UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ending March 31, 2020

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 001-39123

SILVERGATE CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	**33-0227337**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4250 Executive Square, Suite 300, La Jolla, CA 92037
(Address of principal executive offices, including zip code)
(858) 362-6300
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Class A Common Stock, par value $0.01 per share	SI	New York Stock Exchange

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

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

Yes ☒ No ☐

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

Large accelerated filer	☐	Accelerated filer	☐	Emerging growth company	☒
Non-accelerated Filer	☒	Smaller reporting company	☒		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☒

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

As of May 5, 2020, the registrant had 18,371,294 shares of Class A voting common stock and 296,836 shares of Class B non-voting common stock outstanding.

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FORM 10-Q
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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

SILVERGATE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(In Thousands, Except Par Value Amounts)
(Unaudited)

	March 31, 2020	December 31, 2019
ASSETS		
Cash and due from banks	$ 2,778	$ 1,579
Interest earning deposits in other banks	163,422	132,025
Cash and cash equivalents	166,200	133,604
Securities available-for-sale, at fair value	964,317	897,766
Loans held-for-sale, at lower of cost or fair value	435,023	375,922
Loans held-for-investment, net of allowance for loan losses of $6,558 and $6,191 at March 31, 2020 and December 31, 2019, respectively	679,416	664,622
Federal home loan and federal reserve bank stock, at cost	10,269	10,264
Accrued interest receivable	6,344	5,950
Other real estate owned, net	—	128
Premises and equipment, net	3,406	3,259
Operating lease right-of-use assets	4,210	4,571
Derivative assets	33,506	23,440
Low income housing tax credit investment	927	954
Other assets	7,090	7,647
Total assets	$ 2,310,708	$ 2,128,127
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing demand accounts	$ 1,745,219	$ 1,343,667
Interest bearing accounts	257,738	470,987
Total deposits	2,002,957	1,814,654
Federal home loan bank advances	30,000	49,000
Notes payable	—	3,714
Subordinated debentures, net	15,820	15,816
Operating lease liabilities	4,515	4,881
Accrued expenses and other liabilities	12,664	9,026
Total liabilities	2,065,956	1,897,091
Commitments and contingencies		
Preferred stock, $0.01 par value—authorized 10,000 shares; no shares issued or outstanding at March 31, 2020 and December 31, 2019	—	—
Class A common stock, $0.01 par value—authorized 125,000 shares; 18,371 and 17,775 shares issued and outstanding at March 31, 2020 and December 31, 2019, respectively	184	178
Class B non-voting common stock, $0.01 par value—authorized 25,000 shares; 297 and 893 shares issued and outstanding at March 31, 2020 and December 31, 2019, respectively	3	9
Additional paid-in capital	132,336	132,138
Retained earnings	96,703	92,310
Accumulated other comprehensive income	15,526	6,401
Total shareholders' equity	244,752	231,036
Total liabilities and shareholders' equity	$ 2,310,708	$ 2,128,127

See accompanying notes to unaudited consolidated financial statements

SILVERGATE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)
(Unaudited)

	Three Months Ended March 31,	
	2020	2019
Interest income		
Loans, including fees	$ 13,121	$ 13,111
Taxable securities	6,048	3,033
Tax-exempt securities	48	—
Other interest earning assets	724	3,797
Dividends and other	121	122
Total interest income	20,062	20,063
Interest expense		
Deposits	4,051	341
Federal home loan bank advances	227	—
Notes payable and other	36	142
Subordinated debentures	270	264
Total interest expense	4,584	747
Net interest income before provision for loan losses	15,478	19,316
Provision for loan losses	367	267
Net interest income after provision for loan losses	15,111	19,049
Noninterest income		
Mortgage warehouse fee income	382	366
Service fees related to off-balance sheet deposits	70	759
Deposit related fees	1,766	987
Gain on sale of securities, net	1,197	—
Gain on sale of loans, net	506	189
Gain on sale of branch, net	—	5,509
Gain on extinguishment of debt	925	—
Other income	85	61
Total noninterest income	4,931	7,871
Noninterest expense		
Salaries and employee benefits	8,955	8,765
Occupancy and equipment	907	873
Communications and data processing	1,261	1,037
Professional services	985	1,445
Federal deposit insurance	123	175
Correspondent bank charges	373	279
Other loan expense	122	125
Other general and administrative	1,149	787
Total noninterest expense	13,875	13,486
Income before income taxes	6,167	13,434
Income tax expense	1,774	3,998
Net income	$ 4,393	$ 9,436
Basic earnings per share	$ 0.24	$ 0.53
Diluted earnings per share	$ 0.23	$ 0.52
Weighted average shares outstanding:		
Basic	18,668	17,818
Diluted	19,117	18,258

See accompanying notes to unaudited consolidated financial statements

SILVERGATE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2020	**2019**
Net income	$ 4,393	$ 9,436
Other comprehensive income (loss):		
Change in net unrealized (loss) gain on available-for-sale securities	(9,313)	663
Less: Reclassification adjustment for net gains included in net income	(1,197)	—
Income tax effect	3,007	(200)
Unrealized (loss) gain on available-for-sale securities, net of tax	(7,503)	463
Change in net unrealized gain (loss) on derivative assets	23,466	(46)
Less: Reclassification adjustment for net gains included in net income	(171)	—
Income tax effect	(6,667)	19
Unrealized gain (loss) on derivative instruments, net of tax	16,628	(27)
Other comprehensive income	9,125	436
Total comprehensive income	$ 13,518	$ 9,872

See accompanying notes to unaudited consolidated financial statements

SILVERGATE CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In Thousands, Except Share Data)
(Unaudited)

	Class A Common Stock		Class B Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at January 1, 2019	16,628,941	$ 166	1,189,548	$ 12	$ 125,665	$ 67,464	$ (2,061)	$ 191,246
Total comprehensive income, net of tax	—	—	—	—	—	9,436	436	9,872
Stock-based compensation	—	—	—	—	19	—	—	19
Balance at March 31, 2019	16,628,941	166	1,189,548	12	125,684	76,900	(1,625)	201,137

	Class A Common Stock		Class B Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at January 1, 2020	17,775,160	$ 178	892,836	$ 9	$ 132,138	$ 92,310	$ 6,401	$ 231,036
Total comprehensive income, net of tax	—	—	—	—	—	4,393	9,125	13,518
Conversion of Class B common stock to Class A common stock	596,000	6	(596,000)	(6)	—	—	—	—
Stock-based compensation	—	—	—	—	199	—	—	199
Exercise of stock options, net of shares withheld for employee taxes	134	—	—	—	(1)	—	—	(1)
Balance at March 31, 2020	18,371,294	184	296,836	3	132,336	96,703	15,526	244,752

See accompanying notes to unaudited consolidated financial statements

SILVERGATE CAPITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Three Months Ended March 31,	
	2020	**2019**
Cash flows from operating activities		
Net income	$ 4,393	$ 9,436
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	830	255
Amortization of securities premiums and discounts, net	679	130
Amortization of loan premiums and discounts and deferred loan origination fees and costs, net	399	(102)
Stock-based compensation	199	19
Deferred income tax expense (benefit)	487	(6)
Provision for loan losses	367	267
Gain on sale of loans, net	(506)	(189)
Gain on sale of securities, net	(1,197)	—
Originations/purchases of loans held-for-sale	(1,222,816)	(622,318)
Proceeds from sales of loans held-for-sale	1,153,515	606,240
Gain on sale of branch, net	—	(5,509)
Gain on extinguishment of debt	(925)	—
Other, net	(168)	354
Changes in operating assets and liabilities:		
Accrued interest receivable and other assets	(520)	(142)
Accrued expenses and other liabilities	87	398
Net cash used in operating activities	(65,176)	(11,167)
Cash flows from investing activities		
Purchases of securities available-for-sale	(98,986)	(110,319)
Proceeds from paydowns and maturities of securities available-for-sale	7,936	5,498
Proceeds from sale of securities available-for-sale	14,016	—
Loan originations/purchases and payments, net	(41,254)	(12,790)
Proceeds from sale of loans held-for-sale previously classified as held-for-investment	36,400	11,622
Purchase of federal home loan and federal reserve bank stock, net	(5)	(603)
Proceeds from sale of other real estate owned	128	—
Purchase of premises and equipment	(391)	(435)
Proceeds from sale of branch, net of cash	—	32,555
Proceeds from (purchases of) derivative contracts, net	13,370	(2,555)
Other, net	—	2
Net cash used in investing activities	(68,786)	(77,025)
Cash flows from financing activities		
Net change in noninterest bearing deposits	401,552	(86,897)
Net change in interest bearing deposits	(213,250)	(22,893)
Net change in federal home loan bank advances	(18,075)	—
Net change in other borrowings	—	57,135
Payments made on notes payable	(3,714)	(571)
Taxes paid related to net share settlement of equity awards	(1)	—
Other, net	46	22
Net cash provided by (used in) financing activities	166,558	(53,204)
Net increase (decrease) in cash and cash equivalents	32,596	(141,396)
Cash and cash equivalents, beginning of year	133,604	674,420
Cash and cash equivalents, end of year	$ 166,200	$ 533,024

See accompanying notes to unaudited consolidated financial statements

SILVERGATE CAPITAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Nature of Business and Summary of Significant Accounting Policies

Nature of Business

The accompanying consolidated financial statements include the accounts of Silvergate Capital Corporation, a Maryland corporation and its wholly-owned subsidiary, Silvergate Bank (the "Bank"), collectively referred to as (the "Company" or "Silvergate").

The Bank was incorporated in 1987 and commenced business in 1988 under the California Financial Code as an industrial bank. In February 2009 the Bank converted its charter to a California commercial bank, which gave it the added authority to accept demand deposits. At the same time, the Company also became a registered bank holding company under the federal Bank Holding Company Act. The Bank became a member of the Federal Reserve System in December 2012. The Bank is subject to regulation by the California Department of Business Oversight ("DBO"), and the Federal Reserve Bank of San Francisco ("FRB"), and its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to applicable legal limits.

On November 15, 2018, the Company and the Bank entered into a purchase and assumption agreement to sell the Bank's retail branch located in San Marcos, California and business loan portfolio to HomeStreet Bank. The Company completed the sale in March 2019, which included the reduction of $115.4 million in loans and $74.5 million in deposits and resulted in a pre-tax gain on sale of $5.5 million.

Financial Statement Preparation and Presentation

The accompanying interim consolidated financial statements have been prepared by the Company, without audit, in accordance with the instructions to the Quarterly Report on Form 10-Q, and Rule 10-01 of Regulation S-X promulgated by the United States Securities and Exchange Commission (the "SEC") and, therefore, do not include all information and footnotes necessary for a fair presentation of its consolidated financial statements in accordance with accounting principles generally accepted in the United States ("GAAP").

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, consisting of only normal and recurring adjustments, necessary for a fair presentation of the Company's consolidated financial statements as of March 31, 2020, however uncertainty over the ultimate impact that the novel coronavirus disease, (or "COVID-19") will have on the economy generally, and on the Company's business in particular, makes any estimates and assumptions as of March 31, 2020 inherently less certain than they would be absent the current and potential impacts of COVID-19.

These consolidated statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K dated March 10, 2020. Operating results for interim periods are not necessarily indicative of operating results for an entire fiscal year.

The consolidated financial statements include the accounts of the Company and all other entities in which it has a controlling financial interest. All significant intercompany accounts and transactions have been eliminated in consolidation. Unless the context requires otherwise, all references to the Company include its wholly owned subsidiaries. The accounting and reporting policies of the Company are based upon GAAP and conform to predominant practices within the financial services industry.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the Company's financial statements and the accompanying notes. Actual results could materially differ from those estimates.

Recently issued accounting pronouncements not yet effective

In June 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update (or "ASU") 2016-13, Financial Instruments-Credit Losses (Topic 326) to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (or "CECL") model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held to maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor. These amendments were initially effective for fiscal years beginning after December 15, 2019 for SEC registrants and after December 15, 2020, for Public Business Entities, or PBEs. In November 2019, the FASB issued ASU 2019-10, Financial Instruments-Credit Losses (Topic326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates, which finalized the delay of the effective date for smaller reporting companies, such as the Company to apply the standards related to

CECL, until fiscal years beginning after December 15, 2022. For debt securities with other than temporary impairment (OTTI), the guidance will be applied prospectively and for existing purchased credit impaired (PCI) assets will be grandfathered and classified as purchased credit deteriorated (PCD) assets at the date of adoption. The asset will be grossed up for the allowance for expected credit losses for all PCD assets at the date of adoption and will continue to recognize the noncredit discount in interest income based on the yield such assets as of the adoption date. Subsequent changes in expected credit losses will be recorded through the allowance. For all other assets with the scope of CECL, the cumulative effect adjustment will be recognized in retained earnings as of the beginning of the first reporting period in which the guidance is effective. In November 2018, the FASB issued ASU 2018-19, Codification Improvements to Topic 326, Financial Instruments-Credit Losses, which clarify that receivables arising from operating leases are not within the scope of Subtopic 326-20. Instead, impairment of receivables arising from operating leases should be accounted for in accordance with Topic 842, Leases. The Company formed a CECL implementation committee in 2018 which prepared a project plan to migrate towards the adoption date. As part of the project plan, the Company contracted a third-party vendor to assist in the application and analysis of ASU 2016-13 as well as a third party vendor to perform an independent model validation. As part of this process, the Company has determined preliminary loan pool segmentation under CECL, as well as evaluated the key economic loss drivers for each segment. The Company operationalized an initial CECL model during the second quarter of 2019, and is running this preliminary CECL model alongside the existing incurred loss methodology. The Company intends to continue to refine and run the model until the date of adoption. The Company continues to evaluate the effects of ASU 2016-13 on its financial statements and disclosures and whether or not to early adopt the guidance.

In March 2020, the FASB issued ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting (or “ASU 2020-04”), which provides temporary, optional guidance to ease the potential burden in accounting for, or recognizing the effects of, the transition away from the London Interbank Offered Rate (or “LIBOR”) or other interbank offered rate (reference rates) on financial reporting, which currently is expected to be discontinued by the end of 2021. To help with the transition to new reference rates, the ASU provides optional expedients and exceptions for applying GAAP to affected contract modifications and hedge accounting relationships. The guidance is applicable only to contracts or hedge accounting relationships that reference LIBOR or another reference rate expected to be discontinued. The expedients and exceptions in this update are available to all entities starting March 12, 2020 through December 31, 2022. The Company is evaluating the impact that ASU 2020-04 will have on those financial assets where LIBOR is used as an index rate.

With the exception of the updated standards discussed above, there have been no new accounting pronouncements not yet effective that have significance, or potential significance, to the Company’s consolidated financial statements.

Note 2—Securities

The fair value of available-for-sale securities and their related gross unrealized gains and losses at the dates indicated are as follows:

	Available-for-sale securities			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
March 31, 2020				
Residential mortgage-backed securities:				
Government agency mortgage-backed securities	$ 682	$ 34	$ —	$ 716
Government agency collateralized mortgage obligation	236,334	709	(863)	236,180
Private-label collateralized mortgage obligation	25,844	—	(3,462)	22,382
Commercial mortgage-backed securities:				
Private-label collateralized mortgage obligation	364,543	10,913	(806)	374,650
Municipal bonds	85,268	7,388	—	92,656
Asset backed securities:				
Government sponsored student loan pools	256,449	—	(18,716)	237,733
	$ 969,120	$ 19,044	$ (23,847)	$ 964,317

	Available-for-sale securities			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
December 31, 2019				
Residential mortgage-backed securities:				
Government agency mortgage-backed securities	$ 769	$ 32	$ —	$ 801
Government agency collateralized mortgage obligation	242,203	552	(837)	241,918
Private-label collateralized mortgage obligation	26,346	352	(198)	26,500
Commercial mortgage-backed securities:				
Private-label collateralized mortgage obligation	364,719	12,474	(177)	377,016
Asset backed securities:				
Government sponsored student loan pools	258,022	—	(6,491)	251,531
	$ 892,059	$ 13,410	$ (7,703)	$ 897,766

There were no investment securities pledged for borrowings or for other purposes as required or permitted by law as of March 31, 2020 and December 31, 2019.

At March 31, 2020, the total fair value of securities issued by six individual issuers, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity was $343.0 million.

Securities with unrealized losses as of the dates indicated, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Available-for-sale securities					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
March 31, 2020						
Residential mortgage-backed securities:						
Government agency collateralized mortgage obligation	134,490	(820)	4,530	(43)	139,020	(863)
Private-label collateralized mortgage obligation	10,325	(481)	12,057	(2,981)	22,382	(3,462)
Commercial mortgage-backed securities:						
Private-label collateralized mortgage obligation	41,720	(806)	—	—	41,720	(806)
Asset backed securities:						
Government sponsored student loan pools	22,615	(1,772)	215,117	(16,944)	237,732	(18,716)
	$ 209,150	$ (3,879)	$ 231,704	$ (19,968)	$ 440,854	$ (23,847)

	Available-for-sale securities					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
December 31, 2019						
Residential mortgage-backed securities:						
Government agency collateralized mortgage obligation	$ 143,633	$ (785)	$ 15,794	$ (52)	$ 159,427	$ (837)
Private-label collateralized mortgage obligation	59	(1)	15,168	(197)	15,227	(198)
Commercial mortgage-backed securities:						
Private-label collateralized mortgage obligation	13,142	(177)	—	—	13,142	(177)
Asset backed securities:						
Government sponsored student loan pools	62,938	(1,317)	188,593	(5,174)	251,531	(6,491)
	$ 219,772	$ (2,280)	$ 219,555	$ (5,423)	$ 439,327	$ (7,703)

As indicated in the tables above, as of March 31, 2020, the Company's investment securities had gross unrealized losses totaling approximately $23.8 million, compared to approximately $7.7 million at December 31, 2019. The Company analyzed all of its securities with an unrealized loss position. For each security, the Company analyzed the credit quality and performed a projected cash flow analysis. In analyzing the credit quality, management may consider whether the securities are issued by the federal government, its agencies or its sponsored entities, or non-governmental entities, whether downgrades by bond rating agencies have occurred, and if credit quality has deteriorated. When performing a cash flow analysis the Company uses models that project prepayments, default rates, and loss severities on the collateral supporting the security, based on underlying loan level borrower and loan characteristics and interest rate assumptions. In addition, the Company has contracted with third party companies to perform independent cash flow analyses of its securities portfolio as needed. Based on these analyses and reviews conducted by the Company, and assisted by independent third parties, the Company determined that none of its securities required an other-than-temporary impairment charge at March 31, 2020 or December 31, 2019. Management continues to expect to recover the adjusted amortized cost basis of these bonds.

