HERITAGE COMMERCE CORP

2019 Annual Report | On Form 10-K

2020 Notice of Annual Meeting of Shareholders
2020 Annual Meeting Proxy Statement

2019 annual report

To Our Shareholders

April 15, 2020

Dear Fellow Shareholders:

Fiscal year 2019 was the most profitable year in the history of Heritage Commerce Corp, generating earnings of $40.5 million. We also completed the acquisition of Presidio Bank in the fourth quarter of 2019, the largest in our Company's history which significantly expanded our franchise. As a result, we added $904.5 million in assets. We are now a $4.0 billion asset institution with approximately $2.5 billion in total loans and an enviable deposit base of approximately $3.4 billion.

Heritage Bank of Commerce is the premier community business bank in one of the most dynamic economic regions in the country. The acquisition of Presidio Bank further expanded our presence as one of the leading relationship-based business banks in the San Francisco Bay Area. We are very proud of our team's hard work. We are assembling an enduring banking platform for continued growth based on the successful business model that we have been building on for the past 26 years.

We continue to enhance shareholder value and again raised our quarterly cash dividend by 8% to $0.13 per share. We have increased our dividend for the last seven consecutive years.

2019 Highlights:

- Net income was $40.5 million, or $0.84 per average diluted common share, for the full year of 2019. Net interest income increased 8% to $131.8 million for the full year, compared to $122.0 million for 2018, and the net interest margin was solid at 4.28% for 2019.
- We successfully completed the acquisition of Presidio Bank, which included $670 million in loans and $723 million in deposits, growing our total assets to $4.1 billion as of December 31, 2019. The systems conversion and integration of Presidio Bank was completed in the first quarter of 2020. The majority of the cost savings were realized by the end of the first quarter of 2020.
- Credit quality improved with nonperforming assets declining 50% from 2018 to 0.24% of total assets.
- The allowance for loan losses was 0.92% of total loans at December 31, 2019.
- Strong capital levels were maintained with a total risk-based capital ratio of 14.6%, a Tier 1 risk-based ratio of 12.5% and a leverage ratio of 9.8% at year-end 2019. All capital levels exceeded regulatory requirements for a "well-capitalized" financial institution under the Basel III regulatory requirements.
- Walt Kaczmarek retired as CEO in August. His career with Heritage spanned 15 years. We wish to acknowledge Walt for his years of dedication and inspired leadership. We are pleased that he has agreed to remain on the Board of Directors.
- Keith Wilton assumed the position of CEO of the Holding Company and the Bank in August. Keith joined the bank in 2014 as Chief Operating Officer and worked closely with Walt. He was promoted to President of the Bank in 2017. Over the past five years, Keith has gained the experience, knowledge and developed the leadership skills to fill his new roles. He has also quickly gained the full confidence of the Board of Directors.

We are proud of the value Heritage Commerce Corp has created for its shareholders in 2019 and are grateful for the talented and dedicated employees who embrace our culture of integrity and serving our clients, communities, shareholders and each other.

We end this brief letter with the ready acknowledgement that the country and the State of California are experiencing an extraordinary period in our history. All of our thoughts and prayers go out to everyone who has been negatively impacted by the Coronavirus. To our shareholders, customers and employees, we can say that the Bank remains strong with excellent capital and liquidity resources, which we believe will allow us to withstand what we hope will be a short term disruption in economic activity.

Thank you for your loyal support, and please join us for our annual meeting on Thursday, May 21, 2020, at 1:00 p.m. Please go to: https://web.lumiagm.com/242381599. Click on 'I have a control number' and enter the EQ control number. As a shareholder, you will then be required to enter your control number which is located in the upper right hand corner on your proxy card. The Meeting Code is: HERITAGE2020 (case sensitive).

Sincerely,

Jack W. Conner
Chairman of the Board

Keith A. Wilton
President and CEO

Proxy Statement

HERITAGE COMMERCE CORP

Notice of 2020 Annual Meeting and Proxy Statement

HERITAGE COMMERCE CORP

April 15, 2020

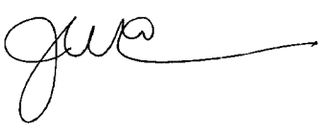
Dear Shareholder:

You are cordially invited to attend the 2020 Annual Meeting of Shareholders, which will be held at 1:00 p.m., Pacific Daylight Time (PDT) on Thursday, May 21, 2020. The accompanying Notice of Annual Meeting and proxy statement describe the business that will be conducted at the meeting and provide information about Heritage Commerce Corp. We have also enclosed our 2019 Annual Report on Form 10-K.

Due to the public health impact of the coronavirus (COVID-19) outbreak and to support the health and well-being of our shareholders, this year's Annual Meeting will be a completely virtual meeting of shareholders, which will be conducted online via live webcast. You will be able to attend the Annual Meeting by visiting https://web.lumiagm.com/242381599.

Whether or not you participate in our virtual Annual Meeting, it is very important that your shares be represented at the meeting. Accordingly, please sign, date, and promptly mail the enclosed proxy card. You may also vote over the Internet or by telephone by following the instructions on the proxy card. If you attend the virtual Annual Meeting and prefer to vote at the meeting, you may do so.

Sincerely,



Jack W. Conner
Chairman of the Board

Keith A. Wilton
President and Chief Executive Officer

150 Almaden Boulevard, San Jose, California 95113 • Telephone (408) 947-6900 • Fax (408) 947-6910

HERITAGE COMMERCE CORP

150 Almaden Boulevard
San Jose, California 95113

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Date and Time:	Thursday, May 21, 2020, at 1:00 p.m., Pacific Daylight Time (PDT).
Items of Business:	1. To elect 12 members of the Board of Directors, each for a term of one year; 2. To approve an amendment to the Heritage Commerce Corp 2013 Equity Incentive Plan to increase the number of shares for issuance under the Plan; 3. To approve an advisory proposal on the Company's 2019 executive compensation; 4. To ratify the selection of Crowe LLP as the Company's independent registered public accounting firm for the year ending December 31, 2020; and 5. To transact such other business as may properly come before the meeting, and any adjournment or postponement.
Record Date:	You can vote if you are a shareholder of record on March 26, 2020.
Mailing Date:	The proxy materials are being distributed to our shareholders on or about April 15, 2020, and include our Annual Report on Form 10-K, Notice of Annual Meeting, this proxy statement, and proxy or voting instruction card.
Important Notice Regarding the Internet Availability of Proxy Materials:	The proxy statement and Annual Report on Form 10-K are available at *www.heritagecommercecorp.com*. **Your Vote is Important.** Please vote as promptly as possible by using the Internet or telephone or by signing, dating and returning the enclosed proxy card.

VIRTUAL ANNUAL MEETING

Due to the public health impact of the coronavirus (COVID-19) outbreak and to support the health and well-being of our shareholders, this year's Annual Meeting will be a completely virtual meeting of shareholders, which will be conducted online via live webcast. You will not be able to attend the Annual Meeting physically. You are entitled to participate in the Annual Meeting if you owned shares of our common stock as of the close of business on March 26, 2020.

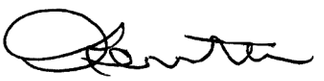
You will be able to participate in the Annual Meeting online and submit your questions during the meeting by visiting https://web.lumiagm.com/242381599. If you own shares as a "Registered Holder," rather than through a broker, you will need the 11-digit control/identification number and meeting code included on your proxy card to participate in the Annual Meeting. If you own shares as a "Beneficial Owner" through a broker or agent, you must contact the broker or agent that holds your shares to obtain an access code for the webcast. You will need your access code and the meeting code included on your proxy card to participate in the Annual Meeting.

The Annual Meeting webcast will begin promptly at 1:00 p.m. Pacific Time on May 21, 2020. Online access will begin at 12:30 p.m. Pacific Daylight Time, and we encourage you to access the meeting prior to the start time. You will not be able to attend the Annual Meeting if you don't have Internet access.

Even if you plan to participate in the Annual Meeting online, we recommend that you also vote by proxy as described in the proxy statement on page 2 as described further in "*How do I vote by proxy?*" so that your vote will be counted if you later decide not to participate in the Annual Meeting.

Live questions may be submitted online during the Annual Meeting, at one or more designated times. We reserve the right to edit or reject all questions we deem profane or otherwise inappropriate.

By Order of the Board of Directors,



Deborah Reuter
Executive Vice President
and Corporate Secretary

April 15, 2020
San Jose, California

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PROXY STATEMENT FOR HERITAGE COMMERCE CORP
2020 ANNUAL MEETING OF SHAREHOLDERS
INFORMATION ABOUT THE ANNUAL MEETING AND VOTING

Why did you send me this proxy statement?

We sent you this proxy statement and the enclosed proxy card because our Board of Directors (the "Board of Directors" or the "Board") is soliciting your proxy to vote at the 2020 Annual Meeting ("Annual Meeting") of Shareholders. This proxy statement summarizes the information you need to know to cast an informed vote at the Annual Meeting. Heritage Commerce Corp is referred to in this proxy statement as the "Company." Along with this proxy statement, we are also sending you the Heritage Commerce Corp 2019 Annual Report on Form 10-K, which includes our consolidated financial statements.

How will our Annual Meeting be held?

Due to the public health impact of the coronavirus (COVID-19) outbreak and to support the health and well-being of our shareholders, this year's Annual Meeting will be a completely virtual meeting of shareholders, which will be conducted online via live webcast. You will not be able to attend the Annual Meeting physically. You are entitled to participate in the Annual Meeting if you owned shares of our common stock as of the close of business on March 26, 2020.

You will be able to participate in the Annual Meeting online and submit your questions during the meeting by visiting https://web.lumiagm.com/242381599. If you own shares as a "Registered Holder," rather than through a broker, you will need the 11-digit control/identification number and meeting code included on your proxy card to participate in the Annual Meeting. If you own shares as a "Beneficial Owner" through a broker or agent, you must contact the broker or agent that holds your shares to obtain an access code for the webcast. You will need your access code and the meeting code included on your proxy card to participate in the Annual Meeting.

The Annual Meeting webcast will begin promptly at 1:00 p.m. Pacific Time on May 21, 2020. Online access will begin at 12:30 p.m. Pacific Daylight Time, and we encourage you to access the meeting prior to the start time. You will not be able to attend the Annual Meeting if you don't have Internet access.

Even if you plan to participate in the Annual Meeting online, we recommend that you also vote by proxy as described in the proxy statement on pages 2 as described further in "*How do I vote by proxy?*" so that your vote will be counted if you later decide not to participate in the Annual Meeting.

Live questions may be submitted online during the Annual Meeting, at one or more designated times. We reserve the right to edit or reject all questions we deem profane or otherwise inappropriate.

Who is entitled to vote?

We will begin sending this proxy statement, the attached Notice of Annual Meeting and the enclosed proxy card on or about April 15, 2020, to all shareholders entitled to vote. Shareholders who were the record owners of the Company's common stock at the close of business on March 26, 2020, are entitled to vote. On this record date, there were 59,568,219 shares of common stock outstanding.

What constitutes a quorum?

A majority of the outstanding shares of the common stock entitled to vote at the Annual Meeting must be present, in person or by proxy, in order to constitute a quorum. We can only conduct the business of the Annual Meeting if a quorum has been established. We will include proxies marked as abstentions and broker non-votes in determining the number of shares present at the Annual Meeting.

How many votes do I have?

Each share of common stock entitles you to one vote in person or by proxy, for each share of common stock outstanding in your name on the books of the Company as of March 26, 2020, the record date for the Annual Meeting on any matter submitted to a vote of the shareholders, except that in connection with the election of directors (Proposal 1), you may cumulate your shares *(see "What is cumulative voting and how do I cumulate my shares?" on page 3)*. The proxy card indicates the number of votes that you have as of the record date.

Is voting confidential?

We have a confidential voting policy to protect the privacy of our shareholders' votes. Under this policy, ballots, proxy cards and voting instructions returned to banks, brokers and other nominees are kept confidential. Only the proxy tabulator and the Inspector of Election have access to the ballots, proxy cards and voting instructions.

How do I vote by proxy?

You may vote by granting a proxy or, for shares held in street name, by submitting voting instructions to your broker or other nominee. If your shares are held by a broker or other nominee, you will receive instructions that you must follow to have your shares voted. If you hold your shares as a shareholder of record, you may vote by completing, signing and dating the enclosed proxy card and returning it promptly in the envelope provided. You may also vote by telephone or over the Internet (see page 3). Returning the proxy card will not affect your right to participate on line at the virtual the Annual Meeting and vote.

If you properly fill in your proxy card and send it to us in time to vote, your "proxy" (one of the individuals named on your proxy card) will vote your shares as you have directed. If you sign the proxy card but do not make specific choices, your proxy will vote your shares as recommended by the Board of Directors as follows:

- **"FOR"** the election of all 12 nominees for director;
- **"FOR"** the amendment to increase the number of shares available under the Heritage Commerce Corp 2013 Equity Incentive Plan;
- **"FOR"** the approval of the advisory proposal on the Company's 2019 executive compensation; and
- **"FOR"** the ratification of the selection of Crowe LLP as our independent registered public accounting firm for 2020.

For the election of directors (Proposal 1), a shareholder may withhold authority for the proxy holders to vote for any one or more of the nominees by marking the enclosed proxy card in the manner instructed on the proxy card. Unless authority to vote for the nominees is withheld, the proxy holders will vote the proxies received by them for the election of the nominees listed on the proxy card as directors of the Company. Your proxy does not have an obligation to vote for nominees not identified on the preprinted proxy card (that is, write-in candidates). Should any shareholder attempt to "write in" a vote for a nominee not identified on the preprinted card (and described in these proxy materials), your proxy will NOT vote the shares represented by your proxy card for any such write-in candidate, but will instead vote the shares for any and all other indicated candidates. If any of the nominees should be unable or decline to serve, which is not now anticipated, your proxy will have discretionary authority to vote for a substitute who shall be designated by the present Board of Directors to fill the vacancy. In the event that additional persons are nominated for election as directors, your proxy intends to vote all of the proxies in such a manner, in accordance with the cumulative voting, as will assure the election of as many of the nominees identified on the proxy card as possible. In such event, the specific nominees to be voted for will be determined by the proxy holders, in their sole discretion.

