First California Financial Group, Inc.
Form 10-K
March 31, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from ____________ to ____________

Commission file number 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**38-3737811**

(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
3027 Townsgate Road, Suite 300 Westlake Village, California	**91361**
(Address of Principal Executive Offices)	**(Zip Code)**

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

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $0.01 par value	**The Nasdaq Global Select Market**

Securities registered pursuant to Section 12(g) of the Exchange Act: None

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

(Do not check if a smaller reporting company)

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

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PART I

Item 1. *Business*

Our Business

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

Business of First California Financial Group

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

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

Business of First California Bank

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

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

The Bank s business strategy has been to attract individuals, professionals, and small- to mid-sized business borrowers in our primary service areas by offering a variety of loan products and a full range of banking services coupled with highly personalized service. The Bank s operations are primarily located within the areas commonly known as the 101 corridor stretching from the City of Ventura to Calabasas, California, the Moorpark-Simi Valley corridor, the western San Fernando Valley, the Tri-Cities area of Glendale-Burbank-Pasadena, the South Bay, the Inland Empire, north San Diego County, Century City and other parts of Los Angeles, Orange and Ventura Counties in Southern California. Our lending products include revolving lines of credit, term loans, commercial real estate loans, construction loans and consumer and home equity loans, which often contain terms and conditions tailored to meet the specific demands of the market niche in which the borrower operates. Additionally, the Bank provides a wide array of deposit and investment products serving the comprehensive banking needs of businesses and consumers in Los Angeles, Orange, Ventura, San Diego, Riverside and San Bernardino counties through traditional business and consumer banking, construction finance, SBA lending, entertainment finance and commercial real estate lending via 18 full-service branch locations.

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

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

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

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

Financial and Statistical Disclosure

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

Competition

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

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

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

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

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

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

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

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

Dependence on One or a Few Major Customers; Business Concentrations

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

Internet Banking Services

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

Employees

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

Supervision and Regulation

Recent Developments

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

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

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

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

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

General

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

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

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

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

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

Regulation of First California

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

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

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

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

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

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

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

Regulation of the Bank

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

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

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Dividends and Capital Distributions

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

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

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

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

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

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

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

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

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2008			(in thousands)			
Total capital (to risk weighted assets)						
First California Financial Group, Inc.	$ 147,680	16.62%	$ 71,102	≥ 8.00%		
First California Bank	109,022	12.27%	71,110	≥ 8.00%	88,888	≥ 10.00%
Tier I capital (to risk weighted assets)						
First California Financial Group, Inc.	139,530	15.70%	35,551	≥ 4.00%		
First California Bank	100,873	11.35%	35,555	≥ 4.00%	53,333	≥ 6.00%
Tier I capital (to average assets)						
First California Financial Group, Inc.	139,530	12.77%	43,699	≥ 4.00%		
First California Bank	100,873	9.26%	43,568	≥ 4.00%	54,460	≥ 5.00%

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2007						
Total capital (to risk weighted assets)						
First California Financial Group, Inc.	$ 115,387	13.35%	$ 69,167	≥ 8.00%		
First California Bank	102,826	11.98%	68,687	≥ 8.00%	85,858	≥ 10.00%
Tier I capital (to risk weighted assets)						
First California Financial Group, Inc.	107,460	12.43%	34,583	≥ 4.00%		
First California Bank	94,899	11.05%	34,343	≥ 4.00%	51,515	≥ 6.00%
Tier I capital (to average assets)						
First California Financial Group, Inc.	107,460	10.42%	41,248	≥ 4.00%		
First California Bank	94,899	9.24%	41,065	≥ 4.00%	51,332	≥ 5.00%

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

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

Prompt Corrective Action and Other General Enforcement Authority. The Federal Deposit Insurance Corporation Improvement Act, or FDICIA, requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. The federal banking agencies possess broad powers to take prompt corrective action to resolve the problems of insured banks. Each federal banking agency has issued regulations defining five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the regulations, a bank shall be deemed to be:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Impact of Monetary Policies

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

Open-market dealings in United States government securities;

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

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

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

Available Information

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

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

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

We have adopted a written code of ethics that applies to all directors, officers and employees of the Company, including our principal executive officer and senior financial officers, in accordance with Section 406 of the Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission promulgated thereunder. The code of ethics is available on our website at www.fcalgroup.com and also upon request, at no charge. Requests for copies should be directed to: Investor Relations Department, 3027 Townsgate Road, Suite 300, Westlake Village, California 91361, telephone number (805) 322-9655. In the Corporate Governance section of our corporate website we have also posted the charters for our Audit Committee and Compensation Committee.

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

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

Risks Related to Our Business

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

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

- a decrease in the demand for loans or other products and services offered by us;
- a decrease in the value of our loans or other assets secured by consumer or commercial real estate;
- a decrease to deposit balances due to overall reductions in the accounts of customers;
- an impairment of certain intangible assets or investment securities;
- a decreased ability to raise additional capital or the terms may not be acceptable to us; or
- an increase in the number of borrowers who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to us. An increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs and provision for credit losses.

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

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

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Current levels of market volatility are unprecedented.

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

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

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

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

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

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

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

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

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

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

A significant source of risk for First California arises from the possibility that losses will be sustained if our borrowers and guarantors fail to perform in accordance with the terms of their loans and guaranties. This risk increases when the economy is weak. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our internal operations are subject to a number of risks.

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

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

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

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We face risks in connection with our strategic undertakings.

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

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

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

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

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

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

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

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

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

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

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

Risks Related to Our Common Stock

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

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

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

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

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

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

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

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

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

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

- actual or anticipated quarterly fluctuations in our operating and financial results;
- developments related to investigations, proceedings or litigation that involve us;
- changes in financial estimates and recommendations by financial analysts;
- dispositions, acquisitions and financings;
- actions of our current stockholders, including sales of our Common Stock by existing stockholders and our directors and executive officers;
- fluctuations in the stock price and operating results of our competitors;

- regulatory developments; and

- developments related to the financial services industry.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

None.

Item 2. ***Properties***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Item 3. ***Legal Proceedings***

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

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

None.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

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

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

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

Dividends

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

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

Securities Authorized for Issuance Under Equity Compensation Plans

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

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

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

Recent Sales of Unregistered Securities

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

Issuer Purchases of Equity Securities

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

Item 6. ***Selected Financial Data***

Not applicable.

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

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

- revenues are lower than expected;
- credit quality deterioration which could cause an increase in the provision for loan losses;
- competitive pressure among depository institutions increases significantly;
- changes in consumer spending, borrowings and savings habits;
- our ability to successfully integrate acquired entities or to achieve expected synergies and operating efficiencies within expected time-frames or at all;
- the integration of acquired businesses costs more, takes longer or is less successful than expected;
- technological changes;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- general economic conditions, particularly those affecting real estate values, either nationally or in the market areas in which we do or anticipate doing business, are less favorable than expected;
- a slowdown in construction activity;
- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq and other conflicts;

legislative or regulatory requirements or changes adversely affecting our business;

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

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

inflation, interest rate, securities market and monetary fluctuations;

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

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

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

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

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

Overview

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

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

Critical Accounting Policies

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

Allowance for loan losses

The allowance for loan losses is established through a provision charged to expense. Loans are charged against the allowance when we believe that the collectibility of principal is unlikely. The allowance is an amount that we believe will be adequate to absorb probable losses on existing loans and leases that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower s ability to pay. Various regulatory agencies, as a regular part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgment of information available to them at the time of their examinations. The allowance for loan losses was $8,048,000 at December 31, 2008 and $7,828,000 at December 31, 2007.

Deferred income taxes

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

Derivative instruments and hedging

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

Assessments of impairment

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

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

- selection of comparable publicly traded companies, based upon location, size and business composition;
- selection of market comparable acquisition transactions, based on location, size, business composition, and date of the transaction;
- the discount rate applied to future earnings, based upon an estimate of the cost of capital;
- the potential future earnings of the Company; and
- the relative weight given to the valuations derived by the three methods described

If the first step indicates a potential impairment, we next determine or estimate the implied fair value of the goodwill. This process estimates the fair value of the Company s individual assets and liabilities in the same manner as if a purchase of the Company were taking place. To do this, we must determine the fair value of the assets, liabilities and identifiable intangible assets of the Company based upon the best available information. We estimate the fair market value of all of the tangible assets, identifiable intangible assets and liabilities of the Company in accordance with the principals of SFAS 157. Loans, deposits with maturities, and debt are valued using assumptions regarding future cash flows, appropriate discount rates and other estimates, such as credit and market liquidity assumptions, to comply with SFAS 157. Deposits with no maturities are valued at book value. Owned properties are appraised, while for furniture, fixtures and equipment it is assumed book value approximates fair market value. Identifiable intangible assets such as core deposit intangibles and trade name intangibles are also identified and valued. If the implied fair value of goodwill calculated in this exercise is less than the carrying amount of goodwill, an impairment is indicated and the carrying value of goodwill is written down to its estimated fair value.

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

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

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

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

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

Net interest income

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

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

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

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

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

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

Average Balance Sheet and Analysis of Net Interest Income

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

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

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

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

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

	2008 vs 2007			2007 vs 2006		
	Increase (Decrease) due to:		Net Increase (Decrease)	Increase (Decrease) due to:		Net Increase (Decrease)
	Volume	Rate		Volume	Rate	
	(Dollars in thousands)					
Interest Income:						
Federal funds sold	$ 32	$ (103)	$ (71)	$ 19	$ (6)	$ 13
Due from banks interest-bearing	(26)	2	(24)	20	(125)	(105)
Securities available-for-sale	2,732	(284)	2,448	4,200	(51)	4,149
Securities held-to-maturity				(96)		(96)
Loans (2)	8,483	(13,351)	(4,868)	27,341	(1,052)	26,289
Total interest-earning assets	11,221	(13,736)	(2,515)	31,484	(1,234)	30,250
Interest Expense:						
Interest-bearing deposits:						
Checking	70	(183)	(113)	70	37	107
Money market and savings	(615)	(2,943)	(3,558)	3,189	557	3,746
Time certificates of deposit:						
$100,000 or more	1,890	(3,027)	(1,137)	1,836	(1,704)	132
Under $100,000	1,087	(1,203)	(116)	5,050	1,188	6,238
Total time certificates of deposit	2,977	(4,230)	(1,253)	6,886	(516)	6,370
Total interest-bearing deposits	2,432	(7,356)	(4,924)	10,145	78	