As of March 31, 2020, the Company had 33 securities whose estimated fair value declined 5.13% from the Company's amortized cost; at December 31, 2019, the Company had 33 securities whose estimated fair value declined 1.72% from the Company's amortized cost. The increase in percentage of unrealized losses is related to market liquidity concerns associated with COVID-19 during the first quarter which widened credit spreads on securities and changes in market interest rates since the purchase dates. Unrecognized losses associated with liquidity concerns as a result of COVID-19 are not expected to remain constant in the future, however, unrecognized losses will continue to vary with general market interest rate fluctuations. Fair values are expected to recover as the securities approach their respective maturity dates and management believes it is not more likely than not it will be required to sell before recovery of the amortized cost basis.

For the three months ended March 31, 2020 the Company received $14.0 million in proceeds and recognized a $1.2 million gain on sales of available-for-sale securities. There were no sales and calls of securities for the three months ended March 31, 2019.

There were no credit losses recognized in earnings for the three months ended March 31, 2020 and 2019.

Note 3—Loans

The following disclosure reports the Company's loan portfolio segments and classes. Segments are groupings of similar loans at a level in which the Company has adopted systematic methods of documentation for determining its allowance for loan and credit losses. Classes are a disaggregation of the portfolio segments. The Company's loan portfolio segments are:

Real estate loans. Real estate includes loans for which the Company holds one-to-four family, multi-family, commercial and construction real property as collateral. Commercial real estate lending activity is typically restricted to owner-occupied properties or to investor properties that are owned by customers with a current banking relationship. The primary risks of real estate mortgage loans include the borrower's inability to pay, material decreases in the value of the real estate that is being held as collateral and significant increases in interest rates, which may make the real estate mortgage loan unprofitable. Real estate loans also may be adversely affected by conditions in the real estate markets or in the general economy.

Commercial and industrial. Commercial and industrial loans consist of loans and lines of credit to small and medium-sized businesses in a wide variety of industries, including distributors, manufacturers, software developers business services companies and independent finance companies. Commercial and industrial loans are generally collateralized by accounts receivable, inventory, equipment, loan and lease receivables, and other commercial assets, and may be supported by other credit enhancements such as personal guarantees. Risk may arise from differences between expected and actual cash flows and/or liquidity levels of the borrowers, as well as the type of collateral securing these loans and the reliability of the conversion thereof to cash. Since the March 2019 sale of the business loan portfolio, commercial and industrial loans consist primarily of asset based loans. In 2020, the Company began offering a new pilot product called SEN Leverage, which will allow Silvergate customers to obtain U.S. dollar loans collateralized by bitcoin held at select digital currency exchanges that are also Silvergate customers. The product uses the Silvergate Exchange Network ("SEN") to fund loans and process repayments in real-time 24 hours per day, 7 days per week. The Company plans to expand this offering in the latter part of 2020. The outstanding loan balance of SEN Leverage loans was immaterial as of March 31, 2020.

Consumer and other. Consumer loans consist of consumer loans and other loans secured by personal property.

Reverse mortgage. From 2012 to 2014, the Company purchased home equity conversion mortgage ("HECM") loans (also known as reverse mortgage loans) which are a special type of home loan, for homeowners aged 62 years or older, that requires no monthly mortgage payments. Reverse mortgage loan insurance is provided by the U.S. Federal Housing Administration through the HECM program which protects lenders from losses due to non-repayment of the loans. In mid-2014, the Company ceased purchases of reverse mortgage loans and, began selling its remaining loans in the secondary market.

Mortgage warehouse. The Company's warehouse lending division provides short-term interim funding for single-family residential mortgage loans originated by mortgage bankers or other lenders pending the sale of such loans in the secondary market. The Company's risk is mitigated by comprehensive policies, procedures, and controls governing this activity, partial loan funding by the originating lender, guaranties or additional monies pledged to the Company as security, and the short holding period of funded loans on the Company's balance sheet. In addition, the loss rates of this portfolio have historically been minimal, and these loans are all subject to written purchase commitments from takeout investors or are hedged. The Company's mortgage warehouse loans may either be held-for-investment or held-for-sale depending on the underlying contract. The Company sold approximately $21.7 million and $63.9 million of loans to participants during the three months ended March 31, 2020 and 2019, respectively. At March 31, 2020 and December 31, 2019, gross warehouse loans were approximately $486.6 million and $405.0 million, respectively.

A summary of loans as of the periods presented are as follows:

	March 31, 2020	December 31, 2019
	(Dollars in thousands)	
Real estate loans:		
One-to-four family	$ 202,214	$ 193,367
Multi-family	76,721	81,233
Commercial	325,116	331,052
Construction	10,034	7,213
Commercial and industrial	15,948	14,440
Consumer and other	154	122
Reverse mortgage	1,431	1,415
Mortgage warehouse	51,596	39,247
Total gross loans held-for-investment	683,214	668,089
Deferred fees, net	2,760	2,724
Total loans held-for-investment	685,974	670,813
Allowance for loan losses	(6,558)	(6,191)
Total loans held-for-investment, net	$ 679,416	$ 664,622
Total loans held-for-sale[(1)]	$ 435,023	$ 375,922

(1) Loans held-for-sale included $435.0 million and $365.8 million of mortgage warehouse loans at March 31, 2020 and December 31, 2019, respectively.

At March 31, 2020 and December 31, 2019, approximately $615.5 million and $614.3 million, respectively, of the Company's loan portfolio were collateralized by various forms of real estate. A significant percentage of such loans are collateralized by properties located in California (74.4% and 64.8% as of March 31, 2020 and December 31, 2019, respectively) and Arizona (6.6% and 10.2% as of March 31, 2020 and December 31, 2019, respectively) with no other state greater than 5%. The Company attempts to address and mitigate concentrations of credit risk by making loans that are diversified by collateral type, placing limits on the amounts of various categories of loans relative to total Company capital, and conducting quarterly reviews of its portfolio by collateral type, geography, and other characteristics. While management believes that the collateral presently securing its portfolio and the recorded allowance for loan losses are adequate to absorb potential losses, there can be no assurances that significant deterioration in the California and Arizona real estate markets would not expose the Company to significantly greater credit risk.

Recorded investment in loans excludes accrued interest receivable, loan origination fees, net and unamortized premium or discount, net due to immateriality. Accrued interest on loans held-for-investment totaled approximately $2.3 million and $2.2 million and deferred fees totaled approximately $2.8 million and $2.7 million at March 31, 2020 and December 31, 2019, respectively.

Allowance for Loan Losses

During the first quarter, the Company recorded a provision for loan losses of $0.4 million and the ratio of the allowance for loan losses to gross loans held-for-investment at March 31, 2020 was 0.96%. The level of the first quarter provision was based on modest increases in loan portfolio balances, Silvergate's historically strong credit quality and minimal loan charge-offs, and was largely influenced by the low to moderate loan-to-value margins in the Company's commercial and multi-family real estate and single-family residential real estate loans held-for-investment, as evidenced by weighted average loan-to-value ratios in the low- to mid-50% range as of March 31, 2020. Although there is significant uncertainly in the current economic environment due to the impact of the COVID-19 pandemic, the Company's relatively low loan-to-value ratios provides a lower probability of loss in the event of defaults in the Company's loan portfolio. The Company will continue to monitor trends in its portfolio segments for any known or probable adverse conditions with a particular emphasis on retail and hospitality loans within the commercial real estate loan portfolio.

The following tables present the allocation of the allowance for loan losses, as well as the activity in the allowance by loan class, and recorded investment in loans held-for-investment as of and for the periods presented:

	Three Months Ended March 31, 2020								
	One-to -Four Family	Multi-Family	Commercial Real Estate	Construction	Commercial and Industrial	Consumer and Other	Reverse Mortgage	Mortgage Warehouse	Total
	(Dollars in thousands)								
Balance, December 31, 2019	$ 2,051	$ 653	$ 2,791	$ 96	$ 312	$ 1	$ 37	$ 250	$ 6,191
Charge-offs	—	—	—	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—	—	—	—
Provision for loan losses	(80)	36	166	162	114	—	1	(32)	367
Balance, March 31, 2020	$ 1,971	$ 689	$ 2,957	$ 258	$ 426	$ 1	$ 38	$ 218	$ 6,558

	Three Months Ended March 31, 2019								
	One-to -Four Family	Multi-Family	Commercial Real Estate	Construction	Commercial and Industrial	Consumer and Other	Reverse Mortgage	Mortgage Warehouse	Total
	(Dollars in thousands)								
Balance, December 31, 2018	$ 1,848	$ 483	$ 3,854	$ 98	$ 156	$ 1	$ 54	$ 229	$ 6,723
Charge-offs	—	—	—	—	—	—	—	—	—
Recoveries	—	—	—	—	—	—	—	—	—
Provision for loan losses	41	28	83	10	100	(1)	—	6	267
Balance, March 31, 2019	$ 1,889	$ 511	$ 3,937	$ 108	$ 256	$ —	$ 54	$ 235	$ 6,990

	March 31, 2020								
	One-to -Four Family	Multi-Family	Commercial Real Estate	Construction	Commercial and Industrial	Consumer and Other	Reverse Mortgage	Mortgage Warehouse	Total
	(Dollars in thousands)								
Amount of allowance attributed to:									
Specifically evaluated impaired loans	$ 11	$ —	$ —	$ —	$ —	$ —	$ 29	$ —	$ 40
General portfolio allocation	1,960	689	2,957	258	426	1	9	218	6,518
Total allowance for loan losses	$ 1,971	$ 689	$ 2,957	$ 258	$ 426	$ 1	$ 38	$ 218	$ 6,558
Loans evaluated for impairment:									
Specifically evaluated	$ 3,732	$ —	$ 1,941	$ —	$ 2,252	$ —	$ 850	$ —	$ 8,775
Collectively evaluated	198,482	76,721	323,175	10,034	13,696	154	581	51,596	674,439
Total gross loans held-for-investment	$ 202,214	$ 76,721	$ 325,116	$ 10,034	$ 15,948	$ 154	$ 1,431	$ 51,596	$ 683,214

	December 31, 2019								
	One-to -Four Family	Multi-Family	Commercial Real Estate	Construction	Commercial and Industrial	Consumer and Other	Reverse Mortgage	Mortgage Warehouse	Total
	(Dollars in thousands)								
Amount of allowance attributed to:									
Specifically evaluated impaired loans	$ 10	$ —	$ —	$ —	$ —	$ —	$ 29	$ —	$ 39
General portfolio allocation	2,041	653	2,791	96	312	1	8	250	6,152
Total allowance for loan losses	$ 2,051	$ 653	$ 2,791	$ 96	$ 312	$ 1	$ 37	$ 250	$ 6,191
Loans evaluated for impairment:									
Specifically evaluated	$ 4,222	$ —	$ 7,353	$ —	$ 2,714	$ —	$ 848	$ —	$ 15,137
Collectively evaluated	189,145	81,233	323,699	7,213	11,726	122	567	39,247	652,952
Total gross loans held-for-investment	$ 193,367	$ 81,233	$ 331,052	$ 7,213	$ 14,440	$ 122	$ 1,415	$ 39,247	$ 668,089

Impaired Loans

The following tables provide a summary of the Company’s investment in impaired loans as of and for the periods presented:

	March 31, 2020		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Real estate loans:			
One-to-four family	$ 4,315	$ 3,666	$ —
Commercial	1,941	1,941	—
Commercial and industrial	2,484	2,252	—
Reverse mortgage	511	511	—
	9,251	8,370	—
With an allowance recorded:			
Real estate loans:			
One-to-four family	66	66	11
Reverse mortgage	339	339	29
	405	405	40
Total impaired loans	$ 9,656	$ 8,775	$ 40

	December 31, 2019		
	Unpaid Principal Balance	Recorded Investment	Related Allowance
	(Dollars in thousands)		
With no related allowance recorded:			
Real estate loans:			
One-to-four family	$ 4,792	$ 4,156	$ —
Commercial	7,632	7,353	—
Commercial and industrial	2,929	2,714	—
Reverse mortgage	510	511	—
	15,863	14,734	—
With an allowance recorded:			
Real estate loans:			
One-to-four family	66	66	10
Reverse mortgage	337	337	29
	403	403	39
Total impaired loans	$ 16,266	$ 15,137	$ 39

	Three Months Ended March 31,			
	2020		2019	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
With no related allowance recorded:				
Real estate loans:				
One-to-four family	$ 3,731	$ 26	$ 3,539	$ 47
Commercial	1,941	21	7,878	97
Commercial and industrial	2,329	42	2,888	53
Reverse mortgage	511	—	798	—
	8,512	89	15,103	197
With an allowance recorded:				
Real estate loans:				
One-to-four family	66	1	8	—
Reverse mortgage	338	—	430	—
	404	1	438	—
Total impaired loans	$ 8,916	$ 90	$ 15,541	$ 197

For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs. Cash basis interest income is not materially different than interest income recognized.

Nonaccrual and Past Due Loans

Nonperforming loans include individually evaluated impaired loans. Nonperforming loans consist of loans on nonaccrual status for which the accrual of interest has been discontinued and loans 90 days or more past due and still accruing interest.

The following tables present by loan class the aging analysis based on contractual terms, nonaccrual loans, and the Company's recorded investment in loans held-for-investment as of the periods presented:

	March 31, 2020							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Current	Total	Nonaccruing	Loans Receivable > 89 Days and Accruing
	(Dollars in thousands)							
Real estate loans:								
One-to-four family	$ 3,587	$ 2,804	$ 2,814	$ 9,205	$ 193,009	$ 202,214	$ 3,478	$ —
Multi-family	—	—	—	—	76,721	76,721	—	—
Commercial	—	—	—	—	325,116	325,116	—	—
Construction	—	—	—	—	10,034	10,034	—	—
Commercial and industrial	—	—	—	—	15,948	15,948	798	—
Consumer and other	—	—	—	—	154	154	—	—
Reverse mortgage	—	—	—	—	1,431	1,431	850	—
Mortgage warehouse	—	—	—	—	51,596	51,596	—	—
Total gross loans held-for-investment	$ 3,587	$ 2,804	$ 2,814	$ 9,205	$ 674,009	$ 683,214	$ 5,126	$ —

	December 31, 2019							
	30-59 Days Past Due	60-89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Current	Total	Nonaccruing	Loans Receivable > 89 Days and Accruing
	(Dollars in thousands)							
Real estate loans:								
One-to-four family	$ 3,573	$ 96	$ 3,302	$ 6,971	$ 186,396	$ 193,367	$ 3,963	$ —
Multi-family	—	—	—	—	81,233	81,233	—	—
Commercial	—	—	—	—	331,052	331,052	—	—
Construction	—	—	—	—	7,213	7,213	—	—
Commercial and industrial	—	—	—	—	14,440	14,440	1,098	—
Consumer and other	—	—	—	—	122	122	—	—
Reverse mortgage	—	—	—	—	1,415	1,415	848	—
Mortgage warehouse	—	—	—	—	39,247	39,247	—	—
Total gross loans held-for-investment	$ 3,573	$ 96	$ 3,302	$ 6,971	$ 661,118	$ 668,089	$ 5,909	$ —

Troubled Debt Restructurings

A loan is identified as a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulties and, for economic or legal reasons related to these difficulties, the Company grants a concession to the borrower in the restructuring that it would not otherwise consider. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. The Company has granted a concession when, as a result of the restructuring, it does not expect to collect all amounts due or within the time periods originally due under the original contract, including one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a temporary forbearance with regard to the payment of principal or interest. All troubled debt restructurings are reviewed for potential impairment. Generally, a nonaccrual loan that is restructured remains on nonaccrual status for a minimum period of six months to demonstrate that the borrower can perform under the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan. Loans classified as TDRs are reported as impaired loans.

As of March 31, 2020 and December 31, 2019, the Company had a recorded investment in TDR's of $1.7 million and $1.8 million, respectively. The Company has not allocated any amount of specific allowance for those loans at March 31, 2020 and December 31, 2019. The Company has not committed to lend additional amounts to these TDRs. No loans were modified as TDRs during the three months ended March 31, 2020 or March 31, 2019.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. There were no loans modified as TDRs for which there was a payment default within twelve months during the three months ended March 31, 2020 or 2019. There was no provision for loan loss or charge-offs for TDR's that subsequently defaulted during the three months ended March 31, 2020 or 2019.

Credit Quality Indicators

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

Pass: Loans in all classes that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.

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

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

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Credits rated as loss are charged-off. Management has no expectation of the recovery of any payments in respect of credits rated as loss.

The following tables present by portfolio class the Company's internal risk grading system as well as certain other information concerning the credit quality of the Company's recorded investment in loans held-for-investment as of the periods presented. No assets were classified as loss or doubtful during the periods presented.