What do I have to do to vote my shares if they are held in the name of my broker?

If your shares are held by your broker, sometimes called "street name" shares, you must vote your shares through your broker. You should receive a form from your broker asking how you want to vote your shares. Follow the instructions on that form to give voting instructions to your broker. Under the rules that govern brokers who are voting with respect to shares held in street name, brokers have the discretion to vote such shares on routine, but not on non-routine matters. A "broker non-vote" occurs when your broker does not vote on a particular proposal because the broker does not receive instructions from the beneficial owner and does not have discretionary authority. Proposal 1 (election of directors), Proposal 2 (amendment to the Heritage Commerce Corp 2013 Equity Incentive Plan to increase the number of shares for issuance under the Plan), and Proposal 3 (advisory proposal on the 2019 executive compensation), are non-routine items on which a broker may vote only if the beneficial owner has provided voting instructions. Proposal 4 (ratification of independent registered public accounting firm) is a routine item.

How do I vote at the virtual meeting?

If you plan to attend the virtual Annual Meeting and desire to vote at the meeting you will have the opportunity to do so, but we recommend you send in a proxy card to vote. However, if your shares are held in the name of your broker, bank or other nominee, you must provide the proper codes as set forth in the proxy card.

May I vote over the Internet or by telephone?

Shareholders whose shares are registered in their own names may vote either over the Internet or by telephone. Special instructions for voting over the Internet or by telephone are set forth on the enclosed proxy card. The Internet and telephone voting procedures are designed to authenticate the shareholder's identity and to allow shareholders to vote their shares and confirm that their voting instructions have been properly recorded.

If your shares are registered in the name of a bank or brokerage firm, you may be eligible to vote your shares by telephone or over the Internet. Most U.S. banks and brokerage firms are clients of Broadridge Financial Solutions ("Broadridge"). As such, shareholders who receive either a paper copy of their proxy statement or electronic delivery notification have the opportunity to vote by telephone or over the Internet. If your bank or brokerage firm is a Broadridge client, your proxy card or Voting Instruction Form ("VIF") will provide the instructions. If your proxy card or VIF does not provide instructions for Internet and telephone voting, please complete and return the proxy card in the self-addressed, postage-paid envelope provided.

What is cumulative voting and how do I cumulate my shares?

For the election of directors (Proposal 1), California law provides that a shareholder of a California corporation, or his/her proxy, may cumulate votes in the election of directors. That is, each shareholder may cast that number of votes equal to the number of shares owned by him/her, multiplied by the number of directors to be elected, and he/she may cumulate such votes for a single candidate or distribute such votes among as many candidates as he/she deems appropriate.

Certain affirmative steps must be taken by you in order to be entitled to vote your shares cumulatively for the election of directors. At the shareholders' meeting at which directors are to be elected, no shareholder is entitled to cumulate votes (i.e., cast for any one or more candidates a number of votes greater than the number of the shareholder's shares) unless the candidates' names have been placed in nomination at the meeting and prior to the commencement of the voting and at least one shareholder has given notice at the meeting and prior to commencement of the voting of the shareholder's intention to cumulate votes. If any shareholder has given such notice, then every shareholder entitled to vote may cumulate votes for candidates in nomination and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which that shareholder's shares are

entitled, or distribute the shareholder's votes on the same principle among any or all of the candidates, as the shareholder thinks appropriate. The candidates receiving the highest number of votes, up to the number of directors to be elected, will be elected.

The proxies designated on your proxy card do not, at this time, intend to cumulate votes, to the extent they have the shareholder's discretionary authority to do so, pursuant to the proxies solicited in this proxy statement unless another shareholder gives notice to cumulate, in which case your proxy may cumulate votes in accordance with the recommendations of the Board of Directors. Therefore, discretionary authority to cumulate votes in such an event is solicited in this proxy statement.

May I change my vote after I return my proxy?

If you fill out and return the enclosed proxy card, or vote by telephone or over the Internet, you may change your vote at any time before the vote is conducted at the Annual Meeting. You may change your vote in any one of four ways:

- You may send to the Company's Corporate Secretary another completed proxy card with a later date.
- You may notify the Company's Corporate Secretary in writing before the Annual Meeting that you have revoked your proxy.
- You may attend the Annual Meeting and vote on line.
- If you have voted your shares by telephone or over the Internet, you can revoke your prior telephone or Internet vote by recording a different vote, or by signing and returning a proxy card dated as of a date that is later than your last telephone or Internet vote.

What if I receive multiple proxy cards?

If you receive multiple proxy cards, your shares are probably registered differently or are in more than one account. Vote all proxy cards received to ensure that all your shares are voted. Unless you need multiple accounts for specific purposes, we recommend that you consolidate as many of your accounts as possible under the same name and address. If the shares are registered in your name, contact our transfer agent, EQ Shareowner Services, 1-866-883-3382; otherwise, contact your bank, broker or other nominee.

What vote is required to approve each proposal?

Approval of Proposal 1 (election of directors) requires a plurality of votes cast for each nominee. This means that the 12 nominees who receive the most votes will be elected. So, if you do not vote for a particular nominee, or you indicate "WITHHOLD AUTHORITY" to vote for a particular nominee on your proxy card, your vote will not count either "for" or "against" the nominee. Abstentions will not have any effect on the outcome of the vote. You may cumulate your votes in the election of directors as described under *"What is cumulative voting and how do I cumulate my shares?"* on page 3. Broker non-votes will not count as a vote on the proposal and will not affect the outcome of the vote.

Proposal 2 (amendment to the 2013 equity incentive plan), Proposal 3 (advisory proposal on the executive compensation) and Proposal 4 (ratification of independent registered public accounting firm) each requires a vote that satisfies two criteria: (i) the affirmative vote for the proposal must constitute a majority of the common shares present or represented or by proxy and voting on the proposal at the Annual Meeting; and (ii) the affirmative vote for the proposal must constitute a majority of the common shares required to constitute the quorum. For purposes of Proposal 2, 3 and 4, abstentions and broker non-votes will not affect the outcome under clause (i), which recognizes only actual votes cast. However, abstentions and broker non-votes will affect the outcome under clause (ii) if the number of affirmative votes, though a majority of the votes represented, does not constitute a majority of the voting power required to constitute a quorum. The ratification of the appointment of the independent registered public

accounting firm for 2020 is a matter on which a broker or other nominee is generally empowered to vote and, therefore, no broker non-votes are expected to exist with respect to Proposal 4.

How will voting on any other business be conducted?

Your proxy card confers discretionary authority to your proxy to vote your shares on the matters which may properly be presented for action at the Annual Meeting, and may include action with respect to procedural matters pertaining to the conduct of the Annual Meeting.

What are the costs of soliciting these proxies?

We will pay all the costs of soliciting these proxies. In addition to mailing proxy soliciting material, our directors, officers and employees also may solicit proxies in person, by telephone or by other electronic means of communication for which they will receive no compensation. We will ask banks, brokers and other institutions, nominees and fiduciaries to forward the proxy materials to their principals and to obtain authority to execute proxies. We will then reimburse them for their reasonable expenses. We have hired Advantage Proxy to seek the proxies of custodians, such as brokers, which hold shares which belong to other people. This service will cost the Company approximately $4,750 plus expenses.

How do I obtain an Annual Report on Form 10-K?

A copy of our 2019 Annual Report on Form 10-K accompanies this proxy statement. If you would like another copy of this report, we will send you one without charge. The Annual Report on Form 10-K includes a list of exhibits filed with the Securities and Exchange Commission ("SEC"), but does not include the exhibits. If you wish to receive copies of the exhibits, we will send them to you. Please write to:

Heritage Commerce Corp
150 Almaden Boulevard
San Jose, California 95113
Attention: Executive Vice President and Corporate Secretary

You can also find out more information about us at our website *www.heritagecommercecorp.com*. Our website is available for information purposes only and should not be relied upon for investment purposes, nor is it incorporated by reference into this proxy statement. On our website you can access electronically filed copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Section 16 filings, and amendments to those reports and filings, free of charge. The SEC also maintains a website at *www.sec.gov* that contains reports, proxy statements and other information regarding SEC registrants, including the Company.

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table sets forth information as of February 28, 2020, pertaining to beneficial ownership of the Company's common stock by persons known to the Company to own 5% or more of the Company's common stock, nominees to be elected to the Board of Directors, the executive officers named in the Summary Compensation Table presented in this proxy statement, and all directors and executive officers of the Company, as a group. This information has been obtained from the Company's records, or from information furnished directly by the individual or entity to the Company.

For purposes of the following table, shares issuable pursuant to stock options which may be exercised within 60 days of February 28, 2020, are deemed to be issued and outstanding and have been treated as outstanding in determining the amount and nature of beneficial ownership and in calculating the percentage of ownership of those individuals possessing such interest, but not for any other individuals.

Name of Beneficial Owner(1)	Position	Shares Beneficially Owned(2)(3)	Exercisable Options	Percent of Class(3)
Michael E. Benito	Executive Vice President/ Business Banking Manager of Heritage Bank of Commerce	87,395(4)(22)	27,000	0.15%
Julianne Biagini-Komas	Director	29,147(5)	—	0.05%
Frank G. Bisceglia	Director	137,771(6)	21,500	0.23%
Margo G. Butsch	Executive Vice President & Chief Credit Officer of Heritage Bank of Commerce	27,783(7)(22)	8,783	0.05%
Bruce H. Cabral	Director	107,199(8)	34,580	0.18%
Jack W. Conner	Director & Chairman of the Board	124,675(9)	—	0.21%
Jason DiNapoli	Director	328,955(10)	—	0.55%
Stephen G. Heitel	Director	290,003(11)	123,499	0.49%
Robertson Clay Jones	Executive Vice President & President of Community Business Bank Group of Heritage Bank of Commerce	252,845(12)(22)	222,299	0.42%
Walter T. Kaczmarek	Director	126,602(13)	—	0.21%
Lawrence D. McGovern	Executive Vice President & Chief Financial Officer	120,220(14)(22)	30,000	0.20%
Robert T. Moles	Director	73,938(15)	21,500	0.12%
Laura Roden	Director	30,534(16)	10,700	0.05%
Marina Park Sutton	Director	101,066(17)	34,580	0.17%
Ranson W. Webster	Director	636,112(18)	21,500	1.07%
Keith A. Wilton	President, Chief Executive Officer and Director	108,483(19)(22)	—	0.18%
All directors, and executive officers (16 individuals)		2,582,728	555,941	4.30%
Black Rock Inc.		4,305,664(20)	—	7.23%
T. Rowe Price Associates, Inc.		6,142,411(21)	—	10.31%

1. Except as otherwise noted, the address for all persons is c/o Heritage Commerce Corp, 150 Almaden Boulevard, San Jose, California, 95113.

2. Subject to applicable community property laws and shared voting and investment power with a spouse, the persons listed have sole voting and investment power with respect to such shares unless otherwise noted. Listed amounts reflect all previous stock splits and stock dividends.

3. Includes shares beneficially owned (including options exercisable within 60 days of February 28, 2020, as shown in the "Exercisable Options" column).

4. Includes 21,375 shares of restricted stock that have not vested and of which Mr. Benito has the right to vote.
5. Includes 2,261 shares of restricted stock that have not vested and of which Ms. Biagini-Komas has the right to vote.
6. Includes 93,237 shares as one of two trustees of the Bisceglia Family Trust, and 11,000 shares held by Mr. Bisceglia in a personal Individual Retirement Account. Also includes 2,261 shares of restricted stock that have not vested and of which Mr. Bisceglia has the right to vote.
7. Includes 17,250 shares of restricted stock that have not vested and of which Ms. Butsch has the right to vote.
8. Includes 46,312 shares held indirectly by trust.
9. Includes 24,344 shares held by Mr. Conner's spouse. Also includes 2,826 shares of restricted stock that have not vested and of which Mr. Conner has the right to vote.
10. Includes 286,694 shares held by a partnership and 20,000 shares held by Mr. DiNapoli's children. Also includes 2,261 shares of restricted stock that have not vested and of which Mr. DiNapoli has the right to vote.
11. Includes 75,658 shares held by Individual Retirement Account.
12. Includes 30,546 shares held directly.
13. Includes 42,906 shares held in a personal Individual Retirement Account. Includes 28,696 shares held indirectly by trust. Also includes 55,000 shares of restricted stock that have not vested and of which Mr. Kaczmarek has the right to vote.
14. Includes 4,980 shares held by Mr. McGovern in a personal Individual Retirement Account. Also includes 28,300 shares of restricted stock that have not vested and of which Mr. McGovern has the right to vote.
15. Includes 18,295 shares held by Mr. Moles' spouse. Also includes 2,261 shares of restricted stock that have not vested and of which Mr. Moles has the right to vote.
16. Includes 2,261 shares of restricted stock that have not vested and of which Ms. Roden has the right to vote.
17. Includes 30,875 shares held indirectly by trust.
18. Includes 8,493 shares held indirectly. Also includes 2,261 shares of restricted stock that have not vested and of which Mr. Webster has the right to vote.
19. Includes 37,250 shares of restricted stock that have not vested and of which Mr. Wilton has the right to vote.
20. BlackRock, Inc. is an investment management firm and may be deemed to beneficially own 4,305,664 shares of the Company which are held of record by clients of BlackRock, Inc. The address for BlackRock, Inc. is 55 East 52nd Street, New York, NY 10055. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 5, 2020.
21. T. Rowe Price Associates, Inc. is an investment management firm and may be deemed to beneficially own 6,142,411 shares of the Company which are held of record by clients of T. Rowe Price Associates, Inc. the address for T. Rowe Price Associates, Inc. is 100 East Pratt Street, Baltimore, MD 21202. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 14, 2020.
22. The Company's Employee Stock Ownership Plan owns 102,834 shares of our common stock, all of which have been allocated. These include shares held for the account of the following named executive officers and includes in the table for Mr. McGovern 5,520 shares, Mr. Benito 2,295 shares, and zero shares for Ms. Butsch, Mr. Jones and Mr. Wilton. Mr. Wilton and Mr. McGovern are two of the three trustees of the Employee Stock Ownership Plan. As trustees, they have the power to vote any unallocated shares of the Employee Stock Ownership Plan (currently no shares are unallocated) and allocated shares for which voting instructions are not otherwise provided.

