

First Foundation Inc.
Form 10-K
March 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2016

Commission file number: 001-36461

FIRST FOUNDATION INC.

(Exact name of registrant as specified in its charter)

Delaware 20-8639702
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

18101 Von Karman Avenue, Suite 700

Irvine, CA 92612 92612
(Address of principal executive offices) (Zip Code)

(949) 202-4160

Edgar Filing: First Foundation Inc. - Form 10-K

(Registrant's telephone number, including area code)

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

Common Stock, par value \$0.001 per share (Title of each class)	NASDAQ Global Stock Market (Name of exchange on which registered)
--	--

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

Indicate by check mark 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 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" and "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of June 30, 2016, the aggregate market value of the common stock held by non-affiliates of the registrant, computed by reference to the average high and low sales prices on the NASDAQ Global Stock Market as of the close of business on June 30, 2016, was approximately \$261 million.

As of March 10, 2017, there were 32,893,491 shares of registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

FIRST FOUNDATION INC.

ANNUAL REPORT ON FORM 10-K

FOR THE YEAR ENDED DECEMBER 31, 2016

TABLE OF CONTENTS

	Page No.
<u>FORWARD-LOOKING STATEMENTS</u>	ii
PART I	
Item 1 <u>Business</u>	1
Item 1A <u>Risk Factors</u>	19
Item 1B <u>Unresolved Staff Comments</u>	34
Item 2 <u>Properties</u>	34
Item 3 <u>Legal Proceedings</u>	34
Item 4 <u>Mine Safety Disclosures</u>	34
PART II	
Item 5 <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	35
Item 6 <u>Selected Financial Data</u>	38
Item 7 <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	41
Item 8 <u>Financial Statements and Supplementary Data</u>	66
Item 9 <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosures</u>	108
Item 9A <u>Controls and Procedures</u>	108
Item 9B <u>Other Information</u>	111
PART III	
Item 10 <u>Directors and Executive Officers of the Registrant</u>	112
Item 11 <u>Executive Compensation</u>	119
Item 12 <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	128
Item 13 <u>Certain Relationships and Related Transactions and Director Independence</u>	129
Item 14 <u>Principal Accountant Fees and Services</u>	130
PART IV	
Item 15 <u>Exhibits and Financial Statements and Schedules</u>	132
Item 16 <u>Form 10-K Summary</u>	132
<u>Signatures</u>	S-1
<u>Index to Exhibits</u>	E-1

FORWARD-LOOKING STATEMENTS

In addition to historical information, this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are those that predict or describe future events or trends or that do not relate solely to historical matters. However, our actual results and financial performance in the future will be affected by known and currently unknown risks, uncertainties and other factors that may cause our actual results or financial performance in the future to differ materially from the results or financial performance that may be expressed, predicted or implied by such forward-looking statements. Such risks, uncertainties and other factors include, among others, those set forth below in Item 1A Risk Factors, and readers of this report are urged to read the cautionary statements contained in that section of this report. In some cases, you can identify forward-looking statements by words like “may,” “will,” “should,” “could,” “believes,” “intends,” “expects,” “anticipates,” “plans,” “estimates,” “predicts,” “potential,” “project” and “continue” and similar expressions. Readers of this report are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the respective dates on which such statements were made and which are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements.

First Foundation Inc. expressly disclaims any intent or any obligation to release publicly any revisions or updates to any of the forward-looking statements contained in this report to reflect events or circumstances after the date of this report or the occurrence of currently unanticipated events or developments or to conform such forward-looking statements to actual results or to changes in its opinions or expectations, except as may be required by applicable law.

PART I

Item 1. Business

Overview

Unless we state otherwise or the context otherwise requires, references in this Annual Report on Form 10-K to “we,” “our,” and “us” refer to First Foundation Inc., a Delaware corporation, (“FFI” or the “Company”) and its consolidated subsidiaries, First Foundation Advisors (“FFA”) and First Foundation Bank (“FFB” or “Bank”), and FFB’s wholly owned subsidiaries, First Foundation Insurance Services (“FFIS”) and Blue Moon Management, LLC.

We are a California based financial services company that provides a comprehensive platform of personalized financial services to individuals, businesses and other organizations. Our integrated platform provides investment advisory and wealth management services, banking products and services, trust services, life and property and casualty insurance services to effectively and efficiently meet the financial needs of our clients. As part of our lending activities, we have established a platform that offers loans to individuals and entities that own and operate multifamily residential and commercial real estate properties. In addition, we provide business banking products and services to small to moderate-sized businesses and professional firms, and consumer banking products and services to individuals and families. As of December 31, 2016, we had \$3.6 billion of assets under management (or AUM), \$4.0 billion of total assets, \$2.6 billion of loans and \$2.4 billion of deposits. Our investment advisory and wealth management, trust and insurance services provide us with substantial, fee-based, recurring revenues, such that in 2016, our non-interest income was 28% of our total revenues.

Our strategy is focused on expanding our strong and stable client relationships by delivering high quality, coordinated products and services. We are able to maintain a client-focused approach by recruiting and retaining experienced and qualified staff.

We intend to continue to grow our business by (i) cross-selling our services among our wealth management and banking clients; (ii) obtaining new client referrals from existing clients, attorney and accountant referral sources and through referral agreements with asset custodial firms; (iii) marketing our services directly to prospective new clients; (iv) adding experienced relationship managers, commercial bankers and commercial real estate (“CRE”) loan producers who may have established client relationships that we can serve; (v) establishing de novo offices in select markets, both within and outside our existing market areas; and (vi) making opportunistic acquisitions of complementary businesses.

Our broad range of financial products and services are more consistent with those offered by larger financial institutions, while our high level of personalized service, accessibility and responsiveness to our clients are more typical of the services offered by boutique investment advisory and wealth management firms and community banks. We believe this combination of an integrated platform of comprehensive financial services and products and personalized and responsive service differentiates us from many of our competitors and has contributed to the growth of our client base and our business.

As a bank holding company, we are subject to regulation and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or “FRB”) and the Federal Reserve Bank of San Francisco (“FRBSF”) under delegated authority from the FRB. FFB is a California state chartered bank that commenced operations in 2007. It is subject to regulation and examination by the Federal Deposit Insurance Corporation (“FDIC”) and the California Department of Business Oversight (“DBO”). FFB also is a member of the Federal Home Loan Bank of San Francisco (“FHLB”), which provides it with a source of funds in the form of short-term and long-term borrowings. FFA is a California corporation that began operating as a fee-based registered investment advisor under the Investment Advisers Act of 1940, (“Investment Advisers Act”) in 1990, and is subject to regulation by the Securities and Exchange Commission, (“SEC”), under that Act.

On October 28, 2015, FFI changed its state of incorporation from California to Delaware. Other than the change in corporate domicile, the reincorporation did not result in any change in the business, physical location, management, assets, liabilities or total shareholders' equity of the Company, nor did it result in any change in location of the Company's employees, including the Company's management. Additionally, the reincorporation did not alter any stockholder's percentage ownership interest or number of shares owned in the Company.

Overview of Our Banking Business

FFB is engaged in offering a broad range of personal and business banking products and services and trust services to its clients, including individuals, small to moderate sized businesses and professional firms. Its banking products and services for individuals include a variety of deposit products, including personal checking, savings and money market deposits and certificates of deposit, single family real estate loans, and consumer loans and online banking services. FFB's business banking products and services include multifamily and commercial real estate loans, commercial term loans and lines of credit, transaction and other deposit

accounts, online banking, mobile banking and enhanced business services. FFIS was established to provide life, property and casualty agency insurance services as part of the platform of financial products and services. Clients are obtained through relationships/referrals from existing client relationships, FFI clients and newly generated clients via prospecting. At December 31, 2016, FFB had \$4.0 billion of total assets, \$2.6 billion of loans and \$2.4 billion of deposits. FFB's operations comprise the banking, trust and insurance segments of our business.

Overview of Our Investment Advisory and Wealth Management Business

FFA is a fee-based investment advisor which provides investment advisory and wealth management services primarily to high net-worth individuals, their families and their family businesses, and other affiliated organizations. FFA strives to provide its clients with a high level of personalized service by its staff of experienced relationship managers. As of December 31, 2016, FFA had \$3.6 billion of AUM. FFA's operations comprise the investment advisory and wealth management segments of our business.

Relationship Managers, Commercial Bankers and CRE Loan Producers

Our operating strategy has been to build strong and stable long-term client relationships, one at a time, by delivering high quality, coordinated investment advisory and wealth management services, banking products and services, trust and insurance services. The success of this strategy is largely attributable to our experienced and high quality client relationship managers, commercial bankers and CRE loan producers. The primary role of our relationship managers, commercial bankers and CRE loan producers, in addition to attracting new clients, is to develop and maintain a strong relationship with their clients and to coordinate the services we provide to their clients. We believe we can continue to attract and retain experienced and client-focused relationship managers, commercial bankers and CRE loan producers.

Banking Products and Services

Through FFB, we offer a wide range of loan products, deposit products, business and personal banking services and trust services. Our loan products are designed to meet the credit needs of our clients in a manner that, at the same time, enables us to effectively manage the credit and interest rate risks inherent in our lending activities. Loan products include commercial lending and commercial real estate lending, predominantly on multifamily properties. Deposits represent our principal source of funds for making loans and investments and acquiring other interest-earning assets. The yields we realize on our loans and other interest-earning assets and the interest rates we pay to attract and retain deposits are the principal determinants of our banking revenues. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" elsewhere in this Annual Report on Form 10-K.

Our lending activities serve the credit needs of individuals, owners of multifamily and commercial real estate properties, small to moderate size businesses and professional firms in our market areas. As a result we offer a variety of loan products consisting of multifamily and single family residential real estate loans, commercial real estate loans, commercial term loans and lines of credit, and consumer loans. We handle substantially all of our loan processing, underwriting and servicing at our administrative office in Irvine, California.

The following table sets forth information regarding the types of loans that we make, by amounts and as a percentage of our total loans outstanding at December 31:

(dollars in thousands)	2016		2015	
	Balance	% of Total	Balance	% of Total
Recorded Investment balance:				
Loans secured by real estate:				
Residential properties:				

Edgar Filing: First Foundation Inc. - Form 10-K

Multifamily	\$1,178,003	46.2	%	\$627,311	35.5	%
Single family	602,886	23.6	%	533,257	30.2	%
Total loans secured by residential properties	1,780,889	69.8	%	1,160,568	65.7	%
Commercial properties	476,959	18.7	%	358,791	20.3	%
Land	24,100	0.9	%	12,320	0.7	%
Total real estate loans	2,281,948	89.4	%	1,531,679	86.7	%
Commercial and industrial loans	237,941	9.3	%	196,584	11.1	%
Consumer loans	32,127	1.3	%	37,206	2.2	%
Total loans	\$2,552,016	100.0	%	\$1,765,469	100.0	%

Residential Mortgage Loans – Multi-family: We make multi-family residential mortgage loans for terms up to 30 years primarily for properties located in California. These loans generally are adjustable rate loans with interest rates tied to a variety of

independent indexes; although in some cases these loans have fixed interest rates for periods ranging from 3 to 10 years and adjust thereafter based on an applicable index. These loans generally have interest rate floors, payment caps, and prepayment penalties. The loans are underwritten based on a variety of underwriting criteria, including an evaluation of the character and creditworthiness of the borrower and guarantors, loan-to-value and debt service coverage ratios, borrower liquidity and credit history. In addition, we perform stress testing for changes in interest rates, capitalization rates and other factors and review general economic trends such as lease rates, values and absorption rates. We typically require personal guarantees from the owners of the entities to which we make such loans.

Residential Mortgage Loans – Single-family: We offer single family residential mortgage loans primarily as an accommodation to our existing clients. In most cases, these take the form of non-conforming jumbo and super jumbo loans and FFB does not currently sell or securitize any of its single family residential mortgage loan originations. FFB does not originate loans defined as high cost by state or federal banking regulators. The majority of FFB's single family residential loan originations are collateralized by first mortgages on real properties located in Southern California. These loans are generally adjustable rate loans with fixed terms ranging from 3 to 10 years and terms of the loan not exceeding 30 years. These loans generally have interest rate floors and payment caps. The loans are underwritten based on a variety of underwriting criteria, including an evaluation of the character and creditworthiness of the borrower and guarantors, loan-to-value and debt to income ratios, borrower liquidity, income verification and credit history. In addition, we perform stress testing for changes in interest rates and other factors and review general economic trends such as market values.

Commercial Real Estate Loans - Owner Occupied: Owner occupied commercial real estate loans are generally made to businesses that have demonstrated a history of profitable operations. To qualify for such loans, prospective borrowers generally must have operating cash flow sufficient to meet their obligations as they become due, and good payment histories. Our commercial real estate loans are secured by first trust deeds on nonresidential real property. These loans generally are adjustable rate loans with interest rates tied to a variety of independent indexes; although in some cases these loans have fixed interest rates for periods ranging from 3 to 10 years and adjust thereafter based on an applicable index. These loans generally have terms of 10 years, interest rate floors, payment caps, and prepayment penalties. The loans are underwritten based on a variety of underwriting criteria, including an evaluation of the character and creditworthiness of the borrower and guarantors, loan-to-value and debt service coverage ratios, borrower liquidity and credit history. In addition, we perform stress testing for changes in interest rates, cap rates and other factors and review general economic trends such as lease rates, values and absorption rates. We typically require personal guarantees from the owners of the entities to which we make such loans.

Commercial Loans: We offer commercial term loans and commercial lines of credit to our clients. Commercial loans generally are made to businesses that have demonstrated a history of profitable operations. To qualify for such loans, prospective borrowers generally must have operating cash flow sufficient to meet their obligations as they become due, and good payment histories. Commercial term loans are either fixed rate loans or adjustable rate loans with interest rates tied to a variety of independent indexes and are made for terms ranging from 1 to 5 years. Commercial lines of credit are adjustable rate loans with interest rates usually tied to the Wall Street Journal prime rate or LIBOR rates, are made for terms ranging from 1 to 2 years, and contain various covenants, including a requirement that the borrower reduce its credit line borrowings to zero for specified time periods during the term of the line of credit. The loans are underwritten based on a variety of underwriting criteria, including an evaluation of the character and creditworthiness of the borrower and guarantors, debt service coverage ratios, historical and projected client income, borrower liquidity and credit history. In addition, we perform stress testing for changes in interest rates and other factors and review general economic trends in the client's industry. We typically require personal guarantees from the owners of the entities to which we make such loans.

Equipment financing: We offer equipment financing to provide financing solutions to third party originators, including equipment brokers, lessors and other referral sources. A majority of the equipment financing business is small in nature, typically averaging below \$250,000, has terms ranging from 3 to 7 years, carry fixed rates and are

secured by the underlying equipment and the operations of the borrower.

Small Business Lending and USDA Lending: The Bank is approved as a Small Business Administration (“SBA”) lender and as a U>S> Department of Agriculture (“USDA”) lender. The Bank uses both the SBA and USDA lending programs to serve existing clients and potential new clients. As government guaranteed programs, the Bank is required to comply with underwriting guidelines and terms and conditions set forth under the related programs.

Consumer Loans: We offer a variety of consumer loans and credit products, including personal installment loans and lines of credit, and home equity lines of credit designed to meet the needs of our clients. Consumer loans are either fixed rate loans or adjustable rate loans with interest rates tied to a variety of independent indexes and are made for terms ranging from 1 to 10 years. The loans are underwritten based on a variety of underwriting criteria, including an evaluation of the character creditworthiness and credit history of the borrower and guarantors, debt to income ratios, borrower liquidity, income verification, and the value of any collateral securing the loan. Consumer loan collections are dependent on the borrower’s ongoing cash flows and financial stability and, as a result, generally pose higher credit risks than the other loans that we make.

For all of our loan offerings, we utilize a comprehensive approach in our underwriting process. This includes the requirement that all factors considered in our underwriting be appropriately documented. In our underwriting, our primary focus is always on the borrower's ability to repay. However, because our underwriting process allows us to view the totality of the borrower's capacity to repay, concerns or issues in one area can be compensated for by other favorable financial criteria. This personalized and detailed approach allows us to better understand and meet our clients' lending needs.

Bank Deposit Products: We offer a wide range of deposit products, including personal and business checking, savings accounts, interest-bearing negotiable order of withdrawal accounts, money market accounts and time certificates of deposit. The following table sets forth information regarding the type of deposits which our clients maintained with us and the average interest rates on those deposits as of December 31:

(dollars in thousands)	2016			2015		
	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate
Demand deposits:						
Noninterest-bearing	\$661,781	27.3	% —	\$299,794	19.7	% —
Interest-bearing	194,274	8.0	% 0.471	260,167	17.1	% 0.359
Money market and savings	941,344	38.8	% 0.677	492,015	32.3	% 0.531
Certificates of deposits	629,396	25.9	% 0.589	470,200	30.9	% 0.554
Total	\$2,426,795	100.0	% 0.453	\$1,522,176	100.0	% 0.404

As of December 31, 2016, our 8 largest bank depositors accounted for, in the aggregate, 30% of our total deposits. See Item 1A—Risk Factors.

Trust Services: FFB is licensed to provide trust services to clients in California, Nevada and Hawaii. Those services, which consist primarily of the management of trust assets, complement the investment advisory and wealth management services that FFA offers to our clients and, as a result, provide us with cross-selling opportunities. Additionally, trust service fees provide an additional source of noninterest income for us. At December 31, 2016, trust AUM totaled \$512 million.

Insurance Services: Through FFIS, we offer life and property and casualty insurance products provided by unaffiliated insurance carriers from whom we collect a brokerage fee.

Wealth Management Products and Services

FFA is a fee-based investment advisor which provides investment advisory and wealth management services primarily for high net-worth individuals and their families, family businesses and other affiliated organizations (including public and closely-held corporations, family foundations and private charitable organizations). FFA provides high net-worth clients with personalized services designed to enable them to reach their personal and financial goals by coordinating FFA's investment advisory and wealth management services with risk management and estate and tax planning services that are provided by outside service providers, for which FFA does not receive commissions or referral fees. FFA's clients benefit from certain cost efficiencies available to institutional managers, such as block trading, access to institutionally priced no-load mutual funds, ability to seek competitive bid/ask pricing for bonds, low transaction costs and management fees charged as a percentage of the assets managed, with tiered pricing for larger accounts.

FFA's investment advisory and wealth management team strives to create diversified investment portfolios for its clients that are individually designed, monitored and adjusted based on the discipline of fundamental investment analysis. FFA focuses on creating investment portfolios that are commensurate with a client's objectives, risk

preference and time horizon, using traditional investments such as individual stocks and bonds and mutual funds. FFA also provides comprehensive and ongoing advice and coordination regarding estate planning, retirement planning, charitable and business ownership issues, and issues faced by executives of publicly-traded companies.

AUM at FFA has grown at a compound annual growth rate of 14% over the five year period ending December 31, 2016. Changes in our AUM reflects additions from new clients, the gains or losses recognized from investment results, additional funds received from existing clients, withdrawals of funds by clients, and terminations.

FFA does not provide custodial services for its clients. Instead, client investment accounts are maintained under custodial arrangements with large, well established brokerage firms, either directly or through FFB. However, FFA advises its clients that they are not obligated to use those services and that they are free to select securities brokerage firms and custodial service providers of their own choosing. FFA has entered into referral agreements with certain of the asset custodial firms that provide custodial services to our

clients. Under these arrangements, the asset custodial firms provide referrals of prospective new clients whose increase in wealth warrants a more personalized and expansive breadth of financial services that we are able to provide in exchange for a fee. This fee is either a percentage of the fees we charge to the client or a percentage of the AUM of the client. The asset custodial firms are entitled to continue to receive these fees for as long as we continue to provide services to the referral client. These referral agreements do not require the client to maintain their assets at the custodial firm and are fully disclosed to the client prior to our providing services to them.

Competition

The banking and investment advisory and wealth management businesses in California, Nevada and Hawaii, generally, and in our market areas, in particular, are highly competitive. A relatively small number of major national and regional banks, operating over wide geographic areas, including Wells Fargo, JP Morgan Chase, US Bank, Comerica, Union Bank and Bank of America, dominate our banking markets. Those banks, or their affiliates, may also offer investment advisory and wealth management services. We also compete with large, well known banking and wealth management firms, including City National, First Republic, Northern Trust and Boston Private. Those banks and investment advisory and wealth management firms generally have much greater financial and capital resources than we do and as a result of their ability to conduct extensive advertising campaigns and their relatively long histories of operations in our markets, are generally better known than us. In addition, by virtue of their greater total capitalization, the large banks have substantially higher lending limits than we do, which enables them to make much larger loans and to offer loan products that we are not able to offer to our clients.

We compete with these much larger banks and investment advisory and wealth management firms primarily on the basis of the personal and “one-on-one” service that we provide to our clients, which many of these competitors are unwilling or unable to provide, other than to their wealthiest clients, due to costs involved or their “one size fits all” approaches to providing financial services to their clients. We believe that our principal competitive advantage is our ability to offer our services through one integrated platform, enabling us to provide our clients with the efficiencies and benefits of dealing with a cohesive group working together to assist our clients to meet their personal investment and financial goals. We believe that only the largest financial institutions in our area provide similar integrated platforms of products and services, which they sometimes reserve for their wealthiest and institutional clients. In addition, while we also compete with many local and regional banks and numerous local and regional investment advisory and wealth management firms, we believe that only a very few of these banks offer investment advisory or wealth management services and that a very few of these investment advisory and wealth management firms offer banking services and, therefore, these competitors are not able to provide such an integrated platform of comprehensive financial services to their clients. This enables us to compete effectively for clients who are dissatisfied with the level of service provided at larger financial institutions, yet are not able to receive an integrated platform of comprehensive financial services from other regional or local financial services organizations.

While we provide our clients with the convenience of technological access services, such as remote deposit capture, internet banking and mobile banking, we compete primarily by providing a high level of personal service. As a result, we do not try to compete exclusively on pricing. However, because we are located in a highly competitive market place and because we are seeking to grow our businesses, we attempt to maintain our pricing in line with our principal competitors.

Supervision and Regulation

Both federal and state laws extensively regulate bank holding companies and banks. Such regulation is intended primarily for the protection of depositors and the FDIC’s deposit insurance fund and is not for the benefit of shareholders. Set forth below are summary descriptions of the material laws and regulations that affect or bear on our operations. Those summaries are not intended, and do not purport, to be complete and are qualified in their entirety by reference to the laws and regulations that are summarized below.

First Foundation Inc.

General

First Foundation Inc. is a registered bank holding company subject to regulation under the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). Pursuant to the Holding Company Act, we are subject to supervision and periodic examination by, and are required to file periodic reports with the FRB.

As a bank holding company, we are allowed to engage, directly or indirectly, only in banking and other activities that the Federal Reserve has determined, or in the future may deem, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Business activities which the Federal Reserve has designated as being closely related to banking include the provision of investment advisory, securities brokerage, insurance agency and data processing services, among others.

As a bank holding company, we also are required to obtain the prior approval of the FRB for the acquisition of more than 5% of the outstanding shares of any class of voting securities, or of substantially all of the assets, by merger or purchase, of (i) any bank or other bank holding company and (ii) any other entities engaged in banking-related businesses or that provide banking-related services.

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 a bank holding company, in serving as a source of strength to its subsidiary banks, 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. For that reason, among others, the Federal Reserve requires all bank holding companies to maintain capital at or above certain prescribed levels. A bank holding company's failure to meet these requirements will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the FRB's regulations or both, which could lead to the imposition of restrictions (including restrictions on growth) on, or a regulatory enforcement order against, the offending bank holding company.

Additionally, among its powers, the Federal Reserve may require any bank holding company to terminate an activity or terminate control of, or liquidate or divest itself of, any subsidiary or affiliated company that the FRB determines constitutes a significant risk to the financial safety, soundness or stability of the bank holding company or any of its banking subsidiaries. The Federal Reserve also has the authority to regulate provisions of a bank holding company's debt, including authority to impose interest ceilings and reserve requirements on such debt. Subject to certain exceptions, bank holding companies also are required to file written notice and obtain approval from the Federal Reserve prior to purchasing or redeeming their common stock or other equity securities. A bank holding company and its non-banking subsidiaries also are prohibited from implementing so-called tying arrangements whereby clients may be required to use or purchase services or products from the bank holding company or any of its non-bank subsidiaries in order to obtain a loan or other services from any of the holding company's subsidiary banks.

Financial Services Modernization Act

The Financial Services Modernization Act (the "Gramm-Leach-Bliley Act" or the "Modernization Act"), was enacted into law in 1999 primarily to establish a comprehensive framework that would permit affiliations among commercial banks, insurance companies, securities and investment banking firms, and other financial service providers. Accordingly, the Modernization Act amended the Holding Company Act to permit a bank holding company that meets certain eligibility requirements to qualify as a "financial holding company," and its non-bank affiliated companies to engage in a broader range of financial activities to foster greater competition among financial services companies both domestically and internationally.

The Modernization Act also contains provisions that expressly preempt and make unenforceable any state law restricting bank holding companies or their affiliates from engaging in the insurance underwriting or related businesses. That Act also:

- broadened the activities that may be conducted by national banks, bank subsidiaries of bank holding companies, and their financial subsidiaries;
- provided an enhanced framework for protecting the privacy of consumer information;
- adopted a number of provisions related to the capitalization, membership, corporate governance, and other measures designed to modernize the Federal Home Loan Bank system;
- modified the laws governing the implementation of the Community Reinvestment Act ("CRA"), which is described in greater detail below; and
- addressed a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of banking institutions.

According to current FRB regulations implementing the Modernization Act, activities that are financial in nature and may be engaged in by financial holding companies, through their non-bank subsidiaries, include:

- securities underwriting, dealing and market making;
- sponsoring mutual funds and investment companies;
- engaging in insurance underwriting; and
- engaging in merchant banking activities.

Before a bank holding company may engage in any of those financial activities, it must file an application with its Federal Reserve Bank that confirms that it meets certain qualitative eligibility requirements established by the FRB. A bank holding company that meets those qualifications and files such an application will be designated as a “financial holding company,” entitling it to affiliate

with securities firms and insurance companies and engage in other activities, primarily through non-banking subsidiaries, that are financial in nature or are incidental or complementary to activities that are financial in nature.

A bank holding company that does not qualify as, or chooses not to submit an application to become, a financial holding company may not engage in such financial activities. Instead, as discussed above, it will be limited to engaging in banking and such other activities that have been determined by the FRB to be closely related to banking.

Acquisition of Control of a Bank Holding Company or a Bank

Subject to certain limited exemptions, the Holding Company Act and the Change in Bank Control Act of 1978, as amended (the “Change in Control Act”), together with their implementing regulations, require:

- the approval of the FRB before any person or company may acquire “control” of a bank holding company; and
- the approval of an insured depository institution’s federal bank regulator before any person or company may acquire “control” of the institution.

Under the Change in Control Act, control of a bank holding company or a bank or other insured depository institution is conclusively presumed to exist if an individual or company (i) acquires 25% or more of any class of voting securities of the bank holding company or the depository institution, or (ii) has the direct or indirect power to direct or cause the direction of the management and policies of the bank holding company or the insured depository institution, whether through ownership of voting securities, by contract or otherwise; except that no individual will be deemed to control a bank holding company or an insured depository institution solely on account of being one of its directors, officers or employees. The Change in Control Act also establishes a presumption, which is rebuttable, that a person will be deemed to control a bank holding company or an insured depository institution if that person acquires 10% or more, but less than 25%, of any class of voting securities of a bank holding company which has a class of equity securities registered with the SEC under the Exchange Act, or if no other person will own a greater percentage of that class of voting securities immediately after the transaction.

However, as a bank holding company, we must obtain the prior approval of the FRB to acquire more than five percent of the outstanding shares of voting securities of a bank or another bank holding company. In addition, the Dodd-Frank Act, which is discussed in greater detail below, provides that an acquisition by a bank holding company of a bank located outside the bank holding company’s home state may not be approved, unless the FRB has determined that the bank holding company is well-capitalized and well managed.

Capital Requirements Applicable to Bank Holding Companies

Because it requires bank holding companies to be a source of financial strength for their bank subsidiaries, the Federal Reserve has adopted regulations that require bank holding companies to meet capital adequacy guidelines similar to those that apply to banks and other insured depository institutions. For additional information regarding these guidelines, see “First Foundation Bank – Capital Adequacy Guidelines” and First Foundation Bank – New Basel III Capital Requirements” below.

Dividends

It is the policy of FRB that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the holding company’s expected future needs for capital and liquidity and to maintain its financial condition. It is also an FRB policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of financial strength for their banking subsidiaries. Additionally, due to the current financial and economic environment, the FRB has indicated that bank holding companies should carefully review their dividend policies and has discouraged dividend payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

The Dodd-Frank Act

From time to time, federal and state legislation is enacted which can affect our operations and our operating results by materially increasing our costs of doing business, limiting or expanding the activities in which banks and other financial institutions may engage, or altering the competitive balance between banks and non-bank financial service providers.

The recent economic recession and credit crisis that required, among other measures, the federal government to provide substantial financial support to many of the largest of the banks and other financial service organizations in the United States, led the U.S. Congress to adopt a number of new laws, and the federal banking regulators, including the FRB and the FDIC, to take broad

actions, to address systemic risks and volatility in the U.S. banking system. Set forth below is a summary of some of the provisions of the most significant of these laws, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”). The regulatory sweep of the Dodd-Frank Act is broad and its provisions apply not only to the regulation of bank holding companies and insured depository institutions, but also to investment banking and other financial companies and to public companies that are regulated by the SEC. Accordingly, the following summary focuses primarily on the provisions of the Dodd-Frank Act that are applicable to banking organizations. It is not intended to be complete and is qualified in its entirety by reference to the Dodd-Frank Act itself and the regulations promulgated thereunder.

The Dodd-Frank Act has significantly changed federal regulation of bank holding companies and banks and other insured depository institutions (collectively, “banking institutions”). Among other things, the Dodd-Frank Act has created a new Financial Stability Oversight Council to identify systemic risks in the country’s banking and financial system and gives federal banking regulators new authority to take control of and liquidate banking institutions, and large investment banking and other financial services firms, facing the prospect of imminent failure in any case where such failure would create systemic risks to the U.S. banking or financial system. The Dodd-Frank Act also created the Consumer Financial Protection Bureau (the “CFPB”), which is a new independent federal regulatory agency with broad powers and authority to adopt regulations under, and administer and regulate, federal consumer protection laws.

Imposition of New Capital Standards on Bank Holding Companies. The Dodd-Frank Act required the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to insured depository institutions, such as FFB. The Federal Reserve implemented this requirement by its adoption of the new Basel III capital rules. See “First Foundation Bank — New Basel III Capital Rules” below.

Increase in Deposit Insurance and Changes Affecting the FDIC Deposit Insurance Fund. The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions from \$100,000 to \$250,000 per depositor. The Dodd-Frank Act also broadened the base for FDIC insurance assessments which are used to fund the FDIC’s Deposit Insurance Fund (“DIF”) which, as a result, are now based on an insured depository institution’s average consolidated total assets, less tangible equity capital, may lead to increases in FDIC insurance assessments for many FDIC insured banks. The Dodd-Frank Act also requires the FDIC to increase the reserve ratio of the DIF from 1.15% to 1.35% of the total deposits insured by the FDIC by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. See also, “First Foundation Bank –The Deposit Insurance Fund and FDIC Insurance Premiums” below.

Payment of Interest on Business Checking Accounts. The Dodd-Frank Act has eliminated a federal statutory prohibition against the payment of interest on business checking accounts, which is expected to increase the competition for and interest that banks are prepared to pay on such accounts.

Limitations on Conversion of Bank Charters. The Dodd-Frank Act prohibits a bank or other depository institution from converting from a state to federal charter or vice versa while it is subject to a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter, unless the federal or state banking regulatory agency that issued the enforcement action does not object to the proposed conversion within 30 days following its receipt of a notice of that conversion.

Interstate Banking. The Dodd-Frank Act authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to establish a branch in that state. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in its state. Accordingly, banks will be able to enter new markets more freely.

