ITLA CAPITAL CORP
Form 10-K
March 31, 2003

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

# FORM 10-K

**(Mark One)**
**[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended December 31, 2002**

**OR**

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

**For the Transition Period From __________________ To __________________**

**Commission File Number 0-26960**

**ITLA CAPITAL CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

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

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

Securities Registered Pursuant to Section 12(b) of the Act:
**None**

Securities Registered Pursuant to Section 12(g) of the Act:
**Common Stock, $.01 Par Value**
(Title of Class)

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 [X] No [ ].

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [X] No [ ].

As of March 21, 2003, there were issued and outstanding 6,061,575 shares of the Registrant s Common Stock. The aggregate market value of the voting stock held by non-affiliates of the Registrant, computed by reference to the closing price of such stock as of June 28, 2002, was $180.5 million. (The exclusion from such amount of the market value of the shares owned by any person shall not be deemed an admission by the Registrant that such person is an affiliate of the Registrant.)

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**ITLA CAPITAL CORPORATION**

**FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002**

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**Forward-Looking Statements**

Safe Harbor statement under the Private Securities Litigation Reform Act of 1995: This Form 10-K contains forward-looking statements that are subject to risks and uncertainties, including, but not limited to, changes in economic conditions in our market areas, changes in policies by regulatory agencies, the impact of competitive loan products, loan demand risks, the quality or composition of our loan or investment portfolios, fluctuations in interest rates and changes in the relative differences between short and long term interest rates, levels of nonperforming assets and operating results, the impact of terrorist actions and other risks detailed from time to time in our filings with the Securities and Exchange Commission. We caution readers not to place undue reliance on forward-looking statements. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for 2003 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of, us.

As used throughout this report, the terms we , our , ITLA Capital or the Company refer to ITLA Capital Corporation and its consolidated subsidiaries.

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## PART I

### Item 1. Business

### General

ITLA Capital Corporation is the largest financial services company headquartered in San Diego County, California with consolidated assets of $1.7 billion, consolidated net loans of $1.3 billion, consolidated deposits of $1.1 billion and consolidated shareholders equity of $156.7 million as of December 31, 2002. We conduct and manage our business principally through our wholly-owned subsidiary, Imperial Capital Bank (the Bank ), a $1.6 billion institution, with eight offices in California, (San Francisco, Encino, Beverly Hills, Glendale, Century City, Santa Monica, Costa Mesa and Del Mar), one office in Carson City, Nevada (opened in January 2003) and one office in Tempe, Arizona, which will open on April 1, 2003. Effective January 1, 2003, the Bank converted from a California industrial bank to a California-chartered commercial bank, and the Company became a bank holding company. The Bank has been in business for 28 years and was formally known as Imperial Thrift and Loan Association until its name change in January 2000. Our branch offices are primarily used for our deposit services and lending business. The Bank is primarily engaged in:

Originating real estate loans secured by income producing properties for retention in its loan portfolio;

Originating film finance loans, franchise loans, tax refund anticipation loans, private label small business revolving credit loans; and

Accepting customer deposits through the following products: certificates of deposits, money market, passbook accounts and effective January 2003, demand deposit accounts. Our deposit accounts are insured by the Federal Deposit Insurance Corporation ( FDIC ), up to the appropriate legal limits.

During 2001 and 2000, the Bank was also engaged in the acquisition of pools of single family mortgages in the secondary market for investment purposes. On March 28, 2002, the Bank disposed of virtually all of its residential loan portfolios through the securitization of $86.3 million of its performing single family mortgages and sale of $17.6 million of the remaining single family mortgages in a whole loan sale.

During 2000, we acquired through our subsidiary, Imperial Capital Real Estate Investment Trust ( Imperial Capital REIT ) all of the equity and certain collateralized mortgage obligations ( CMOs ) of the ICCMAC Multi-family and Commercial Trust 1999-1 (the ICCMAC Trust ). On the date of acquisition, the ICCMAC Trust held assets of $250.5 million as collateral for $205.4 million of investment grade CMOs that had been sold to third party investors by the previous owner. At December 31, 2002 and 2001, real estate loans held in trust, net, for the CMOs totaled $121.9 million and $162.2 million and the CMOs outstanding balance was $69.1 million and $109.6 million, respectively.

During the first quarter of 2002, we completed our acquisition of Asahi Bank of California ( Asahi Bank ) a wholly-owned subsidiary of Asahi Bank Ltd - Japan ( ABLJ ), for approximately $14.9 million in cash. On the date of acquisition, Asahi Bank had total assets of approximately $50.0 million, including $35.0 million of commercial real estate and business loans and $15.0 million of cash and securities. Upon completion of the acquisition, Asahi Bank was merged into the Bank.

On October 25, 2002, we acquired the operating assets and the performing film finance loan portfolio of the Lewis Horwitz Organization ( LHO ), in an all cash transaction valued at approximately $93.0 million. LHO is an internationally recognized lender to the independent film and television production industry. LHO is currently operating as a division of the Bank.

In November 2002, we entered into a strategic business relationship with various subsidiaries of Household International, Inc. ( Household ) relating to certain tax refund products. In connection with this relationship, the Bank originates tax refund anticipation loans and sells Household a non-recourse participation interest representing substantially all of the outstanding loan balance. Under the agreement, Household supports the Bank s credit administration, compliance and accounting functions with a range of services relating to the origination process, and services the loans on behalf of the Bank. Substantially all of the tax refund lending volume is generated during the first quarter of the year. The tax refund agreement is for a four-year term, with substantial break-up fees to apply in the event that Household terminates the agreement during the first two years of the agreement.

We also entered into an agreement in December 2002 with Household pursuant to which the Bank originates relatively small private label commercial revolving loans to small businesses. This agreement is for a two year term. These loans are used primarily to fund purchases from major retailers. Pursuant to this agreement, the Bank sells Household a non-recourse participation interest representing substantially all of the outstanding loan balance.

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We continuously evaluate business expansion opportunities, including acquisitions or joint ventures with companies that originate or purchase commercial and multi-family real estate loans as well as other types of secured commercial loans. In connection with this activity, we periodically have discussions with and receive financial information about other companies that may or may not lead to the acquisition of the company, a segment or division of that company, or a joint venture opportunity.

The executive offices of the Company are located at 888 Prospect Street, Suite 110, La Jolla, California 92037 and its telephone number at that address is (858) 551-0511.

**Lending Activities**

*General.* During 2002, we concentrated our lending activities as follows:

Originating and purchasing real estate loans, including construction loans, secured by income producing properties.

Originating and purchasing franchise and film finance loans.

*Income Producing Property Loans.* We originate and purchase real estate loans secured primarily by first trust deeds on income producing properties. Income property loan collateral consists primarily of the following types of properties:

Apartments
Retail centers
Small office and light industrial buildings
Hotels
Mini-storage facilities
Mobile home parks
Other mixed use or special purpose commercial properties

At December 31, 2002, the Bank had $1.3 billion of income producing property loans outstanding representing 92.1% of its total real estate loans and 81.0% of its gross loan portfolio. Most of the Bank s real estate borrowers are business owners, individual investors, investment partnerships or limited liability corporations. The income producing property lending that the Bank engages in typically involves larger loans to a single borrower and is generally viewed as exposing the lender to a greater risk of loss than one- to four-family residential lending. During 2002, we launched Imperial Capital Express, a new real estate lending platform focusing on originating smaller balance income producing property loans. Income producing property values are also generally subject to greater volatility than residential property values. The liquidation values of income producing properties may be adversely affected by risks generally incident to interests in real property, such as:

Changes or continued weakness in general or local economic conditions;
Changes or continued weakness in specific industry segments;
Declines in real estate values;
Declines in rental, room or occupancy rates in hotels, apartment complexes or commercial properties;
Increases in other operating expenses (including energy costs);
Changes in governmental rules, regulations and fiscal policies, including rent control ordinances, environmental legislation and taxation;
Increases in interest rates, real estate and personal property tax rates; and
Other factors beyond the control of the borrower or the lender.

We originate real estate loans through offices located in San Francisco, Glendale, Santa Monica, Costa Mesa and Del Mar. These offices are staffed by a total of twenty-four loan officers. Loan officers solicit mortgage loan brokers for loan applications that meet our underwriting criteria, and also accept applications directly from borrowers. A majority of the real estate loans funded by us are originated through mortgage loan brokers. Mortgage loan brokers act as intermediaries between us and the property owner in arranging real estate loans and earn a fee based upon the principal amount of each loan funded. Since a large portion of our marketing effort is through the contact of loan officers with mortgage loan brokers, we do not incur significant expenses for advertising our lending services to the general public.

Income producing property loans are generally made in amounts up to 75% of the appraised value; however, in certain instances, multifamily originations may be made at a loan to value ratio of 80%. Loans are generally made for terms up to ten years, with amortization periods up to 30 years. Depending on market conditions at the time the loan was originated, certain loan agreements may include prepayment penalties. Most real estate loans are subject to a quarterly adjustment of their interest rate based on one of several interest rate indexes.

The interest rates charged on real estate loans generally vary based on a number of factors, including the degree of credit risk, size and maturity of the loan, whether the loan has a fixed or a variable rate, and prevailing market rates for similar types of real estate loans. As of December 31, 2002, 61.5% of the Bank s real estate loan portfolio was indexed to the Six-Month London Interbank Offered Rate; 17.1% was indexed to the reference rate charged by Bank of America; 3.2% was indexed to the one-month London Interbank offered rate; 1.5% was indexed to the Federal Home Loan Bank ( FHLB ) 11th District Cost of Funds Index; 9.5% was fixed for an initial period and then adjustable; 2.0% was indexed to either the United States Treasury security indexes or the FHLB of San Francisco advance rate; and the balance of 5.2% was fixed rate. Most of the Bank s variable rate real estate loans may not adjust downward below their initial rate, with increases generally limited to maximum adjustments of 2% per year up to 5% for the life of the loan. The inability of the Bank s real estate loans to adjust downward can contribute to increased income in periods of declining interest rates, and also assists the Bank in our efforts to limit the risks to earnings resulting from changes in interest rates, subject to the risk that borrowers may refinance these loans during periods of declining interest rates. At December 31, 2002, 85.9% of the Bank s variable rate and fixed/adjustable loan portfolio contained interest rate floors. The weighted-average minimum interest rate on this portfolio was 7.84%. At that date, 79.5% of the variable rate loans outstanding had a lifetime interest rate cap. The weighted-average lifetime interest rate cap on this portfolio was 10.03%.

