[MS-0398.040.009.016]

SAN DIEGO STATE UNIVERSITY 1897

Neighborhood Bancorp

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FINANCIAL BUSINESS PLAN

October 1, 1991

Neighborhood Bancorp
Business Plan
EXECUTIVE SUMMARY

Statement of Purpose

The Neighborhood Bancorp is proposed as a private for-profit community development corporation and bank holding company. The overall purpose of the bank is creating new, and supplementing existing financial services and products for San Diego's disadvantaged neighborhoods.

The long-range development of Bancorp will focus on meeting the credit needs of unserved populations. It will specifically address financing for the development, and rehabilitation of affordable housing. It will work to link investment of public and private capital for affordable housing. It will provide access to other forms of credit not available to underserved populations. Furthermore, it will attempt, in its governance and philosophy of business, to encourage the economic self- sufficiency of businesses and organizations representing those populations.

Neighborhood Bancorp is being formed to serve as a centerpiece for numerous efforts to meet unmet credit needs in the San Diego region. It will provide a mechanism for coordinating efforts by public agencies, private and non-profit developers, and lenders seeking to implement effective low-income lending strategies.

In addition to its initial housing focus, efforts will be made to develop multiple services and products which serve to enhance the overall economic well being of the San Diego region. ▲

Plan of Organization

Neighborhood Bancorp will initially incorporate and raise $50,000 of capital. These funds will be used for pre-operating expenses and professional fees to concurrently: 1) obtain approval from the State of California to operate a community development corporation (CDC); 2) begin the regulatory process of a comprehensive business plan, site plan and application to form a bank holding company and bank subsidiary and 3) initiate a stock offering with a capitalization target of $5 million.

Approval for a CDC is expected from the State within three months from the inception of Bancorp. Approvals from the Office of the Comptroller of Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) for the bank holding company and bank charter is anticipated around twelve months from inception. A fully subscribed stock offering which will be necessary to receive final bank approvals is expected nine months after incorporation.

Upon receiving CDC approvals and before regulatory bank approvals, Bancorp intends to borrow and/or sell stock to other financial institutions to provide a pool of community loan funds. The OCC permits national banks to invest in CDCs or participate in CDC projects. Funds provided by financial institutions will help them fulfill their Community Reinvestment Act (CRA)

requirements. Bancorp will use these funds to form loan participations and/or equity partnerships which will invest in low and moderate income areas and for business loans to builders involved in the development, construction or rehabilitation of affordable housing. This CDC phase, which is expected to run twelve months before the opening of the Bank, is not reflected in the financial projections herein of the business plan.

Upon receiving approval to form a bank holding company and bank, Bancorp will form a bank subsidiary to accept wholesale deposits from other banks, non-profit institutions and foundations and governmental agencies. The Bank will also establish a retail banking office to provide home purchase loans, checking, savings and other financial services to underserved, minority and other disadvantaged areas.

It is also envisioned that Bancorp will form other subsidiaries to provide housing to low and moderate income areas by forming joint ventures with developers and governmental organizations, undertaking non-profit projects with a community benefit and establishing loan counseling programs.

The financial information included in this business plan is a projection of the financial results starting at the inception of the bank subsidiary. ▲

Financial Highlights of the Business Plan

Bancorp will be capitalized with $2 million of common stock from private investors and $3 million of subordinated debt from financial institutions. Bancorp in turn will capitalize the Bank subsidiary with $5 million.

Stock issuance and organization costs and pre-operating expenses dilute the initial $10 common share purchase price. However, by the third year the Bank's profitability has increased the share book value to $18.87 and earnings per share are $4.56. Net worth excluding the subordinated debt is $3.8 million or 4.21% of assets at the end of the third year.

The Bank starts operations with $60 million of wholesale deposits which is invested in socially screened securities until the funds are loaned out. Retail loan originations begin in the fourth quarter and retail deposits are accepted starting in the seventh quarter.

Projected loan volume is $46 million per year. This is comprised of permanent residential, development, construction, multi-family, non-residential and business loans. Loans will also include rehabilitative housing programs which will reinvigorate disadvantaged areas and ultimately enhance the community's quality of life and increase property and collateral values.

There is no loan sale activity reflected in the business plan given the goal to increase assets. However, most likely the Bank will form loan participations with other banks on larger loans and sell certain loans in the secondary market. This will allow the Bank to gradually build a loan servicing portfolio which will improve profitability and may also generate profits from loan sales. In addition, loan sales would also allow for the turnover of funds which can be reinvested in other affordable housing loans and projects.

Retail deposit growth is projected at $14 million per year. This consists of passbook, checking, money market and time deposits. Wholesale deposits stay at $60 million all three years.

By the end of the third year, assets total $89.7 million. The Bank seeks to attain total assets of approximately $100 million as soon as it can be absorbed in a safe and sound manner. This level is important because it provides efficiencies and economies of scale relative to the fixed expenses of staffing and operationing a financial institution.

The Bank's asset/liability mix provides a net portfolio spread in the range of 3% and non-interest earning assets are minimized. Nevertheless, the business plan shows a dip in the spread in the third year. This is because the retail deposits which are growing have higher rates than the wholesale deposits. This increases the overall cost of funds. Also, the yield from assets is impaired because the loan origination volume is not adequate to reduce the lower yielding investments. Therefore, there is potential for improvement in the asset/liability mix which would increase the profits.

Operating expenses are kept tight and remain under 2% of assets. This combined with the net portfolio spread helps result in a return on average assets of 1.11% and a return on beginning equity of 31.89% in the third year.

For further insight into the business plan and financial projections, see the financial highlights schedule and statements and summary of assumptions. ▲

Principals

Robert M. McGill

Over Mr. McGill's twenty-five year career, he has been with financial institutions and is currently serving as a finance officer for a real estate development company. As a Senior Vice President for the Federal Reserve Bank of San Francisco, he was Officer-In-Charge of the Los Angeles Office. Prior to that he was an executive with a major California bank for ten years. Mr. McGill has an MBA as well as a bachelors degree in Finance. ▲

James Bliesner

Mr. Bliesner is Reinvestment Director to the City-County Reinvestment Tast Force. The Task Force is a trilateral effort involving lenders, community organizations and elected government representatives. Mr. Bliesner has been an appointee to the Mayor's Growth Management Committee, the City Council Redistricting Committee and the Governor's Advisory Committee on Neighborhoods. He has organized a number of San Diego community-based non-profit housing development corporations and serves on the Board of the City Heights Community Development Corporation and the Multi-Bank Lending Consortium, the California Community Reinvestment Corporation. ▲

Vincent H. Gonzalez

Mr. Gonzalez has been Executive Vice President and Chief Financial Officer of Rancho Bernardo Federal Savings Bank since 1986. He also served as a Director of the Bank. Before 1986, Mr. Gonzalez was the Vice-President of Finance for Provident Capital Corporation which he joined in 1983. This investment company provided equity financing to joint ventures for the development of residential housing. From 1976 to 1983, Mr. Gonzalez worked for the accounting firm of Price Waterhouse as a Manager specializing in financial institutions. Mr. Gonzalez is a member of the American Institute of Certified Public Accountants and the California Society of Certified Public Accountants. ▲

Advisors

Anticipated Counsel

Kurt L. Kickliglter, Attorney at Law
Higgs, Fletcher & Mack

Anticipated Accountant

Gerald T. LaFlamme, Partner
Kenneth Leventhal & Company

Financial Highlights

	Year 1	Year 2	Year 3
FINANCIAL POSITION			
Total assets	$65,843,949	$74,025,506	$89,691,423
Net loans	7,964,533	33,450,462	50,994,193
Deposits	60,000,006	67,000,006	81,000,006
Subordinated debt	3,000,000	3,000,000	3,000,000
Shareholders' equity	2,081,086	2,861,867	3,774,396
Shares outstanding	200,000	200,000	200,000
Book value per share	10.41	14.31	18.87
INCOME DATA			
Net interest income	1,811,768	2,616,108	3,105,889
Operating expenses	1,251,158	1,374,046	1,558,708
Net income	381,086	780,781	912,529
Earnings per share	1.91	3.90	4.56
FINANCIAL RATIOS			
Yield from assets at year end	7.96%	8.20%	8.21%
Cost of funds at year end	5.00	5.09	5.21
Net portfolio spread at year end	2.96	3.12	3.00
Cost of subordinated debt	6.00	6.00	6.00
Return on average assets	0.58	1.12	1.11
Return on beginning equity	22.42	37.52	31.89
Operating expenses to average asset	1.91	1.96	1.90
GAAP capital to total assets	3.16	3.87	4.21

Statement Of Financial Condition

	Inception	End Of Year 1	End Of Year 2	End Of Year 3
ASSETS				
Cash and Liquidity	$64,550,000	$4,200,000	$4,690,000	$5,670,000
Investment Securities	0	52,900,000	35,000,000	32,100,000
Loans Receivable	0	7,964,533	33,450,462	50,994,193
Interest Receivable	0	59,415	245,044	367,230
Real Estate Owned	0	0	0	0
Premises and Equipment - Net	400,000	360,000	320,000	280,000
Other Assets	0	200,000	200,000	200,000
Organization Expense	200,000	160,000	120,000	80,000
Total Assets	**$65,150,000**	**$65,843,949**	**$74,025,506**	**$89,691,423**
LIABILITIES				
Deposit Accounts	$60,000,000	$60,000,006	$67,000,006	$81,000,006
Other Borrowings	0	0	0	0
Accrued Interest Payable	250,000	250,000	283,958	351,875
Income Taxes Payable	0	239,523	760,804	1,395,456
Other Liabilities	200,000	273,334	118,871	169,690
Total Liabilities	**60,450,000**	**60,762,863**	**68,163,639**	**82,917,027**
Subordinated Debt	**3,000,000**	**3,000,000**	**3,000,000**	**3,000,000**
STOCKHOLDERS' EQUITY				
Common Stock (200,000 shs @ $10)	1,700,000	1,700,000	1,700,000	1,700,000
Retained Earnings	0		381,086	1,161,867
Current Earnings	0	381,086	780,781	912,529
Total Stockholders' Equity	**1,700,000**	**2,081,086**	**2,861,867**	**3,774,396**
Total Liabilities and Equity	**$65,150,000**	**$65,843,949**	**$74,025,506**	**$89,691,423**

See accompanying summary of assumptions.

Statement Of Operations

	Year 1	Year 2	Year 3
Interest Income:			
Loans	$181,500	$2,342,549	$4,129,612
Amortization Of Loan Fees	17,361	117,484	152,351
Cash And Investments	4,792,906	3,492,738	2,943,900
Total Interest Income	**4,991,768**	**5,952,770**	**7,225,863**
Interest Expense:			
Deposits	3,000,000	3,156,663	3,939,974
Other Borrowings	0	0	0
Subordinated Debt	180,000	180,000	180,000
Total Interest Expense	**3,180,000**	**3,336,663**	**4,119,974**
Net Interest Margin	1,811,768	2,616,108	3,105,889
Non-Interest Income:			
Other Fees	60,000	120,000	120,000
Fees From Loan Sales	0	0	0
Gain On Sale Of Loans	0	0	0
Other Income	0	0	0
Total Non-Interest Income	**60,000**	**120,000**	**120,000**
Non-Interest Expense:			
Operating Expenses	1,251,158	1,374,046	1,558,708
Provision For Loan Losses	0	60,000	120,000
Total Non-Interest Expense	**1,251,158**	**1,434,046**	**1,678,708**
Net Income (Loss) Before Taxes	620,609	1,302,062	1,547,181
Taxes on Income:			
Federal	173,463	382,684	469,964
State	66,060	138,597	164,688
Net Income	**$381,086**	**$780,781**	**$912,529**

See accompanying summary of assumptions.

Operating Expenses

	Year 1	Year 2	Year 3
COMPENSATION			
Salaries	$433,750	$515,000	$540,000
Payroll taxes	43,375	51,500	54,000
Group insurance	34,700	41,200	43,200
Retirement/Savings plan	0	0	0
Capitalized costs	(34,667)	(138,667)	(138,667)
	477,158	**469,033**	**498,533**
MARKETING	4,000	32,000	60,000
OCCUPANCY			
Rent, net	48,000	69,000	90,000
Maintenance and operations	32,000	40,000	48,000
Property taxes	0	0	0
Depreciation and amortization	40,000	40,000	40,000
Utilities	32,000	40,000	48,000
	152,000	**189,000**	**226,000**
OTHER EXPENSES			
Directors fees	36,000	36,000	36,000
Dues and publications	8,000	12,000	16,000
Legal	32,000	40,000	48,000
Audit and exam fees	32,000	32,000	32,000
Stationery and supplies	32,000	40,000	48,000
Postage	20,000	24,000	28,000
Telephone	24,000	28,000	32,000
Data processing	96,000	96,000	96,000
Courier service	0	4,000	8,000
Equipment expense	16,000	20,000	24,000
Other office expense	16,000	20,000	24,000
Officers and employee expense	16,000	20,000	24,000
Conferences and seminars	0	0	0
Auto and travel	32,000	36,000	40,000
Casualty insurance	40,000	40,000	40,000
Printing and reproduction	16,000	20,000	24,000
Organizational costs	40,000	40,000	40,000
Bank service fees	24,000	36,000	48,000
FDIC premiums	138,000	140,013	166,175
Branch expansion	0	0	0
	618,000	**684,013**	**774,175**
Total Operating Expenses	**$1,251,158**	**$1,374,046**	**$1,558,708**

See accompanying summary of assumptions.

ASSUMPTIONS

The following assumptions apply to the bank subsidiary of Neighborhood Bancorp.

Capitalization

The Bank is capitalized by Neighborhood Bancorp with $2 million of common stock (200,000 shares at $10) and $3 million of subordinated debt bearing a rate of 6%. Common stock proceeds are reduced by $300,000 for stock issue costs. In addition, there are $200,000 of organization costs incurred which are deferred and amortized to expense over five years. This amounts to $10,000 per quarter.

On the day the Bank opens for business, it receives $60 million of wholesale deposits from other banks, non-profit and governmental institutions and foundations at a rate of 5%. Over the first quarter, seven percent of these funds are placed in liquidity instruments with a 5.5% yield and the remainder is placed in various investments including mortgage-backed securities with a yield of 8%. Investments will be socially screened and made in a manner to maximize yields with safety of principal and with maturities matched to cash flow requirements for loan originations. Interest income in the computer model could be increased if all liquidity and investment instruments were locked up at inception, rather than invested over the quarter. ▲

Loans

Loan originations are targeted for low and moderate income areas and residents and small businesses. Lending begins in the fourth quarter with the following quarterly goals:

- ▲ *$5.0 million for residential mortgages at 8%*
- ▲ *$5.0 million for ADC, rehabilitation, commercial property and multifamily at 10%*
- ▲ *$1.5 million for business loans at 11%*

Loan rates were determined based on an average 3% spread for normal residential loans with a higher spread for loans with higher risk. Based upon the Bank's goal of reaching $100 million in assets, a 3% spread is considered reasonable for purposes of covering overhead, building capital and providing a reasonable return to investors. Accordingly, the model uses a 3% spread between wholesale funds and residential loans, 4% for development, commercial and multifamily loans and 5% for business loans.

Loan fee income was calculated using 1.5 points for permanent residential loans over a 30-year life, 2 points for ADC, rehab, commercial property and multifamily over a 15-year life, and 1.5 points for business loans over a 2-year life.

Loan origination costs per loan which are deferred and amortized over their terms are $500, $1,500 and $500 for take-out, ADC and business loans, respectively.

The provision for loan losses is $60,000 per year.

These is no loan activity reflected in the financial model. ▲

Deposits

Retail deposits are brought in starting in the seventh quarter. New retail deposits per quarter consist of:

Passbook	$250,000	5.50%
Checking	500,000	3.00
Money Market	1,000,000	6.00
IRA/Keogh	250,000	6.50
Certificates	1,000,000	6.50
Retail Jumbos	500,000	6.75

Wholesale deposits remain at $60 million for the first twelve quarters, in that additional funds from this source cannot be utilized given the loan origination goals and the retail deposits being brought in. ▲

Salaries

Salaries are $103,750 per quarter for the first three quarters. This is based on the following annual salaries:

President	$100,000
3 Managers at $70,000	210,000
Secretary/Admin. Asst.	35,000
Bookkeeper	24,000
Wholesale Funds Admin.	24,000
Loan/Savings Clerk	22,000

In the fourth quarter, two loan employees (origination and servicing) and an accountant are added for a total of $75,000 per year. In the seventh quarter, two retail savings employees are added for a total of $50,000. ▲

Other Expenses

Furniture, equipment and leasehold improvements are acquired in the first quarter. These total $400,000 and are depreciated over 10 years. Depreciation expense is $10,000 per quarter.

Marketing expense is $1,000 for the first six quarters and then increased to $15,000 thereafter for retail deposit gathering.

Rent expense is based on 2,000 square feet at $1.50 for the first six quarters, then increased to 5,000 square feet thereafter to accommodate the retail deposit operation.

Maintenance and utilities are each $8,000 per quarter through the sixth quarter, then increased in the seventh quarter to $12,000.

There are no property taxes.

Directors fees are $9,000 per quarter based on nine directors at $250 per meeting.

Data processing is $24,000 per quarter or $8,000 per month.

Casualty and D&O insurance is $10,000 per quarter.

FDIC deposit insurance is calculated at 23 basis points for all deposits.

Other G & A expenses are very rough estimates of normal operating expenses.

The effective tax rates used are 31.3% for federal and 10.6% for state. ▲

Regulatory Capital

For regulatory capital purposes, the Bank meets the 1.5% tangible capital requirement, but falls short on the 3% core capital requirement. The shortfall occurs in the first four quarters and is due in part to the stock issue and organization costs which are deleted from regulatory capital. Core capital is generally deferred as GAAP capital less intangibles.

Subordinated debt does not count for tangible or core capital, but does count with certain limitations for the risk based capital requirement. For the risk based capital requirement, supplemental capital which includes subordinated debt and preferred stock is limited to 100% of core capital. In the current scenario, at inception, subordinated debt exceeds core capital by $1.5 million ($3 million less $1.7 million GAAP capital less $200,000 organization costs). Therefore, the amount of subordinated debt that would be allowed for regulatory capital would be limited to $1.5 million.

The core capital shortfall could be eliminated by raising $2.5 million of common stock and $2.5 million of subordinated debt. This would also increase the amount of subordinated debt that could be counted for risk based capital. ▲

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