The Volcker Rule. Pursuant to the Dodd-Frank Act, the Federal Reserve and the FDIC have adopted regulations, which became effective on April 1, 2014, to implement the “Volcker Rule” which prohibits insured depository institutions and companies affiliated with insured depository institutions (“banking organizations”) from engaging in

short-term proprietary trading of certain securities, derivatives, commodity futures, and options on these instruments, for their own account. Those regulations also impose limits on the investments that banking organizations may make in, and other relationships that banking organizations may have with, hedge funds or private equity funds. Certain collateralized debt obligations backed by trust preferred securities have been exempted from those prohibitions due to concerns that many community banks would otherwise have been required to recognize significant losses on such obligations and securities.

These regulations provide exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and, under certain limited circumstances, organizing and offering hedge funds or private equity funds. The regulations also clarify that certain activities are not prohibited by the Volker Rule, including acting as agent, broker, or custodian. The compliance requirements under the regulations vary based on the size of the banking organization and the scope of its activities. Banking organizations with significant trading operations will be required to establish detailed

compliance programs and their CEOs will be required to attest that the programs are reasonably designed to achieve compliance with the final regulations. Independent testing and analyses of a banking organization's compliance program also will be required. On the other hand, the regulations reduce the burden on smaller, less-complex banking organizations by limiting their compliance and reporting requirements. Additionally, a banking organization that does not engage in covered trading activities will not have to establish a compliance program.

Neither the Company nor FFB held any investment positions at December 31, 2016 that were subject to these regulations. Therefore, these regulations have not required us to make any material changes in our operations or businesses.

Executive Compensation Restrictions

In June 2010, the Federal Reserve and the FDIC issued comprehensive guidelines on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of the organizations by encouraging excessive risk-taking. The guidelines apply to any employees of a banking organization that have the ability to materially affect the risk profile of a banking organization, either individually or as part of a group.

Pursuant to these guidelines, each federal bank regulatory agency, as part of its regular, risk-focused examination of the banking organizations it regulates, assesses their incentive compensation arrangements based on the key principles their incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance principles and practices, including active and effective oversight by the banking organization's board of directors. The federal banking regulatory agencies have the authority to bring enforcement actions against a banking organization if the agency concludes that its incentive compensation arrangements, or related risk-management control or governance processes, pose an undue risk to the organization's safety and soundness and that the organization is not taking prompt and effective measures to correct the deficiencies.

In addition, the Dodd-Frank Act directs federal banking regulators to promulgate rules prohibiting incentive-based compensation arrangements that would encourage imprudent risk-taking by executives of depository institutions and their holding companies that have assets of more than \$1.0 billion. Proposed rules were issued in 2011 but have not become final.

Moreover, if an insured bank has been determined by its federal banking regulatory agency to be a "troubled" institution, it may not make or agree to make any change in control payments to its directors, officers, employees or other "institution-affiliated parties", or appoint any new executive officer or director, without first obtaining the approval of its federal banking regulatory agency to do so.

In February 2014, the Company adopted an incentive compensation clawback policy. Among other things, that policy provides that, if any of the Company's previously published financial statements are restated due to a material noncompliance with any financial reporting requirements under the federal securities laws, the Company will seek to recover the amount by which any incentive compensation paid in the previous three years to any executive officer exceeds the incentive compensation which the Company's audit committee determines would have been paid to such executive officer had such compensation been determined on the basis of the restated financial statements.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") was enacted into law on July 30, 2002. The primary purposes of the Sarbanes-Oxley Act were to strengthen (i) the oversight of public accounting firms that audit, and (ii) the corporate governance policies and practices of, companies the common stock or other equity securities of which

are publicly traded. The Sarbanes-Oxley Act granted authority, primarily to the SEC, to adopt rules for implementing that Act. Among other things, the Sarbanes-Oxley Act:

- provided for enhanced regulation of the independence, responsibilities and conduct of accounting firms which provide auditing services to public companies;
- established an independent board, known as the Public Company Accounting Oversight Board (the “PCAOB”), with the authority to set auditing, quality and ethical standards for, and the power to investigate and discipline, public accounting firms;
- increased the criminal penalties for financial fraud committed by public company executives and public accounting firms or their key personnel;

• required enhanced monitoring of, and certifications by, the chief executive and chief financial officers of public companies of their financial disclosures, internal financial controls and their audit processes;

- required accelerated disclosures of material information by public companies; and

• required enhanced disclosures by public companies of their corporate governance policies and practices.

Additionally, pursuant to requirements of the Sarbanes-Oxley Act, the New York, American and NASDAQ Stock Exchanges promulgated rules requiring public companies to adopt and implement expanded corporate governance policies and practices as a condition to the listing, or continued listing, of their shares on those exchanges. Among other things, those rules (i) require public companies to expand the authority, role and responsibilities of their boards of directors, (ii) require that a majority of the members of their boards of directors be independent of management and establish more stringent standards that directors needed to meet to qualify as independent directors, (iii) require boards of directors to establish standing audit, compensation and nominating and corporate governance committees comprised of independent directors and (iv) increased the corporate transactions for which shareholder approval is required.

Regulation of the Company by the California Department of Business Oversight

Because FFB is a California state chartered bank, the Company is deemed to be a bank holding company within the meaning of Section 1280 of the California Financial Code. As such, we are subject to examination by, and may be required to file reports with, the DBO.

First Foundation Bank

General

FFB is subject to primary supervision, periodic examination and regulation by (i) the FDIC, which is its primary federal banking regulator, and (ii) the DBO, because FFB is a California state chartered bank.

Various requirements and restrictions under Federal and California banking laws affect the operations of FFB. These laws and the implementing regulations can determine the extent of supervisory control to which a bank will be subject by its federal and state bank regulators. These laws and regulations cover most aspects of a bank's operations, including:

- the reserves a bank must maintain against deposits and for possible loan losses and other contingencies;
- the types of and limits on loans and investments that a bank may make;
- the borrowings that a bank may incur;
- the opening of branch offices;
- the rate at which it may grow its assets and business;
- the acquisition and merger activities of a bank;
- the amount of dividends that a bank may pay; and
- the capital requirements that a bank must satisfy.

If, as a result of an examination of a federally regulated bank, its federal banking regulatory agency, such as the FDIC, were to determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the bank's operations had become unsatisfactory or that the bank or its management was in violation of any law or regulation, that agency would have the authority to take a number of different remedial actions as it deems appropriate under the circumstances. These actions include the power:

- to enjoin any "unsafe or unsound" banking practices;
- to require that affirmative action be taken to correct any conditions resulting from any violation of law or unsafe or unsound practice;
- to issue an administrative order that can be judicially enforced against the bank;

- to require the bank to increase its capital;
- to restrict the bank's growth;
- to assess civil monetary penalties against the bank or its officers or directors;

to remove officers and directors of the bank; and
if the federal agency concludes that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate a bank's deposit insurance, which in the case of a California state chartered bank would result in revocation of its charter and require it to cease its banking operations.
Additionally, under California law the DBO has many of these same remedial powers with respect to FFB.

Permissible Activities and Subsidiaries

California law permits state chartered commercial banks to engage in any activity permissible for national banks. Those permissible activities include conducting many so-called "closely related to banking" or "nonbanking" activities either directly or through their operating subsidiaries.

Federal Home Loan Bank System

FFB is a member of the FHLB. Among other benefits, each regional Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region and makes available loans or advances to its member banks. Each regional Federal Home Loan Bank is financed primarily from the sale of consolidated obligations of the overall Federal Home Loan Bank system. As an FHLB member, FFB is required to own a certain amount of capital stock in the FHLB. At December 31, 2016, FFB was in compliance with the FHLB's stock ownership requirement. Historically, the FHLB has paid dividends on its capital stock to its members.

Federal Reserve Board Deposit Reserve Requirements

The FRB requires all federally-insured depository institutions to maintain reserves at specified levels against their transaction accounts. At December 31, 2016, FFB was in compliance with these requirements.

Limitations and Restrictions on the Payment of Dividends and Other Transfers of Funds by FFB

Cash dividends from FFB are one of the principal sources of cash (in addition to any cash dividends that might be paid to us by FFA) that is available to the Company for its operations and to fund any cash dividends that our board of directors might declare in the future. We are a legal entity separate and distinct from FFB and FFB is subject to various statutory and regulatory restrictions on its ability to pay cash dividends to us. Those restrictions would prohibit FFB, subject to certain limited exceptions, from paying cash dividends in amounts that would cause FFB to become undercapitalized. Additionally, the FDIC and the DBO have the authority to prohibit FFB from paying cash dividends, if either of those agencies deems the payment of dividends by FFB to be an unsafe or unsound practice.

The FDIC also has established guidelines with respect to the maintenance of appropriate levels of capital by banks under its jurisdiction. Compliance with the standards set forth in those guidelines and the restrictions that are or may be imposed under the prompt corrective action provisions of federal law could limit the amount of dividends which FFB may pay.

Restrictions on Transactions between FFB and the Company and its other Affiliates

FFB is subject to Sections 23A and 23B of, and FRB Regulation W under, the Federal Reserve Act, which impose restrictions on (i) any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, the Company or any of its other subsidiaries; (ii) the purchase of or investments in Company stock or other Company securities; (iii) the taking of Company securities as collateral for the loans that FFB makes; (iv) the purchase of assets from the Company or any of its other subsidiaries and (v) transactions between a bank and its financial subsidiaries, as well as other affiliates. These restrictions prevent the Company and any of its subsidiaries from obtaining borrowings or extensions of credit from FFB, unless the borrowings are secured by marketable obligations in designated amounts, and such secured loans and any investments by FFB in the Company or any of its subsidiaries are limited,

individually, to 10% of FFB's capital and surplus (as defined by federal regulations), and in the aggregate are limited to 20%, of FFB's capital and surplus. California law also imposes restrictions with respect to transactions involving the Company and any other persons that may be deemed under that law to control FFB.

The Dodd-Frank Act extended the application of Section 23A of the Federal Reserve Act to derivative transactions, repurchase agreements and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider of a bank. Any such transactions with any affiliates must be fully secured. In addition, the exemption from Section 23A for transactions with financial subsidiaries has been eliminated. The Dodd-Frank Act also expands the definition of "affiliate" for purposes of

quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or any of its affiliates.

Safety and Soundness Standards

Banking institutions may be subject to potential enforcement actions by the federal banking regulators for unsafe or unsound practices or for violating any law, rule, regulation, or any condition imposed in writing by its primary federal banking regulatory agency or any written agreement with that agency. The federal banking agencies have adopted guidelines designed to identify and address potential safety and soundness concerns that could, if not corrected, lead to deterioration in the quality of a bank's assets, liquidity or capital. Those guidelines set forth operational and managerial standards relating to such matters as:

- internal controls, information systems and internal audit systems;
- risk management;
- loan documentation;
- credit underwriting;
- asset growth;
- earnings; and
- compensation, fees and benefits.

In addition, the federal banking agencies have adopted safety and soundness guidelines with respect to the quality of loans and other assets of insured depository institutions. These guidelines provide standards for establishing and maintaining a system to identify problem loans and other problem assets and to prevent those assets from deteriorating. Under these standards, an FDIC-insured depository institution is expected to:

- conduct periodic asset quality reviews to identify problem loans and any other problem assets, estimate the inherent losses in those loans and other assets and establish reserves that are sufficient to absorb those estimated losses;
- compare problem loans and other problem asset totals to capital;
- take appropriate corrective action to resolve problem loans and other problem assets;
- consider the size and potential risks of material asset concentrations; and
- provide periodic quality reports with respect to their loans and other assets which provide adequate information for the bank's management and the board of directors to assess the level of risk to its loans and other assets.

These guidelines also establish standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

Regulatory Guidelines for Commercial Real Estate Loan Concentrations

The Federal Reserve and the FDIC have published guidelines that call for the adoption of heightened risk mitigation measures by insured banks with a concentration of commercial real estate loans in its loan portfolio. The guidelines provide that a bank will be deemed to have a concentration of commercial real estate loans if (i) the total reported loans for construction, land development and other land represent 100% or more of the bank's total capital, or (ii) the total reported loans secured by multifamily and non-farm residential properties, plus loans for construction, land development and other land, represent 300% or more of the bank's total capital and the bank's commercial real estate loan portfolio has increased by 50% or more during the prior 36 months. If such a concentration exists, the guidelines call for the bank (x) to implement heightened risk assessment and risk management practices, including board and management oversight and strategic planning, (y) to implement and maintain stringent loan underwriting standards, and to use market analyses and stress testing tools to monitor the condition of the bank's commercial real estate loan portfolio and to assess the impact that adverse economic conditions affecting the real estate markets could have on the bank's financial condition and (z) if determined to be necessary on the basis of the results of such stress tests, to increase its allowance for loan losses and its capital.

Single Borrower Loan Limitations

California law imposes on all California state-chartered banks, including FFB, “single borrower loan limitations” which consist of the following:

12

• unsecured borrowings of any customer of a California state-chartered bank, together with the borrowings of any family members or affiliates of the customer, to the bank may not exceed 15% of the sum of the bank's shareholders' equity, allowance for loan losses, capital notes and debentures; and

• the aggregate of secured and unsecured borrowings of any customer of a California state-chartered bank, together with the borrowings of any family members or affiliates of the customer, to the bank may not exceed 25% of the sum of the bank's shareholders' equity, allowance for loan losses, capital notes and debentures.

Technology Risk Management and Consumer Privacy

Federal and state banking regulatory agencies have issued various policy statements focusing on the importance of technology risk management and supervision in evaluating the safety and soundness of the banks they regulate. According to those policy statements, the use by banking organizations of technology-related products, services, processes and delivery channels, such as the internet, exposes them to a number of risks which include operational, compliance, security, privacy, and reputational risk. The banking regulators generally expect the banking organizations they regulate to prudently manage technology-related risks as part of their comprehensive risk management policies in order to identify, monitor, measure and control risks associated with the use of technology.

Pursuant to the Modernization Act, the federal banking agencies have adopted rules and established standards to be followed in implementing safeguards that are designed to ensure the security and confidentiality of customer records and information, protection against any anticipated threats or hazards to the security or integrity of such records and protection against unauthorized access to or use of such records or information in a way that could result in substantial harm or inconvenience to a customer. Among other requirements, these rules require each bank organization to implement a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information.

In addition, the Modernization Act requires banking organizations to provide each of their customers with a notice of their privacy policies and practices and prohibits a banking organization from disclosing nonpublic personal information about a customer to nonaffiliated third parties unless the banking organization satisfies various notice and "opt-out" requirements and the customer has not chosen to opt out of the disclosure. Additionally, the federal banking agencies are authorized to issue regulations as necessary to implement those notice requirements and non-disclosure restrictions. More specifically, the Modernization Act privacy regulations require all banking organizations to develop initial and annual privacy notices that describe in general terms the banking organization's information sharing practices. Any banking organization that shares nonpublic personal information about customers with nonaffiliated third parties must also provide customers with notices advising them that, subject to certain limited exceptions, the customer has the opportunity and a reasonable time period to inform the bank that it may not share the customer's nonpublic personal information with nonaffiliates of the bank. These regulations also place limitations on the extent to which a banking organization may disclose an account number or access code for credit card, deposit, or transaction accounts to any nonaffiliated third party for use in marketing such programs.

Capital Adequacy and Prompt Corrective Action Provisions of the FDIC Improvement Act

Capital Adequacy Guidelines. The Federal Deposit Insurance Corporation Improvement Act of 1991 (the "FDICIA"), established a framework for regulation of federally insured depository institutions, including banks, and their parent holding companies and other affiliates, by their federal banking regulators. Among other things, FDICIA requires the relevant federal banking regulator to take "prompt corrective action" with respect to a depository institution if that institution does not meet certain capital adequacy standards, including requiring the prompt submission by that bank of an acceptable capital restoration plan if its bank regulator has concluded that it needs additional capital.

Supervisory actions by a bank's federal regulator under the prompt corrective action rules generally depend upon an institution's classification within one of five capital categories, which is determined on the basis of a bank's Tier 1 leverage ratio, Tier 1 capital ratio and total capital ratio. Tier 1 capital consists principally of common stock and nonredeemable preferred stock and retained earnings.

Under FDICIA regulations, an insured depository institution's capital category will depend upon how its capital levels compare with these capital measures and the other factors established by the relevant federal banking regulator. Prior to January 1, 2015, those regulations provided that a bank would be classified as:

•“well capitalized” if it had a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater and a Tier 1 leverage ratio of 5.0% or greater, and was not subject to any order or written directive by any such regulatory agency to meet and maintain a specific capital level for any capital measure;

•“adequately capitalized” if it had a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a Tier 1 leverage ratio of 4.0% or greater, but was not “well capitalized”;

•“undercapitalized” if it had a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0% and a Tier 1 leverage ratio of less than 4.0%;

•“significantly undercapitalized” if it had a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0%, or a Tier 1 leverage ratio of less than 3.0%; and

•“critically undercapitalized” if its tangible equity was equal to or less than 2.0% of average quarterly tangible assets. However, if a bank that was classified as “well-capitalized” is determined (after notice and opportunity for hearing), by its federal banking regulator, to be in an unsafe or unsound condition or to be engaging in an unsafe or unsound practice, that agency could, under certain circumstances, reclassify the bank as adequately capitalized. The federal banking regulator of a bank that is classified as adequately capitalized or undercapitalized could require the bank to comply with bank supervisory provisions and restrictions that would apply to a bank in the next lower capital classification, if the banking regulator has obtained supervisory information regarding the bank (other than with respect to its capital levels) which raises safety or soundness concerns. However, a significantly undercapitalized bank may not be treated by its regulatory agency as critically undercapitalized by reason of such safety or soundness concerns alone.

The capital classification of a bank affects the frequency of examinations of the bank by its primary federal bank regulatory agency, impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums that are payable by the bank. Under FDICIA, the federal banking regulators are required to conduct a full-scope, on-site examination of every bank at least once every 12 months.

Corrective Measures for Undercapitalized Banks. FDICIA generally prohibits a bank from paying any dividends or making any capital distributions or paying any management fee to its parent holding company if the bank would thereafter be “undercapitalized.” In addition “undercapitalized” banks are subject to growth limitations and are required to submit a capital restoration plan for approval by its federal regulatory agency. However, that agency may not approve the bank’s capital restoration plan unless the agency determines, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the bank’s capital.

An undercapitalized bank which fails to submit, or fails to obtain the approval by its federal banking regulator of a capital restoration plan will be treated as if it is “significantly undercapitalized.” In that event, the bank’s federal banking regulator may impose a number of additional requirements and restrictions on the bank, including orders or requirements (i) to sell sufficient voting stock to become “adequately capitalized,” (ii) to reduce its total assets, and (iii) cease the receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

If an undercapitalized bank is a subsidiary of a bank holding company, then, for its capital restoration plan to be approved, the bank’s parent holding company must guarantee that the bank will comply with, and provide assurances of the performance by the bank of, its capital restoration plan. Under such a guarantee and assurance of performance, if the bank fails to comply with its capital restoration plan, the parent holding company may become subject to liability for such failure in an amount up to the lesser of (i) 5.0% of its bank subsidiary’s total assets at the time it became undercapitalized, or (ii) the amount that is necessary (or would have been necessary) to bring the bank into compliance with all applicable capital standards as of the time it failed to comply with the plan.

Corrective Measures for Significantly and Critically Undercapitalized Banks. If a bank is classified as “significantly undercapitalized” or “critically undercapitalized,” its federal banking regulator would be required to take one or more prompt corrective actions that would, among other things require the bank to (i) raise additional capital by means of sales of common stock or nonredeemable preferred shares, (ii) improve its management, (iii) limit the interest rates it may pay on deposits, (iv) altogether prohibit transactions by the bank with its affiliates, (v) terminate certain activities that pose undue or unreasonable risks, and (vi) restrict the compensation being paid to its executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership

within 90 days, unless its federal banking regulatory agency determines that there are other measures that would enable the bank, within a relatively short period of time, to increase its capital in an amount sufficient to improve its capital classification under the prompt corrective action framework.

New Basel III Capital Rules

Prior to 2015, the risk-based capital rules applicable to domestic banks and bank holding companies were based on the 1988 capital accord of the International Basel Committee on Banking Supervision (the “Basel Committee”), which is comprised of central banks and bank supervisors and regulators from the major industrialized countries. The Basel Committee develops broad policy

guidelines for use by each country’s banking regulators in determining the banking supervisory policies and rules they apply. In December 2010, the Basel Committee issued a new set of international guidelines for determining regulatory capital, known as “Basel III”. In June 2012, the FRB issued, for public comment, three notices of proposed rulemaking which, if adopted, would have made significant changes, consistent with the Basel III guidelines, to the regulatory risk-based capital and leverage requirements for banks and bank holding companies in the United States.

In July 2012, the FRB adopted final rules (the “New Capital Rules”) establishing a new comprehensive capital framework for U.S. banking organizations, and the FDIC subsequently adopted substantially identical rules. The rules implement the Basel Committee’s December 2010 framework for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The New Capital Rules substantially revised the risk-based capital requirements applicable to U.S. banking organizations, including the Company and FFB, from the prior U.S. risk-based capital rules, redefined the components of capital and addressed other issues affecting the capital ratios applicable to banking organizations. The New Capital Rules also replaced the existing approach used in risk-weighting of a banking organization’s assets with a more risk-sensitive approach. The New Capital Rules became effective for the Company and FFB on January 1, 2015 (subject, in the case of certain of those Rules, to phase-in periods).

Among other things, the New Capital Rules (i) introduced a new capital measure called “Common Equity Tier 1” (“CET-1”), (ii) specified that Tier 1 capital consists of CET-1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) made most deductions and adjustments to regulatory capital measures applicable to CET-1 and not to the other components of capital, and expanded the scope of the deductions and adjustments from capital as compared to the prior capital rules, thus potentially requiring banking organizations to achieve and maintain higher levels of CET-1 in order to meet minimum capital ratios.

Under the New Capital Rules, the minimum capital ratios (including the applicable increment of the capital conservation buffer discussed below) as of January 1, 2016 are as follows:

CET-1 to risk-weighted assets	5.125	%
Tier 1 capital (i.e., CET-1 plus Additional Tier 1) to risk-weighted assets	6.625	%
Total capital (i.e., Tier 1 plus Tier 2) to risk-weighted assets	8.625	%
Tier 1 capital-to-average consolidated assets as reported on consolidated financial statements ⁽¹⁾	4.0	%

(1) Commonly referred to as a banking institution’s “leverage ratio”.

As of January 1, 2017, the above ratios (other than the leverage ratio) were increased by 0.625% to 5.75%, 7.25% and 9.25%, respectively. When fully phased in on January 1, 2019, the New Capital Rules also will require the Company and FFB, as well as most other bank holding companies and banks, to maintain a 2.5% “capital conservation buffer,” on top of the minimum risk-weighted asset ratios set forth in the above table. This capital conservation buffer will have the effect of increasing (i) the CET-1-to-risk-weighted asset ratio to 7.0%, (ii) the Tier 1 capital-to-risk-weighted asset ratio to 8.5%, and (iii) the Total capital-to-risk weighted asset ratio to 10.5%.

The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking organizations with risk-weighted asset ratios above the minimum, but below the capital conservation buffer, will face constraints on dividends, equity repurchases and executive compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625%, and will increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

The New Capital Rules provide for a number of deductions from and adjustments to CET-1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income, and significant investments in common equity issued by nonconsolidated financial entities, be deducted from CET-1 to the extent that any one such category exceeds 10% of CET-1 or all such categories, in the aggregate, exceed 15% of CET-1. Other deductions and adjustments to CET-1 will be phased in incrementally between January 1, 2015 and January 1, 2018. On the other hand, the impact of these deductions and adjustments may be mitigated prior to or during the phase-in period by the determination of other than temporary impairments (“OTTI”) and additional accumulation of retained earnings. Under current capital standards, the effects of certain items of Accumulated Other Comprehensive Income (“AOCI”) included in capital are excluded for purposes of determining regulatory capital ratios. By contrast, under the New Capital Rules, the effects of certain items of AOCI will not be excluded. However, most banking organizations, including the Company and FFB, were entitled to make a one-time permanent election, not later than the call report for the quarter ended March 31, 2015, to continue to exclude these items from capital. In 2015, we elected to continue this exclusion.

The New Capital Rules require that trust preferred securities be phased out from Tier 1 capital by January 1, 2016, except in the case of banking organizations with total consolidated assets of less than \$15 billion, which will be permitted to include trust preferred securities issued prior to May 19, 2010 in Tier 1 capital, subject to a limit of 25% of tier 1 capital elements.

The New Capital Rules prescribe a standardized approach for calculating risk-weighted assets that expand the risk-weighting categories from the former four Basel I-derived categories (0%, 20%, 50% and 100%) to larger and a greater number of risk-sensitive categories, depending on the nature of the assets, generally ranging from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. In addition, the New Capital Rules also provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

The Deposit Insurance Fund and FDIC Deposit Insurance Premiums

The FDIC insures the deposits of the customers of all FDIC insured depository institutions up to prescribed limits for each depositor through a DIF, from which it makes deposit insurance payments to depositors of failed depository institutions and from which it funds the costs incurred and against which it charges the losses sustained in connection with the closure or other resolution of those institutions. Due to higher levels of bank failures resulting from the recent recession and credit crisis, the insurance payments and the resolution costs increased significantly and largely depleted the DIF. In order to restore the DIF to a statutorily mandated minimum of 1.35% of total deposits which it insures (as compared to 1.15% prior to Dodd-Frank), the FDIC has increased deposit insurance premium rates. The FDIC uses a risk-based system to determine a depository institution's insurance premium rate based on the institution's classification. Institutions assigned to higher risk classifications (that is, institutions that pose a higher risk of loss to the DIF) pay premiums at higher rates than institutions that pose a lower risk. A depository institution's risk classification is assigned based primarily on its capital levels and the level of supervisory concern which the institution poses to the DIF. The FDIC also has the authority, under certain circumstances, to further increase the insurance premium rates of depository institutions. Any increase in FDIC insurance premiums assessed on FFB in the future would increase our noninterest expense and thereby reduce our profitability.

Additionally, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the DIF. The FICO assessment rates, which are determined quarterly, averaged 0.075% of insured deposits in fiscal 2016. These assessments will continue until the FICO bonds mature in 2017.

Community Reinvestment Act and Fair Lending Developments

Like all other federally regulated banks, FFB is subject to fair lending requirements and the evaluation of its small business operations under the CRA. The CRA generally requires the federal banking regulatory agencies to evaluate the record of a bank in meeting the credit needs of its local communities, including those of low and moderate income neighborhoods in its service area. A bank's compliance with its CRA obligations is based on a performance-based evaluation system which determines the bank's CRA ratings on the basis of its community lending and community development performance. A bank may have substantial penalties imposed on it and generally will be required to take corrective measures in the event it fails to meet its obligations under the CRA. Federal banking agencies also may take compliance with the CRA and other fair lending laws into account when regulating and supervising other activities of a bank or its bank holding company. Moreover, when a bank holding company files an application for approval to acquire a bank or another bank holding company, the federal banking regulatory agency to which the application is assigned will review the CRA assessment of the subsidiary bank or banks of the applicant bank holding company, and a low CRA rating may be the basis for requiring the applicant's bank subsidiary to take corrective actions to improve its CRA performance as a condition to the approval of the acquisition or as a basis for denying the application altogether.

USA Patriot Act of 2001 and Bank Secrecy Act

In October 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism of 2001 (the “USA Patriot Act”) was enacted into law in response to the September 11, 2001 terrorist attacks. The USA Patriot Act was adopted to strengthen the ability of U.S. law enforcement and intelligence agencies to work cohesively to combat terrorism on a variety of fronts. Of particular relevance to banks and other federally insured depository institutions are the USA Patriot Act’s sweeping anti-money laundering and financial transparency provisions and various related implementing regulations that:

- establish due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts and foreign correspondent accounts;
- prohibit U.S. institutions from providing correspondent accounts to foreign shell banks;
- establish standards for verifying client identification at account opening; and

set rules to promote cooperation among financial institutions, regulatory agencies and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Under implementing regulations issued by the U.S. Treasury Department, banking institutions are required to incorporate a client identification program into their written money laundering plans that includes procedures for:

- verifying the identity of any person seeking to open an account, to the extent reasonable and practicable;
- maintaining records of the information used to verify the person's identity; and
- determining whether the person appears on any list of known or suspected terrorists or terrorist organizations.

The Company and FFB also are subject to the federal Bank Secrecy Act of 1970, as amended (the "Bank Secrecy Act"), which establishes requirements for recordkeeping and reporting by banks and other financial institutions designed to help identify the source, volume and movement of currency and monetary instruments into and out of the United States to help detect and prevent money laundering and other illegal activities. The Bank Secrecy Act requires financial institutions to develop and maintain a program reasonably designed to ensure and monitor compliance with its requirements, to train employees to comply with and to test the effectiveness of the program. Any failure to meet the requirements of the Bank Secrecy Act can result in the imposition of substantial penalties and in adverse regulatory action against the offending bank. FFI and FFB have each adopted policies and procedures to comply with the Bank Secrecy Act.

Consumer Laws and Regulations

The Company and FFB are subject to a broad range of federal and state consumer protection laws and regulations prohibiting unfair or fraudulent business practices, untrue or misleading advertising and unfair competition. Those laws and regulations include:

- The Home Ownership and Equity Protection Act of 1994, which requires additional disclosures and consumer protections to borrowers designed to protect them against certain lending practices, such as practices deemed to constitute "predatory lending."
- The Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act, which requires banking institutions and financial services businesses to adopt practices and procedures designed to help deter identity theft, including developing appropriate fraud response programs, and provides consumers with greater control of their credit data.
 - The Truth in Lending Act which requires that credit terms be disclosed in a meaningful and consistent way so that consumers may compare credit terms more readily and knowledgeably.
- The Equal Credit Opportunity Act, which generally prohibits, in connection with any consumer or business credit transactions, discrimination on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), or the fact that a borrower is receiving income from public assistance programs.
- The Fair Housing Act, which regulates many lending practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status.
- The Home Mortgage Disclosure Act, which includes a "fair lending" aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.
- The Real Estate Settlement Procedures Act, which requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements and prohibits certain abusive practices, such as kickbacks.
- The National Flood Insurance Act, which requires homes in flood-prone areas with mortgages from a federally regulated lender to have flood insurance.
- The Secure and Fair Enforcement for Mortgage Licensing Act of 2008, which requires mortgage loan originator employees of federally insured institutions to register with the Nationwide Mortgage Licensing System and Registry, a database created by the states to support the licensing of mortgage loan originators, prior to originating residential mortgage loans.

Consumer Financial Protection Bureau

The Dodd-Frank Act created a new, independent federal agency, called the Consumer Financial Protection Bureau, which has been granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to the compliance by depository institutions with \$10 billion or more in assets with federal consumer protection laws and regulations. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act also (i) authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay, and (ii) will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal financial consumer protection laws and regulations.

In January 2013, the CFPB approved certain mortgage lending reform regulations impacting the Truth in Lending Act (the "TILA") and the Real Estate Settlement Procedures Act ("RESPA"). Among other things, those reforms:

- expand the population of loans that are subject to higher cost loan regulations and additional disclosures;
 - prohibit the payment of compensation to mortgage brokers based on certain fees or premiums, such as yield spread premiums, payable by or charged to home borrowers;
 - increase the regulation of mortgage servicing activities, including with respect to error resolution, forced-placement insurance and loss mitigation and collection activities;
 - require financial institutions to make a reasonable and good faith determination that the borrower has the ability to repay the residential mortgage loan before it is approved for funding and provides that the failure of a financial institution to make such a determination will entitle the borrower to assert that failure as a defense to any foreclosure action on the mortgage loan; and
 - impose appraisal requirements for high cost loans and loans secured by first mortgage liens on residential real estate.
- The CFPB also issued final rules for residential mortgage lending, which became effective January 10, 2014, including definitions for "qualified mortgages" and detailed standards by which lenders must satisfy themselves of the borrower's ability to repay the loan and revised forms of disclosure under the TILA and RESPA. New CFPB disclosure rules for residential mortgages went into effect in October 2015.

Debit Card Fees

The Dodd-Frank Act provides that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the card issuer and requires the FRB to establish standards for reasonable and proportional fees which may take into account the costs of preventing fraud. As a result, the FRB adopted a rule, effective October 1, 2011, which limits interchange fees on debit card transactions to a maximum of 21 cents per transaction plus 5 basis points of the transaction amount. A debit card issuer may recover an additional one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements prescribed by the FRB. Although, as a technical matter, this new limitation applies only to institutions with assets of more than \$10 billion, it is expected that many smaller institutions will reduce their interchange fees in order to remain competitive with the larger institutions that are required to comply with this new limitation.