In 2002, 2001, and 2000, the Bank purchased income producing real estate loans totaling $83.6 million, $176.9 million, and $110.9 million, respectively. In its commercial real estate loan purchases, the Bank generally reserves the right to reject particular loans from a loan pool being purchased and does so for loans in a pool that do not meet its underwriting criteria.

*Construction Loans.* We also originate construction loans for income producing properties, as well as for single-family home construction. At December 31, 2002, the Bank had $101.4 million of construction loans outstanding, representing 7.5% of its loans receivable. In addition to the lending risks previously discussed, construction loans also present risks associated with the accuracy of the initial estimate of the property s value upon completion compared to its actual value, the timely completion of construction activities for their allotted costs and the time needed to stabilize income properties or sell residential tract developments. These risks can be affected by a variety of factors, including the oversight of the project, localized costs for labor and materials, and the weather.

*Franchise Loans*. In 2000, we commenced purchasing franchise loans through relationships with correspondent franchise loan originators. Franchise loans are loans to owners of businesses, both franchisors and franchisees, such as fast food restaurants or gasoline retailers, that are affiliated with nationally or regionally recognized chains and brand names. Various combinations of land, building, business equipment and fixtures may secure these loans, or they may be a general obligation of the borrower based on a valuation of the borrower s business and debt service ability. In each case, the primary source of repayment is the cash flow of the business and not the underlying value of the collateral. During 2002 and 2001, we purchased three loans and 17 loans, with a total commitment of $7.3 million and $53.3 million, respectively. The outstanding balance of these loans as of December 31, 2002 and 2001 was $54.7 million and $57.6 million, respectively. We expect to increase our franchise loan originations in 2003 through the recent opening of our Imperial Capital Franchise Finance lending platform located in Tempe, Arizona.

*Film Finance Loans*. We acquired LHO in October 2002 and are operating LHO as a division of the Bank. LHO is an internationally recognized commercial finance lender engaged in providing financing for independent motion picture and television production. Typically, LHO lends to independent producers of film and television on a senior secured basis, basing its credit decisions on the creditworthiness and reputation of distributors and sales agents who have contracted to distribute the films. LHO provides loans (with a typical term of 12 to 18 months) and letters of credit for the production of motion pictures and television shows or series that have a predictable market worldwide, and therefore, a predictable level of revenue arising from licensing of the distribution rights throughout the world.

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LHO lends to independent producers of film and television, many of which are located in California. LHO also has borrowing clients outside of the United States. Independent producers tend to be those producers that do not have major studio distribution outlets for their product. Large film and television studios generally maintain their own distribution outlets and finance their projects with internally generated financing. In addition to funding production loans against a number of distribution contracts, LHO has pioneered a valuation of selected unsold rights to permit financing of a portion of the production budget. Typically, this unsecured amount does not exceed 10% of the total loan. LHO s lending officers review the quality of the distributors and their contracts, the budget, the schedule of advances, and valuation of all distribution rights when considering a new lending opportunity. All LHO loans require the borrower to provide a completion bond that guarantees the completion of the film or the payoff of the outstanding balance of the loan in the event the film is not completed. After closing, each requested advance is approved by the bonding company on a weekly basis to ensure that LHO is not advancing ahead of an agreed-upon cash flow schedule. The loan documentation grants LHO the right to impose certain penalties on the borrower and exercise certain other rights, including replacing the sales agent, if sales are not consummated within the appropriate time. Loans are repaid principally from revenue received from distribution contracts. In many instances, the distribution contracts provide for multiple payments payable at certain milestones (such as execution of contract, commencement of principal photography or completion of principal photography). The maturity date of the loan is generally six to nine months after completion of the production. Delivery of the completed production is made to the various distributors only upon or after their minimum guarantees have been paid in full. To the extent a distributor fails to make payment upon completion of the film, or the predicted level of revenue is less than expected, the Bank may incur a loss.

LHO typically charges its customers an interest rate ranging from the prime rate to prime plus a margin (exclusive of loan fees) on the outstanding balance of the loan. Loan fees typically range from, 1.00% to 2.50% with an additional fee up to 7.0% depending on the unsecured amount of the production budget being financed.

At December 31, 2002 our film finance portfolio totaled $119.3 million, of which approximately $48.8 million were issued to producers domiciled outside of the United States. These foreign loans were primarily issued to producers in Australia, Canada, and Germany. Approximately $600,000 of interest income was earned during fiscal 2002 in connection with these loans. There were no non-performing assets attributable to the LHO division at December 31, 2002.

*Loan Underwriting.* Many of the Bank s loans are made to lower credit grade borrowers that have marginal credit histories or the property has other factors such as debt-to-income ratios or property location that prevent the borrower from obtaining a prime interest rate. We attempt to mitigate the risk associated with these loans by charging higher interest rates and through our loan approval and loan purchasing process. The Bank s loan underwriters are responsible for initial reviews of borrowers, collateral, loan terms, and prepare a written presentation on every loan application submitted to its loan committee, which is comprised of the following Bank officers:

Chairman, Chief Executive Officer, President
Vice Chairman and Chief Credit Officer
Senior Managing Director/Chief Banking Officer
Senior Managing Director/Chief Lending Officer
Managing Director/Director of Portfolio Management
Managing Director/Director of Loan Operations
Deputy Managing Director/Production Manager
First Vice President of Business Lending Loan Operations
Vice President/Portfolio Administration

The underwriting standards for loans secured by income producing real estate properties consider the borrower s financial resources and ability to repay and the amount and stability of cash flow, if any, from the underlying collateral, to be comparable in importance to the loan-to-value ratio as a repayment source. Management believes that during 2002, both California and the United States economy continued to experience an economic shock. We believe that a continued decline in economic conditions in California, and in the surrounding states, coupled with the potential threat of a terrorist attack on the United States, could have a material adverse effect on our real estate lending business, including reducing the demand for new loans, limiting the ability of borrowers to pay financed amounts and impairing the value of our real estate collateral.

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All real estate secured loans over $2.0 million must be submitted to the loan committee for approval. At least one loan committee member or designee must personally conduct on-site inspections of any property involved in connection with a real estate loan recommendation of $1.0 million or more. Loans up to $750,000 may be approved by any loan committee member. Loans of $750,000 to $1.5 million require approval by any two members of the Bank s loan committee, while loans in excess of $1.5 million require approval of three loan committee members. Additionally, loans over $2.0 million must be approved by the Managing Director/Director of Portfolio Management; loans over $3.0 million require the additional signature of the Vice Chairman and Chief Credit Officer; and individual loans over $5.0 million, loans resulting in an aggregate borrowing relationship to one borrower in excess of $7.5 million, and all purchased loan pools must be approved by the executive committee of the Bank s board of directors.

All franchise and film finance loans must be submitted to the loan committee for approval regardless of the amount of the loan request. Loan amounts up to $2.0 million require the approval of three loan committee members. Loans over $2.0 million must be approved by the First Vice President of Business Lending Operations and loans over $3.0 million must be approved by the Vice Chairman and Chief Credit Officer.

Our loans are originated on both a non-recourse and full recourse basis and we generally seek to obtain personal guarantees from the principals of borrowers which are single asset or limited liability entities (such as partnerships, corporations or trusts).

The maximum size of a single loan made by the Bank is limited by California law to 25% of the Bank s equity capital. At December 31, 2002, that limit was approximately $47.1 million. The Bank s largest combined credit extension to related borrowers was $14.5 million at December 31, 2002. At December 31, 2002, the Bank had a total of 218 extensions of credit, with a combined outstanding principal balance of $730.8 million, that were over $2.0 million to a single borrower or related borrowers. All combined extensions of credit over $2.0 million were performing in accordance with their repayment terms. At December 31, 2002, the Bank had 1,524 secured real estate loans outstanding, with an average balance per loan of approximately $884,000.

*Servicing and Collections.* Real estate and construction loans held by the Bank are serviced by the Bank s loan servicing department, which is designed to provide prompt customer service, and accurate and timely information for account follow-up, financial reporting and management review. Film finance loans, are serviced by LHO personnel using the Bank s servicing platform. Servicing of substantially all of the franchise loan portfolio and loans held in the ICCMAC Trust is performed by third party servicers. The Bank monitors its loans to ensure that projects are performing as underwritten. This monitoring allows the Bank to take a proactive approach to addressing projects that do not perform as planned. When payments are not received by their contractual due date, collection efforts begin on the fifth day of delinquency with a telephone contact, and proceed to written notices that progress from reminders of the borrower s payment obligation to an advice that a notice of default may be forthcoming. Accounts delinquent for more than 30 days are generally transferred to the Bank s asset management department which, following a review of the account and management approval, implements a collection or restructure plan, or a disposition strategy, and evaluates any potential loss exposure on the asset.

*Competition.* Our competition in originating real estate, construction, franchise and film finance loans is principally from community banks, savings and loan associations, industrial banks, real estate financing conduits, specialty finance companies, small insurance companies, and larger banks. Many of these entities enjoy competitive advantages over us relative to a potential borrower in terms of a prior business relationship, wider geographic presence or more accessible branch office locations, the ability to offer additional services or more favorable pricing alternatives, or a lower cost of funds structure. We attempt to offset the potential effect of these factors by providing borrowers with greater individual attention and a more flexible and time-sensitive underwriting, approval and funding process than they might obtain elsewhere.

**Household Strategic Alliance**

*Tax Refund Lending.* In November 2002, we entered into a strategic business relationship with various subsidiaries of Household relating to certain tax refund anticipation loans. In connection with this relationship, the Bank originates tax refund anticipation loans, and sells to Household a non-recourse participation interest representing substantially all of the outstanding loan balance. The tax refund agreement with Household is for a four year term, with substantial break-up fees to apply in the event that Household terminates the agreement during the initial two year period. Household, a leader in the structuring and implementation of tax refund lending programs, supports our credit administration, compliance, treasury and accounting functions with a range of services relating to the administration of this lending program. The Bank would not originate these loans without the involvement of Household.