	Credit Risk Grades				
	Pass	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)				
March 31, 2020					
Real estate loans:					
One-to-four family	$ 198,736	$ —	$ 3,478	$ —	$ 202,214
Multi-family	76,721	—	—	—	76,721
Commercial	316,595	8,521	—	—	325,116
Construction	10,034	—	—	—	10,034
Commercial and industrial	13,696	—	2,252	—	15,948
Consumer and other	154	—	—	—	154
Reverse mortgage	444	137	850	—	1,431
Mortgage warehouse	51,596	—	—	—	51,596
Total gross loans held-for-investment	$ 667,976	$ 8,658	$ 6,580	$ —	$ 683,214

	Credit Risk Grades				
	Pass	Special Mention	Substandard	Doubtful	Total
	(Dollars in thousands)				
December 31, 2019					
Real estate loans:					
One-to-four family	$ 189,405	$ —	$ 3,962	$ —	$ 193,367
Multi-family	81,233	—	—	—	81,233
Commercial	322,671	8,381	—	—	331,052
Construction	7,213	—	—	—	7,213
Commercial and industrial	11,726	—	2,714	—	14,440
Consumer and other	122	—	—	—	122
Reverse mortgage	435	132	848	—	1,415
Mortgage warehouse	39,247	—	—	—	39,247
Total gross loans held-for-investment	$ 652,052	$ 8,513	$ 7,524	$ —	$ 668,089

Related Party Loans

The Company had related party loans with an outstanding balance of $4.6 million as of March 31, 2020 and December 31, 2019. During the three months ended March 31, 2020, the balance of related party loans decreased by $20,000 due to principal payments.

Note 4—FHLB Advances and Other Borrowings

Federal Home Loan Bank ("FHLB") Advances

The following table sets forth certain information on our FHLB advances during the period presented:

	Three Months Ended March 31, 2020	Year Ended December 31, 2019
	(Dollars in thousands)	
Amount outstanding at period-end	$ 30,000	49,000
Weighted average interest rate at period-end	0.21%	1.66%
Maximum month-end balance during the period	$ 115,000	$ 218,000
Average balance outstanding during the period	$ 63,934	$ 28,205
Weighted average interest rate during the period	1.45%	1.94%

FHLB advances are secured with eligible collateral consisting of certain real estate loans. Advances from the FHLB are subject to the FHLB's collateral and underwriting requirements, and as of March 31, 2020 and December 31, 2019, were limited in the aggregate to 35% of the Company's total assets. Loans with carrying values of approximately $1.0 billion and $875.9 million were pledged to the FHLB as of March 31, 2020 and December 31, 2019, respectively. Unused borrowing capacity based on the lesser of the percentage of total assets and pledged collateral was approximately $643.8 million and $554.6 million as of March 31, 2020 and December 31, 2019, respectively. During the three months ended March 31, 2020, the Company initiated and settled a $64.0 million FHLB five-year term advance. Due to an increase in FHLB advance rates after settlement, the Company repaid the advance and recorded a gain on extinguishment of debt of $0.9 million.

FRB Advances

The Company is also approved to borrow through the Discount Window of the Federal Reserve Bank of San Francisco on a collateralized basis without any fixed dollar limit. Loans with a carrying value of approximately $7.6 million and $10.1 million were pledged to the FRB at March 31, 2020 and December 31, 2019, respectively. The Company's borrowing capacity under the Federal Reserve's discount window program was $5.8 million as of March 31, 2020. At March 31, 2020 and December 31, 2019, there were no borrowings outstanding under any of these lines.

Federal Funds Purchased

The Company may borrow up to an aggregate $32.0 million, overnight on an unsecured basis, from three of its correspondent banks. Access to these funds is subject to liquidity availability, market conditions and any negative material change in the Company's credit profile. As of March 31, 2020 and December 31, 2019, the Company had no outstanding balance of federal funds purchased.

Note 5—Notes Payable

On January 29, 2016, the Company entered into a term loan with a commercial bank for a single principal advance of $8.0 million due to mature on January 29, 2021. Loan interest and principal was payable quarterly commencing April 2016 and accrued interest at an annual rate equal to 2.60% plus the greater of zero percent and the one-month LIBOR rate. The proceeds were used to redeem preferred stock and could be prepaid at any time. During the three months ended March 31, 2020, the Company paid off the note in full. The outstanding principal balance at December 31, 2019 was $3.7 million.

Note 6—Subordinated Debentures, Net

A trust formed by the Company issued $12.5 million of floating rate trust preferred securities in July 2001 as part of a pooled offering of such securities. The Company issued subordinated debentures to the trust in exchange for its proceeds from the offering. The debentures and related accrued interest represent substantially all of the assets of the trust. The subordinated debentures bear interest at six-month LIBOR plus 375 basis points, which adjusts every six months in January and July of each year. Interest is payable semiannually. At March 31, 2020, the interest rate for the Company's next scheduled payment was 5.51%, based on six-month LIBOR of 1.76%. On any January 25 or July 25 the Company may redeem the 2001 subordinated debentures at 100% of principal amount plus accrued interest. The 2001 subordinated debentures mature on July 25, 2031.

A second trust formed by the Company issued $3.0 million of trust preferred securities in January 2005 as part of a pooled offering of such securities. The Company issued subordinated debentures to the trust in exchange for its proceeds from the offering. The debentures and related accrued interest represent substantially all of the assets of the trust. The subordinated debentures bear interest at three-month LIBOR plus 185 basis points, which adjusts every three months. Interest is payable quarterly. At March 31, 2020, the interest rate for the Company's next scheduled payment was 2.59%, based on three-month LIBOR of 0.74%. On the 15th day of any March, June, September, or December, the Company may redeem the 2005 subordinated debentures at 100% of principal amount plus accrued interest. The 2005 subordinated debentures mature on March 15, 2035.

The Company also retained a 3% minority interest in each of these trusts which is included in subordinated debentures. The balance of the equity in the trusts is comprised of mandatorily redeemable preferred securities. The subordinated debentures may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The Company has the right to defer interest payments on the subordinated debentures from time to time for a period not to exceed five years.

Note 7—Derivative and Hedging Activities

The Company is exposed to certain risks relating to its ongoing business operations. The Company utilizes interest rate derivatives as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the derivative does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual derivative agreements. In accordance with accounting guidance, changes in the fair value of derivatives designated and that qualify as cash flow hedges are initially recorded in other comprehensive income ("OCI"), reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item. The Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged transactions. The initial fair value of hedge components excluded from the assessment of effectiveness is recognized in the statement of financial condition under a systematic and rational method over the life of the hedging instrument and is presented in the same income statement line item as the earnings effect of the hedged item. Any difference between the change in the fair value of the hedge components excluded from the assessment of effectiveness and the amounts recognized in earnings is recorded as a component of other comprehensive income.

Interest rate floor. In 2019, the Company entered into 20 interest rate floor agreements (the "Floor Agreements") for a total notional amount of $400.0 million to hedge cash flow receipts on cash and securities or loans, if needed. The original Floor Agreements expire on various dates in April 2024 and July 2029. The Company utilizes one-month LIBOR and three-month LIBOR interest rate floors as hedges against adverse changes in cash flows on the designated cash, securities or loans attributable to fluctuations in the federal funds rate or three-month LIBOR below 2.50% or 2.25%, as applicable. The Floor Agreements were determined to be fully effective during all periods presented and, as such, no amount of ineffectiveness has been included in net income. The upfront fee paid to the counterparty in entering into these Floor Agreements was approximately $20.8 million. During the three months ended March 31, 2020, the Company sold $200.0 million of its total $400.0 million notional amount of interest rate floors for $13.0 million, which resulted in a net gain of $8.4 million, to be recognized over the weighted average remaining term of 4.1 years. The remaining agreements are one-month LIBOR floors with a strike price of 2.25% and expire in July 2029.

Interest rate cap. In 2012, the Company entered into a $12.5 million and a $3.0 million notional forward interest rate cap agreement (the "Cap Agreements") to hedge its variable rate subordinated debentures. The Cap Agreements expire July 25, 2022 and March 15, 2022, respectively. The Company utilizes interest rate caps as hedges against adverse changes in cash flows on the designated preferred trusts attributable to fluctuations in three-month LIBOR beyond 0.50% for the $3.0 million subordinated debenture and six-month LIBOR beyond 0.75% for the $12.5 million subordinated debenture. The Cap Agreements were determined to be fully effective during all periods presented and, as such, no amount of ineffectiveness has been included in net income. The upfront fee paid to the counterparty in entering into these Cap Agreements was approximately $2.5 million.

The table below presents the fair value of the Company's derivative financial instruments as well as the classification within the consolidated balance sheets.

	March 31, 2020		December 31, 2019	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(Dollars in thousands)			
Derivatives designated as hedging instruments:				
Cash flow hedge interest rate floor	Derivative assets	$ 33,445	Derivative assets	$ 23,054
Cash flow hedge interest rate cap	Derivative assets	61	Derivative assets	386

The following table summarizes the effects of derivatives in cash flow hedging relationships designated as hedging instruments on the Company's consolidated statements of operations for the periods presented.

	Amount of Gain (Loss) Recognized in OCI		Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income	
	Three Months Ended March 31,			Three Months Ended March 31,	
	2020	2019		2020	2019
			(Dollars in thousands)		
Derivatives designated as hedging instruments:					
Cash flow hedge interest rate floor	$ 6,096	$ 16	Interest income - Other interest earning assets	$ 125	$ (11)
Cash flow hedge interest rate floor	17,666	14	Interest income - Securities	117	(10)
Cash flow hedge interest rate cap	(280)	(113)	Interest expense - Subordinated debentures	(55)	(16)

The Company estimates that approximately $4.4 million of net derivative gain included in OCI will be reclassified into earnings within the next 12 months. No gain or loss was reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the periods presented.

Note 8—Income Taxes

Comparison of the federal statutory income tax rates to the Company's effective income tax rates for the periods presented are as follows:

	Three Months Ended March 31,			
	2020		2019	
	Amount	Rate	Amount	Rate
	(Dollars in thousands)			
Statutory federal tax	$ 1,295	21.0 %	$ 2,821	21.0 %
State tax, net of federal benefit	494	8.0 %	1,018	7.6 %
Tax credits	(56)	(0.9)%	(43)	(0.3)%
Other items, net	41	0.7 %	202	1.5 %
Actual tax expense	$ 1,774	28.8 %	$ 3,998	29.8 %

Income tax expense was $1.8 million for the three months ended March 31, 2020 compared to $4.0 million for the three months ended March 31, 2019. The decrease was primarily related to reduced pre-tax income for the three months ended March 31, 2020 when compared to the three months ended March 31, 2019. The effective tax rates for the three months ended March 31, 2020 and 2019 were 28.8% and 29.8%, respectively. The decrease in the Company's effective tax rate was primarily related to the recognition of state related tax adjustments during the three months ended March 31, 2019.

The deferred tax liability balance as of March 31, 2020 was $4.6 million compared to $0.4 million as of December 31, 2019. The primary change in balance was due to the increase in unrealized gains on derivative assets, partially offset by unrealized losses on our available-for-sale securities portfolio.

Note 9 —Commitments and Contingencies

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in the consolidated statements of financial condition. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and issue letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk exceeding the amounts recognized on the consolidated statements of financial condition. The Company's exposure to credit loss is represented by the contractual amounts of these commitments. The same credit policies and procedures are used in making these commitments as for on-balance sheet instruments. The Company is not aware of any accounting loss to be incurred by funding these commitments, however, an allowance for off-balance sheet credit risk is recorded in other liabilities on the statements of financial condition. The allowance for these commitments amounted to approximately $0.2 million and $0.1 million as of March 31, 2020 and December 31, 2019, respectively.

The Company's commitments associated with outstanding letters of credit and commitments to extend credit expiring by period as of the date indicated are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements.

	March 31, 2020	December 31, 2019
	(Dollars in thousands)	
Unfunded lines of credit	$ 61,231	$ 47,433
Letters of credit	655	655
Total credit extension commitments	$ 61,886	$ 48,088

Unfunded lines of credit represent unused credit facilities to the Company's current borrowers that represent no change in credit risk that exist in the Company's portfolio. Lines of credit generally have variable interest rates. Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event of nonperformance by the customer in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the client from the underlying collateral, which can include commercial real estate, physical plant and property, inventory, receivables, cash and/or marketable securities. The Company's policies generally require that letter of credit arrangements contain security and debt covenants like those contained in loan agreements and our credit risk associated with issuing letters of credit is essentially the same as the risk involved in extending loan facilities to customers.

The Company minimizes its exposure to loss under letters of credit and credit commitments by subjecting them to the same credit approval and monitoring procedures used for on-balance sheet instruments. The effect on the Company's revenue, expenses, cash flows and liquidity of the unused portions of these letters of credit commitments cannot be precisely predicted because there is no guarantee that the lines of credit will be used.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract, for a specific purpose. Commitments generally have variable interest rates, fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts disclosed above do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company is based on management's credit evaluation of the customer.

Litigation

The Company is involved in various matters of litigation which have arisen in the ordinary course of its business. In the opinion of management, the disposition of such pending litigation will not have a material adverse effect on the Company's financial statements.

Note 10—Stock-based Compensation

In June 2018, the Company adopted the 2018 Equity Compensation Plan, or 2018 Plan, that permits the Compensation Committee, in its sole discretion, to grant various forms of incentive awards. Under the 2018 Plan, the Compensation Committee has the power to grant stock options, stock appreciation rights, or SARs, restricted stock and restricted stock units. The number of shares that may be issued pursuant to awards under the 2018 Plan is 1,596,753.

In 2010, the Company adopted an equity compensation plan, or 2010 Plan, that provides for the grant of stock options to employees, directors, and other persons referred to in Rule 701 under the U.S. Securities Act of 1933. The number of shares that may be issued pursuant to awards under the 2010 Plan is 730,784. The Compensation Committee of the Company's Board of Directors is responsible for administrating the 2010 Plan and determining the terms of all awards under it, including their vesting, except that in the case of a change in control of the Company all options granted under the 2010 Plan shall become 100% vested. As of March 31, 2020, there are no shares available for issuance under the 2010 Plan.

In accordance with authoritative guidance for stock-based compensation, compensation expense is recognized only for those shares expected to vest, based on the Company's historical experience and future expectations. The Company has elected a policy of estimating expected forfeitures.

Total compensation cost charged against income was $199,000 and $19,000 for the three months ended March 31, 2020 and 2019, respectively.

A summary of stock option activity as of March 31, 2020 and changes during the three months ended March 31, 2020 is presented below:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life *(in years)*	Aggregate Intrinsic Value *(in thousands)*
Outstanding at January 1, 2020	917,857	$ 7.54		
Granted	3,456	14.89		
Exercised	(1,250)	12.00		
Forfeited/Expired	(3,636)	11.67		
Outstanding at March 31, 2020	916,427	$ 7.20	4.1 years	$ 3,249
Exercisable at March 31, 2020	681,909	$ 4.97	2.3 years	$ 3,246
Vested or Expected to Vest at March 31, 2020	882,558	$ 7.25	3.9 years	$ 3,249

As of March 31, 2020, there was $0.8 million of total unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of 3.4 years.

Restricted Stock Units

A summary of the status of the Company's nonvested restricted stock unit awards as of March 31, 2020, and changes during the three months ended March 31, 2020, is presented below:

	Number of Shares	Weighted-Average Grant Date Fair Value Per Share
Nonvested at January 1, 2020	82,627	$ 16.09
Granted	1,175	14.89
Canceled or Forfeited	(3,944)	16.09
Nonvested at March 31, 2020	79,858	$ 16.07

At March 31, 2020, there was approximately $0.9 million of total unrecognized compensation expense related to nonvested restricted stock unit awards, which is expected to be recognized over a weighted-average period of 3.0 years.

Note 11—Regulatory Capital

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. As of January 1, 2019, the capital conservation buffer had fully phased in to 2.50%. Management believes, as of March 31, 2020, the Company and the Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. For the periods presented, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual capital amounts and ratios for the Company (assuming minimum capital adequacy ratios were applicable to the Company) and the Bank as of March 31, 2020 and December 31, 2019, are presented in the following tables:

	Actual		Minimum capital adequacy		To be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
March 31, 2020						
The Company						
Tier 1 leverage ratio	$ 244,726	10.98%	$ 89,127	4.00%	N/A	N/A
Common equity tier 1 capital ratio	229,226	23.75%	43,436	4.50%	N/A	N/A
Tier 1 risk-based capital ratio	244,726	25.35%	57,915	6.00%	N/A	N/A
Total risk-based capital ratio	251,438	26.05%	77,219	8.00%	N/A	N/A
The Bank						
Tier 1 leverage ratio	230,056	10.33%	89,096	4.00%	$ 111,371	5.00%
Common equity tier 1 capital ratio	230,056	23.86%	43,398	4.50%	62,686	6.50%
Tier 1 risk-based capital ratio	230,056	23.86%	57,864	6.00%	77,151	8.00%
Total risk-based capital ratio	236,768	24.55%	77,151	8.00%	96,439	10.00%

	Actual		Minimum capital adequacy		To be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2019						
The Company						
Tier 1 leverage ratio	$ 240,135	11.23%	$ 85,501	4.00%	N/A	N/A
Common equity tier 1 capital ratio	224,635	24.52%	41,233	4.50%	N/A	N/A
Tier 1 risk-based capital ratio	240,135	26.21%	54,978	6.00%	N/A	N/A
Total risk-based capital ratio	246,447	26.90%	73,304	8.00%	N/A	N/A
The Bank						
Tier 1 leverage ratio	224,605	10.52%	85,399	4.00%	$ 106,749	5.00%
Common equity tier 1 capital ratio	224,605	24.55%	41,163	4.50%	59,458	6.50%
Tier 1 risk-based capital ratio	224,605	24.55%	54,884	6.00%	73,179	8.00%
Total risk-based capital ratio	230,917	25.24%	73,179	8.00%	91,474	10.00%

The Bank is restricted as to the amount of dividends that it can pay to the Company. Dividends declared in excess of the lesser of the Bank's undivided profits or the Bank's net income for its last three fiscal years less the amount of any distribution made to the Bank's shareholders during the same period must be approved by the California DBO. Also, the Bank may not pay dividends that would result in capital levels being reduced below the minimum requirements shown above.