First Foundation Advisors

Registered Investment Advisor Regulation

FFA is a registered investment advisor under the Investment Advisers Act and the SEC's regulations promulgated thereunder. The Investment Advisers Act imposes numerous obligations on registered investment advisors, including fiduciary, recordkeeping, operational, and disclosure obligations. FFA is also subject to regulation under the securities laws and fiduciary laws of certain states and to Employee Retirement Income Security Act of 1974 ("ERISA"), and to regulations promulgated thereunder, insofar as it is a "fiduciary" under ERISA with respect to certain of its clients. ERISA and the applicable provisions of the Code, impose certain duties on persons who are fiduciaries under ERISA, and prohibit certain transactions by the fiduciaries (and certain other related parties) to

such plans. The foregoing laws and regulations generally grant supervisory agencies broad administrative powers, including the power to limit or restrict FFA from conducting its business in the event that it fails to comply with such laws and regulations. Possible sanctions that may be imposed in the event of such noncompliance include the suspension of individual employees, limitations on the business activities for specified periods of time, revocation of registration as an investment advisor and/or other registrations, and other censures and fines. Changes in these laws or regulations could have a material adverse impact on the profitability and mode of operations of FFI and its subsidiaries.

Future Legislation

Congress may enact legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulations, or the application thereof, cannot be predicted, although enactment of the proposed legislation could impact the regulatory structure under which we operate and may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase our regulatory capital, modify our business strategy and limit our ability to pursue business opportunities in an efficient manner.

Employees

As of December 31, 2016, the Company had approximately 335 full-time employees.

Available Information

The Company's annual reports on Form 10-K, proxy statements, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 (a) or 15 (d) of the Exchange Act are accessible for free at the Investor Relations section of our website at www.ff-inc.com as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. These reports are also available for free on the SEC's website at www.sec.gov. Additionally, these reports can be found and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549, or by calling the SEC at 1-800-SEC-0330. All website addresses given in this report are for information only and are not intended to be an active link or to incorporate any website information into this report.

Item 1A. Risk Factors

Our business is subject to a number of risks and uncertainties that could prevent us from achieving our business objectives and could hurt our future financial performance and the price performance of our common stock. Such risks and uncertainties also could cause our future financial condition and future financial performance to differ significantly from our current expectations, which are described in the forward-looking statements contained in this report. Those risks and uncertainties, many of which are outside of our ability to control or prevent, include the following:

Risks Related to Our Business

We could incur losses on the loans we make.

Loan defaults and the incurrence of losses on loans are inherent risks in our business. The incurrence of loan losses necessitate loan charge-offs and write-downs in the carrying values of a banking organization's loans and, therefore,

can adversely affect its results of operations and financial condition. Accordingly, our results of operations will be directly affected by the volume and timing of loan losses, which for a number of reasons can vary from period to period. The risks of loan losses are exacerbated by economic recessions and downturns, or by other events that can lead to local or regional business downturns. If there is a sustained weakness or further weakening in business and economic conditions generally or specifically in the principal markets in which we do business, more of our borrowers may fail to perform in accordance with the terms of their loans, in which event loan charge-offs and asset write-downs could increase, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

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

In accordance with regulatory requirements and generally accepted accounting principles in the United States, we maintain an allowance for loan and lease losses (“ALLL”) to provide for loan and lease defaults and non-performance and a reserve for unfunded loan commitments, which, when combined, we refer to as the allowance for credit losses. Our allowance for credit losses may not be

adequate to absorb actual credit losses, and future provisions for credit losses could materially and adversely affect our operating results. Our allowance for credit losses is based on prior experience and an evaluation of the risks inherent in our then-current portfolio. The amount of future losses may also vary depending on 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 and state regulators, as an integral part of their examination process, review our loans and leases and allowance for credit losses. While we believe our allowance for credit losses is appropriate for the risk identified in our loan and lease portfolio, we cannot provide assurance that we will not further increase the allowance for credit losses, that it will be sufficient to address losses, or that regulators will not require us to increase this allowance. Any of these occurrences could have a material adverse effect on our business, financial condition, results of operations and prospects.

Our business and operations may be adversely affected in numerous and complex ways by weak economic conditions.

Our businesses and operations, which primarily consist of lending money to customers in the form of loans, borrowing money from customers in the form of deposits, investing in securities and investment management, are sensitive to general business and economic conditions in the United States. If the United States economy weakens, our growth and profitability from our lending, deposit and investment operations could be constrained. Uncertainty about the federal fiscal policymaking process, the medium and long-term fiscal outlook of the federal government, and future tax rates is a concern for businesses, consumers and investors in the United States. In addition, economic conditions in foreign countries could affect the stability of global financial markets, which could hinder United States economic growth. Weak economic conditions are characterized by deflation, fluctuations in debt and equity capital markets, a lack of liquidity and/or depressed prices in the secondary market for loans, increased delinquencies on mortgage, consumer and commercial loans, residential and commercial real estate price declines and lower home sales and commercial activity. The current economic environment is also characterized by interest rates at historically low levels, which impacts our ability to attract deposits and to generate attractive earnings through our investment portfolio. All of these factors are detrimental to our business, and the interplay between these factors can be complex and unpredictable. Adverse economic conditions and government policy responses to such conditions could have a material adverse effect on our business, financial condition, results of operations and prospects.

Our banking, investment advisory and wealth management operations are geographically concentrated in California, Nevada and Hawaii, leading to significant exposure to those markets.

Our business activities and credit exposure, including real estate collateral for many of our loans, are concentrated in California, Nevada and Hawaii, as approximately 95% of the loans in our loan portfolio were made to borrowers who live and/or conduct business in those states. This geographic concentration imposes risks from lack of geographic diversification. Difficult economic conditions, including state and local government deficits, in California, Nevada and Hawaii may affect our business, financial condition, results of operations and future prospects, where adverse economic developments, among other things, could affect the volume of loan originations, increase the level of nonperforming assets, increase the rate of foreclosure losses on loans and reduce the value of our loans and loan servicing portfolio. Any regional or local economic downturn that affects California, Nevada or Hawaii or existing or prospective borrowers or property values in such areas may affect us and our profitability more significantly and more adversely than our competitors whose operations are less geographically concentrated.

Changes in interest rates could reduce our net interest margins and net interest income.

Income and cash flows from our banking operations depend to a great extent on the difference or “spread” between the interest we earn on interest-earning assets, such as loans and investment securities, and the rates at which we pay interest on interest-bearing liabilities, such as deposits and borrowings. However, interest rates are highly sensitive to many factors that are beyond our control, including (among others) general and regional and local economic conditions, the monetary policies of the Federal Reserve Board, bank regulatory requirements, competition from other banks and financial institutions and a change over time in the mix of our loans, investment securities, on the one hand,

and on our deposits and other liabilities, on the other hand. Changes in monetary policy will, in particular, influence the origination and market value of and the yields we can realize on loans and investment securities and the interest we pay on deposits. Additionally, sustained low levels of market interest rates, as we have experienced during the past five years, could continue to place downward pressure on our net interest margins and, therefore, on our earnings. Our net interest margins and earnings also could be adversely affected if we are unable to adjust our interest rates on loans and deposits on a timely basis in response to changes in economic conditions or monetary policies. For example, if the rates of interest we pay on deposits, borrowings and other interest-bearing liabilities increase faster than we are able to increase the rates of interest we charge on loans or the yields we realize on investments and other interest-earning assets, our net interest income and, therefore, our earnings will decrease. In particular, the rates of interest we charge on loans may be subject to longer fixed interest periods compared to the interest we must pay on deposits. On the other hand, increasing interest rates generally lead to increases in net interest income; however, such increases also may result in a reduction in loan originations, declines in loan prepayment rates and reductions in the ability of borrowers to repay their current loan obligations, which could result in increased loan defaults and charge-offs and could require increases to our ALLL, thereby offsetting either partially or totally the increases in net interest income resulting from the increase in interest rates.

Additionally, we could be prevented from increasing the interest rates we charge on loans or from reducing the interest rates we offer on deposits due to “price” competition from other banks and financial institutions with which we compete. Conversely, in a declining interest rate environment, our earnings could be adversely affected if the interest rates we are able to charge on loans or other investments decline more quickly than those we pay on deposits and borrowings. On November 8, 2016, a Republican was elected President of the United States and Republicans retained majority control over both the U.S. House of Representatives and the U.S. Senate. This transition of power in the United States government may create additional uncertainty regarding future interest rate policies at the Federal Reserve Board and such uncertainty may result in unexpected losses or other adverse effects on our financial condition and results of operations.

Real estate loans represent a high percentage of the loans we make, making our results of operations vulnerable to downturns in the real estate market.

At December 31, 2016, loans secured by multifamily and commercial real estate represented approximately 65% of our outstanding loans. The repayment of such loans is highly dependent on the ability of the borrowers to meet their loan repayment obligations to us, which can be adversely affected by economic downturns that can lead to (i) declines in the rents and, therefore, in the cash flows generated by those real properties on which the borrowers depend to fund their loan payments to us, and (ii) decreases in the values of those real properties, which make it more difficult for the borrowers to sell those real properties for amounts sufficient to repay their loans in full. As a result, our operating results are more vulnerable to adverse changes in the real estate market than other financial institutions with more diversified loan portfolios and we could incur losses in the event of changes in economic conditions that disproportionately affect the real estate markets.

Liquidity risk could adversely affect our ability to fund operations and hurt our financial condition.

Liquidity is essential to our banking business, as we use cash to make loans and purchase investment securities and other interest-earning assets and to fund deposit withdrawals that occur in the ordinary course of our business. Our principal sources of liquidity include earnings, deposits, FHLB borrowings, sales of loans or investment securities held for sale, repayments by clients of loans we have made to them, and the proceeds from sales by us of our equity securities or from borrowings that we may obtain. If our ability to obtain funds from these sources becomes limited or the costs of those funds increase, whether due to factors that affect us specifically, including our financial performance, or due to factors that affect the financial services industry in general, including weakening economic conditions or negative views and expectations about the prospects for the financial services industry as a whole, then our ability to grow our banking and investment advisory and wealth management businesses would be harmed, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We may not be able to maintain a strong core deposit base or other low-cost funding sources.

We depend on checking, savings and money market deposit account balances and other forms of customer deposits as our primary source of funding for our lending activities. Our future growth will largely depend on our ability to maintain and grow a strong deposit base. There is no assurance that we will be able to grow and maintain our deposit base. The account and deposit balances can decrease when customers perceive alternative investments, such as the stock market or real estate, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into investments (or similar deposit products at other institutions that may provide a higher rate of return), we could lose a relatively low cost source of funds, increasing our funding costs and reducing our net interest income and net income. Additionally, any such loss of funds could result in lower loan originations, which could materially negatively impact our growth strategy.

Our eight largest deposit clients account for 30% of our total deposits.

As of December 31, 2016, our eight largest bank depositors accounted for, in the aggregate, 30% of our total deposits. As a result, a material decrease in the volume of those deposits by a relatively small number of our depositors could reduce our liquidity, in which event it could become necessary for us to replace those deposits with higher-cost deposits, lower-yielding securities or FHLB borrowings, which would adversely affect our net interest income and, therefore, our results of operations.

Although we plan to grow our business by acquiring other banks, there is no assurance that we will succeed in doing so.

One of the key elements of our business plan is to grow our banking franchise and increase our market share, and for that reason, we intend to take advantage of opportunities to acquire other banks. However, there is no assurance that we will succeed in doing so. Our ability to execute on our strategy to acquire other banks may require us to raise additional capital and to increase FFB's capital position to support the growth of our banking franchise, and will also depend on market conditions, over which we have no control. Moreover, any bank acquisitions will require the approval of our bank regulators and there can be no assurance that we will be able to obtain such approvals on acceptable terms, if at all.

Our acquisitions may subject us to unknown risks.

Certain events may arise after the date of an acquisition, or we may learn of certain facts, events or circumstances after the closing of an acquisition, that may affect our financial condition or performance or subject us to risk of loss. These events include, but are not limited to: our success in integrating the operations, retaining key employees and customers, achieving anticipated synergies, meeting expectations and otherwise realizing the undertaking's anticipated benefits; litigation resulting from circumstances occurring at the acquired entity prior to the date of acquisition; loan downgrades and credit loss provisions resulting from underwriting of certain acquired loans determined not to meet our credit standards; personnel changes that cause instability within a department; delays in implementing new policies or procedures or the failure to apply new policies or procedures; and other events relating to the performance of our business. In addition, if we determined that the value of an acquired business had decreased and that the related goodwill was impaired, an impairment of goodwill charge to earnings would be recognized. Acquisitions involve inherent uncertainty and we cannot determine all potential events, facts and circumstances that could result in loss or increased costs or give assurances that our due diligence or mitigation efforts will be sufficient to protect against any such loss or increased costs.

Growing our banking business may not increase our profitability and may adversely affect our future operating results.

Since we commenced our banking business in October 2007, we have grown our banking franchise and now have 11 branch offices and four loan production offices in California, Nevada and Hawaii. We plan to continue to grow our banking business both organically and through acquisitions of other banks. However, the implementation of our growth strategy poses a number of risks for us, including:

- the risk that any newly established offices will not generate revenues in amounts sufficient to cover the start-up costs of those offices, which would reduce our earnings;
- the risk that any bank acquisitions we might consummate in the future will prove not to be accretive to or may reduce our earnings if we do not realize anticipated cost savings or if we incur unanticipated costs in integrating the acquired banks into our operations or if a substantial number of the clients of any of the acquired banks move their banking business to our competitors;
- the risk that such expansion efforts will divert management time and effort from our existing banking operations, which could adversely affect our future financial performance; and
- the risk that the additional capital which we may need to support our growth or the issuance of shares in any bank acquisitions will be dilutive of the investments that our existing stockholders have in the shares of our common stock that they own and in their respective percentage ownership interests they have in the Company.

We may not have the ability to attract capital necessary to maintain regulatory ratios and fund growth.

We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate. Our ability to raise additional capital, if needed, will depend on several things, especially conditions in the capital markets at that time, that are outside of our control, as well as our own financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funds and limit our access to some customary sources of capital. We cannot provide assurances that such capital will be available on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, our depositors, or counterparties participating in the capital markets may adversely affect our capital costs, ability to raise capital, and liquidity. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital which, in turn, would require that we compete with those other institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our financial condition, results of operations and liquidity.

New lines of business or new products and services may subject us to additional risks.

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts. We may invest significant time and resources in developing and marketing new lines of business and/or new products and services. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible or may be dependent on identifying and hiring a qualified person to lead the division. In addition, existing management personnel may not have the experience or capacity to provide effective oversight of new lines of business and/or new products and services.

External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations, financial condition and prospects.

A reduction in demand for our products and our failure to adapt to such a reduction could adversely affect our business, results of operations and financial condition.

The demand for the products that we offer may be reduced due to a variety of factors, such as demographic patterns, changes in customer preferences or financial conditions, regulatory restrictions that decrease customer access to particular products, or the availability of competing products. Should we fail to adapt to significant changes in our customers' demand for, or access to, our products, our revenues could decrease significantly and our operations could be harmed. Even if we do make changes to existing products or introduce new products to fulfill customer demand, customers may resist such changes or may reject such products. Moreover, the effect of any product change on the results of our business may not be fully ascertainable until the change has been in effect for some time, and, by that time, it may be too late to make further modifications to such product without causing further harm to our business, results of operations, and financial condition.

We face intense competition from other banks and financial institutions and other wealth and investment management firms that could hurt our business.

We conduct our business operations in markets where the banking business is highly competitive and is dominated by large multi-state and in-state banks with operations and offices covering wide geographic areas. We also compete with other financial service businesses, including investment advisory and wealth management firms, mutual fund companies, financial technology companies, and securities brokerage and investment banking firms that offer competitive banking and financial products and services as well as products and services that we do not offer. Larger banks and many of those other financial service organizations have greater financial and marketing resources than we do that enable them to conduct extensive advertising campaigns and to shift resources to regions or activities of greater potential profitability. They also have substantially more capital and higher lending limits than we do, which enable them to attract larger clients and offer financial products and services that we are unable to offer, putting us at a disadvantage in competing with them for loans and deposits and investment management clients. If we are unable to compete effectively with those banking or other financial services businesses, we could find it more difficult to attract new and retain existing clients and our net interest margins, net interest income and investment management advisory fees could decline, which would materially adversely affect our business, results of operations and prospects, and could cause us to incur losses in the future.

In addition, our ability to successfully attract and retain investment advisory and wealth management clients is dependent on our ability to compete with competitors' investment products, level of investment performance, client services and marketing and distribution capabilities. If we are not successful in retaining existing and attracting new investment management clients, our business, financial condition, results of operations and prospects may be materially and adversely affected.

The loss of key personnel or inability to attract additional personnel could hurt our future financial performance.

We currently depend heavily on the contributions and services provided by Rick Keller, our Executive Chairman, Scott Kavanaugh, Chief Executive Officer of FFI and FFB, David DePillo, President of FFB, John Hakopian, President of FFA, and John Michel, Chief Financial Officer of FFI, FFB and FFA, as well as a number of other key management personnel. Our future success also will depend, in part, on our ability to retain our existing, and attract additional, qualified private banking officers, relationship managers and investment advisory personnel. Competition

for such personnel is intense. If we are not successful in retaining and attracting key personnel, our ability to retain existing clients or attract new clients could be adversely affected and our business, financial condition, results of operations or prospects could be significantly harmed.

We are required to make significant estimates and assumptions in the preparation of our financial statements and our estimates and assumptions may not be accurate.

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires our management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income and expense during the reporting periods. Critical estimates are made by management in determining, among other things, the allowance for loan losses, amounts of impairment of assets, and valuation of income taxes. If our underlying estimates and assumptions prove to be incorrect, our financial condition and results of operations may be materially adversely affected.

The fair value of our investment securities can fluctuate due to factors outside of our control.

As of December 31, 2016, the fair value of our investment securities portfolio was \$510 million. Factors beyond our control can significantly influence and cause adverse changes to occur in the fair values of securities in that portfolio. These factors include, but are not limited to, rating agency actions in respect of the investment securities in our portfolio, defaults by the issuers of such securities, concerns with respect to the enforceability of the payment or other key terms of such securities, changes in market interest rates and continued instability in the capital markets. Any of these factors, as well as others, could cause other-than-temporary impairments and realized and/or unrealized losses in future periods and declines in other comprehensive income, which could materially and adversely affect our business, results of operations, financial condition and prospects. In addition, the process for determining whether an impairment of a security is other-than-temporary usually requires complex, subjective judgments, which could subsequently prove to have been wrong, regarding the future financial performance and liquidity of the issuer of the security, the fair value of any collateral underlying the security and whether and the extent to which the principal of and interest on the security will ultimately be paid in accordance with its payment terms.

A loss or material reduction of access to securitization markets for multifamily loans may adversely impact our business model, profitability and growth.

We intend to sell multifamily loans through the securitization market. The securitization market, along with credit markets in general, experienced unprecedented disruptions during the recent economic downturn. Although market conditions have improved since 2009, for a number of years following the economic downturn, certain issuers experienced increased risk premiums while there was a relatively lower level of investor demand for certain asset-backed securities (particularly those securities backed by nonprime collateral). In addition, the risk of volatility surrounding the global economic system and uncertainty surrounding regulatory reforms such as the Dodd-Frank Act continue to create uncertainty around access to the capital markets. The shift of power in the United States government following the 2016 election may increase uncertainty as the new administration may seek to unwind or reverse regulatory reforms impacting the financial industry which were put in place during the prior administration. As a result, there can be no assurance that we will continue to be successful in selling multifamily loans through the securitization market. Adverse changes in the securitization market generally could materially adversely affect our ability to securitize loans on a timely basis or upon terms acceptable to us. This could increase our cost of funding, reduce our margins or cause us to hold assets until investor demand improves.

Technology and marketing costs may negatively impact our future operating results.

The financial services industry is constantly undergoing technological changes in the types of products and services provided to clients to enhance client convenience. Our future success will depend upon our ability to address the changing technological needs of our clients and to compete with other financial services organizations which have successfully implemented new technologies. The costs of implementing technological changes, new product development and marketing costs may increase our operating expenses without a commensurate increase in our business or revenues, in which event our business, financial condition, results of operations and prospects could be materially and adversely affected.

The occurrence of fraudulent activity, breaches of our information security, and cyber-security attacks could have a material adverse effect on our business, financial condition, results of operations or future prospects.

As a financial institution, we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us or our clients and that may result in financial losses or increased costs to us or our clients, disclosure or misuse of confidential information belonging to us or personal or confidential information belonging to our clients, misappropriation of assets, litigation, or damage to our reputation. Fraudulent activity may take many forms, including check “kiting” or fraud, electronic fraud, wire fraud, “phishing” and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or

unauthorized access to data processing or data storage systems used by us or by our clients, denial or degradation of service attacks, and malware or other cyber-attacks. We have been seeing increases in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, including in the commercial banking sector, as cyber-criminals have been targeting commercial bank and brokerage accounts on an increasing basis. Moreover, in recent periods, several governmental agencies and large corporations, including financial service organizations and retail companies, have suffered major data breaches, in some cases exposing not only their confidential and proprietary corporate information, but also sensitive financial and other personal information of their clients or customers and their employees or other third parties, and subjecting those agencies and corporations to potential fraudulent activity and their clients, customers and other third parties to identity theft and fraudulent activity in their credit card and banking accounts. Therefore, security breaches and cyber-attacks can cause significant increases in operating costs, including the costs of compensating clients and customers for any resulting losses they may incur and the costs and capital expenditures required to correct the deficiencies in and strengthen the security of data processing and storage systems.

Although we invest in systems and processes that are designed to detect and prevent security breaches and cyber-attacks and we conduct periodic tests of our security systems and processes, there is no assurance that we will succeed in anticipating or adequately protecting against or preventing all security breaches and cyber-attacks from occurring due to a number of possible causes, many of which will be outside of our control, including the changing nature and increasing frequency of such attacks, the increasing sophistication of cyber-criminals, and possible weaknesses that go undetected in our data systems notwithstanding the testing we conduct of those systems. If we are unable to detect or prevent a security breach or cyber-attack from occurring, then we and our clients could incur losses or damages; and we could sustain damage to our reputation, lose clients and business, suffer disruptions to our business and incur increased operating costs, and be exposed to additional regulatory scrutiny or penalties and to civil litigation and possible financial liability, any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We rely on communications, information, operating and financial control systems technology and related services from third-party service providers and there can be no assurance that we will not suffer an interruption in those systems.

We rely heavily on third-party service providers for much of our communications, information, operating and financial control systems technology, including our internet banking services and data processing systems. Any failure or interruption of, or security breaches in, these systems could result in failures or interruptions in our operations or in the client services we provide. Additionally, interruptions in service and security breaches could damage our reputation, lead existing clients to terminate their business relationships with us, make it more difficult for us to attract new clients and subject us to additional regulatory scrutiny and possibly financial liability, any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We continually encounter technological change, and we may have fewer resources than many of our competitors to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many national vendors provide turn-key services that allow smaller banks to compete with institutions that have substantially greater resources to invest in technological improvements. We may not be able, however, to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

Our ability to attract and retain clients and key employees could be adversely affected if our reputation is harmed.

Our ability (and the ability of FFB and FFA) to attract and retain clients and key employees could be adversely affected if our reputation is harmed. Any actual or perceived failure to address various issues could cause reputational harm, including a failure to address any of the following types of issues: legal and regulatory requirements; the proper maintenance or protection of the privacy of client and employee financial or other personal information; record keeping deficiencies or errors; money-laundering; potential conflicts of interest and ethical issues. Moreover, any failure to appropriately address any issues of this nature could give rise to additional regulatory restrictions, and legal risks, which could lead to costly litigation or subject us to enforcement actions, fines, or penalties and cause us to incur related costs and expenses. In addition, our banking, investment advisory and wealth management businesses are dependent on the integrity of our banking personnel and our investment advisory and wealth managers. Lapses in integrity could cause reputational harm to our businesses that could lead to the loss of existing clients and make it more difficult for us to attract new clients and, therefore, could have a material adverse effect on our business, financial condition, results of operations and prospects.

We may incur significant losses due to ineffective risk management processes and strategies.

We seek to monitor and control our risk exposures through a risk and control framework encompassing a variety of separate but complementary financial, credit, operational and compliance systems, and internal control and management review processes. However, those systems and review processes and the judgments that accompany their application may not be effective and, as a result, we may not anticipate every economic and financial outcome in all market environments or the specifics and timing of such outcomes, particularly in the event of the kinds of dislocations in market conditions experienced in recent years, which highlight the limitations inherent in using historical data to manage risk. If those systems and review processes prove to be ineffective in identifying and managing risks, we could be subjected to increased regulatory scrutiny and regulatory restrictions could be imposed on our business, including on our potential future business lines, as a result of which our business and operating results could be adversely affected.

A natural disaster could harm our business.

Historically, California, in which a substantial portion of our business is located, has been susceptible to natural disasters, such as earthquakes, floods and wild fires. The nature and level of natural disasters cannot be predicted. These natural disasters could harm our operations through interference with communications, including the interruption or loss of our computer systems, which could prevent or impede us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. Additionally, natural disasters could negatively impact the values of collateral securing our borrowers' loans and interrupt our borrowers' abilities to conduct their business in a manner to support their debt obligations, either of which could result in losses and increased provisions for loan losses for us.

We are exposed to risk of environmental liabilities with respect to real properties that we may acquire.

From time to time, in the ordinary course of our business, we acquire, by or in lieu of foreclosure, real properties which collateralize nonperforming loans. As an owner of such properties, we could become subject to environmental liabilities and incur substantial costs for any property damage, personal injury, investigation and clean-up that may be required due to any environmental contamination that may be found to exist at any of those properties, even if we did not engage in the activities that led to such contamination and those activities took place prior to our ownership of the properties. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties seeking damages for environmental contamination emanating from the site. If we were to become subject to significant environmental liabilities or costs, our business, financial condition, results of operations and prospects could be materially and adversely affected.

Our investment advisory and wealth management business may be negatively impacted by changes in economic and market conditions.

Our investment advisory and wealth management business may be negatively impacted by changes in general economic and market conditions because the performance of that business is directly affected by conditions in the financial and securities markets. The performance of the financial markets and the businesses operating in the securities industry can be highly volatile within relatively short periods of time and is directly affected by, among other factors, domestic and foreign economic conditions and general trends in business and finance, and by the threat, as well as the occurrence, of global conflicts, all of which are beyond our ability to control. We cannot assure you that broad market performance will be favorable in the future. Declines or a lack of sustained growth in the financial markets may adversely affect the market value and performance of the investment securities that we manage, which could lead to reductions in our investment management and advisory fees and, therefore, may result in a decline in the performance of our investment advisory and wealth management business. Additionally, if FFA's performance were to decline, that could lead some of our clients to reduce their assets under management by us and make it more difficult for us to retain existing clients and attract new clients. If any of these events or circumstances were to occur, the operating results of our investment advisory and wealth management business and, therefore, our earnings could be materially and adversely affected.

The investment management contracts we have with our clients are terminable without cause and on relatively short notice by our clients, which makes us vulnerable to short term declines in the performance of the securities under our management.

Like most investment advisory and wealth management businesses, the investment advisory contracts we have with our clients are typically terminable by the client without cause upon less than 30 days' notice. As a result, even short term declines in the performance of the securities we manage, which can result from factors outside our control, such as adverse changes in market or economic condition or the poor performance of some of the investments we have recommended to our clients, could lead some of our clients to move assets under our management to other asset classes such as broad index funds or treasury securities, or to investment advisors which have investment product offerings or investment strategies different than ours. Therefore, our operating results are heavily dependent on the

financial performance of our investment portfolios and the investment strategies we employ in our investment advisory businesses and even short-term declines in the performance of the investment portfolios we manage for our clients, whatever the cause, could result in a decline in assets under management and a corresponding decline in investment management fees, which would adversely affect our results of operations.

The market for investment managers is extremely competitive and the loss of a key investment manager to a competitor could adversely affect our investment advisory and wealth management business.

We believe that investment performance is one of the most important factors that affect the amount of assets under our management and, for that reason, the success of FFA's business is heavily dependent on the quality and experience of our investment managers and their track records in terms of making investment decisions that result in attractive investment returns for our clients. However, the market for such investment managers is extremely competitive and is increasingly characterized by frequent movement of investment managers among different firms. In addition, our individual investment managers often have direct contact with particular clients, which can lead to a strong client relationship based on the client's trust in that individual manager. As a result, the

loss of a key investment manager to a competitor could jeopardize our relationships with some of our clients and lead to the loss of client accounts, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We may be adversely affected by the soundness of certain securities brokerage firms.

FFA does not provide custodial services for its clients. Instead, client investment accounts are maintained under custodial arrangements with large, well established securities brokerage firms, either directly or through arrangements made by FFA with those firms. As a result, the performance of, or even rumors or questions about the integrity or performance of, any of those brokerage firms could adversely affect the confidence of FFA's clients in the services provided by those firms or otherwise adversely impact their custodial holdings. Such an occurrence could negatively impact the ability of FFA to retain existing or attract new clients and, as a result, could have a material adverse effect on our business, financial condition, results of operations and prospects.

Risks Related to Our Regulatory Environment

The banking industry is highly regulated, and legislative or regulatory actions taken now or in the future may have a significant adverse effect on our operations.

The banking industry is extensively regulated and supervised under both federal and state laws and regulations that are intended primarily to protect customers, depositors, the FDIC's Deposit Insurance Fund, and the banking system as a whole, not our stockholders. We are subject to the regulation and supervision of the Federal Reserve Board, the FDIC and the DBO. The banking laws, regulations and policies applicable to us govern matters ranging from the maintenance of adequate capital, safety and soundness, mergers and changes in control to the general business operations conducted by us, including permissible types, amounts and terms of loans and investments, the amount of reserves held against deposits, restrictions on dividends, imposition of specific accounting requirements, establishment of new offices and the maximum interest rate that may be charged on loans.

We are subject to changes in federal and state banking statutes, regulations and governmental policies, or the interpretation or implementation of them, including regulations to be implemented as a result of the enactment of the Dodd-Frank Act. Any changes in any federal or state banking statute, regulation or governmental policy, including changes which may occur in 2017 and beyond during the new administration, could affect us in substantial and unpredictable ways, including ways that may adversely affect our business, results of operations, financial condition or prospects. Compliance with laws and regulations can be difficult and costly, and changes to laws and regulations often impose additional compliance costs. In addition, federal and state banking regulators have broad authority to supervise our banking business and that of our subsidiaries, including the authority to prohibit activities that represent unsafe or unsound banking practices or constitute violations of statute, rule, regulation, or administrative order. Failure to comply with any such laws, regulations or regulatory policies could result in sanctions by regulatory agencies, restrictions on our business activities, civil money penalties or damage to our reputation, all of which could adversely affect our business, results of operations, financial condition or prospects.

Federal and state banking agencies periodically conduct examinations of our business, including compliance with laws and regulations, and our failure to comply with any supervisory actions which we are, or may become, subject to as a result of such examinations may adversely affect us.

The Federal Reserve Board, the FDIC, and the DBO may conduct examinations of our business, including for compliance with applicable laws and regulations. As a result of an examination, regulatory agencies may determine that the financial condition, capital resources, asset quality, asset concentrations, earnings prospects, management, liquidity, sensitivity to market risk, or other aspects of any of our operations are unsatisfactory, or that we or our management are in violation of any law, regulation or guideline in effect from time to time. Regulatory agencies may take a number of different remedial actions, including the power to enjoin "unsafe or unsound" practices, to require

affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to change the composition of our concentrations in portfolio or balance sheet assets, to assess civil monetary penalties against officers or directors, to remove officers and directors and, if such conditions cannot be corrected or there is an imminent risk of loss to depositors, the FDIC may terminate our deposit insurance. A regulatory action against us could have a material adverse effect on our business, results of operations, financial condition and prospects.

The Dodd-Frank Act may have a material effect on our operations.