Pursuant to our agreement with Household, the Bank offers tax refund anticipation loans ( RALs ) to taxpayers who have filed their returns electronically with the IRS and do not want to wait for the IRS to send them their refund check. For this product, a taxpayer requests a loan through a tax preparer, with the anticipated tax refund as the source of repayment. The taxpayer s application is then subjected to an automated credit review process. If the application passes this review, the Bank advances to the taxpayer the amount of the refund due on the taxpayer s return up to specified amounts based on certain criteria, less a pre-paid finance charge and certain other fees. Each taxpayer signs an agreement permitting the IRS to send their refund directly to the Bank instead of to the taxpayer. The refund received from the IRS is used to pay off the loan. Any amount due the taxpayer above the amount of the RAL is then sent to the taxpayer. The Bank also provides refund transfers to customers who do not want or do not qualify for loans. The transfer product facilitates the receipt of the refund by the customer by authorizing the customer s tax preparer to print a check for the customer after the refund has been received by the Bank from the IRS ( RACs ). Because of the mid-April tax-filing deadline, almost all of the loans and transfers are made and repaid during the first quarter of the year. The Bank s revenue, under the program, consists of RAL and RAC transaction fees and the earnings stream from RALs originated under the program to the extent of its retained interest in such RALs.

There is a higher credit risk associated with refund loans than with other types of loans because (1) the Bank does not have personal contact with the customers of this product; and (2) the customers conduct no business with the Bank other than this once a year transaction. Much of this risk is eliminated due to the immediate sale by the Bank to Household, of a participation interest representing virtually all of the RAL outstanding balance.

Because these programs relate to the filing of income tax returns, activity is concentrated in the first quarter of each year. This causes first quarter net income to become a greater percentage of each year s net income. This seasonality impacts a number of performance ratios, including return on assets (ROA), return on equity (ROE) and the operating efficiency ratio. These impacts should be apparent in both the first quarter of 2003 and the year-to-date ratios in subsequent quarters.

*Private Label Commercial Revolving Credit Loans*. We also entered into an agreement in December, 2002 with Household pursuant to which the Bank originates private label small commercial revolving loans to small businesses. This agreement is for a two year term. These loans are used primarily for purchases from major retailers. Pursuant to this agreement, the Bank sells Household a non-recourse participation interest representing substantially all of the outstanding loan balance. The Bank participates in the earnings stream from the loans originated under the program to the extent of its retained interest in such loans. At December 31, 2002, our retained interest in commercial revolving credit loans aggregated $4.2 million.

**Imperial Capital Real Estate Investment Trust**

During 2000, we acquired all of the equity and certain CMOs of the ICCMAC Trust through our real estate investment trust subsidiary, Imperial Capital REIT. At December 31, 2002, the ICCMAC Trust held real estate loans of $121.9 million, comprised of approximately 74 percent and 26 percent of multifamily and commercial loans, respectively, with over 50 percent of the loans secured by property located in California. Over two-thirds of the loans are adjustable rate mortgages. At December 31, 2002, the ICCMAC Trust s real estate loans were held as collateral for $69.1 million of investment grade CMOs sold to third party investors. The cash flow from the ICCMAC Trust s loan pool pays principal and interest on the CMOs, and also provides cash flow on a monthly basis to ITLA Capital. ITLA Capital recorded $7.9 million of pre-tax income from its investment in the ICCMAC Trust during the year ended December 31, 2002.

Servicing of the ICCMAC Trust loans is performed by Orix Capital Markets, LLC ( Orix ), a Delaware limited liability company. Under the servicing agreement, Orix is required to service and administer the commercial mortgage loans held in trust solely for the benefit of the holders of the CMOs in accordance with the terms of the servicing agreement and the commercial mortgage loans.

Orix is required to perform other customary functions of a servicer of comparable loans, including monitoring insurance coverage; maintaining escrow or impoundment accounts of borrowers for payment of taxes, insurance and other items required to be paid pursuant to the loan agreement; processing assumptions or substitutions in those cases where the loan servicer has determined not to enforce any applicable due-on-sale clause; demanding that the borrower cure delinquencies; inspecting and managing commercial mortgaged properties under certain circumstances; and maintaining records relating to the commercial mortgage loans.

**Nonperforming Assets and Other Loans of Concern**

At December 31, 2002, nonperforming assets totaled $18.5 million or 1.07% of total assets. Nonperforming assets consisted of $5.9 million of nonaccrual loans and $12.6 million of other real estate owned. Two of our nonperforming loans had an outstanding balance greater than $1.0 million. For additional information regarding nonperforming assets see Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations-Credit Risk Elements .

The following is a brief discussion of the non-accrual loans where the remaining principal balance of the loan at December 31, 2002, exceeded $1.0 million.

*Loan Secured by 4 Office Buildings Nevada.* This loan was originated by the Bank in May 2000 with an original commitment of $4.2 million, which included funds to finish the construction of one of the buildings. One building and 2 vacant lots were released for consideration during the loan s history. No payments have been received since June 2002. The loan balance as of December 31, 2002 was $3.0 million. The property was 78% occupied as of December 2002. A notice of default has been filed and the loan is currently in foreclosure.

*Loan Secured by a Truck Stop Texas.* This loan was purchased by the Bank in June 2001 with an original commitment of $2.0 million, which included funds to repave the collateral site. The loan balance as of December 31, 2002 was $2.0 million. The operation has been under-performing, with cash flows insufficient to make its debt service payments. A notice of default has been filed and the loan is currently in foreclosure.

As of December 31, 2002, we had loans with an aggregate outstanding balance of $35.5 million with respect to which known information concerning possible credit problems with the borrowers or the cash flows of the properties securing the respective loans has caused management to be concerned about the ability of the borrowers to comply with present loan repayment terms, which may result in the future inclusion of such loans in the non-accrual loan category. All of these loans are classified as substandard pursuant to the regulatory guidelines discussed below. The following is a brief discussion of our other loans of concern where the remaining principal balance of the loan at December 31, 2002 exceeded $2.0 million.

*Loan Secured by Office Building Missouri.* This loan was originated by the Bank in June 1999 with an original commitment of $10.2 million to refinance a 20-story office tower. The outstanding principal balance at December 31, 2002 was $9.8 million. The property has suffered from high market vacancy and the cash flow is currently insufficient to cover the debt service on our loan. The property was 55% occupied and the loan was performing in accordance with its payment terms, as of December 31, 2002. On February 21, 2003 the loan was placed on nonaccrual status and a notice of default was filed. See Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Note 23.

*Loan Secured by Office with Retail Building California*. This loan was originated by the Bank in July 2001 with an original commitment of $8.4 million. The outstanding principal balance at December 31, 2002 was $7.8 million. The loan has paid as agreed since inception, however, the occupancy has declined to 63% as of December 2002. We continue to monitor the borrowers efforts to improve the occupancy.

*Loan Secured by Hotel Arizona*. This loan was originated by the Bank in July 1998 with an original commitment of $4.0 million secured by a 99-unit hotel. The outstanding principal balance at December 31, 2002 was $2.8 million. The loan is current pursuant to the repayment terms of its forbearance agreement. The cash flow from the operations of the collateral has been less than the debt service on our loan for the last four years. We continue to monitor the borrowers efforts to improve the cash flow of the hotel.

*Loan Secured by a Hotel Washington*. This loan was originated by the Bank in February 1998 with an original commitment of $3.7 million secured by a 123-unit hotel. The outstanding principal balance at December 31, 2002 was $2.8 million. The loan has paid as agreed since inception, however, the cash flow from the operations of the collateral has been less than the debt service on our loan. A demand for payoff has been issued. In January 2003, the loan was paid off and resulted in a loss of approximately $200,000.

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**Classified Assets**

Management uses a loan classification system consistent with the classification system used by bank regulatory agencies to help it evaluate the risks inherent in its real estate loan portfolio. Loans are identified as pass , substandard , doubtful or loss based upon consideration of all sources of repayment, underlying collateral values, current and anticipated economic conditions, trends and uncertainties, and historical experience. Pass loans are further divided into four additional sub-categories, based on the borrower s financial strength and ability to service the debt and/or the value and debt service coverage of the underlying collateral. Underlying collateral values for real estate dependent loans are supported by property appraisals or evaluations. We review our loan classifications on at least a quarterly basis. At December 31, 2002, we classified $41.4 million of loans as substandard , none as doubtful and none as loss . $5.9 million of these classified loans were included in the nonperforming assets table in Item 7. Management s Discussion and Analysis of Results of Financial Condition and Operations - Credit Risk Elements , and the balance was included in the $35.5 million of other loans of concern , discussed above.

**Funding Sources**

The primary source of funding for the Bank s lending operations and investments are deposits. The Bank s deposits are federally insured by the FDIC to the maximum extent permitted by law. Approximately 83.3% of the Bank s deposits are term deposits that pay fixed rates of interest for periods ranging from 90 days to five years. The remaining 16.7% of the Bank s deposits are variable rate passbook accounts and variable rate money market accounts with limited checking features.

The Bank s strategy with all deposit accounts is to offer rates significantly above those customarily offered by other financial institutions in its market. The Bank has generally accumulated deposits by relying on renewals of term accounts by existing depositors, participating in deposit rate surveys which promote the rate offered by the Bank on its deposit products, and periodically advertising in various local market newspapers and other media. The Bank is able to pursue this strategy by operating a savings branch system offering fewer products and services than many institutions. Because the Bank does not provide safe deposit boxes, money orders, trust services, and various other retail banking services, management believes its staffing and overhead costs are significantly lower than banks and savings institutions. Management further believes that its deposits are a reliable funding source and that the cost of funds resulting from the Bank s deposit gathering strategy is comparable to those of other banks pursuing a similar strategy. However, because the Bank competes for deposits primarily on the basis of rates, the Bank could experience difficulties in attracting deposits if it could not continue to offer deposit rates at levels above those of other financial institutions. Management also believes that any efforts to significantly increase the size of its deposit base may require greater marketing efforts and/or increases in deposit rates. At December 31, 2002, the Bank had $103.6 million of brokered deposits.

We intend to begin offering our customers in 2003 commercial banking products and services, including consumer and business checking accounts. As the Bank acquires non-interest bearing checking account balances, it anticipates that its dependence on interest rate sensitive certificates of deposit as a funding source will slowly diminish.

