

PACWEST BANCORP
Form 10-Q
November 07, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2016

Commission File No. 001-36408

PACWEST BANCORP

(Exact name of registrant as specified in its charter)

Delaware 33-0885320

(State of Incorporation) (I.R.S. Employer
Identification No.)

9701 Wilshire Blvd., Suite 700

Beverly Hills, CA 90212

(Address of Principal Executive Offices, Including Zip Code)

(310) 887-8500

(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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 (Do not check if a smaller reporting company) ☐ 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 ☒

As of October 26, 2016, there were 120,279,633 shares of the registrant's common stock outstanding, excluding 1,393,373 shares of unvested restricted stock.

PACWEST BANCORP
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PACWEST BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (Unaudited)	December 31, 2015 (Dollars in thousands, except par value amounts)
ASSETS:		
Cash and due from banks	\$286,371	\$ 161,020
Interest-earning deposits in financial institutions	253,994	235,466
Total cash and cash equivalents	540,365	396,486
Securities available-for-sale, at fair value	3,341,335	3,559,437
Federal Home Loan Bank stock, at cost	19,386	19,710
Total investment securities	3,360,721	3,579,147
Gross loans and leases	14,806,427	14,528,165
Deferred fees, net	(63,581)	(49,911)
Allowance for loan and lease losses	(147,976)	(115,111)
Total loans and leases, net	14,594,870	14,363,143
Equipment leased to others under operating leases	198,931	197,452
Premises and equipment, net	38,977	39,197
Foreclosed assets, net	15,113	22,120
Goodwill	2,173,949	2,176,291
Core deposit and customer relationship intangibles, net	39,542	53,220
Deferred tax asset, net	27,073	126,389
Other assets	325,750	335,045
Total assets	\$21,315,291	\$21,288,490
LIABILITIES:		
Noninterest-bearing deposits	\$6,521,946	\$6,171,455
Interest-bearing deposits	9,123,722	9,494,727
Total deposits	15,645,668	15,666,182
Borrowings	541,011	621,914
Subordinated debentures	441,112	436,000
Accrued interest payable and other liabilities	144,905	166,703
Total liabilities	16,772,696	16,890,799
Commitments and contingencies (Note 8)		
STOCKHOLDERS' EQUITY:		
Preferred stock (\$0.01 par value; 5,000,000 shares authorized; none issued and outstanding)	—	—
Common stock (\$0.01 par value, 200,000,000 shares authorized at September 30, 2016 and December 31, 2015, 123,320,121 and 122,791,729 shares issued, respectively, including 1,397,715 and 1,211,951 shares of unvested restricted stock, respectively)	1,233	1,228
Additional paid-in capital	4,244,521	4,405,775

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Retained earnings	280,426	13,907
Treasury stock, at cost (1,502,597 and 1,378,002 shares at September 30, 2016 and December 31, 2015)	(55,658) (51,047)
Accumulated other comprehensive income, net	72,073	27,828
Total stockholders' equity	4,542,595	4,397,691
Total liabilities and stockholders' equity	\$21,315,291	\$21,288,490

See Notes to Condensed Consolidated Financial Statements.

PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

	Three Months Ended		Nine Months Ended		
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	2015
	(Unaudited)				
	(Dollars in thousands, except per share amounts)				
Interest income:					
Loans and leases	\$225,370	\$224,326	\$193,539	\$686,071	\$599,417
Investment securities	22,187	22,420	13,955	67,154	40,720
Deposits in financial institutions	298	308	178	914	304
Total interest income	247,855	247,054	207,672	754,139	640,441
Interest expense:					
Deposits	7,247	7,823	10,400	24,143	32,112
Borrowings	695	352	72	1,628	395
Subordinated debentures	5,278	5,122	4,680	15,382	13,787
Total interest expense	13,220	13,297	15,152	41,153	46,294
Net interest income	234,635	233,757	192,520	712,986	594,147
Provision for credit losses	8,471	13,903	8,746	42,514	31,709
Net interest income after provision for credit losses	226,164	219,854	183,774	670,472	562,438
Noninterest income:					
Service charges on deposit accounts	3,488	3,633	2,601	10,977	7,787
Other commissions and fees	12,528	11,073	6,376	35,090	18,895
Leased equipment income	8,538	8,523	5,475	25,305	16,232
Gain on sale of loans and leases	157	388	27	790	190
Gain on sale of securities	382	478	655	8,970	3,744
FDIC loss sharing expense, net	—	(6,502)	(4,449)	(8,917)	(13,955)
Other income	1,827	4,528	5,073	11,365	23,359
Total noninterest income	26,920	22,121	15,758	83,580	56,252
Noninterest expense:					
Compensation	62,661	62,174	48,152	185,900	144,922
Occupancy	12,010	12,193	10,762	36,835	31,950
Data processing	6,234	5,644	4,322	17,782	13,032
Other professional services	4,625	3,401	3,396	11,598	9,949
Insurance and assessments	4,324	4,951	3,805	14,240	11,546
Intangible asset amortization	4,224	4,371	1,497	13,341	4,500
Leased equipment depreciation	5,298	5,286	3,162	15,608	9,368
Foreclosed assets (income) expense, net	(248)	(3)	4,521	(812)	2,517
Acquisition, integration and reorganization costs	—	—	747	200	3,647
Other expense	11,582	12,064	9,775	36,787	28,344
Total noninterest expense	110,710	110,081	90,139	331,479	259,775
Earnings before income taxes	142,374	131,894	109,393	422,573	358,915
Income tax expense	(48,479)	(49,726)	(39,777)	(156,054)	(131,137)
Net earnings	\$93,895	\$82,168	\$69,616	\$266,519	\$227,778
Earnings per share:					
Basic	\$0.77	\$0.68	\$0.68	\$2.19	\$2.21
Diluted	\$0.77	\$0.68	\$0.68	\$2.19	\$2.21

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Dividends declared per share	\$0.50	\$0.50	\$0.50	\$1.50	\$1.50
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See Notes to Condensed Consolidated Financial Statements.

PACWEST BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended		September 30,		Nine Months Ended	
	September 30,	June 30,	September 30,	September 30,	September 30,	September 30,
	2016	2016	2015	2016	2015	2015
	(Unaudited)		(Unaudited)		(Unaudited)	
	(In thousands)		(In thousands)		(In thousands)	
Net earnings	\$93,895	\$82,168	\$69,616	\$266,519	\$227,778	
Other comprehensive income (loss), net of tax:						
Unrealized net holding gains (losses) on securities available-for-sale arising during the period	(15,954)	56,514	14,466	83,653	616	
Income tax (expense) benefit related to net unrealized holding gains (losses) arising during the period	6,509	(22,965)	(5,873)	(34,111)	(364)	
Unrealized net holding gains (losses) on securities available-for-sale, net of tax	(9,445)	33,549	8,593	49,542	252	
Reclassification adjustment for net (gains) losses included in net earnings ⁽¹⁾	(382)	(478)	(655)	(8,970)	(3,744)	
Income tax expense (benefit) related to reclassification adjustment	156	194	266	3,673	1,571	
Reclassification adjustment for net (gains) losses included in net earnings, net of tax	(226)	(284)	(389)	(5,297)	(2,173)	
Other comprehensive income (loss), net of tax	(9,671)	33,265	8,204	44,245	(1,921)	
Comprehensive income	\$84,224	\$115,433	\$77,820	\$310,764	\$225,857	

(1) Entire amounts are recognized in "Gain on sale of securities" on the Condensed Consolidated Statements of Earnings.

See Notes to Condensed Consolidated Financial Statements.

PACWEST BANCORP AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Nine Months Ended September 30, 2016						Accumulated Other Comprehensive Income	Total
	Common Stock	Par Value	Additional Paid-in Capital	Retained Earnings	Treasury Stock			
	Shares (Unaudited) (Dollars in thousands)							
Balance, December 31, 2015	121,413,727	\$ 1,228	\$ 4,405,775	\$ 13,907	\$(51,047)	\$ 27,828		\$ 4,397,691
Net earnings	—	—	—	266,519	—	—		266,519
Other comprehensive income - net								
unrealized gain on securities available-for-sale, net of tax	—	—	—	—	—	44,245		44,245
Restricted stock awarded and earned stock compensation, net of shares forfeited	528,392	5	17,270	—	—	—		17,275
Restricted stock surrendered	(124,595)	—	—	—	(4,611)	—		(4,611)
Tax effect from vesting of restricted stock	—	—	4,226	—	—	—		4,226
Cash dividends paid	—	—	(182,750)	—	—	—		(182,750)
Balance, September 30, 2016	121,817,524	\$ 1,233	\$ 4,244,521	\$ 280,426	\$(55,658)	\$ 72,073		\$ 4,542,595

See Notes to Condensed Consolidated Financial Statements.

PACWEST BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2016 (Unaudited) (In thousands)		2015
Cash flows from operating activities:			
Net earnings	\$	266,519	\$ 227,778
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	66,114		33,239
Provision for credit losses	42,514		31,709
(Gain) loss on sale of foreclosed assets	(837)	)	42
Provision for losses on foreclosed assets	—		5,163
Gain on sale of loans and leases	(790)	)	(190)
Gain on sale of premises and equipment	(23)	)	(54)
Gain on sale of securities	(8,970)	)	(3,744)
Unrealized gain on derivatives and foreign currencies, net	(374)	)	(909)
Earned stock compensation	17,275		11,836
Loss on sale of leasing unit	720		—
Tax effect included in stockholders' equity of restricted stock vesting	(4,226)	)	(596)
Decrease in accrued and deferred income taxes, net	74,946		108,553
Decrease in other assets	2,070		15,786
Decrease in accrued interest payable and other liabilities	(23,600)	)	(25,336)
Net cash provided by operating activities	431,338		403,277
Cash flows from investing activities:			
Net increase in loans and leases	(514,224)	)	(612,008)
Proceeds from sales of loans and leases	106,109		10,557
Securities available-for-sale:			
	184,644		93,389