The Dodd-Frank Act imposes significant regulatory and compliance changes on financial institutions and non-bank providers of financial products. The Dodd-Frank Act has had and will continue to have an impact on our business in the following ways:

- changes to regulatory capital requirements;

- creation of new government regulatory agencies (particularly the Consumer Financial Protection Bureau (the “CFPB”), which will develop and enforce rules for bank and non-bank providers of consumer financial products);
- changes to deposit insurance assessments;
- regulation of debit interchange fees we earn;
- changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments. Some provisions of the Dodd-Frank Act have not been completely implemented and future implementation is uncertain in light of the transition of power in the United States federal government to the new administration following the 2016 election. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities or otherwise adversely affect our business. Failure to comply with the requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to investors in our equity securities.

As a result of the Dodd-Frank Act and associated rulemaking, we have become subject to stringent capital requirements.

The Dodd-Frank Act required, among other things, that the federal banking agencies establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. In July 2013, the federal banking agencies adopted final rules (the “Final Capital Rule”), implementing the Basel III capital standards and establishing the minimum capital levels required under the Dodd-Frank Act, which apply to all U.S. banks, subject to various transition periods. We were required to comply with the Final Capital Rule by January 1, 2015 with capital conservation buffer and deductions from common equity tier 1 capital phased in through 2019. The Final Capital Rule establishes a common equity Tier 1 capital ratio of 6.5% of risk-weighted assets, tier 1 capital ratio of 8.0%, and total capital ratio of 10.0%, and leverage ratio of 5.0% for a financial institution to be considered “well capitalized” for regulatory purposes. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier 1 capital conservation buffer (phased in in annual increments of 0.625% beginning January 1, 2016) over the minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and to engage in share repurchases. The Final Capital Rule increases the required capital for certain categories of assets, including high volatility construction real estate loans and certain exposures related to securitizations; however, the Final Capital Rule retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we made a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. Implementation of these capital requirements, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations, financial condition or prospects.

New and future rulemaking by the CFPB and other regulators, as well as enforcement of existing consumer protection laws, may have a material and adverse effect on our operations and operating costs.

The CFPB has the authority to implement and enforce a variety of existing federal consumer protection statutes and to issue new regulations but, with respect to institutions of our size, does not have primary examination and enforcement authority with respect to such laws and regulations. The authority to examine depository institutions with \$10.0 billion or less in assets, like us, for compliance with federal consumer laws remains largely with our primary federal regulator, the FDIC. However, the CFPB may participate in examinations of smaller institutions on a “sampling basis” and may refer potential enforcement actions against such institutions to their primary regulators. In some cases, regulators such as the Federal Trade Commission and the Department of Justice also retain certain rulemaking or enforcement authority, and we also remain subject to certain state consumer protection laws. As an independent bureau within the Federal Reserve Board, the CFPB may impose requirements more severe than the previous bank

regulatory agencies. The CFPB has placed significant emphasis on consumer complaint management and has established a public consumer complaint database to encourage consumers to file complaints they may have against financial institutions. We are expected to monitor and respond to these complaints, including those that we deem frivolous, and doing so may require management to reallocate resources away from more profitable endeavors.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, the CFPB and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the Community Reinvestment Act or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Any such actions could have a material adverse effect on our business, financial condition, results of operations and prospects.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the USA PATRIOT Act of 2001 and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the Treasury to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of any financial institutions that we may acquire in the future are deemed deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could materially and adversely affect our business, financial condition, results of operations and prospects.

Regulations relating to privacy, information security and data protection could increase our costs, affect or limit how we collect and use personal information and adversely affect our business opportunities.

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively impacted by these laws. For example, our business is subject to the Gramm-Leach-Bliley Act which, among other things: (i) imposes certain limitations on our ability to share non-public personal information about our customers with non-affiliated third parties; (ii) requires that we provide certain disclosures to customers about our information collection, sharing and security practices and afford customers the right to "opt out" of any information sharing by us with non-affiliated third parties (with certain exceptions) and (iii) requires we develop, implement and maintain a written comprehensive information security program containing safeguards appropriate based on our size and complexity, the nature and scope of our activities, and the sensitivity of customer information we process, as well as plans for responding to data security breaches. Various state and federal banking regulators and states and foreign countries have also enacted data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the United States and other countries are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information, and some of our current or planned business activities. This could also increase our costs of compliance and business operations and could reduce income from certain business initiatives. This includes increased privacy-related enforcement activity at the federal level, by the Federal Trade Commission, as well as at the state level, such as with regard to mobile applications.

Compliance with current or future privacy, data protection and information security laws (including those regarding security breach notification) affecting customer or employee data to which we are subject could result in higher compliance and technology costs and could restrict our ability to provide certain products and services, which could have a material adverse effect on our business, financial conditions or results of operations. Our failure to comply with privacy, data protection and information security laws could result in potentially significant regulatory or governmental investigations or actions, litigation, fines, sanctions and damage to our reputation, which could have a material adverse effect on our business, financial condition or results of operations.

FFA's business is highly regulated, and the regulators have the ability to limit or restrict, and impose fines or other sanctions on, FFA's business.

FFA is registered as an investment adviser with the SEC under the Investment Advisers Act and its business is highly regulated. The Investment Advisers Act imposes numerous obligations on registered investment advisers, including fiduciary, record keeping, operational and disclosure obligations. Moreover, the Investment Advisers Act grants broad administrative powers to regulatory agencies such as the SEC to regulate investment advisory businesses. If the SEC or other government agencies believe that FFA has failed to comply with applicable laws or regulations, these agencies have the power to impose fines, suspensions of individual employees or other sanctions, which could include revocation of FFA's registration under the Investment Advisers Act. We are also subject to the provisions and regulations of ERISA to the extent that we act as a "fiduciary" under ERISA with respect to certain of our clients. ERISA and the applicable provisions of the federal tax laws, impose a number of duties on persons who are fiduciaries under ERISA and prohibit certain transactions involving the assets of each ERISA plan which is a client, as well as certain transactions by the fiduciaries (and certain other related parties) to such plans. Additionally, like other investment advisory and wealth management companies, FFA also faces the risks of lawsuits by clients. The outcome of regulatory proceedings and lawsuits is uncertain and difficult to predict. An adverse resolution of any regulatory proceeding or lawsuit against FFA could result in substantial costs or reputational harm to FFA and, therefore, could have an adverse effect on the ability of FFA to retain key relationship and wealth managers, and to retain existing clients or attract new clients, any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

Risks Related to Ownership of Our Common Stock

We do not plan to pay dividends for the foreseeable future. Additionally, our ability to pay dividends is subject to statutory, regulatory and other restrictions.

In order to support and fund the growth of our banking business, it is our policy to retain cash to use in our business rather than pay dividends to our stockholders. As a result, we have not paid any cash dividends since FFB commenced its banking operations in October 2007 and we have no plans to pay cash dividends at least for the foreseeable future. Additionally, our ability to pay dividends to our stockholders is restricted by Delaware and federal law and the policies and regulations of the Federal Reserve Board, which is our federal banking regulator.

Our ability to pay dividends to stockholders is also dependent on the payment to us of cash dividends by our subsidiaries, FFA and FFB. FFA and FFB are corporations that are separate and distinct from us and, as a result, they are subject to separate statutory or regulatory dividend restrictions that can affect their ability to pay cash dividends to us. FFA's ability to pay cash dividends to us is restricted under California corporate law. FFB's ability to pay dividends to us is limited by various banking statutes and regulations and California law. Moreover, based on their assessment of the financial condition of FFB or other factors, the FDIC or the DBO could find that payment of cash dividends by FFB to us would constitute an unsafe or unsound banking practice, in which event they could restrict FFB from paying cash dividends, even if FFB meets the statutory requirements to do so. See the section entitled "Dividend Policy and Restrictions on the Payment of Dividends" in Item 5 of this report below for additional information about our dividend policy and the dividend restrictions that apply to us and to FFB and FFA.

Trading in our common stock has been limited and there is no assurance that a more active trading market for our shares will develop in the future. As a result, stockholders may not be able to sell their shares of our common stock at attractive prices if and when they need or desire to do so.

On November 3, 2014, our common stock was listed and commenced trading on the NASDAQ Global Market, under the ticker symbol "FFWM". However, the trading volume in our common stock has been limited. For example, the average daily trading volume of our shares on NASDAQ during the month of February 2017 was approximately 75,000 shares. There can be no assurance that a more active trading market for our shares will develop or can be sustained in the future. If a more active trading market does not develop, or cannot be sustained, our stockholders may have difficulty selling their shares at attractive prices when they need or desire to do so. Additionally, the lack of an active trading market for our shares may make it more difficult for us to sell shares in the future to raise additional

capital and to offer our shares as consideration for future acquisitions of other banks or investment management or other financial services businesses, without diluting our existing stockholders.

The market prices and trading volume of our common stock may be volatile.

Even if an active market develops for our common stock, the market prices of our common stock may be volatile and the trading volume may fluctuate and cause significant price variations to occur. We cannot assure you that, if a more active market does develop for our common stock, the market prices of our common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect the prices of our shares or result in fluctuations in those prices or in trading volume of our common stock could include the following, many of which are outside of our control:

- quarterly variations in our operating results or in the quality of our earnings or assets;
- operating results that differ from the expectations of management, securities analysts and investors;

- changes in expectations as to our future financial performance;
- the operating and securities price performance of other companies that investors believe are comparable to us;
- the implementation of our growth strategy and performance of acquired businesses that vary from the expectations of securities analysts and investors;
- the enactment of new more costly government regulations that are applicable to our businesses or the imposition of regulatory restrictions on us;
- our dividend policy and any changes that might occur to that policy in the future;
- future sales by us of our common stock or any other of our equity securities;
- changes in global financial markets and global economies and general market conditions, such as changes in interest rates or fluctuations in stock, commodity or real estate valuations; and
- announcements of strategic developments, material acquisitions and other material events in our business or in the businesses of our competitors.

These broad market and industry factors may decrease the market price of our common stock, regardless of our actual operating performance. The stock market in general has from time to time experienced extreme price and volume fluctuations, including in recent months. In addition, in the past, following periods of volatility in the overall market and the market price of a company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

Share ownership by our officers and directors and certain agreements may make it more difficult for third parties to acquire us or effectuate a change of control that might be viewed favorably by other stockholders.

As of March 10, 2017, our executive officers and directors owned, in the aggregate, approximately 16% of our outstanding shares. As a result, if our executive officers and directors were to oppose a third party's acquisition proposal for, or a change in control of, the Company, our executive officers and directors may have sufficient voting power to be able to block or at least delay such an acquisition or change in control from taking place, even if other stockholders would support such a sale or change of control. In addition, a number of our executive officers have change of control agreements which could increase the costs and, therefore, lessen the attractiveness of an acquisition of the Company to a potential acquiring party.

Our corporate governance documents, and certain corporate and banking laws applicable to us, could make a takeover attempt, which may be beneficial to our stockholders, more difficult.

Our Board of Directors has the power under our certificate of incorporation to issue additional shares of common stock and create and authorize the sale of one or more series of preferred stock without having to obtain stockholder approval for such action. As a result, our Board could authorize the issuance of shares of a series of preferred stock to implement a stockholders rights plan (often referred to as a "poison pill") or could sell and issue preferred shares with special voting rights or conversion rights, which could deter or delay attempts by our stockholders to remove or replace management, and attempts of third parties either to engage in proxy contests or to acquire control of the Company. In addition, our charter documents:

- enable our Board to fill any vacancy on the Board, unless the vacancy was created by the removal of a director;
- enable our Board to amend our bylaws without stockholder approval, subject to certain exceptions; and
- require compliance with an advance notice procedure with regard to any business that is to be brought by a stockholder before an annual or special meeting of stockholders and with regard to the nomination by stockholders of candidates for election as directors.

These provisions could delay or prevent an acquisition of the Company or other transaction that some of our stockholders may believe is beneficial to them. Furthermore, federal and state banking laws and regulations applicable to us require anyone seeking to acquire more than 10% of our outstanding shares or otherwise effectuate a change of control of the Company or of FFB, to file an application with, and to receive approval from, the Federal Reserve Board, the DBO, and the FDIC to do so. These laws and regulations may discourage potential acquisition

proposals and could delay or prevent a change of control of the Company, including by means of a transaction in which our stockholders might receive a premium over the market price of our common stock.

We may sell additional shares of common stock in the future which could result in dilution to our stockholders.

A total of approximately 34 million authorized but unissued shares of our common stock are available for future sale and issuance by action of our Board of Directors alone. Accordingly, if we were to sell additional shares in the future, our stockholders could suffer dilution in their investment in their shares of our common stock and in their percentage ownership of the Company.

We may issue additional equity securities, or engage in other transactions which could dilute our book value or affect the priority of our common stock, which may adversely affect the market price of our common stock.

Our Board of Directors may determine from time to time to raise additional capital by issuing additional shares of our common stock or other securities. In addition, we may issue additional securities in connection with future acquisitions we may make. We are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. We cannot predict or estimate the amount, timing, or nature of any future offerings or issuances of additional stock in connection with acquisitions, or the prices at which such offerings may be affected. Such offerings could be dilutive to common stockholders. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, our then-current common stockholders. Additionally, if we raise additional capital by making additional offerings of debt or preferred equity securities, upon liquidation of the Company, holders of our debt securities and shares of preferred stock, and lenders with respect to other borrowings, will receive distributions of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

We may elect under the JOBS Act to use an extended transition period for complying with new or revised accounting standards.

We are an “emerging growth company” under the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). The JOBS Act allows us, as an emerging growth company, to take advantage of extended transition periods for the implementation of new or revised accounting standards. As a result, we will not be required to comply with new or revised accounting standards (i) until those standards apply to private companies, even if that is later than the date or dates on which they become effective for public companies or (ii) if sooner, until we cease to be an “emerging growth company” as defined in the JOBS Act (December 31, 2020). As a result, our financial statements may not be fully comparable to the financial statements of public companies that contain new or revised accounting standards not yet applicable to private companies or emerging growth companies, which could make our common stock less attractive to investors.

The reduced disclosures and relief from certain other significant disclosure requirements that are available to emerging growth companies may make our common stock less attractive to investors.

As an “emerging growth company” we are entitled to exemptions from certain reporting requirements that apply to public companies that are not emerging growth companies. These exemptions include the following:

- an exemption from the requirements of the Section 404 of the Sarbanes-Oxley Act of 2002, which requires public companies that are accelerated filers or large accelerated filers (within the meaning of the Exchange Act) to obtain and include in their annual reports on Form 10-K an attestation report from their independent registered public accountants with respect to the effectiveness of their internal control over financial reporting;
- less extensive disclosure obligations regarding executive compensation in our proxy statements or other periodic reports that we file with the SEC; and
- exemptions from the requirements to have our stockholders vote, on an advisory and nonbinding basis, on executive compensation and on any golden parachute payments.

In addition, even if we choose voluntarily to comply with any of the requirements from which we are exempt, we may later rely on those exemptions to avail ourselves of the reduced reporting and disclosure requirements applicable to emerging growth companies.

We may remain an emerging growth company for the period ending in December 2018, although we may cease to be an emerging growth company earlier under certain circumstances, including if, before the end of that period, it is determined that we have become a large accelerated filer under the rules of the SEC (which depends on, among other things, having a market value of common stock held by non-affiliates in excess of \$700 million).

Because we will be relying on one or more of these exemptions, investors and securities analysts may find it more difficult to evaluate our common stock, and some investors may find our common stock less attractive, and, as a result, there may be a less active

trading market for our common stock than would be the case if we were not an emerging growth company, which could result in a reduction to the trading volume and greater volatility in the prices of our common stock.

A failure to maintain effective internal control over financial reporting could have a material adverse effect on our business and stock prices.

Although, as an emerging growth company, we are not required to obtain or include in our annual reports on Form 10-K an attestation report from our independent registered accountants with respect to the effectiveness of our internal control over financial reporting, like all other public companies, our Chief Executive Officer and our Chief Financial Officer are required, annually, to assess, and disclose their findings in our annual reports on Form 10-K with respect to, the effectiveness of our internal control over financial reporting in a manner that meets the requirements of Section 404(a) of the Sarbanes-Oxley Act. The rules governing the standards that must be met for our Chief Executive and Chief Financial Officers to assess and report on the effectiveness of our internal control over financial reporting are complex and require significant documentation, testing and possible remediation, which could significantly increase our operating expenses. See Item 9A “Controls and Procedures” below to review the attestation report of our Chief Executive Officer and Chief Financial Officer regarding the effectiveness of our internal control over financial reporting as of December 31, 2016.

Additionally, if we are unable to maintain the effectiveness of our internal control over financial reporting in the future, we may be unable to report our financial results accurately and on a timely basis. In such an event, investors and clients may lose confidence in the accuracy and completeness of our financial statements, as a result of which our liquidity, access to capital markets, and perceptions of our creditworthiness could be adversely affected and the market prices of our common stock could decline. In addition, we could become subject to investigations by NASDAQ, the SEC, or the Federal Reserve Board, or other regulatory authorities, which could require us to expend additional financial and management resources. As a result, an inability to maintain the effectiveness of our internal control over financial reporting in the future could have a material adverse effect on our business, financial condition, results of operations and prospects.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our stock or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

An investment in our common stock is not an insured deposit and is not guaranteed by the FDIC, so you could lose some or all of your investment.

An investment in our common stock is not a bank deposit and is not insured against loss or guaranteed by the FDIC, any other deposit insurance fund or by any other public or private entity. An investment in our common stock is inherently risky for the reasons described herein. As a result, if you acquire our common stock, you could lose some or all of your investment.

There can be no assurance that the total market capitalization of our common stock after our January 2017 stock split will be equal to or greater than the total market capitalization before such stock split.

There can be no assurance that the market price per share of our common stock after the two-for-one stock split completed in January 2017 will decrease in proportion to the increase in the number of shares of our common stock outstanding before the stock split. For example, based on the closing price on the NASDAQ Global Market of our

common stock prior to distribution of the stock split effected in the form of a stock dividend on January 18, 2017 of \$27.70 per share, there can be no assurance that the post-split market price of our common stock will maintain a price per share equal to or greater than \$13.85 per share, which is $\frac{1}{2}$ the value of our common stock immediately prior to such stock split. The market price of our common stock will be based on our performance and other factors, many of which are unrelated to the number of shares outstanding. Accordingly, the total market capitalization of our common stock after the stock split may be lower than the total market capitalization before the stock split and, in the future, the market price of our common stock may not equal or exceed $\frac{1}{2}$ of the market price of our common stock prior to the stock split, which our investors may expect following the two-for-one stock split.

Following the stock split, the resulting per-share stock price may not attract additional retail investors or other new investors which we believe may have been attracted to invest in the Company at a lower per share stock price.

While our Board of Directors believes that a lower stock price may help generate investor interest and broaden our stockholder base, including among retail investors or our customers who may be less interested in investing in our stock at a higher per share stock price, there can be no assurance that the stock split will result in a per-share price that will attract such investors or that our stockholder base will increase in the future. Potential investors may find our stock price to be too high even after the stock split to be an attractive investor for them or our stock may not be attractive as an investment opportunity to potential investors for other reasons. We can provide no assurances that the stock split will have the desired results or that the benefits from the stock split will outweigh the costs and risks to us associated with the stock split.

Other Risks and Uncertainties.

Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business, financial condition, operating results and future prospects.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

The corporate headquarters for all of the companies is located in Irvine, California. The Company has offices in California in Irvine, Indian Wells, Pasadena, El Centro, West Los Angeles, El Segundo, Laguna Hills, Seal Beach, Oakland, Sacramento, Burlingame, and San Diego and in Las Vegas, Nevada, and in Honolulu, Hawaii. All of these offices are leased pursuant to non-cancelable operating leases that will expire between 2017 and 2025.

Item 3. Legal Proceedings.

In the ordinary course of business, we are subject to claims, counter claims, suits and other litigation of the type that generally arise from the conduct of financial services businesses. We are not aware of any threatened or pending litigation that we expect will have a material adverse effect on our business operations, financial condition or results of operations.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market Information

On November 3, 2014, our common stock became listed and commenced trading on the NASDAQ Global Stock Market under the trading symbol "FFWM". The following table shows the high and low sales prices of our shares for the respective periods set forth below, as reported on the NASDAQ Global Stock Market:

Quarter Ended	High	Low
2016:		
March 31 ⁽¹⁾	\$11.80	\$10.46
June 30 ⁽¹⁾	11.50	10.11
September 30 ⁽¹⁾	12.58	10.31
December 31 ⁽¹⁾	14.90	11.90
2015:		
March 31 ⁽¹⁾	\$9.88	\$8.80
June 30 ⁽¹⁾	9.90	9.30
September 30 ⁽¹⁾	12.17	9.76
December 31 ⁽¹⁾	12.31	11.10

(1) Per share data has been adjusted to reflect the two-for-one stock split effective January 18, 2017. The closing per share sales price of our common stock, as reported by NASDAQ, on March 10, 2017 was \$15.69. As of the same date, a total of 32,893,491 shares of our common stock were issued and outstanding which were held of record by approximately 2,000 shareholders.

Dividend Policy and Restrictions on the Payment of Dividends

We have not previously paid cash dividends on our common stock. It is our current intention to invest our cash flow and earnings in the growth of our businesses and, therefore, we have no plans to pay cash dividends for the foreseeable future.

Our ability to pay dividends to our stockholders is subject to the restrictions set forth in the Delaware General Corporation Law (the "DGCL") and the regulatory authority of the Federal Reserve. The DGCL provides that a corporation, unless otherwise restricted by its certificate of incorporation, may declare and pay dividends out of its surplus or, if there is no surplus, out of net profits for the fiscal year in which the dividend is declared and/or for the preceding fiscal year, as long as the amount of capital of the corporation is not 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. Surplus is defined as the excess of a corporation's net assets (i.e., its total assets minus its total liabilities) over the capital associated with issuances of its common stock. Moreover, the DGCL permits a board of directors to reduce its capital and transfer such amount to its surplus. In determining the amount of surplus of a Delaware corporation, the assets of the corporation, including stock of subsidiaries owned by the corporation, must be valued at their fair market value as determined by the board of directors, regardless of their historical book value. In addition, since we are a bank holding company subject to regulation by the FRB, it may become necessary for us to obtain the approval of the FRB before we can pay cash dividends to our stockholders.

Cash dividends from our two wholly-owned subsidiaries, FFB and FFA, represent the principal source of funds available to us, which we might use to pay cash dividends to our shareholders or for other corporate purposes. Since FFA and FFB are California corporations, they are subject to dividend payment restrictions under the California

General Corporation Law (the "CGCL"). The laws of the State of California, as they pertain to the payment of cash dividends by California state chartered banks, limit the amount of funds that FFB would be permitted to dividend to us more strictly than does the CGCL. In particular, under California law, cash dividends by a California state chartered bank may not exceed, in any calendar year, the lesser of (i) the sum of its net income for the year and its retained net income from the preceding two years (after deducting all dividends paid during the period), or (ii) the amount of its retained earnings.

Also, because the payment of cash dividends has the effect of reducing capital, capital requirements imposed on FFB by the DBO and the FDIC may operate, as a practical matter, to preclude the payment, or limit the amount of, cash dividends that might otherwise be permitted to be made under California law; and the DBO and the FDIC, as part of their supervisory powers, generally require insured banks to adopt dividend policies which limit the payment of cash dividends much more strictly than do applicable state laws.

Restrictions on Intercompany Transactions

Sections 23A and 23B of the Federal Reserve Act, and the implementing regulations thereunder, limit transactions between a bank and its affiliates and limit a bank's ability to transfer to its affiliates the benefits arising from the bank's access to insured deposits, the payment system and the discount window and other benefits of the Federal Reserve System. Those Sections of the Act and the implementing regulations impose quantitative and qualitative limits on the ability of a bank to extend credit to, or engage in certain other transactions with, an affiliate (and a non-affiliate if an affiliate benefits from the transaction).

Equity Compensation Plans

Certain information with respect to our equity compensation plans, as of December 31, 2016, is set forth in Item 12, in Part III of this Report and is incorporated herein by this reference.

Recent Sales of Unregistered Securities

During 2015, we sold 544,070 shares of common stock to Mr. DePillo. These shares were exempt from the registration requirements under the Securities Act of 1933, as amended (or Securities Act). The sales of these shares were made in reliance on the exemptions from registration under Section 4(2) of, and Regulation D and Rule 506 promulgated under, the Securities Act. Mr. DePillo represented his intention to acquire the shares for investment only, and not with a view to offer or sell any such shares in connection with any distribution of the shares, and appropriate restrictive legends were set forth on the share certificates issued.

Use of Proceeds

On August 12, 2015, we issued 12,467,532 shares of common stock, at a price of \$9.63 per share, in a registered, underwritten public offering. The offering resulted in gross proceeds of \$120.0 million and net proceeds of approximately \$113.7 million, after underwriting discounts and estimated expenses of the offering. The Company used a portion of the net proceeds from the offering to repay all of its \$29 million of outstanding term debt and intends to use the remaining proceeds for general corporate purposes, including to support of organic growth and possible acquisitions. On August 14, 2015, the underwriters exercised their option to purchase an additional 1,870,130 shares of the Company's common stock, at a price of \$9.63 per share, to cover any over-allotments in the public offering. As a result, the Company received additional gross proceeds of \$18.0 million and net proceeds of \$17.1 million, after underwriting discounts. The Company intends to use the proceeds for general corporate purposes, including to support organic growth and possible acquisitions.

Stock Performance Graph

The following graph shows a comparison from November 3, 2014 (the date our common stock commenced trading on the NASDAQ Global Market) through December 31, 2016 of the cumulative total return for our common stock, compared against (i) the Russell 2000 Index, which measures the performance of the smallest 2,000 members, by market cap, (i) the Russell 3000 Index, which measures the performance of the smallest 3,000 members, by market cap, of the Russell Index, and (ii) an index published by SNL Securities L.C. (“SNL”) and known as the SNL Western Bank Index, which is comprised of 51 banks and bank holding companies (including the Company), the shares of which are listed on NASDAQ or the New York Stock Exchange and most of which are based in California and the remainder of which are based in nine other western states.

The stock performance graph assumes that \$100 was invested in Company common stock at the close of market on November 3, 2014, and, at that same date, in the Russell 2000 Index, the Russell 3000 Index and the SNL Western Bank Index and that any dividends paid in the indicated periods were reinvested. Shareholder returns shown in the stock performance graph are not necessarily indicative of future stock price performance.

	Period Ending			
	11/3/2014	12/31/2014	12/31/2015	12/31/2016
First Foundation Inc. (FFWM)	100.00	97.21	126.42	152.73
Russell 2000 Index	100.00	102.95	97.07	115.97
Russell 3000 Index	100.00	102.06	100.55	111.03
SNL Western Bank Index	100.00	103.25	106.98	118.60

The above performance graph shall not be deemed “filed” for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities under that section and shall not be deemed to be incorporated by reference into any of our filings under the Securities Act or the Exchange Act.

Item 6. Selected Financial Data

With the exception of the certain items included in the selected performance and capital ratios, the following selected consolidated financial information as of and for the years ended December 31, 2016, 2015, and 2014 have been derived from our audited consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K, and the selected consolidated financial information as of and for the years ended December 31, 2013 and 2012 have been derived from our audited consolidated financial statements not appearing in this Annual Report on Form 10-K.

Edgar Filing: First Foundation Inc. - Form 10-K

You should read the following selected financial and operating data in conjunction with other information contained in this Annual Report on Form 10-K, including the information set forth in the sections entitled “Capitalization” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, as well as our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. The average balances used in computing certain ratios, have been computed using daily averages, except for average equity, which is computed using the average of beginning and end of month balances.

	As of and for the Year Ended December 31,					
(In thousands, except share and per share data)	2016	2015	2014	2013	2012	
Selected Income Statement Data:						
Net interest income	\$89,449	\$64,471	\$42,814	\$35,674	\$27,729	
Provision for loan losses	4,681	2,673	235	2,395	2,065	
Noninterest Income:						
Asset management, consulting and other fees	24,384	23,486	21,798	18,240	15,326	
Other ⁽¹⁾	10,176	5,287	2,951	1,584	1,294	
Noninterest expense	80,994	61,458	52,507	43,622	34,476	
Income before taxes	38,334	22,832	14,821	9,481	7,808	
Net income	23,303	13,378	8,394	7,851	5,801	
Share and Per Share Data: ⁽²⁾						
Net income per share:						
Basic	\$0.72	\$0.60	\$0.54	\$0.53	\$0.44	
Diluted	0.70	0.58	0.51	0.51	0.42	
Shares used in computation:						
Basic	32,365,800	22,310,014	15,474,072	14,848,420	13,207,066	
Diluted	33,471,816	23,151,710	16,332,686	15,484,430	13,663,910	
Tangible book value per share ⁽³⁾	\$8.62	\$8.05	\$6.33	\$5.59	\$4.97	
Shares outstanding at end of period ⁽⁴⁾	32,719,632	31,961,052	15,690,364	15,467,028	14,732,252	
Selected Balance Sheet Data:						
Cash and cash equivalents	\$597,946	\$215,748	\$29,692	\$56,954	\$63,108	
Loans, net of deferred fees ⁽⁵⁾	2,791,251	1,754,883	1,166,392	903,645	743,627	
Allowance for loan and lease losses (“ALLL”)	(15,400)	(10,600)	(10,150)	(9,915)	(8,340)	
Total assets	3,975,403	2,592,579	1,355,424	1,037,360	830,509	
Noninterest-bearing deposits	661,781	299,794	246,137	217,782	131,827	
Interest-bearing deposits	1,765,014	1,222,382	716,817	584,255	517,914	
Borrowings ⁽⁶⁾	1,250,000	796,000	282,886	141,603	100,000	
Shareholders’ equity ⁽⁴⁾	284,264	259,736	99,496	86,762	73,580	
Selected Performance and Capital Ratios:						
Return on average assets	0.80	% 0.76	% 0.71	% 0.86	% 0.80	%
Return on average equity	8.4	% 8.1	% 9.1	% 10.2	% 9.9	%
Net yield on interest-earning assets	3.13	% 3.39	% 3.70	% 4.06	% 4.20	%
Efficiency ratio ⁽⁷⁾	65.3	% 70.7	% 76.0	% 78.6	% 77.7	%
Noninterest income as a % of total revenues	27.9	% 33.1	% 36.6	% 35.7	% 37.5	%
Tangible common equity to tangible assets ⁽³⁾	7.10	% 9.93	% 7.33	% 8.34	% 8.82	%

Edgar Filing: First Foundation Inc. - Form 10-K

Tier 1 leverage ratio	8.76	%	11.81	%	7.32	%	8.67	%	9.19	%
Tier 1 risk-based capital ratio	12.80	%	17.44	%	11.02	%	13.04	%	13.60	%
Total risk-based capital ratio	13.52	%	18.19	%	12.23	%	14.30	%	14.85	%
Other Information:										
Assets under management (end of period)	3,586,672									
	\$		\$3,471,237		\$3,221,674		\$2,594,961		\$2,229,116	
NPAs to total assets	0.25	%	0.32	%	0.11	%	0.32	%	0.17	%
Charge-offs to average loans	0.00	%	0.15	%	0.00	%	0.10	%	0.04	%
Ratio of ALLL to loans ⁽⁸⁾	0.60	%	0.61	%	0.87	%	1.16	%	1.25	%
Number of wealth management offices	7		7		7		7		6	

(1) The 2016 and 2015 amounts include \$7.8 million and \$2.9 million in gains on sales of loans, respectively. The 2014 amount includes \$1.0 million of gains on sale of REO.

(2) Share and per share data has been adjusted to reflect the two-for-one stock split effective January 18, 2017.