For information concerning overall deposits outstanding during the periods indicated and the rates paid thereon, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Net Interest Income .

The Bank has also used advances from the FHLB of San Francisco as a funding source. FHLB advances are collateralized by pledges of qualifying cash equivalents, investment securities, mortgage-backed securities and whole loan collateral. At December 31, 2002, FHLB advances outstanding totaled $338.7 million, and the remaining available borrowing capacity, based on the loans and securities pledged as collateral, totaled $65.2 million, net of the $3.4 million of additional FHLB Stock that we would be required to purchase to support the additional borrowings. Additionally, the Bank also has uncommitted, unsecured lines of credit with other banks renewable daily in the amount of $30.0 million. In connection with our tax refund lending business, ITLA Capital had a $35.0 million revolving credit facility with a bank commencing on January 24, 2003, and matured on March 31, 2003. See Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Notes 3, 4, 8, and 9 .

**Regulation**

On January 1, 2003, the Bank converted from a California industrial bank to a California-chartered commercial bank, and the Company became a bank holding company. As a result, the Company is now regulated by the Board of Governors of the Federal Reserve System (the Federal Reserve Board ). The Bank continues to be regulated by the California Department of Financial Institutions (the DFI ) and the Federal Deposit Insurance Corporation (the FDIC ). Due to legislation which became effective in October 2000, California industrial banks are now generally subject to the same California banking laws as California commercial banks. Accordingly, the regulatory oversight to which the Bank is now subject as a commercial bank is not significantly different from the regulatory oversight to which it was subject as an industrial bank.

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*Holding Company Regulation*. Bank holding companies are subject to comprehensive regulation by the Federal Reserve Board under the Bank Holding Company Act of 1956, and the regulations of the Federal Reserve Board. As a bank holding company, the Company is required to file reports with the Federal Reserve Board and such additional information as the Federal Reserve Board may require, and the Company and its non-bank subsidiaries are subject to examination by the Federal Reserve Board. The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a bank holding company divest subsidiaries, including its bank subsidiaries. In general, enforcement actions may be initiated for violations of law and regulation as well as unsafe or unsound practices.

Under Federal Reserve Board policy, a bank holding company must serve as a source of strength for its subsidiary banks. Under this policy, the Federal Reserve Board may require, and has required in the past, bank holding companies to contribute additional capital to undercapitalized subsidiary banks.

Under the Bank Holding Company Act of 1956, a bank holding company must obtain Federal Reserve Board approval before, among other matters:

acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after the acquisition, it would own or control more than 5% of these shares (unless it already owns or controls a majority of these shares);

acquiring all or substantially all of the assets of another bank or bank holding company; or

merging or consolidating with another bank holding company.

This statute also prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by Federal Reserve Board regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks.

*Dividends*. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board s view that a bank holding company should pay cash dividends only to the extent that its net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the bank holding company s capital needs, asset quality and overall financial condition. Furthermore, under the prompt corrective action regulations adopted by the Federal Reserve Board, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if any of the holding company s bank subsidiaries are classified as undercapitalized.

*Repurchase or Redemption of Equity Securities.* A bank holding company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of its consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve Board order, or any condition imposed by, or written agreement with, the Federal Reserve Board. This notification requirement does not apply to any company that meets the well-capitalized standard for commercial banks, has a safety and soundness examination rating of at least a 2 and is not subject to any unresolved supervisory issues.

*Capital Requirements*. The Federal Reserve Board has established capital requirements for bank holding companies that generally parallel the capital requirements for insured depository institutions. The Company was not subject to any minimum capital requirements prior to becoming a bank holding company. The Company currently is deemed well capitalized under the Federal Reserve Board capital requirements.

***Bank Regulation California Law***

The regulations of the DFI govern most aspects of the Bank s businesses and operations, including, but not limited to, the scope of its business, investments, the nature and amount of any collateral for loans, the issuance of securities, the payment of dividends, bank expansion and bank activities. The DFI s supervision of the Bank includes comprehensive reviews of all aspects of the Bank s business and condition, and the DFI possesses broad remedial enforcement authority to influence the Bank s operations, both formally and informally.

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***Bank Regulation Federal Law***

Because our deposits are insured by the Bank Insurance Fund of the FDIC, the FDIC, in addition to the DFI, also broadly regulates the Bank. As an insurer of deposits, the FDIC issues regulations, conducts examinations, requires the filing of reports, and generally supervises the operations of institutions to which it provides deposit insurance. The FDIC is also the federal agency charged with regulating state-chartered banks that are not members of the Federal Reserve System, such as the Bank. Insured depository institutions, and their institution-affiliated parties, may be subject to potential enforcement actions by the FDIC and the DFI for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Management is not aware of any pending or threatened enforcement actions against the Bank.

*Regulatory Capital Requirements.* Federally-insured, state-chartered banks such as the Bank, are required to maintain minimum levels of regulatory capital as specified in the FDIC s capital maintenance regulations. The FDIC also is authorized to impose capital requirements in excess of these standards on individual banks on a case-by-case basis.

The Bank is required to comply with three separate minimum capital requirements: a tier 1 capital ratio and two risk-based capital requirements. Tier 1 capital generally includes common shareholders equity, including retained earnings, qualifying noncumulative perpetual preferred stock and any related surplus, and minority interests in the equity accounts of fully consolidated subsidiaries, less intangible assets, other than properly valued purchased mortgage servicing rights up to certain specified limits and less net deferred tax assets in excess of certain specified limits.

*Tier 1 Capital Ratio.* FDIC regulations establish a minimum 3.0% ratio of Tier 1 capital to total average assets for the most highly-rated state-chartered, FDIC-supervised banks. All other FDIC supervised banks must maintain at least a 4.0% tier 1 capital ratio. At December 31, 2002, the Bank s required tier 1 capital ratio was 4.0% and its actual tier 1 capital ratio was 13.0%.

*Risk-Based Capital Requirements.* The risk-based capital requirements generally require the Bank to maintain a ratio of tier 1 capital to risk-weighted assets of at least 4.0% and a ratio of total risk-based capital to risk-weighted assets of at least 8.0%. To calculate the amount of capital required, assets are placed in one of four categories and given a percentage weight (0%, 20%, 50% or 100%) based on the relative risk of the category. For example, United States Treasury Bills and Ginnie Mae securities are placed in the 0% risk category. Fannie Mae and Freddie Mac securities are placed in the 20% risk category, loans secured by one-to four-family residential properties and certain privately-issued mortgage-backed securities are generally placed in the 50% risk category, and commercial and consumer loans and other assets are generally placed in the 100% risk category. In addition, certain off-balance-sheet items are converted to balance sheet credit equivalent amounts and each amount is then assigned to one of the four categories.

For purposes of the risk-based capital requirements, total capital means tier 1 capital plus supplementary or tier 2 capital, so long as the amount of supplementary or tier 2 capital that is used to satisfy the requirement does not exceed the amount of tier 1 capital. Tier 2 capital includes cumulative or other perpetual preferred stock, mandatory convertible subordinated debt and perpetual subordinated debt, mandatory redeemable preferred stock, intermediate-term preferred stock, mandatory convertible subordinated debt and subordinated debt, and the allowance for loan losses up to a maximum of 1.25% of risk-weighted assets. At December 31, 2002 the Bank s tier 1 risk-based and total capital ratios were 13.2% and 14.4%, respectively.

The federal banking agencies have adopted regulations specifying that the agencies will include, in their evaluation of a bank s capital adequacy, an assessment of the exposure to declines in the economic value of the bank s capital due to changes in interest rates. The FDIC and the other federal banking agencies have also promulgated final amendments to their respective risk-based capital requirements which identify concentration of credit risk and certain risks arising from nontraditional activities, and the management of such risk, as important factors to consider in assessing an institution s overall capital adequacy. The FDIC may require higher minimum capital ratios based on certain circumstances, including where the institution has significant risks from concentration of credit or certain risks arising from nontraditional activities.

*Prompt Corrective Action Requirements.* The FDIC has implemented a system requiring regulatory sanctions against state-chartered banks (which, for this purpose, includes the Bank) that are not adequately capitalized, with the sanctions growing more severe the lower the institution s capital. The FDIC has established specific capital ratios for five separate capital categories: well capitalized , adequately capitalized , undercapitalized , significantly undercapitalized , and critically undercapitalized .

An institution is treated as well capitalized if its total risk based capital ratio is 10.0% or more, its tier 1 risk-based ratio is 6.0% or more, its tier 1 capital ratio is 5.0% or greater, and it is not subject to any order or directive by the FDIC to meet a specific capital level. The Bank exceeded these requirements at December 31, 2002.

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The FDIC is authorized and, under certain circumstances, required to take certain actions against institutions that fail to meet their capital requirements. The FDIC is generally required to take action to restrict the activities of an undercapitalized institution. Any such institution must submit a capital restoration plan and, until such plan is approved by the FDIC, may not increase its assets, acquire another institution, establish a branch or engage in any new activities, and generally may not make capital distributions.

In addition, the FDIC must appoint a receiver or conservator for an institution, with certain limited exceptions, within 90 days after it becomes critically undercapitalized . Any undercapitalized institution is also subject to the general enforcement authority of the FDIC, including the appointment of a conservator or a receiver.

The FDIC is also generally authorized to reclassify an institution into a lower capital category and impose the restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

*Community Reinvestment Act and Fair Lending Requirements.* The Bank is subject to certain fair lending requirements and reporting obligations involving lending operations and Community Reinvestment Act activities. Federal banking agencies are required to evaluate the record of financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods. In addition to substantial penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws into account when regulating and supervising other activities such as mergers and acquisitions. In its most recent examination, the FDIC rated the Bank satisfactory in complying with its Community Reinvestment Act obligations.

*Fiscal and Monetary Policies.* Our business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. We are particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States. Among the instruments of monetary policy available to the Federal Reserve Board are (a) conducting open market operations in United States government securities; (b) changing the discount rates of borrowings of depository institutions, (c) imposing or changing reserve requirements against depository institutions deposits, and (d) imposing or changing reserve requirements against certain borrowings by banks and their affiliates. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. The policies of the Federal Reserve Board may have a material effect on the Company s business, results of operations and financial condition.