Note 12—Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This standard's fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

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

Financial Instruments Required To Be Carried At Fair Value

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities available-for-sale. The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Derivatives. The Company's derivative assets and liabilities are carried at fair value as required by GAAP. The estimated fair values of the derivative assets and liabilities are based on current market prices for similar instruments. Given the meaningful level of secondary market activity for derivative contracts, active pricing is available for similar assets and accordingly, the Company classifies its derivative assets and liabilities as Level 2.

Impaired loans (collateral-dependent). The Company does not record impaired loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs, through charge-offs or specific allowances, that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. These appraisals may utilize a single valuation approach or a combination of approaches, which generally include various Level 3 inputs. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available and such adjustments are typically significant. Appraisals may be adjusted by management for qualitative factors such as economic factors and estimated liquidation expenses. The range of these possible adjustments may vary. Impaired loans presented in the table below as of the periods presented include impaired loans with specific allowances as well as impaired loans that have been partially charged-off.

Other real estate owned. Fair value estimates for foreclosed real estate are obtained from real estate brokers or other third-party consultants (Level 3). When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value as a result of known changes in the market or the collateral and there is no observable market price, such valuation inputs result in a fair value measurement that is categorized as a Level 3 measurement. To the extent a negotiated sales price or reduced listing price represents a significant discount to an observable market price, such valuation input would result in a fair value measurement that is also considered a Level 3 measurement.

The following tables provide the hierarchy and fair value for each class of assets and liabilities measured at fair value at March 31, 2020 and December 31, 2019.

As of March 31, 2020 and December 31, 2019, assets and liabilities measured at fair value on a recurring basis are as follows:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
March 31, 2020				
Assets				
Securities available-for-sale	$ —	$ 964,317	$ —	$ 964,317
Derivative assets	—	33,506	—	33,506
	$ —	$ 997,823	$ —	$ 997,823

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
December 31, 2019				
Assets				
Securities available-for-sale	$ —	$ 897,766	$ —	$ 897,766
Derivative assets	—	23,440	—	23,440
	$ —	$ 921,206	$ —	$ 921,206

As of March 31, 2020 and December 31, 2019, assets measured at fair value on a non-recurring basis are summarized as follows:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
March 31, 2020				
Assets				
Impaired loans:				
Reverse mortgage	$ —	$ —	$ 310	$ 310

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
December 31, 2019				
Assets				
Impaired loans:				
Real estate:				
One-to-four family	$ —	$ —	$ 56	$ 56
Reverse mortgage	—	—	308	308
Other real estate owned	—	—	128	128
	$ —	$ —	$ 492	$ 492

Quantitative Information about Level 3 Fair Value Measurements

The following table presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a nonrecurring basis as of the date indicated:

	Fair Value	Valuation Technique(s)	Significant Unobservable Inputs	Range	Weighted Average(1)
			(Dollars in thousands)		
March 31, 2020					
Collateral-dependent impaired loans	$ 310	Market comparable properties	Marketability discount	10.0%	10.0%
			Selling cost	8.0%	8.0%

(1) Unobservable inputs were weighted by the relative fair value of the instruments.

Financial Instruments Not Required To Be Carried At Fair Value

FASB ASC Topic 825, *Financial Instruments*, requires the disclosure of the estimated fair value of financial instruments. The Company's estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to develop the estimates of fair value. Accordingly, the estimates are not necessarily indicative of the amounts the Company could have realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following tables present information about the Company's assets and liabilities that are not measured at fair value in the consolidated statements of financial condition as of the dates presented:

	Carrying Amount	Fair Value Measurements Using			
		Level 1	Level 2	Level 3	Total
		(Dollars in thousands)			
March 31, 2020					
Financial assets:					
Cash and due from banks	$ 2,778	$ 2,778	$ —	$ —	$ 2,778
Interest earning deposits	163,422	163,422	—	—	163,422
Loans held-for-sale	435,023	—	435,023	—	435,023
Loans held-for-investment, net	679,416	—	—	681,447	681,447
Accrued interest receivable	6,344	3	3,480	2,861	6,344
Financial liabilities:					
Deposits	$ 2,002,957	$ —	$ 2,064,700	$ —	$ 2,064,700
FHLB advances	30,000	—	30,000	—	30,000
Subordinated debentures	15,820	—	14,982	—	14,982
Accrued interest payable	215	—	215	—	215

	Carrying Amount	Fair Value Measurements Using Level 1	Level 2	Level 3	Total
	(Dollars in thousands)				
December 31, 2019					
Financial assets:					
Cash and due from banks	$ 1,579	$ 1,579	$ —	$ —	$ 1,579
Interest earning deposits	132,025	132,025	—	—	132,025
Loans held-for-sale	375,922	—	376,126	—	376,126
Loans held-for-investment, net	664,622	—	—	666,272	666,272
Accrued interest receivable	5,950	86	3,643	2,221	5,950
Financial liabilities:					
Deposits	$ 1,814,654	$ —	$ 1,826,100	$ —	$ 1,826,100
Notes payable	3,714	—	3,714	—	3,714
Subordinated debentures	15,816	—	15,203	—	15,203
Accrued interest payable	559	—	559	—	559

Note 13—Earnings Per Share

The computation of basic and diluted earnings per share is shown below.

	Three Months Ended March 31, 2020	2019
	(In thousands, except per share data)	
Basic		
Net income	$ 4,393	$ 9,436
Weighted average common shares outstanding	18,668	17,818
Basic earnings per common share	$ 0.24	$ 0.53
Diluted		
Net income	$ 4,393	$ 9,436
Weighted average common shares outstanding for basic earnings per common share	18,668	17,818
Add: Dilutive effects of stock-based awards	449	440
Average shares and dilutive potential common shares	19,117	18,258
Dilutive earnings per common share	$ 0.23	$ 0.52

Stock options for 235,000 and 110,000 shares of common stock for the three months ended March 31, 2020 and 2019, respectively were excluded from the computation of diluted earnings per share, because they were anti-dilutive.

Note 14 —Subsequent Events

Impact of COVID-19 Pandemic

Subsequent to March 31, 2020, the Company began modifying loans by offering payment deferrals for customers experiencing difficulty due to COVID-19, with payment deferrals of two or three months. As of May 5, 2020, 33 loans or a total of $118.7 million in loan balances had been modified to provide payment deferrals, with the majority of the modifications for our commercial real estate borrowers. The two sectors within our commercial real estate loan portfolio that are expected to be most heavily impacted by COVID-19, hospitality and retail, made up $91.1 million of these modifications. As of May 5, 2020, the Company had an additional 37 customers with total loan balances of $34.0 million that were in the process of modification. Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") addressed COVID-19 related modifications and specified that such modifications made on loans that were current as of December 31, 2019 are not TDRs. In accordance with interagency guidance issued in April 2020, these short-term modifications made to a borrower affected by the COVID-19 pandemic and governmental shutdown orders, such as payment deferrals, fee waivers and extensions of repayment terms, do not need to be identified as TDRs if the loans were current at the time a modification plan was implemented. None of the modified loans met or are expected to meet the criteria of a TDR under the CARES Act or the related interagency statement.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis is intended as a review of significant factors affecting the Company's financial condition and results of operations for the periods indicated. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and the related notes and the Company's Annual Report on Form 10-K, which contains audited financial statements of the Company as of and for the year ended December 31, 2019, previously filed with the Securities and Exchange Commission ("SEC"). Results for the three month period ended March 31, 2020 are not necessarily indicative of results for the year ending December 31, 2020 or any future period.

Cautionary Note Regarding Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "should," "could," "predict," "potential," "believe," "will likely result," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "project," "projection," "forecast," "goal," "target," "would," "aim" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry and management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. The inclusion of these forward-looking statements should not be regarded as a representation by us or any other person that such expectations, estimates and projections will be achieved. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. New risks and uncertainties may emerge from time to time, and it is not possible for us to predict their occurrence. In addition, we cannot assess the impact of each risk and uncertainty on our business or the extent to which any risk or uncertainty, or combination of risks and uncertainties, may cause actual results to differ materially from those contained in any forward-looking statements. Further, given its ongoing and dynamic nature, it is difficult to predict the full impact of the COVID-19 outbreak on our business. The extent of such impact will depend on future developments, which are highly uncertain, including when the coronavirus can be controlled and abated and when and how the economy may be reopened. As the result of the COVID-19 pandemic (as defined below) and the related adverse local and national economic consequences, we could be subject to any of the following risks, any of which could have a material, adverse effect on our business, financial condition, liquidity, and results of operations: the demand for our products and services may decline, making it difficult to grow assets and income; if the economy is unable to substantially reopen, and high levels of unemployment continue for an extended period of time, loan delinquencies, problem assets, and foreclosures may increase, resulting in increased charges and reduced income; collateral for loans, especially real estate, may decline in value, which could cause loan losses to increase; our allowance for loan losses may increase if borrowers experience financial difficulties, which will adversely affect our net income; the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; as the result of the decline in the Federal Reserve Board's ("Federal Reserve") target federal funds rate to near 0%, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread and reducing net income; our cybersecurity risks are increased as the result of an increase in the number of employees working remotely; and FDIC premiums may increase if the agency experiences additional resolution costs.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Quarterly Report on Form 10-Q and other reports and registration statements filed by us with the SEC. For information on the factors that could cause actual results to differ from the expectations stated in the forward- looking statements, see "Risk Factors" under Part I, Item 1A of our 2019 Form 10-K in addition to Part II, Item 1A - Risk Factors of this Quarterly Report on Form 10-Q and other reports as filed with the SEC.

Any forward-looking statement speaks only as of the date of this report, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether because of new information, future developments or otherwise, except as required by law.

Novel Coronavirus Disease ("COVID-19") Pandemic

In March 2020, the World Health Organization categorized the current coronavirus disease ("COVID-19") as a pandemic, and the President of the United States declared the COVID-19 outbreak a national emergency. COVID-19 continues to spread throughout the United States and other countries across the world, and the duration and severity of its effects are currently unknown. In an emergency measure aimed at blunting the economic impact of COVID-19, the Federal Reserve lowered the target for the federal funds rate to a range of between zero to 0.25 percent on March 16, 2020. The following is a summary of some of the actions that we have taken in response to COVID-19 as well as the current and potential effects of COVID-19 on the Company's financial condition and results of operations.

Employees

Silvergate has prioritized ensuring the safety of the Company’s employees. Silvergate maintains a robust business continuity plan with periodic tests to ensure the plan’s effectiveness. Our most recent test of the pandemic portion of our business continuity plan was staged in September of 2019. That test positioned Silvergate to quickly adapt to the spreading pandemic in early March 2020, when we started to move a majority of the Company’s employees to a remote working environment while seamlessly maintaining our operations. The Company adheres to social distancing policies for those few employees still working in the office, has reduced branch hours and continually provides guidelines to employees to promote healthy habits and ways to stay connected while working remotely.

Customers and Community

To support the Company’s customers and the local community, Silvergate has initiated payment relief for borrowers impacted by COVID-19, and established referral relationships for those seeking assistance under the Small Business Administration’s (or SBA’s) Paycheck Protection Program (“PPP”). The Company has contacted the vast majority of all of the Company’s commercial real estate borrowers to discuss and assess their financial status. Silvergate has instructed the sub-servicer for the Company’s one-to-four family residential mortgages to offer borrower payment deferrals for confirmed hardships related to COVID-19. During this pandemic Silvergate has provided its customers uninterrupted banking access, including through the SEN.

Silvergate partners with various community organizations that address the needs of low to moderate income individuals and small businesses. Recently, the Company donated $45,000 to a number of nonprofit organizations trying to achieve their service missions in the wake of increased demand due to COVID-19, and the Company funded eight $1,000 scholarships for college students who are experiencing housing challenges.

Loan Portfolio

At March 31, 2020, Silvergate’s loans gross held-for-investment portfolio was $683.2 million, with its largest segments consisting of commercial real estate and one-to-four-family real estate loans. Within the commercial real estate loan portfolio, the Company had $61.9 million of retail loans and $46.1 million of hospitality loans at such date. During the first quarter, the Company recorded a provision for loan losses of $0.4 million and the ratio of the allowance for loan losses to gross loans held-for-investment at March 31, 2020 was 0.96%. The level of the first quarter provision was based on modest increases in loan portfolio balances, Silvergate’s historically strong credit quality and minimal loan charge-offs, and was largely influenced by the low to moderate loan-to-value margins in the Company's commercial and multi-family real estate and single-family residential real estate loans held-for-investment, as evidenced by weighted average loan-to-value ratios in the low- to mid-50% range as of March 31, 2020. Although there is significant uncertainly in the current economic environment due to the impact of the COVID-19 pandemic, the Company’s relatively low loan-to-value ratios provides a lower probability of loss in the event of defaults in the Company’s loan portfolio. The Company will continue to monitor trends in its loan portfolio segments for any known or probable adverse conditions with a particular emphasis on our retail and hospitality loans within our commercial real estate loan portfolio.

Subsequent to March 31, 2020, the Company began modifying loans by offering payment deferrals for customers experiencing difficulty due to COVID-19, with payment deferrals of two or three months. As of May 5, 2020, 33 loans or a total of $118.7 million in loan balances had been modified to provide payment deferrals, with the majority of the modifications for our commercial real estate borrowers. The two sectors within our commercial real estate loan portfolio that are expected to be most heavily impacted by COVID-19, hospitality and retail, made up $91.1 million of these modifications. As of May 5, 2020, the Company had an additional 37 customers with total loan balances of $34.0 million that were in the process of modification. Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) addressed COVID-19 related modifications and specified that such modifications made on loans that were current as of December 31, 2019 are not troubled debt restructurings (“TDRs”). In accordance with interagency guidance issued in April 2020, these short-term modifications made to a borrower affected by the COVID-19 pandemic and governmental shutdown orders, such as payment deferrals, fee waivers and extensions of repayment terms, do not need to be identified as TDRs if the loans were current at the time a modification plan was implemented. None of the modified loans met or are expected to meet the criteria of a TDR under the CARES Act or the related interagency statement.

Overview

Silvergate Capital Corporation is the holding company for our wholly-owned subsidiary, Silvergate Bank, which we believe is the leading provider of innovative financial infrastructure solutions and services to participants in the nascent and expanding digital currency industry. Instrumental to our leadership position and growth strategy is the Silvergate Exchange Network, or SEN, our proprietary, virtually instantaneous payment network for participants in the digital currency industry which serves as a platform for the development of additional products and services. The SEN has a powerful network effect that makes it more valuable as participants and utilization increase. The SEN has enabled us to focus on significantly growing our noninterest bearing deposit product for digital currency industry participants, which has provided the majority of our funding over the last two years. This unique source of funding is a distinctive advantage over most traditional financial institutions and allows us to generate revenue from a conservative portfolio of investments in cash, short term securities and certain types of loans that we believe generate attractive risk-adjusted returns. In addition, use of the SEN has resulted in an increase in noninterest income that we believe will become a valuable source of additional revenue as we develop and deploy fee-based solutions in connection with our digital currency initiative. We are also evaluating additional products or product enhancements specifically targeted at providing further financial infrastructure solutions to our customers and strengthening SEN network effects.

The Company is a Maryland corporation that is the parent company of Silvergate Bank. The Company's assets consist primarily of its investment in the Bank and its primary activities are conducted through the Bank. The Company is a registered bank holding company that is subject to supervision by the Federal Reserve. The Bank is subject to supervision by the California Department of Business Oversight, Division of Financial Institutions, or DBO and, as a Federal Reserve member bank since 2012, the Federal Reserve Bank of San Francisco, or FRB. The Bank's deposits are insured up to legal limits by the Federal Deposit Insurance Corporation, or FDIC.

The Bank provides financial services that include commercial banking, commercial and residential real estate lending, mortgage warehouse lending and commercial business lending. Our client base is diverse and consists of business and individual clients in California and other states and includes digital currency-related customers in the United States and internationally. Following the Bank's conversion to a commercial bank we began introducing an expanded array of relationship-oriented business products and services, which in the past five years has been augmented by our digital currency initiative. While our commercial real estate lending activities are concentrated in California, we have a broader, nationwide focus on deposit and cash management services for digital currency-related businesses, as well as mortgage warehouse and correspondent residential lending. Our goal is to establish profitable long-term banking relationships.

In March 2019, the Company and the Bank completed the sale of the Bank's retail branch located in San Marcos, California and business loan portfolio to HomeStreet Bank. This transaction generated a pre-tax gain on sale of $5.5 million and reduced total loans by $115.4 million and total deposits by $74.5 million. Further, on June 28, 2019, the Company consolidated its La Mesa Business Banking Center into its La Jolla headquarters branch office, resulting in the Company having only one branch location.

Digital Currency Initiative

We leverage the SEN and our management team's expertise in the digital currency industry to develop, implement and maintain critical financial infrastructure solutions and services for many of the largest U.S. digital currency exchanges and global investors, as well as other digital currency infrastructure providers that utilize the Company as a foundational layer for their products. The SEN is a central element of the operations of our digital currency related customers, which enables us to grow with our existing customers and to attract new customers who can benefit from our innovative solutions and services. We believe that our vision and advanced approach to compliance complement the SEN and empower us to extend our leadership position in the industry by developing additional infrastructure solutions and services that will facilitate growth in our business.

We began exploring the digital currency industry in 2013 based on market dynamics which we believed were highly attractive:

- **Significant and Growing Industry:** Digital currency presented a revolutionary model for executing financial transactions with substantial potential for growth.
- **Infrastructure Needs:** In order to become widely adopted, digital currency would need to rely on many traditional elements of financial services, including those services that support funds transfers, customer account controls and other security measures.
- **Regulatory Complexity as a Barrier to Entry:** Providing infrastructure solutions and services to the digital currency industry would require specialized compliance capabilities and a management team with a deep understanding of both the digital currency and the financial services industries.

These insights have been proven correct and we believe they remain true today. In fact, we believe that the market opportunity for digital currencies, the need for infrastructure solutions and services and the regulatory complexity have all expanded significantly since 2013. Our ability to address these market dynamics over the past six years has provided us with a first-mover advantage within the digital currency industry that is the cornerstone of our leadership position today.

Digital Currency Customers

Our customer base has grown rapidly, as many customers proactively approach us due to our reputation as the leading provider of innovative financial infrastructure solutions and services to participants in the digital currency industry, which includes our unique technology solutions. As of March 31, 2020, we had over 200 prospective digital currency customer leads in various stages of our customer onboarding process and pipeline, which includes extensive regulatory compliance diligence and integrating of the customer's technology stack for those new digital currency customers interested in using our API.

The following list sets forth summary information regarding the types of market participants who are our primary customers:

- **Digital Currency Exchanges:** Exchanges through which digital currencies are bought and sold; includes over-the-counter, or OTC, trading desks.
- **Institutional Investors:** Hedge funds, venture capital funds, private equity funds, family offices and traditional asset managers, which are investing in digital currencies as an asset class.
- **Other Customers:** Companies developing new protocols, platforms and applications; mining operations; and providers of other services.

Our customers include some of the largest U.S. exchanges and global investors in the digital currency industry. These market participants generally hold either or both of two distinct types of funds: (i) those funds that market participants use for digital currency investment activities, which we refer to as investor funds, and (ii) those funds that market participants use for business operations, which we refer to as operating funds.

Our customer ecosystem also includes software developers, digital currency miners, custodians and general industry participants that need our solutions and services.

Silvergate Exchange Network

The following table presents the number of transactions and the U.S. dollar volume of transactions that occurred on the SEN for the periods presented:

	Three Months Ended March 31,	
	2020	**2019**
	(Dollars in millions)	
# SEN Transactions	31,405	7,097
$ Volume of SEN Transfers	$ 17,372	$ 4,076

Financial Results

The following table presents the components of results of operations, performance ratios and share data for the periods indicated:

	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
	(In thousands, except per share data)	
Statement of Operations Data:		
Interest income	$ 20,062	$ 20,063
Interest expense	4,584	747
Net interest income	15,478	19,316
Provision for loan losses	367	267
Net interest income after provision	15,111	19,049
Noninterest income	4,931	7,871
Noninterest expense	13,875	13,486
Income before income taxes	6,167	13,434
Income tax expense	1,774	3,998
Net income	$ 4,393	$ 9,436
Financial Ratios(1):		
Return on average assets (ROAA)(2)	0.79%	1.94%
Return on average equity (ROAE)(2)	7.14%	19.53%
Net interest margin(3)	2.86%	4.01%
Noninterest income to average assets(2)	0.89%	1.62%
Noninterest expense to average assets	2.50%	2.77%
Efficiency ratio(2)(4)	67.98%	49.60%
Loan yield(5)	5.15%	5.75%
Cost of deposits	0.87%	0.08%
Cost of funds	0.94%	0.17%
Share Data:		
Basic earnings per share	$ 0.24	$ 0.53
Diluted earnings per share	$ 0.23	$ 0.52
Basic weighted average shares outstanding	18,668	17,818
Diluted weighted average shares outstanding	19,117	18,258

(1) Data has been annualized except for efficiency ratio.

(2) Excluding the gain attributed to the branch sale, net income would have been $5.5 million and ROAA, ROAE, noninterest income to average assets and efficiency ratio would have been 1.13%, 11.38%, 0.49% and 62.21%, respectively, for the three months ended March 31, 2019. See "Non-GAAP Financial Measures" for a reconciliation of these metrics.

(3) Net interest margin is a ratio calculated as net interest income divided by average interest earning assets for the same period.

(4) Efficiency ratio is calculated by dividing noninterest expenses by net interest income plus noninterest income.

(5) Includes nonaccrual loans and loans 90 days and more past due.

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The following table presents the components of financial condition and ratios at the dates indicated:

	March 31, 2020	December 31, 2019
	(Dollars in thousands)	
Statement of Financial Condition Data:		
Cash and cash equivalents	$ 166,200	$ 133,604
Securities	964,317	897,766
Loans held-for-sale	435,023	375,922
Loans held-for-investment, net	679,416	664,622
Other assets	65,752	56,213
Total assets	$ 2,310,708	$ 2,128,127
Deposits	$ 2,002,957	$ 1,814,654
Borrowings	45,820	68,530
Other liabilities	17,179	13,907
Total liabilities	2,065,956	1,897,091
Total shareholders’ equity	244,752	231,036
Total liabilities and shareholders' equity	$ 2,310,708	$ 2,128,127
Nonperforming Assets:		
Nonperforming loans	$ 5,126	$ 5,909
Troubled debt restructurings	$ 1,676	$ 1,791
Other real estate owned, net	—	$ 128
Nonperforming assets	$ 5,126	$ 6,037
Asset Quality Ratios:		
Nonperforming assets to total assets	0.22%	0.28%
Nonperforming loans to gross loans[1]	0.75%	0.88%
Nonperforming assets to gross loans and other real estate owned[1]	0.75%	0.90%
Net charge-offs (recoveries) to average total loans[1]	0.00%	0.01%
Allowance for loan losses to gross loans[1]	0.96%	0.93%
Allowance for loan losses to nonperforming loans	127.94%	104.77%
Company Capital Ratios:		
Tier 1 leverage ratio	10.98%	11.23%
Common equity tier 1 capital ratio	23.75%	24.52%
Tier 1 risk-based capital ratio	25.35%	26.21%
Total risk-based capital ratio	26.05%	26.90%
Total shareholders’ equity to total assets	10.59%	10.86%
Book value per share	$ 13.11	$ 12.38
Bank Capital Ratios:		
Tier 1 leverage ratio	10.33%	10.52%
Common equity tier 1 capital ratio	23.86%	24.55%
Tier 1 risk-based capital ratio	23.86%	24.55%
Total risk-based capital ratio	24.55%	25.24%
Other:		
Total headcount	211	215

(1) Loans exclude loans held-for-sale at each of the dates presented.

Critical Accounting Policies and Estimates

The accompanying management's discussion and analysis of results of operations and financial condition is based upon our unaudited interim consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements in accordance with GAAP requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are not readily available from other sources. We evaluate our estimates on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions. Other than uncertainty related to COVID-19, there have been no significant changes during the three months ended March 31, 2020 to the items that we disclosed as our critical accounting policies and estimates in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K filed with the SEC on March 10, 2020.

Accounting policies, as described in detail in the notes to our consolidated financial statements, included in the Company's Annual Report on Form 10-K, are an integral part of our financial statements. A thorough understanding of these accounting policies is essential when reviewing our reported results of operations and our financial position. We believe that those critical accounting policies and estimates require us to make difficult, subjective or complex judgments about matters that are inherently uncertain. Changes in these estimates, which are likely to occur from period to period, or use of different estimates that we could have reasonably used in the current period, would have a material impact on our financial position, results of operations or liquidity.

Results of Operations

Net Income

The following table sets forth the principal components of net income for the periods indicated.

	Three Months Ended March 31,		
	2020	**2019**	**% Increase/ (Decrease)**
	(Dollars in thousands)		
Interest income	$ 20,062	$ 20,063	0.0 %
Interest expense	4,584	747	513.7 %
Net interest income	15,478	19,316	(19.9)%
Provision for loan losses	367	267	37.5 %
Net interest income after provision	15,111	19,049	(20.7)%
Noninterest income	4,931	7,871	(37.4)%
Noninterest expense	13,875	13,486	2.9 %
Net income before income taxes	6,167	13,434	(54.1)%
Income tax expense	1,774	3,998	(55.6)%
Net income	$ 4,393	$ 9,436	(53.4)%

Net income for the three months ended March 31, 2020 was $4.4 million, a decrease of $5.0 million or 53.4% from net income of $9.4 million for the three months ended March 31, 2019. The decrease was primarily due to a $3.8 million increase in interest expense, a $2.9 million decrease in noninterest income, a $0.4 million increase in noninterest expense and a $2.2 million decrease in income tax expense, all as described below.

Net Interest Income and Net Interest Margin Analysis

We analyze our ability to maximize income generated from interest earning assets and control the interest expenses of our liabilities, measured as net interest income, through our net interest margin and net interest spread. Net interest income is the difference between the interest and fees earned on interest earning assets, such as loans, interest earning deposits in other banks and securities, and the interest expense incurred on interest bearing liabilities, such as deposits and borrowings, which are used to fund those assets.

Changes in market interest rates and the interest rates we earn on interest earning assets or pay on interest bearing liabilities, as well as in the volume and types of interest earning assets, interest bearing and noninterest bearing liabilities and shareholders' equity, are usually the largest drivers of periodic changes in net interest income, net interest margin and net interest spread. Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets. Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in the Southern California region, developments affecting the real estate, technology, hospitality, tourism and financial services sectors within our target markets and throughout the Southern California region, the volume and availability of residential loan pools and non-qualified residential loans and mortgage banker relationships. Our ability to respond to changes in these factors by using effective asset-liability management techniques is critical to maintaining the stability of our net interest income and net interest margin as our primary sources of earnings.

The following tables show the average outstanding balance of each principal category of our assets, liabilities and shareholders' equity, together with the average yields on our assets and the average costs of our liabilities for the periods indicated. Such yields and cost are calculated by dividing income or expense by the average daily balances of the associated assets or liabilities for the same period.

AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

	Three Months Ended March 31,					
	2020			2019		
	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate
	(Dollars in thousands)					
Assets						
Interest earning assets:						
Interest earning deposits in other banks	$ 234,356	$ 724	1.24%	$ 635,073	$ 3,797	2.42%
Securities[1]	908,776	6,096	2.70%	380,403	3,033	3.23%
Loans[2][3]	1,024,982	13,121	5.15%	925,389	13,111	5.75%
Other	10,746	121	4.53%	10,514	122	4.71%
Total interest earning assets	2,178,860	20,062	3.70%	1,951,379	20,063	4.17%
Noninterest earning assets	49,307			21,104		
Total assets	$ 2,228,167			$ 1,972,483		
Liabilities and Shareholders' Equity						
Interest bearing liabilities:						
Interest bearing deposits	$ 441,682	$ 4,051	3.69%	$ 201,194	$ 341	0.69%
FHLB advances and other borrowings	67,229	263	1.57%	16,921	142	3.40%
Subordinated debentures	15,818	270	6.87%	15,803	264	6.78%
Total interest bearing liabilities	524,729	4,584	3.51%	233,918	747	1.30%
Noninterest bearing liabilities:						
Noninterest bearing deposits	1,436,062			1,531,877		
Other liabilities	19,900			10,699		
Shareholders' equity	247,476			195,989		
Total liabilities and shareholders' equity	$ 2,228,167			$ 1,972,483		
Net interest spread[4]			0.19%			2.87%
Net interest income		$ 15,478			$ 19,316	
Net interest margin[5]			2.86%			4.01%

(1) Securities interest income includes $48,000 of tax-exempt income associated with municipal bonds purchased in the first quarter of 2020.

(2) Loans include nonaccrual loans and loans held-for-sale, net of deferred fees and before allowance for loan losses.

(3) Interest income includes amortization of deferred loan fees, net of deferred loan costs.

(4) Net interest spread is the difference between interest rates earned on interest earning assets and interest rates paid on interest bearing liabilities.

(5) Net interest margin is a ratio calculated as annualized net interest income divided by average interest earning assets for the same period.

Information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest earning assets and interest bearing liabilities and distinguishes between the changes attributable to changes in volume and changes attributable to changes in interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been proportionately allocated to both volume and rate.

ANALYSIS OF CHANGES IN NET INTEREST INCOME

	For the Three Months Ended March 31, 2020 Compared to 2019		
	Change Due To		Interest Variance
	Volume	Rate	
	(Dollars in thousands)		
Interest Income:			
Interest earning deposits in other banks	$ (1,740)	$ (1,333)	$ (3,073)
Securities	3,613	(550)	3,063
Loans	1,339	(1,329)	10
Other	3	(4)	(1)
Total interest income	3,215	(3,216)	(1)
Interest Expense:			
Interest bearing deposits	791	2,919	3,710
FHLB advances and other borrowings	231	(110)	121
Subordinated debentures	—	6	6
Total interest expense	1,022	2,815	3,837
Net interest income	$ 2,193	$ (6,031)	$ (3,838)

Net interest income decreased $3.8 million to $15.5 million for the three months ended March 31, 2020 compared to $19.3 million for the three months ended March 31, 2019, due to an increase of $3.8 million in interest expense.

Average total interest earning assets increased $227.5 million or 11.7%, from $2.0 billion for the three months ended March 31, 2019 to $2.2 billion for the three months ended March 31, 2020. This increase was due to increases in securities and loans offset by decreases in interest earning deposits in other banks. The average balance of securities increased from $380.4 million for the three months ended March 31, 2019 to $908.8 million for the three months ended March 31, 2020 while the average balance of interest bearing deposits in other banks decreased from $635.1 million to $234.4 million over the same time period. The movement in these asset classes was primarily due to the implementation of the Company's hedging strategy, intended to protect earnings in a declining interest rate environment that was implemented starting in March 2019. The total balances of the hedging strategy included the purchase of $400.0 million in notional amount of interest rate floors, $350.4 million in fixed-rate commercial mortgage-backed securities and issuing $325.0 million of callable brokered certificates of deposit. At March 31, 2019, we had purchased $100.0 million in notional amount of interest rate floors and $92.1 million in commercial mortgage-backed securities. The average annualized yield on total interest earning assets decreased from 4.17% for the three months ended March 31, 2019 to 3.70% for the three months ended March 31, 2020 primarily due to lower yields on interest earning deposits in other banks and securities as well as loans. The lower yields were due to declines in federal funds rate and London Interbank Offered Rate (or "LIBOR") which was partially offset by the interest rate floors. During the three months ended March 31, 2020, the Company sold $200.0 million of its total $400.0 million notional amount of interest rate floors, which resulted in a net gain of $8.4 million, to be recognized over the weighted average remaining term of 4.1 years. The sale of the floors secured the benefit of lower interest rates at the time of the sale.

Average interest bearing liabilities increased $290.8 million or 124.3% for the three months ended March 31, 2020 as compared to the same period in 2019 primarily due to an increase in interest bearing deposits between periods, and an increase in Federal Home Loan Bank ("FHLB") advances and other borrowings. The outstanding balance of brokered certificates of deposit was $142.6 million as of March 31, 2020 compared to zero outstanding as of March 31, 2019. The average annualized rate on total interest bearing liabilities increased to 3.51% for the three months ended March 31, 2020 compared to 1.30% for the same period in 2019, primarily due to the callable brokered certificates of deposits associated with our hedging strategy. During the three months ended March 31, 2020, the Company called $278.3 million and reissued $95.9 million of the callable brokered certificates of deposit, which resulted in the recognition of $2.1 million of premium amortization in interest expense. The accelerated impact of premium expense is being offset by lower rates on the newly issued certificates of deposits and overall lower outstanding balance. The weighted average all-in cost of the brokered certificates of deposit was 1.92% as of March 31, 2020.

For the three months ended March 31, 2020, the net interest spread was 0.19% and the net interest margin was 2.86% compared to 2.87% and 4.01%, respectively, for the comparable period in 2019. The decrease in the net interest spread in the three months ended March 31, 2020 was primarily due to the impact of lower federal funds rates and LIBOR, along with increased FHLB borrowings, partially mitigated by the combined effects associated with the hedging strategy, which included the impacts of calling and reissuing a portion of the brokered callable certificates of deposit, along with the benefit derived from the interest rate floors.

Provision for Loan Losses

The provision for loan losses is a charge to income to bring our allowance for loan losses to a level deemed appropriate by management. For a description of the factors considered by our management in determining the allowance for loan losses see "—Financial Condition—Allowance for Loan Losses".

We recorded a provision for loan losses of $0.4 million and $0.3 million for the three months ended March 31, 2020 and 2019, respectively. The allowance for loan losses to total gross loans held-for-investment was 0.96% at March 31, 2020 compared to 1.14% at March 31, 2019. The provision for the three months ended March 31, 2020 was due to increases in loan portfolio balances and recalibration of qualitative factors in our allowance for loan losses methodology for certain portfolio segments to reflect current economic conditions at the end of the quarter.

Noninterest Income

The following table presents, for the periods indicated, the major categories of noninterest income:

NONINTEREST INCOME

	Three Months Ended March 31,		
	2020	**2019**	**% Increase/ (Decrease)**
	(Dollars in thousands)		
Noninterest income:			
Mortgage warehouse fee income	$ 382	$ 366	4.4 %
Service fees related to off-balance sheet deposits	70	759	(90.8)%
Deposit related fees	1,766	987	78.9 %
Gain on sale of securities, net	1,197	—	N/M
Gain on sale of loans, net	506	189	167.7 %
Gain on sale of branch, net	—	5,509	N/M
Gain on extinguishment of debt	925	—	N/M
Other income	85	61	39.3 %
Total noninterest income	$ 4,931	$ 7,871	(37.4)%

N/M—Not meaningful

Noninterest income for the three months ended March 31, 2020 was $4.9 million, a decrease of $2.9 million or 37.4% compared to noninterest income of $7.9 million for the three months ended March 31, 2019. This decrease was primarily due to a pre-tax gain on sale of $5.5 million for our San Marcos branch and business loan portfolio that was completed in March 2019 and a $0.7 million decrease in service fees related to off-balance sheet deposits. The decline in service fees related to off-balance sheet deposits was due to a $102.8 million decline in average off-balance sheet deposit balances from $174.7 million for the three months ended March 31, 2019 to $71.9 million for the three months ended March 31, 2020 and a decline in interest rate spread on these balances. Service fees related to off-balance sheet deposits was an opportunity in the prior year, but is not expected to be an area of focused growth. These decreases were partially offset by increases of $1.2 million in gain on sale of securities, $0.9 million in gain on extinguishment of debt and $0.8 million in deposit related fees. During the three months ended March 31, 2020, the Company initiated and settled a $64.0 million FHLB five-year term advance. Due to an increase in FHLB advance rates after settlement, the Company repaid the advance and recorded a gain of $0.9 million. The $0.8 million increase in deposit related fees was primarily due to increases in cash management, foreign exchange, and SEN related fees associated with our digital currency initiative.

Noninterest Expense

The following table presents, for the periods indicated, the major categories of noninterest expense:

NONINTEREST EXPENSE

	Three Months Ended March 31,		
	2020	**2019**	**% Increase/ (Decrease)**
	(Dollars in thousands)		
Noninterest expense:			
Salaries and employee benefits	$ 8,955	$ 8,765	2.2 %
Occupancy and equipment	907	873	3.9 %
Communications and data processing	1,261	1,037	21.6 %
Professional services	985	1,445	(31.8)%
Federal deposit insurance	123	175	(29.7)%
Correspondent bank charges	373	279	33.7 %
Other loan expense	122	125	(2.4)%
Other general and administrative	1,149	787	46.0 %
Total noninterest expense	$ 13,875	$ 13,486	2.9 %

Noninterest expense increased $0.4 million or 2.9% for the three months ended March 31, 2020 compared to the three months ended March 31, 2019 primarily due to increases in salaries and employee benefits, occupancy and equipment and communications and data processing expense, partially offset by decreases in professional services. The increase of $0.2 million or 2.2% in salaries and employee benefits was primarily due to a moderate increase in cost per full-time equivalent employee including an increase of $0.2 million in stock-based compensation expense. Communications and data processing increased $0.2 million or 21.6% primarily due to expansion projects to support our digital currency initiative and amortization of previously capitalized foreign currency platform enhancements. We continue to invest in scalable technology, and are committed to expanding our banking platform with a cloud-based API-enabled payment hub to complement our API-enabled SEN. In addition, we are implementing a customer-facing foreign exchange platform. While we continue to invest in projects to strengthen our ability to operate efficiently and effectively while leveraging existing and new technology, professional service fees have decreased by $0.5 million or 31.8% due to decreased consulting expense related to our foreign exchange platform and the Bank's implementation of the Current Expected Credit Losses methodology ("CECL") which has been delayed.

Income Tax Expense

Income tax expense was $1.8 million for the three months ended March 31, 2020 compared to $4.0 million for the three months ended March 31, 2019. The decrease was primarily related to decreased pre-tax income. Our effective tax rates for the three months ended March 31, 2020 and 2019 were 28.8% and 29.8%, respectively. The decrease in our effective tax rate was primarily related to the recognition of state related tax adjustments during the three months ended March 31, 2019.

Financial Condition

As of March 31, 2020, our total assets increased to $2.3 billion compared to $2.1 billion as of December 31, 2019. Shareholders' equity increased $13.7 million, or 5.9%, to $244.8 million at March 31, 2020 compared to $231.0 million at December 31, 2019. A summary of the individual components driving the changes in total assets, total liabilities and shareholders' equity is discussed below.

Interest Earning Deposits in Other Banks

Interest earning deposits in other banks increased from $132.0 million at December 31, 2019 to $163.4 million at March 31, 2020.

Securities

We use our securities portfolio to provide a source of liquidity, provide an appropriate return on funds invested, manage interest rate risk, meet collateral requirements and meet regulatory capital requirements.

Management classifies investment securities as either held-to-maturity or available-for-sale based on our intentions and the Company's ability to hold such securities until maturity. In determining such classifications, securities that management has the positive intent and the Company has the ability to hold until maturity are classified as held to maturity and carried at amortized cost. All other securities are designated as available-for-sale and carried at estimated fair value with unrealized gains and losses included in shareholders' equity on an after-tax basis. For the years presented, all securities were classified as available-for-sale.

Our securities available-for-sale increased $66.6 million, or 7.4%, from $897.8 million at December 31, 2019 to $964.3 million at March 31, 2020. To supplement interest income earned on our loan portfolio, we invest in high quality mortgage-backed securities, collateralized mortgage obligations, municipal bonds and asset backed securities. Our securities portfolio has grown substantially due to the implementation of a hedging strategy and utilizing cash to purchase high quality available-for-sale securities. During the three months ended March 31, 2020, we sold $12.8 million of fixed-rate commercial mortgage-backed securities and realized a gain on sale of $1.2 million. In addition, during the three months ended March 31, 2020, we purchased $13.2 million of fixed-rate commercial mortgage-backed securities and $85.8 million of highly rated tax-exempt municipal bonds. These municipal bonds are all general obligation or revenue bonds that are fixed rate and have call dates within 10 years. The purchase of such fixed rate investments helps mitigate a decline in interest income in a declining rate environment and also provides higher returns compared to lower yielding cash and cash alternatives.

The following tables summarize the contractual maturities and weighted-average yields of investment securities at March 31, 2020 and the amortized cost and carrying value of those securities as of the indicated dates.

SECURITIES

	One Year or Less		More Than One Year Through Five Years		More Than Five Years Through 10 Years		More Than 10 Years		Total		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
	(Dollars in thousands)										
March 31, 2020											
Securities Available-for-Sale:											
Residential mortgage-backed securities:											
Government agency mortgage-backed securities	$ —	—	$ —	—	$ —	—	$ 682	3.67%	$ 682	$ 716	3.67%
Government agency collateralized mortgage obligation	—	—	—	—	349	1.33%	235,985	2.14%	236,334	236,180	2.14%
Private-label collateralized mortgage obligation	—	—	—	—	—	—	25,844	2.89%	25,844	22,382	2.89%
Commercial mortgage-backed securities:											
Private-label collateralized mortgage obligation	—	—	—	—	—	—	364,543	3.00%	364,543	374,650	3.00%
Municipal bonds	—	—	—	—	13,975	3.15%	71,293	3.39%	85,268	92,656	3.35%
Asset backed securities:											
Government sponsored student loan pools	—	—	—	—	—	—	256,449	2.31%	256,449	237,733	2.31%
Total securities	$ —	—	$ —	—	$ 14,324	3.11%	$ 954,796	2.63%	$ 969,120	$ 964,317	2.64%

	March 31, 2020		December 31, 2019	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Securities Available-for-Sale:				
Residential mortgage-backed securities:				
Government agency mortgage-backed securities	$ 682	$ 716	$ 769	$ 801
Government agency collateralized mortgage obligation	236,334	236,180	242,203	241,918
Private-label collateralized mortgage obligation	25,844	22,382	26,346	26,500
Commercial mortgage-backed securities:				
Private-label collateralized mortgage obligation	364,543	374,650	364,719	377,016
Municipal bonds	85,268	92,656	—	—
Asset backed securities:				
Government sponsored student loan pools	256,449	237,733	258,022	251,531
Total securities	$ 969,120	$ 964,317	$ 892,059	$ 897,766

Loan Portfolio

Our primary source of income is derived from interest earned on loans. Our loan portfolio consists primarily of loans secured by real estate and mortgage warehouse loans. Our loan customers primarily consist of small- to medium-sized businesses, professionals, real estate investors, small residential builders and individuals. Our owner-occupied and investment commercial real estate loans, multi-family loans and commercial and industrial loans provide us with higher risk-adjusted returns, relatively shorter maturities and more sensitivity to interest rate fluctuations, and are complemented by our relatively lower risk residential real estate loans to individuals. Our commercial real estate, multi-family real estate, construction and commercial and industrial lending activities are primarily directed to our market area of Southern California. Our one-to-four family residential loans and warehouse loans are sourced throughout the United States.

The following table summarizes our loan portfolio by loan segment as of the dates indicated:

COMPOSITION OF LOAN PORTFOLIO

	March 31, 2020		December 31, 2019	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Real estate:				
One-to-four family	$ 202,214	29.6%	$ 193,367	28.9%
Multi-family	76,721	11.2%	81,233	12.2%
Commercial	325,116	47.6%	331,052	49.6%
Construction	10,034	1.5%	7,213	1.1%
Commercial and industrial	15,948	2.3%	14,440	2.1%
Consumer and other	154	0.0%	122	0.0%
Reverse mortgage	1,431	0.2%	1,415	0.2%
Mortgage warehouse	51,596	7.6%	39,247	5.9%
Total gross loans held-for-investment	683,214	100.0%	668,089	100.0%
Deferred fees, net	2,760		2,724	
Total loans held-for-investment	685,974		670,813	
Allowance for loan losses	(6,558)		(6,191)	
Total net loans held-for-investment	$ 679,416		$ 664,622	
Loans held-for-sale	$ 435,023		$ 375,922	

The repayment of loans is a source of additional liquidity for us. The following table details maturities and sensitivity to interest rate changes for our loans held-for-investment at March 31, 2020:

LOAN MATURITY AND SENSITIVITY TO CHANGES IN INTEREST RATES

	March 31, 2020			
	Due in One Year or Less	Due in One to Five Years	Due After Five Years	Total
	(Dollars in thousands)			
Real estate:				
One-to-four family	$ 2	$ 355	$ 201,857	$ 202,214
Multi-family	1,227	36,173	39,321	76,721
Commercial	33,475	133,572	158,069	325,116
Construction	6,923	3,111	—	10,034
Commercial and industrial	12,442	3,506	—	15,948
Consumer and other	154	—	—	154
Reverse mortgage	—	—	1,431	1,431
Mortgage warehouse	51,596	—	—	51,596
Total gross loans held-for-investment	$ 105,819	$ 176,717	$ 400,678	$ 683,214
Amounts with fixed rates	$ 73,765	$ 91,551	$ 121,324	$ 286,640
Amounts with floating rates	$ 32,054	$ 85,166	$ 279,354	$ 396,574

Nonperforming Assets

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether such loans are actually past due. In general, we place loans on nonaccrual status when they become 90 days past due. We also place loans on nonaccrual status if they are less than 90 days past due if the collection of principal or interest is in doubt. When interest accrual is discontinued, all unpaid accrued interest is reversed from income. Interest income is subsequently recognized only to the extent cash payments received exceed principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are, in management's opinion, reasonably assured. Any loan which the Bank deems to be uncollectible, in whole or in part, is charged off to the extent of the anticipated loss. Loans that are past due for 180 days or more are charged off unless the loan is well secured and in the process of collection.

We believe our disciplined lending approach and focused management of nonperforming assets has resulted in sound asset quality and timely resolution of problem assets. We have several procedures in place to assist us in maintaining the overall quality of our loan portfolio. We have established underwriting guidelines to be followed by our loan officers, and we also monitor our delinquency levels for any negative or adverse trends. There can be no assurance, however, that our loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

Nonperforming loans decreased to $5.1 million, or 0.75% of total loans, at March 31, 2020 compared to $5.9 million, or 0.88% of total loans, at December 31, 2019. The decrease in nonperforming loans during the three months ended March 31, 2020 was due to principal repayments on nonperforming commercial and industrial loans and payoffs on one-to-four family real estate loans.

Other real estate owned was zero as of March 31, 2020 compared to $128,000 at December 31, 2019.

Total nonperforming assets were $5.1 million and $6.0 million at March 31, 2020 and December 31, 2019, respectively, or 0.22% and 0.28%, respectively, of total assets.

The following table presents information regarding nonperforming assets at the dates indicated:

NONPERFORMING ASSETS

	March 31, 2020	December 31, 2019
	(Dollars in thousands)	
Nonaccrual loans		
Real estate:		
One-to-four family	$ 3,478	$ 3,963
Commercial and industrial	798	1,098
Reverse mortgage	850	848
Accruing loans 90 or more days past due	—	—
Total gross nonperforming loans	5,126	5,909
Other real estate owned, net	—	128
Total nonperforming assets	$ 5,126	$ 6,037
Ratio of nonperforming loans to total loans[(1)]	0.75%	0.88%
Ratio of nonperforming assets to total assets	0.22%	0.28%
Troubled debt restructurings		
Restructured loans-nonaccrual	$ 1,065	$ 1,202
Restructured loans-accruing	611	589
Total troubled debt restructurings	$ 1,676	$ 1,791

(1) Total loans exclude loans held-for-sale at each of the dates presented.

Loans Grading

From a credit risk standpoint, we grade watchlist and problem loans into one of five categories: pass, special mention, substandard, doubtful or loss. The classifications of loans reflect a judgment about the risks of default and loss associated with the loan. We review the ratings on credits regularly. Ratings are adjusted regularly to reflect the degree of risk and loss that our management believes to be appropriate for each credit. Our methodology is structured so that specific reserve allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss). The Bank uses the following definitions for watch list risk ratings:

- *Pass.* Loans in all classes that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.
- *Special Mention.* A special mention loan has potential weaknesses deserving of management's close attention. If uncorrected, such weaknesses may result in deterioration of the repayment prospects for the asset or in our credit position at some future date.
- *Substandard.* A substandard loan is inadequately protected by the current financial condition and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if deficiencies are not corrected.
- *Doubtful*. A doubtful loan has all weaknesses inherent in one classified as substandard, with the added characteristic that weaknesses make collection or liquidation in full, on the basis of existing facts, conditions, and values, highly questionable and improbable.
- *Loss.* Credits rated as loss are charged-off. We have no expectation of the recovery of any payments in respect of credits rated as loss.

The following table presents the loan balances by segment as well as risk rating. No assets were classified as loss during the periods presented.

LOAN CLASSIFICATION

	Credit Risk Grades				
	Pass	**Special Mention**	**Substandard**	**Doubtful**	**Total**
	(Dollars in thousands)				
March 31, 2020					
Real estate loans:					
One-to-four family	$ 198,736	$ —	$ 3,478	$ —	$ 202,214
Multi-family	76,721	—	—	—	76,721
Commercial	316,595	8,521	—	—	325,116
Construction	10,034	—	—	—	10,034
Commercial and industrial	13,696	—	2,252	—	15,948
Consumer and other	154	—	—	—	154
Reverse mortgage	444	137	850	—	1,431
Mortgage warehouse	51,596	—	—	—	51,596
Total gross loans held-for-investment	$ 667,976	$ 8,658	$ 6,580	$ —	$ 683,214

	Credit Risk Grades				
	Pass	**Special Mention**	**Substandard**	**Doubtful**	**Total**
	(Dollars in thousands)				
December 31, 2019					
Real estate loans:					
One-to-four family	$ 189,405	$ —	$ 3,962	$ —	$ 193,367
Multi-family	81,233	—	—	—	81,233
Commercial	322,671	8,381	—	—	331,052
Construction	7,213	—	—	—	7,213
Commercial and industrial	11,726	—	2,714	—	14,440
Consumer and other	122	—	—	—	122
Reverse mortgage	435	132	848	—	1,415
Mortgage warehouse	39,247	—	—	—	39,247
Total gross loans held-for-investment	$ 652,052	$ 8,513	$ 7,524	$ —	$ 668,089

Loan Reviews and Problem Loan Management.

Our credit administration staff conducts meetings at least four times a year to review asset quality and loan delinquencies. The Bank's Lending and Collection Policy requires that we perform annual reviews of every loan of $500,000 or more not rated special mention or adversely classified. Individual loan reviews encompass a loan's payment status and history, current and projected paying capacity of the borrower and/or guarantor(s), current condition and estimated value of any collateral, sufficiency of credit and collateral documentation, and compliance with Bank and regulatory lending standards. Loan reviewers assign an overall loan risk rating from one of the Bank's loan rating categories and prepare a written report summarizing the review.

Once a loan is identified as a problem loan or a loan requiring a workout, the Bank makes an evaluation and develops a plan for handling the loan. In developing such a plan, management reviews all relevant information from the loan file and any loan review reports. We have a conversation with the borrower and update current and projected financial information (including borrower global cash flows when possible) and collateral valuation estimates. Following analysis of all available relevant information, management adopts an action plan from the following alternatives: (a) continuation of loan collection efforts on their existing terms, (b) a restructure of the loan's terms, (c) a sale of the loan, (d) a charge off or partial charge off, (e) foreclosure on pledged collateral, or (f) acceptance of a deed in lieu of foreclosure.

Impaired Loans and TDRs. Impaired loans also include certain loans that have been modified as TDRs. As of March 31, 2020, the Company held nine loans amounting to $1.7 million, which were TDRs, compared to nine loans amounting to $1.8 million at December 31, 2019.

A loan is identified as a TDR when a borrower is experiencing financial difficulties and, for economic or legal reasons related to these difficulties, the Company grants a concession to the borrower in the restructuring that it would not otherwise consider. The Company has granted a concession when, as a result of the restructuring, it does not expect to collect all amounts due or within the time periods originally due under the original contract, including one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a temporary forbearance with regard to the payment of principal or interest. All TDRs are reviewed for potential impairment. Generally, a nonaccrual loan that is restructured remains on nonaccrual status for a minimum period of six months to demonstrate that the borrower can perform under the restructured terms. If the borrower's performance under the new terms is not reasonably assured, the loan remains classified as a nonaccrual loan. Loans classified as TDRs are reported as impaired loans.

Allowance for Loan Losses

We maintain an allowance for loan losses that represents management's best estimate of the loan losses and risks inherent in our loan portfolio. The amount of the allowance for loan losses should not be interpreted as an indication that charge-offs in future periods will necessarily occur in those amounts, or at all. In determining the allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the nature of our loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates.

In reviewing our loan portfolio, we consider risk elements attributable to particular loan types or categories in assessing the quality of individual loans. Some of the risk elements we consider include:

- For residential mortgage loans, the borrower's ability to repay the loan, including a consideration of the debt-to-income ratio and employment and income stability, the loan-to-value ratio, and the age, condition and marketability of the collateral;
- For commercial and multi-family mortgage loans, the debt service coverage ratio, operating results of the owner in the case of owner-occupied properties, the loan-to-value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;
- For construction loans, the perceived feasibility of the project including the ability to sell improvements constructed for resale, the quality and nature of contracts for presale, if any, experience and ability of the builder, loan-to-cost ratio and loan-to-value ratio;
- For commercial and industrial loans, the debt service coverage ratio (income from the business exceeding operating expenses compared to loan repayment requirements), the operating results of the commercial or professional enterprise, the borrower's business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral; and
- For mortgage warehouse loans held-for-investment, despite our negligible loss history, we provide a loss allowance factor subject to quarterly adjustment. Mortgage warehouse loans held-for-sale are not subject to any loan loss allowance.

The following table presents a summary of changes in the allowance for loan losses for the periods and dates indicated:

ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

	Three Months Ended March 31, 2020	Three Months Ended March 31, 2019
	(Dollars in thousands)	
Allowance for loan losses at beginning of period	$ 6,191	$ 6,723
Net charge-offs (recoveries)	—	—
Provision for loan losses	367	267
Allowance for loan losses at period end	$ 6,558	$ 6,990
Total gross loans outstanding (end of period)	$ 683,214	$ 615,571
Average loans outstanding	$ 664,040	$ 606,985
Allowance for loan losses to period end loans	0.96%	1.14%
Net charge-offs (recoveries) to average loans	0.00%	0.00%

Our allowance for loan losses at March 31, 2020 and 2019 was $6.6 million and $7.0 million, respectively, or 0.96% and 1.14% of loans for each respective period-end.

We had no charge-offs and no recoveries for the three months ended March 31, 2020 and 2019.

Although we believe that we have established our allowance for loan losses in accordance with GAAP and that the allowance for loan losses was adequate to provide for known and inherent losses in the portfolio at all times shown above, future provisions for loan losses will be subject to ongoing evaluations of the risks in our loan portfolio.

The following table shows the allocation of the allowance for loan losses among loan categories and certain other information as of the dates indicated. The total allowance is available to absorb losses from any loan category.

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

	March 31, 2020		December 31, 2019	
	Amount	Percent(1)	Amount	Percent(1)
	(Dollars in thousands)			
Real estate:				
One-to-four family	$ 1,971	0.29%	$ 2,051	0.31%
Multi-family	689	0.10%	653	0.10%
Commercial	2,957	0.43%	2,791	0.41%
Construction	258	0.04%	96	0.01%
Commercial and industrial	426	0.06%	312	0.05%
Consumer and other	1	0.00%	1	0.00%
Reverse mortgage	38	0.01%	37	0.01%
Mortgage warehouse	218	0.03%	250	0.04%
Total allowance for loan losses	$ 6,558	0.96%	$ 6,191	0.93%

(1) Loan category as a percentage of total gross loans.

Deposits

Deposits are the major source of funding for the Company. We offer a variety of deposit products including interest and noninterest bearing demand accounts, money market and savings accounts and certificates of deposit, all of which we market at competitive pricing. We generate deposits from our customers on a relationship basis and through the efforts of our commercial lending officers. Deposits increased to $2.0 billion at March 31, 2020 compared to $1.8 billion December 31, 2019. Noninterest bearing deposits totaled $1.7 billion (representing approximately 87.1% of total deposits) at March 31, 2020, compared to $1.3

billion (representing approximately 74.0% of total deposits) at December 31, 2019. At March 31, 2020, deposits by foreign depositors amounted to $752.8 million or 37.6% of total deposits. The increase in total deposits from December 31, 2019 was driven by an increase in deposit levels from our digital currency customers who maintained excess capital with Silvergate as a result of the dislocation taking place in the digital currency markets during March 2020.

The following table presents a breakdown of our digital currency customer base and the deposits held by such customers at the dates noted below:

	March 31, 2020		December 31, 2019	
	Number of Customers	Total Deposits[1]	Number of Customers	Total Deposits[1]
	(Dollars in millions)			
Digital currency exchanges	61	$ 599	60	$ 527
Institutional investors	541	715	509	432
Other customers	248	379	235	286
Total	850	$ 1,693	804	$ 1,246

(1) Total deposits may not foot due to rounding.

Our cost of total deposits and our cost of funds was 0.87% and 0.94%, respectively, for the three months ended March 31, 2020 as compared to 0.08% and 0.17%, respectively, for the three months ended March 31, 2019. The increase in the weighted average cost of deposits compared to the prior period was driven by the addition of new callable brokered certificates of deposit associated with a hedging strategy and the $2.1 million premium amortization expense recognized during the three months ended March 31, 2020, as discussed in "—Results of Operations—Net Interest Income and Net Interest Margin Analysis" above.

The following table presents the average balances and average rates paid on deposits for the periods indicated:

COMPOSITION OF DEPOSITS

	Three Months Ended March 31, 2020		Year Ended December 31, 2019	
	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)			
Noninterest bearing demand accounts	$ 1,436,062	—	$ 1,445,232	—
Interest bearing accounts:				
Interest bearing demand accounts	51,551	0.13%	49,052	0.14%
Money market and savings accounts	81,670	0.97%	90,551	0.87%
Certificates of deposit:				
Brokered certificates of deposit	306,828	5.02%	187,966	3.54%
Other	1,633	0.99%	13,026	1.49%
Total interest bearing deposits	441,682	3.69%	340,595	2.26%
Total deposits	$ 1,877,744	0.87%	$ 1,785,827	0.43%

The following table presents the maturities of our certificates of deposit as of March 31, 2020:

MATURITIES OF CERTIFICATES OF DEPOSIT

	Three Months or Less	Over Three Through Six Months	Over Six Through Twelve Months	Over Twelve Months	Total
	(Dollars in thousands)				
$100,000 or more	$ 111	$ 250	$ 282	$ 473	$ 1,116
Less than $100,000	132	17	68	141,518	141,735
Total	$ 243	$ 267	$ 350	$ 141,991	$ 142,851

Borrowings

We primarily utilize short-term and long-term borrowings to supplement deposits to fund our lending and investment activities, each of which is discussed below.

FHLB Advances. The FHLB allows us to borrow up to 35% of the Bank's assets on a blanket floating lien status collateralized by certain securities and loans. As of March 31, 2020, approximately $1.0 billion in real estate loans were pledged as collateral for our FHLB borrowings. We utilize these borrowings to meet liquidity needs and to fund certain fixed rate loans in our portfolio. As of March 31, 2020, we had $643.8 million in available borrowing capacity from the FHLB. At March 31, 2020, we had $30.0 million in outstanding FHLB advances.

The following table sets forth certain information on our FHLB borrowings during the periods presented:

FHLB ADVANCES

	Three Months Ended March 31, 2020	Year Ended December 31, 2019
	(Dollars in thousands)	
Amount outstanding at period-end	$ 30,000	$ 49,000
Weighted average interest rate at period-end	0.21%	1.66%
Maximum month-end balance during the period	$ 115,000	$ 218,000
Average balance outstanding during the period	$ 63,934	$ 28,205
Weighted average interest rate during the period	1.45%	1.94%

Federal Reserve Bank of San Francisco. The FRB has an available borrower in custody arrangement that allows us to borrow on a collateralized basis. The Company's borrowing capacity under the Federal Reserve's discount window program was $5.8 million as of March 31, 2020. Certain commercial loans are pledged under this arrangement. We maintain this borrowing arrangement to meet liquidity needs pursuant to our contingency funding plan. No advances were outstanding under this facility as of March 31, 2020.

The Company has also issued subordinated debentures, and has access to borrow federal funds or lines of credit with correspondent banks. At March 31, 2020, these borrowings amounted to $15.8 million.

Subordinated Debentures. A trust formed by the Company issued $12.5 million of floating rate trust preferred securities in July 2001 as part of a pooled offering of such securities. The Company issued subordinated debentures to the trust in exchange for its proceeds from the offering. The debentures and related accrued interest represent substantially all the assets of the trust. The subordinated debentures bear interest at six-month LIBOR plus 375 basis points, which adjusts every six months in January and July of each year. Interest is payable semiannually. At March 31, 2020, the interest rate for the Company's next scheduled payment was 5.51%, based on six-month LIBOR of 1.76%. On any January 25 or July 25 the Company may redeem the 2001 subordinated debentures at 100% of principal amount plus accrued interest. The 2001 subordinated debentures mature on July 25, 2031.

A second trust formed by the Company issued $3.0 million of trust preferred securities in January 2005 as part of a pooled offering of such securities. The Company issued subordinated debentures to the trust in exchange for its proceeds from the offering. The debentures and related accrued interest represent substantially all the assets of the trust. The subordinated debentures bear interest at three-month LIBOR plus 185 basis points, which adjusts every three months. Interest is payable quarterly. At March 31, 2020, the interest rate for the Company's next scheduled payment was 2.59%, based on three-month LIBOR of 0.74%. On the 15th day of any March, June, September, or December, the Company may redeem the 2005 subordinated debentures at 100% of principal amount plus accrued interest. The 2005 subordinated debentures mature on March 15, 2035.

The Company also retained a 3% minority interest in each of these trusts which is included in subordinated debentures. The balance of the equity in the trusts is comprised of mandatorily redeemable preferred securities. The subordinated debentures may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The Company has the right to defer interest payments on the subordinated debentures from time to time for a period not to exceed five years.

Other Borrowings. At March 31, 2020, the Company had no outstanding balance of federal funds purchased and had available lines of credit of $32.0 million with other correspondent banks.

Liquidity and Capital Resources

Liquidity

Liquidity is defined as the Bank's capacity to meet its cash and collateral obligations at a reasonable cost. Maintaining an adequate level of liquidity depends on the Bank's ability to meet both expected and unexpected cash flows and collateral needs efficiently without adversely affecting either daily operations or the financial condition of the Bank. Liquidity risk is the risk that we will be unable to meet our obligations as they become due because of an inability to liquidate assets or obtain adequate funding. The Bank's obligations, and the funding sources used to meet them, depend significantly on our business mix, balance sheet structure and the cash flow profiles of our on- and off-balance sheet obligations. In managing our cash flows, management regularly confronts situations that can give rise to increased liquidity risk. These include funding mismatches, market constraints on the ability to convert assets into cash or in accessing sources of funds (i.e., market liquidity) and contingent liquidity events. Changes in economic conditions or exposure to credit, market, operation, legal and reputational risks also could affect the Bank's liquidity risk profile and are considered in the assessment of liquidity and asset/liability management.

We maintain high levels of liquidity for our customers who operate in the digital currency industry, as these deposits are subject to potentially dramatic fluctuations due to certain factors that may be outside of our control. As a result, our investment portfolio is comprised primarily of mortgage-backed securities backed by government-sponsored entities, collateralized mortgage obligations and asset-backed securities.

Management has established a comprehensive management process for identifying, measuring, monitoring and controlling liquidity risk. Because of its critical importance to the viability of the Bank, liquidity risk management is fully integrated into our risk management processes. Critical elements of our liquidity risk management include: effective corporate governance consisting of oversight by the board of directors and active involvement by management; appropriate strategies, policies, procedures, and limits used to manage and mitigate liquidity risk; comprehensive liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds) that are commensurate with the complexity and business activities of the Bank; active management of intraday liquidity and collateral; an appropriately diverse mix of existing and potential future funding sources; adequate levels of highly liquid marketable securities free of legal, regulatory or operational impediments, that can be used to meet liquidity needs in stressful situations; comprehensive contingency funding plans that sufficiently address potential adverse liquidity events and emergency cash flow requirements; and internal controls and internal audit processes sufficient to determine the adequacy of the institution's liquidity risk management process.

The movement of funds on our balance sheet among different SEN deposit customers does not reduce the Bank's deposits and thus does not present liquidity issues or require any borrowing by the Company or the Bank. In addition, to the extent that SEN participants fully withdraw funds from the Bank, no material liquidity issues or borrowing needs would be presented since the majority of SEN deposit funds are held in cash or other short duration liquid assets.

We expect funds to be available from basic banking activity sources, including the core deposit base, the repayment and maturity of loans and investment security cash flows. Other potential funding sources include borrowings from the FHLB, the FRB, other lines of credit and brokered certificates of deposit. At March 31, 2020, we had $30.0 million in outstanding FHLB advances. We did not have any borrowings outstanding with the FRB at March 31, 2020. As of March 31, 2020, we had $643.8 million of available borrowing capacity from the FHLB, $5.8 million of available borrowing capacity from the FRB and available lines of credit of $32.0 million with other correspondent banks. Cash and cash equivalents at March 31, 2020 were $166.2 million. Accordingly, our liquidity resources were at sufficient levels to fund loans and meet other cash needs as necessary.

Capital Resources

Shareholders' equity increased $13.7 million to $244.8 million at March 31, 2020 compared to $231.0 million at December 31, 2019. The increase in shareholders' equity was primarily due to net income for the three months ended March 31, 2020, which amounted to $4.4 million and an increase in accumulated other comprehensive income of $9.1 million. The increase in accumulated other comprehensive income was primarily due to unrealized gains on derivatives purchased in connection with our hedging strategy, partially offset by unrealized losses on our available-for-sale securities portfolio.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios of common equity Tier 1, Tier 1, and total capital as a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 1,250%. The Bank is also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio.

In July 2013, federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by Basel III and certain provisions of the Dodd-Frank Act. The final rule currently applies to all depository institutions and bank holding companies and savings and loan holding companies with total consolidated assets of more than $3 billion. The Company has total consolidated assets of less than $3 billion and is currently exempt from the consolidated capital requirements.

As of March 31, 2020, the Bank was in compliance with all applicable regulatory capital requirements to which it was subject, and was classified as “well capitalized” for purposes of the prompt corrective action regulations. As we deploy our capital and continue to grow our operations, our regulatory capital levels may decrease depending on our level of earnings. However, we intend to monitor and control our growth to remain in compliance with all regulatory capital standards applicable to us.

The following table presents the regulatory capital ratios for the Company (assuming minimum capital adequacy ratios were applicable to the Company) and the Bank as of the dates indicated:

	Actual		Minimum capital adequacy		To be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
March 31, 2020						
The Company						
Tier 1 leverage ratio	$ 244,726	10.98%	$ 89,127	4.00%	N/A	N/A
Common equity tier 1 capital ratio	229,226	23.75%	43,436	4.50%	N/A	N/A
Tier 1 risk-based capital ratio	244,726	25.35%	57,915	6.00%	N/A	N/A
Total risk-based capital ratio	251,438	26.05%	77,219	8.00%	N/A	N/A
The Bank						
Tier 1 leverage ratio	230,056	10.33%	89,096	4.00%	$ 111,371	5.00%
Common equity tier 1 capital ratio	230,056	23.86%	43,398	4.50%	62,686	6.50%
Tier 1 risk-based capital ratio	230,056	23.86%	57,864	6.00%	77,151	8.00%
Total risk-based capital ratio	236,768	24.55%	77,151	8.00%	96,439	10.00%

	Actual		Minimum capital adequacy		To be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2019						
The Company						
Tier 1 leverage ratio	$ 240,135	11.23%	$ 85,501	4.00%	N/A	N/A
Common equity tier 1 capital ratio	224,635	24.52%	41,233	4.50%	N/A	N/A
Tier 1 risk-based capital ratio	240,135	26.21%	54,978	6.00%	N/A	N/A
Total risk-based capital ratio	246,447	26.90%	73,304	8.00%	N/A	N/A
The Bank						
Tier 1 leverage ratio	224,605	10.52%	85,399	4.00%	$ 106,749	5.00%
Common equity tier 1 capital ratio	224,605	24.55%	41,163	4.50%	59,458	6.50%
Tier 1 risk-based capital ratio	224,605	24.55%	54,884	6.00%	73,179	8.00%
Total risk-based capital ratio	230,917	25.24%	73,179	8.00%	91,474	10.00%

Off-Balance Sheet Items

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated statements of financial condition. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and issue letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk exceeding the amounts recognized in our consolidated statements of financial condition. Our exposure to credit loss is represented by the contractual amounts of these commitments. The same credit policies and procedures are used in making these commitments as for on-balance sheet instruments. We are not aware of any accounting loss to be incurred by funding these commitments; however, we maintain an allowance for off-balance sheet credit risk which is recorded in other liabilities on the consolidated statements of financial condition. For details of our commitments to extend credit, and commercial and standby letters of credit, please refer to "Note 9—Commitments and Contingencies—Off-Balance Sheet Items" of the "Notes to Unaudited Consolidated Financial Statements" under Part I, Item 1 of this Quarterly Report on Form 10-Q.

Non-GAAP Financial Measures

Our accounting and reporting policies conform to GAAP and the prevailing practices in the banking industry. However, we also evaluate our performance based on certain additional financial measures discussed in this Quarterly Report on Form 10-Q as being "non-GAAP financial measures." We identify certain financial measures as non-GAAP financial measures if that financial measure excludes or includes amounts, that are not included or excluded, as the case may be, in the most directly comparable measure calculated and presented in accordance with GAAP in our statements of operations, financial condition or cash flows. Non-GAAP financial measures do not include operating and other statistical measures or ratios that are calculated using exclusively financial measures presented in accordance with GAAP.

This Quarterly Report on Form 10-Q includes certain non-GAAP financial measures for the three months ended March 31, 2020 and 2019 in order to present our results of operations for that period on a basis consistent with our historical operations. On November 15, 2018, the Company and the Bank entered into a purchase and assumption agreement with HomeStreet Bank to sell the Bank's retail branch located in San Marcos, California and business loan portfolio to HomeStreet Bank. This transaction, which was completed in March 2019, generated a pre-tax gain on sale of $5.5 million. There were no non-GAAP adjustments for the three months ended March 31, 2020.