- (3) Tangible common equity, (also referred to as tangible book value) and tangible assets, are equal to common equity and assets, respectively, less \$2.2 of intangible assets as of December 31, 2016, \$2.4 million of intangible assets as of December 31, 2015, \$0.2 million of intangible assets as of December 31, 2014, and less \$0.3 million of intangible assets as of December 31, 2013 and December 31, 2012. We believe that this information is consistent with the treatment by bank regulatory agencies, which exclude intangible assets from the calculation of capital ratios. Accordingly, we believe that tangible common equity to tangible assets and tangible book value per share provide information that is important to investors and that is useful in understanding our capital position and ratios. However, these non-GAAP financial measures are supplemental and are not a substitute for an analysis based on GAAP measures. As other companies may use different calculations for these measures, this presentation may not be comparable to other similarly titled measures reported by other companies.
- (4) In 2015, we issued 14,337,662 shares at a price of \$9.63 per share in a public offering and sold 544,070 shares to the President of FFB at a price of 9.19 per share. As a result of private offerings, we sold and issued shares of our common stock, (i) in 2013, 637,974 shares at a price of \$9.00 per share, and 77,468 shares at a price of \$7.50 per share; and (ii) in 2012, 748,876 shares at a price of \$7.50 per share. As a result of our acquisition of Pacific Rim Bank (“PRB”) in 2015, we issued 1,242,690 shares of our common stock to the former PRB shareholders, valued at \$9.50 per share. As a result of our acquisition of Desert Commercial Bank (“DCB”), in 2012 we issued to the former DCB shareholders a total of 1,630,894 shares of our common stock, valued at \$7.50 per share, in exchange for all of the outstanding shares of DCB, in 2014, we issued 47,160 shares, valued at \$7.50 per share, to the former DCB shareholders as part of a contingent payout, and in 2015 we issued 62,128 shares, valued at \$7.50 per share. In 2016, we issued 690,592 shares as a result of the exercise of stock options at an average exercise price of \$6.17 per share; in 2015, we issued 62,614 shares as a result of the exercise of stock options at an average exercise price of \$6.47 per share; and in 2014, we issued 169,732 shares as a result of the exercise of stock options at an average exercise price of \$5.60 per share. We issued 802,689, 226,684, 57,996, 145,005 and 145,005 shares of common stock upon the vesting of restricted stock units in 2016, 2015, 2014, 2013 and 2012, respectively.
- (5) Includes loans classified as loans held for sale.
- (6) Borrowings consist primarily of overnight and short-term advances obtained by FFB from the Federal Home Loan Bank.
- (7) The efficiency ratio is the ratio of noninterest expense to the sum of net interest income and noninterest income. The efficiency ratio excludes (i) gains on sale of REO of \$1.0 million in 2014; and (ii) in 2014, \$1.0 million of costs related to a cancelled initial public offering and \$1.0 million of contingent payout expense related to the acquisition of DCB.
- (8) This ratio excludes loans acquired in our acquisitions of PRB and DCB, as generally accepted accounting principles in the United States, or GAAP, requires estimated credit losses for acquired loans to be recorded as discounts to those loans.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended to facilitate the understanding and assessment of significant changes and trends in our businesses that accounted for the changes in our results of operations in the year ended December 31, 2016, as compared to our results of operation in the year ended December 31, 2015; in our results of operations in the year ended December 31, 2015, as compared to our results of operations in the year ended December 31, 2014, and our financial condition at December 31, 2016 as compared to our financial condition at December 31, 2015. This discussion and analysis is based on and should be read in conjunction with our consolidated financial statements and the accompanying notes thereto contained elsewhere in this Annual Report on Form 10-K. In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause results to differ materially from management's expectations. Some of the factors that could cause results to differ materially from expectations are discussed in the sections entitled "Risk Factors" and "Forward-Looking Statements" contained elsewhere in this Annual Report on Form 10-K.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and accounting practices in the banking industry. Certain of those accounting policies are considered critical accounting policies, because they require us to make estimates and assumptions regarding circumstances or trends that could materially affect the value of those assets, such as economic conditions or trends that could impact our ability to fully collect our loans or ultimately realize the carrying value of certain of our other assets. Those estimates and assumptions are made based on current information available to us regarding those economic conditions or trends or other circumstances. If changes were to occur in the events, trends or other circumstances on which our estimates or assumptions were based, or other unanticipated events were to occur that might affect our operations, we may be required under GAAP to adjust our earlier estimates and to reduce the carrying values of the affected assets on our balance sheet, generally by means of charges against income, which could also affect our results of operations in the fiscal periods when those charges are recognized.

Utilization and Valuation of Deferred Income Tax Benefits. We record as a "deferred tax asset" on our balance sheet an amount equal to the tax credit and tax loss carryforwards and tax deductions (collectively "tax benefits") that we believe will be available to us to offset or reduce income taxes in future periods. Under applicable federal and state income tax laws and regulations, tax benefits related to tax loss carryforwards will expire if they cannot be used within specified periods of time. Accordingly, the ability to fully use our deferred tax asset related to tax loss carryforwards to reduce income taxes in the future depends on the amount of taxable income that we generate during those time periods. At least once each year, or more frequently, if warranted, we make estimates of future taxable income that we believe we are likely to generate during those future periods. If we conclude, on the basis of those estimates and the amount of the tax benefits available to us, that it is more likely, than not, that we will be able to fully utilize those tax benefits prior to their expiration, we recognize the deferred tax asset in full on our balance sheet. On the other hand, if we conclude on the basis of those estimates and the amount of the tax benefits available to us that it has become more likely, than not, that we will be unable to utilize those tax benefits in full prior to their expiration, then, we would establish a valuation allowance to reduce the deferred tax asset on our balance sheet to the amount with respect to which we believe it is still more likely, than not, that we will be able to use to offset or reduce taxes in the future. The establishment of such a valuation allowance, or any increase in an existing valuation allowance, would be effectuated through a charge to the provision for income taxes or a reduction in any income tax credit for the period in which such valuation allowance is established or increased.

Allowance for Loan and Lease Losses. Our ALLL is established through a provision for loan losses charged to expense and may be reduced by a recapture of previously established loss reserves, which are also reflected in the statement of income. Loans are charged against the ALLL when management believes that collectability of the principal is unlikely. The ALLL is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible based on an evaluation of the collectability of loans and prior loan loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the

loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions and certain other subjective factors that may affect the borrower's ability to pay. While we use the best information available to make this evaluation, future adjustments to our ALLL may be necessary if there are significant changes in economic or other conditions that can affect the collectability in full of loans in our loan portfolio.

Adoption of new or revised accounting standards. For some accounting standards, we may elect to take advantage of the extended transition period afforded by the JOBS Act, for the implementation of new or revised accounting standards. As a result, we may not be required to comply with new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies or we cease to be an "emerging growth" company as defined in the JOBS Act. As a result of this election, our financial statements may not be comparable to the financials statements of companies that comply with public company effective dates.

We have two business segments, “Banking” and “Investment Management and Wealth Planning” (“Wealth Management”). Banking includes the operations of FFB and FFIS and Wealth Management includes the operations of FFA. The financial position and operating results of the stand-alone holding company, FFI, are included under the caption “Other” in certain of the tables that follow, along with any consolidation elimination entries.

Recent Developments and Overview

In 2016, a \$7.2 million gain was realized on the sale of \$265 million of loans secured by multifamily properties to Freddie Mac who securitized the loans as part of their small balance loan program. The agreement with Freddie Mac to sell these loans provided for changes in pricing based upon changes in rates on certain treasury swap indices. In an effort to reduce the interest rate risk associated with this agreement, we entered into a swap agreement. In conjunction with the finalization of pricing under the agreement, we closed out our swap position and paid \$2.4 million, including fees, to counterparties under the swap agreement, and the pricing on the loan sale increased by \$2.2 million. In 2016, we also sold \$41 million of loans to another financial institution and realized a gain of \$0.6 million. As of December 31, 2016, we have \$251 million of multifamily loans classified as loans held for sale.

A \$1.0 million reduction in taxes on income was realized in 2016 as a result of the early adoption of ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting” (“ASU 2016-09”). Under this new standard, excess tax benefits and deficiencies resulting from the exercise of, or vesting of, stock awards are now recognized as income tax benefit or expense in the period in which they occur. For purposes of determining an annual effective tax rate, the excess tax benefits or deficiencies cannot be included but rather are required to be treated as discrete items in the period in which they occur. In addition, for diluted earnings per share calculations, excess tax benefits are no longer included in assumed proceeds when determining average diluted shares outstanding under the treasury stock method. As set forth in ASU 2016-09, we recognized the impact of these changes on a prospective basis.

We experienced strong growth during 2016 with loan originations of \$1.8 billion and deposit growth of \$905 million. Wealth Management’s AUM increased by \$115 million or 3% during 2016, and totaled \$3.59 billion as of December 31, 2016. Revenues and income before taxes continue to increase as our investments in staffing and systems are resulting in higher levels of interest earnings assets. Comparing 2016 to 2015, we have increased our revenues (net interest income and noninterest income) by 43%.

The results of operations for Banking reflect the benefits of this growth. Income before taxes for Banking increased \$15.1 million from \$25.0 million in 2015 to \$40.2 million in 2016. Income before taxes for Wealth Management decreased slightly from \$2.2 million in 2015 to \$2.1 million in 2016. On a consolidated basis, income before taxes increased \$15.5 million from \$22.8 million in 2015 to \$38.3 million in 2016.

Results of Operations

Years Ended December 31, 2016 and 2015.

Our net income for 2016 was \$23.3 million, as compared to \$13.4 million for 2015. The primary sources of revenue for Banking are net interest income, fees from its deposits, trust and insurance services, gains on sales of loans, certain loan fees, and consulting fees. The primary sources of revenue for Wealth Management are asset management fees assessed on the balance of AUM. Compensation and benefit costs, which represent the largest component of noninterest expense, accounted for 57% and 76%, respectively, of the total noninterest expense for Banking and Wealth Management in 2016.

Edgar Filing: First Foundation Inc. - Form 10-K

The following tables show key operating results for each of our business segments for the years ended December 31:

(dollars in thousands)	Banking	Wealth Management	Other	Total
2016:				
Interest income	\$100,642	\$ —	\$—	\$100,642
Interest expense	11,193	—	—	11,193
Net interest income	89,449	—	—	89,449
Provision for loan losses	4,681	—	—	4,681
Noninterest income	3,585	21,348	(620)	34,560
Noninterest expense	58,422	19,232	3,340	80,994
Income (loss) before taxes on income	\$40,178	\$ 2,116	\$(3,960)	\$38,334
2015:				
Interest income	\$64,471	\$ —	\$—	\$64,471
Interest expense	5,607	—	674	6,281
Net interest income	58,864	—	(674)	58,190
Provision for loan losses	2,673	—	—	2,673
Noninterest income	8,833	20,530	(590)	28,773
Noninterest expense	39,982	18,352	3,124	61,458
Income (loss) before taxes on income	\$25,042	\$ 2,178	\$(4,388)	\$22,832

General. Our net income and income before taxes for 2016 were \$23.3 million and \$38.3 million, respectively, as compared to \$13.4 million and \$22.8 million, respectively, for 2015. The increase in income before taxes was the result of a \$15.1 million increase in income before taxes for Banking and a \$0.5 million decrease in corporate expenses. Earnings before taxes for Wealth Management for 2016 were consistent with 2015 as a \$0.8 million increase in noninterest income was offset by a commensurate increase in noninterest expenses. The increase in income before taxes in Banking was due to higher net interest income and higher noninterest income which was partially offset by a higher provision for loan losses and higher noninterest expenses. Corporate interest expense decreased by \$0.7 million due to the payoff of a term note in 2015, while corporate noninterest expenses increased by \$0.2 million.

The effective tax rate for 2016 was 39.2% as compared to 41.4% for 2015, with the benefit primarily due to the reductions in taxes on income from excess tax benefits resulting from the exercise of stock awards under ASU 2016-09.

Edgar Filing: First Foundation Inc. - Form 10-K

Net Interest Income. The following tables set forth information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yields on those assets; (ii) the total dollar amount of interest expense and the average rate of interest on our interest-bearing liabilities; (iii) net interest income; (iv) net interest rate spread; and (v) net yield on interest-earning assets for the years ended December 31:

(dollars in thousands)	2016				2015			
	Average Balances	Interest	Average Yield /Rate		Average Balances	Interest	Average Yield /Rate	
Interest-earning assets:								
Loans	\$2,263,292	\$85,080	3.76	%	\$1,450,081	\$57,481	3.96	%
Securities	525,480	12,781	2.43	%	224,906	5,227	2.32	%
FHLB stock, fed funds and deposits	64,626	2,781	4.30	%	41,356	1,763	4.26	%
Total interest-earning assets	2,853,398	100,642	3.53	%	1,716,343	64,471	3.76	%
Noninterest-earning assets:								
Nonperforming assets	7,261				2,098			
Other	33,696				24,741			
Total assets	\$2,894,355				\$1,743,182			
Interest-bearing liabilities:								
Demand deposits	\$214,120	978	0.46	%	\$293,502	1,351	0.46	%
Money market and savings	704,644	4,663	0.66	%	281,539	1,641	0.58	%
Certificates of deposit	525,685	3,275	0.62	%	339,846	1,894	0.56	%
Total interest-bearing deposits	1,444,449	8,916	0.62	%	914,887	4,886	0.53	%
Borrowings	507,025	2,277	0.45	%	369,225	1,395	0.38	%
Total interest-bearing liabilities	1,951,474	11,193	0.57	%	1,284,112	6,281	0.49	%
Noninterest-bearing liabilities:								
Demand deposits	650,956				282,822			
Other liabilities	15,809				10,865			
Total liabilities	2,618,239				1,577,799			
Stockholders' equity	276,116				165,383			
Total liabilities and equity	\$2,894,355				\$1,743,182			
Net Interest Income		\$89,449				\$58,190		
Net Interest Rate Spread			2.96	%			3.27	%
Net Yield on Interest-earning Assets			3.13	%			3.39	%

Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume) and mix of interest-earning assets and interest-bearing liabilities. The following table provides a breakdown of the changes in net interest income due to volume and rate changes between 2016 as compared to 2015.

(dollars in thousands)	Increase (Decrease) due to		Net Increase (Decrease)
	Volume	Rate	
Interest earned on:			
Loans	\$ 30,697	\$ (3,098)	\$ 27,599
Securities	7,306	248	7,554
FHLB stock, fed funds and deposits	1,004	14	1,018
Total interest-earning assets	39,007	(2,836)	36,171

Edgar Filing: First Foundation Inc. - Form 10-K

Interest paid on:			
Demand deposits	(372)	(1)	(373)
Money market and savings	2,779	243	3,022
Certificates of deposit	1,148	233	1,381
Borrowings	581	301	882
Total interest-bearing liabilities	4,136	776	4,912
Net interest income	\$ 34,871	\$ (3,612)	\$ 31,259

Net interest income increased 54% from \$58.2 million in 2015, to \$89.4 million in 2016 due to a 66% increase in interest-earning assets, which was partially offset by a decrease in our net interest rate spread. The decrease in the net interest rate spread from 3.27% for 2015 to 2.96% for 2016 was due to a decrease in yield on total interest earning assets and an increase in the cost of interest bearing liabilities. The yield on interest earning assets decreased from 3.76% to 3.53% due to an increase in the proportion of lower

yielding securities to total interest earning assets and a decrease in the yield on loans which was partially offset by a \$0.9 million increase in FHLB dividends. The decrease in yield on loans was due to payments and prepayments of higher yielding loans and the addition of loans at current market rates which are lower than the current yield on our loan portfolio. We realized \$0.7 million and \$0.3 million on the net recovery of mark to mark adjustments related to payoffs of acquired loans in 2016 and 2015, respectively. The increase in the cost of interest-bearing liabilities was due to increased costs of interest-bearing deposits and to increased costs of borrowings. The increase in the cost of deposits was the result of increases in deposit market rates and the use of promotional rates to attract deposits. The increased costs of borrowings related to higher rates on FHLB advances which were partially offset by the payoff of our higher cost term note in the third quarter of 2015. The average rate on FHLB advances increased from 0.20% in 2015 to 0.45% in 2016.

Provision for loan losses. The provision for loan losses represents our estimate of the amount necessary to be charged against the current period's earnings to maintain the ALLL at a level that we consider adequate in relation to the estimated losses inherent in the loan portfolio. The provision for loan losses is impacted by changes in loan balances as well as changes in estimated loss assumptions and charge-offs and recoveries. The amount of the provision also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions and certain other subjective factors that may affect the ability of borrowers to meet their repayment obligations to us. For 2016 and 2015, we recorded provisions for loan losses of \$4.7 million and \$2.7 million, respectively. The increase in the provision for loan losses for 2016 as compared to 2015 reflects the increase in loan balances during 2016 when compared to the increase in loan balances during 2015. We recognized \$0.1 million in recoveries in 2016 as compared to \$2.2 million in chargeoffs in 2015.

Noninterest income. Noninterest income for Banking includes fees charged to clients for trust services and deposit services, consulting fees, prepayment and late fees charged on loans and insurance commissions. The following table provides a breakdown of noninterest income for Banking for the years ended December 31:

(dollars in thousands)	2016	2015
Trust fees	\$2,798	\$2,210
Consulting fees	680	1,100
Deposit charges	444	427
Gain on sale of loans	7,812	2,935
Loss on capital market activities	(1,043)	—
Prepayment fees	1,161	1,317
Other	1,980	844
Total noninterest income	\$13,832	\$8,833

The \$5.0 million increase in noninterest income for Banking in 2016 as compared to 2015 was due to higher gains on sales of loans, gains on sales of securities realized in 2016 and increases in revenues related to our insurance agency operations which were partially offset by \$2.4 million of costs incurred to close out a swap. The gain on sale of loans includes gains realized on the sale of \$265 million of loans secured by multifamily properties to Freddie Mac who securitized the loans as part of their small balance loan program. The agreement with Freddie Mac to sell these loans provided for changes in pricing based upon changes in rates on certain treasury swap indices. In an effort to reduce the interest rate risk associated with this agreement, we entered into a swap agreement. In conjunction with the finalization of pricing under the agreement, we closed out our swap position and paid \$2.4 million, including fees, to counterparties under the swap agreement, and the pricing on the loan sale increased by \$2.2 million. We also realized a \$0.6 million gain on the sale of \$41 million of loans to another financial institution in 2016. The \$2.9 million gain on sale of loans in 2015 was primarily related to the sale of \$102 million of loans to Freddie Mac who securitized the loans as part of their small balance loan program. During 2016, during favorable market conditions, we sold securities with less desirable features and higher prepayment risk to better position our securities portfolio and realized gains on sales of securities of \$1.3 million. Included in other noninterest income for 2016 are \$1.2 million of revenues related

to our insurance agency operations, an increase of \$0.7 million from 2015, due to a premium earned on a large life insurance policy and increasing revenues from our property and casualty activities which began operations in 2015.

Noninterest income for Wealth Management includes fees charged to high net-worth clients for managing their assets and for providing financial planning consulting services. The following table provides a breakdown of noninterest income for Wealth Management for the years ended December 31:

(dollars in thousands)	2016	2015
Asset management fees	\$21,277	\$20,470
Consulting fees	88	121
Other	(17)	(61)
Total noninterest income	\$21,348	\$20,530

Edgar Filing: First Foundation Inc. - Form 10-K

The \$0.8 million increase in noninterest income in Wealth Management in 2016 as compared to 2015 was due to increases in asset management fees as a result of a 6% increase in AUM balances on which asset management fees are calculated. AUM, which totaled \$3.6 billion at December 31, 2016, increased by \$115 million during 2016 as new account growth of \$321 million and portfolio gains of \$221 million were partially offset by net withdrawals and account terminations of \$427 million.

Noninterest Expense. The following table provides a breakdown of noninterest expense for Banking and Wealth Management for the years ended December 31:

(dollars in thousands)	Banking		Wealth Management	
	2016	2015	2016	2015
Compensation and benefits	\$33,024	\$25,273	\$14,579	\$14,031
Occupancy and depreciation	9,731	7,117	2,151	1,952
Professional services and marketing	6,664	2,863	1,852	1,549
Other expenses	9,003	4,729	650	820
Total noninterest expense	\$58,422	\$39,982	\$19,232	\$18,352

The \$18.4 million increase in noninterest expense in Banking in 2016 as compared to 2015 was due primarily due primarily to increases in staffing and costs associated with the Bank's expansion, the growth of its balances of loans and deposits and costs associated with our property and casualty insurance agency operations which started during 2015. Compensation and benefits for Banking increased \$7.8 million during 2016 as compared to 2015 as the number of full time equivalent employees ("FTE") in Banking increased to 260.2 during 2016 from 191.3 during 2015, as a result of the staffing added as a result of the acquisition of PRB, increased staffing to support the growth in loans and deposits and increased staffing for our property and casualty insurance agency operations which were partially offset by increased deferred costs relating to the higher loan originations. The \$10.7 million increase in occupancy and depreciation, professional services and marketing and other expenses were related to increased costs related to the acquisition of PRB, higher legal costs related to ongoing litigation matters, costs associated with our expansion into additional corporate space and opening of new offices, and costs related to the higher levels of loans and deposits, including FDIC insurance and customer service costs.

Noninterest expense in Wealth Management increased \$0.8 million for 2016 as compared to 2015 primarily due to increased compensation costs related to the increase in FTE from 55.8 for 2015 to 58.8 for 2016.

Years Ended December 31, 2015 and 2014.

Our net income for 2015 was \$13.4 million, as compared to \$8.4 million for 2014. The primary sources of revenue for Banking are net interest income, fees from its deposits, trust and insurance services, gains on sales of loans, certain loan fees, and, beginning in the second half of 2014, fees charged for consulting and administrative services. The primary sources of revenue for Wealth Management are asset management fees assessed on the balance of AUM and, up through the first half of 2014, fees charged for consulting and administrative services. Compensation and benefit costs, which represent the largest component of noninterest expense, accounted for 63% and 76%, respectively, of the total noninterest expense for Banking and Wealth Management in 2015.

The following tables show key operating results for each of our business segments for the years ended December 31:

(dollars in thousands)	Banking	Wealth Management	Other	Total
	2015:			
Interest income	\$64,471	\$—	\$—	\$64,471
Interest expense	5,607	—	674	6,281

Edgar Filing: First Foundation Inc. - Form 10-K

Net interest income	58,864	—	(674)	58,190
Provision for loan losses	2,673	—	—	2,673
Noninterest income	8,833	20,530	(590)	28,773
Noninterest expense	39,982	18,352	3,124	61,458
Income (loss) before taxes on income	\$ 25,042	\$ 2,178	\$(4,388)	\$ 22,832
2014:				
Interest income	\$ 47,398	\$ —	\$ —	\$ 47,398
Interest expense	3,844	—	740	4,584
Net interest income	43,554	—	(740)	42,814
Provision for loan losses	235	—	—	235
Noninterest income	5,866	19,422	(539)	24,749
Noninterest expense	30,509	17,979	4,019	52,507
Income (loss) before taxes on income	\$ 18,676	\$ 1,443	\$(5,298)	\$ 14,821

Edgar Filing: First Foundation Inc. - Form 10-K

General. Income before taxes was \$22.8 million in 2015 as compared to \$14.8 million in 2014. This increase was due to increases in income before taxes for Banking and Wealth Management of \$6.4 million and \$0.7 million, respectively, and a \$0.9 million decrease in corporate interest and noninterest expenses. The \$6.4 million increase in income before taxes for Banking in 2015 as compared to 2014 was due to higher net interest income and higher noninterest income, which were partially offset by a higher provision for loan losses and higher noninterest expenses. For Wealth Management, the \$0.7 million increase was due to higher noninterest income which was partially offset by higher noninterest expenses.

The decrease in corporate interest and noninterest expenses in 2015 as compared to 2014 was primarily due to a \$0.9 million decrease in professional services and marketing expenses.

Net Interest Income: The following tables set forth information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yields on those assets; (ii) the total dollar amount of interest expense and the average rate of interest on our interest-bearing liabilities; (iii) net interest income; (iv) net interest rate spread; and (v) net yield on interest-earning assets for the year ended December 31:

(dollars in thousands)	2015			2014				
	Average Balances	Interest	Average Yield /Rate	Average Balances	Interest	Average Yield /Rate		
Interest-earning assets:								
Loans	\$1,450,081	\$57,481	3.96	% \$1,016,374	\$44,140	4.34	%	
Securities	224,906	5,227	2.32	% 105,755	2,545	2.41	%	
FHLB stock, fed funds and deposits	41,356	1,763	4.26	% 33,749	713	2.11	%	
Total interest-earning assets	1,716,343	64,471	3.76	% 1,155,878	47,398	4.10	%	
Noninterest-earning assets:								
Nonperforming assets	2,098				3,581			
Other	24,741				16,116			
Total assets	\$1,743,182				\$1,175,575			
Interest-bearing liabilities:								
Demand deposits	\$293,502	1,351	0.46	% \$245,969	1,248	0.51	%	
Money market and savings	281,539	1,641	0.58	% 148,541	841	0.57	%	
Certificates of deposit	339,846	1,894	0.56	% 262,070	1,497	0.57	%	
Total interest-bearing deposits	914,887	4,886	0.53	% 656,580	3,586	0.55	%	
Borrowings	369,225	1,395	0.38	% 192,768	998	0.52	%	
Total interest-bearing liabilities	1,284,112	6,281	0.49	% 849,348	4,584	0.54	%	
Noninterest-bearing liabilities:								
Demand deposits	282,822				226,367			
Other liabilities	10,865				8,484			
Total liabilities	1,577,799				1,084,199			
Stockholders' equity	165,383				91,376			
Total liabilities and equity	\$1,743,182				\$1,175,575			
Net Interest Income		\$58,190				\$42,814		
Net Interest Rate Spread			3.27	%			3.56	%
Net Yield on Interest-earning Assets			3.39	%			3.70	%

Edgar Filing: First Foundation Inc. - Form 10-K

Net interest income is impacted by the volume (changes in volume multiplied by prior rate), interest rate (changes in rate multiplied by prior volume) and mix of interest-earning assets and interest-bearing liabilities. The following table provides a breakdown of the changes in net interest income due to volume and rate changes between 2015 as compared to 2014.

(dollars in thousands)	Increase (Decrease) due to		Net Increase (Decrease)
	Volume	Rate	
Interest earned on:			
Loans	\$ 17,472	\$ (4,131)	\$ 13,341
Securities	2,772	(90)	2,682
FHLB stock, fed funds and deposits	191	859	1,050
Total interest-earning assets	20,435	(3,362)	17,073
Interest paid on:			
Demand deposits	224	(121)	103
Money market and savings	774	26	800
Certificates of deposit	435	(38)	397)
Borrowings	725	(328)	397
Total interest-bearing liabilities	2,158	(461)	1,697
Net interest income	\$ 18,277	\$ (2,901)	\$ 15,376

Net interest income increased 36% from \$42.8 million in 2014, to \$58.2 million in 2015 because of a 48% increase in interest-earning assets, which was partially offset by a decrease in our net interest rate spread. The decrease in the net interest rate spread from 3.56% for 2014 to 3.27% for 2015 was due to a decrease in yield on total interest earning assets which was partially offset by a decrease in rates paid on interest bearing liabilities. The yield on interest earning assets decreased from 4.10% to 3.76% due to an increase in the proportion of lower yielding securities to total interest earning assets and a decrease in the yield on loans. The decrease in yield on loans was due to prepayments of higher yielding loans and the addition of loans at current market rates which are lower than the current yield on our loan portfolio. The rate on interest bearing liabilities decreased as a result of the payoff of the higher cost term loan in August of 2015 and the impact of lower cost deposits from the acquisition of PRB in 2015. We realized \$0.3 million and \$1.3 million on the net recovery of mark to mark adjustments related to payoffs of acquired loans in 2015 and 2014, respectively.

Provision for loan losses. The provision for loan losses represents our determination of the amount necessary to be charged against the current period's earnings to maintain the ALLL at a level that is considered adequate in relation to the estimated losses inherent in the loan portfolio. The provision for loan losses is impacted by changes in loan balances as well as changes in estimated loss assumptions and charge-offs and recoveries. The amount of our provision for loan losses also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions and certain other subjective factors that may affect the ability of borrowers to meet their repayment obligations to us. The provision for loan losses was \$2.7 million for 2015 and \$0.2 million for 2014. The increase reflects the significant increase in loans and increase in loan chargeoffs, which were partially offset by a decrease in estimated loss assumptions. We recognized \$2.2 million in chargeoffs in 2015, and we did not recognize any chargeoffs in 2014.

Noninterest income: Noninterest income for Banking includes fees charged to clients for trust services and deposit services, consulting fees, prepayment and late fees charged on loans, gain on sale or REO and insurance commissions. The following table provides a breakdown of noninterest income for Banking for the years ended December 31:

(dollars in thousands)	2015	2014
------------------------	------	------

Edgar Filing: First Foundation Inc. - Form 10-K

Trust fees	\$2,210	\$2,153
Consulting fees	1,100	576
Deposit charges	427	397
Gain on sale of REO	2,935	—
Prepayment fees	—	1,038
Other	1,317	903
Total noninterest income	\$844	799
	8,833	\$5,866

The \$3.0 million increase in noninterest income for Banking in 2015 as compared to 2014 was due primarily to a \$2.7 million gain on sale of \$102 million of loans in the fourth quarter of 2015, and an increase of \$0.4 million loan prepayment fees. In June of 2014, the foundation and family consulting activities were transferred from Wealth Management to Banking and, as a result, the related revenues are now recognized under Banking.

Edgar Filing: First Foundation Inc. - Form 10-K

Noninterest income for Wealth Management includes fees charged to high net-worth clients for managing their assets and for providing financial planning consulting services. The following table provides a breakdown of noninterest income for Wealth Management for the years ended December 31:

(dollars in thousands)	2015	2014
Asset management fees	\$20,470	\$18,904
Consulting and administration fees	121	533
Other	(61)	(15)
Total noninterest income	\$20,530	\$19,422

The \$1.1 million increase in noninterest income in Wealth Management in 2015 as compared to 2014 was primarily due to increases in asset management fees of 8% which was partially offset by a decrease in consulting and administration fees. The increases in asset management fees were primarily due to a 8% increase in the AUM balances used for computing the asset management fees in 2015, as compared to AUM balances used for computing the asset management fees in 2014. In June of 2014, the foundation and family consulting activities were transferred from Wealth Management to Banking and, as a result, the related revenues are now recognized under Banking.

Noninterest Expense: The following table provides a breakdown of noninterest expense for Banking and Wealth Management for the years ended December 31:

(dollars in thousands)	Banking		Wealth Management	
	2015	2014	2015	2014
Compensation and benefits	\$25,273	\$18,694	\$14,031	\$13,760
Occupancy and depreciation	7,117	5,366	1,952	1,818
Professional services and marketing	2,863	2,420	1,549	1,645
Other expenses	4,729	4,029	820	756
Total noninterest expense	\$39,982	\$30,509	\$18,352	\$17,979

The \$9.5 million increase in noninterest expense in Banking in 2015 as compared to 2014 was due primarily to increases in staffing and costs associated with the Bank's expansion and growth of its balances of loans and deposits. Compensation and benefits for Banking increased \$6.6 million during 2015 as compared to 2014 as the number of FTE in Banking increased to 191.3 during 2015 from 144.5 during 2014, as a result of the acquisition of PRB and increased staffing to support the growth in loans and deposits. The \$2.9 million increase in occupancy and depreciation, professional services and marketing and other expenses were related to increased costs related to the acquisition of PRB and costs associated with its expansion into additional corporate space and opening of new offices. In addition, \$0.3 million of costs related to the conversion of PRB core processing systems were included in other expenses in the third quarter of 2015.

Noninterest expenses in Wealth Management increased \$0.4 million in 2015 as compared to 2014 primarily due to increases in compensation and benefits. The increase in compensation and benefits reflects increased incentive compensation incurred primarily as a result of the increase in AUM.