CORPORATE GOVERNANCE AND BOARD MATTERS

The Board of Directors is committed to good business practices, transparency in financial reporting and the highest level of corporate governance. To that end, the Board continually reviews its governance policies and practices, as well as the requirements of the Sarbanes-Oxley Act of 2002 and the listing standards of the Nasdaq Stock Market, to help ensure that such policies and practices are compliant and up to date.

Board of Directors

Board Independence

In 2019 eleven (11) out of thirteen (13) members of the Board of Directors were independent directors, as defined by the applicable rules and regulations of the Nasdaq Stock Market, as follows:

Julianne M. Biagini-Komas
Frank G. Bisceglia
Bruce H. Cabral
Jack W. Conner, Chairman of the Board
Jason DiNapoli
Steven L. Hallgrimson*
Stephen G. Heitel
Robert T. Moles
Laura Roden
Marina Park Sutton
Ranson W. Webster

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* Mr. Hallgrimson will retire from the Board at the Annual Meeting.

Board and Committee Meeting Attendance

During the fiscal year ended December 31, 2019, our Board of Directors held a total of 17 meetings. For the meetings directors were qualified to attend in 2019, each incumbent director who was a director during 2019 attended at least 75% of the aggregate of (a) the total number of such meetings and (b) the total number of meetings held by the standing committees of the Board on which such director served.

Director Attendance at Annual Meetings of Shareholders

The Board believes it is important for all directors to attend the Annual Meeting of Shareholders in order to show their support for the Company and to provide an opportunity for shareholders to communicate any concerns to them. The Company's policy is to encourage, but not require, attendance by each director at the Company's Annual Meeting of Shareholders. All of the directors of the Company are encouraged to attend the Annual Meeting of Shareholders and at the 2019 Annual Meeting of Shareholders nine out of ten of our directors at that time were in attendance.

Communications with the Board

Shareholders may communicate with the Board of Directors, including a committee of the Board or individual directors, by writing to the Corporate Secretary, Heritage Commerce Corp, 150 Almaden Boulevard, San Jose, California 95113. Each communication from a shareholder should include the

following information in order to permit shareholder status to be confirmed and to provide an address to forward a response if deemed appropriate:

- The name, mailing address and telephone number of the shareholder sending the communication; and
- If the shareholder is not a record holder of our common stock, the name of the record holder of our common stock beneficially owned must be identified along with the shareholder.

Our Corporate Secretary will forward all appropriate communications to the Board or individual members of the Board specified in the communication. Our Corporate Secretary may (but is not required to) review all correspondence addressed to the Board or any individual member of the Board, for any inappropriate correspondence more suitably directed to management. Communications may be deemed inappropriate for this purpose if it is reasonably apparent from the face of the correspondence that it relates principally to a customer dispute. Our policies regarding the handling of security holder communications were approved by a majority of our independent directors.

Nomination of Directors

The Company has a Corporate Governance and Nominating Committee. The duties of the Corporate Governance and Nominating Committee include the recommendation of candidates for election to the Company's Board of Directors.

The Corporate Governance and Nominating Committee's minimum qualifications for a director are persons of high ethical character who have both personal and professional integrity, which is consistent with the image and values of the Company. The Corporate Governance and Nominating Committee considers some or all of the following criteria in considering candidates to serve as directors:

- commitment to ethical conduct and personal and professional integrity as evidenced through the person's business associations, diversity, service as a director or executive officer or other commitment to ethical conduct and personal and professional integrity as evidenced in organizations and/or education;
- objective perspective and mature judgment developed through business experiences and/or educational endeavors;
- the candidate's ability to work with other members of the Board of Directors and management to further our goals and increase shareholder value;
- the ability and commitment to devote sufficient time to carry out the duties and responsibilities as a director;
- demonstrated experience at policy making levels in various organizations and in areas that are relevant to our activities;
- the skills and experience of the potential nominee in relation to the capabilities already present on the Board of Directors; and
- such other attributes, including independence, relevant in constituting a board that also satisfies the requirements imposed by the SEC and the Nasdaq Stock Market.

The Corporate Governance and Nominating Committee does not have a separate policy for consideration of any director candidates recommended by shareholders. Instead, the Corporate Governance and Nominating Committee considers any candidate meeting the requirements for nomination by a shareholder set forth in the Company's Bylaws (as well as applicable laws and regulations) in the same manner as any other director candidate. The Corporate Governance and Nominating Committee believes that requiring shareholder recommendations for director candidates to comply with the requirements for nominations in accordance with the Company's Bylaws ensures that the Corporate

Governance and Nominating Committee receives at least the minimum information necessary for it to begin an appropriate evaluation of any such director nominee.

Section 5.14 of the Company's Bylaws provide that any shareholder must give advance written notice to the Company of an intention to nominate a director at a shareholder meeting. Notice of intention to make any nominations must be delivered to the Secretary of the Company at the principal executive offices of the Company not later than the close of business 90 days nor earlier than the close of business 120 days prior to the first anniversary of the preceding year's annual meeting. If the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date of the annual meeting, notice by the shareholder must be delivered not earlier than the close of business 120 days prior to such annual meeting and not later than the close of business 90 days prior to such annual meeting or 10 days following the day on which public announcement of the date of such meeting is first made by the Company.

To be in proper written form, a shareholder's notice to the Corporate Secretary must provide as to each person, whom the shareholder proposes to nominate for election as a director (each referred to as the "Nominee"): (i) all information relating to the Nominee that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to and in accordance with Regulation 14A under the Securities Exchange Act of 1934 (the "Exchange Act"); (ii) the Nominee's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (iii) the number of shares of capital stock of any bank, bank holding company, savings and loan association or other depository institution owned beneficially by the Nominee and the identities and locations of any such institutions; (iv) whether the Nominee has ever been convicted of or pleaded nolo contender to any criminal offensive involving dishonestly or breach of trust, filed a petition in bankruptcy or been adjudged bankrupt; (v) a written statement executed by the Nominee acknowledging that as a director of the Company, the Nominee will owe a fiduciary duty exclusively to the Company and its shareholders; (vi) a representation whether the Nominee satisfies the requirements of Section 2.2(b) of the Company's Bylaws (see below); (vii) whether and the extent to which any hedging or other transaction or series of transactions has been entered into by or on behalf of the Nominee respect to any securities of the Company, and a description of any other agreement, arrangement or understanding (including any short position or any borrowing or lending of shares), the effect or intent of which is to mitigate loss to, or to manage the risk or benefit of share price changes for, or to increase or decrease the voting power of the Nominee, and (viii) a description of all arrangements or understandings between the shareholder and the Nominee and any other person or persons (naming such person or persons) pursuant to which the nomination is to be made by the shareholder.

The notice must also set forth with respect to the shareholder submitting the nomination: (i) the name and address of the shareholder (and beneficial owner, if applicable), as it appears on the Company's books, (and of such beneficial owner, if applicable) and any other shareholders and beneficial owners known by such shareholder to be supporting the Nominee(s) for election; (ii) the class or series and number of shares of capital stock of the Company that are, directly or indirectly, owned beneficially and of record by such shareholder (and by such beneficial owner, if applicable); (iii) any derivative positions with respect to shares of capital stock of the Company held or beneficially held by or on behalf of such shareholder (and by or on behalf of such beneficial owner), the extent to which any hedging or other transaction or series of transactions has been entered into with respect to the shares of capital stock of the Company by or on behalf of such shareholder (and by or on behalf of such beneficial owner), and the extent to which any other agreement, arrangement or understanding has been made, the effect or intent of which is to increase or decrease the voting power of such shareholder (and such beneficial owner) with respect to shares of capital stock of the Company; (iv) a representation that the shareholder is a holder of record of stock of the Company entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to propose the Nominee, and (v) a representation whether the shareholder (or the beneficial owner, if any), intends or is part of a group that intends to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding capital stock required to elect the nominee or otherwise to solicit proxies from shareholders in support of such nomination (and a copy of such documents must be

provided with the notice). The information required of clauses (iii) and (iv) must be supplemented not later than ten days following the record date to disclose the information contained in clauses (iii) and (iv) above as of the record date.

The Company may require any proposed nominee to furnish such other information as it may reasonably require to determine: (i) the eligibility of the Nominee to serve as a director of the Company (including the information required to be set forth in the shareholder's notice of nomination of such person as a director as of a date subsequent to the date on which the notice of such person's nomination was given), and (ii) whether the Nominee qualifies as an "independent director" or "audit committee financial expert" under applicable law, securities exchange rule or regulation, or any publicly-disclosed corporate governance guideline or committee charter of the Company.

Nominees for the Board must also meet certain qualifications set forth in Section 2.2(b) of our Bylaws, which prohibit the election as a director of any person who is a director, executive officer, branch manager or trustee for any unaffiliated commercial bank, savings bank, trust company, savings and loan association, building and loan association, industrial bank or credit union that is engaged in business in: (i) any city, town or village in which the Company or any affiliate or subsidiary thereof has offices; or (ii) any city, town or village adjacent to a city, town or village in which the Company or any affiliate or subsidiary thereof has offices.

In connection with its Agreement and Plan of Merger with Presidio Bank, the Company agreed to nominate for election to the Board at the 2020 Annual meeting the following former directors of Presidio Bank: Bruce H. Cabral, Stephen G. Heitel and Marina Park Sutton.

Diversity of the Board of Directors

In considering diversity of the Board (in all aspects of that term) as a criteria for selecting nominees in accordance with its charter, the Corporate Governance and Nominating Committee takes into account various factors and perspectives, including differences of viewpoint, high quality business and professional experience, education, skills and other individual qualities and attributes that contribute to Board heterogeneity, as well as race, gender and national origin. The Committee does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. The Committee seeks persons with leadership experience in a variety of contexts and industries. The Committee believes that this expansive conceptualization of diversity is the most effective means to implement Board diversity. The Corporate Governance and Nominating Committee will assess the effectiveness of this approach as part of its annual review of its charter.

Term of Office

Directors serve for a one-year term or until their successors are elected. The Board does not have term limits, instead preferring to rely upon the evaluation procedures described herein as the primary methods of ensuring that each director continues to act in a manner consistent with the best interests of the shareholders and the Company.

Board Committees

The Board may delegate portions of its responsibilities to committees of its members. These standing committees of the Board meet at regular intervals to attend to their particular areas of responsibility. Our Board has five standing committees: Audit Committee, Compensation Committee, Corporate Governance and Nominating Committee, Finance and Investment Committee, and Strategic Initiatives Committee. In addition, Heritage Bank of Commerce maintains a Loan Committee. An independent director, as defined by the applicable rules and regulations of the Nasdaq Stock Market, chairs the Board and its other standing committees (including Heritage Bank of Commerce's Loan Committee). The Chair determines the agenda, the frequency and the length of the meetings and receives input from Board members.

Executive Sessions

Independent directors meet in executive sessions throughout the year including meeting annually to consider and act upon the recommendation of the Compensation Committee regarding the compensation and performance of the Chief Executive Officer.

Evaluation of Board Performance

A Board assessment and director self-evaluations are conducted annually in accordance with an established evaluation process and includes performance of committees. The Corporate Governance and Nominating Committee oversees this process and reviews the assessment and self-evaluation with the full Board.

Management Performance and Compensation

The Compensation Committee reviews and approves the Chief Executive Officer's evaluation of the management team on an annual basis. The Board (largely through the Compensation Committee) evaluates the compensation plans for senior management and other employees to ensure they are appropriate, competitive and properly reflect the Company's objectives and performance.

Director Stock Ownership Guidelines

The Board has adopted a policy that each member of the Board who is not an employee of the Company is expected to hold a minimum number of shares of the Company's common stock. In 2019, each such director was required to hold, at a minimum, 17,500 shares of the Company's common stock. Any director not meeting the minimum level as of the effective date of their initial election to the Board or on the effective date of any change in policy has three years to bring his or her holdings up to this minimum level. The Corporate Governance and Nominating Committee will review this policy on an annual basis.

Code of Ethics

The Board expects all directors, as well as officers and employees, to display the highest standard of ethics, consistent with the principles that have guided the Company over the years.

The Board has adopted an Executive and Principal Financial Officer's Code of Ethics that applies to the Chief Executive Officer, Chief Financial Officer and the senior financial officers of the Company to help ensure that the financial affairs of the Company are conducted honestly, ethically, accurately, objectively, consistent with generally accepted accounting principles and in compliance with all applicable governmental law, rules and regulations. We will disclose any amendment to, or a waiver from a provision of our Code of Ethics on our website. The Executive and Principal Financial Officer's Code of Ethics is available on our website at *www.heritagecommercecorp.com*.

Reporting of Complaints/Concerns Regarding Accounting or Auditing Matters

The Company's Board has adopted procedures for receiving and responding to complaints or concerns regarding accounting and auditing matters. These procedures were designed to provide a channel of communication for employees and others who have complaints or concerns regarding accounting or auditing matters involving the Company.

Employee concerns may be communicated in a confidential or anonymous manner to the Audit Committee of the Board. The Audit Committee Chair will make a determination on the level of inquiry, investigation or disposal of the complaint. All complaints are discussed with the Company's senior management and monitored by the Audit Committee for handling, investigation and final disposition. The Chair of the Audit Committee will report the status and disposition of all complaints to the Board.

INFORMATION ABOUT DIRECTORS AND EXECUTIVE OFFICERS

The Board of Directors

The Board of Directors oversees our business and monitors the performance of management. In accordance with corporate governance principles, the Board does not involve itself in day-to-day operations. The directors keep themselves informed through, among other things, discussions with the Chief Executive Officer, other key executives and our principal outside advisors (legal counsel, outside auditors, and other consultants), by reading reports and other materials that we send them and by participating in Board and committee meetings.