*Privacy Provisions of the Gramm-Leach-Bliley Act*. Federal banking regulators, as required under the Gramm-Leach-Bliley Act (the GLB Act ), have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to nonaffiliated third parties. The privacy provisions of the GLB Act will affect how consumer information is transmitted through diversified financial service companies and conveyed to outside vendors. In California, the attempt in the state legislature to pass a California version of a privacy bill failed in 2001, but it is expected that the proponents of such privacy proposals will re-introduce financial privacy bills in the next session in 2003. The GLB Act permits states to enact their own privacy rules which may be stricter than those under the GLB Act. We cannot predict at this time what terms will be considered in any proposed California privacy legislation, whether any such proposed legislation will be enacted and if so, when such legislation may become effective. Therefore, it is not possible at this time to assess fully the impact of the privacy provisions on our business, results of operations or financial condition.

*Future Legislation.* Various legislation, including proposals to change substantially the financial institution regulatory system, is from time to time introduced in Congress. This legislation may change banking statutes and our operating environment in substantial and unpredictable ways. If enacted, this legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether any of this potential legislation will be enacted and, if enacted, the effect that it, or any implementing regulations, would have on our business, results of operations or financial condition.

**Employees**

As of December 31, 2002, we had 178 employees. Management believes that its relations with employees are satisfactory. We are not subject to any collective bargaining agreements.

**Segment Reporting**

Financial and other information regarding our operating segments is contained in Note 21 to our audited consolidated financial statements included in Item 8 of this report.

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**Internet Website**

We maintain a website with the address www.itlacapital.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor s own Internet access charges, we make available free of charge through our website our Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we have electronically filed such material with, or furnished such material to, the Securities and Exchange Commission.

**Item 2. Properties**

ITLA Capital leases approximately 74,500 square feet of office space for its operations as shown below.

| Locations | Office Uses | Square Footage | Year Current Lease Term Expires |
|---|---|---|---|
| La Jolla, CA | Corporate Headquarters | 16,403 | 2008 |
| La Jolla, CA | Audit and Marketing | 2,325 | 2006 |
| Glendale, CA | Loan Operations Division/Real Estate Lending | 8,932 | 2005 |
| San Francisco, CA | Retail Deposit Branch/Real Estate Lending | 5,005 | 2007 |
| Beverly Hills, CA | Retail Deposit Branch | 2,218 | 2005 |
| Costa Mesa, CA | Retail Deposit Branch/Money Desk Operations/Real Estate Lending | 3,609 | 2006 |
| Del Mar, CA | Retail Deposit Branch/Savings Operations Division/Real Estate Lending | 2,847 | 2004 |
| Encino, CA | Retail Deposit Branch | 5,298 | 2004 |
| Santa Monica, CA | Loan Operations/Imperial Capital Express | 4,991 | 2004 |
| Encino, CA | Operations Support | 3,170 | 2004 |
| Glendale, CA | Retail Deposit Branch/Loan Administration Division | 6,257 | 2006 |
| Century City, CA | Lewis Horwitz Organization 2003 | 7,003 | 2003 |
| Carson City, NV | Savings Branch/Tax Refund Lending/ Private Label Credit Card | 2,500 | 2003 |
| Tempe, AZ | Loan Operations/Imperial Capital Franchise Finance | 3,920 | 2006 |

For additional information regarding our premises, see Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements - Note 17 .

Management believes that ITLA Capital s present facilities are adequate for its current needs, and that alternative or additional space, if necessary, will be available on reasonable terms.

**Item 3. Legal Proceedings**

We are party to certain legal proceedings incidental to our business. Management believes that the outcome of such proceedings, in the aggregate, will not have a material effect on our business, financial condition or results of operations.

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

No matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the quarter ended December 31, 2002.

## PART II

### Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Our common stock is traded on the NASDAQ national market system under the symbol ITLA . As of December 31, 2002, there were nine holders of record of our common stock representing an estimated 1,000 beneficial shareholders with a total of 6,061,575 shares outstanding. We have not paid any cash dividends since our holding company reorganization in 1996.

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The following table sets forth, for the periods indicated, the range of high and low trade prices for our common stock. Stock price data on NASDAQ reflects inter-dealer prices, without retail mark-up, mark-down or commission.

| | Market Price | | | Average Daily Closing Price |
|---|---|---|---|---|
| | High | Low | Close | |
| **2002** | | | | |
| 4th Quarter | $36.25 | $26.37 | $33.23 | $31.36 |
| 3rd Quarter | 31.25 | 27.18 | 30.19 | 29.66 |
| 2nd Quarter | 31.15 | 25.05 | 29.69 | 29.25 |
| 1st Quarter | 20.75 | 20.25 | 24.75 | 22.39 |
| **2001** | | | | |
| 4th Quarter | $21.05 | $17.86 | $20.96 | $19.20 |
| 3rd Quarter | 20.25 | 17.57 | 20.25 | 18.22 |
| 2nd Quarter | 19.75 | 15.90 | 18.00 | 17.55 |
| 1st Quarter | 20.00 | 18.75 | 20.00 | 19.56 |

The following table includes supplementary quarterly operating results and per share information for the past two years. The data presented should be read along with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and with Item 8. Financial Statements and Supplementary Data included elsewhere in this report.

**Quarterly Operations (Unaudited)**

| | For the Quarter Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| | (in thousands except per share amounts) | | | |
| **2002** | | | | |
| Interest income | $27,035 | $26,570 | $27,380 | $29,623 |
| Interest expense | 10,489 | 9,076 | 8,800 | 8,957 |
| Net interest income before provision for loan losses | 16,546 | 17,494 | 18,580 | 20,666 |
| Provision for loan losses | 1,325 | 2,100 | 2,700 | 2,905 |
| Non-interest income | 125 | 102 | (54) | 200 |
| General and administrative expense | 6,318 | 6,312 | 6,459 | 7,943 |
| Total real estate owned expense, net | 467 | 508 | 71 | 277 |
| Provision for income taxes | 3,043 | 3,074 | 3,326 | 3,345 |
| Net income | 4,719 | 4,805 | 5,155 | 5,326 |
| Basic earnings per share | $ 0.79 | $ 0.80 | $ 0.86 | $ 0.89 |
| Diluted earnings per share | $ 0.74 | $ 0.75 | $ 0.80 | $ 0.84 |
| **2001** | | | | |
| Interest income | $32,266 | $31,428 | $29,633 | $29,768 |
| Interest expense | 18,638 | 16,913 | 15,223 | 13,089 |
| Net interest income before provision for loan losses | 13,628 | 14,515 | 14,410 | 16,679 |
| Provision for loan losses | 450 | 500 | 1,500 | 2,125 |
| Non-interest income | 314 | 239 | 251 | 255 |
| General and administrative expense | 5,131 | 5,781 | 5,672 | 6,234 |
| Total real estate owned expense, net | 169 | 47 | 68 | 103 |
| Provision for income taxes | 2,905 | 2,911 | 2,583 | 2,994 |
| Net income | 4,713 | 4,719 | 4,039 | 4,680 |
| Basic earnings per share | $ 0.70 | $ 0.71 | $ 0.64 | $ 0.77 |
| Diluted earnings per share | $ 0.67 | $ 0.69 | $ 0.62 | $ 0.74 |

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**Item 6. Selected Financial Data**

The following condensed consolidated statements of operations and financial condition and selected performance ratios as of December 31, 2002, 2001, 2000, 1999, and 1998 and for the years then ended have been derived from our audited consolidated financial statements. The information below is qualified in its entirety by the detailed information included elsewhere herein and should be read along with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 8. Financial Statement and Supplementary Data.

| | As of and for the years ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| **Condensed Consolidated Statements of Operations** | (in thousands except per share amount) | | | | |
| Total interest income | $ 110,608 | $ 123,095 | $ 123,775 | $ 101,213 | $ 101,665 |
| Total interest expense | 37,322 | 63,863 | 68,642 | 48,460 | 51,387 |
| Net interest income before provisions for loan losses and valuation allowance on loans held for sale | 73,286 | 59,232 | 55,133 | 52,753 | 50,278 |
| Provision for loan losses | 9,030 | 4,575 | 4,775 | 4,950 | 4,550 |
| Provision for valuation allowance on loans held for sale | | | | | 1,400 |
| Net interest income after provisions for losses and valuation allowance on loans held for sale | 64,256 | 54,657 | 50,358 | 47,803 | 44,328 |
| Non-interest income | 373 | 1,059 | 2,331 | 901 | 2,447 |
| Non-interest expense: | | | | | |
| Compensation and benefits | 13,954 | 11,778 | 9,958 | 9,739 | 10,564 |
| Occupancy and equipment | 3,165 | 2,968 | 2,567 | 2,788 | 2,783 |
| Other general and administrative expenses | 9,913 | 8,072 | 8,129 | 8,230 | 7,317 |
| Real estate owned expense, net | 1,323 | 387 | 138 | 472 | 984 |
| Total recurring non-interest expense | 28,355 | 23,205 | 20,792 | 21,229 | 21,648 |
| Nonrecurring expense | | | *(1)* 1,400 | | |
| Total non-interest expense | 28,355 | 23,205 | 22,192 | 21,229 | 21,648 |
| Income before provision for income taxes and minority interest in income of subsidiary | 36,274 | 32,511 | 30,497 | 27,475 | 25,127 |
| Minority interest in income of subsidiary*(2)* | 3,481 | 2,967 | 478 | | |
| Income before provision for income taxes | 32,793 | 29,544 | 30,019 | 27,475 | 25,127 |
| Provision for income taxes | 12,788 | 11,393 | 11,880 | 11,270 | 10,304 |
| NET INCOME | $ 20,005 | $ 18,151 | $ 18,139 | $ 16,205 | $ 14,823 |
| BASIC EARNINGS PER SHARE | $ 3.35 | $ 2.82 | $ 2.57 | $ 2.26 | $ 1.95 |
| DILUTED EARNINGS PER SHARE | $ 3.16 | $ 2.72 | $ 2.51 | $ 2.21 | $ 1.89 |
| Dividends paid | $ | $ | $ | $ | $ |

