under this transition method, stock-based compensation expense for the three and nine months ended September 30, 2007 and 2006 includes compensation expense for stock-based compensation awards for which the requisite service was performed during the period. Compensation expense for unvested stock-based compensation awards granted prior to January 1, 2006 are based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". Compensation expense for all stock-based compensation awards granted subsequent to January 1, 2006 are based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Total stock-based compensation expense included in our consolidated statements of income for the three and nine months ended September 30, 2007 was approximately $68,000 ($41,000, net of tax or $0.01 per diluted share) and $126,000 ($76,000, net of tax or $0.01 per diluted share), respectively. For the three and nine months ended September 30, 2006, these amounts were $73,000 ($44,000, net of tax or $0.01 per diluted share) and $212,000 ($127,000, net of tax or $0.02 per diluted share), respectively. Unrecognized stock-based compensation expense related to stock options was approximately $879,000 and $105,000, respectively, at September 30, 2007 and 2006. The weighted-average period over which the unrecognized expense was expected to be recognized was 2.7

years and 1.7 years at September 30, 2007 and 2006, respectively.

Table of Contents

The fair value of each option grant was estimated on the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for option grants:

	Weighted-Average Assumptions for Option Grants	
	2007	2006
Dividend Yield	1.87%	1.20%
Expected Volatility	24.31%	22.94%
Risk-Free Interest Rates	4.67%	5.00%
Expected Lives	Five Years	Five Years
Weighted-Average Fair Value	$9.12	$13.32

NOTE 3 – EARNINGS PER SHARE

Basic Earnings Per Share ("Basic EPS") is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted Earnings Per Share ("Diluted EPS") reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock which shared in the Company's earnings.

The following is a reconciliation of the calculation of Basic EPS and Diluted EPS:

	Net Income	Weighted-Average Shares Outstanding	Per Share Amount
	(in thousands, except per share data)		
For the Three Months Ended September 30,			
2007			
Basic EPS	$ 1,714	5,453	$ 0.31
Effect of dilutive stock options	—	75	—
Diluted EPS	$ 1,714	5,528	$ 0.31
2006			
Basic EPS	$ 6,848	5,534	$ 1.24
Effect of dilutive stock options	—	156	(0.04)
Diluted EPS	$ 6,848	5,690	$ 1.20
For the Nine Months Ended September 30,			
2007			
Basic EPS	$ 14,489	5,490	$ 2.64
Effect of dilutive stock options	—	117	(0.06)
Diluted EPS	$ 14,489	5,607	$ 2.58
2006			
Basic EPS	$ 19,926	5,570	$ 3.58
Effect of dilutive stock options	—	147	(0.09)
Diluted EPS	$ 19,926	5,717	$ 3.49

-7-

Table of Contents

NOTE 4 – COMPREHENSIVE INCOME

Comprehensive income, which encompasses net income and the net change in unrealized gains (losses) on investment securities available-for-sale, is presented below:

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands)			
Net Income	$ 1,714	$ 6,848	$ 14,489	$ 19,926
Other comprehensive income:				
Change in net unrealized gains on investment securities available-for-sale, net of tax expense of $575 and $222 for the three months ended September 30, 2007 and 2006, respectively, and $262 and $174 for the nine months ended September 30, 2007 and 2006, respectively.	862	333	393	263
Comprehensive Income	$ 2,576	$ 7,181	$ 14,882	$ 20,189

NOTE 5 – IMPAIRED LOANS RECEIVABLE

As of September 30, 2007 and December 31, 2006, the recorded investment in impaired loans was $49.9 million and $35.5 million, respectively. The average recorded investment in impaired loans was $46.4 million and $42.1 million, respectively, for the three and nine months ended September 30, 2007, and $31.0 million and $32.4 million, respectively, for the same periods last year. Interest income recognized on impaired loans totaled $212,000 and $618,000 respectively, for the three and nine months ended September 30, 2007, as compared to $279,000 and $608,000, respectively, for the same periods last year.

NOTE 6 – NEW ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments” — an amendment of SFAS Nos. 133 and 140. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The Company adopted this statement on January 1, 2007. Adoption of SFAS No. 155 did not have a material impact on the Company’s financial condition or results of operations.