Financial Condition

The following table shows the financial position for each of our business segments, and of FFI and elimination entries used to arrive at our consolidated totals which are included in the column labeled Other, at December 31:

(dollars in thousands)	Banking	Wealth Management	Other and Eliminations	Total
2016:				
Cash and cash equivalents	\$597,795	\$ 2,576	\$ (2,425)	\$597,946
Securities AFS	509,578	—	—	509,578
Loans Held For Sale	250,942	—	—	250,942
Loans, net	2,540,309	—	—	2,540,309
Premises and equipment	5,603	991	136	6,730
FHLB Stock	33,750	—	—	33,750
Deferred taxes	16,602	283	(74)	16,811
REO	1,734	—	—	1,734
Goodwill and Intangibles	2,177	—	—	2,177
Other assets	13,270	445	1,711	15,426
Total assets	\$3,971,760	\$ 4,295	\$ (652)	\$3,975,403
Deposits	\$2,435,538	\$ —	\$ (8,743)	\$2,426,795
Borrowings	1,250,000	—	—	1,250,000
Intercompany balances	3,019	539	(3,558)	—
Other liabilities	11,670	2,744	(70)	14,344
Shareholders' equity	271,533	1,012	11,719	284,264
Total liabilities and equity	\$3,971,760	\$ 4,295	\$ (652)	\$3,975,403
2015:				
Cash and cash equivalents	\$215,671	\$ 5,682	\$ (5,605)	\$215,748
Securities AFS	565,135	—	—	565,135
Loans, net	1,754,883	—	—	1,754,883
Premises and equipment	1,996	545	112	2,653
FHLB Stock	21,492	—	—	21,492
Deferred taxes	14,466	630	296	15,392
REO	4,036	—	—	4,036
Goodwill and Intangibles	2,416	—	—	2,416
Other assets	8,645	314	1,865	10,824
Total assets	\$2,588,740	\$ 7,171	\$ (3,332)	\$2,592,579
Deposits	\$1,569,932	\$ —	\$ (47,756)	\$1,522,176
Borrowings	796,000	—	—	796,000
Intercompany balances	2,748	121	(2,869)	—
Other liabilities	9,309	2,634	2,724	14,667
Shareholders' equity	210,751	4,416	44,569	259,736
Total liabilities and equity	\$2,588,740	\$ 7,171	\$ (3,332)	\$2,592,579
2014:				
Cash and cash equivalents	\$29,585	\$ 3,750	\$ (3,643)	\$29,692
Securities AFS	138,270	—	—	138,270
Loans, net	1,156,021	221	—	1,156,242
Premises and equipment	1,539	548	100	2,187
FHLB Stock	12,361	—	—	12,361
Deferred taxes	9,196	601	(49)	9,748

Edgar Filing: First Foundation Inc. - Form 10-K

REO	334	—	—	334
Other assets	4,827	500	1,263	6,590
Total assets	\$1,352,133	\$ 5,620	\$ (2,329)	\$1,355,424
Deposits	\$972,319	\$ —	\$ (9,365)	\$962,954
Borrowings	263,000	—	19,886	282,886
Intercompany balances	1,287	73	(1,360)	—
Other liabilities	6,352	2,486	1,250	10,088
Shareholders' equity	109,175	3,061	(12,740)	99,496
Total liabilities and equity	\$1,352,133	\$ 5,620	\$ (2,329)	\$1,355,424

Our consolidated balance sheet is primarily affected by changes occurring in our Banking operations as our Wealth Management operations do not maintain significant levels of assets. Banking has experienced and is expected to continue to experience increases in its total assets as a result of our growth strategy.

During 2016, total assets for the Company and the Bank increased by \$1.4 billion. For the Bank, during 2016, loans, including loans held for sale, increased by \$1.0 billion, deposits increased by \$866 million, cash and cash equivalents increased by \$382 million, securities AFS decreased by \$56 million and FHLB advances increased by \$454 million. During 2015, total assets for the Company and the Bank increased by \$1.2 billion. For the Bank, during 2015, loans increased by \$599 million, deposits increased by \$598 million, cash and cash equivalents increased by \$186 million, securities AFS increased by \$427 million and FHLB advances increased by \$533 million. Borrowings at FFI decreased by \$20 million during 2015.

Cash and cash equivalents, certificates of deposit and securities: Cash and cash equivalents, which primarily consist of funds held at the Federal Reserve Bank or at correspondent banks, including fed funds, increased by \$382 million during 2016. Changes in cash and cash equivalents are primarily affected by the funding of loans, investments in securities, and changes in our sources of funding: deposits, FHLB advances and FFI borrowings.

Securities available for sale: The following table provides a summary of the Company's AFS securities portfolio at December 31:

	Amortized	Gross Unrealized	Estimated	
(dollars in thousands)	Cost	Gains	Losses	Fair Value
2016:				
US Treasury securities	\$ 300	\$—	\$(3)	\$ 297
Agency mortgage-backed securities	476,163	160	(7,414)	468,909
Beneficial interest – FHLMC securitization	42,028	711	(2,367)	40,372
Total	\$ 518,491	\$ 871	\$(9,784)	\$ 509,578
2015:				
US Treasury Securities	\$ 300	\$—	\$—	\$ 300
Agency notes	16,108	—	(95)	16,013
Agency mortgage-backed securities	538,269	909	(3,030)	536,148
Beneficial interest – FHLMC securitization	12,674	476	(476)	12,674
Total	\$ 567,351	\$ 1,385	\$(3,601)	\$ 565,135
2014:				
US Treasury Securities	\$ 300	\$—	\$—	\$ 300
Agency note	10,496	—	(219)	10,277
Agency mortgage-backed securities	125,944	1,881	(132)	127,693
Total	\$ 136,740	\$ 1,881	\$(351)	\$ 138,270

The US Treasury Securities are pledged as collateral to the State of California to meet regulatory requirements related to FFB's trust operations.

The \$56 million decrease in AFS securities was primarily the result of the sale of \$104 million of AFS securities and the collection of \$91 million in principal payments which were partially offset by the purchase of \$146 million of AFS securities. The \$427 million increase in AFS Securities in 2015 was the result of a capital leverage strategy under which the Company utilized the capital raised in its public offering to leverage an increase in its AFS securities portfolio through the use of FHLB advances. The purchases of securities under this strategy were limited to fifteen year term agency mortgage-backed securities.

Edgar Filing: First Foundation Inc. - Form 10-K

The table below indicates, as of December 31, 2016, the gross unrealized losses and fair values of our investments, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

(dollars in thousands)	Securities with Unrealized Loss at December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
US Treasury Securities	\$297	\$ (3)	\$ —	\$ —	\$297	\$ (3)
Agency mortgage backed securities	\$445,591	\$ (7,414)	\$ —	\$ —	\$445,591	\$ (7,414)
Beneficial interest – FHLMC securitization	18,636	(2,367)	—	—	18,636	(2,367)
Total temporarily impaired securities	\$464,227	\$ (9,784)	\$ —	\$ —	\$464,227	\$ (9,784)

Edgar Filing: First Foundation Inc. - Form 10-K

Unrealized losses on agency notes and agency mortgage-backed securities have not been recognized into income because the issuer bonds are of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds approach maturity.

The scheduled maturities of securities AFS, other than agency mortgage backed securities, and the related weighted average yield is as follows as of December 31, 2016:

(dollars in thousands)	Less than 1 Year	1 Through 5 years	5 Through 10 Years	After 10 Years	Total
Amortized Cost:					
US Treasury securities	\$ —	\$ 300	\$ —	\$ —	\$300
Total	\$ —	\$ 300	\$ —	\$ —	\$300
Weighted average yield	— %	0.90 %	— %	— %	0.90 %
Estimated Fair Value:					
US Treasury securities	\$ —	\$ 297	\$ —	\$ —	\$297
Total	\$ —	\$ 297	\$ —	\$ —	\$297

Agency mortgage backed securities and beneficial interests in FHLMC securitizations are excluded from the above table because such securities are not due at a single maturity date. The weighted average yield of the agency mortgage backed securities and beneficial interests in FHLMC securitizations as of December 31, 2016 was 2.58%.

Loans. The following table sets forth our loans, by loan category, as of December 31:

(dollars in thousands)	2016	2015	2014	2013	2012
Recorded investment balance:					
Loans secured by real estate:					
Residential properties:					
Multifamily	\$1,178,003	\$627,311	\$481,491	\$405,984	\$367,412
Single family	602,886	533,257	360,644	227,096	155,864
Total real estate loans secured by residential properties	1,780,889	1,160,568	842,135	633,080	523,276
Commercial properties	476,959	358,791	205,320	154,982	132,217
Land	24,100	12,320	4,309	3,794	7,575
Total real estate loans	2,281,948	1,531,679	1,051,764	791,856	663,068
Commercial and industrial loans	237,941	196,584	93,537	93,255	67,920
Consumer loans	32,127	37,206	21,125	18,484	12,585
Total loans	2,552,016	1,765,469	1,166,426	903,595	743,573
Premiums, discounts and deferred fees and expenses	3,693	14	(34)	50	54
Total	\$2,555,709	\$1,765,483	\$1,166,392	\$903,645	\$743,627

Edgar Filing: First Foundation Inc. - Form 10-K

The \$1.0 billion increase in loans, including loans held for sale, during 2016 was the result of loan originations and funding of existing credit commitments of \$1.8 billion, which were partially offset by \$430 million of payoffs and scheduled principal payments and the sale of \$306 million in loans. The \$599 million increase in loans during 2015 was the result of loan originations and funding of existing credit commitments of \$944 million and \$80 million of loans obtained in the acquisition of PRB, which were partially offset by \$324 million of payoffs and scheduled principal payments and the sale of \$102 million of loans. The scheduled maturities, as of December 31, 2016, of the performing loans categorized as land loans and as commercial and industrial loans, are as follows:

(dollars in thousands)	Scheduled Maturity Due After One Year		Loans With a Scheduled Maturity After One Year		
	Due in One Year or Less	Through Five Years	Due After Five Years	Loans With Fixed Rates	Loan With Adjustable Rates
Land loans	\$6,414	\$ 14,182	\$ 3,504	\$ 3,781	\$ 13,905
Commercial and industrial loans	\$97,873	\$ 86,957	\$ 53,410	\$ 78,650	\$ 83,313

Deposits: The following table sets forth information with respect to our deposits and the average rates paid on deposits, as of December 31:

(dollars in thousands)	2016		2015		2014	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Demand deposits:						
Noninterest-bearing	\$661,781	—	\$299,794	—	\$246,137	
Interest-bearing	194,274	0.471 %	260,167	0.359 %	291,509	0.502 %
Money market and savings	941,344	0.677 %	492,015	0.531 %	171,958	0.626 %
Certificates of deposits	629,396	0.589 %	470,200	0.554 %	253,350	0.619 %
Total	\$2,426,795	0.453 %	\$1,522,176	0.404 %	\$962,954	0.427 %

The \$905 million increase in deposits during 2016 reflects the organic growth of our Banking operations, \$179 million of deposits acquired in an acquisition of two branches in December 2016 and a \$116 million increase in brokered deposits. The \$559 million increase in deposits during 2015 reflects the organic growth of our Banking operations, \$120 million of deposits acquired in an acquisition, and a \$251 million increase in brokered deposits.

During 2016, deposit market rates, which were declining in prior years, increased. The weighted average rate of interest-bearing deposits, which decreased from 0.57% at December 31, 2014 to 0.50% at December 31, 2015, increased to 0.62% at December 31, 2016, while the weighted average interest rates of both interest-bearing and noninterest-bearing deposits, which decreased from 0.43% at December 31, 2014, to 0.40% at December 31, 2015, increased to 0.45% at December 31, 2016. As the Company continues to grow, it has offered increased rates on promotional products to attract new deposit clients.

The maturities of our certificates of deposit of \$100,000 or more were as follows as of December 31, 2016:

(dollars in thousands)	
3 months or less	\$143,496
Over 3 months through 6 months	96,116
Over 6 months through 12 months	80,829

Edgar Filing: First Foundation Inc. - Form 10-K

Over 12 months	21,842
Total	\$342,283

FFB utilizes a third party program called CDARs which allows FFB to transfer funds of its clients in excess of the FDIC insurance limit (currently \$250,000) to other institutions in exchange for an equal amount of funds from clients of these other institutions. This has allowed FFB to provide FDIC insurance coverage to its clients. Under certain regulatory guidelines, these deposits are considered brokered deposits. From time to time, the Bank will utilize brokered deposits as a source of funding. As of December 31, 2016, the Bank held \$327.0 million of deposits which are classified as brokered deposits, including \$45.1 million of CDARs reciprocal deposits.

Borrowings: At December 31, 2016, our borrowings consisted of \$1.3 billion of overnight FHLB advances at FFB. At December 31, 2015, our borrowings consisted of \$796 million of overnight FHLB advances at FFB. These overnight FHLB advances were paid in full in the early parts of January 2016 and January 2017, respectively. Because FFB utilizes overnight borrowings, the balance of outstanding borrowings fluctuates on a daily basis. The weighted average interest rate on these overnight borrowings was

Edgar Filing: First Foundation Inc. - Form 10-K

0.45% for 2016 and 0.20% for 2015. The average balance of overnight borrowings was \$507 million during 2016, as compared to \$352 million during 2015. The maximum amount of short-term FHLB advances outstanding at any month-end during 2016, and 2015, was \$1.3 million, and \$796 million, respectively.

Term Loan. In the second quarter of 2013, we entered into a secured loan agreement with a lender to borrow \$7.5 million for a term of five years. In the first quarter of 2014, we entered into an amendment to this loan agreement pursuant to which we obtained an additional \$15.0 million of borrowings. This amendment did not alter any of the terms of the loan agreement or the loan, other than to increase the principal amount and to correspondingly increase the amount of the monthly installments of principal and interest payable on the loan. In the first quarter of 2015, we entered into a second amendment to this loan agreement pursuant to which, we obtained an additional \$10.3 million of borrowings, bringing the outstanding balance of this loan to \$30.0 million as of February 28, 2015. This second amendment also reduced the interest rate on this loan to 3.75% over ninety day LIBOR from 4.00% over ninety day LIBOR, extended the maturity date of this loan to May 1, 2022 and made corresponding changes to the amount of the principal payments required to be made by us on this loan. This loan was paid off in full on August 13, 2015.

Delinquent Loans, Nonperforming Assets and Provision for Credit Losses

Loans are considered past due following the date when either interest or principal is contractually due and unpaid. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is discontinued when reasonable doubt exists as to the full, timely collection of interest or principal and, generally, when a loan becomes contractually past due for 90 days or more with respect to principal or interest. However, the accrual of interest may be continued on a well-secured loan contractually past due 90 days or more with respect to principal or interest if the loan is in the process of collection or collection of the principal and interest is deemed probable. The following tables provide a summary of past due and nonaccrual loans as of December 31:

(dollars in thousands)	Past Due and Still Accruing			Nonaccrual	Total Past Due and		Total
	30-59 Days	60-89 Days	90 Days or More		Nonaccrual	Current	
2016:							
Real estate loans:							
Residential properties	\$—	\$ —	\$ —	\$ 3,759	\$ 3,759	\$1,777,130	\$1,780,889
Commercial properties	—	—	2,128	1,120	3,248	473,711	476,959
Land	—	—	—	—	—	24,100	24,100
Commercial and industrial loans	—	2	3,800	3,359	7,161	230,780	237,941
Consumer loans	—	—	—	—	—	32,127	32,127
Total	\$—	\$ 2	\$ 5,928	\$ 8,238	\$ 14,168	\$2,537,848	\$2,552,016
Percentage of total loans	— %	0.00 %	0.23 %	0.32 %	0.56 %		
2015:							
Real estate loans:							
Residential properties	\$—	\$ —	\$ —	\$ —	\$ —	\$1,160,568	\$1,160,568
Commercial properties	1,232	—	793	1,552	3,577	355,214	358,791
Land	—	—	—	—	—	12,320	12,320
Commercial and industrial loans	2,425	1,639	5,713	2,509	12,286	184,298	196,584
Consumer loans	1,010	—	1,991	75	3,076	34,130	37,206
Total	\$4,667	\$ 1,639	\$ 8,497	\$ 4,136	\$ 18,939	\$1,746,530	\$1,765,469
Percentage of total loans	0.26 %	0.09 %	0.48 %	0.23 %	1.07 %		

Edgar Filing: First Foundation Inc. - Form 10-K

2014:

Real estate loans:

Residential properties	\$—	\$ —	\$—	\$ —	\$ —	\$842,135	\$842,135
Commercial properties	—	805	200	596	1,601	203,719	205,320
Land	—	—	651	—	651	3,658	4,309
Commercial and industrial loans	2,092	289	700	342	3,423	90,114	93,537
Consumer loans	—	—	637	163	800	20,325	21,125
Total	\$2,092	\$ 1,094	\$ 2,188	\$ 1,101	\$ 6,475	\$1,159,951	\$1,166,426
Percentage of total loans	0.18 %	0.09 %	0.19 %	0.09 %	0.56 %		

54

Edgar Filing: First Foundation Inc. - Form 10-K

The level of delinquent loans and nonaccrual loans have been adversely impacted by the loans acquired in an acquisition. As of December 31, 2016, of the \$14.2 million in loans over 90 days past due, including loans on nonaccrual, \$3.7 million, or 27% were loans acquired in an acquisition.

The following table presents the composition of troubled debt restructurings (“TDRs”) by accrual and nonaccrual status as of:

(dollars in thousands)	December 31, 2016			December 31, 2015		
	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total
Commercial and industrial	\$317	\$3,109	\$3,426	\$—	\$344	\$344

These loans were classified as a TDR as a result of a reduction in required principal payments and/or an extension of the maturity date of the loans.

The following is a breakdown of our loan portfolio by the risk category of loans at December 31:

(dollars in thousands)	Pass	Special Mention	Substandard	Impaired	Total
2016:					
Real estate loans:					
Residential properties	\$1,773,296	\$1,500	\$—	\$6,093	\$1,780,889
Commercial properties	470,484	1,913	2,414	2,148	476,959
Land	24,100	—	—	—	24,100
Commercial and industrial loans	219,676	3,625	13,887	753	237,941
Consumer loans	32,137	—	—	—	32,127
Total	\$2,519,683	\$7,038	\$16,301	\$8,994	\$2,552,016
2015:					
Real estate loans:					
Residential properties	\$1,159,029	\$1,539	\$—	\$—	\$1,160,568
Commercial properties	351,988	174	354	6,275	358,791
Land	11,180	—	1,140	—	12,320
Commercial and industrial loans	180,755	4,977	5,165	5,687	196,584
Consumer loans	37,130	—	—	76	37,206
Total	\$1,740,082	\$6,690	\$6,659	\$12,038	\$1,765,469
2014:					
Real estate loans:					
Residential properties	\$841,538	\$554	\$—	\$43	\$842,135
Commercial properties	198,112	1,266	200	5,742	205,320
Land	4,309	—	—	—	4,309
Commercial and industrial loans	81,067	5,276	1,559	5,635	93,537
Consumer loans	20,962	—	47	116	21,125
Total	\$1,145,988	\$7,096	\$1,806	\$11,536	\$1,166,426
2013:					
Real estate loans:					
Residential properties	\$630,832	\$—	\$—	\$2,248	\$633,080
Commercial properties	150,053	—	4,108	821	154,982
Land	2,314	—	1,480	—	3,794
Commercial and industrial loans	88,166	43	2,047	2,999	93,255

Edgar Filing: First Foundation Inc. - Form 10-K

Consumer loans	18,309	—	175	—	18,484
Total	\$889,674	\$ 43	\$ 7,810	\$ 6,068	\$903,595
2012:					
Real estate loans:					
Residential properties	\$519,288	\$ —	\$ 1,731	\$ 2,257	\$523,276
Commercial properties	127,803	—	4,414	—	132,217
Land	3,818	—	3,214	543	7,575
Commercial and industrial loans	62,000	889	2,295	2,736	67,920
Consumer loans	12,387	127	71	—	12,585
Total	\$725,296	\$ 1,016	\$ 11,725	\$ 5,536	\$743,573

We consider a loan to be impaired when, based upon current information and events, we believe that it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan. We measure impairment using either the present value of the expected future cash flows discounted at the loan's effective interest rate, or the fair value of the properties collateralizing the loan, for collateral dependent loans. Impairment losses are included in the allowance for loan losses through a charge to provision for loan losses. Adjustments to impairment losses due to changes in the fair value of the property collateralizing an impaired loan are considered in computing the provision for loan losses. Loans collectively reviewed for impairment include all loans except for loans which are individually reviewed based on specific criteria, such as delinquency, debt coverage, adequacy of collateral and condition of property collateralizing the loans. Impaired loans include nonaccrual loans (excluding those collectively reviewed for impairment), certain restructured loans and certain performing loans less than ninety days delinquent ("other impaired loans") which we believe are not likely to be collected in accordance with contractual terms of the loans.

In 2012 and 2015, we purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of these purchased credit impaired loans is as follows at December 31:

(dollars in thousands)	2016	2015
Outstanding principal balance:		
Loans secured by real estate:		
Commercial properties	\$295	\$533
Land	—	1,616
Total real estate loans	295	2,149
Commercial and industrial loans	4,258	6,787
Consumer loans	17	14
Total loans	4,570	8,950
Unaccreted discount on purchased credit impaired loans	(1,197)	(2,291)
Total	\$3,373	\$6,659

Edgar Filing: First Foundation Inc. - Form 10-K

Allowance for Loan Losses. The following table summarizes the activity in our ALLL for the year ended December 31:

(dollars in thousands)	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
2016:					
Real estate loans:					
Residential properties	\$ 6,799	\$ (130)	\$ —	\$ —	\$6,669
Commercial properties	1,813	1,051	(50)	169	2,983
Land and construction	103	130	—	—	233
Commercial and industrial loans	1,649	3,578	—	—	5,227
Consumer loans	236	52	—	—	288
Total	\$ 10,600	\$ 4,681	\$ (50)	\$ 169	\$ 15,400
2015:					
Real estate loans:					
Residential properties	\$ 6,546	\$ 253	\$ —	\$ —	\$6,799
Commercial properties	1,499	624	(310)	—	1,813
Land and construction	67	36	—	—	103
Commercial and industrial loans	1,897	1,665	(1,913)	—	1,649
Consumer loans	141	95	—	—	236
Total	\$ 10,150	\$ 2,673	\$ (2,223)	\$ —	\$ 10,600
2014:					
Real estate loans:					
Residential properties	\$ 6,135	\$ 411	\$ —	\$ —	\$6,546
Commercial properties	1,425	74	—	—	1,499
Land and construction	37	30	—	—	67
Commercial and industrial loans	2,149	(252)	—	—	1,897
Consumer loans	169	(28)	—	—	141
Total	\$ 9,915	\$ 235	\$ —	\$ —	\$ 10,150
2013:					
Real estate loans:					
Residential properties	\$ 4,355	\$ 1,802	\$ —	\$ —	\$6,157
Commercial properties	936	561	(57)	—	1,440
Commercial and industrial loans	2,841	71	(763)	—	2,149
Consumer loans	208	(39)	—	—	169
Total	\$ 8,340	\$ 2,395	\$ (820)	\$ —	\$ 9,915
2012:					
Real estate loans:					
Residential properties	\$ 3,984	\$ 646	\$ (275)	\$ —	\$4,355
Commercial properties	1,218	(282)	—	—	936
Commercial and industrial loans	1,104	1,737	—	—	2,841
Consumer loans	244	(36)	—	—	208
Total	\$ 6,550	\$ 2,065	\$ (275)	\$ —	\$ 8,340

Excluding the loans acquired in an Acquisition and any related allocated ALLL, our ALLL as a percentage of total loans was 0.60% and 0.61% as of December 31, 2016, and December 31, 2015, respectively.

The amount of the ALLL is adjusted periodically by charges to operations (referred to in our income statement as the “provision for loan losses”) (i) to replenish the ALLL after it has been reduced due to loan write-downs or charge-offs, (ii) to reflect increases in the volume of outstanding loans, and (iii) to take account of changes in the risk of potential

loan losses due to a deterioration in the condition of borrowers or in the value of property securing non-performing loans or adverse changes in economic conditions. The amounts of the provisions we make for loan losses are based on our estimate of losses in our loan portfolio. In estimating such losses, we use economic and loss migration models that are based on bank regulatory guidelines and industry standards, and our historical charge-off experience and loan delinquency rates, local and national economic conditions, a borrower's ability to repay its borrowings, and the value of any property collateralizing the loan, as well as a number of subjective factors. However, these determinations involve judgments about changes and trends in current economic conditions and other events that can affect the ability of borrowers to meet their loan obligations to us and a weighting among the quantitative and qualitative factors we consider in determining the sufficiency of the ALLL. Moreover, the duration and anticipated effects of prevailing economic conditions or trends can be uncertain and can be affected by a number of risks and circumstances that are outside of our control. If changes in economic or market conditions or unexpected subsequent events were to occur, or if changes were made to bank regulatory guidelines

or industry standards that are used to assess the sufficiency of the ALLL, it could become necessary for us to incur additional, and possibly significant, charges to increase the ALLL, which would have the effect of reducing our income.

In addition, the FDIC and the DBO, as an integral part of their examination processes, periodically review the adequacy of our ALLL. These agencies may require us to make additional provisions for loan losses, over and above the provisions that we have already made, the effect of which would be to reduce our income.

The following table presents the balance in the ALLL and the recorded investment in loans by impairment method at December 31:

(dollars in thousands)	Allowance for Loan Losses Evaluated for Impairment			Total	Unaccrued Credit Component Other Loans
	Individually	Collectively	Purchased Impaired		
2016:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$ —	\$ 6,669	\$ —	\$ 6,669	\$ 128
Commercial properties	—	2,983	—	2,983	136
Land	—	233	—	233	2
Commercial and industrial loans	—	5,227	—	5,227	147
Consumer loans	—	288	—	288	19
Total	\$ —	\$ 15,400	\$ —	\$ 15,400	\$ 432
Loans:					
Real estate loans:					
Residential properties	\$ 6,093	\$ 1,774,796	\$ —	\$ 1,780,889	\$ 12,373
Commercial properties	2,148	474,634	177	476,959	24,796
Land	—	24,100	—	24,100	437
Commercial and industrial loans	753	233,992	3,196	237,941	20,165
Consumer loans	—	32,127	—	32,127	1,266
Total	\$ 8,994	\$ 2,539,649	\$ 3,373	\$ 2,552,016	\$ 59,037
2015:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$ —	\$ 6,799	\$ —	\$ 6,799	\$ 127
Commercial properties	30	1,783	—	1,813	363
Land	—	103	—	103	42
Commercial and industrial loans	—	1,649	—	1,649	187
Consumer loans	—	236	—	236	13
Total	\$ 30	\$ 10,570	\$ —	\$ 10,600	\$ 732
Loans:					
Real estate loans:					
Residential properties	\$ —	\$ 1,160,568	\$ —	\$ 1,160,568	\$ 7,747
Commercial properties	6,275	352,162	354	358,791	43,287
Land	—	11,180	1,140	12,320	4,267
Commercial and industrial loans	5,687	185,732	5,165	196,584	28,231
Consumer loans	76	37,130	—	37,206	1,761
Total	\$ 12,038	\$ 1,746,772	\$ 6,659	\$ 1,765,469	\$ 85,293

Edgar Filing: First Foundation Inc. - Form 10-K

(dollars in thousands)	Allowance for Loan Losses Evaluated for Impairment			Total	Unaccrued Credit Component Other Loans
	Individually	Collectively	Purchased Impaired		
2014:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$ —	\$ 6,586	\$ —	\$6,586	\$ 26
Commercial properties	26	1,500	—	1,526	193
Land	—	—	—	—	4
Commercial and industrial loans	686	1,211	—	1,897	45
Consumer loans	—	141	—	141	—
Total	\$ 712	\$ 9,438	\$ —	\$10,150	\$ 268
Loans:					
Real estate loans:					
Residential properties	\$ 43	\$ 842,092	\$ —	\$842,135	\$ 2,861
Commercial properties	5,742	199,378	200	205,320	21,126
Land	—	4,309	—	4,309	1,099
Commercial and industrial loans	5,635	86,343	1,559	93,537	5,893
Consumer loans	116	20,962	47	21,125	8
Total	\$ 11,536	\$ 1,153,084	\$ 1,806	\$1,166,426	\$ 30,987
2013:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$ —	\$ 6,157	\$ —	\$6,157	\$ 36
Commercial properties	190	1,250	—	1,440	290
Land	—	—	—	—	26
Commercial and industrial loans	925	1,224	—	2,149	126
Consumer loans	—	169	—	169	11
Total	\$ 1,115	\$ 8,800	\$ —	\$9,915	\$ 489
Loans:					
Real estate loans:					
Residential properties	\$ 2,248	\$ 630,832	\$ —	\$633,080	\$ 3,449
Commercial properties	821	150,053	4,108	154,982	23,968
Land	—	2,314	1,480	3,794	1,939
Commercial and industrial loans	2,999	88,209	2,047	93,255	10,354
Consumer loans	—	18,441	43	18,484	160
Total	\$ 6,068	\$ 889,849	\$ 7,678	\$903,595	\$ 39,870
2012:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$ —	\$ 4,355	\$ —	\$4,355	\$ 62
Commercial properties	—	936	—	936	617
Land	—	—	—	—	129
Commercial and industrial loans	1,536	1,305	—	2,841	302
Consumer loans	—	208	—	208	19
Total	\$ 1,536	\$ 6,804	\$ —	\$8,340	\$ 1,129
Loans:					
Real estate loans:					
Residential properties	\$ 2,257	\$ 519,288	\$ 1,731	\$523,276	\$ 5,121
Commercial properties	—	128,035	4,182	132,217	39,862

Edgar Filing: First Foundation Inc. - Form 10-K

Commercial and industrial loans	543	3,818	3,214	7,575	4,521
Consumer loans	2,736	62,989	2,195	67,920	16,512
Total	\$—	12,514	71	12,585	324
	5,536	\$ 726,644	\$ 11,393	\$ 743,573	\$ 66,340

The column labeled “Unaccreted Credit Component Other Loans” represents the amount of unaccreted credit component discount for the other loans acquired in the DCB and PRB acquisitions, and the stated principal balance of the related loans. The discount is equal to 0.73% and 0.86% of the stated principal balance of these loans as of December 31, 2016 and 2015, respectively. In addition to this unaccreted credit component discount, an additional \$0.5 million and \$0.3 million of the ALLL were provided for these loans as of December 31, 2016 and 2015, respectively.

Liquidity

Liquidity management focuses on our ability to generate, on a timely and cost-effective basis, cash sufficient to meet the funding needs of current loan demand, deposit withdrawals, principal and interest payments with respect to outstanding borrowings and to pay operating expenses. Our liquidity management is both a daily and long-term function of funds management. Liquid assets are generally invested in marketable securities or held as cash at the FRB or other financial institutions.

We monitor our liquidity in accordance with guidelines established by our Board of Directors and applicable regulatory requirements. Our need for liquidity is affected by our loan activity, net changes in deposit levels and the maturities of our borrowings. The principal sources of our liquidity consist of deposits, loan interest and principal payments and prepayments, investment management and consulting fees, FHLB advances and proceeds from borrowings and sales of shares by FFI. The remaining balances of the Company’s lines of credit available to draw down totaled \$172 million at December 31, 2016.

Cash Flows Provided by Operating Activities. During the year ended December 31, 2016 operating activities provided net cash of \$19.8 million, comprised primarily of our net income of \$23.3 million. During the year ended December 31, 2015 operating activities provided net cash of \$13.9 million, comprised primarily of our net income of \$13.4 million.

Cash Flows Used in Investing Activities. During the year ended December 31, 2016, investing activities used net cash of \$1.0 billion, primarily to fund a \$1.3 billion net increase in loans and a \$55.6 million net increase in securities AFS, offset partially by \$311.7 million in proceeds from loan sales and \$104.1 million in proceeds from securities sales. During the year ended December 31, 2015, investing activities used net cash of \$916.5 million, primarily to fund a \$626.2 million net increase in loans and a \$426.9 million net increase in securities AFS, offset partially by \$106.2 million in proceeds from loan sales and \$38.1 million of cash in from the acquisition of PRB.

Cash Flow Provided by Financing Activities. During the year ended December 31, 2016, financing activities provided net cash of \$1.4 billion, consisting primarily of a net increase of \$904.6 million in deposits and a net increase of \$454 million in borrowings. During the year ended December 31, 2015, financing activities provided net cash of \$1.1 billion, consisting primarily of a net increase of \$439.4 million in deposits and a net increase of \$533.0 million in borrowings, and \$136.2 million proceeds from the sale of stock.

Ratio of Loans to Deposits. The relationship between gross loans and total deposits can provide a useful measure of a bank’s liquidity. Since repayment of loans tends to be less predictable than the maturity of investments and other liquid resources, the higher the loan-to-deposit ratio the less liquid are our assets. On the other hand, since we realize greater yields on loans than we do on other interest-earning assets, a lower loan-to-deposit ratio can adversely affect interest income and earnings. As a result, our goal is to achieve a loan-to-deposit ratio that appropriately balances the requirements of liquidity and the need to generate a fair return on our assets. At December 31, 2016 and December 31, 2015, the loan-to-deposit ratios at FFB were 115.7%, and 116.0%, respectively.