| **Condensed Consolidated Statements of Financial Condition** | | | | | |
|---|---|---|---|---|---|
| Cash and cash equivalents | $ 160,848 | $ 134,241 | $ 70,950 | $ 72,242 | $ 125,602 |
| Investment securities available for sale, at fair value | 54,677 | 29,411 | 46,325 | 59,247 | 329 |
| Stock in Federal Home Loan Bank | 16,934 | 13,464 | 3,963 | 8,894 | 12,633 |
| Loans, net | 1,316,298 | 1,122,370 | 1,045,927 | 951,480 | 862,089 |
| Real estate loans held in trust, net | 121,936 | 162,158 | 211,722 | | |
| Loans held for sale, at lower of cost or fair market value | | | | | 12,188 |
| Interest receivable | 9,158 | 11,144 | 11,821 | 7,383 | 6,321 |
| Other real estate owned, net | 12,593 | 13,741 | 2,250 | 1,041 | 1,201 |
| Premises and equipment, net | 4,197 | 2,177 | 2,690 | 3,253 | 3,493 |
| Deferred income taxes | 13,822 | 11,869 | 11,302 | 9,401 | 6,270 |
| Goodwill | 3,118 | | | | |
| Other assets | 8,384 | 7,733 | 8,193 | 2,882 | 2,521 |
| Total Assets | $ 1,721,965 | $ 1,508,308 | $ 1,415,143 | $ 1,115,823 | $ 1,032,647 |
| Deposit accounts | $ 1,065,911 | $ 953,654 | $ 1,015,699 | $ 913,613 | $ 866,798 |
| Collateralized mortgage obligations | 69,077 | 109,648 | 161,852 | | |
| Federal Home Loan Bank advances | 338,685 | 269,285 | 79,250 | 67,250 | 48,500 |
| Account payable and other liabilities | 10,006 | 9,674 | 11,269 | 11,265 | 11,467 |
| Guaranteed preferred beneficial interests in the Company s junior subordinated deferrable interest debentures | 81,595 | 28,118 | 13,519 | | |
| Shareholders equity | 156,691 | 137,929 | 133,554 | 123,695 | 105,882 |
| Total Liabilities and Shareholders Equity | $ 1,721,965 | $ 1,508,308 | $ 1,415,143 | $ 1,115,823 | $ 1,032,647 |
| Book value per share | $ 27.11 | $ 23.54 | $ 20.05 | $ 17.22 | $ 14.77 |

*(1) Represents expenses related to the consolidation of the Bank s headquarters with ITLA Capital s headquarters in La Jolla, California.*

*(2) Represents accrued distributions payable on our trust preferred securities.*

| | As of and for the years ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| **Selected Performance Ratios** | | | | | |
| Return on average assets | 1.41% | 1.32% | 1.47% | 1.57% | 1.46% |
| Return on average shareholders equity | 13.56% | 13.28% | 13.95% | 14.23% | 13.95% |
| Net interest margin *(1)* | 5.30% | 4.33% | 4.47% | 5.11% | 4.96% |
| Average interest-earning assets to average interest bearing liabilities | 113.94% | 113.80% | 113.49% | 113.74% | 113.06% |
| Efficiency ratio *(2)* | 38.50% | 38.49% | 38.62% | 39.57% | 41.06% |
| Efficiency ratio excluding real estate operations and nonrecurring expense, net | 36.70% | 37.85% | 35.94% | 38.69% | 39.19% |
| Total recurring general and administrative expense to average assets | 1.90% | 1.66% | 1.78% | 2.01% | 2.04% |
| Average shareholders equity to average assets | 10.36% | 9.93% | 10.86% | 11.01% | 10.47% |
| Nonperforming assets to total assets | 1.08% | 1.92% | 1.44% | 0.81% | 0.64% |
| Allowance for loan losses to loans held for investment, net *(3)* | 2.31% | 2.16% | 2.12% | 2.05% | 1.91% |
| Allowance for loan loss to nonaccrual loans | 555.61% | 174.30% | 149.85% | 249.40% | 309.37% |
| Net charge-offs (recoveries) to average loans held for investment, net | 0.36% | 0.39% | 0.18% | 0.20% | (0.01%) |

*(1) Net interest margin represents net interest income divided by total average interest-earning assets.*

*(2) Efficiency ratio represents non-interest expense divided by non-interest income and net interest income before provision for loan losses.*

*(3) Real estate loans before allowance for loan losses and net of unearned finance charges and loan fees.*

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

**General**

The following discussion and analysis reviews the financial condition and results of our consolidated operations, including our consolidated subsidiaries: Imperial Capital Bank and the Imperial Capital Real Estate Investment Trust.

The following discussion and analysis is intended to identify the major factors that influenced our financial condition as of December 31, 2002 and 2001 and our results of operations for the years ended December 31, 2002, 2001 and 2000. Our primary business involves the origination and purchase of loans secured by income producing real estate, located predominately in California and, to a lesser extent, the purchase of franchise loans and the funding of film finance loans.

Consolidated net income in 2002 was $20.0 million, or $3.16 per diluted share, compared to $18.2 million, or $2.72 per diluted share, in 2001 and $18.1 million, or $2.51 per diluted share, in 2000. The increase in net income in 2002 was primarily due to an increase in net interest income to $73.3 million for 2002 as compared to $59.2 million in 2001. This increase was partially offset by a $4.5 million increase in provision for loan losses and a $5.2 million increase in non-interest expense.

The increase in net income in 2001 was primarily due to an increase in net interest income to $59.2 million for 2001 as compared to $55.1 million in 2000. This increase was partially offset by a $2.5 million increase in minority interest in income of subsidiary, a decrease of $1.3 million in non-interest income and an increase of $1.0 million in non-interest expense.

Total loan production including the unfunded portion of construction loans was $674.1 million for the year ended December 31, 2002, as compared to $502.1 million and $653.9 million for the years ended December 31, 2001 and 2000. Loan production in 2002 consisted of real estate loan originations of $412.3 million, real estate loan purchases of $120.4 million (including the $36.8 million of loans relating to the acquisition of Asahi Bank of California), the acquisition of $92.6 million and the origination of $34.3 million of film finance loans and the purchase of $7.3 million of franchise loans. In addition, at December 31, 2002, we held $4.2 million of commercial revolving credit loans relating to our strategic alliance with Household.

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Our average total assets increased approximately 3.4% during 2002 to $1.4 billion. Average deposit accounts totaled $931.4 million in 2002 compared to $960.0 million in 2001, a decrease of $28.6 million, or 3.0%. FHLB advances averaged $194.2 million in 2002, compared to $103.7 million in 2001, an increase of $90.5 million, or 87.3%. This increase in average FHLB advances was primarily utilized to fund the increase in the loan portfolio. The average balance of the CMOs was $88.5 million during 2002 compared to $139.3 million in 2001 reflecting repayments on loans held in trust.

**Results of Operations**

**Net Interest Income**

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

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| | Years Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2002 | | | 2001 | | | 2000 | | |
| | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate |
| | (dollars in thousands) | | | | | | | | |
| **Assets** | | | | | | | | | |
| Cash and investment securities | $ 77,384 | $ 3,475 | 4.49% | $ 73,823 | $ 3,192 | 4.32% | $ 84,660 | $ 5,164 | 6.10% |
| Loans *(1)* | 1,083,645 | 91,066 | 8.40% | 1,072,792 | 102,233 | 9.53% | 964,620 | 102,419 | 10.62% |
| Real estate loans held in trust | 143,705 | 10,239 | 7.13% | 189,349 | 14,954 | 7.90% | 182,982 | 16,192 | 8.85% |
| Franchise loans | 60,492 | 4,479 | 7.40% | 32,956 | 2,716 | 8.24% | | | |
| Motion picture financing | 18,060 | 1,349 | 7.47% | | | | | | |
| Total loans receivable | 1,305,902 | 107,133 | 8.20% | 1,295,097 | 119,903 | 9.26% | 1,147,602 | 118,611 | 10.34% |
| Total interest earning assets | 1,383,286 | $ 110,608 | 8.00% | 1,368,920 | $ 123,095 | 8.99% | 1,232,262 | $ 123,775 | 10.04% |
| Non-interest-earning assets | 70,468 | | | 34,218 | | | 28,963 | | |
| Allowance for loan losses | (30,071) | | | (26,835) | | | (24,571) | | |
| Total assets | $ 1,423,683 | | | $ 1,376,303 | | | $ 1,236,654 | | |
| **Liabilities and Shareholders Equity** | | | | | | | | | |
| Deposit accounts: | | | | | | | | | |
| Money market and passbook accounts | $ 151,258 | $ 2,873 | 1.90% | $ 119,022 | $ 4,767 | 4.01% | $ 115,035 | $ 6,384 | 5.55% |
| Time certificates | 780,168 | 26,476 | 3.39% | 841,002 | 48,097 | 5.72% | 798,599 | 49,584 | 6.21% |
| Total deposit accounts | 931,426 | 29,349 | 3.15% | 960,024 | 52,864 | 5.51% | 913,634 | 55,968 | 6.13% |
| Collateralize mortgage obligations | 88,485 | 2,301 | 2.60% | 139,267 | 6,209 | 4.46% | 141,796 | 10,901 | 7.69% |
| FHLB Advances | 194,160 | 5,672 | 2.92% | 103,675 | 4,790 | 4.62% | 30,366 | 1,773 | 5.84% |
| Total interest bearing liabilities | 1,214,071 | $ 37,322 | 3.07% | 1,202,966 | $ 63,863 | 5.31% | 1,085,796 | $ 68,642 | 6.32% |
| Noninterest-bearing liabilities | 62,080 | | | 36,644 | | | 16,586 | | |
| Shareholders equity | 147,532 | | | 136,693 | | | 134,272 | | |
| Total liabilities and shareholders equity | $ 1,423,683 | | | $ 1,376,303 | | | $ 1,236,654 | | |
| Net interest spread *(2)* | | | 4.93% | | | 3.68% | | | 3.72% |
| Net interest income before provisions for loan losses | | $ 73,286 | | | $ 59,232 | | | $ 55,133 | |
| Net interest margin *(3)* | | | 5.30% | | | 4.33% | | | 4.47% |

(1) *Before allowance for loan losses and net of deferred loan fees and costs. Net loan fee amortization of $1.7 million, $1.3 million and $1.7 million was included in net interest income for 2002, 2001 and 2000, respectively.*

*(2) Average yield on interest-earning assets minus average rate paid on interest-bearing liabilities.*

*(3) Net interest income divided by total average interest-earning assets.*

Our primary source of revenue is net interest income. Our net interest income is affected by (a) the difference between the yields recognized on interest-earning assets, including loans and investments, and the interest rates paid on interest-bearing liabilities, which is referred to as net interest spread , and (b) the relative amounts of interest-earning assets and interest-bearing liabilities. As of December 31, 2002, 2001 and 2000, our ratio of average interest-earning assets to average interest-bearing liabilities was 113.93%, 113.80% and 113.49%, respectively.