Table of Contents

In March 2006, the FASB issued SFAS No. 156, “Accounting for Servicing of Financial Assets”. This statement amends SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires companies to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. The statement permits a company to choose either the amortized cost method or fair value measurement method for each class of separately recognized servicing assets. The Company adopted this statement on January 1, 2007. Adoption of SFAS No. 156 did not have a material impact on the Company’s financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company on January 1, 2008. Management does not expect the adoption of SFAS No. 157 to have a material impact on the Company’s financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for us on January 1, 2008. Management does not expect the adoption of SFAS No. 159 to have a material impact on the Company’s financial condition or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 establishes a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition requirements. The Company adopted FIN 48 on January 1, 2007. Adoption of FIN 48 did not have a material impact on the Company’s financial condition or results of operations.

NOTE 7 – BUSINESS SEGMENT INFORMATION

SFAS No. 131, “Disclosures About Segments of an Enterprise and Related Information” (“SFAS No. 131”), requires disclosure of segment information in a manner consistent with the “management approach”. The management approach is based on the way the chief operating decision-maker organizes segments within a company for making operating decisions and assessing performance.

Table of Contents

The main factors used to identify operating segments are the specific product and business lines of the various operating segments of the Company. Operating segments are organized separately by product and service offered. We have identified one operating segment that meets the criteria of being a reportable segment in accordance with the provisions of SFAS No. 131. This reportable segment is the origination and purchase of loans, which by its legal form, is identified as operations of the Bank and Imperial Capital REIT. This segment derives the majority of its revenue by originating and purchasing loans. Other operating segments of the Company that did not meet the criteria of being a reportable segment in accordance with SFAS No. 131 have been aggregated and reported as "All Other". Substantially all of the transactions from the Company's operating segments occur in the United States.

Transactions between the reportable segment of the Company and its other operating segments are made at terms which approximate arm's-length transactions and in accordance with accounting principles generally accepted in the United States. There is no significant difference between the measurement of the reportable segments profits and losses disclosed below and the measurement of profits and losses in the Company's consolidated statements of income. Accounting allocations are made in the same manner for all operating segments.

	Lending Operations	All Other	Consolidated
		(in thousands)	
For the three months ended September 30,			
2007			
Revenues from external customers	$ 63,404	$ 244	$ 63,648
Total interest income	62,636	63	62,699
Total interest expense	39,919	2,102	42,021
Net income (loss)	3,349	(1,635)	1,714
2006			
Revenues from external customers	$ 59,341	$ 367	$ 59,708
Total interest income	58,836	294	59,130
Total interest expense	32,736	2,104	34,840
Net income (loss)	8,324	(1,476)	6,848
For the nine months ended September 30,			
2007			
Revenues from external customers	$ 190,362	$ 1,160	$ 191,522
Total interest income	188,242	772	189,014
Total interest expense	116,262	6,268	122,530
Net income (loss)	19,396	(4,907)	14,489
2006			
Revenues from external customers	$ 167,710	$ 510	$ 168,220
Total interest income	165,730	588	166,318
Total interest expense	89,046	6,088	95,134
Net income (loss)	24,626	(4,700)	19,926

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to identify the major factors that affected our financial condition and results of operations as of and for the three and nine months ended September 30, 2007.

Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies followed by us conform, in all material respects, to accounting principles generally accepted in the United States ("GAAP") and to general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While we base our estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

We consider accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on our financial statements. Accounting polices related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management. We also consider our accounting polices related to other real estate and other assets owned to be critical due to the potential significance of these activities and the estimates involved.

For additional information regarding critical accounting policies, refer to Note 1 – "Organization and Summary of Significant Accounting Policies" in the Notes to Consolidated Financial Statements and the sections captioned "Application of Critical Accounting Policies and Accounting Estimates" and "Allowance for Loan Losses and Nonperforming Assets" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Form 10-K for the year ended December 31, 2006. There have been no significant changes in the Company's application of accounting policies since December 31, 2006.

Table of Contents

RESULTS OF OPERATIONS

Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006

Executive Summary

Consolidated net income and diluted EPS were $1.7 million and $0.31, respectively, for the three months ended September 30, 2007, compared to $6.8 million and $1.20 for the same periods last year. The decline in net income during the current period was primarily caused by a $3.6 million reduction in net interest income before provision for loan losses and a $3.8 million increase in provision for loan losses recorded.

Net interest income before provision for loan losses decreased to $20.7 million for the quarter ended September 30, 2007 compared to $24.3 million for the same period last year. This decrease was primarily due to the decline in the yield earned on our loan portfolio, as higher yielding loans have continued to pay-off and are being replaced by our current loan production, which are originated at lower spreads over our cost of funds due to competitive pricing pressures. Net interest income was further negatively impacted by the increase in our cost of funds as deposits and other interest bearing liabilities repriced to higher current market interest rates, as well as the addition of new borrowings at higher current market interest rates, partially offset by the growth in the average balance of our loan portfolio.

The provision for loan losses was $5.3 million and $1.5 million, respectively, for the quarters ended September 30, 2007 and 2006. The increase in provision for loan losses during the quarter was primarily due to the increase in our non-performing loans. Non-performing loans as of September 30, 2007 were $40.8 million, compared to $26.3 million at December 31, 2006. As a percentage of our total loan portfolio, the amount of non-performing loans was 1.28% and 0.88% at September 30, 2007 and December 31, 2006, respectively. The increase in non-performing loans was primarily related to the addition of two lending relationships that in aggregate represented $19.5 million of the total of $26.6 million of loans transferred to non-performing status during the quarter.

The return on average assets was 0.19% for the three months ended September 30, 2007, compared to 0.86% for the same period last year. The return on average shareholders' equity was 2.97% for the three months ended September 30, 2007, compared to 12.77% for the same period last year.

Loan originations were $340.1 million for the quarter ended September 30, 2007, compared to $265.2 million for the same period last year. During the current quarter, the Bank originated $215.1 million of commercial real estate loans, $90.2 million of small balance multi-family real estate loans, and $34.8 million of entertainment finance loans. Loan originations for the same period last year consisted of $201.2 million of commercial real estate loans, $54.3 million of small balance multi-family real estate loans, and $9.7 million of entertainment finance loans. In addition, the Bank's wholesale loan operations acquired $120.9 million of multi-family real estate loans during the quarter ended September 30, 2006. The Bank did not purchase any loans during the current period.

Net Interest Income and Margin

The following table presents for the three months ended September 30, 2007 and 2006, our condensed average balance sheet information, together with interest income and yields earned on average interest earning assets and interest expense and rates paid on average interest bearing liabilities. Average balances are computed using daily average balances. Nonaccrual loans are included in loans receivable.

Table of Contents

	For the Three Months Ended September 30,					
	2007			2006		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
	(dollars in thousands)					
Assets						
Cash and investment securities	$ 349,765	$ 4,249	4.82%	$ 471,381	$ 5,525	4.65%
Loans receivable	3,114,776	58,450	7.44%	2,667,130	53,605	7.97%
Total interest earning assets	3,464,541	$ 62,699	7.18%	3,138,511	$ 59,130	7.47%
Non-interest earning assets	75,030			72,131		
Allowance for loan losses	(43,302)			(47,200)		
Total assets	$ 3,496,269			$ 3,163,442		
Liabilities and Shareholders' Equity						
Interest bearing deposit accounts:						
Interest bearing demand	$ 25,627	$ 251	3.89%	$ 25,329	$ 188	2.94%
Money market and passbook	248,955	3,152	5.02%	212,501	2,593	4.84%
Time certificates	1,879,726	25,076	5.29%	1,670,231	20,307	4.82%
Total interest bearing deposit accounts	2,154,308	28,479	5.24%	1,908,061	23,088	4.80%
FHLB advances and other borrowings	980,776	11,440	4.63%	908,897	9,648	4.21%
Junior subordinated debentures	86,600	2,102	9.63%	86,600	2,104	9.64%
Total interest bearing liabilities	3,221,684	$ 42,021	5.17%	2,903,558	$ 34,840	4.76%
Non-interest bearing demand accounts	10,022					