Contractual Obligations

The following table summarizes the indicated contractual obligations of the Company as of the December 31, 2016:

(dollars in thousands)	Payments Due by Period				
	Total	Less Than			More Than
		1 Year	1 – 3 Years	3 – 5 Years	5 Years
FHLB Advances	\$1,250,000	\$1,250,000	\$—	\$—	\$—
Operating lease obligations	25,393	4,638	8,751	7,861	4,143
Total	\$1,275,393	\$1,254,638	\$8,751	\$7,861	\$4,143

Off-Balance Sheet Arrangements

The following table provides the off-balance sheet arrangements of the Company as of December 31, 2016:

(dollars in thousands)	
Commitments to fund new loans	\$43,006
Commitments to fund under existing loans, lines of credit	211,745
Commitments under standby letters of credit	4,830

Some of the commitments to fund existing loans, lines of credit and letters of credit are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. As of December 31, 2016, FFB was obligated on \$129.0 million of letters of credit to the FHLB which were being used as collateral for public fund deposits, including \$111.0 million of deposits from the State of California.

Asset and Liability Management: Interest Rate Risk

Interest rate risk is inherent in financial services businesses. Management of interest-earning assets and interest-bearing liabilities in terms of rate and maturity has an important effect on our liquidity and net interest margin. Interest rate risk results from interest-earning assets and interest-bearing liabilities maturing or repricing at different times, on a different basis or in unequal amounts. The Board of Directors of FFB approves policies and limits governing the management of interest rate risk. The asset / liability committee formed by these policies is responsible for monitoring our interest rate risk and providing periodic reports to the Board of Directors regarding our compliance with these policies and limits. We have established three primary measurement processes to quantify and manage our interest rate risk. These include: (i) gap analysis which measures the repricing mismatches of asset and liability cash flows; (ii) net interest income simulations which are used to measure the impact of instantaneous changes in interest rates on net interest income over a 12 month forecast period; and (iii) economic value of equity calculations which measure the sensitivity of our economic value of equity to simultaneous changes in interest rates.

Gap Analysis. Under this analysis, rate sensitivity is measured by the extent to which our interest-earning assets and interest-bearing liabilities reprice or mature at different times. Rate sensitivity gaps in which the repricing of interest-earning assets exceed the repricing of interest-bearing liabilities tend to produce an expanded net yield on interest-earning assets in rising interest rate environments and a reduced net yield on interest-earning assets in declining interest rate environments. Conversely, when the repricing of interest-bearing liabilities exceed the repricing of interest-earning assets, the net yield on interest-earning assets generally declines in rising interest rate environments and increases in declining interest rate environments. The following table sets forth the interest-earning assets and interest-bearing liabilities on the basis of when they reprice or mature as of December 31, 2016:

(dollars in thousands)	Less than 1 year	From 1 to 3 Years	From 3 to 5 Years	Over 5 Years	Total
Interest-earnings assets:					
Cash equivalents	\$586,331	\$—	\$—	\$—	\$586,331
Securities, FHLB stock	105,471	121,205	95,969	229,786	552,431
Loans	389,441	473,157	949,195	984,081	2,795,874
Interest-bearing liabilities:					
Deposits:					
Interest-bearing checking	(194,274)	—	—	—	(194,274)
Money market and savings	(941,344)	—	—	—	(941,344)
Certificates of deposit	(599,033)	(27,422)	(2,846)	(95)	(629,396)
Borrowings	(1,250,000)	—	—	—	(1,250,000)
Net: Current Period	\$(1,903,408)	\$566,940	\$1,042,318	\$1,213,772	\$919,622
Net: Cumulative	\$(1,903,408)	\$(1,336,468)	\$(294,150)	\$919,622	

The cumulative positive total of \$919.6 million reflects the funding provided by noninterest-bearing deposits and equity. Because we had a \$1.9 billion net negative position at December 31, 2016 for the repricing period of less than one year, the result of this analysis indicate that we would be adversely impacted by a short term increase in interest rates and would benefit from a short term decrease in interest rates.

However, the extent to which our net interest margin will be impacted by changes in prevailing interest rates will depend on a number of factors, including how quickly interest-earning assets and interest-bearing liabilities react to interest rate changes. It is not uncommon for rates on certain assets or liabilities to lag behind changes in the market rates of interest. Additionally, prepayments of loans and early withdrawals of certificates of deposit could cause interest sensitivities to vary. As a result, the relationship or “gap” between interest-earning assets and interest-bearing liabilities, as shown in the above table, is only a general indicator of interest rate sensitivity and the effect of changing rates of interest on our net interest income is likely to be different from that predicted solely on the basis of the interest rate sensitivity analysis set forth in the above table.

Net Interest Income Simulations (“NII”). Under this analysis, we use a simulation model to measure and evaluate potential changes in our net interest income resulting from changes in interest rates. This model measures the impact of instantaneous shocks of 100, 200, 300 and 400 basis points on our net interest income over a 12 month forecast period. The computed changes to our net interest income between hypothetical rising and declining rate scenarios for the twelve month period beginning December 31, 2016 are as follows:

Assumed Instantaneous Change in Interest Rates	Estimated Increase (Decrease) in Net Interest Income	%
+ 100 basis points	(11.1)	%

Edgar Filing: First Foundation Inc. - Form 10-K

+ 200 basis points	(21.2)	%
+ 300 basis points	(32.5)	%
+ 400 basis points	(42.9)	%
- 100 basis points	(2.3)	%
- 200 basis points	(3.4)	%

We did not include scenarios below the minus 200 basis point scenario because we believe those scenarios are not meaningful based on current interest rate levels. The NII results indicate that we would be adversely impacted by a short term increase in interest rates and would benefit from a short term decrease in interest rates. The results of the NII are hypothetical, and a variety of factors might cause actual results to differ substantially from what is depicted. These could include, but are not limited to, non-parallel yield curve shifts, changes in market interest rate spreads and the actual reaction to changes in interest rate levels of interest-earning assets and interest-bearing liabilities. It is not uncommon for rates on certain assets or liabilities to lag behind changes in the market

rates of interest. Additionally, prepayments of loans and early withdrawals of certificates of deposit could cause interest sensitivities to vary.

Economic Value of Equity Calculations (“EVE”). The EVE measures the sensitivity of our market value equity to simultaneous changes in interest rates. EVE is derived by subtracting the economic value of FFB’s liabilities from the economic value of its assets, assuming current and hypothetical interest rate environments. EVE is based on all of the future cash flows expected to be generated by the FFB’s current balance sheet, discounted to derive the economic value of FFB’s assets & liabilities. These cash flows may change depending on the assumed interest rate environment and the resulting changes in other assumptions, such as prepayment speeds. The computed changes to our economic value of equity between hypothetical rising and declining rate scenarios as of December 31, 2016 are as follows:

Assumed Simultaneous Change in Interest Rates	Estimated Increase (Decrease) in Economic Value of Equity	
+ 100 basis points	5.5	%
+ 200 basis points	(5.5)	%
+ 300 basis points	(7.4)	%
+ 400 basis points	(10.1)	%
- 100 basis points	(5.1)	%
- 200 basis points	(16.2)	%

We did not include scenarios below the minus 200 basis point scenario because we believe those scenarios are not meaningful based on current interest rate levels. The EVE results indicate that we would be adversely impacted by a short term increase in interest rates and a short term decrease in interest rates. This differs from the NII results because, in the current interest rate environment, assumed interest rate floors for loans eliminates the benefit normally derived for loans in a declining interest rate environment. The results of the EVE are hypothetical, and a variety of factors might cause actual results to differ substantially from what is depicted. These could include, but are not limited to, non-parallel yield curve shifts, changes in market interest rate spreads and the actual reaction to changes in interest rate levels of interest-earning assets and interest-bearing liabilities. It is not uncommon for rates on certain assets or liabilities to lag behind changes in the market rates of interest. Additionally, prepayments of loans and early withdrawals of certificates of deposit could cause interest sensitivities to vary.

The results of these analyses and simulations do not contemplate all of the actions that we may undertake in response to changes in interest rates. In response to actual or anticipated changes in interest rates, we have various alternatives for managing and reducing FFB’s exposure to interest rate risk, such as entering into hedges and obtaining long-term fixed rate FHLB advances.

Capital Resources and Dividends

Under federal banking regulations that apply to all United States based bank holding companies and federally insured banks, the Company (on a consolidated basis) and FFB (on a stand-alone basis) must meet specific capital adequacy requirements that, for the most part, involve quantitative measures, primarily in terms of the ratios of their capital to their assets, liabilities, and certain off-balance sheet items, calculated under regulatory accounting practices. Under those regulations, which are based primarily on those quantitative measures, each bank holding company must meet a minimum capital ratio and each federally insured bank is determined by its primary federal bank regulatory agency to come within one of the following capital adequacy categories on the basis of its capital ratios: (i) well capitalized; (ii) adequately capitalized; (iii) undercapitalized; (iv) significantly undercapitalized; or (v) critically undercapitalized.

Certain qualitative assessments also are made by a banking institution's primary federal regulatory agency that could lead the agency to determine that the banking institution should be assigned to a lower capital category than the one indicated by the quantitative measures used to assess the institution's capital adequacy. At each successive lower capital category, a banking institution is subject to greater operating restrictions and increased regulatory supervision by its federal bank regulatory agency.

Edgar Filing: First Foundation Inc. - Form 10-K

The following table sets forth the capital and capital ratios of FFI (on a consolidated basis) and FFB as of the respective dates indicated below, as compared to the respective regulatory requirements applicable to them:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
FFI						
December 31, 2016						
CET1 capital ratio	\$285,754	12.80 %	\$ 100,432	4.50 %		
Tier 1 leverage ratio	285,754	8.76 %	130,525	4.00 %		
Tier 1 risk-based capital ratio	285,754	12.80 %	133,910	6.00 %		
Total risk-based capital ratio	301,664	13.52 %	178,547	8.00 %		
December 31, 2015						
Tier 1 leverage ratio	\$256,007	17.44 %	\$ 66,072	4.50 %		
Tier 1 risk-based capital ratio	256,007	11.81 %	86,736	4.00 %		
Total risk-based capital ratio	256,007	17.44 %	88,096	6.00 %		
Total risk-based capital ratio	267,027	18.19 %	117,461	8.00 %		
December 31, 2014						
Tier 1 leverage ratio	\$95,582	7.32 %	\$ 52,200	4.00 %		
Tier 1 risk-based capital ratio	95,582	11.02 %	34,700	4.00 %		
Total risk-based capital ratio	106,132	12.23 %	69,399	8.00 %		
FFB						
December 31, 2016						
CET1 capital ratio	\$272,221	12.23 %	\$ 100,166	4.50 %	\$ 144,685	6.50 %
Tier 1 leverage ratio	272,221	8.36 %	130,305	4.00 %	162,881	5.00 %
Tier 1 risk-based capital ratio	272,221	12.23 %	133,555	6.00 %	178,074	8.00 %
Total risk-based capital ratio	288,131	12.94 %	178,074	8.00 %	222,592	10.00 %
December 31, 2015						
Tier 1 leverage ratio	\$206,341	14.10 %	\$ 65,872	4.50 %	\$ 95,148	6.50 %
Tier 1 risk-based capital ratio	206,341	9.54 %	86,543	4.00 %	108,179	5.00 %
Total risk-based capital ratio	206,341	14.10 %	87,829	6.00 %	117,106	8.00 %
Total risk-based capital ratio	217,361	14.85 %	117,106	8.00 %	146,382	10.00 %
December 31, 2014						
Tier 1 leverage ratio	\$105,261	8.09 %	\$ 52,036	4.00 %	\$ 65,045	5.00 %
Tier 1 risk-based capital ratio	105,261	12.18 %	34,572	4.00 %	51,858	6.00 %
Total risk-based capital ratio	115,811	13.40 %	69,144	8.00 %	86,430	10.00 %

As of each of the dates set forth in the above table, the Company (on a consolidated basis) exceeded the minimum required capital ratios applicable to it and FFB (on a stand-alone basis) qualified as a well-capitalized depository institution under the capital adequacy guidelines described above.

As of December 31, 2016, the amount of capital at FFB in excess of amounts required to be Well Capitalized was \$127.5 million for the CET1 capital ratio, \$109.3 million for the Tier 1 Leverage Ratio, \$94.1 million for the Tier 1 risk-based capital ratio and \$65.5 million for the Total risk-based capital ratio.

During the years ended December 31, 2016 and 2015, FFI made capital contributions to FFB of \$40.0 million and \$76.5 million, respectively. As of December 31, 2016, FFI had \$11.9 million of available capital and, therefore, has the ability and financial resources to contribute additional capital to FFB, if needed.

In July, 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. The new rules became effective on January 1, 2015, with certain of the requirements phased-in over a multi-year schedule, and fully phased in by January 1, 2019. The rules include a new common equity Tier 1 ("CET1") capital to risk-weighted assets ratio with minimums for capital adequacy and prompt corrective action purposes of 4.5% and 6.5%, respectively. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules. For additional information regarding these New Capital Rules, see Item 1 "Business —Supervision and Regulation—First Foundation Bank —New Basel III Capital Rules" in Part I above.

We did not pay dividends in 2016 or 2015 and we have no plans to pay dividends at least for the foreseeable future. Instead, it is our intention to retain internally generated cash flow to support our growth. Moreover, the payment of dividends is subject to certain regulatory restrictions, which are discussed in Item 1 “Business—Supervision and Regulation—Dividends” in Part I above.

We had no material commitments for capital expenditures as of December 31, 2016. However, we intend to take advantage of opportunities that may arise in the future to grow our businesses, including by opening additional wealth management offices or acquiring complementary businesses that we believe will provide us with attractive risk-adjusted returns, although we do not have any immediate plans, arrangements or understandings relating to any material acquisition. As a result, we may seek to obtain additional borrowings and to sell additional shares of our common stock to raise funds which we might need for these purposes. There is no assurance, however, that, if required, we will succeed in obtaining additional borrowings or selling additional shares of our common stock on terms that are acceptable to us, if at all, as this will depend on market conditions and other factors outside of our control, as well as our future results of operations. See Item 1A – “Risk Factors” in Part I above for information regarding the impact that future sales of our common stock may have on the share ownership of our existing stockholders.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures regarding market risk in the Company’s portfolio, please see Item 7 “Management’s Discussion and Analysis—Asset and Liability Management: Interest Rate Risk” in Part II above.

Item 8. Financial Statements and Supplementary Data
FIRST FOUNDATION INC

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

<u>Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements</u>	67
<u>Consolidated Balance Sheets: December 31, 2016 and December 31, 2015</u>	68
<u>Consolidated Income Statements: Years Ended December 31, 2016, December 31, 2015, and December 31, 2014</u>	69
<u>Consolidated Statements of Comprehensive Income: Years Ended December 31, 2016, December 31, 2015, and December 31, 2014</u>	70
<u>Consolidated Statements of Changes in Shareholders' Equity: Years Ended December 31, 2016, December 31, 2015, and December 31, 2014</u>	71
<u>Consolidated Statements of Cash Flows: Years Ended December 31, 2016, December 31, 2015, and December 31, 2014</u>	72
<u>Notes to the Consolidated Financial Statements</u>	73

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

First Foundation Inc. and Subsidiaries

Irvine, California

We have audited the accompanying consolidated balance sheets of First Foundation Inc. and Subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements are the responsibility of First Foundation, Inc. and Subsidiaries' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Foundation Inc. and Subsidiaries as of December 31, 2016 and 2015 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First Foundation Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2017, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for stock-based compensation in the consolidated financial statements referred to above due to the adoption of

Accounting Standards Update (ASU) No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.

Laguna Hills, California

March 15, 2017

FIRST FOUNDATION INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	December 31,	
	2016	2015
ASSETS		
Cash and cash equivalents	\$597,946	\$215,748
Securities available-for-sale ("AFS")	509,578	565,135
Loans held for sale	250,942	—
Loans, net of deferred fees	2,555,709	1,765,483
Allowance for loan and lease losses ("ALLL")	(15,400)	(10,600)
Net loans	2,540,309	1,754,883
Premises and equipment, net	6,730	2,653
Investment in FHLB stock	33,750	21,492
Deferred taxes	16,811	15,392
Real estate owned ("REO")	1,734	4,036
Goodwill and intangibles	2,177	2,416
Other assets	15,426	10,824
Total Assets	\$3,975,403	\$2,592,579
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	\$2,426,795	\$1,522,176
Borrowings	1,250,000	796,000
Accounts payable and other liabilities	14,344	14,667
Total Liabilities	3,691,139	2,332,843
Commitments and contingencies	—	—
Shareholders' Equity		
Common Stock, par value \$.001: 70,000,000 shares authorized; 32,719,632 and 31,961,052 shares issued and outstanding at December 31, 2016 and December 31, 2015, respectively	16	16
Additional paid-in-capital	232,428	227,262
Retained earnings	57,065	33,762
Accumulated other comprehensive (loss), net of tax	(5,245)	(1,304)
Total Shareholders' Equity	284,264	259,736
Total Liabilities and Shareholders' Equity	\$3,975,403	\$2,592,579

(See accompanying notes to the consolidated financial statements)

FIRST FOUNDATION INC.

CONSOLIDATED INCOME STATEMENTS

(In thousands, except share and per share amounts)

	For the Year Ended December 31,		
	2016	2015	2014
Interest income:			
Loans	\$85,080	\$57,481	\$44,140
Securities	12,781	5,227	2,545
FHLB stock, fed funds sold and interest-bearing deposits	2,781	1,763	713
Total interest income	100,642	64,471	47,398
Interest expense:			
Deposits	8,916	4,886	3,586
Borrowings	2,277	1,395	998
Total interest expense	11,193	6,281	4,584
Net interest income	89,449	58,190	42,814
Provision for loan losses	4,681	2,673	235
Net interest income after provision for loan losses	84,768	55,517	42,579
Noninterest income:			
Asset management, consulting and other fees	24,384	23,486	21,798
Gain on sale of loans	7,812	2,935	—
Gain (loss) on capital market activities	(1,043)	—	—
Other income	3,407	2,352	2,951
Total noninterest income	34,560	28,773	24,749
Noninterest expense:			
Compensation and benefits	48,574	40,456	33,550
Occupancy and depreciation	11,978	9,260	7,325
Professional services and marketing costs	9,825	5,490	5,995
Other expenses	10,617	6,252	5,637
Total noninterest expense	80,994	61,458	52,507
Income before taxes on income	38,334	22,832	14,821
Taxes on income	15,031	9,454	6,427
Net income	\$23,303	\$13,378	\$8,394
Net income per share:			
Basic	\$0.72	\$0.60	\$0.54
Diluted	\$0.70	\$0.58	\$0.51
Shares used in computation:			
Basic	32,365,800	22,310,014	15,474,072
Diluted	33,471,816	23,151,710	16,332,686

(See accompanying notes to the consolidated financial statements)

FIRST FOUNDATION INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	For the Year Ended December 31,		
	2016	2015	2014
Net income	\$ 23,303	\$ 13,378	\$ 8,394
Other comprehensive income (loss):			
Unrealized holding gains (losses) on securities arising during the period	(6,697)	(3,746)	4,198
Other comprehensive income (loss) before tax	(6,697)	(3,746)	4,198
Income tax (expense) benefit related to items of other comprehensive income	2,122	1,542	(1,728)
Other comprehensive income (loss)	(4,575)	(2,204)	2,470
Less: Reclassification adjustment for gains (loss) included in net earnings	1,043	—	—
Income tax (expense) benefit related to reclassification adjustment	(409)	—	—
Reclassification adjustment for gains included in net earnings, net of tax	634	—	—
Other comprehensive income (loss), net of tax	(3,941)	(2,204)	2,470
Total comprehensive income	\$ 19,362	\$ 11,174	\$ 10,864

(See accompanying notes to the consolidated financial statements)

FIRST FOUNDATION INC.

CONSOLIDATED STATEMENTS OF CHANGES

IN SHAREHOLDERS' EQUITY

(In thousands, except share amounts)

	Common Stock		Additional Paid-in- Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Number of Shares	Amount					
Balance: December 31, 2013	15,467,028	\$ 8	\$ 76,334	\$ 11,990	\$ (1,570)		\$ 86,762
Net income	—	—	—	8,394	—		8,394
Other comprehensive income	—	—	—	—	2,470		2,470
Issuance of restricted stock	6,444	—	—	—	—		—
Issuance of common stock:							
Exercise of options	169,732	—	949	—	—		949
Payout of contingent consideration	47,160	—	354	—	—		354
Stock-based compensation	—	—	451	—	—		451
Tax windfall from exercise of stock options	—	—	116	—	—		116
Balance: December 31, 2014	15,690,364	8	78,204	20,384	900		99,496
Net income	—	—	—	13,378	—		13,378
Other comprehensive loss	—	—	—	—	(2,204)		(2,204)
Stock-based compensation	—	—	613	—	—		613
Issuance of common stock:							
Exercise of options	62,614	—	405	—	—		405
Stock grants – vesting of RSUs	21,524	—	—	—	—		—
Payout of contingent consideration	62,128	—	452	—	—		452
Sale of stock	544,070	—	5,000	—	—		5,000
Stock issued in acquisition	1,242,690	1	11,805	—	—		11,806
Public offering	14,337,662	7	130,751	—	—		130,758
Tax windfall from exercise of stock options	—	—	32	—	—		32
Balance: December 31, 2015	31,961,052	16	227,262	33,762	(1,304)		259,736
Net income	—	—	—	23,303	—		23,303
Other comprehensive loss	—	—	—	—	(3,941)		(3,941)
Stock based compensation	—	—	899	—	—		899
Issuance of common stock:							
Exercise of options	690,592	—	4,267	—	—		4,267
Issuance of restricted stock	67,988	—	—	—	—		—
Balance: December 31, 2016	32,719,632	\$ 16	\$ 232,428	\$ 57,065	\$ (5,245)		\$ 284,264

(See accompanying notes to the consolidated financial statements)

71

FIRST FOUNDATION INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the Year Ended December 31,		
	2016	2015	2014
Cash Flows from Operating Activities:			
Net income	\$23,303	\$13,378	\$8,394
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	4,681	2,673	235
Depreciation and amortization	1,858	1,350	1,231
Stock-based compensation expense	899	613	451
Deferred tax expense (benefit)	1,337	(1,866)	576
Amortization of (discounts) premiums on purchased loans - net	(1,200)	(612)	(2,310)
Gain on sale of REO	—	—	(1,038)
Gain on sale of loans	(7,812)	(2,935)	—
Gain on sale of securities	(1,307)	—	—
Increase in other assets	(1,666)	(3,473)	(1,244)
Increase in accounts payable and other liabilities	(323)	4,741	3,060
Net cash provided by operating activities	19,770	13,869	9,355
Cash Flows from Investing Activities:			
Net increase in loans	(1,348,286)	(626,245)	(262,271)
Proceeds from sale of loans	311,709	106,251	—
Purchases of AFS securities	(145,614)	(446,652)	(83,527)
Proceeds from sale of securities	104,146	—	—
Maturities of AFS securities	91,128	22,826	8,388
Proceeds from sale of REO	4,652	—	4,198
Purchase of note on REO property	—	—	(1,285)
Cash in from merger	—	38,081	—
Sale (purchase) of FHLB stock, net	(12,258)	(8,979)	(5,640)
Purchase of premises and equipment	(5,935)	(1,753)	(169)
Net cash used in investing activities	(1,000,458)	(916,471)	(340,306)
Cash Flows from Financing Activities:			
Increase in deposits	904,619	439,381	160,917
Net increase in FHLB advances	454,000	533,000	129,000
Term note - borrowings	—	10,114	15,000
Term note - payments	—	(30,000)	(2,177)
Proceeds from the sale of stock, net	4,267	136,163	949
Net cash provided by financing activities	1,362,886	1,088,658	303,689
Increase (decrease) in cash and cash equivalents	382,198	186,056	(27,262)
Cash and cash equivalents at beginning of year	215,748	29,692	56,954
Cash and cash equivalents at end of year	\$597,946	\$215,748	\$29,692
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	\$10,695	\$6,082	\$4,585
Income taxes	\$17,156	\$10,050	\$5,394

Edgar Filing: First Foundation Inc. - Form 10-K

Noncash transactions:

Transfer of loans to loans held for sale	\$519,721	\$102,026	\$—
Chargeoffs (recoveries) against allowance for loans losses	\$(119) \$2,223	\$—
Transfer from loans to REO	\$2,350	\$—	\$1,834

(See accompanying notes to the consolidated financial statements)

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2016, 2015, and 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

First Foundation Inc. (“FFI”) is a financial services holding company whose operations are conducted through its wholly owned subsidiaries: First Foundation Advisors (“FFA”) and First Foundation Bank (“FFB” or the “Bank”) and the wholly owned subsidiaries of FFB, First Foundation Insurance Services (“FFIS”) and Blue Moon Management, LLC (collectively the “Company”). FFI also has two inactive wholly owned subsidiaries, First Foundation Consulting (“FFC”) and First Foundation Advisors, LLC (“FFA LLC”). In addition, FFA has set up a limited liability company, which is not included in these consolidated financial statements, as a private investment fund to provide an investment vehicle for its clients. The corporate headquarters for all of the companies is located in Irvine, California. The Company has offices in California, Nevada, and Hawaii.

On October 28, 2015, FFI changed its state of incorporation from California to Delaware. Other than the change in corporate domicile, the reincorporation did not result in any change in the business, physical location, management, assets, liabilities or total shareholders’ equity of the Company, nor did it result in any change in location of the Company’s employees, including the Company’s management. Additionally, the reincorporation did not alter any shareholder’s percentage ownership interest or number of shares owned in the Company.

FFA, established in 1985 and incorporated in the State of California, began operating in 1990 as a fee-based registered investment advisor. FFA provides (i) investment management and financial planning services for high net-worth individuals, retirement plans, charitable institutions and private foundations; (ii) financial, investment and economic advisory and related services to high net-worth individuals and their families, family-owned businesses, and other related organizations; and (iii) support services involving the processing and transmission of financial and economic data for charitable organizations. At the end of 2016, these services were provided to approximately 1,400 clients, primarily located in Southern California, with an aggregate of \$3.6 billion of assets under management.

The Bank commenced operations in 2007 and currently operates in California, Nevada, and in Hawaii. The Bank offers a wide range of deposit instruments including personal and business checking and savings accounts, including interest-bearing negotiable order of withdrawal (“NOW”) accounts, money market accounts, and time certificates of deposit (“CD”) accounts. As a lender, the Bank originates, and retains for its portfolio, loans secured by real estate and commercial loans. Over 90% of the Bank’s loans are to clients located in California. The Bank also offers a wide range of specialized services including trust services, on-line banking, remote deposit capture, merchant credit card services, ATM cards, Visa debit cards, business sweep accounts, and through FFIS, insurance brokerage services. The Bank has a state non-member bank charter and it is subject to continued examination by the California Department of Business Oversight and the Federal Deposit Insurance Corporation (“FDIC”).

At December 31, 2016, the Company employed 335 employees.

Basis of Presentation

The consolidated financial statements have been prepared in conformity with U. S. generally accepted accounting standards and prevailing practices within the banking industry. In preparing the consolidated financial statements,

management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses during the reporting periods and related disclosures. Actual results could differ significantly from those estimates.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

Variable Interest Entities

The Company may have variable interests in Variable Interest Entities (“VIEs”) arising from debt, equity or other monetary interests in an entity, which change with fluctuations in the fair value of the entity's assets. VIEs are entities that, by design, either (1) lack sufficient equity to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) have equity investors that do not have the ability to make significant decisions relating to the entity's operations through voting rights, or do not have the obligation to absorb the expected losses, or do not have the right to receive the residual returns of the entity.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The primary beneficiary of a VIE (i.e., the party that has a controlling financial interest) is required to consolidate the assets and liabilities of the VIE. The primary beneficiary is the party that has both (1) the power to direct the activities of an entity that most significantly impact the VIE's economic performance and (2) through its interests in the VIE, the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The Company has sold loans through securitizations sponsored by a government sponsored entity, Freddie Mac, who also provided credit enhancement of the loans through certain guarantee provisions. The Company retained the right to provide servicing for the loans except for special servicing for which an unrelated third party was engaged by the VIE. In addition the Company acquired the "B" piece of the securitizations, which is structured to absorb any losses from the securitizations, and interest only strips from the securitization. Because the Company does not act as the special servicer for the VIE and because of the power of Freddie Mac over the VIE that holds the assets from the mortgage loan securitizations, the Company is not the primary beneficiary of the VIE and therefore the VIE is not consolidated.

Reclassifications

Certain amounts in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, due from banks, certificates of deposits with maturities of less than ninety days, investment securities with original maturities of less than ninety days, money market mutual funds and federal funds sold. At times, the Bank maintains cash at major financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with major well-capitalized financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal. The Bank maintains most of its excess cash at the Federal Reserve Bank, with well-capitalized correspondent banks or with other depository institutions at amounts less than the FDIC insured limits. At December 31, 2016, included in cash and cash equivalents were \$585.5 million in funds held at the Federal Reserve Bank.

Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank was in compliance with its reserve requirements as of December 31, 2016.

Certificates of Deposit

From time to time, the Company may invest funds with other financial institutions through certificates of deposit. Certificates of deposit with maturities of less than ninety days are included as cash and cash equivalents. Certificates of deposit are carried at cost.

Investment Securities

Investment securities for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method.

Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method. Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are considered other-than-temporary impairment ("OTTI") result in write-downs of the individual securities to their fair value. The credit component of any OTTI related write-downs is charged against earnings.

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

impairment is split into two components as follows; OTTI related to credit loss, which must be recognized in the income statement and; OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

In order to determine OTTI for purchased beneficial interests that, on the purchase date, were not highly rated, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

Loan Origination Fees and Costs

Net loan origination fees and direct costs associated with lending are deferred and amortized to interest income as an adjustment to yield over the respective lives of the loans using the interest method. The amortization of deferred fees and costs is discontinued on loans that are placed on nonaccrual status. When a loan is paid off, any unamortized net loan origination fees are recognized in interest income.

Loans Held for Investment

Loans held for investment are reported at the principal amount outstanding, net of cumulative chargeoffs, interest applied to principal (for loans accounted for using the cost recovery method), unamortized net deferred loan origination fees and costs and unamortized premiums or discounts on purchased loans. Interest on loans is accrued and recognized as interest income at the contractual rate of interest. When a loan is designated as held for investment, the intent is to hold these loans for the foreseeable future or until maturity or payoff. If subsequent changes occur, the Company may change its intent to hold these loans. Once a determination has been made to sell such loans, they are immediately transferred to loans held for sale and carried at the lower of cost or fair value.

Loans Held for Sale

Loans designated for sale through securitization or in the secondary market are classified as loans held for sale. Loans held for sale are accounted for at the lower of amortized cost or fair value. The fair value of loans held for sale is generally based on observable market prices from other loans in the secondary market that have similar collateral, credit, and interest rate characteristics. If quoted market prices are not readily available, the Company may consider other observable market data such as dealer quotes for similar loans or forward sale commitments. In certain cases, the fair value may be based on a discounted cash flow model. Related gains and losses are recognized in net gain on mortgage loan origination and sale activities. Direct loan origination costs and fees for loans classified as held for sale are deferred at origination and recognized in earnings at the time of sale.

Nonaccrual Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment. All payments received on nonaccrual loans are accounted for using the cost recovery method. Under the cost recovery method, all cash

collected is applied to first reduce the principal balance. A loan may be returned to accrual status if all delinquent principal and interest payments are brought current and the collectability of the remaining principal and interest payments in accordance with the loan agreement is reasonably assured. Loans that are well secured and in the collection process may be maintained on accrual status, even if they are 90 days or more past due.

Purchased Credit Impaired Loans

The Company may purchase individual loans and groups of loans which have shown evidence of credit deterioration and are considered credit impaired. Purchased credit impaired loans are recorded at the amount paid and there is no carryover of the seller's allowance for loan losses.

Purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as, credit score, loan type, and date of origination. The Company estimates the amount and timing of expected cash flows for each loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded by an increase in the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Provisions for loan losses are charged to operations based on management's evaluation of the estimated losses in its loan portfolio. The major factors considered in evaluating losses are historical charge-off experience, delinquency rates, local and national economic conditions, the borrower's ability to repay the loan and timing of repayments, and the value of any related collateral. Management's estimate of fair value of the collateral considers current and anticipated future real estate market conditions, thereby causing these estimates to be particularly susceptible to changes that could result in a material adjustment to results of operations in the future. Recovery of the carrying value of such loans and related real estate is dependent, to a great extent, on economic, operating and other conditions that may be beyond the Bank's control.