We believe that these non-GAAP financial measures provide useful information to management and investors that is supplementary to our financial condition, results of operations and cash flows computed in accordance with GAAP. However, non-GAAP financial measures have a number of limitations, are not necessarily comparable to GAAP measures and should not be considered in isolation or viewed as a substitute for the most directly comparable or other financial measures calculated in accordance with GAAP. Moreover, the manner in which we calculate non-GAAP financial measures may differ from that of other companies reporting non-GAAP measures with similar names. You should understand how such other companies calculate their financial measures that may be similar or have names that are similar to the non-GAAP financial measures discussed herein when comparing such non-GAAP financial measures. Our management uses the non-GAAP financial measures set forth below in its analysis of our performance.

	Three Months Ended March 31, 2020	2019
	(Dollars in thousands)	
Net income		
Net income, as reported	$ 4,393	$ 9,436
Adjustments:		
Gain on sale of branch, net	—	(5,509)
Tax effect[1]	—	1,574
Adjusted net income	$ 4,393	$ 5,501
Noninterest income / average assets[2]		
Noninterest income	$ 4,931	$ 7,871
Adjustments:		
Gain on sale of branch, net	—	(5,509)
Adjusted noninterest income	4,931	2,362
Average assets	2,228,167	1,972,483
Noninterest income / average assets, as reported	0.89%	1.62%
Adjusted noninterest income / average assets	0.89%	0.49%
Return on average assets (ROAA)[2]		
Adjusted net income	$ 4,393	$ 5,501
Average assets	2,228,167	1,972,483
Return on average assets (ROAA), as reported	0.79%	1.94%
Adjusted return on average assets	0.79%	1.13%
Return on average equity (ROAE)[2]		
Adjusted net income	$ 4,393	$ 5,501
Average equity	247,476	195,989
Return on average equity (ROAE), as reported	7.14%	19.53%
Adjusted return on average equity	7.14%	11.38%
Efficiency ratio		
Noninterest expense	$ 13,875	$ 13,486
Net interest income	15,478	19,316
Noninterest income	4,931	7,871
Total net interest income and noninterest income	20,409	27,187
Adjustments:		
Gain on sale of branch, net	—	(5,509)
Adjusted total net interest income and noninterest income	20,409	21,678
Efficiency ratio, as reported	67.98%	49.60%
Adjusted efficiency ratio	67.98%	62.21%

(1) Amount represents the total income tax effect of the adjustment, which is calculated based on the applicable marginal tax rate of 28.58%.

(2) Data has been annualized.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a financial institution, our primary component of market risk is interest rate volatility. Our Asset Liability Management Policy sets forth guidelines for effective funds management and establishes an approach for measuring and monitoring our net interest rate sensitivity.

Interest rate risk is the probability of an increase or decline in the value of an asset or liability due to fluctuations in interest rates. These fluctuations have an impact on both the level of interest income and interest expense as well as the market value of all interest earning assets and liabilities. The objective is to measure the impact that different interest rate scenarios

have on net interest income and ensure that the results are within policy limits while maximizing income. The results can be reflected as an increase or decrease of future net interest income or an increase or decrease of current fair market value.

Exposure to interest rates is managed by structuring the balance sheet in a ‘business as usual’ or ‘base case’ scenario. We do not enter into instruments such as leveraged derivatives, financial options or financial future contracts for the purpose of reducing interest rate risk. We hedge interest rate risk by utilizing interest rate floors and interest rate caps. The interest rate floors hedge our cash and securities and the interest rate caps hedge our subordinated debentures. Based on the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Exposure to interest rate risk is managed by the Bank’s Asset Liability Management Committee, in accordance with policies approved by the board of directors. The committee formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the committee considers the impact on earnings and capital under the current interest rate outlook, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The committee meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans, and the maturities of investments and borrowings. Additionally, the committee reviews liquidity, cash flow flexibility, maturities of deposits, and consumer and commercial deposit activity. Management employs methodologies to manage interest rate risk that include an analysis of relationships between interest earning assets and interest-bearing liabilities as well as utilizing an interest rate simulation model where various rate scenarios can be analyzed.

The following table indicates that, for periods less than one year, rate-sensitive assets exceed rate-sensitive liabilities, resulting in an asset-sensitive position. For a bank with an asset-sensitive position, or positive gap, rising interest rates would generally be expected to have a positive effect on net interest income, and falling interest rates would generally be expected to have the opposite effect. Due to our asset sensitive position, we have implemented a hedging strategy to reduce our interest rate risk exposure in a declining rate environment.

INTEREST SENSITIVITY GAP

	Within One Month	After One Month Through Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Non -Sensitive	Total
			(Dollars in thousands)			
March 31, 2020						
Assets						
Interest earning assets						
Loans[1]	$ 543,981	$ 50,264	$ 181,790	$ 776,035	$ 344,962	$ 1,120,997
Securities[2]	477,696	3,123	20,106	500,925	473,661	974,586
Interest earning deposits in other banks	160,391	—	—	160,391	—	160,391
Total earning assets	$ 1,182,068	$ 53,387	$ 201,896	$ 1,437,351	$ 818,623	$ 2,255,974
Liabilities						
Interest bearing liabilities						
Interest bearing deposits	$ 114,887	$ —	$ —	$ 114,887	$ —	$ 114,887
Certificates of deposit	131	111	617	859	141,992	142,851
Total interest bearing deposits	115,018	111	617	115,746	141,992	257,738
FHLB advances	30,000	—	—	30,000	—	30,000
Total interest bearing liabilities	$ 145,018	$ 111	$ 617	$ 145,746	$ 141,992	$ 287,738
Period gap	$ 1,037,050	$ 53,276	$ 201,279	$ 1,291,605	$ 676,631	$ 1,968,236
Cumulative gap	$ 1,037,050	$ 1,090,326	$ 1,291,605	$ 1,291,605	$ 1,968,236	
Ratio of cumulative gap to total earning assets	45.97%	48.33%	57.25%	57.25%	87.25%	

(1) Includes loans held-for-sale.

(2) Includes FHLB and FRB stock.

We use quarterly Interest Rate Risk, or IRR, simulations to assess the impact of changing interest rates on our net interest income and net income under a variety of scenarios and time horizons. These simulations utilize both instantaneous and parallel changes in the level of interest rates, as well as non-parallel changes such as changing slopes and twists of the yield curve. Static simulation models are based on current exposures and assume a constant balance sheet with no new growth. Dynamic simulation models are also utilized that rely on detailed assumptions regarding changes in existing lines of business, new business, and changes in management and client behavior.

We also use economic value-based methodologies to measure the degree to which the economic values of the Bank's positions change under different interest rate scenarios. The economic-value approach focuses on a longer-term time horizon and captures all future cash flows expected from existing assets and liabilities. The economic value model utilizes a static approach in that the analysis does not incorporate new business; rather, the analysis shows a snapshot in time of the risk inherent in the balance sheet.

Many assumptions are used to calculate the impact of interest rate fluctuations on our net interest income, such as asset prepayments, non-maturity deposit price sensitivity and decay rates, and key rate drivers. Because of the inherent use of these estimates and assumptions in the model, our actual results may, and most likely will, differ from our static IRR results. In addition, static IRR results do not include actions that our management may undertake to manage the risks in response to anticipated changes in interest rates or client behavior. For example, as part of our asset/liability management strategy, management can increase asset duration and decrease liability duration to reduce asset sensitivity, or to decrease asset duration and increase liability duration in order to increase asset sensitivity.

The following table summarizes the results of our IRR analysis in simulating the change in net interest income and fair value of equity over a 12-month horizon as of March 31, 2020:

IMPACT ON NET INTEREST INCOME UNDER A STATIC BALANCE SHEET, PARALLEL INTEREST RATE SHOCK

Earnings at Risk as of:	-100 bps	Flat	+100 bps	+200 bps	+300 bps
March 31, 2020	(11.97)%	0.00%	9.26%	20.74%	31.27%

Utilizing an economic value of equity, or EVE, approach, we analyze the risk to capital from the effects of various interest rate scenarios through a long-term discounted cash flow model. This measures the difference between the economic value of our assets and the economic value of our liabilities, which is a proxy for our liquidation value. While this provides some value as a risk measurement tool, management believes IRR is more appropriate in accordance with the going concern principle.

The following table illustrates the results of our EVE analysis as of March 31, 2020.

ECONOMIC VALUE OF EQUITY ANALYSIS UNDER A STATIC BALANCE SHEET, PARALLEL INTEREST RATE SHOCK

As of:	-100 bps	Flat	+100 bps	+200 bps	+300 bps
March 31, 2020	(4.39)%	0.00%	5.15%	9.55%	13.00%

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2020.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

The section titled Risk Factors in Part I, Item 1A of our 2019 Form 10-K includes a discussion of the many risks and uncertainties we face, any one or more of which could have a material adverse effect on our business, results of operations, financial condition (including capital and liquidity), or prospects or the value of or return on an investment in the Company. The information presented below provides an update to, and should be read in conjunction with, the risk factors and other information contained in our 2019 Form 10-K.

The recent COVID-19 pandemic has led to periods of significant volatility in financial, commodities and other markets and could harm our business and results of operations.

In December 2019, COVID-19 was first reported in Wuhan, Hubei Province, China. Since then, COVID-19 infections have spread to additional countries including the United States. In March 2020, the World Health Organization declared COVID-19 to be a pandemic. Given the ongoing and dynamic nature of the circumstances surrounding this pandemic, it is difficult to predict the impact of the pandemic on our business, and there is no guarantee that our efforts to address or mitigate the adverse impacts of the coronavirus pandemic will be effective. The impact to date has included periods of significant volatility in financial, commodities and other markets. This volatility, if it continues, could have an adverse impact on our customers and on our business, financial condition and results of operations as well as our growth strategy.

Our business is dependent upon the willingness and ability of our customers to conduct banking and other financial transactions. The spread of COVID-19 has caused and could continue to cause severe disruptions in the U.S. economy at large, and has resulted and may continue to result in disruptions to our customers' businesses, and a decrease in consumer confidence and business generally. In addition, recent actions by U.S. federal, state and local governments to address the pandemic, including travel bans, stay-at-home orders and school, business and entertainment venue closures, may have a significant adverse effect on our customers and the markets in which we conduct our business. The extent of impacts resulting from the coronavirus pandemic and other events beyond our control will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus pandemic and actions taken to contain the coronavirus or its impact, among others.

Disruptions to our customers could result in increased risk of delinquencies, defaults, foreclosures and losses on our loans. The escalation of the pandemic may also negatively impact regional economic conditions for a period of time, resulting in declines in local loan demand, liquidity of loan guarantors, loan collateral (particularly in real estate), loan originations and deposit availability. If the global response to contain COVID-19 escalates or is unsuccessful, we could experience a material adverse effect on our business, financial condition, results of operations and cash flows.

The spread of the COVID-19 outbreak and the governmental responses may disrupt banking and other financial activity in the areas in which we operate and could potentially create widespread business continuity issues for us.

The outbreak of COVID-19 and the U.S. federal, state and local governmental responses may result in a disruption in the services we provide. We rely on our third-party vendors to conduct business and to process, record, and monitor transactions. If any of these vendors are unable to continue to provide us with these services or experience interruptions in their ability to provide us with these services, it could negatively impact our ability to serve our customers. Furthermore, the coronavirus pandemic could negatively impact the ability of our employees and customers to engage in banking and other financial transactions in the geographic areas in which we operate and could create widespread business continuity issues for us. We also could be adversely affected if key personnel or a significant number of employees were to become unavailable due to infection, quarantine or other effects and restrictions of a COVID-19 outbreak in our market areas. Although we have business continuity plans and other safeguards in place, there is no assurance that such plans and safeguards will be effective. If we are unable to promptly recover from such business disruptions, our business and financial conditions and results of operations would be adversely affected. We also may incur additional costs to remedy damages caused by such disruptions, which could adversely affect our financial condition and results of operations.

Interest rate volatility stemming from COVID-19 could negatively affect our net interest income, lending activities, deposits and profitability.

Our net interest income, lending activities, deposits and profitability could be negatively affected by volatility in interest rates caused by uncertainties stemming from COVID-19. In March 2020, the Federal Reserve lowered the target range for the federal funds rate to a range from 0 to 0.25 percent, citing concerns about the impact of COVID-19 on markets and stress in the energy sector. A prolonged period of extremely volatile and unstable market conditions may increase our funding costs and negatively affect market risk mitigation strategies. Higher income volatility from changes in interest rates and spreads to benchmark indices could cause a loss of future net interest income and a decrease in current fair market values of our assets. Fluctuations in interest rates will impact both the level of income and expense recorded on most of our assets and liabilities and the market value of all interest-earning assets and interest-bearing liabilities, which in turn could have a material adverse effect on our net income, operating results, or financial condition.

We are subject to increasing credit risk as a result of the COVID-19 pandemic, which could adversely impact our profitability.

Our business depends on our ability to successfully measure and manage credit risk. As a commercial lender, we are exposed to the risk that the principal of, or interest on, a loan will not be paid timely or at all or that the value of any collateral supporting a loan will be insufficient to cover our outstanding exposure. In addition, we are exposed to risks with respect to the risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual loans and borrowers. As the overall economic climate in the U.S., generally, and in our market areas specifically, experiences material disruption due to the COVID-19 pandemic, our borrowers may experience difficulties in repaying their loans and governmental actions may provide payment relief to borrowers affected by COVID-19 and preclude our ability to initiate foreclosure proceedings in certain circumstances and, as a result, the collateral we hold may decrease in value or become illiquid, and the level of our nonperforming loans, charge-offs and delinquencies could rise and require significant additional provisions for credit losses. Additional factors related to the credit quality of certain commercial real estate and multi-family residential loans include the duration of state and local moratoriums on evictions for non-payment of rent or other fees. The payment on these loans that are secured by income producing properties are typically dependent on the successful operation of the related real estate property and may subject us to risks from adverse conditions in the real estate market or the general economy.

We are actively working to support our borrowers to mitigate the impact of the COVID-19 pandemic on them and on our loan portfolio, including through loan modifications that defer payments for those who experienced a hardship as a result of the COVID-19 pandemic. Although recent regulatory guidance provides that such loan modifications are exempt from the calculation and reporting of TDRs and loan delinquencies, we cannot predict whether such loan modifications may ultimately have an adverse impact on our profitability in future periods. Our inability to successfully manage the increased credit risk caused by the COVID-19 pandemic could have a material adverse effect on our business, financial condition and results of operations.

Unpredictable future developments related to or resulting from the COVID-19 pandemic could materially and adversely affect our business and results of operations.

Because there have been no comparable recent global pandemics that resulted in a similar global impact, we do not yet know the full extent of the COVID-19 pandemic's effects on our business, operations, or the global economy as a whole. Any future development will be highly uncertain and cannot be predicted, including the scope and duration of the pandemic, the effectiveness of our work from home arrangements, third party providers' ability to support our operation, and any actions taken by governmental authorities and other third parties in response to the pandemic. We are continuing to monitor the COVID-19 pandemic and related risks, although the rapid development and fluidity of the situation precludes any specific prediction as to its ultimate impact on us. However, if the pandemic continues to spread or otherwise results in a continuation or worsening of the current economic and commercial environments, our business, financial condition, results of operations and cash flows as well as our regulatory capital and liquidity ratios could be materially adversely affected and many of the risks described in our 2019 Form 10-K will be heightened.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Number	Description
3.1	Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of the Registrant’s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on October 28, 2019 (File No. 333-228446)).
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 of the Registrant’s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on October 28, 2019 (File No. 333-228446)).
31.1	Rule 13a-14(a) Certification of the Principal Executive Officer.
31.2	Rule 13a-14(a) Certification of the Principal Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer.
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

SIGNATURES

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

SILVERGATE CAPITAL CORPORATION

Date:	May 12, 2020	By:	/s/ Alan J. Lane
			Alan J. Lane
			President and Chief Executive Officer (Principal Executive Officer)
Date:	May 12, 2020	By:	/s/ Antonio Martino
			Antonio Martino
			Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Alan J. Lane, certify that:

1. I have reviewed this periodic report on Form 10-Q of Silvergate Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this reports;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
   (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)]
   (c) evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
   (d) disclosed in this Report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the Audit Committee of the Registrant’s Board of Directors (or persons performing the equivalent functions):
   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

SILVERGATE CAPITAL CORPORATION

Date: May 12, 2020

By: /s/ Alan J. Lane

Alan J. Lane
President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Antonio Martino, certify that:

1. I have reviewed this periodic report on Form 10-Q of Silvergate Capital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this reports;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
   (b) [Paragraph omitted in accordance with Exchange Act Rule 13a-14(a)]
   (c) evaluated the effectiveness of the Registrant’s disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
   (d) disclosed in this Report any change in the Registrant’s internal control over financial reporting that occurred during the Registrant’s most recent fiscal quarter (the Registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant’s internal control over financial reporting; and
5. The Registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant’s auditors and the Audit Committee of the Registrant’s Board of Directors (or persons performing the equivalent functions):
   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant’s ability to record, process, summarize and report financial information; and
   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant’s internal control over financial reporting.

SILVERGATE CAPITAL CORPORATION

Date:	May 12, 2020	By:	/s/ Antonio Martino
			Antonio Martino
			Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the periodic report of Silvergate Capital Corporation (the "Company") on Form 10-Q for the period ended March 31, 2020, as filed with the Securities and Exchange Commission (the “Report”), each of the undersigned, in his respective capacities indicated below, hereby certifies as of the date hereof, solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code, that to the undersigned's best knowledge and belief:

(1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This Certification has not been, and shall not be deemed, “filed” with the Securities and Exchange Commission.

SILVERGATE CAPITAL CORPORATION

Date:	May 12, 2020	By:	/s/ Alan J. Lane
			Alan J. Lane
			President and Chief Executive Officer
Date:	May 12, 2020	By:	/s/ Antonio Martino
			Antonio Martino
			Chief Financial Officer