The Company's Bylaws currently permit the number of Board members to range from 9 to 15, leaving the Board authority to fix the exact number of directors within that range. The Board has fixed the current number of directors at 12.

Board Leadership Structure

The Board is committed to maintaining an independent Board, and a majority of the Board has been comprised of independent directors. It has further been the practice for many years of the Company to separate the roles of Chief Executive Officer and Chairman of the Board in recognition of the differences between the two roles. The Chief Executive Officer is responsible for setting the strategic direction for the Company and the day-to-day leadership and performance of the Company. The Chairman of the Board provides guidance to the Chief Executive Officer, sets the agenda for Board meetings, presides over meetings of the full Board (including executive sessions), and facilitates communication among the independent directors and between the independent directors and the Chief Executive Officer. The Board further believes that the separation of the duties of the Chief Executive Officer and the Chairman of the Board eliminates any inherent conflict of interest that may arise when the roles are combined, and that an independent director who has not served as an executive of the Company can best provide the necessary leadership and objectivity required as Chairman of the Board.

Board Authority for Risk Oversight

The Board has active involvement and the responsibility for overseeing risk management of the Company arising out of its operations and business strategy. The Board monitors, reviews and reacts to material enterprise risks identified by management. The Board receives specific oral and written reports from officers with oversight responsibility for particular risks within the Company. Reports cover executive management on financial, credit, liquidity, interest rate, capital, operational, legal and regulatory compliance and reputation risks and the Company's degree of exposure to those risks. The Board helps ensure that management is properly focused on risk by, among other things, reviewing and discussing the performance of senior management and business line leaders.

Board committees also have responsibility for risk oversight in specific areas. The Audit Committee oversees financial, accounting and internal control risk management policies. The Company's internal Risk Management Steering Committee reports directly to the Audit Committee. The Audit Committee is responsible for monitoring the Company's overall risk program. The Audit Committee receives quarterly reports from the Risk Management Steering Committee and the Company's internal audit department. The Audit Committee reports periodically to the Board on the effectiveness of risk management processes in place, risk trends, and the overall risk assessment of the Company's activities. The Compensation Committee assesses and monitors risks in the Company's compensation program. The Corporate Governance and Nominating Committee recommends director candidates with appropriate experience and skills who will set the proper tone for the Company's risk profile and provide competent oversight over our material risks.

The Committees of the Board

The Board may delegate portions of its responsibilities to committees of its members. These standing committees of the Board meet at regular intervals to attend to their particular areas of responsibility. Our Board has five standing committees: the Audit Committee, Compensation Committee, Corporate Governance and Nominating Committee, Finance and Investment Committee, and Strategic Initiatives Committee. In addition, Heritage Bank of Commerce also maintains a Loan Committee.

Audit Committee. The Company has a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Audit Committee charter adopted by the Board sets out the responsibilities, authority and specific duties of the Audit Committee. The Audit Committee charter is available on the Company's website at *www.heritagecommercecorp.com*.

The responsibilities of the Audit Committee include the following:

- oversee our financial, accounting and reporting process, our system of internal accounting and financial controls, and our compliance with related legal and regulatory requirements;
- oversee the appointment, compensation, retention and oversight of our independent auditors, including conducting a review of their independence, reviewing and approving the planned scope of our annual audit, overseeing the independent auditors' work, and reviewing and pre-approving any audit and non-audit services that may be performed by them;
- review with management and our independent auditors the effectiveness of our internal controls over financial reporting;
- approve the scope and engagement of external audit services and review significant accounting policies and adjustments recommended by the independent auditors and address any significant, unresolved disagreements between the independent auditors and management;
- review and discuss the annual audited financial statements with management and the independent auditors prior to publishing the annual report and filing the Annual Report on Form 10-K with the SEC;
- review and discuss with management and the independent auditors any significant changes, significant deficiencies and material weaknesses regarding internal controls over financial reporting required by the Sarbanes-Oxley Act of 2002, and oversee the corrective action taken to mitigate any significant deficiencies and material weaknesses identified;
- review with management and the independent auditors the effect of significant regulatory and accounting initiatives, changes, and pronouncements as well as significant and unique transactions and financial relationships;
- review with the independent auditors the matters required to be discussed by Auditing Standards No. 61, and receive and discuss with the independent auditors disclosures regarding the auditors' independence;
- oversee the internal audit function and the audits directed under its auspices;.
- establish policies to ensure all non-audit services provided by the independent auditors are approved prior to work being performed; and
- oversee and report to the full Board on the effectiveness of the Company's risk management processes and overall risk assessment of the Company's activities.

Each member of the Audit Committee meets the independence criteria as defined by applicable rules and regulations of the SEC for audit committee membership and is independent and is "financially sophisticated" as defined by the applicable rules and regulations of the Nasdaq Stock Market. The members of the Audit Committee are Julianne M. Biagini-Komas (Committee Chair), Bruce H. Cabral, Laura Roden and Marina Park Sutton. The Audit Committee met 13 times during 2019.

The Board has determined that Julie Biagini-Komas meets the definition of "audit committee financial expert" under the applicable rules and regulations of the SEC and is "financially sophisticated" as defined by the applicable rules and regulations of the Nasdaq Stock Market. The designation of a person as an audit committee financial expert does not result in the person being deemed an expert for any purpose, including under Section 11 of the Securities Act of 1933. The designation does not impose on the person any duties, obligations or liability greater than those imposed on any other audit committee member or any other director and does not affect the duties, obligations or liability of any other member of the Audit Committee or Board.

The Audit Committee Report for 2019 appears on page 67 of this Proxy Statement.

Compensation Committee. The Company has a separately designated Compensation Committee, which consists entirely of independent directors as defined by the applicable rules and regulations of the Nasdaq Stock Market. The Compensation Committee has adopted a charter, which is available on the Company's website at *www.heritagecommercecorp.com*. The Compensation Committee has the following responsibilities:

- review and approve our compensation philosophy;
- review industry compensation practices and our relative compensation positioning;
- review the incentive compensation programs by the Company to evaluate and ensure that none of them encourage excessive risk;
- retain compensation consultants to provide independent professional advice;
- approve compensation paid to our Chief Executive Officer and other executive officers;
- review and approve the Compensation Discussion and Analysis appearing in our proxy statement;
- review director compensation programs, plans and awards;
- administer our short-term and long-term executive incentive plans and stock or stock-based plans; and
- review and approve general employee welfare benefit plans and other plans on an as needed basis.

The members of the Compensation Committee are Julianne M. Biagini-Komas (Committee Chair), Frank G. Bisceglia, Robert T. Moles, Marina Park Sutton and Ranson W. Webster. The Committee met 8 times during 2019. Marina Park Sutton will become the Committee Chair effective May 1, 2020.

Corporate Governance and Nominating Committee. The Company has a separately designated Corporate Governance and Nominating Committee, which consists of entirely independent directors as defined by the applicable rules and regulations of the Nasdaq Stock Market. The Corporate Governance and Nominating Committee have adopted a charter, which is available on the Company's website at *www.heritagecommercecorp.com*.

The purposes of the Corporate Governance and Nominating Committee include the following responsibilities:

- identifying individuals qualified to become Board members and making recommendations to the full Board of candidates for election to the Board;
- recommending to the Board corporate governance guidelines;
- leading the Board in an annual review of its performance; and
- recommending director appointments to Board committees.

The members of the Corporate Governance and Nominating Committee are Jason DiNapoli, Robert T. Moles, Marina Park Sutton, and Ranson W. Webster (Committee Chair). The Committee met 7 times during 2019.

Finance and Investment Committee. The Finance and Investment Committee is responsible for the development of policies and procedures related to liquidity, asset-liability management, and supervision of the Company's investments. The Committee also oversees and reviews internal financial reports including annual forecasts and budgets, and stress test analysis prepared by management. The members of the Finance and Investment Committee are Frank G. Bisceglia, Jack W. Conner (Committee Chair), Stephen G. Heitel, Walter T. Kaczmarek, Laura Roden and Keith A. Wilton. The Finance and Investment Committee met 9 times during 2019.

Strategic Initiatives Committee. The principal duties of the Strategic Initiatives Committee are to provide oversight and guidance to senior management regarding the strategic direction of the Company, including development of an overall strategic business plan. The members of the Strategic Initiatives Committee are Jack W. Conner, Jason DiNapoli, Keith A. Wilton, Laura Roden (Committee Chair), and Ranson W. Webster. The Strategic Initiatives Committee met 5 times during 2019.

Heritage Bank of Commerce Loan Committee. The Heritage Bank of Commerce Loan Committee is responsible for the approval and supervision of loans and the development of the Company's loan policies and procedures. The members of the Loan Committee are Bruce H. Cabral (Committee Chair), Jason DiNapoli, Stephen G. Heitel, Walter T. Kaczmarek, and Keith A. Wilton. The Loan Committee met 32 times during 2019.

Role of Compensation Consultant

The Compensation Committee of the Board retained McLagan, an Aon Hewitt Company ("McLagan") as its independent compensation consultant in the fourth quarter of 2018 and it delivered its report in the first quarter of 2019.

The Compensation Committee has the authority to obtain assistance and advice from advisors to assist it with the evaluation of compensation matters without the approval or permission of management or the Board. The Compensation Committee uses advisors to obtain candid and direct advice independent of management, and takes steps to satisfy this objective. First, in evaluating firms to potentially provided advisory services to the Compensation Committee, the Compensation Committee considers if the firm provides any other services to the Company. In addition, while members of management may assist the Compensation Committee in the search for advisors, the Compensation Committee ultimately and in its sole discretion makes the decision to hire or engage a consultant and provides direction as to the scope of work to be conducted. The Chair of the Compensation Committee has evaluated the relationship of the compensation consultant with both the Company and the Compensation Committee, including the nature

and amount of work performed for the Compensation Committee during the year. The Compensation Committee retained McLagan, to:

- review existing compensation programs for executive officers;
- provide information based on third-party data and analysis of compensation programs at comparable financial institutions for the design and implementation of our executive compensation programs;
- assist the Compensation Committee in forming a peer group; and
- provide independent information as to the reasonableness and appropriateness of the compensation levels and compensation programs of the Company as compared to comparable financial services companies.

Executive Officers of the Company

Set forth below is certain information with respect to the executive officers of the Company:

Name	Position
Keith A. Wilton	President and Chief Executive Officer of Heritage Commerce Corp and Heritage Bank of Commerce
Michael E. Benito	Executive Vice President/Business Banking Manager of Heritage Bank of Commerce
Margo G. Butsch	Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce
Robertson Clay Jones	Executive Vice President/President of Community Business Banking Group for Heritage Bank of Commerce
Lawrence D. McGovern	Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce

Biographical information for Keith A. Wilton is found under "Proposal 1—Election of Directors."

Michael E. Benito, age 59, has served as Executive Vice President/Business Banking Manager of Heritage Bank of Commerce since January 2012. Mr. Benito joined Heritage Bank of Commerce in 2003 as Senior Vice President/Director of Sales & Business Development. From 1998 through 2003, Mr. Benito served as a Managing Director for Greater Bay Bank and from December 1986 through 1998, he served as Regional Vice President with Imperial Bancorp. Mr. Benito began his banking career more than 32 years ago at Union Bank of California (formerly Union Bank).

Margo G. Butsch, age 55, has served as Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce since July 2017. Ms. Butsch joined Heritage Bank of Commerce through Focus Business Bank which was acquired by Heritage Bank of Commerce in August 2015. After the acquisition, Ms. Butsch joined Heritage Bank of Commerce as Vice-President/Credit Administration and was promoted to Senior Vice President/Credit Administration in November 2015. Since 1995 and prior to joining Heritage Bank of Commerce, Ms. Butsch held various Vice-President and Senior Vice President relationship management and loan administration positions with Focus Business Bank, The Independent Bankers Bank, Greater Bay Bank, and Imperial Bank.

Robertson Clay Jones, age 49, has served as Executive Vice President/President Community Business Banking Group for Heritage Bank of Commerce since October 12, 2019. Mr. Jones was formally the

President of Presidio Bank assuming the positon in July 2018. Mr. Jones joined Presidio Bank in 2010 as Executive Vice President and Mid-Peninsula Market President. Prior to joining Presidio Bank, Mr. Jones was the organizing and initial President and Chief Executive Officer of New Resource Bank. From October 1993 to May 2005 Mr. Jones served in ever increasing corporate capacities for subsidiaries of Greater Bay Bancorp and Comerica Bank, including his position as Executive Vice President & Chief Operating Officer at Cupertino National Bank and Executive Vice President and Manager of the Venture Banking Group.

Lawrence D. McGovern, age 65, has served as Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce since July 1998.

Transactions with Management

Some of the Company's directors and executive officers, as well as other related persons (as defined under "Policies and Procedures for Approving Related Party Transactions" below), are customers of, and have banking transactions with, the Company's subsidiary, Heritage Bank of Commerce, in the ordinary course of business, and Heritage Bank of Commerce expects to have such ordinary banking transactions with these persons in the future. In the opinion of the management of the Company and Heritage Bank of Commerce, all loans and commitments to lend included in such transactions were made in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other persons of similar creditworthiness, and do not involve more than the normal risk of collectability or present other unfavorable features. Loans to individual directors, officers and related persons must comply with Heritage Bank of Commerce's lending policies and statutory lending limits. In addition, prior approval of the Board is required for all loans advanced to directors and executive officers. These loans are exempt from the loan prohibitions of the Sarbanes-Oxley Act.

Policies and Procedures for Approving Related Party Transactions

The Board has adopted a written Statement of Policy with Respect to Related Party Transactions. Under this policy, any "related party transaction" may be consummated or may continue only if the Audit Committee approves or ratifies the transaction in accordance with the guidelines in the policy and if the transaction is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party. For purposes of this policy, a "related person" means: (i) any person who is, or at any time since the beginning of the Company's last fiscal year was, a director or executive officer of the Company or a nominee to become a director of the Company; (ii) any person who is known to be the beneficial owner of more than 5% of any class of the Company's voting securities; (iii) any immediate family member of any of the foregoing persons, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the director, executive officer, nominee or more than 5% beneficial owner, and any person (other than a tenant or employee) sharing the household of such director, executive officer, nominee or more than 5% beneficial owner, and (iv) any firm, corporation or other entity in which any of the foregoing persons is employed or is a partner, principal or in a similar position, or in which such person has a 10% or greater beneficial ownership interest.

A "related party transaction" is a transaction in which the Company or any of its subsidiaries is a participant and in which a related person had or will have a direct or indirect interest, other than transactions involving: (i) less than $5,000 when aggregated with all similar transactions; (ii) customary bank deposits and accounts (including certificates of deposit), and (iii) loans and commitments to lend included in such transactions that are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other persons of similar creditworthiness, and do not involve more than the normal risk of collectability or present other unfavorable features to the Company.

A related party who has a position or relationship with a firm, corporation, or other entity that engaged in a transaction with the Company shall not be deemed to have an indirect material interest within the meaning of this policy where the interest in the transaction arises only: (1) from such related party's position as a director of another corporation or organization that is party to the transaction; (2) from the direct or indirect ownership by the related party of less than a 10% equity interest in another person (other than a partnership) which is a party to the transaction; or (3) from the related party's position as a limited partner in a partnership in which the related party has an interest of less than 10%, and the related party is not a general partner of and does not hold another position in the partnership.

The Board has determined that the Audit Committee is best suited to review and approve related party transactions. The Committee considers all of the relevant facts and circumstances available to the Committee, including (if applicable) but not limited to: (i) the benefits to the Company; (ii) the impact on a director's independence in the event the related person is a director, an immediate family member of a director or an entity in which a director is a partner, shareholder or executive officer; (iii) the availability of other sources for comparable products or services; (iv) the terms of the transaction; and (v) the terms available to unrelated third parties or to employees generally. No member of the Audit Committee may participate in any review, consideration or approval of any related person transaction with respect to which such member or any of his or her immediate family members is the related person. The Committee will approve only those related person transactions that are in, or are not inconsistent with, the best interests of the Company and its shareholders, as the Committee determines in good faith. The Audit Committee conveys its decision to the Chief Executive Officer, who conveys the decision to the appropriate persons within the Company.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This Compensation Discussion and Analysis identifies the Company's current compensation philosophy and objectives and describes the various methodologies, policies and practices for establishing and administering the compensation programs for our executives including the named executive officers. The strategies and policies of the Compensation Committee have been developed so that there is a direct correlation between executive compensation and the Company's overall performance and individual performance. The individuals who served as the Company's Chief Executive Officer and Chief Financial Officer during 2019, as well as, the other individuals included in the Summary Compensation Table, are referred to as the "named executive officers."

Overview of Compensation Philosophy

Our compensation philosophy is driven by our objective to attract and retain the premier talent needed to lead our Company in an extremely competitive environment and to strongly align the interests of our executives with those of our shareholders for the long term. Our executive compensation is aligned with our overall business strategy, with a focus on driving growth, profitability and long-term value for our shareholders.

We structure our executive compensation program with a mix of base salary, annual performance-based cash incentive awards and long-term equity awards to incentivize and reward those individuals who make the greatest contributions to our performance and creation of shareholder value over time.

The first goal of our compensation program is to link a reasonable percentage of executive compensation to the financial performance of the Company. We achieve this goal by providing our named executive officers the opportunity to significantly increase their annual cash compensation through our variable performance based cash award incentive plan. The plan awards improvement in the Company's

performance in key financial metrics on an annual basis. We also expect that as those improvements are maintained and built upon, they will be reflected in the Company's stock price.

The second goal of our compensation program is to align the interests of our executive officers with the interests of our shareholders. We use equity awards (stock options and/or restricted stock) to reward the long-term efforts of management and to retain management. These equity awards serve to increase the ownership stake of our management in the Company, further aligning the interests of the executives with those of our shareholders.

The third goal of our compensation program is to attract and retain highly competent executives. Our executives, and particularly our named executive officers, are talented managers and they are often presented with opportunities at other institutions, including opportunities at potentially higher compensation levels. We seek to attract and retain our executives by setting base compensation and incentives at competitive levels and awarding equity based awards. We also consider other forms of executive pay, including severance arrangements (including change of control provisions) as a means to attract and retain our executive officers including the named executive officers.

The use of these compensation programs and benefits enables us to reinforce our pay-for-performance philosophy, align our executives' interests with shareholders, and strengthen our ability to attract, retain and motivate highly qualified executives. We believe that this combination of programs provides an appropriate mix of fixed and variable pay, balances short-term operational performance with long-term shareholder value, and encourages executive recruitment and retention.

Compensation Program Objectives and Rewards

The components of Company's compensation and benefits programs are driven by our business environment and are designed to enable us to achieve the goals of our compensation program within a framework that adheres to the Company's mission and values. The programs' objectives are to:

- Reflect our position as a leading community bank in our service areas;
- Attract, engage and retain the workforce that helps ensure our current and future success;
- Motivate and inspire employee behavior that fosters a high performance culture;
- Support a one company culture;
- Support the integration of employees hired from acquired banks;
- Support overall business objectives;
- Provide shareholders with a superior rate of return over the long term; and
- Create shareholder value through the continuous provision of quality service to our customers.

Consequently, the guiding principles of our programs are to:

- Promote and maintain a high performance banking organization;
- Remain competitive in our marketplace for talent;
- Balance our compensation costs with our desire to provide value to employees and shareholders; and
- Avoid encouraging excessive risk taking.

To this end, we will measure success of our programs by:

- Overall business performance and employee engagement;
- Ability to attract and retain key talent;
- Costs and business risks that are limited to levels that optimize risk and return;
- Employee understanding and perceptions that ensure program value equals or exceeds program cost; and
- Employee turnover metrics.

All of our compensation and benefits for our named executive officers described below have as a primary purpose our need to attract, retain and motivate the highly talented individuals whose performance will enable us to succeed in creating shareholder value in a highly competitive marketplace. Beyond that, different elements have specific purposes designed to reward different performance and retention goals.

- *Base salary and benefits* are designed to:
  - Reward core competence in the executive role relative to position, performance, experience and responsibility;
  - Provide fixed cash compensation with merit increases competitive with the market place; and
  - Control fixed expenses.
- *Annual incentive variable cash awards* are designed to:
  - Focus employees on annual financial objectives derived from the business plan that lead to long-term success;
  - Provide annual variable performance based cash awards to reward and motivate achievement of critical annual performance metrics selected by the Compensation Committee; and
  - Foster a pay for performance culture that aligns our compensation programs with our overall business strategy.
- *Equity based compensation awards* are designed to:
  - Align the interests of executives with those of our shareholders;
  - Promote teamwork by tying compensation significantly to the value of our common stock;
  - Attract the next generation of management by providing significant capital accumulation opportunities; and
  - Retain executives by providing a long-term-oriented program whose value could only be achieved by remaining with and performing for the Company.
- *Change of control and separation benefits*:
  - Individual employment contracts with certain executives provide for double-trigger change of control and separation benefits;
  - Separation benefits provide benefits to ease an employee's transition due to an unexpected employment termination by the Company due to ongoing changes in the Company's employment needs; and

- Change in control benefits encourage key executives to remain focused on the Company's business in the event of rumored or actual fundamental corporate changes which will enhance shareholder value.

- *Manage excessive risk-taking* through plan design and oversight of incentive plans:
  - Incentive awards are capped;
  - Performance objectives are aligned with annual financial plan approval by the Board of Directors;
  - Multiple financial metrics are used taking into account performance and risk;
  - A "claw-back policy" is applied to performance based cash payments;
  - Payouts are modified through the use of risk-based capital ratio metrics;
  - Long-term incentive equity awards are deferred through vesting requirements; and
  - The Compensation Committee has discretion to reduce cash bonus payments.

Role of Shareholder Input

The Compensation Committee has been mindful of the strong support our shareholders expressed for our compensation program when making executive compensation decisions, including base salary adjustments and long-term incentive awards. In making these executive compensation decisions, which are discussed more fully below, the Compensation Committee's main considerations included our shareholders' support for our executive compensation program, and the peer and market information provided by the Compensation Committee's compensation consultant. The Compensation Committee will continue to consider our shareholders' views when making executive compensation decisions in the future.

Commencing last year we are including a say-on-pay non-binding advisory proposal every year with our annual meeting proxy statement. Last year our non-binding shareholder advisory vote on executive compensation was approved, with approximately 81% of voting shareholders casting their votes in favor of the say-on-pay resolution.

Role of Compensation Committee in Determining Compensation

The Compensation Committee of the Board has strategic and oversight responsibility for the overall compensation and benefits programs for executives of the Company. These responsibilities include establishing, implementing, and continually monitoring the compensation structure, policies, and programs of the Company. The Compensation Committee also periodically reviews, assesses and monitors the performance, and regularly reviews the design and function, of the Company's incentive compensation arrangements to ensure that any risk-taking incentives are consistent with regulatory guidance and the safety and soundness of the organization. The Compensation Committee is responsible for assessing and approving the total compensation paid to the Chief Executive Officer and all executive officers. The Compensation Committee is responsible for determining whether the compensation paid to each of these executives is fair, reasonable and competitive, and whether the compensation program serves the interests of the Company's shareholders.

At least annually, the Compensation Committee reviews the executive compensation program overall, and establishes base salaries, target annual cash bonus opportunities and equity grants (if any) for the fiscal year. In setting these elements of compensation, the Compensation Committee reviews the total target compensation for our executives and also considers developments in compensation practices outside of the Company. Specifically, the Compensation Committee is provided with competitive positioning data for similarly situated executives at companies in our peer group, as well as summary consolidated information about our executives' total compensation and pay history to use in setting individual compensation

elements and making decisions on total executive compensation levels. Peer data is a helpful reference for the Compensation Committee to assess the competitiveness and appropriateness of our executive compensation program within the banking industry and the broader business community. Ultimately, the Compensation Committee applies its own business judgment and experience to determine the individual compensation elements, the amount of each compensation element and total target compensation

The Compensation Committee generally targets compensation in relation to the Company's Compensation Peer Group (discussed under "*Market Positioning and Pay Benchmarking*"). We strive to compete with the prevailing market taking into account the competition in our market for talented executives and our desire to attract and, more importantly, retain and motivate talented individuals we believe are necessary to achieve the goals and objectives of our Board of Directors. Depending upon Company and individual performance, as well as the various other factors discussed in this Compensation Discussion and Analysis, target and actual total direct compensation of our executives, as well as individual compensation elements, may be within, below or above the market range for their positions.

The Compensation Committee periodically reviews the compensation levels of the Board. In its review, the Compensation Committee looks to ensure that the compensation is fair, reasonably competitive and commensurate to the responsibilities of both the individual directors as well as the Board in the aggregate. Additionally, the Committee specifically takes into consideration the Directors' adherence to the Company's director Stock Ownership Guidelines when reviewing compensation.

The Compensation Committee is comprised of five independent directors who satisfy The Nasdaq Stock Market listing requirements and relevant SEC regulations on independence. The Compensation Committee's Chair regularly reports to the Board on the Compensation Committee actions and recommendations. To evaluate and administer the compensation practices of the Chief Executive Officer and other executive officers, the Compensation Committee meets a minimum of four times a year. The Compensation Committee also holds special meetings and meets telephonically to discuss extraordinary items, such as the hiring or dismissal of executive officers.

Role of the Chief Executive Officer

The Chief Executive Officer is not a member of the Compensation Committee but is invited to attend meetings as necessary to provide input and recommendations on compensation for the other named executive officers. The Chief Executive Officer provides the Compensation Committee with his assessment of the performance of each named executive officer and his perspective on the factors described above in developing his recommendations for the executive's compensation, including salary adjustments, incentive bonuses, annual equity grants and equity grants awarded in conjunction with promotions. Because the Chief Executive Officer works closely with and supervises our executive team, the Compensation Committee believes that the Chief Executive Officer provides valuable insight in evaluating their performance. The Chief Executive Officer also provides the Compensation Committee with additional information regarding the effect, if any, of market competition and changes in business strategy or priorities. The Compensation Committee takes the Chief Executive Officer's general input into consideration when determining and approving executive officer compensation, including for the named executive officers other than the Chief Executive Officer.

Role of Compensation Consultants

Generally, at least every two years the Compensation Committee retains the services of an independent executive compensation consultant to assess the competitiveness of our compensation programs, conduct other research as directed by the Compensation Committee, and support the Compensation Committee in the design and implementation of executive and Board of Director compensation. In the fourth quarter of 2018, the Compensation Committee retained McLagan, an Aon Hemitt Company ("McLagan") to: (i) review existing compensation programs; (ii) provide market

benchmark information pertaining to both cash and noncash compensation for executives; (iii) provide recommendations and guidance to the Compensation Committee to support its oversight over such compensation programs; and (iv) provide other advice and consultation, including guidance relative to evolving compensation-related regulatory requirements and industry best practices. McLagan delivered its report in the first quarter of 2019 ("*2019 Report*"). The information from the 2019 Report was used in making compensation decisions for 2019.

Representatives of the compensation consultant attend meetings of the Compensation Committee as requested and also communicate with the Compensation Committee outside of meetings. The compensation consultant reports to the Compensation Committee rather than to management, although representatives of the firm may meet with members of management, including our Chief Executive Officer for purposes of gathering information on proposals that management may make to the Compensation Committee. During the fourth quarter of 2018, the compensation consultant met with various executives to collect data and obtain management's perspective on the fiscal year 2019 compensation for our executives. The Compensation Committee may replace its compensation consultant or hire additional advisors at any time. After the Committee's review of applicable rules for independence, the Committee determined that there are no known conflicts of interest between McLagan and its affiliates and the Company and its affiliates. McLagan reports directly to the Committee and does not provide services to, or on behalf of, any other part of the Company's business.

Market Positioning and Pay Benchmarking

Many factors are taken into account in determining the actual positioning of each executive officer's compensation, including the executive's experience, responsibilities, management abilities and job performance, overall performance of the Company, current market conditions and competitive pay for similar positions at comparable companies. In addition, the Compensation Committee reviews the relationship of various positions between departments, the affordability of desired pay levels and the importance of each position within the Company. These factors are considered by the Compensation Committee in a subjective manner without any specific formula or weighting.

McLagan, in consultation with the Compensation Committee, selected a custom peer group of financial institutions to establish a "Compensation Peer Group" for the 2019 Report. The companies included in the Compensation Peer Group were selected from publicly traded banks in California, Colorado, Nevada, Oregon, Utah and Washington based on: (i) compatibility of the bank based on size as measured through total assets with a median of $3.8 billion as of December 31, 2018; (ii) similarity of their product lines and business focus; and (iii) comparable performance criteria including, asset growth, profitability, credit quality, capitalization and total shareholder return. In addition to the Compensation Peer Group, McLagan's primary data sources also included its proprietary 2018 Regional & Community Banking Survey database. Peer Group and proprietary survey data represented actual 2017 compensation information. McLagan aged salary data to 2019 at annual rate of 3%. National survey data was adjusted to account for the cost of salaries and wages in San Jose, California relative to the national average.

The Compensation Peer Group component companies used in the evaluation of the Company's executive compensation programs in the 2019 Report for executive officers were as follows:

Bank of Commerce Holdings	National Bank Holdings
Bank of Marin Bancorp	Opus Bank*
BayCom Corp	Pacific Mercantile Bancorp
Central Valley Community Bancorp	Peoples Utah Bancorp
Farmers & Merchants Bancorp	Preferred Bank
First Foundation Inc.	RBB Bancorp
Hanmi Financial Corp.	Sierra Bancorp
Heritage Financial Corp.	TriCo Bancshares
Luther Burbank Corp.	Westamerica Bancorp

* Recently acquired.

Chief Executive Officer Compensation

The Compensation Committee meets with the other independent directors each year in an executive session without management present to evaluate the performance of the Chief Executive Officer. The Chief Executive Officer does not participate in any deliberations regarding his own compensation. The Compensation Committee annually reviews and approves goals and objectives relevant to the Chief Executive Officer and evaluates the Chief Executive's performance against those objectives. The Compensation Committee typically considers corporate financial performance, the Company's achievement of its short and long-term goals versus its strategic objectives and financial targets. With the assistance of the compensation consultant, the Compensation Committee also considers the compensation data related to the Compensation Peer Group for base pay, total cash compensation, and total direct compensation.

Walter T. Kaczmarek retired effective August 8, 2019 as President and Chief Executive Officer of the Company. He has remained as a director following his retirement. In view of his retirement, the Compensation Committee did not increase his salary for 2019 and it remained at $500,000 on an annual basis through August 8, 2019. Keith A. Wilton's salary for 2019 as Chief Operating Officer of the Company was $400,000, however, when he assumed the position of Chief Executive Officer his salary was increased to $500,000 while below the 50th percentile, it has been generally the practice when an executive assumes a new role to set compensation below market, but to increase base salary over time based on performance.

Base Salary Decisions for the Other Named Executive Officers

Generally the Compensation Committee believes that executive base salaries should be competitive with its peer group and prevailing market conditions for executives in similar positions with similar responsibilities. Base salaries are reviewed annually and adjusted as necessary to realign them with market levels after taking into account the value of the position in the marketplace, career experience, and the contribution and performance of the individual. Although each of the named executive officers has an employment agreement with the Company, the initial base salary in each of the agreements may be increased (and has been in the past) in accordance with the Chief Executive Officer's evaluation of the executive's performance and the Compensation Committee's evaluation of the Company's overall compensation programs and policies.

For 2019, the Compensation Committee reviewed the 2019 Report, which indicated that on average the Company's salaries paid in 2018 were 11% below the 50th percentile of estimated market 2019 salaries.

At its March 2019, meeting the Compensation Committee approved the following salaries for 2019 that approximate for each of the named executives the 60th percentile of estimated market 2019 salaries:

Named Executive	2019 Salary
Keith A. Wilton	$400,000*
Michael E. Benito	$296,000
Margo G. Butsch	$290,000
Lawrence D. McGovern	$340,000

* Mr. Wilton's salary was increased to $500,000 effective August 8, 2019 when he assumed the positions of President and Chief Executive Officer.

Base salary drives the formula used in the Management Incentive Plan as discussed below under "Management Incentive Plan."

Management Incentive Plan

We provide annual performance-based cash incentive awards linked to achievement against certain corporate performance goals under our Management Incentive Plan ("Incentive Plan"). The Compensation Committee believes that the annual performance metrics used in the bonus plan contribute to driving long-term stockholder value, play an important role in influencing executive performance and are an important component of our compensation program to help attract, motivate and retain our executives.

To establish our executive officers' individual target cash bonus opportunities, which are expressed as a percentage of base salary, the Compensation Committee considers competitive pay data, input from its compensation consultant, and the level, position, objectives and scope of responsibilities of each executive, as well as considerations of internal parity among similarly situated Company executives.

In late fiscal year 2018, based on its review of our executive compensation program, peer company data, and the other factors described above, the Compensation Committee approved the following annual cash bonus opportunities for fiscal year 2019.

Payouts generally are not calculated by mathematical interpolation (on a continuous scale), therefore an incentive level must be reached or exceeded for a cash award.

	As a percent of base salary		
Named Executive	Threshold	Target	Maximum
Walter T. Kaczmarek	10%	60%	100%
Keith A. Wilton*	10%	40%	60%
Michael E. Benito	10%	40%	60%
Margo G. Butsch	10%	40%	60%
Lawrence D. McGovern	10%	40%	60%

* Mr. Wilton's cash bonus opportunity increased to Threshold (10%), Target (60%) and Maximum (100%) on a prorated basis when he assumed the position of President and Chief Executive Officer effective August 8, 2019.

The Compensation Committee reviews and approves the financial metrics for each plan year. The Compensation Committee identifies from three to six financial metrics which may be revised from year to year to align them with the Company's annual strategic plan. The Compensation Committee determines the weighting of financial metrics each year based upon recommendations from the Chief Executive

Officer. For 2019, the following financial metrics along with the relative weights of each financial metric were established by the Compensation Committee:

Financial Metrics	Weight
Pre-Tax Income	20%
Nonperforming Assets	15%
Loan Growth	20%
Noninterest Income	15%
Noninterest Expense	15%
Deposit Growth	15%

The Compensation Committee believes pre-tax income is a valid measurement in assessing how the Company is performing from a financial standpoint. Pre-tax income is an accepted accounting measures that drives earnings per share and shareholder returns over the long term. Noninterest income and noninterest expense are important components of net income that senior management and the Board of Directors sought to improve upon in 2019. In addition, the Compensation Committee, in consultation with the Chief Executive Officer, concluded that management should continue its focus on credit quality and loan and deposit growth. Financial metrics for noninterest income and noninterest expense are financial metrics that drive overall net income. The Compensation Committee believes that nonperforming assets are an effective measure to monitor the Company's progress in improving its credit quality.

The Compensation Committee did not realign the weighting of the mix of the financial metrics in 2019 from 2018. Because the Compensation Committee believed that the Incentive Plan should also balance risk-taking with performance, the Compensation Committee maintained a risk-based capital element to the Incentive Plan. If the total risk-based capital ratio was below 10% at year-end 2019, bonus payments would be reduced to zero. The Incentive Plan is also subject to a claw back policy if financial statements or other financial metric criteria are found to be materially inaccurate as determined by the Audit Committee.

Performance objectives were generally identified through our annual financial planning and budgeting process. Senior management developed a financial plan for 2019, and the financial plan was reviewed and approved by the Board. The Compensation Committee received recommendations from senior management for financial performance objective ranges. In setting the Threshold, Target and Maximum levels, the Compensation Committee considered specific circumstances anticipated to be encountered by the Company during the coming year and the level of improvement from year-to-year required to achieve the performance level. The Compensation Committee believed that the Threshold, Target and Maximum levels established for the Incentive Plan in 2019 were sufficiently challenging given the economic climate and the level of growth and improvement in the various financial metrics that would have to occur to meet the various performance objectives.

For 2019, performance was assessed relative to performances for the year ended December 31, 2019, as shown below and compared to actual results:

Financial Metrics	Threshold (90% of Plan)	Target (Plan)	Maximum (110% of Plan)	2019 Actual
Pre-Tax Income	$ 61,367,000	$ 68,185,000	$ 75,004,000	$ 56,312,000
Nonperforming Assets	$ 11,000,000	$ 10,000,000	$ 9,000,000	$ 9,828,000
Loans Outstanding(1)	$1,906,362,000	$2,006,697,000	$2,107,032,000	$2,533,844,000
Noninterest Income(2)	$ 9,216,000	$ 10,240,000	$ 11,264,000	$ 9,583,000
Noninterest Expense(3)	$ 75,433,000	$ 73,433,000	$ 71,433,000	$ 84,898,000
Deposits Outstanding(4)	$2,656,342,000	$2,796,149,000	$2,935,956,000	$3,385,921,000

(1) Threshold and Maximum at 95% and 105% of plan (includes factored receivables).

(2) Securities gains or losses excluded from calculations.

(3) 90% and 110% of plan not used. A $2.0 million differential below and over Target was used for Threshold and Maximum.

(4) Threshold and Maximum at 95% and 105% of plan (excludes brokered deposits, CDARS and State CDs).

During the first quarter of the following fiscal year, the Compensation Committee assesses the performance of the Company for each financial metric comparing the actual fiscal year results to the pre-determined performance objectives for each financial metric calculated with reference to the pre-determined weight accorded the financial metric, and an overall percentage amount for the award is calculated. In addition, the Compensation Committee has discretionary authority to include qualitative subjective measures which may increase or decrease an award by an additional 15% of base salary. The positive discretion may be utilized to address completion of special projects, department initiatives, or favorable achievements reflected in regulatory exam results. The Compensation Committee may also use its discretion in adjusting financial metrics and performance objectives for unexpected economic conditions or changes in the business of the Company.

During the fourth quarter of 2019, the Company completed the acquisition of Presidio Bank. The addition of Presidio Bank in the fourth quarter materially impacted the 2019 budget that served as the basis for the financial metrics for the Incentive Plan. As a result of the acquisition, the Company did not meet the "Threshold" for Pre-Tax Income or Noninterest Expense. The Company, however, reached (i) "Maximum" for Loans Outstanding and for Deposits, (ii) "Target" for Nonperforming Assets and (iii) "Threshold" for Noninterest Income. Based on these results, Keith A. Wilton, the current Chief Executive Officer, would have been entitled to a cash award of 45.5% of his salary and the other named executive officers would have been entitled to 28.5% of their respective base salaries. The Compensation Committee reviewed these results and also reviewed the Incentive Plan matrix with the quantitative metrics originally approved for the 2019 fiscal year. In its discussions the Compensation Committee reviewed the performance of the current Chief Executive Officer and the other named executive officers for 2019. The Compensation Committee reviewed that various metrics that were achieved balanced against the metrics that were not achieved with respect to the assigned weight given to each metric. The Compensation Committee also noted the exceptional efforts made by the management team in negotiating and closing the Presidio Bank acquisition. The Compensation Committee reviewed its discretionary authority under the Plan that allows it to adjust the Incentive Plan and payout for a year for extraordinary events that affect the Company (including mergers) that were not incorporated in the development of the Incentive Plan for 2019. The Committee also reviewed its discretionary authority to increase or decrease a payout by an additional 15% of salary for qualitative performance reasons. The Compensation Committee concluded that although some of the metrics were favorably impacted and some unfavorably by the acquisition, the current Chief Executive Officer should continue to earn an award equal to 45.5% of his base salary, and the other named executive officers should earn an award equal to 28.5% of their respective base salaries plus an additional $6,805 as follows:

Named Executive	Bonus Award
Keith A. Wilton(1)	$151,733
Walter T. Kaczmarek(2)	$137,958
Michael E. Benito	$ 90,172
Margo G. Butsch	$ 86,961
Lawrence D. McGovern	$101,456

(1) Mr. Wilton assumed the position of President and Chief Executive Officer effective August 8, 2019. His payout calculation represents the prorated portion of the year in which

Mr. Wilton was President and Chief Operating Officer of HBC, and then as President and Chief Executive Officer of the Company.

(2) Mr. Kaczmarek retired from his positions of President and Chief Executive Officer effective August 8, 2019. Mr. Kaczmarek is entitled to a prorated portion of is bonus for his service in 2019. His payout calculation represents the prorated portion of the year in which Mr. Kaczmarek was the President and Chief Executive Officer of the Company and represents 45.5% of his prorated salary through August 8, 2019.

Equity Based Compensation

The Compensation Committee periodically reviews our equity compensation program from a market perspective as well as in the context of our overall compensation philosophy. The Compensation Committee also considers the appropriateness of various equity vehicles, such as stock options, and restricted stock as well as overall program costs (which include both stockholder dilution and compensation expense), when evaluating the long-term incentive mix.

The Compensation Committee believes that equity based compensation should be a significant component of total executive compensation to align executive compensation with the long-term performance of the Company and to encourage executives to make value enhancing decisions for the benefit of our shareholders. Each of the named executive officers is eligible to receive equity compensation. The Compensation Committee is responsible for determining equity grants to all staff members, including named executive officers. The Compensation Committee may also grant equity-based awards to award performance, coincide with promotions and hirings, and for recruiting and retention purposes.

In considering whether to grant an equity award and the size of the grants to be awarded, the Compensation Committee considers, among other things, with respect to each executive officer, (i) the salary level, (ii) the contributions expected toward the growth and profitability of the Company, (iii) extraordinary contribution to the Company's financial performance, (iv) prior award levels, and (v) peer survey data indicating grants made to similarly situated officers at comparable financial institutions.

The Company's Amended and Restated 2004 Equity Plan (the "2004 Plan") provided for the grant of non-qualified and incentive stock options, and restricted stock. In 2013, the Board of Directors and shareholders approved the 2013 Equity Incentive Plan (the "2013 Plan") and the 2004 Plan was terminated. Stock options and restricted stock awards issued under the 2004 Plan remain outstanding. The Compensation Committee approved all awards under the 2004 Plan and continues to do so under the 2013 Plan. The Compensation Committee is the administrator of the 2013 Plan.

We may grant stock options to our executives to align their interests with those of our shareholders and as an incentive to remain with us. The Compensation Committee believes that options to purchase shares of our common stock, with an exercise price equal to the market price of our common stock on the date of grant, are inherently performance-based and are a very effective tool to motivate our executives to build shareholder value and reinforce our position as a growth company. With stock options, our executives can realize value only to the extent that the market price of our common stock increases during the period that the option is outstanding, which provides a strong incentive to our executives to increase shareholder value. Further, because these options typically vest over a four-year period, they incentivize our executives to build value that can be sustained over time.

The Compensation Committee approves primarily nonstatutory stock options instead of incentive stock options because of the tax advantages available to the Company for nonstatutory options and

because employees generally do not take full advantage of the tax benefits available to them from incentive stock options.

We also may grant restricted stock to our executives. Restricted stock aligns the interests of our executives with those of our shareholders and helps manage the dilutive effect of our equity compensation program. Our awards of restricted stock are subject to time-based vesting. Because restricted stock has value to the recipient even in the absence of stock price appreciation, awards of restricted stock help us retain and incentivize executives during periods of market volatility, and also result in our granting fewer shares of common stock than through stock options of equivalent grant date fair value. Our awards of restricted stock typically vest over a three to four-year period for executives, and we believe that, like stock options, they help incentivize our executives to build value that can be sustained over time.

The Compensation Committee has established a stock option and restricted stock policy which recognizes that stock options and restricted stock have an impact on the profits of the Company under current accounting rules and also have a dilutive effect on the Company's shareholders. Accordingly, they are recognized as a scarce resource and option grants and awards of restricted stock are given the same consideration as any other form of compensation. The Compensation Committee has established ranges for the amount of options that may be granted that depend on the individual's position with the Company and whether the option is awarded as an incentive to attract an individual, to retain an individual or to reward performance.

We do not backdate options or grant options or award restricted stock retroactively. In addition, we do not coordinate grants of options or awards of restricted stock so that they are made before announcement of favorable information, or after announcement of unfavorable information. The Company's options and restricted stock are granted at fair market value on a fixed date or event (the first day of service for new hires and the date of Compensation Committee approval for existing employees), with all required approvals obtained in advance of or on the actual grant date. All grants to executive officers require the approval of the Compensation Committee and the Board of Directors. Fair market value has been consistently determined as the closing price on The Nasdaq Global Select Market on the grant date. In order to ensure that an option exercise price or restricted stock date of grant valuation fairly reflects all material information, without regard to whether the information seems positive or negative, every grant of options and restricted stock is contingent upon an assurance by management and legal counsel that the Company is not in possession of material undisclosed information. If the Company is in a "black-out" period for trading under its trading policy or otherwise in possession of inside information, the date of grant is suspended until the second business day after public dissemination of the information. We do not grant stock options with a so-called "reload" feature, nor do we loan funds to employees to enable them to exercise stock options. We have never re-priced stock options.

The Company's general practice has been to grant options and restricted stock at the Compensation Committee and Board of Directors' regular meeting held during the first quarter for the named executive officers as well as current staff, and at any other Compensation Committee meeting (whether a regular meeting or otherwise) held on the same date as a regularly scheduled Board meeting (which are held monthly) as required to attract new staff, retain staff or recognize key specific achievements.

For 2019, the Compensation Committee approved the following restricted stock awards:

Named Executive	Restricted Shares
Keith A. Wilton	20,000
Walter T. Kaczmarek	25,000
Michael E. Benito	12,000
Margo G. Butsch	12,000
Robertson Clay Jones*	—
Lawrence D. McGovern	15,000

* Mr. Jones joined the Company in October, 2019.

Retirement Plans

Our Amended and Restated Supplemental Retirement Plan ("SERP") is an element of our compensation program that was offered to certain executive officers. These types of plans had been commonly offered in the community bank industry for some time. The SERP is a nonqualified defined benefit plan and is unsecured and unfunded and there are no plan assets. When the Company offered key employees participation in the SERP, including some but not all of the named executive officers, the supplemental retirement benefit awarded was based on the individual's position within the Company and a vesting schedule determined by the desirability of incenting the retention element of the program. The participant receives his or her vested benefit at retirement. A participant whose employment terminates after the normal retirement date will receive 100% of his or her supplemental retirement benefit, payable monthly, commencing on the first of the month following retirement (unless selected otherwise by the participant and except executive officers who will receive their benefit six months following retirement) and continuing until the death of the participant (unless the joint survivor option is selected). For information on the plan, see the "Summary Compensation" table and the "Supplemental Retirement Plan for Executive Officers." The Company has reduced its use of the SERP as a program to attract and retain executives and key employees. It has been more than eight years since the Company has offered SERP benefits to executives and key employees.

Prohibition on Hedging

Our stock trading guidelines prohibit executives and directors from speculating in our stock, which includes, but is not limited to, short selling (profiting if the market price of the securities decreases), buying or selling publicly traded options, including writing covered calls, and hedging or any other type of derivative arrangement that has a similar economic effect.

Termination of Employment and Change in Control Provisions

We recognize that it is possible that we may be involved in a transaction involving a change of control of the Company, and that this possibility could result in the departure or distraction of our executives to the detriment of our business. The Compensation Committee and the Board believe that the prospect of such a change of control transaction would likely result in our executives facing uncertainties about their future employment and distractions resulting from concern over how the potential transaction might affect them.

To allow our executives to focus solely on making decisions that are in the best interests of our shareholders in the event of a possible, threatened, or pending change of control transaction, and to encourage them to remain with us despite the possibility that a change of control might affect them adversely, each of our named executives and chief executive officer have change of control provisions in

their respective employment agreements that provide them with certain payments and benefits in the event of the termination of their employment within 120 days prior to, or the 24 month period following, a change of control of the Company (referred to as the "change of control period"). The Compensation Committee and the Board believe that these "double-trigger" agreements serve as an important retention tool to ensure that personal uncertainties do not dilute our executives' complete focus on building shareholder value.

The Compensation Committee considers the use of change of control provisions and severance provisions on a case by case basis depending on the individual's position with the Company and the need to attract and/or retain the individuals. The employment agreements for Mr. Benito and Mr. McGovern contain excise tax gross-up provisions for purposes of Section 280G of the Internal Revenue Code of 1986, as amended. It has been the policy of the Company since those agreements were entered into to exclude such provisions from its executive contracts.

The severance benefits provided for our named executive officers were determined by the Compensation Committee based on its judgment of prevailing market practices at the time each agreement was entered into. At present, we have employment agreements with the Chief Executive Officer and the other named executive officers, which detail their eligibility for payments under various termination scenarios. In addition, certain equity grants made to the named executive officers provide for vesting of stock options and restricted stock upon a change of control. We have disclosed the severance and/or change in control payouts that would be payable to each named executive officer if the triggering event occurred on December 31, 2019, in the "Change in Control Arrangements and Termination of Employment" section in this proxy statement.

Tax Considerations

Section 162(m) of the Code generally limits the allowable deduction of publicly held corporations for compensation paid or accrued with respect to a "covered employee" to no more than $1 million per taxable year. A "covered employee" includes (i) an employee who is the corporation's principal executive officer or principal financial officer at any time during the taxable year (or who acts in such a capacity at any time during the year), (ii) any other employee whose total compensation must be reported under the Securities Act of 1933 by reason of such employee being among the three highest compensated officers for the year (other than those listed in clause (1) above), and (iii) an employee was who a "covered employee" for any taxable year beginning after December 31, 2016.

In light of Section 162(m) of the Code, it is the policy of the Compensation Committee to examine our executive compensation program to maximize the tax deductibility of compensation paid to our executive officers when and if the $1 million threshold becomes an issue. At the same time, the Compensation Committee also believes that the overall performance of our executives cannot in all cases be reduced to a fixed formula and that the prudent use of discretion in determining pay levels is in our best interests and those of our shareholders. Under some circumstances, the Compensation Committee's use of discretion in determining appropriate amounts of compensation may be essential. In those situations where discretion is or can be used by the Compensation Committee, compensation may not be fully deductible.

Federal tax legislation enacted in December 2017 eliminated the performance-based compensation exemption to the $1 million limitation in Section 162(m) of the Code prospectively and made other changes to Section 162(m), but with a transition rule that preserves the performance-based compensation exemption for certain arrangements and awards provided pursuant to a written binding contract that was in effect on November 2, 2017 and not materially modified on or after such date. We intend to continue to administer arrangements and awards subject to this transition rule with a view toward preserving their eligibility for the performance-based compensation exemption to the extent practicable and consistent with the non-tax compensation program objectives noted above.

Section 409A of the Code ("Section 409A"), among other things, limits flexibility with respect to the time and form of payment of deferred compensation. If a payment or award is subject to Section 409A, but does not meet the requirements that exempt such amounts from taxation under such section, the recipient is subject to: (i) income tax at the time the payment or award is not subject to a substantial risk of forfeiture; (ii) an additional 20% tax at that time; and (iii) an additional tax equal to the amount of interest (at the underpayment rate under the Code plus one percentage point) on the underpayment that would have occurred had the award been includable in the recipient's income when first deferred or, if later, when not subject to a substantial risk of forfeiture. We have made modifications to our plans and arrangements such that payments and awards under those arrangements either are intended to not constitute "deferred compensation" for Section 409A purposes (and will thereby be exempt from Section 409A's requirements) or, if they constitute "deferred compensation," are intended to comply with the Section 409A statutory provisions and final regulations.

Accounting Considerations

Accounting considerations play an important role in the design of our executive compensation program. Accounting rules require us to expense the fair value of restricted stock awards and the estimated fair value of our stock option grants which reduces the amount of our reported profits. The Compensation Committee considers the amount of this expense in determining the amount of equity compensation awards.

Dodd-Frank and Regulating Considerations

The Compensation Committee undertakes to review, consider and approve compensation decisions in accordance with proposed regulations and guidelines set forth under Dodd-Frank and bank regulators. Dodd-Frank requires the federal bank regulators and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, including the Company and Heritage Bank of Commerce, having at least $1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. The proposed regulations apply to incentive compensation paid to "covered persons" at covered financial institutions, including executive officers. The proposed regulations prohibit a covered financial institution from creating or maintaining an incentive-based compensation arrangement that encourages inappropriate risks by providing a covered person either: (i) with excessive compensation; or (ii) with incentive-based compensation that could lead to material financial loss to the financial institution. A compensation arrangement would be considered able to lead to material financial loss unless: (a) it balances risk and financial reward; (b) is compatible with effective controls and risk management, and (c) is supported by strong corporate governance.

The Federal Reserve and Federal Deposit Insurance Corporation have also issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee serves or has served as an employee of the Company or its subsidiaries, and there are no common participants between the compensation committee of any other entity and the Company.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 401(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement.

Compensation Committee of the Board

Julianne M. Biagini-Komas, Chair
Frank G. Bisceglia
Robert T. Moles
Marin Park Sutton
Ranson W. Webster

Executive Compensation Tables

The following table provides for the periods shown, information as to compensation for services of the Company's principal executive officer, principal financial officer, and the three other executive officers of the Company who had the highest total compensation (as defined in accordance with applicable regulations) with respect to the year ended 2019 (collectively referred to as the "named executive officers"):

Summary Compensation Table

Name and Principal Position (a)	Year (b)	Salary ($) (c)(1)	Bonus ($) (d)	Stock Awards ($) (e)(2)	Option Awards ($) (f)(2)	Non-Equity Incentive Plan Compensation ($) (g)(3)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (h)(4)	All Other Compensation ($) (i)(5)	Total ($) (j)
Keith A. Wilton*	2019	$429,839	—	$243,200	$ —	$151,733	$ —	$ 30,834	$ 855,606
President and Chief Executive Officer	2018	$358,440	—	$201,600	$ —	$ 89,610	$ —	$ 32,229	$ 681,879
of Heritage Commerce Corp and	2017	$341,750	—	$173,760	$ —	$114,486	$ —	$ 34,614	$ 664,610
President of Heritage Bank of Commerce									
Walter T. Kaczmarek*	2019	$303,205	—	$304,000	$ —	$137,958	$627,100	$238,357	$1,610,620
President & Chief Executive Officer of	2018	$495,000	—	$420,000	$ —	$148,500	$ —	$ 48,950	$1,112,450
Heritage Commerce Corp and	2017	$470,000	—	$217,200	$ —	$186,824	$ 92,700	$ 40,302	$1,007,026
Chief Executive Officer of Heritage Bank of Commerce									
Michael E. Benito	2019	$292,517	—	$145,920	$ —	$ 90,172	$374,600	$ 30,220	$ 933,429
Executive Vice President/Business Banking Manager	2018	$280,013	—	$100,800	$ —	$ 70,003	$ 24,000	$ 28,053	$ 502,869
of Heritage Bank of Commerce	2017	$271,852	—	$ 86,880	$ —	$ 91,070	$126,400	$ 26,258	$ 602,427
Margo G. Butsch	2019	$281,250	—	$145,920	$ —	$ 86,961	$ —	$ 19,332	$ 533,463
Executive Vice President & Chief Credit Officer	2018	$250,000	—	$117,600	$ —	$ 62,500	$ —	$ 14,431	$ 444,531
of Heritage Bank of Commerce	2017	$190,153	—	$ 21,450	$ —	$ 63,701	$ —	$ 7,120	$ 282,424
Robertson Clay Jones	2019	$ 68,015	$142,500	$ —	$ —	$ —	$ 38,315	$ 4,585	$ 253,415
Executive Vice President & President of Community Business Bank Group of Heritage Bank of Commerce**									
Lawrence D. McGovern	2019	$332,109	—	$182,400	$ —	$101,456	$352,100	$ 32,820	$1,000,885
Executive Vice President & Chief Financial Officer	2018	$305,471	—	$151,200	$ —	$ 76,368	$ —	$ 30,030	$ 563,069
of Heritage Commerce Corp and	2017	$293,824	—	$130,320	$ —	$ 98,431	$ —	$ 27,118	$ 549,693
Heritage Bank of Commerce									

* Effective August 8, 2019, Mr. Kaczmarek retired and Mr. Wilton assumed the positions of President and Chief Executive Officer of the Company and Heritage Bank of Commerce.