The Bank's primary regulatory agencies periodically review the allowance for loan losses and such agencies may require the Bank to recognize additions to the allowance based on information and factors available to them at the time of their examinations. Accordingly, no assurance can be given that the Bank will not recognize additional provisions for loan losses with respect to its loan portfolio.

The allowance consists of specific and general reserves. Specific reserves relate to loans that are individually classified as impaired. Loan losses are charged against the allowance when management believes a loan balance is uncollectible. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The Bank considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Bank bases the measurement of loan impairment using either the present value of the expected future cash flows discounted at the loan's effective interest rate, or the fair value of the loan's collateral properties. Impairment losses are included in the allowance for loan losses through a charge to provision for loan losses. Adjustments to impairment losses due to changes in the fair value of impaired loans' collateral properties are included in the provision for loan losses. The Bank's impaired loans include nonaccrual loans (excluding those collectively reviewed for impairment), certain restructured loans and certain performing loans less than ninety days delinquent ("other impaired loans") that the Bank believes will likely not be collected in accordance with contractual terms of the loans. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are generally considered troubled debt restructurings and classified as impaired.

Commercial loans and loans secured by multifamily and commercial real estate are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present

value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Because the Bank has not experienced any meaningful amount of losses in any of its current portfolio segments, the Bank calculates the historical loss rates on industry data, specifically loss rates published by the FDIC. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions, changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Bank include loans secured by residential real estate, including multifamily and single family properties, loans secured by commercial real estate, loans secured by vacant land and construction loans, commercial and industrial loans and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and debt-to income, collateral type and loan-to-value ratios for consumer loans.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Real Estate Owned

REO represents the collateral acquired through foreclosure in full or partial satisfaction of the related loan. REO is recorded at the fair value less estimated selling costs at the date of foreclosure. Any write-down at the date of transfer is charged to the allowance for loan losses. The recognition of gains or losses on sales of REO is dependent upon various factors relating to the nature of the property being sold and the terms of sale. REO values are reviewed on an ongoing basis and any decline in value is recognized as foreclosed asset expense in the current period, as are the net operating results from these assets.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization, which is charged to expense on a straight-line basis over the estimated useful lives of 3 to 10 years. Premises under leasehold improvements are amortized on a straight-line basis over the term of the lease or the estimated useful life of the improvements, whichever is shorter. Expenditures for major renewals and betterments of premises and equipment are capitalized and those for maintenance and repairs are charged to expense as incurred. A valuation allowance is established for any impaired long-lived assets. The Company did not have impaired long-lived assets as of December 31, 2016 or 2015.

Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (“FHLB”), the Bank is required to purchase FHLB stock in accordance with its advances, securities and deposit agreement. This stock, which is carried at cost, may be redeemed at par value. However, there are substantial restrictions regarding redemption and the Bank can only receive a full redemption in connection with the Bank surrendering its FHLB membership. At December 31, 2016, the Bank held \$33.8 million of FHLB stock. The Company does not believe that this stock is currently impaired and no adjustments to its carrying value have been recorded.

Mortgage Servicing Rights

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income, which is reported on the income statement as other income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Goodwill

Goodwill is recorded upon completion of a business combination as the difference between the purchase price and the fair value of net identifiable assets acquired. Subsequent to initial recognition, the Company will test goodwill for impairment on an annual basis by comparing the fair value of the reporting unit to its carrying amount. The goodwill recorded by the Company was recognized from the acquisition of Pacific Rim Bank in June of 2015, and was not considered impaired at December 31, 2016.

Other Intangible Assets

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Other intangible assets consist of core deposit intangible assets arising from whole bank acquisitions and are amortized on an accelerated method over their estimated useful lives, which range from 7 to 10 years. At December 31, 2016 and 2015, core deposit intangible assets totaled \$0.9 million and \$1.1 million, respectively, and we recognized \$0.2 million, \$0.2 million and \$0.1 million in core deposit intangible amortization expense in 2016, 2015 and 2014, respectively.

Revenue Recognition

Interest on Loans: Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is discontinued when reasonable doubt exists as to the full, timely collection of interest or principal and, generally, when a loan becomes contractually past due for ninety days or more with respect to principal or interest. The accrual of interest may be continued on a well-secured loan contractually past due ninety days or more with respect to principal or interest if the loan is in the process of collection or collection of the principal and interest is deemed probable.

When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period income. Interest on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Accrual of interest is resumed on loans only when, in the judgment of management, the loan is estimated to be fully collectible. The Bank continues to accrue interest on restructured loans since full payment of principal and interest is expected and such loans are performing or are less than ninety days delinquent and, therefore, do not meet the criteria for nonaccrual status. Restructured loans that have been placed on nonaccrual

status are returned to accrual status when the remaining loan balance, net of any charge-offs related to the restructure, is estimated to be fully collectible by management and performing in accordance with the applicable loan terms.

Other Fees: Asset management fees are billed on a monthly or quarterly basis based on the amount of assets under management and the applicable contractual fee percentage. Asset management fees are recognized as revenue in the period in which they are billed and earned. Financial planning fees are due and billed at the completion of the planning project and are recognized as revenue at that time.

Stock-Based Compensation

The Company recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period in which an employee is required to provide services in exchange for the award, generally the vesting period. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for stock awards.

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, Compensation - Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting. The new standard

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The changes in the new standard eliminate the accounting for excess tax benefits to be recognized in additional paid-in capital and tax deficiencies recognized either in the income tax provision or in additional paid-in capital. The Company elected early adoption of ASU 2016-09 in the third quarter of 2016 which was applied using a modified retrospective approach. For 2016, we recognized all excess tax benefits and tax deficiencies that occurred in 2016 as income tax expense or benefit as a discrete event. An income tax benefit of approximately \$1.0 million was recognized in 2016 as a result of the adoption of ASU 2016-09. There was no change to retained earnings with respect to excess tax benefits, as this is not applicable to the Company. In addition there was no cumulative effect on retained earnings as a result of the election by the Company to adopt an accounting policy to account for forfeitures as they occur. With the early adoption of 2016-09, we have elected to present the cash flow statement on a prospective transition method and no prior periods have been adjusted. ASU 2016-09 requires the recognition of any tax benefits or deficiencies to be recognized in the period in which they occur. As a result of the adoption of ASU 2016-09, our effective tax rate for 2016 was decreased by approximately 270 basis points.

Marketing Costs

The Company expenses marketing costs, including advertising, in the period incurred.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is established if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized.

The tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Changes in unrealized gains and losses on available-for-sale securities and the related tax costs or benefits are the only components of other comprehensive income for the Company.

Stock Split

On January 18, 2017, the Company completed a two-for-one stock split in the form of a stock dividend. Each stockholder of record at the close of business of January 4, 2017 received one additional share of common stock for every share held. All share and per share amounts included in the financial statements have been adjusted to reflect the effect of this stock split.

Earnings Per Share (“EPS”)

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and restricted stock, which are determined using the treasury stock method.

Fair Value Measurement

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

New Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-15 “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” which provides guidance for eight specific cash flow issues. FASB issued the standard to clarify areas where GAAP has been either unclear or lacking in specific guidance. This update is effective for the Company for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The adoption of ASU No. 2016-15 is not expected to have a material impact on the Company’s Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13 “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” which introduces new guidance for the accounting for credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. The new model, referred to as the current expected credit losses (CECL) model, will apply to financial assets subject to credit losses and measured at amortized cost, and certain off-balance sheet credit exposures. Upon initial recognition of the exposure, the CECL model requires an entity to estimate the credit losses expected over the life of an exposure. This update is effective for the Company for annual periods beginning after December 15, 2019, and interim periods within those annual periods. The Company has begun analyzing the data requirements needed to implement the adoption of ASU 2016-13 and we expect that the adoption of ASU 2016-13 may have a significant impact on the Company recording of its allowance for loan losses. The impact of the implementation of ASU 2016-13 is undeterminable at this time.

On February 25, 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-02, Leases (Topic 842). The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. The amendments in this Update are effective for interim and annual periods beginning after December 15, 2018. We expect the adoption of ASU 2016-02 to impact the Company’s accounting for its building leases at each of its locations and the Company is evaluating the effects of the adoption of ASU 2016-02 on its financial statements and disclosures.

On January 5, 2016, the FASB issued ASU 2016-01, Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU No. 2016-16 is not expected to have a material impact on the Company’s Consolidated Financial Statements.

In September, 2015, the FASB issued ASU 2016-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2016, including interim periods within those fiscal periods. The adoption of ASU No. 2016-16 is not expected to have a material impact on the Company's Consolidated Financial Statements.

NOTE 2: ACQUISITIONS

On June 16, 2015, the Company completed the acquisition of Pacific Rim Bank ("PRB"), through a merger of PRB with and into the Bank, in exchange for 1,242,690 shares of its common stock with a fair value of \$9.50 per share and \$543,000 in cash, which was paid to dissenting shareholders. The primary reason for acquiring PRB was to expand our operations into Hawaii.

The acquisition of PRB was accounted for under the purchase method of accounting. The acquired assets, assumed liabilities and identifiable intangible assets are recorded at their respective acquisition date fair values. Goodwill of \$1.3 million, which is not tax deductible, is included in intangible assets in the table below.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The following table represents the assets acquired and liabilities assumed of PRB as of June 15, 2015 and the fair value adjustments and amounts recorded by the Bank in 2016 under the acquisition method of accounting:

(dollars in thousands)	PRB Book Fair Value		Fair Value
	Value	Adjustments	
Assets Acquired:			
Cash and cash equivalents	\$38,624	\$ —	\$38,624
Securities AFS	7,179	115	7,294
Loans, net of deferred fees	80,192	(2,419)	77,773
Allowance for loan losses	(2,034)	2,034	—
Premises and equipment, net	251	(188)	63
Investment in FHLB stock	152	—	152
Deferred taxes	—	2,258	2,258
REO	4,374	(672)	3,702
Goodwill	—	1,300	1,300
Core deposit intangible	—	1,099	1,099
Other assets	269	—	269
Total assets acquired	\$129,007	\$ 3,527	\$132,534
Liabilities Assumed:			
Deposits	\$119,663	\$ 178	\$119,841
Accounts payable and other liabilities	442	(98)	344
Total liabilities assumed	120,105	80	120,185
Excess of assets acquired over liabilities assumed	8,902	3,447	12,349
Total	\$129,007	\$ 3,527	\$132,534
Consideration:			
Stock issued			\$11,806
Cash paid			543
Total			\$12,349

In many cases, the fair values of assets acquired and liabilities assumed were determined by estimating the cash flows expected to result from those assets and liabilities and discounting them at appropriate market rates. The most significant category of assets for which this procedure was used was that of acquired loans. The excess of expected cash flows above the fair value of the majority of loans will be accreted to interest income over the remaining lives of the loans in accordance with FASB Accounting Standards Codification (“ASC”) 310-20.

Certain loans, for which specific credit-related deterioration since origination was identified, are recorded at fair value reflecting the present value of the amounts expected to be collected. Income recognition on these “purchased credit impaired” loans is based on a reasonable expectation about the timing and amount of cash flows to be collected.

Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on nonaccrual status and have no accretable yield. All purchased credit impaired loans were classified as accruing loans as of and subsequent to the acquisition date.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

For loans acquired from PRB, the contractual amounts due, expected cash flows to be collected and fair value as of the acquisition date were as follows:

(dollars in thousands)	Purchased Credit Impaired	All Other Acquired Loans
Contractual amounts due	\$ 9,418	\$ 86,466
Cash flows not expected to be collected	2,201	1,155
Expected cash flows	7,217	85,311
Interest component of expected cash flows	805	13,950
Fair value of acquired loans	\$ 6,412	\$ 71,361

In accordance with generally accepted accounting principles there was no carryover of the allowance for loan losses that had been previously recorded by PRB.

The Company recorded a deferred income tax asset of \$2.3 million related to PRB's operating loss carry-forward and other tax attributes of PRB, along with the effects of fair value adjustments resulting from applying the purchase method of accounting.

The fair value of savings and transaction deposit accounts acquired from PRB were assumed to approximate their carrying value as these accounts have no stated maturity and are payable on demand. Certificates of deposit accounts were valued by comparing the contractual cost of the portfolio to an identical portfolio bearing current market rates. The portfolio was segregated into pools based on remaining maturity. For each pool, the projected cash flows from maturing certificates were then calculated based on contractual rates and prevailing market rates. The valuation adjustment for each pool is equal to the present value of the difference of these two cash flows, discounted at the assumed market rate for a certificate with a corresponding maturity. This valuation adjustment will be accreted to reduce interest expense over the remaining maturities of the respective pools. The Company also recorded a core deposit intangible, which represents the value of the deposit relationships acquired from PRB, of \$1.1 million. The core deposit intangible will be amortized over a period of 7 years.

Pro Forma Information (unaudited)

The following table presents unaudited pro forma information as if the acquisition of PRB had occurred on January 1, 2015, and January 1, 2014, for 2015 and 2014, respectively, after giving effect to certain adjustments. The unaudited pro forma information for these periods includes adjustments for interest income on loans acquired, amortization of intangibles arising from the transaction, adjustments for interest expense on deposits acquired, and the related income

Edgar Filing: First Foundation Inc. - Form 10-K

tax effects of all these items and the income tax benefits derived from PRB's loss before taxes. The net effect of these pro forma adjustments were increases of \$0.3 million and \$0.5 million in net income for 2015 and 2014, respectively. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transaction been effected on the assumed dates.

	2015	2014
(dollars in thousands)		
Net interest income	\$59,918	\$46,935
Provision for loan losses	2,673	235
Noninterest income	28,891	25,156
Noninterest expenses	64,167	57,577
Income before taxes	21,969	14,279
Taxes on income	9,097	6,192
Net income	\$12,872	\$8,087
Net income per share:		
Basic	\$0.55	\$0.49
Diluted	\$0.53	\$0.46

The revenues (net interest income and noninterest income) and income before taxes for the period from June 16, 2015 to December 31, 2015 related to the operations acquired from PRB and included in the results of operations for 2015 was approximately \$2.5 million and \$0.8 million, respectively.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

NOTE 3: FAIR VALUE

Assets Measured at Fair Value on a Recurring Basis

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

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect the Company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following tables show the recorded amounts of assets and liabilities measured at fair value on a recurring basis as of:

	Total	Fair Value Measurement Level		
		Level 1	Level 2	Level 3
(dollars in thousands)				
December 31, 2016:				
Investment securities available for sale				
US Treasury securities	\$297	\$297	\$—	\$—
Agency mortgage-backed securities	468,909	—	468,909	—

Edgar Filing: First Foundation Inc. - Form 10-K

Beneficial interest – FHLMC securitization	40,372	—	—	40,372
Total assets at fair value on a recurring basis	\$509,578	\$297	\$468,909	\$40,372
December 31, 2015:				
Investment securities available for sale				
US Treasury securities	\$300	\$300	\$—	\$—
FNMA and FHLB Agency notes	16,013	—	16,013	—
Agency mortgage-backed securities	536,148	—	536,148	—
Beneficial interest – FHLMC securitization	12,674	—	—	12,674
Total assets at fair value on a recurring basis	\$565,135	\$300	\$552,161	\$12,674

The increase in level 3 assets from December 31, 2015 was due to Beneficial interest – FHLMC securitization purchases. The Company did not have any material assets measured at fair value on a nonrecurring basis as of December 31, 2016 and December 31, 2015.

Fair Value of Financial Instruments

We have elected to use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale are measured at fair value on a recurring basis. Additionally, from time to time, we may be required to measure at fair value other assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair value estimates are made at a discrete point in time based on relevant market information and other information about the financial instruments. Because no active market exists for a significant portion of our financial instruments, fair value estimates are based in large part on judgments we make primarily regarding current economic conditions, risk characteristics of various financial

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

instruments, prepayment rates, and future expected loss experience. These estimates are subjective in nature and invariably involve some inherent uncertainties. Additionally, unexpected changes in events or circumstances can occur that could require us to make changes to our assumptions and which, in turn, could significantly affect and require us to make changes to our previous estimates of fair value.

In addition, the fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of existing and anticipated future customer relationships and the value of assets and liabilities that are not considered financial instruments, such as premises and equipment and other real estate owned.

The following methods and assumptions were used to estimate the fair value of financial instruments.

Cash and Cash Equivalents. The fair value of cash and cash equivalents approximates its carrying value.

Interest-Bearing Deposits with Financial Institutions. The fair values of interest-bearing deposits maturing within ninety days approximate their carrying values.

Investment Securities Available for Sale. Investment securities available-for-sale are measured at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. When a market is illiquid or there is a lack of transparency around the inputs to valuation, the securities are classified as Level 3 and reliance is placed upon internally developed models, and management judgment and evaluation for valuation. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as level 3 include beneficial interests – FHLMC securitization. Significant assumptions in the valuation of these Level 3 securities as of December 31, 2016 included a prepayment rate of 15% and discount rates ranging from 4.0% to 10%.

Federal Home Loan Bank Stock. The Bank is a member of the Federal Home Loan Bank (the "FHLB"). As a member, we are required to own stock of the FHLB, the amount of which is based primarily on the level of our borrowings from this institution. The fair value of the stock is equal to the carrying amount, is classified as restricted securities and is periodically evaluated for impairment based on our assessment of the ultimate recoverability of our investments in that stock. Any cash or stock dividends paid to us on such stock are reported as income.

Loans, other than impaired loans. The fair value for loans with variable interest rates is the carrying amount. The fair value of fixed rate loans is derived by calculating the discounted value of future cash flows expected to be received by the various homogeneous categories of loans. All loans have been adjusted to reflect changes in credit risk.

Deposits. The fair value of demand deposits, savings deposits, and money market deposits is defined as the amounts payable on demand. The fair value of fixed maturity certificates of deposit is estimated based on the discounted value of the future cash flows expected to be paid on the deposits.

Borrowings. The fair value of borrowings is the carrying value of overnight FHLB advances that approximate fair value because of the short-term maturity of this instrument, resulting in a Level 2 classification. The fair value of term borrowings is derived by calculating the discounted value of future cash flows expected to be paid out by the Company.

Assets Measured at Fair Value on a Nonrecurring Basis

Impaired Loans. ASC 820-10 applies to loans measured for impairment in accordance with ASC 310-10, “Accounting by Creditors for Impairment of a Loan”, at the fair value of the loan’s collateral (if the loan is collateral dependent) less estimated selling costs. When the fair value of the collateral is based on an observable market price or a current appraised value, we measure the impaired loan at nonrecurring Level 2. When an appraised value is not available, or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price or a discounted cash flow has been used to determine the fair value, we measure the impaired loan at nonrecurring Level 3. The total collateral dependent impaired Level

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

3 loans were \$9.0 million and \$12.0 million at December 31, 2016 and December 31, 2015, respectively. There were no specific reserves related to these loans at December 31, 2016 and December 31, 2015.

Real Estate Owned. The fair value of real estate owned is based on external appraised values that include adjustments for estimated selling costs and assumptions of market conditions that are not directly observable, resulting in a Level 3 classification. As of December 31, 2016 and 2015, the fair value of real estate owned was \$1.7 million and \$4.0 million, respectively.

The following table sets forth the estimated fair values and related carrying amounts of our financial instruments as of:

(dollars in thousands)	Carrying Value	Fair Value Measurement Level			Total
		1	2	3	
December 31, 2016:					
Assets:					
Cash and cash equivalents	\$597,946	\$597,946	\$—	\$—	\$597,946
Securities AFS	509,578	297	468,909	40,372	509,578
Loans, net	2,540,309	—	—	2,529,360	2,529,360
Loans held for sale	250,942	—	—	253,953	253,953
Investment in FHLB stock	33,750	—	33,750	—	33,750
Liabilities:					
Deposits	2,426,795	1,797,329	629,594	—	2,426,923
Borrowings	1,250,000	—	1,250,000	—	1,250,000
December 31, 2015:					
Assets:					
Cash and cash equivalents	\$215,748	\$215,748	\$—	\$—	\$215,748
Securities AFS	565,135	300	552,161	12,674	565,135
Loans	1,754,883	—	—	1,779,941	1,779,941
Investment in FHLB stock	21,492	—	21,492	—	21,492
Liabilities:					
Deposits	1,522,176	1,051,976	470,128	—	1,522,104
Borrowings	796,000	—	796,000	—	796,000

NOTE 4: SECURITIES

The following table provides a summary of the Company's AFS securities portfolio at December 31:

Edgar Filing: First Foundation Inc. - Form 10-K

(dollars in thousands)	Amortized Cost	Gross Gains	Unrealized Losses	Estimated Fair Value
2016:				
US Treasury securities	\$300	\$—	\$(3)	\$297
Agency mortgage-backed securities	476,163	160	(7,414)	468,909
Beneficial interest – FHLMC securitization	42,028	711	(2,367)	40,372
Total	\$518,491	\$871	\$(9,784)	\$509,578
2015:				
US Treasury securities	\$300	\$—	\$—	\$300
Agency notes	16,108	—	(95)	16,013
Agency mortgage-backed securities	538,269	909	(3,030)	536,148
Beneficial interest – FHLMC securitization	12,674	476	(476)	12,674
Total	\$567,351	\$1,385	\$(3,601)	\$565,135

The US Treasury Securities are pledged as collateral to the State of California to meet regulatory requirements related to the Bank's trust operations.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The table below indicates, as of December 31, 2016, the gross unrealized losses and fair values of our investments, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

(dollars in thousands)	Securities with Unrealized Loss at December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
US Treasury securities	297	(3)	—	—	297	(3)
Agency mortgage backed securities	445,591	(7,414)	—	—	445,591	(7,414)
Beneficial interest – FHLMC securitization	18,636	(2,367)	—	—	18,636	(2,367)
Total temporarily impaired securities	\$464,524	\$ (9,784)	\$ —	\$ —	\$464,524	\$ (9,784)

Unrealized losses on US Treasury securities, agency notes and agency mortgage-backed securities have not been recognized into income because the issuer bonds are of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds approach maturity.

The scheduled maturities of securities AFS, other than agency mortgage backed securities, and the related weighted average yield is as follows as of December 31, 2016:

(dollars in thousands)	Less than 1 Year	1 Through 5 years	5 Through 10 Years	After 10 Years	Total
Amortized Cost:					
US Treasury securities	\$ —	\$ 300	\$ —	\$ —	\$ 300
Weighted average yield	— %	0.90 %	— %	— %	0.90 %
Estimated Fair Value:					
US Treasury securities	\$ —	\$ 297	\$ —	\$ —	\$ 297
Total	\$ —	\$ 297	\$ —	\$ —	\$ 297

Agency mortgage backed securities and beneficial interests in FHLMC securitizations are excluded from the above table because such securities are not due at a single maturity date. The weighted average yield of the agency mortgage backed securities and beneficial interests in FHLMC securitizations as of December 31, 2016 was 2.58%.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

NOTE 5: LOANS

The following is a summary of our loans as of December 31:

(dollars in thousands)	2016	2015
Recorded investment balance:		
Loans secured by real estate:		
Residential properties:		
Multifamily	\$1,178,003	\$627,311
Single family	602,886	533,257
Total real estate loans secured by residential properties	1,780,889	1,160,568
Commercial properties	476,959	358,791
Land	24,100	12,320
Total real estate loans	2,281,948	1,531,679
Commercial and industrial loans	237,941	196,584
Consumer loans	32,127	37,206
Total loans	2,552,016	1,765,469
Deferred expenses, net	3,693	14
Total	\$2,555,709	\$1,765,483

As of December 31, 2016 and 2015, the principal balances shown above are net of unaccreted discount related to loans acquired in an acquisition of \$1.6 million and \$2.8 million, respectively.

In 2012 and 2015, the Company purchased loans, for which there was, at acquisition, evidence of deterioration in credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of these purchased credit impaired loans is as follows at December 31:

(dollars in thousands)	2016	2015
Outstanding principal balance:		
Loans secured by real estate:		
Commercial properties	\$295	\$533
Land	—	1,616
Total real estate loans	295	2,149
Commercial and industrial loans	4,258	6,787
Consumer loans	17	14
Total loans	4,570	8,950
Unaccreted discount on purchased credit impaired loans	(1,198)	(2,291)
Total	\$3,373	\$6,659

Accrutable yield, or income expected to be collected on purchased credit impaired loans, is as follows at December 31:

(dollars in thousands)	2016	2015
Beginning balance	\$582	\$130
Accretion of income	(185)	(529)
Reclassifications from nonaccretable difference	—	176
Acquisitions	—	805
Disposals	(108)	—
Ending balance	\$289	\$582

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The following table summarizes our delinquent and nonaccrual loans as of December 31:

(dollars in thousands)	Past Due and Still Accruing			Nonaccrual	Total Past Due and Nonaccrual	Current	Total
	30-59 Days	60-89 Days	90 Days or More				
2016:							
Real estate loans:							
Residential properties	\$—	\$—	\$—	\$ 3,759	\$ 3,759	\$1,777,130	\$1,780,889
Commercial properties	—	—	2,128	1,120	3,248	473,711	476,959
Land	—	—	—	—	—	24,100	24,100
Commercial and industrial loans	—	2	3,800	3,359	7,161	230,780	237,941
Consumer loans	—	—	—	—	—	32,127	32,127
Total	\$—	\$ 2	\$5,928	\$ 8,238	\$ 14,168	\$2,537,848	\$2,552,016
Percentage of total loans	— %	0.00 %	0.23 %	0.32 %	0.56 %		
2015:							
Real estate loans:							
Residential properties	\$—	\$—	\$—	\$—	\$—	\$1,160,568	\$1,160,568
Commercial properties	1,232	—	793	1,552	3,577	355,214	358,791
Land	—	—	—	—	—	12,320	12,320
Commercial and industrial loans	2,425	1,639	5,713	2,509	12,286	184,298	196,584
Consumer loans	1,010	—	1,991	75	3,076	34,130	37,206
Total	\$4,667	\$ 1,639	\$ 8,497	\$ 4,136	\$ 18,939	\$1,746,530	\$1,765,469
Percentage of total loans	0.26 %	0.09 %	0.48 %	0.23 %	1.07 %		

The level of delinquent loans and nonaccrual loans have been adversely impacted by the loans acquired in an acquisition. As of December 31, 2016, of the \$14.2 million in loans over 90 days past due, including loans on nonaccrual, \$3.8 million, or 27% were loans acquired in an acquisition.

As of December 31, 2016, the Company had five loans with a balance of \$3.1 million classified as troubled debt restructurings (“TDR”) which are included as nonaccrual in the table above. All five loans were classified as a TDR as a result of a reduction in required principal payments and an extension of the maturity date of the loans. As of December 31, 2015, the Company had two loans with a balance of \$0.3 million classified as troubled debt restructurings (“TDR”) which are included as nonaccrual in the table above. These loans have been paying in accordance with the terms of their restructure.

The following table presents the composition of TDRs by accrual and nonaccrual status as of:

December 31, 2016

December 31, 2015

Edgar Filing: First Foundation Inc. - Form 10-K

(dollars in thousands)	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total
Commercial and industrial	\$317	\$3,109	\$3,426	\$—	\$ 344	\$344

These loans were classified as a TDR as a result of a reduction in required principal payments and/or an extension of the maturity date of the loans.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

NOTE 6: ALLOWANCE FOR LOAN LOSSES

The following is a rollforward of the Bank's allowance for loan losses for the years ended December 31:

(dollars in thousands)	Beginning Balance	Provision for Loan Losses	Charge-offs	Recoveries	Ending Balance
2016:					
Real estate loans:					
Residential properties	\$ 6,799	\$ (130)	\$ —	\$ —	\$6,669
Commercial properties	1,813	1,051	(50)	169	2,983
Land and construction	103	130	—	—	233
Commercial and industrial loans	1,649	3,578	—	—	5,227
Consumer loans	236	52	—	—	288
Total	\$ 10,600	\$ 4,681	\$ (50)	\$ 169	\$15,400
2015:					
Real estate loans:					
Residential properties	\$ 6,546	\$ 253	\$ —	\$ —	\$6,799
Commercial properties	1,499	624	(310)	—	1,813
Land and construction	67	36	—	—	103
Commercial and industrial loans	1,897	1,665	(1,913)	—	1,649
Consumer loans	141	95	—	—	236
Total	\$ 10,150	\$ 2,673	\$ (2,223)	\$ —	\$10,600
2014:					
Real estate loans:					
Residential properties	\$ 6,135	\$ 411	\$ —	\$ —	\$6,546
Commercial properties	1,425	74	—	—	1,499
Land and construction	37	30	—	—	67
Commercial and industrial loans	2,149	(252)	—	—	1,897
Consumer loans	169	(28)	—	—	141
Total	\$ 9,915	\$ 235	\$ —	\$ —	\$10,150

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by impairment method as of December 31:

(dollars in thousands)	Allowance for Loan Losses Evaluated for Impairment			Total	Unaccrued Credit Component Other Loans
	Individual	Collectively	Purchased Impaired		
2016:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$—	\$ 6,669	\$ —	\$ 6,669	\$ 128
Commercial properties	—	2,983	—	2,983	136
Land	—	233	—	233	2
Commercial and industrial loans	—	5,227	—	5,227	147
Consumer loans	—	288	—	288	19
Total	\$—	\$ 15,400	\$ —	\$ 15,400	\$ 432
Loans:					
Real estate loans:					
Residential properties	\$ 6,093	\$ 1,774,796	\$ —	\$ 1,780,889	\$ 12,373
Commercial properties	2,148	474,634	177	476,959	24,796
Land	—	24,100	—	24,100	437
Commercial and industrial loans	753	233,992	3,196	237,941	20,165
Consumer loans	—	32,127	—	32,127	1,266
Total	\$ 8,994	\$ 2,539,649	\$ 3,373	\$ 2,552,016	\$ 59,037
2015:					
Allowance for loan losses:					
Real estate loans:					
Residential properties	\$—	\$ 6,799	\$ —	\$ 6,799	\$ 127
Commercial properties	30	1,783	—	1,813	363
Land	—	103	—	103	42
Commercial and industrial loans	—	1,649	—	1,649	187
Consumer loans	—	236	—	236	13
Total	\$ 30	\$ 10,570	\$ —	\$ 10,600	\$ 732
Loans:					
Real estate loans:					
Residential properties	\$—	\$ 1,160,568	\$ —	\$ 1,160,568	\$ 7,747
Commercial properties	6,275	352,162	354	358,791	43,287
Land	—	11,180	1,140	12,320	4,267
Commercial and industrial loans	5,687	185,732	5,165	196,584	28,231
Consumer loans	76	37,130	—	37,206	1,761
Total	\$ 12,038	\$ 1,746,772	\$ 6,659	\$ 1,765,469	\$ 85,293

The column labeled “Unaccreted Credit Component Other Loans” represents the amount of unaccreted credit component discount for the other loans acquired in a business combination, and the stated principal balance of the related loans. The discount is equal to 0.73% and 0.86% of the stated principal balance of these loans as of December 31, 2016 and 2015, respectively. In addition to this unaccreted credit component discount, an additional \$0.5 million and \$0.3 million of the ALLL was provided for these loans as of December 31, 2016 and 2015, respectively.

FIRST FOUNDATION INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2016, 2015, and 2014

The Bank categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, collateral adequacy, credit documentation, and current economic trends, among other factors. The Bank analyzes loans individually by classifying the loans as to credit risk. This analysis typically includes larger, non-homogeneous loans such as loans secured by multifamily or commercial real estate and commercial and industrial loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for risk ratings:

Pass: Loans classified as pass are strong credits with no existing or known potential weaknesses deserving of management's close attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Impaired: A loan is considered impaired, when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Additionally, all loans classified as troubled debt restructurings ("TDRs") are considered impaired. Purchased credit impaired loans are not considered impaired loans for these purposes.

Loans listed as pass include larger non-homogeneous loans not meeting the risk rating definitions above and smaller, homogeneous loans not assessed on an individual basis.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows as of December 31:

(dollars in thousands)	Pass	Special Mention	Substandard	Impaired	Total
2016:					
Real estate loans:					
Residential properties	\$1,773,296	\$ 1,500	\$ —	\$ 6,093	\$1,780,889
Commercial properties	470,484	1,913	2,414	2,148	476,959
Land	24,100	—	—	—	24,100
Commercial and industrial loans	219,676	3,625	13,887	753	237,941
Consumer loans	32,127	—	—	—	32,127
Total	\$2,519,683	\$ 7,038	\$ 16,301	\$ 8,994	\$2,552,016

2015: