

COMMUNITY WEST BANCSHARES /  
Form 10-Q  
May 13, 2011

---

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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: 000-23575

COMMUNITY WEST BANCSHARES

(Exact name of registrant as specified in its charter)

California  
(State or other jurisdiction of incorporation or organization)

77-0446957  
(I.R.S. Employer Identification No.)

445 Pine Avenue, Goleta, California  
(Address of principal executive offices)

93117  
(Zip Code)

(805) 692-5821

(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 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 definition 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  x

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

Number of shares of common stock of the registrant outstanding as of May 13, 2011: 5,980,981 shares

---

---

---

## TABLE OF CONTENTS

| PART I.  | FINANCIAL INFORMATION  | PAGE |
|--|--|------|
| ITEM 1.  | <u>FINANCIAL STATEMENTS</u><br><u>(UNAUDITED)</u>  |      |
|  | <u>CONSOLIDATED BALANCE SHEETS</u>   | 3    |
|  | <u>CONSOLIDATED INCOME</u><br><u>STATEMENTS</u>  | 4    |
|  | <u>CONSOLIDATED STATEMENT OF</u><br><u>STOCKHOLDERS' EQUITY</u>  | 5    |
|  | <u>CONSOLIDATED STATEMENTS OF</u><br><u>CASH FLOWS</u>   | 6    |
|  | <u>NOTES TO UNAUDITED</u><br><u>CONSOLIDATED FINANCIAL</u><br><u>STATEMENTS</u>  | 7    |
| The unaudited consolidated financial statements included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto of Community West Bancshares included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2014. |  |      |
|  | <u>MANAGEMENT'S DISCUSSION AND</u><br><u>ANALYSIS OF FINANCIAL</u><br><u>CONDITION AND RESULTS OF</u><br><u>OPERATIONS</u> | 23   |
| ITEM 4.  | <u>CONTROLS AND PROCEDURES</u>   | 32   |
| PART II. OTHER INFORMATION   |  |      |
| ITEM 1.  | <u>LEGAL PROCEEDINGS</u>   | 32   |
| ITEM 1A.   | <u>RISK FACTORS</u>  | 32   |
| ITEM 2.  | <u>UNREGISTERED SALES OF EQUITY</u><br><u>SECURITIES AND USE OF</u><br><u>PROCEEDS</u>                                     | 32   |
| ITEM 3.  | <u>DEFAULTS UPON SENIOR</u><br><u>SECURITIES</u>   | 32   |
| ITEM 4.  | <u>REMOVED AND RESERVED</u>  | 33   |
| ITEM 5.  | <u>OTHER INFORMATION</u>   | 33   |
| ITEM 6.  | <u>EXHIBITS</u>  | 33   |

SIGNATURES

34

2

---

Table of ContentsPART I – FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTSCOMMUNITY WEST BANCSHARES  
CONSOLIDATED BALANCE SHEETS

|   | March 31,<br>2011<br>(unaudited) | December 31,<br>2010 |
|---|----------------------------------|----------------------|
| (dollars in thousands)  |                                  |                      |
| <b>ASSETS</b>   |                                  |                      |
| Cash and due from banks   | \$ 15,239                        | \$ 6,201             |
| Federal funds sold  | 25                               | 25                   |
| Cash and cash equivalents   | 15,264                           | 6,226                |
| Time deposits in other financial institutions   | 290                              | 290                  |
| Investment securities available-for-sale, at fair value; amortized cost of \$23,017 at March 31, 2011 and \$23,038 at December 31, 2010                               | 23,261                           | 23,342               |
| Investment securities held-to-maturity, at amortized cost; fair value of \$16,335 at March 31, 2011 and \$17,514 at December 31, 2010                                 | 15,767                           | 16,893               |
| Federal Home Loan Bank (FHLB) stock, at cost  | 4,831                            | 5,031                |
| Federal Reserve Bank (FRB) stock, at cost   | 1,322                            | 1,322                |
| <b>Loans:</b>   |                                  |                      |
| Loans held for sale, at lower of cost or fair value   | 77,440                           | 82,320               |
| Loans held for investment, net of allowance for loan losses of \$13,172 at March 31, 2011 and \$13,302 at December 31, 2010   | 490,255                          | 498,312              |
| Total loans   | 567,695                          | 580,632              |
| Foreclosed real estate and repossessed assets   | 9,664                            | 8,478                |
| Premises and equipment, net   | 2,947                            | 2,915                |
| Other assets  | 24,498                           | 22,475               |
| <b>TOTAL ASSETS</b>   | <b>\$ 665,539</b>                | <b>\$ 667,604</b>    |
| <b>LIABILITIES</b>  |                                  |                      |
| <b>Deposits:</b>  |                                  |                      |
| Non-interest-bearing demand   | \$ 47,951                        | \$ 35,767            |
| Interest-bearing demand   | 280,989                          | 262,431              |
| Savings   | 21,844                           | 20,371               |
| Time certificates   | 176,833                          | 211,324              |
| Total deposits  | 527,617                          | 529,893              |
| Other borrowings  | 64,000                           | 64,000               |
| Convertible debentures  | 7,872                            | 8,081                |
| Other liabilities   | 3,807                            | 3,988                |
| Total liabilities   | 603,296                          | 605,962              |
| <b>STOCKHOLDERS' EQUITY</b>   |                                  |                      |
| Preferred stock, no par value; 10,000,000 shares authorized; 15,600 shares issued and outstanding   | 14,874                           | 14,807               |
| Common stock, no par value; 10,000,000 shares authorized; 5,980,981 and 5,916,272 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively | 33,369                           | 33,133               |
| Retained earnings   | 13,856                           | 13,523               |
| Accumulated other comprehensive income, net   | 144                              | 179                  |
| Total stockholders' equity  | 62,243                           | 61,642               |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$ 665,539</b>                | <b>\$ 667,604</b>    |

See accompanying notes

3

---

Table of Contents

COMMUNITY WEST BANCSHARES  
CONSOLIDATED INCOME STATEMENTS (UNAUDITED)

|   | Three Months Ended<br>March 31,             |                  |
|---|---|------------------|
|   | 2011  | 2010             |
|   | (in thousands, except per share<br>amounts) |                  |
| <b>INTEREST INCOME</b>  |   |                  |
| Loans   | \$ 9,044                                    | \$ 9,534         |
| Investment securities   | 283   | 399              |
| Other   | 3   | 9                |
| Total interest income   | 9,330                                       | 9,942            |
| <b>INTEREST EXPENSE</b>                                       |   |                  |
| Deposits  | 1,670                                       | 2,059            |
| Other borrowings and convertible debentures                   | 591   | 588              |
| Total interest expense  | 2,261                                       | 2,647            |
| <b>NET INTEREST INCOME</b>                                    | <b>7,069</b>                                | <b>7,295</b>     |
| Provision for loan losses                                     | 983   | 3,074            |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>    | <b>6,086</b>                                | <b>4,221</b>     |
| <b>NON-INTEREST INCOME</b>                                    |   |                  |
| Other loan fees   | 230   | 352              |
| Gains from loan sales, net                                    | 82  | 103              |
| Document processing fees                                      | 105   | 125              |
| Loan servicing, net   | 148   | 89               |
| Service charges   | 130   | 129              |
| Other   | 43  | 41               |
| Total non-interest income                                     | 738   | 839              |
| <b>NON-INTEREST EXPENSES</b>                                  |   |                  |
| Salaries and employee benefits                                | 3,109                                       | 3,008            |
| Occupancy and equipment expenses                              | 505   | 499              |
| FDIC assessment   | 302   | 325              |
| Professional services   | 215   | 203              |
| Advertising and marketing                                     | 70  | 92               |
| Depreciation and amortization                                 | 98  | 113              |
| Loss on sale of foreclosed real estate and repossessed assets | 459   | 62               |
| Data processing   | 127   | 127              |
| Other operating expenses                                      | 924   | 542              |
| Total non-interest expenses                                   | 5,809                                       | 4,971            |
| Income before provision for income taxes                      | 1,015                                       | 89               |
| Provision for income taxes                                    | 420   | 38               |
| <b>NET INCOME</b>   | <b>\$ 595</b>                               | <b>\$ 51</b>     |
| Preferred stock dividends                                     | 262   | 262              |
| <b>NET INCOME (LOSS) APPLICABLE TO COMMON STOCKHOLDERS</b>    | <b>\$ 333</b>                               | <b>\$ (211 )</b> |
| <b>Earnings (loss) per common share:</b>                      |   |                  |
| Basic   | \$ 0.06                                     | \$ (0.04 )       |
| Diluted   | \$ 0.05                                     | \$ (0.04 )       |
| Basic weighted average number of common shares outstanding    | 5,960                                       | 5,915            |

|  |       |       |
|--|-------|-------|
| Diluted weighted average number of common shares outstanding | 8,245 | 5,915 |
|--|-------|-------|

See accompanying notes.



Table of Contents

COMMUNITY WEST BANCSHARES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(Unaudited)

|   | Preferred<br>Stock | Common Stock<br>Shares<br>(in thousands) | Amount    | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Stockholders'<br>Equity |
|---|--------------------|--|-----------|----------------------|---|----------------------------------|
| BALANCES AT JANUARY<br>1, 2011  | \$ 14,807          | 5,916                                    | \$ 33,133 | \$ 13,523            | \$ 179  | \$ 61,642                        |
| Stock option expense,<br>recognized in earnings                       |                    |  | 7         |                      |   | 7                                |
| Conversion of debentures  |                    | 60                                       | 210       |                      |   | 210                              |
| Exercise of stock options   |                    | 5  | 19        |                      |   | 19                               |
| Comprehensive income:   |                    |  |           |                      |   |                                  |
| Net income  |                    |  |           | 595                  |   | 595                              |
| Change in unrealized loss on<br>securities available-for-sale,<br>net |                    |  |           |                      | (35 )   | (35 )                            |
| Comprehensive income  |                    |  |           |                      |   | 560                              |
| Dividends on preferred stock  | 67                 |  |           | (262 )               |   | (195 )                           |
| BALANCES AT MARCH 31,<br>2011   | \$ 14,874          | 5,981                                    | \$ 33,369 | \$ 13,856            | \$ 144  | \$ 62,243                        |
| See accompanying notes.   |                    |  |           |                      |   |                                  |

Table of Contents

COMMUNITY WEST BANCSHARES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

|   | Three Months Ended<br>March 31, |                 |
|---|---------------------------------|-----------------|
|   | 2011                            | 2010            |
|   | (in thousands)                  |                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                 |                 |
| Net income  | \$595                           | \$51            |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |                 |
| Provision for loan losses   | 983                             | 3,074           |
| Depreciation and amortization   | 98                              | 113             |
| Stock-based compensation  | 7                               | 5               |
| Net amortization of discounts and premiums for investment securities              | (22 )                           | (66 )           |
| Loss (gain) on:   |                                 |                 |
| Sale of foreclosed real estate and repossessed assets                             | 459                             | 62              |
| Sale of loans held for sale   | (82 )                           | (103 )          |
| Loan originated for sale and principal collections, net                           | 3,171                           | 5,795           |
| Changes in:   |                                 |                 |
| Servicing rights, net of amortization   | 29                              | 62              |
| Other assets  | (1,993 )                        | (145 )          |
| Other liabilities   | (216 )                          | (118 )          |
| Net cash provided by operating activities   | 3,029                           | 8,730           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                 |                 |
| Purchase of available-for-sale securities   | (2,362 )                        | (2,204 )        |
| Principal pay downs and maturities of available-for-sale securities               | 2,407                           | 2,298           |
| Redemptions of Federal Home Loan Bank stock                                       | 200                             | -               |
| Principal pay downs and maturities of held-to-maturity securities                 | 1,125                           | 2,571           |
| Loan originations and principal collections, net                                  | 6,396                           | 3,893           |
| Proceeds from sale of foreclosed real estate and repossessed assets               | 824                             | 359             |
| Net decrease in time deposits in other financial institutions                     | -                               | 165             |
| Purchase of premises and equipment, net   | (130 )                          | (23 )           |
| Net cash provided by investing activities   | 8,460                           | 7,059           |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                                 |                 |
| Preferred stock dividends   | (262 )                          | (262 )          |
| Amortization of discount on preferred stock                                       | 67                              | 67              |
| Exercise of stock options   | 19                              | -               |
| Net increase in demand deposits and savings accounts                              | 32,215                          | 34,859          |
| Net decrease in time certificates of deposit                                      | (34,490 )                       | (26,152 )       |
| Proceeds from FHLB and FRB advances   | -                               | 22,000          |
| Repayment of FHLB and the FRB advances  | -                               | (37,000 )       |
| Net cash used in financing activities   | (2,451 )                        | (6,488 )        |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>                                  | <b>9,038</b>                    | <b>9,301</b>    |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>                               | <b>6,226</b>                    | <b>5,511</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                                   | <b>\$15,264</b>                 | <b>\$14,812</b> |
| Supplemental Disclosure of Cash Flow Information:                                 |                                 |                 |
| Cash paid for interest  | \$2,495                         | \$2,380         |
| Cash paid for income taxes  | 815                             | 5               |
| Supplemental Disclosure of Noncash Investing Activity:                            |                                 |                 |

|  |         |         |
|--|---------|---------|
| Transfers to foreclosed real estate and repossessed assets | \$2,469 | \$2,299 |
| See accompanying notes.                                    |         |         |

Table of Contents

COMMUNITY WEST BANCSHARES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The interim consolidated financial statements reflect all adjustments and reclassifications that, in the opinion of management, are necessary for the fair presentation of the results of operations and financial condition for the interim period. The unaudited consolidated financial statements include Community West Bancshares ("CWBC") and its wholly-owned subsidiary, Community West Bank, N.A. ("CWB" or the "Bank"). CWBC and CWB are referred to herein collectively as "the Company". The accompanying unaudited condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and with the instructions to Form 10-Q and Article 8-03 of Regulation S-X promulgated by the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair statement have been reflected in the financial statements. However, the results of operations for the three-month period ended March 31, 2011 are not necessarily indicative of the results to be expected for the full year.

These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Loans Held for Investment – Loans are recognized at the principal amount outstanding, net of unearned income, loan participations and amounts charged off. Unearned income includes deferred loan origination fees reduced by loan origination costs. Unearned income on loans is amortized to interest income over the life of the related loan using the level yield method. The following is a description of the loan categories held for investment.

Commercial Loans

In addition to traditional term commercial loans made to business customers, CWB grants revolving business lines of credit. Under the terms of the revolving lines of credit, CWB grants a maximum loan amount, which remains available to the business during the loan term. Generally, as part of the loan requirements, the business agrees to maintain its primary banking relationship with CWB. CWB does not extend material loans of this type in excess of two years.

Commercial Real Estate

Commercial real estate and construction loans are primarily made for the purpose of purchasing, improving or constructing single-family residences, commercial or industrial properties. This loan category also includes SBA 504 loans and loans made on land.

A substantial portion of CWB's real estate construction loans are first and second trust deeds on the construction of owner-occupied single family dwellings. CWB also makes real estate construction loans on commercial properties. These consist of first and second trust deeds collateralized by the related real property. Construction loans are generally written with terms of six to eighteen months and usually do not exceed a loan to appraised value of 80%.

Commercial and industrial real estate loans are secured by nonresidential property. Office buildings or other commercial property primarily secure these loans. Loan to appraised value ratios on nonresidential real estate loans are generally restricted to 80% of appraised value of the underlying real property if occupied by the owner or owner's business; otherwise, these loans are generally restricted to 75% of appraised value of the underlying real property.

SBA 504 loans are made in conjunction with Certified Development Companies. These loans are granted to purchase or construct real estate or acquire machinery and equipment. The loan is structured with a conventional first trust deed provided by a private lender and a second trust deed which is funded through the sale of debentures. The predominant structure is terms of 10% down payment, 50% conventional first loan and 40% debenture.

Conventional and investor loans are sometimes funded by our secondary-market partners and CWB receives a premium for these transactions.

#### SBA Loans

The SBA loans consist of 7(a) and Business and Industry loans (“B&I”). The 7(a) loan proceeds are used for working capital, machinery and equipment purchases, land and building purposes, leasehold improvements and debt refinancing. In general, the SBA guarantees up to 85% of the loan amount depending on loan size. In certain instances, the Company sells a portion of the loans, however, under the SBA 7(a) loan program, the Company is required to retain a minimum of 5% of the principal balance of each loan it sells into the secondary market.

## Table of Contents

B&I loans are guaranteed by the U.S. Department of Agriculture. The guaranteed amount is generally 80%. B&I loans are similar to the 7(a) loans but are made to businesses in designated rural areas. These loans can also be sold into the secondary market.

### Single Family Real Estate Loans

The mortgage loans consist of first and second mortgage loans secured by trust deeds on one to four family homes. These loans are made to borrowers for purposes such as purchasing a home, refinancing an existing home, interest rate reduction, home improvement, or debt consolidation. Generally, these loans are underwritten to specific investor guidelines and are committed for sale to that investor. Although the majority of these loans are sold servicing released into the secondary market, a relatively small percentage is held as part of the Bank's portfolio.

### Manufactured Housing Loans

The Bank originates loans secured by manufactured homes located in mobile home parks along the California coast and in the Sacramento area. The loans are serviced internally and are originated under one of two programs: fixed rate loans written for terms of 10 to 20 years; adjustable rate loans written for a term of 30 years with the initial interest rates fixed for the first 5 or 10 years and then adjusting annually subject to caps and floors.

### HELOC

The Bank provides lines of credit collateralized by residential real estate, home equity lines of credit (HELOC), for consumer related purposes. Typically, HELOCs are collateralized by a second deed of trust.

### Other Installment Loans

Installment loans consist of automobile and general-purpose loans made to individuals. These loans are primarily fixed rate.

Provision and Allowance for Loan Losses – The Company maintains a detailed, systematic analysis and procedural discipline to determine the amount of the allowance for loan losses (“ALL”). The ALL is based on estimates and is intended to be adequate to provide for probable losses inherent in the loan portfolio. This process involves deriving probable loss estimates that are based on migration analysis/historical loss rates and qualitative factors that are based on management's judgment. The migration analysis and historical loss rate calculations are based upon the annualized loss rates utilizing a twelve quarter loss history. Migration analysis is utilized for the Commercial Real Estate, Commercial and SBA portfolios. The historical loss rate method is utilized for the homogeneous loan categories which include Manufactured Housing, HELOC's, Single Family Residential and Consumer loans. The migration analysis takes into account the risk rating of loans that are charged off in each loan category. In loan categories that historic loss rates are utilized, management increases the reserve requirement for Special Mention and Substandard loans. Loans that are considered Doubtful are typically charged off. The following is a description of the characteristics of loans graded Pass, Special Mention, Substandard, Doubtful and Loss. Loan ratings are reviewed as part of our normal loan monitoring process, but, at a minimum, updated on an annual basis.

#### Pass

Loans rated in this category are acceptable loans, appropriately underwritten, bearing an ordinary risk of loss to the Bank. Loans in this category are loans to quality borrowers with financial statements presenting a good primary source as well as an adequate secondary source of repayment. In the case of individuals, borrowers deserving of this rating are quality borrowers demonstrating a reasonable level of secure income, a net worth adequate to support the loan and presenting a good primary source as well as an adequate secondary source of repayment.

#### Special Mention

A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit

position at some future date.

**Substandard**

A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans does not have to exist in individual loans classified Substandard.

8

---

Table of Contents

Doubtful

A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss Loans

Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be affected in the future. Losses are taken in the period in which they surface as uncollectible. The following is the Bank's policy regarding charging off loans by loan categories.

Commercial, Commercial Real Estate and SBA Loans

Charge-Offs on these loan categories are taken as soon as all or a portion of any loan balance is deemed to be uncollectible. A loan is considered uncollectible when the debtor is delinquent in principal or interest repayment 90 days or more and, in the opinion of the Bank, improvement in the debtor's ability to repay the debt in a timely manner is doubtful. Also, collateral value is insufficient to cover the outstanding indebtedness and outside guarantors do not provide adequate support. Loans secured by real estate on which principal or interest is due and unpaid for 90 days are evaluated for possible charge-down. Loan balances are charged-down to the fair value of the property, if, based on a current appraisal, an apparent deficiency exists. In the event there is no perceived equity, the loan is charged-off in full like any other unsecured loan, which is not secured and over 90 days.

Single Family Real Estate, HELOC's and Manufactured Housing Loans

Consumer loans and residential mortgages secured by one-to-four family residential properties, HELOC and manufactured housing loans in which principal or interest is due and unpaid for 90 days, are evaluated for possible charge-down. Loan balances are charged-down to the fair value of the property if, based on a current appraisal, an apparent deficiency exists. In the event there is no perceived equity, the loan is charged-off in full like any other consumer loan, which is not secured and unpaid over 90-120 days.

Consumer Loans

All consumer loans (excluding real estate mortgages, home equity loans and savings secured loans) are charged-off or charged-down to net recoverable value before becoming 120 days or 5 payments delinquent. Consumer losses are identified well before the 120 day limit whenever possible. Net recoverable value can only be determined if the collateral is in the Bank's possession, and its liquidation value can be verified and realized in the near term.

The second component of the ALL covers qualitative factors related to non-impaired loans. The qualitative allowance on each of the loan pools is based on the following factors:

- Concentrations of credit
- Trends in volume, maturity, composition
- Volume and trend in delinquency
- Economic conditions
- Outside exams
- Geographic distance
- Policy and procedures
- Staff experience and ability



The ALL calculation for the different loan portfolios is as follows:

- Commercial Real Estate, Commercial and SBA – Migration analysis combined with risk rating is used to determine the required allowance for all non-impaired loans. In addition, the migration results are adjusted based upon the qualitative factors previously discussed that affect this specific portfolio category. Reserves on impaired loans are assigned based upon the individual characteristics of the loan.
- Manufactured Housing, Single Family Residential, HELOC and Consumer – The allowance is calculated on the basis of loss history and risk rating, which is primarily a function of delinquency. In addition, the migration results are adjusted based upon the qualitative factors previously discussed that affect this specific portfolio.

## Table of Contents

The Company evaluates and individually assesses impairment on loans greater than \$100,000 classified as substandard or doubtful that are either non-performing or considered a trouble debt restructure. Measured impairment is determined on a loan-by-loan basis and in total establishes a specific reserve for impaired loans. The amount of impairment is determined by comparing the recorded investment in each loan with its value measured by one of three methods.

- The expected future cash flows are estimated and then discounted at the effective interest rate.
- The loan's observable market price, if it is of a kind for which there is a secondary market.
- The value of the underlying collateral net of selling costs. Selling costs are estimated based on industry standards, the Bank's actual experience, or based on actual costs incurred as appropriate. When evaluating real estate collateral, the Bank typically uses appraisals or valuations, no more than twelve months old at time of evaluation. When evaluating non-real estate collateral securing the loan, the Bank will use audited financial statements or appraisals no more than twelve months old. Additionally for both real estate and non-real estate collateral, the Bank may use other sources to determine value as deemed appropriate.

Interest income is not recognized on impaired loans except for limited circumstances in which a loan, although impaired, continues to perform in accordance with the loan contract.

The Company determines the appropriate ALL on a monthly basis. Any differences between estimated and actual observed losses from the prior month are reflected in the current period in determining the appropriate ALL determination and adjusted as deemed necessary. The review of the adequacy of the allowance takes into consideration such factors as concentrations of credit, changes in the growth, size and composition of the loan portfolio, overall and individual portfolio quality, review of specific problem loans, collateral, guarantees and economic conditions that may affect the borrowers' ability to pay and/or the value of the underlying collateral. Additional factors considered include: geographic location of borrowers, changes in the Company's product-specific credit policy and lending staff experience. These estimates depend on the outcome of future events and, therefore, contain inherent uncertainties.

The Company's ALL is maintained at a level believed adequate by management to absorb known and inherent probable losses on existing loans. A provision for loan losses is charged to expense. The allowance is charged for losses when management believes that full recovery on the loan is unlikely.

The Bank has a centralized appraisal management process that tracks and monitors appraisals, appraisal reviews and other valuations. The centralization focus is to ensure the use of qualified and independent appraisers capable of providing reliable real estate values in the context of ever changing market conditions. The review process is monitored to ensure application of the appropriate appraisal methodology, agreement with the interpretation of market data and the resultant real estate value. The process also provides the means of tracking the performance quality of the appraisers on the Bank's approved appraiser list. Any loan evaluation that results in the Bank determining that elevated credit risk and/or default risk exists and also exhibits a lack of a timely valuation of the collateral or apparent collateral value deterioration is reappraised and reevaluated to determine the current extent of any change in collateral value and credit risk. A similar review process is conducted quarterly on all classified and criticized real estate credits to determine the timeliness and adequacy of the real estate collateral value. A detection of non-compliance is then addressed through a new appraisal or reappraisal and review.

Foreclosed Real Estate and Repossessed Assets – Foreclosed real estate and other repossessed assets includes real estate and other repossessed assets and the collateral property is recorded at fair value at the time of foreclosure less estimated costs to sell. Any excess of loan balance over the fair value less estimated costs to sell of the other assets is

charged-off against the allowance for loan losses. Subsequent to the legal ownership date, management periodically performs a new valuation and the asset is carried at the lower of carrying amount or fair value. Operating expenses or income, and gains or losses on disposition of such properties, are recorded in current operations.

Income Taxes – The Company uses the asset and liability method, which recognizes a liability or asset representing the tax effects of future deductible or taxable amounts that have been recognized in the consolidated financial statements. Due to tax regulations, certain items of income and expense are recognized in different periods for tax return purposes than for financial statement reporting. These items represent “temporary differences.” Deferred income taxes are recognized for the tax effect of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is established for deferred tax assets if, based on weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets may not be realized.

Table of Contents

The Company is subject to the provisions of ASC 740, “Income Taxes” (ASC 740). ASC 740 prescribes a more-likely-than-not threshold for the financial statement recognition of uncertain tax positions. ASC 740 clarifies the accounting for income taxes by prescribing a minimum 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. On a quarterly basis the Company evaluates income tax accruals in accordance with ASC 740 guidance on uncertain tax positions.

Recent Accounting Pronouncements – In July 2010, FASB issued a final Accounting Standards Update, ASU 2010-20, that requires entities to provide extensive new disclosures in their financial statements about their financial receivables, including credit risk exposures and allowance for credit losses. The ASU requires new qualitative and quantitative disclosures on the allowance for credit losses, credit quality, impaired loans, modifications and nonaccrual and past due financing receivables. Generally, the update was effective for interim or annual reporting periods ended subsequent to December 15, 2010. Certain elements of the ASU regarding disclosures for troubled debt restructuring have been deferred and will be effective for periods ending on or after June 15, 2011. Adoption of ASU 2010-20 did not have a material impact on the Company’s financial condition, results of operations or cash flows.

Table of Contents

## 2. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities is as follows:

| March 31, 2011                | (in thousands)  |                        |                         |                 |
|-------------------------------|-----------------|------------------------|-------------------------|-----------------|
|                               | Amortized Cost  | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value      |
| Available-for-sale securities |                 |                        |                         |                 |
| U.S. Government agency: MBS   | \$5,291         | \$202                  | \$-                     | \$5,493         |
| U.S. Government agency: CMO   | 17,726          | 62                     | (20 )                   | 17,768          |
| <b>Total</b>                  | <b>\$23,017</b> | <b>\$264</b>           | <b>\$(20 )</b>          | <b>\$23,261</b> |
| Held-to-maturity securities   |                 |                        |                         |                 |
| U.S. Government agency: MBS   | \$15,767        | \$642                  | \$(74 )                 | \$16,335        |
| U.S. Government agency: CMO   | -               | -                      | -                       | -               |
| <b>Total</b>                  | <b>\$15,767</b> | <b>\$642</b>           | <b>\$(74 )</b>          | <b>\$16,335</b> |

| December 31, 2010             | (in thousands)  |                        |                         |                 |
|-------------------------------|-----------------|------------------------|-------------------------|-----------------|
|                               | Amortized Cost  | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value      |
| Available-for-sale securities |                 |                        |                         |                 |
| U.S. Government agency: MBS   | \$5,472         | \$206                  | \$-                     | \$5,678         |
| U.S. Government agency: CMO   | 17,566          | 102                    | (4 )                    | 17,664          |
| <b>Total</b>                  | <b>\$23,038</b> | <b>\$308</b>           | <b>\$(4 )</b>           | <b>\$23,342</b> |
| Held-to-maturity securities   |                 |                        |                         |                 |
| U.S. Government agency: MBS   | \$16,893        | \$698                  | \$(77 )                 | \$17,514        |
| U.S. Government agency: CMO   | -               | -                      | -                       | -               |
| <b>Total</b>                  | <b>\$16,893</b> | <b>\$698</b>           | <b>\$(77 )</b>          | <b>\$17,514</b> |

At March 31, 2011, \$39.0 million of securities, at carrying value, was pledged to the Federal Home Loan Bank, San Francisco, as collateral for current and future advances.

The maturity periods and weighted average yields of investment securities at March 31, 2011 are as follows:

|                               | Total Amount    |              | Less than One Year |              | One to Five Years |              | Five to Ten Years |              |
|-------------------------------|-----------------|--------------|--------------------|--------------|-------------------|--------------|-------------------|--------------|
|                               | Amount          | Yield        | Amount             | Yield        | Amount            | Yield        | Amount            | Yield        |
| (dollars in thousands)        |                 |              |                    |              |                   |              |                   |              |
| Available-for-sale securities |                 |              |                    |              |                   |              |                   |              |
| U. S. Government:             |                 |              |                    |              |                   |              |                   |              |
| Agency: MBS                   | \$5,493         | 2.4 %        | \$-                | -            | \$5,422           | 2.4 %        | \$71              | 2.7 %        |
| Agency: CMO                   | 17,768          | 0.9 %        | 3,994              | 0.9 %        | 13,774            | 0.9 %        | -                 | -            |
| <b>Total</b>                  | <b>\$23,261</b> | <b>1.3 %</b> | <b>\$3,994</b>     | <b>0.9 %</b> | <b>\$19,196</b>   | <b>1.3 %</b> | <b>\$71</b>       | <b>2.7 %</b> |
| Held-to-maturity securities   |                 |              |                    |              |                   |              |                   |              |
| U.S. Government:              |                 |              |                    |              |                   |              |                   |              |
| Agency: MBS                   | \$15,767        | 4.4 %        | \$50               | 5.0 %        | \$8,802           | 4.7 %        | \$6,915           | 4.0 %        |
| Agency: CMO                   | -               | -            | -                  | -            | -                 | -            | -                 | -            |
| <b>Total</b>                  | <b>\$15,767</b> | <b>4.4 %</b> | <b>\$50</b>        | <b>5.0 %</b> | <b>\$8,802</b>    | <b>4.7 %</b> | <b>\$6,915</b>    | <b>4.0 %</b> |



Table of Contents

The following tables show all securities that are in an unrealized loss position and temporarily impaired as of:

| March 31, 2011 | Less than 12 months |                   | More than 12 months |                   | Total      |                   |
|----------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |

## Available-for-sale securities

|                             |                |             |            |            |                |             |
|-----------------------------|----------------|-------------|------------|------------|----------------|-------------|
| U.S. Government agency: MBS | \$-            | \$-         | \$-        | \$-        | \$-            | \$-         |
| U.S. Government agency: CMO | 8,843          | 20          | -          | -          | 8,843          | 20          |
| <b>Total</b>                | <b>\$8,843</b> | <b>\$20</b> | <b>\$-</b> | <b>\$-</b> | <b>\$8,843</b> | <b>\$20</b> |

## Held-to-maturity securities

|                             |                |             |            |            |                |             |
|-----------------------------|----------------|-------------|------------|------------|----------------|-------------|
| U.S. Government agency: MBS | \$1,513        | \$74        | \$-        | \$-        | \$1,513        | \$74        |
| U.S. Government agency: CMO | -              | -           | -          | -          | -              | -           |
| <b>Total</b>                | <b>\$1,513</b> | <b>\$74</b> | <b>\$-</b> | <b>\$-</b> | <b>\$1,513</b> | <b>\$74</b> |

December 31, 2010

| December 31, 2010 | Less than 12 months |                   | More than 12 months |                   | Total      |                   |
|-------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|                   | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |

## Available-for-sale securities

|                             |                |            |            |            |                |            |
|-----------------------------|----------------|------------|------------|------------|----------------|------------|
| U.S. Government agency: MBS | \$-            | \$-        | \$-        | \$-        | \$-            | \$-        |
| U.S. Government agency: CMO | 3,118          | 4          | -          | -          | 3,118          | 4          |
| <b>Total</b>                | <b>\$3,118</b> | <b>\$4</b> | <b>\$-</b> | <b>\$-</b> | <b>\$3,118</b> | <b>\$4</b> |

## Held-to-maturity securities

|                             |                |             |            |            |                |             |
|-----------------------------|----------------|-------------|------------|------------|----------------|-------------|
| U.S. Government agency: MBS | \$1,444        | \$77        | \$-        | \$-        | \$1,444        | \$77        |
| U.S. Government agency: CMO | -              | -           | -          | -          | -              | -           |
| <b>Total</b>                | <b>\$1,444</b> | <b>\$77</b> | <b>\$-</b> | <b>\$-</b> | <b>\$1,444</b> | <b>\$77</b> |

As of March 31, 2011 and December 31, 2010, there were eight and three securities, respectively, in an unrealized loss position.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost (ii) the financial condition and near-term prospects of the issuer and (iii) the Company's intent to sell an impaired security and if it is not more likely than not it will be required to sell the security before the recovery of its amortized basis.

The unrealized losses are primarily due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality, as all are direct or indirect agencies of the U. S. Government. Accordingly, as of March 31, 2011 and December 31, 2010, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment loss has been realized in the Company's consolidated income statements.

SBA Loan Sales - The Company periodically sells the guaranteed portion of selected SBA loans into the secondary market, on a servicing-retained basis. The Company retains the unguaranteed portion of these loans and services the loans as required under the SBA programs to retain specified yield amounts. The SBA program stipulates that the Company retains a minimum of 5% of the loan balance, which is unguaranteed. The percentage of each unguaranteed loan in excess of 5% may be periodically sold to a third party, typically for a cash premium. The Company records servicing liabilities for the unguaranteed loans sold calculated based on the present value of the estimated future servicing costs associated with each loan. The balance of all servicing rights and obligations is subsequently amortized over the estimated life of the loans using an estimated prepayment rate of 5-25%. Quarterly, the servicing asset is analyzed for impairment.



Table of Contents

The Company also periodically sells certain SBA loans into the secondary market, on a servicing-released basis, typically for a cash premium.

As of March 31, 2011 and December 31, 2010, the Company had approximately \$75.7 million and \$77.5 million, respectively, in SBA loans included in loans held for sale.

**Mortgage Loan Sales** – The Company enters into mortgage loan rate lock commitments (normally for 30 days) with potential borrowers. In conjunction therewith, the Company enters into a forward sale commitment to sell the locked loan to a third party investor. This forward sale agreement requires delivery of the loan on a “best efforts” basis but does not obligate the Company to deliver if the mortgage loan does not fund.

The mortgage rate lock agreement and the forward sale agreement qualify as derivatives. The value of these derivatives is generally equal to the fee, if any, charged to the borrower at inception but may fluctuate in the event of changes in interest rates. These derivative financial instruments are recorded at fair value if material. Although the Company does not attempt to qualify these transactions for the special hedge accounting, management believes that changes in the fair value of the two commitments generally offset and create an economic hedge. At March 31, 2011 and December 31, 2010, the Company had \$3.8 million and \$10.9 million, respectively, in outstanding mortgage loan interest rate lock and forward sale commitments, the value of related derivative instruments were not material to the Company’s financial position or results of operations.

#### 4. LOANS HELD FOR INVESTMENT

The composition of the Company’s loans held for investment loan portfolio follows:

|                                | March 31,<br>2011 | December<br>31,<br>2010 |
|--------------------------------|-------------------|-------------------------|
|                                | (in thousands)    |                         |
| Commercial                     | \$49,413          | \$57,369                |
| Commercial real estate         | 181,043           | 173,906                 |
| SBA                            | 46,724            | 51,549                  |
| Manufactured housing           | 192,920           | 194,682                 |
| Single family real estate      | 12,463            | 13,722                  |
| HELOC                          | 20,728            | 20,273                  |
| Consumer                       | 408               | 379                     |
|                                | 503,699           | 511,880                 |
| Less:                          |                   |                         |
| Allowance for loan losses      | 13,172            | 13,302                  |
| Deferred costs                 | (160 )            | (181 )                  |
| Purchased premiums             | (12 )             | (14 )                   |
| Discount on SBA loans          | 444               | 461                     |
| Loans held for investment, net | \$490,255         | \$498,312               |

Table of Contents

At March 31, 2011, the aging of the Company's loans held for investment was as follows:

|                           | 30-59<br>Days Past<br>Due | 60-89<br>Days<br>Past Due | Greater<br>Than 90<br>Days<br>(in thousands) | Total Past<br>Due | Current    | Total<br>Financing<br>Receivables | Recorded<br>Investment<br>> 90<br>Days<br>and<br>Accruing |
|---------------------------|---------------------------|---------------------------|--|-------------------|------------|-----------------------------------|---|
| Single family real estate | \$ 1,530                  | \$ -                      | \$ 465                                       | \$ 1,995          | \$ 10,468  | \$ 12,463                         | \$ -  |
| Commercial real estate:   |                           |                           |  |                   |            |                                   |   |
| Commercial real estate    | 8,372                     | 770                       | 974  | 10,116            | 102,542    | 112,658                           | -   |
| SBA 504 1st TD            | 1,734                     | 331                       | 266  | 2,331             | 35,876     | 38,207                            | -   |
| Land                      | -                         | -                         | 567  | 567               | 5,937      | 6,504                             | -   |
| Construction              | 8,411                     | -                         | 31   | 8,442             | 15,232     | 23,674                            | -   |
| Commercial loans          | 1,141                     | 30                        | 436  | 1,607             | 47,806     | 49,413                            | -   |
| SBA loans                 | 761                       | 1,037                     | 14,749                                       | 16,547            | 30,177     | 46,724                            | -   |
| Mfg. housing              | 997                       | 285                       | 120  | 1,402             | 191,518    | 192,920                           | -   |
| HELOC                     | 30                        | -                         | -  | 30                | 20,698     | 20,728                            | -   |
| Consumer                  | 18                        | -                         | -  | 18                | 390        | 408                               | -   |
| Total                     | \$ 22,994                 | \$ 2,453                  | \$ 17,608                                    | \$ 43,055         | \$ 460,644 | \$ 503,699                        | \$ -  |

Of the \$16.5 million SBA loans past due, \$13.8 million is guaranteed.

At December 31, 2010, the aging of the Company's loans held for investment was as follows:

|                           | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater<br>Than 90<br>Days<br>(in thousands) | Total Past<br>Due | Current    | Total<br>Financing<br>Receivables | Recorded<br>Investment<br>> 90<br>Days<br>and<br>Accruing |
|---------------------------|---------------------------|---------------------------|--|-------------------|------------|-----------------------------------|---|
| Single family real estate | \$ 40                     | \$ 504                    | \$ 143                                       | \$ 687            | \$ 13,035  | \$ 13,722                         | \$ 143  |
| Commercial real estate:   |                           |                           |  |                   |            |                                   |   |
| Commercial real estate    | 331                       | -                         | 981  | 1,312             | 103,118    | 104,430                           | -   |
| SBA 504 1st TD            | -                         | -                         | 1,100  | 1,100             | 38,267     | 39,367                            | -   |
| Land                      | 195                       | -                         | 571  | 766               | 5,970      | 6,736                             | -   |
| Construction              | -                         | -                         | 49   | 49                | 23,324     | 23,373                            | -   |
| Commercial loans          | 739                       | -                         | 174  | 913               | 56,456     | 57,369                            | 34  |
| SBA loans                 | 2,098                     | 910                       | 17,129                                       | 20,137            | 31,412     | 51,549                            | -   |
| Mfg. housing              | 914                       | 318                       | 894  | 2,126             | 192,556    | 194,682                           | -   |
| HELOC                     | -                         | -                         | 2  | 2                 | 20,271     | 20,273                            | -   |
| Consumer                  | -                         | -                         | 21   | 21                | 358        | 379                               | -   |
| Total                     | \$ 4,317                  | \$ 1,732                  | \$ 21,064                                    | \$ 27,113         | \$ 484,767 | \$ 511,880                        | \$ 177  |

Of the \$20.1 million SBA loans past due, \$17.3 million is guaranteed.



Table of Contents

An analysis of the allowance for credit losses for loans held for investment is as follows:

|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2011                            | 2010      |
|  | (in thousands)                  |           |
| Balance, beginning of period               | \$ 13,302                       | \$ 13,733 |
| Loans charged off                          | (1,194 )                        | (2,442 )  |
| Recoveries on loans previously charged off | 81                              | 44        |
| Net charge-offs                            | (1,113 )                        | (2,398 )  |
| Provision for loan losses                  | 983                             | 3,074     |
| Balance, end of period                     | \$ 13,172                       | \$ 14,409 |

As of March 31, 2011 and December 31, 2010, the Company also had established reserves for credit losses on undisbursed loans of \$229,000 and \$194,000, respectively, which are included in other liabilities in the consolidated balance sheet.

The following schedule summarizes the provision, charge-offs and recoveries by loan category:

|                           | Allowance<br>12/31/10 | Provision | Charge-offs<br>(in thousands) | Recoveries | Net<br>Charge-offs | Allowance<br>3/31/11 |
|---------------------------|-----------------------|-----------|-------------------------------|------------|--------------------|----------------------|
| Commercial real estate    | \$ 2,532              | \$ 315    | \$ (18 )                      | \$ 2       | \$ (16 )           | \$ 2,831             |
| Manufactured housing      | 4,168                 | 368       | (281 )                        | 25         | (256 )             | 4,280                |
| Commercial                | 2,094                 | 98        | (322 )                        | 10         | (312 )             | 1,880                |
| SBA                       | 3,753                 | (48 )     | (423 )                        | 42         | (381 )             | 3,324                |
| Single family real estate | 135                   | 192       | (150 )                        | 1          | (149 )             | 178                  |
| HELOC                     | 547                   | 36        | -                             | 1          | 1                  | 584                  |
| Consumer                  | 73                    | 22        | -                             | -          | -                  | 95                   |
| Total                     | \$ 13,302             | \$ 983    | \$ (1,194 )                   | \$ 81      | \$ (1,113 )        | \$ 13,172            |

  

|                           | Allowance<br>12/31/09 | Provision | Charge-offs<br>(in thousands) | Recoveries | Net<br>Charge-offs | Allowance<br>3/31/10 |
|---------------------------|-----------------------|-----------|-------------------------------|------------|--------------------|----------------------|
| Commercial real estate    | \$ 2,843              | \$ (353 ) | \$ -                          | \$ -       | \$ -               | \$ 2,490             |
| Manufactured housing      | 2,255                 | 913       | (462 )                        | -          | (462 )             | 2,706                |
| Commercial                | 3,448                 | (416 )    | (21 )                         | 4          | (17 )              | 3,015                |
| SBA                       | 4,837                 | 2,355     | (1,680 )                      | 37         | (1,643 )           | 5,549                |
| Single family real estate | 143                   | 36        | (34 )                         | 2          | (32 )              | 147                  |
| HELOC                     | 124                   | 499       | (245 )                        | -          | (245 )             | 378                  |
| Consumer                  | 83                    | 40        | -                             | 1          | 1                  | 124                  |

Edgar Filing: COMMUNITY WEST BANCSHARES / - Form 10-Q

Total                    \$ 13,733        \$ 3,074        \$ (2,442 ) \$ 44        \$ (2,398 ) \$ 14,409

16

---

Table of Contents

The recorded investment in loans that is considered to be impaired:

|   | March 31,<br>2011 | December 31,<br>2010 |
|---|-------------------|----------------------|
|   | (in thousands)    |                      |
| Impaired loans without specific valuation allowances      | \$29,476          | \$ 13,285            |
| Impaired loans with specific valuation allowances         | 2,270             | 1,703                |
| Specific valuation allowances allocated to impaired loans | (404 )            | (362 )               |
| Impaired loans, net                                       | \$31,342          | \$ 14,626            |

The following schedule reflects the average investment in impaired loans:

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2011                            | 2010     |
|  | (in thousands)                  |          |
| Average investment in impaired loans         | \$26,139                        | \$14,560 |
| Interest income recognized on impaired loans | 180                             | 87       |

The following schedule reflects recorded investment at the dates indicated in certain types of loans:

|  | March 31,<br>2011      | December 31,<br>2010 |
|--|------------------------|----------------------|
|  | (dollars in thousands) |                      |
| Nonaccrual loans   | \$41,423               | \$ 34,950            |
| SBA guaranteed portion of loans included above               | (17,840 )              | (22,279 )            |
| Nonaccrual loans, net  | \$23,583               | \$ 12,671            |
| Troubled debt restructured loans, gross                      | \$15,996               | \$ 11,088            |
| Loans 30 through 89 days past due with interest accruing     | \$17,080               | \$ 2,586             |
| Allowance for loan losses to gross loans held for investment | 2.62 %                 | 2.60 %               |

CWB generally repurchases the guaranteed portion of SBA loans from investors when those loans become past due 120 days. After the foreclosure and collection process is complete, the SBA reimburses CWB for this principal balance. Therefore, although these balances do not earn interest during this period, they generally do not result in a loss of principal to CWB.

The composition of the Company's net nonaccrual loans is as follows:

|                         | March 31,<br>2011 | December 31,<br>2010 |
|-------------------------|-------------------|----------------------|
|                         | (in thousands)    |                      |
| Commercial              | \$689             | \$ 602               |
| Commercial real estate: |                   |                      |
| Commercial real estate  | 7,001             | 3,226                |
| SBA 504 1st             | 1,327             | 1,612                |
| Land                    | 566               | 571                  |
| Construction            | 8,442             | 49                   |
| SBA                     | 3,494             | 4,181                |

Edgar Filing: COMMUNITY WEST BANCSHARES / - Form 10-Q

|                           |          |           |
|---------------------------|----------|-----------|
| Manufactured housing      | 1,606    | 1,917     |
| Single family real estate | 428      | 461       |
| HELOC                     | 30       | 31        |
| Consumer                  | -        | 21        |
| Nonaccrual loans, net     | \$23,583 | \$ 12,671 |

17

---

Table of Contents

At March 31, 2011, the recorded investment in loans by rating is as follows:

|                           | Pass<br>(in thousands) | Special<br>Mention | Substandard | Doubtful | Total      |
|---------------------------|------------------------|--------------------|-------------|----------|------------|
| Single family real estate | \$ 12,035              | \$-                | \$ 428      | \$-      | \$ 12,463  |
| Commercial real estate:   |                        |                    |             |          |            |
| Commercial real estate    | 79,556                 | 11,236             | 21,866      | -        | 112,658    |
| SBA 504 1st               | 34,150                 | 891                | 3,166       | -        | 38,207     |
| Land                      | 4,389                  | 1,048              | 1,067       | -        | 6,504      |
| Construction              | 9,267                  | 3,852              | 10,555      | -        | 23,674     |
| Commercial                | 38,122                 | 4,726              | 6,479       | 86       | 49,413     |
| SBA                       | 21,041                 | 780                | 4,270       | 66       | 26,157     |
| Manufactured housing      | 191,273                | -                  | 1,647       | -        | 192,920    |
| HELOC                     | 15,430                 | 258                | 5,040       | -        | 20,728     |
| Consumer                  | 390                    | -                  | 18          | -        | 408        |
| Total                     | \$ 405,653             | \$ 22,791          | \$ 54,536   | \$ 152   | \$ 483,132 |
| SBA guarantee             | -                      | 531                | 12,876      | 7,160    | 20,567     |
| Total                     | \$ 405,653             | \$ 23,322          | \$ 67,412   | \$ 7,312 | \$ 503,699 |

At December 31, 2010, the recorded investment in loans by rating is as follows:

|                           | Pass<br>(in thousands) | Special<br>Mention | Substandard | Doubtful | Total      |
|---------------------------|------------------------|--------------------|-------------|----------|------------|
| Single family real estate | \$ 13,261              | \$-                | \$ 461      | \$-      | \$ 13,722  |
| Commercial real estate:   |                        |                    |             |          |            |
| Commercial real estate    | 82,058                 | 9,520              | 12,852      | -        | 104,430    |
| SBA 504 1st               | 35,645                 | 891                | 2,831       | -        | 39,367     |
| Land                      | 4,592                  | 1,073              | 1,071       | -        | 6,736      |
| Construction              | 10,665                 | 10,546             | 2,162       | -        | 23,373     |
| Commercial                | 46,825                 | 6,961              | 3,494       | 89       | 57,369     |
| SBA                       | 21,724                 | 511                | 4,898       | 82       | 27,215     |
| Manufactured housing      | 192,490                | 60                 | 2,132       | -        | 194,682    |
| HELOC                     | 19,664                 | 463                | 144         | 2        | 20,273     |
| Consumer                  | 339                    | -                  | 40          | -        | 379        |
| Total                     | \$ 427,263             | \$ 30,025          | \$ 30,085   | \$ 173   | \$ 487,546 |
| SBA guarantee             | -                      | -                  | 17,109      | 7,225    | 24,334     |
| Total                     | \$ 427,263             | \$ 30,025          | \$ 47,194   | \$ 7,398 | \$ 511,880 |

## 5. FAIR VALUE MEASUREMENT

Fair value is the exchange price that would be received for an asset or the price that would be paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U. S. GAAP establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:



Table of Contents

Level 1 – Quoted prices in active markets for identical assets and liabilities

Level 2 – Observable inputs other than quoted market prices in active markets for identical assets and liabilities

Level 3 – Unobservable inputs

The following summarizes the fair value measurements of assets measured on a recurring basis as of March 31, 2011 and December 31, 2010 and the relative levels of inputs from which such amounts were derived:

| Description                                     | Fair value measurements at March 31, 2011 using |  |   |   |
|---|---|--|---|---|
|   | Total   | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   |   | (in thousands)   |   |   |
| Investment securities available-for-sale        | \$23,261  | \$-  | \$23,261                                      | \$ -                                      |
| Interest only strips (included in other assets) | 530   | -  | -   | 530                                       |
| <b>Total</b>                                    | <b>\$23,791</b>                                 | <b>\$-</b>   | <b>\$23,261</b>                               | <b>\$ 530</b>                             |

| Description                                     | Fair value measurements at December 31, 2010 using |  |   |   |
|---|--|--|---|---|
|   | Total  | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   |  | (in thousands)   |   |   |
| Investment securities available-for-sale        | \$23,342   | \$-  | \$23,342                                      | \$ -                                      |
| Interest only strips (included in other assets) | 492  | -  | -   | 492                                       |
| <b>Total</b>                                    | <b>\$23,834</b>                                    | <b>\$-</b>   | <b>\$23,342</b>                               | <b>\$ 492</b>                             |

Market valuations of our investment securities which are classified as level 2 are provided by an independent third party. The fair values are determined by using several sources for valuing fixed income securities. Their techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid and other market information. In accordance with the fair value hierarchy, the market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values.

On certain SBA loan sales that occurred prior to 2003, the Company retained interest only strips (“I/O strips”), which represent the present value of excess net cash flows generated by the difference between (a) interest at the stated rate paid by borrowers and (b) the sum of (i) pass-through interest paid to third-party investors and (ii) contractual servicing fees. I/O strips are classified as level 3 in the fair value hierarchy. The fair value is determined on a quarterly basis through a discounted cash flow analysis prepared by an independent third party using industry prepayment speeds. The I/O strips were valued at \$492,000 as of December 31, 2010 and a valuation adjustment of \$38,000 was recorded in income during the first three months of 2011. No other changes in the balance have occurred related to the I/O strips and such valuation adjustments are included as additions or offsets to loan servicing income.

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. There were no liabilities measured at fair value for the periods presented and there were no transfers in or out of the Company's Level 3 financial assets and liabilities. Included in these assets are loans that are considered impaired per generally accepted accounting principles. A loan is considered impaired when, based on current information or events, it is probable that not all amounts due will be collected according to the contractual terms of the loan agreement. Impairment is measured based on the fair value of the underlying collateral. The collateral value is determined based on appraisals and other market valuations for similar assets.

Table of Contents

The following summarizes the fair value measurements of assets measured on a non-recurring basis as of March 31, 2011 and December 31, 2010 and the relative levels of inputs from which such amounts were derived:

| Description                                   | Fair value measurements at March 31, 2011 using |  |   |   |
|---|---|--|---|---|
|   | Total   | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   | (in thousands)                                  |  |   |   |
| Impaired loans                                | \$ 31,342                                       | \$-  | \$ 26,116                                     | \$ 5,226                                  |
| Loans held for sale                           | 77,440  | -  | 77,440  | -   |
| Foreclosed real estate and repossessed assets | 9,664   | -  | 9,664   | -   |
| Total   | \$ 118,446                                      | \$-  | \$ 113,220                                    | \$ 5,226                                  |

| Description                                   | Fair value measurements at December 31, 2010 using |  |   |   |
|---|--|--|---|---|
|   | Total  | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|   | (in thousands)                                     |  |   |   |
| Impaired loans                                | \$ 14,626  | \$-  | \$ 13,527                                     | \$ 1,099                                  |
| Loans held for sale                           | 82,320   | -  | 82,320  | -   |
| Foreclosed real estate and repossessed assets | 8,478  | -  | 8,478   | -   |
| Total   | \$ 105,424   | \$-  | \$ 104,325                                    | \$ 1,099                                  |

## 6. BORROWINGS

Federal Home Loan Bank Advances – The Company has a blanket lien credit line with the FHLB. Advances are collateralized in the aggregate by CWB’s eligible loans and securities. Total FHLB advances were \$64.0 million at March 31, 2011 and December 31, 2010, borrowed at fixed rates. At March 31, 2011, CWB had securities and loans pledged to FHLB with a carrying value of \$39.0 million and \$70.6 million, respectively. At December 31, 2010, CWB had securities and loans pledged with a carrying value of \$40.2 million and \$76.6 million, respectively. Total FHLB interest expense for the three months ended March 31, 2011 and 2010 was \$416,000 and \$571,000, respectively. At March 31, 2011, CWB had \$62.0 million available for additional borrowing.

Federal Reserve Bank – CWB has established a credit line with the FRB. Advances are collateralized in the aggregate by eligible loans for up to 28 days. The discount rate is 0.75% and there were no outstanding FRB advances as of March 31, 2011 and December 31, 2010. CWB had \$115.3 million in borrowing capacity as of March 31, 2011.

## 7. STOCKHOLDERS’ EQUITY

Preferred Stock

On December 19, 2008, as part of the United States Department of the Treasury's (the "Treasury") Troubled Asset Relief Program - Capital Purchase Program (the "TARP Program"), the Company entered into a Letter Agreement with the Treasury, pursuant to which the Company issued to the Treasury, in exchange for the payment of an aggregate purchase price of \$15.6 million in cash: (i) 15,600 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of \$1,000 per share (the "Series A Preferred Stock"), and (ii) a warrant (the "Warrant") to purchase up to 521,158 shares of the Company's common stock, no par value (the "Common Stock"), at an exercise price of \$4.49 per share.

Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and at a rate of 9% per year thereafter, but will be paid only if, as and when declared by the Company's Board of Directors. The Series A Preferred Stock has no maturity date and ranks senior to the common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. The Series A Preferred Stock is generally non-voting, other than class voting on certain matters that could adversely affect the Series A Preferred Stock. In the event that dividends payable on the Series A Preferred Stock have not been paid for the equivalent of six or more quarters, whether or not consecutive, the Company's authorized number of Directors will be automatically increased by two and the holders of the Series A Preferred Stock, voting together with holders of any then outstanding voting parity stock, will have the right to elect those Directors at the Company's next annual meeting of shareholders or at a special meeting of shareholders called for that purpose. These Directors will be elected annually and will serve until all accrued and unpaid dividends on the Series A Preferred Stock have been paid.

Table of Contents

Notwithstanding the terms of the Series A Preferred Stock, the Treasury has issued guidance that permits institutions that participated in the TARP Program, such as the Company, to redeem the Series A Preferred Stock and to repurchase the warrants issued to the Treasury subject to prior consultation with the institutions primary federal banking regulator.

## Common Stock Warrant

The Warrant issued as part of the TARP provide for the purchase of up to 521,158 shares of the common stock, at an exercise price of \$4.49 per share (Warrant Shares). The Warrant is immediately exercisable and has a 10-year term. The exercise price and the ultimate number of shares of common stock that may be issued under the Warrant are subject to certain anti-dilution adjustments, such as upon stock splits or distributions of securities or other assets to holders of the common stock, and upon certain issuances of the common stock at or below a specified price relative to the then current market price of the common stock. Pursuant to the Securities Purchase Agreement, the Treasury has agreed not to exercise voting power with respect to any Warrant Shares.

## 8. EARNINGS PER SHARE

The following table presents a reconciliation of basic earnings per share and diluted earnings per share:

|  | Three Months Ended<br>March 31,                  |           |
|--|--|-----------|
|  | 2011   | 2010      |
|  | (dollars in thousands,<br>except per share data) |           |
| Net income   | \$595  | \$51      |
| Less: Preferred stock dividends  | 262  | 262       |
| Net income (loss) applicable to common stockholders                    | \$333  | \$(211 )  |
| Add: Debenture interest expense and costs, net of income taxes         | 111  | -         |
| Net income for diluted calculation of earnings (loss) per common share | \$444  | \$(211 )  |
| Basic weighted average number of common shares outstanding             | 5,960  | 5,915     |
| Dilutive weighted average number of common shares outstanding          | 8,244  | 5,915     |
| Earnings (loss) per common share:                                      |  |           |
| Basic  | \$0.06   | \$(0.04 ) |
| Diluted  | \$0.05   | \$(0.04 ) |

## 9. FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair values of financial instruments have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Table of Contents

The following table represents the estimated fair values:

|  | March 31, 2011  |                      | December 31, 2010 |                      |
|--|-----------------|----------------------|-------------------|----------------------|
|  | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| (in thousands)                                   |                 |                      |                   |                      |
| Assets:  |                 |                      |                   |                      |
| Cash and cash equivalents                        | \$15,264        | \$15,264             | \$6,226           | \$6,226              |
| Time deposits in other financial institutions    | 290             | 290                  | 290               | 290                  |
| Federal Reserve and Federal Home Loan Bank stock | 6,153           | 6,153                | 6,353             | 6,353                |
| Investment securities                            | 39,028          | 39,596               | 40,235            | 40,856               |
| Loans  | 567,695         | 546,068              | 580,632           | 562,508              |
| Liabilities:                                     |                 |                      |                   |                      |
| Deposits (other than time deposits)              | 350,784         | 350,784              | 318,569           | 318,569              |
| Time deposits                                    | 176,833         | 179,611              | 211,324           | 214,473              |
| Other borrowings                                 | 71,872          | 72,699               | 72,081            | 71,676               |

The methods and assumptions used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value are explained below:

Cash and cash equivalents - The carrying amounts approximate fair value because of the short-term nature of these instruments.

Time deposits in other financial institutions - The carrying amounts approximate fair value because of the relative short-term nature of these instruments.

Federal Reserve Stock - The carrying value approximates the fair value because the stock can be sold back to the Federal Reserve at any time at par.

Federal Home Loan Bank Stock - The carrying value approximates the fair value. The FHLB is rated AAA by Moody's and S&P and no impairment was recognized as of March 31, 2011.

Investment securities – Market valuations of our investment securities are provided by an independent third party. The fair values are determined by using several sources for valuing fixed income securities. Their techniques include pricing models that vary based on the type of asset being valued and incorporate available trade, bid and other market information. In accordance with the fair value hierarchy, the market valuation sources include observable market inputs and are therefore considered Level 2 inputs for purposes of determining the fair values.

Loans – For most loan categories, the fair value is estimated using discounted cash flows utilizing an appropriate discount rate and historical prepayment speeds. For certain adjustable loans that reprice on a frequent basis carrying value approximates fair value.

Deposits – The amount payable at demand at report date is used to estimate the fair value of demand and savings deposits. The estimated fair values of fixed-rate time deposits are determined by discounting the cash flows of segments of deposits that have similar maturities and rates, utilizing a discount rate that approximates the prevailing rates offered to depositors as of the measurement date.

Other borrowings – The fair value is estimated using a discounted cash flow analysis based on rates for similar types of borrowing arrangements.

Commitments to Extend Credit, Commercial and Standby Letters of Credit – Due to the proximity of the pricing of these commitments to the period end, the fair values of commitments are immaterial to the financial statements.

The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2011 and December 31, 2010. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

10. SUBSEQUENT EVENTS

Subsequent events have been evaluated through the date the financial statements were issued.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion is designed to provide insight into management's assessment of significant trends related to the Company's consolidated financial condition, results of operations, liquidity, capital resources and interest rate sensitivity. It should be read in conjunction with the Company's unaudited interim consolidated financial statements and notes thereto the audited consolidated financial statement and notes thereto included in the Company's Annual Report or Form 10-K for the year ended December 31, 2010, and the other financial information appearing elsewhere in this report.

Forward Looking Statements

This Report on Form 10-Q contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Those forward-looking statements include statements regarding the intent, belief or current expectations of the Company and its management. Any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those projected in the forward-looking statements. The Company does not undertake any obligation to revise or update publicly any forward-looking statements for any reason.

The following discussion should be read in conjunction with the Company's financial statements and the related notes provided under "Item 1—Financial Statements" above.

Overview of Earnings Performance

For the 1Q11, net income was \$595,000 compared to net income of \$51,000 for 1Q10.

The significant factors impacting net income for 1Q11 were:

- The provision for loan losses was \$983,000 for 1Q11 compared to \$3.1 million for 1Q10.
- The decline in rates paid on funding sources contributed to a slight improvement in the margin which increased to 4.53% for 1Q11 compared to 4.48% for 1Q10.
- Loss on sale and write-down of foreclosed real estate and repossessed assets increased to \$459,000 for 1Q11 compared to \$62,000 for 1Q10
- Expenses related to foreclosed real estate and repossessed assets were \$278,000 for 1Q11 compared to \$99,000 for 1Q10.
- An increase in nonperforming loans primarily related to one loan relationship totaling \$8.5 million which is real estate secured.

Critical Accounting Policies

A number of critical accounting policies are used in the preparation of the Company's consolidated financial statements. These policies relate to areas of the financial statements that involve estimates and judgments made by management. These include: provision and allowance for loan losses and servicing rights. These critical accounting policies are discussed in the Company's 2010 Form 10-K with a description of how the estimates are determined and an indication of the consequences of an over or under estimate.





Table of Contents

## Results of Operations-First Quarter Comparison

The following table sets forth for the periods indicated, certain items in the consolidated statements of income of the Company and the related changes between those periods:

|   | Three Months Ended                               |           |            |
|---|--|-----------|------------|
|   | March 31,  | 2010      | Increase   |
|   | 2011   |           | (Decrease) |
|   | (dollars in thousands, except per share amounts) |           |            |
| Interest income                                     | \$9,330  | \$9,942   | \$(612 )   |
| Interest expense                                    | 2,261  | 2,647     | (386 )     |
| Net interest income                                 | 7,069  | 7,295     | (226 )     |
| Provision for loan losses                           | 983  | 3,074     | (2,091 )   |
| Net interest income after provision for loan losses | 6,086  | 4,221     | 1,865      |
| Non-interest income                                 | 738  | 839       | (101 )     |
| Non-interest expenses                               | 5,809  | 4,971     | 838        |
| Income before provision for income taxes            | 1,015  | 89        | 926        |
| Provision for income taxes                          | 420  | 38        | 382        |
| Net income  | \$595  | \$51      | \$544      |
| Preferred stock dividends                           | 262  | 262       | -          |
| Net income (loss) applicable to common stockholders | \$333  | \$(211 )  | \$544      |
| Earnings (loss) per common share:                   |  |           |            |
| Basic   | \$0.06   | \$(0.04 ) | \$0.10     |
| Diluted   | \$0.05   | \$(0.04 ) | \$0.09     |
| Dividends per common share                          | \$-  | \$-       | \$-        |
| Comprehensive income                                | \$560  | \$65      | \$495      |

The following table sets forth the changes in interest income and expense attributable to changes in rate and volume:

|                                    | Three Months Ended |               |          |
|------------------------------------|--------------------|---------------|----------|
|                                    | March 31,          |               |          |
|                                    | 2011 versus 2010   |               |          |
|                                    | Total              | Change due to |          |
|                                    | change             | Rate          | Volume   |
|                                    | (in thousands)     |               |          |
| Loans, net                         | \$(490 )           | \$(140 )      | \$(350 ) |
| Investment securities              | (116 )             | (110 )        | (6 )     |
| Other                              | (6 )               | (1 )          | (5 )     |
| Total interest-earning assets      | (612 )             | (251 )        | (361 )   |
| Deposits                           | (389 )             | (295 )        | (94 )    |
| Other borrowings                   | 3                  | 106           | (103 )   |
| Total interest-bearing liabilities | (386 )             | (189 )        | (197 )   |
| Net interest income                | \$(226 )           | \$(62 )       | \$(164 ) |

## Net Interest Income

Net interest income declined by \$226,000 for 1Q11 compared to 1Q10. Total interest income declined by \$612,000. Of this decline, \$361,000 was due to the decline in average earning assets from \$660.9 million for 1Q10 to

\$633.2 million for 1Q11. The remaining decline of \$251,000 was due to rates.

The decline in interest expense was due in almost equal proportion to lower rates and a decline in the average balance of interest-bearing liabilities from \$579.6 million for 1Q10 to \$560.4 million for 1Q11. The net impact of the decline in yields on interest earning assets and the decline in rates on interest-bearing liabilities was an increase in the margin from 4.48% for 1Q10 to 4.53% for 1Q11.

Table of Contents

## Provision for Loan Losses

The provision for loan losses was \$983,000 for 1Q11 compared to \$3.1 million for 1Q10.

The following schedule summarizes the provision, charge-offs and recoveries by loan category:

|                           | Allowance<br>12/31/10 | Provision | Charge-offs<br>(in thousands) | Recoveries | Net<br>Charge-offs | Allowance<br>3/31/11 |
|---------------------------|-----------------------|-----------|-------------------------------|------------|--------------------|----------------------|
| Commercial real estate    | \$2,532               | \$315     | \$ (18 )                      | \$2        | \$ (16 )           | \$2,831              |
| Manufactured housing      | 4,168                 | 368       | (281 )                        | 25         | (256 )             | 4,280                |
| Commercial                | 2,094                 | 98        | (322 )                        | 10         | (312 )             | 1,880                |
| SBA                       | 3,753                 | (48 )     | (423 )                        | 42         | (381 )             | 3,324                |
| Single family real estate | 135                   | 192       | (150 )                        | 1          | (149 )             | 178                  |
| HELOC                     | 547                   | 36        | -                             | 1          | 1                  | 584                  |
| Consumer                  | 73                    | 22        | -                             | -          | -                  | 95                   |
| Total                     | \$13,302              | \$983     | \$ (1,194 )                   | \$81       | \$ (1,113 )        | \$13,172             |

|                           | Allowance<br>12/31/09 | Provision | Charge-offs<br>(in thousands) | Recoveries | Net<br>Charge-offs | Allowance<br>3/31/10 |
|---------------------------|-----------------------|-----------|-------------------------------|------------|--------------------|----------------------|
| Commercial real estate    | \$2,843               | \$(353 )  | \$ -                          | \$-        | \$ -               | \$2,490              |
| Manufactured housing      | 2,255                 | 913       | (462 )                        | -          | (462 )             | 2,706                |
| Commercial                | 3,448                 | (416 )    | (21 )                         | 4          | (17 )              | 3,015                |
| SBA                       | 4,837                 | 2,355     | (1,680 )                      | 37         | (1,643 )           | 5,549                |
| Single family real estate | 143                   | 36        | (34 )                         | 2          | (32 )              | 147                  |
| HELOC                     | 124                   | 499       | (245 )                        | -          | (245 )             | 378                  |
| Consumer                  | 83                    | 40        | -                             | 1          | 1                  | 124                  |
| Total                     | \$13,733              | \$3,074   | \$ (2,442 )                   | \$44       | \$ (2,398 )        | \$14,409             |

Included in the Company's held-to-maturity portfolio is home equity loans, "HELOC", which guidance issued by the SEC characterizes as higher-risk. The HELOC portfolio of \$20.7 million consists of credits secured by residential real estate in Santa Barbara and Ventura counties. In 1Q11, the net charge-offs in this portfolio were \$1,000. As of March 31, 2011, \$30,000 of the portfolio is past due and on non-accrual status. The allowance for loan losses for this portfolio is \$584,000, or 2.8%. The Company believes that, overall, this portfolio is adequately supported by real estate collateral.

The percentage of net non-accrual loans to the total loan portfolio has increased to 4.06% as of March 31, 2011 from 2.13% at December 31, 2010. The increase compared to the prior quarter-end is primarily related to one loan relationship that totals \$8.5 million. The loan relationship is real estate secured and a current appraisal indicates that the indebtedness is well secured by the underlying collateral. The real property is currently listed for sale at a price in excess of the amount of the principal and interest currently outstanding on the loan. The relationship was classified as nonperforming as marketing and sale of the property has been protracted in relationship to the original expectation of the Bank and the borrower.

The allowance for loan losses compared to net non-accrual loans has declined to 56% as of March 31, 2011 from 105% as of December 31, 2010.

## Non-Interest Income

Non-interest income includes gains from sale of loans, loan document fees, service charges on deposit accounts, loan servicing fees and other revenues not derived from interest on earning assets. Total non-interest income decreased by \$101,000, or 12.0%, for 1Q11 compared to 1Q10, primarily due to lower loan origination fees and referral fees on SBA 504 loans.

#### Non-Interest Expenses

Non-interest expenses increased \$838,000, or 16.9%, for 1Q11 compared to 1Q10. The loss on sale and write-down of foreclosed real estate and repossessed assets and expenses related to these assets increased \$397,000 and \$179,000, respectively, for 1Q11 over 1Q10. Also contributing to the increase in non-interest expenses was the provision for undisbursed loans which was \$166,000 higher in 1Q11 than 1Q10.

Table of Contents

## Interest Rates and Differentials

The following table illustrates average yields on interest-earning assets and average rates on interest-bearing liabilities for the periods indicated:

|  | Three Months<br>Ended March 31, |           |
|--|---------------------------------|-----------|
|  | 2011                            | 2010      |
| (dollars in thousands)                                     |                                 |           |
| Interest-earning assets:                                   |                                 |           |
| Interest-earning deposits in other financial institutions: |                                 |           |
| Average balance  | \$333                           | \$819     |
| Interest income  | 2                               | 6         |
| Average yield  | 2.44                            | % 2.95    |
| Federal funds sold:  |                                 |           |
| Average balance  | \$919                           | \$4,217   |
| Interest income  | 1                               | 3         |
| Average yield  | 0.30                            | % 0.31    |
| Investment securities:                                     |                                 |           |
| Average balance  | \$44,758                        | \$45,766  |
| Interest income  | 283                             | 399       |
| Average yield  | 2.56                            | % 3.54    |
| Gross loans:   |                                 |           |
| Average balance  | \$587,193                       | \$610,137 |
| Interest income  | 9,044                           | 9,534     |
| Average yield  | 6.25                            | % 6.34    |
| Total interest-earning assets:                             |                                 |           |
| Average balance  | \$633,203                       | \$660,939 |
| Interest income  | 9,330                           | 9,942     |
| Average yield  | 5.98                            | % 6.10    |
| Interest-bearing liabilities:                              |                                 |           |
| Interest-bearing demand deposits:                          |                                 |           |
| Average balance  | \$274,485                       | \$204,944 |
| Interest expense   | 800                             | 808       |
| Average cost of funds                                      | 1.18                            | % 1.60    |
| Savings deposits:  |                                 |           |
| Average balance  | \$20,743                        | \$17,992  |
| Interest expense   | 108                             | 108       |
| Average cost of funds                                      | 2.12                            | % 2.43    |
| Time certificates of deposit:                              |                                 |           |
| Average balance  | \$193,229                       | \$272,171 |
| Interest expense   | 762                             | 1,143     |
| Average cost of funds                                      | 1.60                            | % 1.70    |
| Convertible debentures:                                    |                                 |           |
| Average balance  | \$7,930                         | \$-       |
| Interest expense   | 176                             | -         |
| Average cost of funds                                      | 9.00                            | % -       |
| Other borrowings:  |                                 |           |
| Average balance  | \$64,000                        | \$84,489  |
| Interest expense   | 415                             | 588       |

Edgar Filing: COMMUNITY WEST BANCSHARES / - Form 10-Q

|  |           |   |           |   |
|--|-----------|---|-----------|---|
| Average cost of funds                      | 2.63      | % | 2.82      | % |
| <b>Total interest-bearing liabilities:</b> |           |   |           |   |
| Average balance                            | \$560,387 |   | \$579,596 |   |
| Interest expense                           | 2,261     |   | 2,647     |   |
| Average cost of funds                      | 1.64      | % | 1.85      | % |
| Net interest income                        | \$7,069   |   | \$7,295   |   |
| Net interest spread                        | 4.34      | % | 4.25      | % |
| Average net margin                         | 4.53      | % | 4.48      | % |

26

---

Table of Contents

In calculating interest rates and differentials:

- Average yields and rates are derived by dividing interest income by the average balances of interest-earning assets and by dividing interest expense by the average balances of interest-bearing liabilities for the periods indicated. Amounts outstanding are averages of daily balances during the applicable periods.
  - Nonaccrual loans are included in the average balance of loans outstanding.
- Net interest income is the difference between the interest and fees earned on loans and investments and the interest expense paid on deposits and other liabilities. The amount by which interest income will exceed interest expense depends on the volume or balance of earning assets compared to the volume or balance of interest-bearing deposits and liabilities and the interest rate earned on those interest-earning assets compared to the interest rate paid on those interest-bearing liabilities.
- Net interest margin is net interest income expressed as a percentage of average earning assets. It is used to measure the difference between the average rate of interest earned on assets and the average rate of interest that must be paid on liabilities used to fund those assets. To maintain its net interest margin, the Company must manage the relationship between interest earned and paid.

## Financial Condition

Average total assets declined by \$9.6 million, or 1.4%, to \$672.5 million for 1Q11 compared to \$682.1 million 1Q10. Average total gross loans declined by \$22.9 million, or 3.8%, to \$587.2 million for 1Q11 from \$610.1 million for 1Q10. Average deposits also declined by 0.2% from \$535.1 million for 1Q10 to \$534.0 million for 1Q11.

The book value per common share was \$7.92 at March 31, 2011 and December 31, 2010. During 1Q11, the increase in outstanding shares offset the increase to Stockholders' Equity.

| Selected balance sheet accounts<br>(dollars in thousands) | March 31,<br>2011 | December 31,<br>2010 | Increase<br>(Decrease) | Percent of<br>Increase<br>(Decrease) |   |
|---|-------------------|----------------------|------------------------|--------------------------------------|---|
| Cash and cash equivalents                                 | \$ 15,264         | \$ 6,226             | \$9,038                | 145.2                                | % |
| Investment securities available-for-sale                  | 23,261            | 23,342               | (81)                   | (0.3)                                | % |
| Investment securities held-to-maturity                    | 15,767            | 16,893               | (1,126)                | (6.7)                                | % |
| Loans-Held for sale                                       | 77,440            | 82,320               | (4,880)                | (5.9)                                | % |
| Loans-Held for investment, net                            | 490,255           | 498,312              | (8,057)                | (1.6)                                | % |
| Total Assets  | 665,539           | 667,604              | (2,065)                | (0.3)                                | % |
| Total Deposits  | 527,617           | 529,893              | (2,276)                | (0.4)                                | % |
| Other borrowings and convertible debentures               | 71,872            | 72,081               | (209)                  | (0.3)                                | % |
| Total Stockholders' Equity                                | 62,243            | 61,642               | 601                    | 1.0                                  | % |



Table of Contents

The following schedule shows the balance and percentage change in the various deposits:

|  | March 31,<br>2011      | December 31,<br>2010 | Increase<br>(Decrease) | Percent of<br>Increase<br>(Decrease) |   |
|--|------------------------|----------------------|------------------------|--------------------------------------|---|
|  | (dollars in thousands) |                      |                        |                                      |   |
| Non-interest-bearing deposits          | \$47,951               | \$ 35,767            | \$12,184               | 34.1                                 | % |
| Interest-bearing deposits              | 280,989                | 262,431              | 18,558                 | 7.1                                  | % |
| Savings                                | 21,844                 | 20,371               | 1,473                  | 7.2                                  | % |
| Time certificates of \$100,000 or more | 137,423                | 163,117              | (25,694 )              | (15.8 )                              | % |
| Other time certificates                | 39,410                 | 48,207               | (8,797 )               | (18.2 )                              | % |
| Total deposits                         | \$527,617              | \$ 529,893           | \$(2,276 )             | (0.4 )                               | % |

## Nonaccrual, Past Due and Restructured Loans

A loan is considered impaired when, based on current information, it is probable that the Company will be unable to collect the scheduled payments of principal or interest under the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays or payment shortfalls on a case-by-case basis. When determining the possibility of impairment, management considers the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. For collateral-dependent loans, the Company uses the fair value of collateral method to measure impairment. All other loans are measured for impairment based on the present value of future cash flows. Impairment is measured on a loan-by-loan basis for all loans in the portfolio.

The recorded investment in loans that is considered to be impaired:

|   | March 31,<br>2011 | December 31,<br>2010 |
|---|-------------------|----------------------|
|   | (in thousands)    |                      |
| Impaired loans without specific valuation allowances      | \$29,476          | \$ 13,285            |
| Impaired loans with specific valuation allowances         | 2,270             | 1,703                |
| Specific valuation allowances allocated to impaired loans | (404 )            | (362 )               |
| Impaired loans, net                                       | \$31,342          | \$ 14,626            |

The following schedule reflects the average investment in impaired loans:

|  | Three Months Ended<br>March 31, |          |
|--|---------------------------------|----------|
|  | 2011                            | 2010     |
|  | (in thousands)                  |          |
| Average investment in impaired loans         | \$26,139                        | \$14,560 |
| Interest income recognized on impaired loans | 180                             | 87       |

Table of Contents

The following schedule reflects recorded investment at the dates indicated in certain types of loans:

|  | March 31,<br>2011      | December 31,<br>2010 |      |   |
|--|------------------------|----------------------|------|---|
|  | (dollars in thousands) |                      |      |   |
| Nonaccrual loans   | \$41,423               | \$ 34,950            |      |   |
| SBA guaranteed portion of loans included above               | (17,840 )              | (22,279 )            |      |   |
| Nonaccrual loans, net  | \$23,583               | \$ 12,671            |      |   |
|  |                        |                      |      |   |
| Troubled debt restructured loans, gross                      | \$15,996               | \$ 11,088            |      |   |
| Loans 30 through 89 days past due with interest accruing     | \$17,080               | \$ 2,586             |      |   |
| Allowance for loan losses to gross loans held for investment | 2.62                   | %                    | 2.60 | % |

The increase in non-accrual loans compared to the prior quarter-end is primarily related to one loan relationship that totals \$8.5 million. The loan relationship is real estate secured and a current appraisal indicates that the indebtedness is well secured by the underlying collateral. The real property is currently listed for sale at a price in excess of the amount of the principal and interest currently outstanding on the loan. The relationship was classified as nonperforming as marketing and sale of the property has been protracted in relationship to the original expectation of the Bank and the borrower.

CWB generally repurchases the guaranteed portion of SBA loans from investors when those loans become past due 120 days. After the foreclosure and collection process is complete, the SBA reimburses CWB for this principal balance. Therefore, although these balances do not earn interest during this period, they generally do not result in a loss of principal to CWB.

### Liquidity and Capital Resources

#### Liquidity Management

The Company has established policies as well as analytical tools to manage liquidity. Proper liquidity management ensures that sufficient funds are available to meet normal operating demands in addition to unexpected customer demand for funds, such as high levels of deposit withdrawals or increased loan demand, in a timely and cost effective manner. The most important factor in the preservation of liquidity is maintaining public confidence that facilitates the retention and growth of core deposits. Ultimately, public confidence is gained through profitable operations, sound credit quality and a strong capital position. The Company's liquidity management is viewed from a long-term and short-term perspective, as well as from an asset and liability perspective. Management monitors liquidity through regular reviews of maturity profiles, funding sources and loan and deposit forecasts to minimize funding risk. The Company has asset/liability committees (ALCO) at the Board and Bank management level to review asset/liability management and liquidity issues.

The Company has a blanket lien credit line with the FHLB. Advances are collateralized in the aggregate by CWB's eligible loans and securities. Total FHLB advances were \$64.0 million at March 31, 2011 and December 31, 2010 borrowed at fixed rates. At March 31, 2011, CWB had securities and loans pledged to FHLB with a carrying value of \$39.0 million and \$70.6 million, respectively. At December 31, 2010, CWB had securities and loans pledged with a carrying value of \$40.2 million and \$76.6 million, respectively. Total FHLB interest expense for the three months ended March 31, 2011 and 2010 was \$416,000 and \$571,000, respectively. At March 31, 2011, CWB had \$62.0 million available for additional borrowing.

CWB has established a credit line with the FRB. Advances are collateralized in the aggregate by eligible loans for up to 28 days. The discount rate is 0.75% and there were no outstanding FRB advances as of March 31, 2011 and December 31, 2010. CWB had \$115.3 million in borrowing capacity as of March 31, 2011.

CWB also maintains four federal funds purchased lines for a total borrowing capacity of \$23.5 million. Of the \$23.5 million in borrowing capacity, two of the lines for \$10.0 million require the Company to furnish acceptable collateral.

## Table of Contents

The Company has not experienced disintermediation and does not believe this is a likely occurrence, although there is significant competition for core deposits. The liquidity ratio of the Company was 17% at March 31, 2011 and December 31, 2010. The Company's liquidity ratio fluctuates in conjunction with loan funding demands. The liquidity ratio consists of cash and due from banks, deposits in other financial institutions, available for sale investments, federal funds sold and loans held for sale, divided by total assets.

CWBC's routine funding requirements primarily consist of certain operating expenses, TARP preferred dividends and, beginning in the fourth quarter of 2010, interest payments on outstanding convertible debentures. Normally, CWBC obtains funding to meet its obligations from dividends collected from CWB and has the capability to issue debt securities. Federal banking laws regulate the amount of dividends that may be paid by banking subsidiaries without prior approval. CWBC anticipates that for the foreseeable future, it will fund its expenses, TARP preferred dividends and interest payments on the debentures from proceeds of the debenture offering and will not receive dividends from CWB.

### Interest Rate Risk

The Company is exposed to different types of interest rate risks. These risks include: lag, repricing, basis and prepayment risk.

- **Lag Risk** – lag risk results from the inherent timing difference between the repricing of the Company's adjustable rate assets and liabilities. For instance, certain loans tied to the prime rate index may only reprice on a quarterly basis. However, at a community bank such as CWB, when rates are rising, funding sources tend to reprice more slowly than the loans. Therefore, for CWB, the effect of this timing difference is generally favorable during a period of rising interest rates and unfavorable during a period of declining interest rates. This lag can produce some short-term volatility, particularly in times of numerous prime rate changes.
- **Repricing Risk** – repricing risk is caused by the mismatch in the maturities / repricing periods between interest-earning assets and interest-bearing liabilities. If CWB was perfectly matched, the net interest margin would expand during rising rate periods and contract during falling rate periods. This is so since loans tend to reprice more quickly than do funding sources. Typically, since CWB is somewhat asset sensitive, this would also tend to expand the net interest margin during times of interest rate increases. However, the margin relationship is somewhat dependent on the shape of the yield curve.
- **Basis Risk** – item pricing tied to different indices may tend to react differently, however, all CWB's variable products are priced off the prime rate.
- **Prepayment Risk** – prepayment risk results from borrowers paying down / off their loans prior to maturity. Prepayments on fixed-rate products increase in falling interest rate environments and decrease in rising interest rate environments. Since a majority of CWB's loan originations are adjustable rate and set based on prime, and there is little lag time on the reset, CWB does not experience significant prepayments. However, CWB does have more prepayment risk on its manufactured housing loans and its mortgage-backed investment securities.

### Management of Interest Rate Risk

To mitigate the impact of changes in market interest rates on the Company's interest-earning assets and interest-bearing liabilities, the amounts and maturities are actively managed. Short-term, adjustable-rate assets are generally retained as they have similar repricing characteristics as our funding sources. CWB sells mortgage products and a portion of its SBA loan originations. While the Company has some interest rate exposure in excess of five years, it has internal policy limits designed to minimize risk should interest rates rise. Currently, the Company does

not use derivative instruments to help manage risk, but will consider such instruments in the future if the perceived need should arise.

Loan sales - The Company's ability to originate, purchase and sell loans is also significantly impacted by changes in interest rates. Increases in interest rates may also reduce the amount of loan and commitment fees received by CWB. A significant decline in interest rates could also decrease the size of CWB's servicing portfolio and the related servicing income by increasing the level of prepayments.

Table of Contents

## Capital Resources

The Company (on a consolidated basis) and CWB are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's and CWB's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and CWB must meet specific capital guidelines that involve quantitative measures of the Company's and CWB's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and CWB's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

The Federal Deposit Insurance Corporation Improvement Act ("FDICIA") contains rules as to the legal and regulatory environment for insured depository institutions, including increased supervision by the federal regulatory agencies, increased reporting requirements for insured institutions and regulations concerning internal controls, accounting and operations. The prompt corrective action regulations of FDICIA define specific capital categories based on the institutions' capital ratios. The capital categories, in declining order, are "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized" and "critically undercapitalized". To be considered "well capitalized", an institution must have a core or leverage capital ratio of at least 5%, a Tier I risk-based capital ratio of at least 6%, and a total risk-based capital ratio of at least 10%. Tier I risk-based capital is, primarily, common stock and retained earnings, net of goodwill and other intangible assets.

Quantitative measures established by regulation to ensure capital adequacy require the Company and 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 leverage capital (as defined) to adjusted average assets (as defined). The Company's and CWB's actual capital amounts and ratios as of March 31, 2011 and December 31, 2010 are also presented in the table below:

| (dollars in thousands)                | Total Capital | Tier 1 Capital | Risk-Weighted Assets<br>(dollars in thousands) | Adjusted Average Assets | Total Risk-Based Capital Ratio | Tier 1 Risk-Based Capital Ratio | Tier 1 Leverage Ratio |
|---------------------------------------|---------------|----------------|--|-------------------------|--------------------------------|---------------------------------|-----------------------|
| March 31, 2011                        |               |                |  |                         |                                |                                 |                       |
| CWBC<br>(Consolidated)                | \$76,659      | \$62,023       | \$ 534,462                                     | \$672,428               | 14.34 %                        | 11.60 %                         | 9.22 %                |
| Capital in excess of well capitalized |               |                |  |                         | \$23,213                       | \$29,955                        | \$28,402              |
| CWB                                   | \$70,006      | \$63,246       | \$ 534,178                                     | \$672,155               | 13.11 %                        | 11.84 %                         | 9.41 %                |
| Capital in excess of well capitalized |               |                |  |                         | \$16,588                       | \$31,195                        | \$29,638              |
| December 31, 2010                     |               |                |  |                         |                                |                                 |                       |
| CWBC<br>(Consolidated)                | \$76,283      | \$61,385       | \$ 538,685                                     | \$676,397               | 14.16 %                        | 11.40 %                         | 9.08 %                |
|                                       |               |                |  |                         | \$22,415                       | \$29,064                        | \$27,565              |

Capital in excess  
of well  
capitalized

|     |          |          |            |           |       |   |       |   |      |   |
|-----|----------|----------|------------|-----------|-------|---|-------|---|------|---|
| CWB | \$69,308 | \$62,494 | \$ 538,463 | \$676,127 | 12.87 | % | 11.61 | % | 9.24 | % |
|-----|----------|----------|------------|-----------|-------|---|-------|---|------|---|

Capital in excess  
of well  
capitalized

|  |  |  |  |  |           |  |           |  |           |  |
|--|--|--|--|--|-----------|--|-----------|--|-----------|--|
|  |  |  |  |  | \$ 15,462 |  | \$ 30,186 |  | \$ 28,688 |  |
|--|--|--|--|--|-----------|--|-----------|--|-----------|--|

Well capitalized  
ratios

|  |  |  |  |  |       |   |      |   |      |   |
|--|--|--|--|--|-------|---|------|---|------|---|
|  |  |  |  |  | 10.00 | % | 6.00 | % | 5.00 | % |
|--|--|--|--|--|-------|---|------|---|------|---|

Minimum capital ratios

|  |  |  |  |  |      |   |      |   |      |   |
|--|--|--|--|--|------|---|------|---|------|---|
|  |  |  |  |  | 8.00 | % | 4.00 | % | 4.00 | % |
|--|--|--|--|--|------|---|------|---|------|---|

The Company and CWB each met the minimum ratios required to be classified as “well capitalized” under generally applicable regulatory guidelines.

Table of Contents

Supervision and Regulation

Banking is a complex, highly regulated industry. The banking regulatory scheme serves not to protect investors, but is designed to maintain a safe and sound banking system, to protect depositors and the FDIC insurance fund, and to facilitate the conduct of sound monetary policy. 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 banking industry. Consequently, the Company's growth and earnings performance, as well as that of CWB, may be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes and regulations and the policies of various governmental regulatory authorities, including the Board of Governors of the Federal Reserve Bank ("FRB"), the FDIC, and the Office of the Comptroller of the Currency ("OCC"). For a detailed discussion of the regulatory scheme governing the Company and CWB, please see the discussion in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operation – Supervision and Regulation."

ITEM 4. CONTROLS AND PROCEDURES

The Company's Management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e). Based upon that evaluation, the Company's Management has concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in ensuring that information relating to the Company (including its consolidated subsidiary required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity's disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors or mistakes or intentional circumvention of the established process.

There was no change in the Company's internal control over financial reporting identified in connection with the above-referred evaluation of the Company's Management with the participation of the Company's Chief Executive Officer and Chief Financial Officer, that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is involved in various litigation of a routine nature that is being handled and defended in the ordinary course of the Company's business. In the opinion of management, based in part on consultation with legal counsel, the resolution of these litigation matters will not have a material impact on the Company's financial position or results of operations.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K



for the fiscal year ended December 31, 2010, as filed with the SEC on March 25, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

32

---

Table of Contents

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

(a) On May 9, 2011, Richard M. Favor, Executive Vice President and Chief Credit Officer, notified the Company that he would resign, effective May 20, 2011, to pursue another business opportunity. The Company announced that, effective upon Mr. Favor's resignation, Mark J. Mediate, Senior Vice President, will discharge the position duties until a permanent replacement is named. Mr. Mediate, age 44, has been the Director of the Bank's Special Assets' group since September 2010. He worked from June 2009 to September 2010 as a Managing Consultant for Society Consulting Group, a firm that manages loan portfolio services for banks. From December 2006 to June 2009, Mr. Mediate was Executive Vice President, Chief Lending Officer and Chief Credit Officer of Metropolitan Bancorp. Mr. Mediate was a Senior Vice President, Town & Country Bank, from June 2005 to December 2006, and was responsible for loan production and supervision of other lenders.

ITEM 6. EXHIBITS

Exhibits.

31.1 Certification of Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) or Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.

31.2 Certification of Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) or Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.

32.1\* Certification of Chief Executive Officer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(b) or Rule 15d-14(b), promulgated under the Securities Exchange Act of 1934, as Amended, and 18 U.S.C. 1350.

\*This certification is furnished to, but shall not be deemed filed, with the Commission. This certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Registrant specifically incorporates it by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMUNITY WEST BANCSHARES  
(Registrant)

Date: May 13, 2011

/s/ Charles G. Baltuskonis  
Charles G. Baltuskonis  
Executive Vice President and  
Chief Financial Officer

On Behalf of Registrant and as  
Principal Financial and Accounting

Table of Contents

EXHIBIT INDEX

| Exhibit<br>Number | Description of Document  |
|-------------------|--|
| <u>31.1</u>       | Certification of Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) or Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.  |
| <u>31.2</u>       | Certification of Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) or Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.  |
| <u>32.1*</u>      | Certification of Chief Executive Officer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(b) or Rule 15d-14(b), promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C.1350. |

=====

\*This certification is furnished to, but shall not be deemed filed, with the Commission. This certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Registrant specifically incorporates it by reference.