The following table sets forth a summary of the changes in interest income and interest expense resulting from changes in average interest-earning asset and interest-bearing liability balances and changes in average interest rates. The change in interest due to both volume and rate has been allocated to change due to volume and rate in proportion to the relationship of the absolute dollar amounts of each.

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| | 2002 vs. 2001 | | | 2001 vs. 2000 | | |
|---|---|---|---|---|---|---|
| | Increase (Decrease) Due to: | | | Increase (Decrease) Due to: | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| | (in thousands) | | | | | |
| Interest and fees earned on: | | | | | | |
| Loans, net | $ 4,695 | $ (12,750) | $ (8,055) | $ 13,414 | $ (10,884) | $ 2,530 |
| Cash and investment securities | 159 | 124 | 283 | (467) | (1,505) | (1,972) |
| Real estate loans held in trust | (3,256) | (1,459) | (4,715) | 502 | (1,740) | (1,238) |
| Total increase (decrease) in interest income | 1,598 | (14,085) | (12,487) | 13,449 | (14,129) | (680) |
| Interest paid on: | | | | | | |
| Deposit accounts | (899) | (22,616) | (23,515) | 2,557 | (5,661) | (3,104) |
| Collateralized mortgage obligations | (1,319) | (2,589) | (3,908) | (113) | (4,579) | (4,692) |
| FHLB advances | 2,644 | 1,762 | 882 | 3,387 | (370) | 3,017 |
| Total increase (decrease) in interest expense | 426 | (26,967) | (26,541) | 5,831 | (10,610) | (4,779) |
| Increase (decrease) net interest income | $ 1,172 | $ 12,882 | $ 14,054 | $ 7,618 | $ (3,519) | $ 4,099 |

*2002 Compared to 2001*

Net interest income increased $14.1 million or 23.8% to $73.3 million in 2002 compared to $59.2 million in 2001. The increase in net interest income was primarily attributable to the improvement in net interest spread caused by the declining rate environment, which lowered our average cost of funds and resulted in most of our loans reaching their interest rate floors.

Interest income decreased $12.5 million or 10.1% to $110.6 million in 2002 compared to $123.1 million in 2001. The decrease in interest income was due primarily to our loans being originated or repricing at lower rates due to the general decline in market interest rates. The average yield on our loans was 8.40% in 2002 compared to 9.53% in 2001. Our commercial real estate loan portfolio is primarily comprised of adjustable rate mortgages indexed to the six month LIBOR. Approximately 91.6% of our real estate loan portfolio (including real estate loans held in trust) were adjustable rate mortgages at December 31, 2002. These adjustable rate mortgages generally re-price on a quarterly basis and, as of December 31, 2002, approximately $1.1 billion or 87.1% of our real estate loan portfolio contained interest rate floors, below which the loans contractual interest rate may not adjust. At December 31, 2002, the weighted average floor interest rate of these loans was 7.45%. At that date, approximately $1.1 billion or 97.9% of those loans were at the floor interest rate.

Interest expense on interest-bearing liabilities decreased $26.5 million or 41.6% to $37.3 million in 2002 compared to $63.9 million in 2001 primarily due to a decrease in interest expense on deposits and CMOs. Interest expense from deposit accounts decreased $23.5 million or 44.5% to $29.3 million in 2002 compared to $52.9 million in 2001 due to decreases in the average rate paid on deposits as a result of lower market interest rates. The average rate paid on deposits was 3.15% in 2002 compared to 5.51% in 2001.

Interest expense from the CMOs decreased $3.9 million or 62.9% to $2.3 million in 2002 as compared to $6.2 million in 2001. The decrease was primarily due to a decrease in rates paid on CMOs, as well as a decline in average balance of CMOs. The average balance and average yield on the CMOs was $88.5 million and 2.60% in 2002 as compared to $139.3 million and 4.46% in 2001, respectively.

Interest expense from FHLB advances increased $0.9 million to $5.7 million in 2002 compared to $4.8 million in 2001, due to an increase in the average outstanding balance, which was partially offset by a decrease in the average rate paid on FHLB advances. The average balance of FHLB advances increased $90.5 million or 87.3% to $194.2 million in 2002 compared to $103.7 million in 2001. The average rate paid on FHLB advances was 2.92% in 2002 compared to 4.62% in 2001. We have used our borrowing capacity under our FHLB credit line to take advantage of the current favorable short-term rate environment through effective liability management, which has lowered our cost of funds and enhanced our net interest income.

**Provision for Loan losses**

Provision for loan losses increased to $9.0 million in 2002 compared to $4.6 million in 2001. The current period provision for loan losses was recorded to provide the reserves adequate to support the known and inherent risk of loss resulting from the current growth in the loan portfolio and due to the increase in other loans of concern to $35.5 million from $21.5 million at December 31, 2001. See also Credit Risk Elements Allowance for Loan Losses and Nonperforming Assets .

**Non-interest Income**

Non-interest income decreased $0.7 million to $0.4 million in 2002 compared to $1.1 million in 2001. The decrease in non-interest income was due primarily to a $0.5 million net valuation provision recorded in 2002 for the Company s residual interest relating to the securitization of our residential loan portfolio.

**Non-interest Expense**

**General and Administrative Expense**

General and administrative expense totaled $27.0 million and $22.8 million in 2002 and 2001, respectively. In 2002, our ratio of recurring general and administrative expenses to average assets was 1.90%, compared to 1.66% in 2001. This increase was primarily attributable to the additions made to the retail and wholesale loan originations sales and support staff, and certain infrastructure costs relating to the charter conversion activities, including core processing system conversion costs, and additions to the information technology and savings and operation staff. Full time equivalent associates averaged 154 in 2002 compared to 133 in 2001.

**Real Estate Owned Expense**

Real estate owned expense, net, increased to $1.3 million in 2002 compared to $0.4 million in 2001. The increase was primarily attributable to a $0.5 million increase in real estate owned expense and to the $0.5 million increase in the provision for losses on other real estate owned ( OREO ). These increases were offset by a $0.1 million increase in gain on sale of OREO, net. See also Credit Risk Elements Allowance for Loan Losses and Nonperforming Assets .

**Income Taxes**

Provision for income taxes increased to $12.8 million in 2002 compared to $11.4 million in 2001. The increase in provision for income taxes was primarily due to an increase in taxable income. The effective tax rate was 39.0% and 38.6% for 2002 and 2001, respectively. The effective tax rate differed from the applicable statutory federal tax rate due to state income taxes and the state income tax deduction for tax exempt income on loans located in designated redevelopment and enterprise zones and due to federal income tax credits received from a low income housing tax credit investment.

At December 31, 2002, we had a net deferred tax asset of $13.8 million. The deferred tax asset related primarily to loss provisions recognized on our financial statements that have not yet been recognized on our income tax returns. During 2002, we had no deferred tax assets relating to net operating loss carry forward deductions. The deferred tax asset is considered fully realizable, as when the temporary differences associated with the deferred tax assets are recognized for income tax purposes, those deductions are expected to be fully offset, either by carryback against previously taxed income or by a reduction of future taxable income. Accordingly, we have not established a valuation allowance on the deferred tax asset.

**Minority Interest in Income of Subsidiary**

Minority interest in income of subsidiary, consisting of accrued distributions payable on our Trust Preferred securities, was $3.5 million in 2002 as compared to $3.0 million in 2001. The increase was due to the additional issuance of $55.0 million of variable rate cumulative Trust Preferred securities in 2002, as well as the Trust Preferred securities issued in 2001 being outstanding for the entire fiscal year in 2002. See

Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Note 10 .

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*2001 Compared to 2000*

Net interest income increased $4.1 million or 7.4% to $59.2 million in 2001 compared to $55.1 million in 2000. The increase in net interest income was primarily attributable to the improvement in net interest spread realized by the REIT due to its liability sensitive position as its liabilities re-priced faster than its assets during the year. The net interest income of the Bank increased as the interest income attributable to the growth in the average balance of its loan portfolio was offset by the spread compression experienced due to the general market decline in interest rates during the year.

Interest income decreased $680,000 or 0.5% to $123.1 million in 2001 compared to $123.8 million in 2000. The decrease in interest income was due primarily to a $2.0 million decrease in interest income from cash and investment securities and a $1.2 million decrease in interest income from real estate loans held in trust, partially offset by a $2.5 million increase in interest income from real estate loans. Interest and fee income from real estate loans increased due to higher loan volume in 2001, partially offset by a decrease in loan yield. The average balance of the Bank s real estate loans increased $108.2 million to $1.1 billion in 2001 compared to $964.6 million in 2000. The average yield on these real estate loans was 9.53% in 2001 compared to 10.62% in 2000. The average balance of the real estate loans held in trust increased $6.4 million to $189.3 million in 2001 compared to $183.0 million in 2000. The average yield on these loans was 7.90% in 2001 compared to 8.85% in 2000. The decrease in the yield on real estate loans was primarily due to the repricing of variable rate loans at lower interest rates resulting from the general decline in market interest rates. Our commercial real estate loan portfolio is primarily comprised of adjustable rate mortgages indexed to the six month LIBOR. Approximately 92.8% of our real estate loan portfolio (including real estate loans held in trust) were adjustable rate mortgages at December 31, 2001. These adjustable rate mortgages generally reprice on a quarterly basis and approximately $1.1 billion or 94.1% of our real estate loan portfolio contained interest rate floors, below which the loans contractual interest rate may not adjust. At December 31, 2001, the weighted average floor interest rate of these loans was 8.97%. At that date, approximately $1.1 billion or 95.5% of those loans were at the floor interest rate, approximately $41.4 million or 3.7% were within 50 basis points of their floor interest rate, and approximately $46.6 million or 4.2% were greater than 50 but less than 100 basis points from their floor interest rate. Excluding this income from prepayments, the yields on the Bank s real estate loans would have been 9.30% in 2001 and 10.34% in 2000 and the yields on the real estate loans held in trust would have been 7.81% in 2001 and 8.65% in 2000.

Interest income from cash and investments decreased to $3.2 million in 2001 compared to $5.2 million in 2000, due primarily to a decrease in yield and a decrease in the average outstanding balance. The average balance of cash and investment securities decreased $10.9 million or 12.9% to $73.8 million in 2001 compared to $84.7 million in 2000. The average yield on cash and investment securities was 4.32% in 2001 compared to 6.10% in 2000, which was consistent with the decrease in short-term market interest rates.

Interest expense on interest-bearing liabilities decreased $4.8 million or 6.9% to $63.9 million in 2001 compared to $68.6 million in 2000 primarily due to a decrease in interest expense on deposits and CMOs partially offset by an increase in interest expense on FHLB advances. Interest expense from deposit accounts decreased $3.1 million or 5.5% to $52.9 million in 2001 compared to $56.0 million in 2000 due to decreases in the average rate paid on deposits. The average rate paid on deposits was 5.51% in 2001 compared to 6.13% in 2000. The average balance of deposits increased $46.4 million or 5.1% to $960.0 million in 2001 compared to $913.6 million in 2000 as we increased deposits to fund growth in the loan portfolio.

Interest expense from the CMOs decreased $4.7 million or 43.1% to $6.2 million in 2001 as compared to $10.9 million in 2000. The decrease is primarily due to a decrease in rates paid on CMOs partially offset by a higher average balance of CMOs. The average balance and average yield on the CMOs was $139.3 million and 4.46% in 2001 as compared to $141.8 million and 7.69% in 2000, respectively.

Interest expense from FHLB advances increased $3.0 million to $4.8 million in 2001 compared to $1.8 million in 2000, due to an increase in the average outstanding balance partially offset by a decrease in the average rate paid on FHLB advances. The average balance of FHLB advances increased $73.3 million or 241.4% to $103.7 million in 2001 compared to $30.4 million in 2000. The average rate paid on FHLB advances was 4.62% in 2001 compared to 5.84% in 2000.

**Provision for Loan losses**

Provision for loan losses decreased to $4.6 million in 2001 compared to $4.8 million in 2000. The decrease in the provision for loan losses was due to the reduction in our nonperforming loans to 1.17% of total gross loans at December 31, 2001, compared to 1.42% of total gross loans as of December 31, 2000, and the decline in other loans of concern of $49.4 million since December 31, 2000. In addition, the provision also reflects the reallocation of $2.7 million of allowance for loan losses from the Imperial Capital REIT to the Bank, as actual loan losses related to real estate loans held in trust had been negligible, and this loan portfolio had decreased due to principal payments. See also Credit Risk Elements Allowance for Loan Losses and Nonperforming Assets .

**Non-interest Income**

Non-interest income decreased $1.2 million to $1.1 million in 2001 compared to $2.3 million in 2000. The decrease in non-interest income was due primarily to a $1.4 million gain realized on the sale investment securities in 2000. Excluding this gain on sale of investment securities in 2000, other non-interest income increased slightly to $1.1 million in 2001 compared to $0.9 million in 2000.

**Non-interest Expense**

**General and Administrative Expense**

General and administrative expense totaled $22.8 million and $22.1 million in 2001 and 2000, respectively. In 2001, our ratio of recurring general and administrative expenses to average assets was 1.66%, compared to 1.78% in 2000. Our efficiency ratio, excluding real estate owned and nonrecurring expenses, was 37.85% in 2001 compared to 35.94% in 2000.

General and administrative expense increased $0.8 million to $22.8 million in 2001 compared to $22.1 million in 2000. The previous year s non-interest expense included a $1.4 million non-recurring charge relating to the consolidation of the Bank s headquarters with ITLA Capital s headquarters in La Jolla, California. Compensation and benefits expense totaled $11.8 million in 2001 compared to $10.0 million in 2000. The increase in compensation and benefits expense was primarily due to additions made to the retail and wholesale loan originations sales and support staff. Full time equivalent associates averaged 133 in 2001 compared to 122 in 2000.

**Real Estate Owned Expense**

Real estate owned expense, net, increased to $0.4 million in 2001 compared to $0.1 million in 2000. The increase in real estate owned expense in 2001 compared to 2000 was primarily due to the increase in the outstanding balance of OREO to $13.7 million at December 31, 2001 compared to $2.3 million at December 31, 2000. The increase in OREO during 2001 was primarily related to three commercial properties. Provision for losses on other real estate owned totaled $0.3 million in 2001 compared to $0.2 million in 2000. Other real estate owned expense was $0.1 million in 2001 compared to income of $31,000 in 2000. There was a net gain of $18,000 from sales of other real estate owned in 2001 compared to a net loss of $2,000 in 2000. See also Credit Risk Elements Allowance for Loan Losses and Nonperforming Assets .

**Income Taxes**

Provision for income taxes decreased to $11.4 million in 2001 compared to $11.9 million in 2000. The decrease in provision for income taxes was primarily due to a lower effective tax rate. The effective tax rate was 38.6% and 39.6% for 2001 and 2000, respectively. The effective tax rate differed from the applicable statutory federal tax rate due to state income taxes and the state income tax deduction for tax exempt income on loans located in designated redevelopment and enterprise zones and due to federal income tax credits received from a low income housing tax credit investment.

At December 31, 2001, we had a net deferred tax asset of $11.9 million. The deferred tax asset related primarily to loss provisions recognized on our financial statements that have not yet been recognized on our income tax returns. During 2001, we had no deferred tax assets relating to net operating loss carry forward deductions. The deferred tax asset is considered fully realizable, as when the temporary differences associated with the deferred tax assets are recognized for income tax purposes, those deductions are expected to be fully offset, either by carryback against previously taxed income or by a reduction of future taxable income. Accordingly, we have not established a valuation allowance on the deferred tax asset.

**Minority Interest in Income of Subsidiary**

Minority interest in income of subsidiary, consisting of accrued distributions payable on our Trust Preferred securities, was $3.0 million in 2001 as compared to $0.5 million in 2000. The increase in the minority interest in income of subsidiary is due to an additional issuance of Trust Preferred securities in 2001 as well as the Trust Preferred securities issued in September 2000 being outstanding for all of 2001. See Item 8. Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Note 10 .

**Financial Condition**

*At December 31, 2002 Compared with December 31, 2001*

Total assets increased by $213.7 million, or 14.2%, to $1.7 billion at December 31, 2002 compared to $1.5 billion at December 31, 2001. This increase was primarily due to a $26.6 million, or 19.8%, increase in cash and cash equivalents to $160.8 million at December 31, 2002 from $134.2 million at December 31, 2001, and a $193.9 million, or 17.3%, increase in loans receivable, net to $1.3 billion at December 31, 2002 from $1.1 billion at December 31, 2001. These increases were partially offset by the reductions in net real estate loans held in trust of $40.2 million. The growth in assets was funded primarily by an increase in FHLB advances of $69.4 million and deposits of $112.3 million. The increase in deposits was primarily concentrated in brokered deposits with a lower cost of funds than the current market rates offered through the Bank s retail branch network. CMOs decreased from $109.6 million at December 31, 2001 to $69.1 million at December 31, 2002, reflecting the repayments on loans held in trust. Shareholders equity increased primarily due to the retention of $20.0 million of net income as retained earnings for the year, partially offset by the purchase of $2.3 million of ITLA Capital s common stock currently held as treasury stock.

*At December 31, 2001 Compared with December 31, 2000*

Total assets increased by $93.2 million, or 6.6%, to $1.5 billion at December 31, 2001 compared to $1.4 billion at December 31, 2000. This increase was primarily due to a $63.3 million, or 89.2%, increase in cash and cash equivalents to $134.2 million at December 31, 2001 from $71.0 million at December 31, 2000 and a $76.4 million, or 7.31%, increase in net real estate loans receivable to $1.1 billion at December 31, 2001 from $1.0 billion at December 31, 2000. Asset growth also included increases in FHLB Stock of $9.5 million and other real estate owned, net, of $11.5 million. These increases were partially offset by the reductions in net real estate loans held in trust of $49.5 million and investment securities available for sale of $16.9 million. The growth in assets was funded primarily by an increase in FHLB advances of $190.0 million partially offset by a decrease in deposits of $62.0 million. The decrease in deposits was primarily concentrated in time certificates, which decreased $117.3 million and was partially offset by an increase in money market and passbooks of $55.3 million, as depositors moved their investments to liquid and short term accounts during the declining market rate environment. CMOs decreased from $161.9 million at December 31, 2000 to $109.6 million at December 31, 2001. Shareholders equity increased primarily due to the retention of $18.2 million of net income as retained earnings for the year, partially offset by the purchase of $14.8 million of ITLA Capital s common stock currently held as treasury stock.

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**Loans Receivable, Net**

The following table shows the comparison of our loan portfolio by major categories as of the dates indicated.

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| | | | (in thousands) | | |
| Real estate loans | $1,189,258 | $1,191,688 | $1,176,988 | $864,048 | $811,076 |
| Construction loans | 101,422 | 54,129 | 95,206 | 107,833 | 71,385 |
| Total real estate loans | 1,290,680 | 1,245,817 | 1,272,194 | 971,881 | 882,461 |
| Film finance | 119,283 | | | | |
| Franchise loans | 54,672 | 57,617 | 3,912 | | |
| Commercial and other loans | 4,314 | | | | |
| | 1,468,949 | 1,303,434 | 1,276,106 | 971,881 | 882,461 |
| Unamortized premium | 7,898 | 9,773 | 11,300 | 2,590 | |
| Deferred loan origination fees and costs | (5,604) | (2,029) | (2,571) | (3,096) | (3,561) |
| | 1,471,243 | 1,311,178 | 1,284,835 | 971,375 | 878,900 |
| Allowance for loan losses | (33,009) | (26,650) | (27,186) | (19,895) | (16,811) |
| | 1,438,234 | 1,284,528 | 1,257,649 | 951,480 | 862,089 |
| **Real Estate Loans Held for Sale (at lower of cost or fair market value)** | | | | | |
| Real estate loans | | | | | 12,188 |
| Gross loans held for sale | | | | | |