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Proceeds from maturities and
paydowns

Proceeds from sales	392,841		212,169	
Purchases	(303,742	)	(557,769)
Net redemptions of Federal Home Loan Bank stock	324		23,359	
Proceeds from sales of foreclosed assets	7,973		18,772	
Purchases of premises and equipment, net	(6,185	)	(5,872)
Proceeds from sales of premises and equipment	24		108	
Proceeds from sale of leasing unit	138,955		—	
Proceeds from BOLI death benefit	1,853		—	
Net increase of equipment leased to others under operating leases	(15,802	)	(26,174)
Net cash used in investing activities	(7,230	)	(843,469)

Cash flows from financing
activities:

Net increase (decrease) in
deposits:

Noninterest-bearing	352,784		573,101	
Interest-bearing	(371,005	)	(216,717)
Net (decrease) increase in borrowings	(78,873	)	169,095	
Common stock repurchased	(4,611	)	(8,391)
Tax effect included in stockholders' equity of restricted stock vesting	4,226		596	
Cash dividends paid	(182,750	)	(154,424)
Net cash (used in) provided by financing activities	(280,229	)	363,260	
Net increase (decrease) in cash and cash equivalents	143,879		(76,932)
Cash and cash equivalents, beginning of period	396,486		313,226	
Cash and cash equivalents, end of period	\$ 540,365		\$ 236,294	

Supplemental disclosures of
cash flow information:

Cash paid for interest	\$ 41,392	\$ 51,218
Cash paid for income taxes	82,721	13,760
Loans transferred to foreclosed assets	129	13,472
	—	20,833

Partnership interest
transferred to equipment
leased to others under
operating leases

See Notes to Condensed Consolidated Financial Statements.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Organization

PacWest Bancorp is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. Our principal business is to serve as the holding company for our wholly-owned banking subsidiary, Pacific Western Bank. References to "Pacific Western" or the "Bank" refer to Pacific Western Bank together with its wholly-owned subsidiaries. References to "we," "us," "our," or the "Company," refer to PacWest Bancorp together with its subsidiaries on a consolidated basis. When we refer to "PacWest" or to the holding company, we are referring to PacWest Bancorp, the parent company, on a stand alone basis. As of September 30, 2016, the Company had total assets of \$21.3 billion, gross loans and leases of \$14.8 billion, total deposits of \$15.6 billion and total stockholders' equity of \$4.5 billion. We are focused on relationship-based business banking to small, middle-market and venture-backed businesses nationwide. The Bank offers a broad range of loan and lease and deposit products and services through 79 full-service branches located throughout the State of California, one branch located in Durham, North Carolina, and several loan production offices located in cities across the country. The Bank provides commercial banking services, including real estate, construction, and commercial loans and leases, and comprehensive deposit and treasury management services to small and middle-market businesses. Pacific Western offers additional products and services through its CapitalSource and Square 1 Bank divisions. CapitalSource provides cash flow, asset-based, equipment and real estate loans and treasury management services to established middle-market businesses on a national basis. Square 1 Bank offers a comprehensive suite of financial services focused on entrepreneurial businesses and their venture capital and private equity investors, with offices located in key innovation hubs across the United States. In addition, we provide investment advisory and asset management services to select clients through Square 1 Asset Management, Inc., a wholly-owned subsidiary of the Bank and a SEC-registered investment adviser. When we refer to "CapitalSource Inc." we are referring to the company acquired on April 7, 2014 and when we refer to the "CapitalSource Division" we are referring to a division of Pacific Western.

We generate our revenue primarily from interest received on loans and leases and, to a lesser extent, from interest received on investment securities, and fees received in connection with deposit services, extending credit and other services offered, including foreign exchange services. Our major operating expenses are compensation, occupancy, general operating expenses, and the interest paid by the Bank on deposits and borrowings.

We have completed 28 acquisitions from May 1, 2000 through September 30, 2016, including the acquisition of Square 1 Financial, Inc. ("Square 1") on October 6, 2015. Our acquisitions have been accounted for using the acquisition method of accounting and, accordingly, the operating results of the acquired entities have been included in the consolidated financial statements from their respective acquisition dates. See Note 2. Acquisitions, for more information about the Square 1 acquisition.

On March 31, 2016, we sold our Pacific Western Equipment Finance ("PWEF") leasing unit in Midvale, Utah, including approximately \$139 million of outstanding lease balances.

Significant Accounting Policies

Except as discussed below, our accounting policies are described in Note 1. Nature of Operations and Summary of Significant Accounting Policies, of our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the Securities and Exchange Commission ("Form 10-K").

Basis of Presentation

Our interim consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, certain disclosures accompanying annual consolidated financial statements are omitted. In the opinion of management, all significant intercompany accounts and transactions have been eliminated and adjustments, consisting solely of normal recurring accruals and considered necessary for the fair presentation of financial statements for the interim periods, have been included. The current period's results of operations are not necessarily indicative of the results that ultimately may be

achieved for the year. The interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Form 10-K.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Use of Estimates

We have made a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period to prepare these condensed consolidated financial statements in conformity with U.S. GAAP. Material estimates subject to change in the near term include, among other items, the allowance for credit losses, the carrying value and useful lives of intangible assets, the realization of deferred tax assets, and the fair value estimates of assets acquired and liabilities assumed in acquisitions. These estimates may be adjusted as more current information becomes available, and any adjustment may be significant.

As described in Note 2. Acquisitions, the acquired assets and liabilities of Square 1 were measured at their estimated fair values. We made significant estimates and exercised significant judgment in estimating fair values and accounting for such acquired assets and assumed liabilities.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period's presentation format. The operating segments previously reported have been aggregated into one segment to conform to the current period's presentation format.

Note 2. Acquisitions

Square 1 Financial, Inc. Acquisition

We acquired Square 1 on October 6, 2015. As part of the acquisition, Square 1 Bank, a wholly-owned subsidiary of Square 1, merged with and into Pacific Western. At closing, we formed the Square 1 Bank Division of Pacific Western to focus on providing a comprehensive suite of financial services to entrepreneurial businesses and their venture capital and private equity investors nationwide. When we refer to "Square 1", we are referring to the company acquired on October 6, 2015, and when we refer to the "Square 1 Bank Division", we are referring to a division of Pacific Western.

We completed this acquisition to increase our core deposits, expand our nationwide lending platform, and increase our presence in the technology and life-sciences credit markets. The Square 1 acquisition has been accounted for under the acquisition method of accounting. We acquired \$4.6 billion of assets and assumed \$3.8 billion of liabilities upon closing of the acquisition. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date. We made significant estimates and exercised significant judgment in estimating fair values and accounting for such acquired assets and liabilities. The application of the acquisition method of accounting resulted in goodwill of \$446.1 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 3. Goodwill and Other Intangible Assets

Goodwill arises from the acquisition method of accounting for business combinations and represents the excess of the purchase price over the fair value of the net assets and other identifiable intangible assets acquired. Our intangible assets with definite lives are core deposit intangibles ("CDI") and customer relationship intangibles ("CRI").

Goodwill and other intangible assets deemed to have indefinite lives generated from business combinations are not subject to amortization and are instead tested for impairment no less than annually. Impairment exists when the carrying value of goodwill exceeds its implied fair value. An impairment loss would be recognized in an amount equal to that excess and would be included in "Noninterest expense" in the condensed consolidated statements of earnings.

CDI and CRI are amortized over their respective estimated useful lives and reviewed for impairment at least quarterly.

The amortization expense represents the estimated decline in the value of the underlying deposits or loan and lease customers acquired. The weighted average amortization period remaining for all of our CDI and CRI as of

September 30, 2016 is 5.6 years. The aggregate CDI and CRI amortization expense is expected to be \$16.5 million for 2016. The estimated aggregate amortization expense related to these intangible assets for each of the next five years is \$11.5 million for 2017, \$8.8 million for 2018, \$6.7 million for 2019, \$4.7 million for 2020, and \$3.0 million for 2021.

The following table presents the changes in the carrying amount of goodwill for the period indicated:

	Goodwill (In thousands)
Balance, December 31, 2015	\$ 2,176,291
Adjustment to acquired Square 1 tax assets	(1,842)
Reduction due to sale of PWEF leasing unit	(500)
Balance, September 30, 2016	\$ 2,173,949

Goodwill adjustments include the finalization of the acquired Square 1 net tax assets and the reduction of goodwill in connection with the sale of the PWEF leasing unit. The finalization of the day 1 fair value of the acquired tax assets is due to completion of the 2015 tax returns. Through the sale of the PWEF leasing unit on March 31, 2016, \$0.5 million of goodwill was allocated to this business group; such goodwill reduction is included in the \$0.7 million loss on sale of the PWEF leasing unit and included in "Other income" in the condensed consolidated statements of earnings.

The following table presents the changes in CDI and CRI and the related accumulated amortization for the periods indicated:

	Three Months Ended			Nine Months Ended	
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(In thousands)				
Gross Amount of CDI and CRI:					
Balance, beginning of period	\$76,513	\$93,824	\$53,090	\$95,524	\$53,090
Fully amortized portion	(2,811)	(17,311)	—	(20,122)	—
Reduction due to sale of PWEF leasing unit	—	—	—	(1,700)	—
Balance, end of period	73,702	76,513	53,090	73,702	53,090
Accumulated Amortization:					
Balance, beginning of period	(32,747)	(45,687)	(38,889)	(42,304)	(35,886)
Amortization	(4,224)	(4,371)	(1,497)	(13,341)	(4,500)
Fully amortized portion	2,811	17,311	—	20,122	—
Reduction due to sale of PWEF leasing unit	—	—	—	1,363	—
Balance, end of period	(34,160)	(32,747)	(40,386)	(34,160)	(40,386)

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Net CDI and CRI, end of period	\$39,542	\$43,766	\$12,704	\$39,542	\$12,704
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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 4. Investment Securities

Securities Available-for-Sale

The following table presents amortized cost, gross unrealized gains and losses, and carrying values of securities available-for-sale as of the dates indicated:

Security Type:	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In thousands)								
Residential mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMOs"):								
Agency MBS	\$518,996	\$10,639	\$(694)	\$528,941	\$660,069	\$11,517	\$(3,746)	\$667,840
Agency CMOs	154,216	3,196	(181)	157,231	193,148	2,633	(1,026)	194,755
Private label CMOs	133,917	5,377	(669)	138,625	140,065	5,837	(1,106)	144,796
Municipal securities	1,437,952	84,571	(29)	1,522,494	1,508,968	39,435	(1,072)	1,547,331
Agency commercial MBS	517,163	15,299	(1,189)	531,273	392,729	1,509	(2,797)	391,441
Corporate debt securities	47,155	1,856	—	49,011	49,047	327	(950)	48,424
Collateralized loan obligations	155,373	1,511	(237)	156,647	133,192	128	(1,131)	132,189
SBA securities	185,639	1,909	(248)	187,300	211,946	41	(830)	211,157
US Treasury securities	—	—	—	—	70,196	—	(816)	69,380
Agency debt securities	—	—	—	—	36,302	611	—	36,913
Asset-backed and other securities	69,189	722	(98)	69,813	116,723	119	(1,631)	115,211
Total	\$3,219,600	\$125,080	\$(3,345)	\$3,341,335	\$3,512,385	\$62,157	\$(15,105)	\$3,559,437

As of September 30, 2016, securities available-for-sale with a carrying value of \$342.2 million were pledged as collateral for borrowings, public deposits and other purposes as required by various statutes and agreements.

During the three months ended September 30, 2016, we sold \$39.1 million of securities available-for-sale for a gross realized gain of \$1.0 million and a gross realized loss of \$0.6 million. During the three months ended September 30, 2015, we sold \$52.0 million of securities available-for-sale for a gross realized gain of \$0.7 million.

During the nine months ended September 30, 2016, we sold \$383.9 million of securities available-for-sale for a gross realized gain of \$10.5 million and a gross realized loss of \$1.6 million. During the nine months ended September 30, 2015, we sold \$208.4 million of securities available-for-sale for a gross realized gain of \$4.4 million and a gross realized loss of \$0.7 million.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Unrealized Losses on Securities Available-for-Sale

The following tables present the gross unrealized losses and fair values of securities available-for-sale that were in unrealized loss positions, for which other-than-temporary impairments have not been recognized in earnings, as of the dates indicated:

Security Type:	September 30, 2016					
	Less Than 12 Months		12 Months or More		Total	
	Gross		Gross		Gross	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Residential MBS and CMOs:						
Agency MBS	\$33,817	\$ (100)	\$130,786	\$ (594)	\$164,603	\$ (694)
Agency CMOs	18,893	(95)	26,476	(86)	45,369	(181)
Private label CMOs	14,552	(98)	29,058	(571)	43,610	(669)
Municipal securities	5,338	(29)	—	—	5,338	(29)
Agency commercial MBS	77,706	(1,189)	—	—	77,706	(1,189)
Collateralized loan obligations	2,506	(5)	39,197	(232)	41,703	(237)
SBA securities	2,956	(9)	39,842	(239)	42,798	(248)
Asset-backed and other securities	5	(2)	14,974	(96)	14,979	(98)
Total	\$155,773	\$ (1,527)	\$280,333	\$ (1,818)	\$436,106	\$ (3,345)
Security Type:	December 31, 2015					
	Less Than 12 Months		12 Months or More		Total	
	Gross		Gross		Gross	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Residential MBS and CMOs:						
Agency MBS	\$352,042	\$ (3,480)	\$9,342	\$ (266)	\$361,384	\$ (3,746)
Agency CMOs	117,786	(1,026)	—	—	117,786	(1,026)
Private label CMOs	93,533	(1,000)	1,638	(106)	95,171	(1,106)
Municipal securities	126,892	(1,061)	531	(11)	127,423	(1,072)
Agency commercial MBS	236,098	(2,156)	14,230	(641)	250,328	(2,797)
US Treasury securities	69,380	(816)	—	—	69,380	(816)
Corporate debt securities	29,379	(950)	—	—	29,379	(950)
Collateralized loan obligations	100,993	(1,131)	—	—	100,993	(1,131)
SBA securities	179,942	(830)	—	—	179,942	(830)
Asset-backed and other securities	71,619	(1,182)	16,091	(449)	87,710	(1,631)
Total	\$1,377,664	\$ (13,632)	\$41,832	\$ (1,473)	\$1,419,496	\$ (15,105)

We reviewed the securities that were in a loss position at September 30, 2016, and concluded their unrealized losses were not a result of downgraded credit ratings or other indicators of deterioration of the underlying issuers' ability to repay. Such unrealized losses were a result of the level of market interest rates and pricing changes caused by shifting supply and demand dynamics relative to the types of securities. Accordingly, we determined the securities were temporarily impaired and we did not recognize such impairment in the condensed consolidated statements of earnings. Although we occasionally sell securities for portfolio management purposes, we do not foresee having to sell any temporarily impaired securities strictly for liquidity needs and believe that it is more likely than not we would not be required to sell any temporarily impaired securities before recovery of their amortized cost.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Contractual Maturities of Securities Available-for-Sale

The following table presents the contractual maturities of our securities available-for-sale portfolio based on amortized cost and carrying value as of the date indicated:

Maturity:	September 30, 2016	
	Amortized Cost	Fair Value
	(In thousands)	
Due in one year or less	\$8,352	\$8,562
Due after one year through five years	252,427	259,096
Due after five years through ten years	714,467	738,034
Due after ten years	2,244,354	2,335,643
Total securities available-for-sale	\$3,219,600	\$3,341,335

Mortgage-backed securities have contractual terms to maturity but require periodic payments to reduce principal. In addition, expected maturities may differ from contractual maturities because obligors and/or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Interest Income on Investment Securities

The following table presents the composition of our interest income on investment securities for the periods indicated:

	Three Months Ended			Nine Months Ended	
	September 30, 2016	June 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(In thousands)				
Taxable interest	\$11,446	\$11,406	\$ 7,323	\$34,248	\$22,373
Non-taxable interest	10,333	10,503	6,058	31,562	14,760
Dividend income	408	511	574	1,344	3,587
Total interest income on investment securities	\$22,187	\$22,420	\$ 13,955	\$67,154	\$40,720

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 5. Loans and Leases

The Company's loan and lease portfolio includes originated and purchased loans and leases. Originated and purchased loans and leases for which there was no evidence of credit deterioration at their acquisition date and for which it was probable that all contractually required payments would be collected, are referred to collectively as non-purchased credit impaired loans, or "Non-PCI loans." Purchased loans for which there was, at the acquisition date, evidence of credit deterioration since their origination and for which it was deemed probable that we would be unable to collect all contractually required payments, are referred to as purchased credit impaired loans, or "PCI loans".

Non-PCI loans are carried at the principal amount outstanding, net of deferred fees and costs, and in the case of acquired loans, net of purchase discounts and premiums. Deferred fees and costs and purchase discounts and premiums are recognized as an adjustment to interest income over the contractual life of the loans using the effective interest method or taken into income on an accelerated basis when the related loans are paid off or sold.

PCI loans are accounted for in accordance with ASC Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality". For PCI loans, at the time of acquisition we (i) calculate the contractual amount and timing of undiscounted principal and interest payments (the "undiscounted contractual cash flows") and (ii) estimate the amount and timing of undiscounted expected principal and interest payments (the "undiscounted expected cash flows"). The difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The difference between the undiscounted cash flows expected to be collected and the estimated fair value of the acquired loans is the accretable yield. The nonaccretable difference represents an estimate of the loss exposure of principal and interest related to the PCI loan portfolio; such amount is subject to change over time based on the performance of such loans. The carrying value of PCI loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income.

The following table summarizes the composition of our loan and lease portfolio as of the dates indicated:

	September 30, 2016			December 31, 2015		
	Non-PCI			Non-PCI		
	Loans and Leases	PCI Loans	Total	Loans and Leases	PCI Loans	Total
	(In thousands)					
Real estate mortgage	\$5,481,922	\$104,896	\$5,586,818	\$5,706,903	\$168,725	\$5,875,628
Real estate construction and land	843,097	2,423	845,520	534,307	2,656	536,963
Commercial	8,104,711	12,649	8,117,360	7,977,067	17,415	7,994,482
Consumer	256,476	253	256,729	120,793	299	121,092
Total gross loans and leases	14,686,206	120,221	14,806,427	14,339,070	189,095	14,528,165
Deferred fees, net	(63,559)	(22)	(63,581)	(49,861)	(50)	(49,911)
Total loans and leases, net of deferred fees	14,622,647	120,199	14,742,846	14,289,209	189,045	14,478,254
Allowance for loan and lease losses	(136,747)	(11,229)	(147,976)	(105,534)	(9,577)	(115,111)
Total net loans and leases	\$14,485,900	\$108,970	\$14,594,870	\$14,183,675	\$179,468	\$14,363,143

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

Non Purchased Credit Impaired (Non PCI) Loans and Leases

The following tables present an aging analysis of our Non PCI loans and leases by portfolio segment and class as of the dates indicated:

	September 30, 2016				
	30 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
	(In thousands)				
Real estate mortgage:					
Commercial	\$10,489	\$5,772	\$16,261	\$4,262,571	\$4,278,832
Residential	266	2,520	2,786	1,183,323	1,186,109
Total real estate mortgage	10,755	8,292	19,047	5,445,894	5,464,941
Real estate construction and land:					
Commercial	1,245	—	1,245	507,166	508,411
Residential	—	—	—	323,104	323,104
Total real estate construction and land	1,245	—	1,245	830,270	831,515
Commercial:					
Cash flow	66	2,128	2,194	3,063,297	3,065,491
Asset-based	6,644	15	6,659	2,565,142	2,571,801
Venture capital	—	1,095	1,095	1,760,517	1,761,612
Equipment finance	3,304	350	3,654	667,129	670,783
Total commercial	10,014	3,588	13,602	8,056,085	8,069,687
Consumer	—	4	4	256,500	256,504
Total Non-PCI loans and leases	\$22,014	\$11,884	\$33,898	\$14,588,749	\$14,622,647

	December 31, 2015				
	30 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Current	Total
	(In thousands)				
Real estate mortgage:					
Commercial	\$3,947	\$13,075	\$17,022	\$4,534,936	\$4,551,958
Residential	3,391	905	4,296	1,131,809	1,136,105
Total real estate mortgage	7,338	13,980	21,318	5,666,745	5,688,063
Real estate construction and land:					
Commercial	—	—	—	343,360	343,360
Residential	—	—	—	184,360	184,360
Total real estate construction and land	—	—	—	527,720	527,720
Commercial:					
Cash flow	2,048	1,427	3,475	3,058,793	3,062,268
Asset-based	1	—	1	2,547,532	2,547,533
Venture capital	250	700	950	1,451,477	1,452,427

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Equipment finance	359	94	453	889,896	890,349
Total commercial	2,658	2,221	4,879	7,947,698	7,952,577
Consumer	626	1,307	1,933	118,916	120,849
Total Non-PCI loans and leases	\$10,622	\$17,508	\$28,130	\$14,261,079	\$14,289,209

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PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

It is the Company's policy to discontinue accruing interest when, in the opinion of management, there is a reasonable doubt as to the collectability of a loan or lease in the normal course of business or when principal or interest payments are past due 90 days or more unless the loan is both well secured and in the process of collection. Interest income on nonaccrual loans is recognized only to the extent cash is received and the principal balance of the loan is deemed collectable.

The following table presents our nonaccrual and performing Non-PCI loans and leases by portfolio segment and class as of the dates indicated:

	September 30, 2016			December 31, 2015		
	Nonaccrual	Performing	Total	Nonaccrual	Performing	Total
	(In thousands)					
Real estate mortgage:						
Commercial	\$74,606	\$4,204,226	\$4,278,832	\$52,363	\$4,499,595	\$4,551,958
Residential	5,089	1,181,020	1,186,109	4,914	1,131,191	1,136,105
Total real estate mortgage	79,695	5,385,246	5,464,941	57,277	5,630,786	5,688,063
Real estate construction and land:						
Commercial	1,245	507,166	508,411	—	343,360	343,360
Residential	366	322,738	323,104	372	183,988	184,360
Total real estate construction and land	1,611	829,904	831,515	372	527,348	527,720
Commercial:						
Cash flow	27,831	3,037,660	3,065,491	15,800	3,046,468	3,062,268
Asset-based	4,044	2,567,757	2,571,801	2,505	2,545,028	2,547,533
Venture capital	10,782	1,750,830	1,761,612	124	1,452,303	1,452,427
Equipment finance	46,916	623,867	670,783	51,410	838,939	890,349
Total commercial	89,573	7,980,114	8,069,687	69,839	7,882,738	7,952,577
Consumer	206	256,298	256,504	1,531	119,318	120,849
Total Non-PCI loans and leases	\$171,085	\$14,451,562	\$14,622,647	\$129,019	\$14,160,190	\$14,289,209

At September 30, 2016, nonaccrual loans and leases totaled \$171.1 million and included \$11.9 million of loans and leases 90 or more days past due, \$13.2 million of loans and leases 30 to 89 days past due, and \$146.0 million of loans and leases current with respect to contractual payments that were placed on nonaccrual status based on management's judgment regarding their collectability. Nonaccrual loans and leases totaled \$129.0 million at December 31, 2015, including \$16.8 million of the loans and leases 90 or more days past due, \$3.6 million of loans and leases 30 to 89 days past due, and \$108.6 million of current loans and leases that were placed on nonaccrual status based on management's judgment regarding their collectability.

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table presents the credit risk rating categories for Non-PCI loans and leases by portfolio segment and class as of the dates indicated. Nonclassified loans and leases are those with a credit risk rating of either pass or special mention, while classified loans and leases are those with a credit risk rating of either substandard or doubtful.

	September 30, 2016			December 31, 2015		
	Classified	Nonclassified	Total	Classified	Nonclassified	Total
	(In thousands)					
Real estate mortgage:						
Commercial	\$104,914	\$4,173,918	\$4,278,832	\$98,436	\$4,453,522	\$4,551,958
Residential	15,876	1,170,233	1,186,109	12,627	1,123,478	1,136,105
Total real estate mortgage	120,790	5,344,151	5,464,941	111,063	5,577,000	5,688,063
Real estate construction and land:						
Commercial	1,839	506,572	508,411	571	342,789	343,360
Residential	366	322,738	323,104	1,395	182,965	184,360
Total real estate construction and land	2,205	829,310	831,515	1,966	525,754	527,720
Commercial:						
Cash flow	174,490	2,891,001	3,065,491	183,726	2,878,542	3,062,268
Asset-based	34,791	2,537,010	2,571,801	19,340	2,528,193	2,547,533
Venture capital	37,986	1,723,626	1,761,612	19,105	1,433,322	1,452,427
Equipment finance	46,916	623,867	670,783	54,054	836,295	890,349
Total commercial	294,183	7,775,504	8,069,687	276,225	7,676,352	7,952,577
Consumer	363	256,141	256,504	2,500	118,349	120,849
Total Non-PCI loans and leases	\$417,541	\$14,205,106	\$14,622,647	\$391,754	\$13,897,455	\$14,289,209

In addition to our internal risk rating process, our federal and state banking regulators, as an integral part of their examination process, periodically review the Company's loan and lease risk rating classifications. Our regulators may require the Company to recognize rating downgrades based on their judgments related to information available to them at the time of their examinations. Risk rating downgrades generally result in higher allowances for credit losses. Non-PCI nonaccrual loans and leases and performing troubled debt restructured loans are considered impaired for reporting purposes. The following table presents the composition of our impaired loans and leases as of the dates indicated:

	September 30, 2016			December 31, 2015		
	Nonaccrual Loans and Leases	Performing Troubled Debt Restructured Loans	Total Impaired and Leases	Nonaccrual Loans and Leases	Performing Troubled Debt Restructured Loans	Total Impaired and Leases
	(In thousands)					
Real estate mortgage	\$79,695	\$59,793	\$139,488	\$57,277	\$27,133	\$84,410
Real estate construction and land	1,611	7,089	8,700	372	7,631	8,003
Commercial	89,573	3,250	92,823	69,839	5,221	75,060
Consumer	206	216	422	1,531	197	1,728
Total	\$171,085	\$70,348	\$241,433	\$129,019	\$40,182	\$169,201

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

The following tables present information regarding our Non-PCI impaired loans and leases by portfolio segment and class as of and for the dates indicated:

	September 30, 2016			December 31, 2015		
	Unpaid			Unpaid		
	Recorded Investment	Principal Balance	Related Allowance	Recorded Investment	Principal Balance	Related Allowance
	(In thousands)					
With An Allowance Recorded:						
Real estate mortgage:						
Commercial	\$67,821	\$68,852	\$ 7,055	\$17,967	\$19,219	\$ 777
Residential	2,517	2,573	244	2,278	2,435	681
Real estate construction and land:						
Residential	736	736	11	747	747	26
Commercial:						
Cash flow	25,936	26,971	4,686	14,072	20,312	7,079
Asset-based	4,136	4,584	2,899	3,901	4,423	2,511
Venture capital	10,781	10,856	3,331	—	—	—
Equipment finance	46,916	52,908	12,715	11,193	11,894	8,032
Consumer	346	355	179	365	372	157
With No Related Allowance Recorded:						
Real estate mortgage:						
Commercial	\$59,090	\$68,390		\$58,678	\$68,333	
Residential	10,060	15,309		5,487	11,406	
Real estate construction and land:						
Commercial	7,964	7,964		7,256	7,256	
Commercial:						
Cash flow	2,519	4,783		2,825	5,121	
Asset-based	2,535	2,575		2,729	2,726	
Venture capital	—	—		124	125	
Equipment finance	—	11,709		40,216	44,194	
Consumer	76	146		1,363	1,945	
Total Non-PCI Loans and Leases With and Without an Allowance Recorded:						
Real estate mortgage	\$139,488	\$155,124	\$ 7,299	\$84,410	\$101,393	\$ 1,458
Real estate construction and land	8,700	8,700	11	8,003	8,003	26
Commercial	92,823	114,386	23,631	75,060	88,795	17,622
Consumer	422	501	179	1,728	2,317	157
Total	\$241,433	\$278,711	\$ 31,120	\$169,201	\$200,508	\$ 19,263

PACWEST BANCORP AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

	Three Months Ended September 30,			
	2016		2015	
	Weighted	Interest	Weighted	Interest
	Average	Income	Average	Income
	Balance ⁽¹⁾	Recognized	Balance ⁽¹⁾	Recognized
	(In thousands)			
With An Allowance Recorded:				
Real estate mortgage:				
Commercial	\$ 18,580	\$ 262	\$ 13,230	\$ 152
Residential	2,505	15	2,478	9
Real estate construction and land:				
Residential	736	4	751	4
Commercial:				
Cash flow	25,933	9	13,653	13
Asset-based	2,730	5	4,906	48
Venture capital	6,878	—	—	—
Equipment finance	42,913	—	9,654	—