** Mr. Jones joined the Company on October 12, 2019. Mr. Jones annual salary is $324,250, the amount reported is from October 12, 2019 through the end of year. His bonus in column (d) was paid to him on March 11, 2020 and represents an amount accrued by Presidio Bank prior to the acquisition of Presidio Bank or the Company on October 11, 2019, pursuant to a Presidio Bank bonus plan.

(1) The amounts in column (c) include amounts voluntarily deferred by each of the named executive officers into their 401(k) plan accounts. For 2019, Mr. Wilton deferred $25,000, Mr. Kaczmarek deferred $15,625, Mr. Jones deferred $3,186, Mr. McGovern deferred $25,000, Mr. Benito deferred $25,000 and Ms. Butsch deferred $25,000.

(2) The amounts shown in columns (e) and (f) reflect the applicable full grant date fair values for stock options and stock awards in accordance with ASC 718 (excluding the effect of forfeitures), and are reported for the fiscal year during which the stock options and stock awards were issued. The assumptions used in calculating the valuation for stock options and stock awards may be found in Note 13 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

(3) The amounts shown in column (g) for 2019 reflect payments made under the terms of the Management Incentive Plan for 2019 performance and paid in the first quarter of 2020.

(4) The amounts shown in column (h) for 2019 represent only the aggregate change in the actuarial present value of the accumulated benefit under the Company's Supplemental Executive Retirement Plan from December 31, 2018 to December 31, 2019. The amounts in column (h) were determined using interest rate and mortality rate assumptions consistent with those used in the Company's consolidated financial statements and include amounts which the named executive officer may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

Mr. Jones has a Supplemental Executive Retirement Agreement, dated November 28, 2017 (amended November 9, 2018) that was entered into with Presidio Bank. The agreement was assumed by the Company when the Company acquired Presidio Bank. Under the agreement Mr. Jones is entitled to a present value accumulated benefit of $61,244 as of December 31, 2019. The amount shown in column (h) for 2019 represents only the aggregate change in the actuarial present value of the accumulated benefit from December 31, 2018 to December 31, 2019. He is fully vested.

(5) The amounts shown in column (i) for 2019 include the following for each named executive:

Named Executive	Economic Value of Death Benefit of Life Insurance for Beneficiaries(*)	401(k) Plan Company Matching Contributions	Other Insurance Benefit	Vacation	Auto Compensation	Cash Dividend on Unvested Restricted Stock Award	Other (**)	Total
Keith A. Wilton	—	$3,000	$3,564	—	$ 9,900	$14,370	—	$ 30,834
Walter T. Kaczmarek . .	$10,021	$3,000	$4,286	$108,171	$ 7,258	$22,288	$83,333	$238,357
Michael E. Benito . . .	$ 2,519	$3,000	$2,419	$ 5,692	$ 8,400	$ 8,190	—	$ 30,220
Margo G. Butsch	—	$3,000	$2,322	—	$ 8,400	$ 5,610	—	$ 19,332
Robertson Clay Jones .	—	$3,000	$ 169	—	$ 1,000	—	—	$ 4,585
Lawrence D. McGovern	$ 2,500	$3,000	$3,712	$ 6,538	$ 6,000	$11,070	—	$ 32,820

* The economic value of the death benefit amounts shown above reflects the annual income imputed to each executive in connection with Company owned split-dollar life insurance policies for which the Company has fully paid the applicable premiums. These policies are discussed under "Supplemental Retirement Plan for Executive Officers."

** When Mr. Kaczmarek retired effective August 8, 2019, he became entitled to $83,333 from the Company's 2005 Amended and Restated Supplemental Executive Retirement Plan (referred to as a SERP). The amount was accrued in 2019 and paid in February 2020.

CEO Pay Ratio

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and SEC rules require us to disclose the pay ratio of our CEO to our median employee. The pay ratio disclosure below is a reasonable estimate calculated in a manner consistent with SEC rules and guidance.

We identified the median employee for 2019 by examining the 2019 total W-2 compensation from our payroll and employment records, including 401(k) deferrals and 401(k) matching of up to $3,000 per employee, for all individuals, excluding our CEO, who were employed by us on December 31, 2019. We included all employees, whether employed on a full-time, part-time, temporary or seasonal basis as of that payroll date. We did not make any assumptions, adjustments or estimates with respect to such total W-2 reported compensation except for the 401(k) matching as described above. We did not annualize the compensation for any full or part time employees that were not employed by us for all of 2019. We believe the use of total W-2 compensation, including 401(k) deferrals and 401(k) matching of up to $3,000 per employee, for all employees is a consistently applied compensation measure.

After identifying the median employee based upon the methodology described above, we calculated annual total compensation for such employee using the same methodology we used for our CEO and other

named executive officers as set forth in the 2019 Summary Compensation Table in this proxy statement. Our CEO assumed his position in August 2019 so we therefore annualized his base salary for the entire year in calculating his total compensation. The annual total compensation in 2019 for our median employee using this methodology was $72,961. The annual total compensation in 2019 for our CEO using this methodology is shown in the Summary Compensation Table and was $915,880 which includes an additional $60,274 to annualize his increased salary (from $400,000 to $500,000) effective August 8, 2019. This adjustment reflects the promotion of our new CEO effective August 8, 2019. The ratio of the annual total compensation of our CEO to the annual total compensation of our median employee in 2019 was 12.55 to 1.

This pay ratio is a reasonable estimate calculated in a manner consistent with SEC rules based on our payroll and employment records and the methodology described above. Because the SEC rules identifying the median compensated employee and calculating the pay ratio based on the employee's annual total compensation allow companies to adopt a variety of methodologies, to apply certain exclusions, and to make reasonable estimates and assumptions that reflect their compensation practices, the pay ratio reported by other companies may not be comparable to the pay ratio reported above, as other companies may have different employment and compensation practices and may utilize different methodologies, exclusions, estimates and assumptions in calculating their own pay ratios.

Executive Contracts

Keith A. Wilton—Prior to his current employment agreement, Mr. Wilton had an employment agreement dated February 18, 2014. The employment contract was for one year and was automatically renewed for one year terms. Under the agreement, Mr. Wilton received an annual salary of $550,000 (last increased in March 2020) with annual increases, if any, as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to his salary, he was eligible to participate in the Management Incentive Plan. Mr. Wilton participated in the Company's 401(k) plan, under which he received matching contributions up to $3,000. The Company provided to Mr. Wilton, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. He also received an automobile allowance in the amount of $700 per month. Mr. Wilton was provided with life insurance coverage in the amount of two times his salary not to exceed $700,000. He was also provided with long term care insurance, with a lifetime benefit of up to $72,000.

On August 8, 2019, the Company and Heritage Bank of Commerce entered into a new employment agreement with Keith A. Wilton who assumed the role of President and Chief Executive Officer of Heritage Commerce Corp and Heritage Bank of Commerce upon the retirement of Walter T. Kaczmarek. The employment agreement is for one year and is automatically renewed each year. Under the agreement, Mr. Wilton receives an annual salary of $500,000 with annual increases, if any, as determined by the Board of Directors' annual review of executive salaries. His salary was increased to $550,000 in March 2020. In addition to his salary, he is eligible to participate in the Heritage Commerce Corp Management Incentive Plan. Mr. Wilton participates in the Company's 401(k) plan, under which he may receive matching contributions up to $3,000. He also participates in the Company's Employee Stock Ownership Plan. The Company provides Mr. Wilton, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Wilton is provided with life insurance coverage in the amount of $700,000. He is provided with long term care insurance, with a lifetime benefit of up to $72,000. The Company reimburses Mr. Wilton for up to $1,200 for tax consultation and tax return preparation. He is also reimbursed for expenses that exceed insurance coverage for an annual physical examination, monthly dues for one country club membership and one business club membership. He receives an automobile allowance in the amount of $1,000 per month, together with reimbursements for gasoline and maintenance expenditures.

Under his employment agreement, Mr. Wilton is entitled to certain severance benefits on termination of his employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Walter T. Kaczmarek—Mr. Kaczmarek retired from the Company on August 8, 2019. On October 17, 2007, the Company entered into an amended and restated employment agreement with Walter T. Kaczmarek. His employment contract was for three years and was automatically renewed each month for three additional years. Under the agreement, Mr. Kaczmarek received an annual salary of $500,000 with annual increases, if any (last increased in March 2018), as determined by the Board of Directors' annual review of executive salaries. In addition to his salary, he was eligible to participate in the Management Incentive Plan. Mr. Kaczmarek participated in the Company's 401(k) plan, under which he may received matching contributions up to $3,000. He also participated in the Company's Employee Stock Ownership Plan. The Company provided Mr. Kaczmarek, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Kaczmarek was provided with life insurance coverage in the amount of two times his then current salary but no more than $700,000. He was provided with long term care insurance, with a lifetime benefit of up to $432,000. The Company reimbursed Mr. Kaczmarek for up to $1,200 for tax consultation and tax return preparation. He was also reimbursed for expenses that exceed insurance coverage for an annual physical examination, monthly dues for one country club membership and one business club membership. He received an automobile allowance in the amount of $1,000 per month, together with reimbursements for gasoline and maintenance expenditures.

Under his employment agreement, Mr. Kaczmarek was entitled to certain severance benefits on termination of his employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Michael E. Benito—On February 1, 2012, the Company entered into an employment agreement with Michael E. Benito when he was promoted to Executive Vice President/Business Banking Manager. The employment contract is for one year and is automatically renewed for one year terms. Under the Agreement, Mr. Benito receives an annual salary of $304,880 with annual increases, if any (last increased in March 2020), as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Benito participates in the Company's 401(k) plan, under which he may receive matching contributions up to $3,000. Mr. Benito also participates in the Company's Employee Stock Ownership Plan. The Company provides to Mr. Benito, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Benito receives an automobile allowance in the amount of $700 per month, together with reimbursements for gasoline expenditures. Mr. Benito is provided with life insurance coverage in the amount of two times his salary not to exceed $700,000. He is also provided with long term care insurance, with a lifetime benefit of up to $72,000.

Under his employment agreement, Mr. Benito is entitled to certain severance benefits on termination of his employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Margo G. Butsch—On July 8, 2017, the Company entered into an employment agreement with Margo G. Butsch when she was promoted by the Company to Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce. The employment contract is for one year and is automatically renewed for one year terms. Under the agreement, Ms. Butsch receives an annual salary of $298,700 with annual increases, if any (last increased in March 2020), as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to her salary, she is eligible to participate in the Management Incentive Plan. Ms. Butsch participates in the Company's 401(k) plan, under which she could receive matching contributions up to $3,000. Ms. Butsch also participates in the Company's Employee Stock Ownership Plan. The Company provides to

Ms. Butsch, at no cost to her, group life, health, accident and disability insurance coverage for herself and her dependents. Ms. Butsch also receives an automobile allowance in the amount of $700 per month. Ms. Butsch is provided with life insurance coverage in the amount of two times her salary not to exceed $700,000. She is also provided with long term care insurance, with a lifetime benefit of up to $72,000.

Under her employment agreement, Ms. Butsch is entitled to certain severance benefits on termination of her employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Robertson Clay Jones—On October 11, 2019, the Company entered into an employment agreement with Robertson Clay Jones. The employment agreement is for one year and is automatically renewed for one year terms. Under the Agreement, Mr. Jones receives an annual salary of $324,250 (last increased in March, 2020) with annual increases, if any, as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Jones participates in the Company's 401(k) plan, under which he may receive matching contributions up to $3,000. The Company provides to Mr. Jones, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Jones receives an automobile allowance in the amount of $500 per month. Mr. Jones is provided with life insurance coverage in the amount of two times his salary not to exceed $700,000. He is also provided with long term care insurance, with a lifetime benefit of up to $72,000.

Under his employment agreement, Mr. Jones is entitled to certain severance benefits on termination of his employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Lawrence D. McGovern—On July 21, 2011, the Company entered into an Employment Agreement with Lawrence D. McGovern. The employment contract is for one year and is automatically renewed for one year terms. Under the agreement, Mr. McGovern receives an annual salary of $350,200 with annual increases, if any (last increased in March 2020), as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. McGovern participates in the Company's 401(k) plan, under which he may receive matching contributions up to $3,000. He also participates in the Company's Employee Stock Ownership Plan. The Company provides to Mr. McGovern, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. McGovern receives an automobile allowance in the amount of $500 per month, together with reimbursements for gasoline expenditures. Mr. McGovern is provided with life insurance coverage in the amount of two times his salary but not to exceed $700,000. He is also provided with long term care insurance, with a lifetime benefit of up to $72,000.

Under his employment agreement, Mr. McGovern is entitled to certain severance benefits on termination of his employment, including a change of control. See "Change of Control Arrangements and Termination of Employment."

Plan Based Awards

Equity Based Plans. In 2004, the Board of Directors adopted the Heritage Commerce Corp 2004 Stock Option Plan (the "2004 Plan"), which was approved by the Company's shareholders at the 2004 Annual Meeting. The 2004 Plan authorized the Company to grant stock options to officers, employees and directors of the Company and its affiliates. In 2009, the 2004 Plan was amended and restated as the 2004 Equity Plan to authorize the issuance of restricted stock in addition to stock options. The 2004 Equity Plan was approved by the Company's shareholders at the 2009 Annual Meeting. The 2004 Equity Plan has expired but there remain outstanding stock options issued under the Plan prior to its expiration.

In 2013, the Board of Directors approved the 2013 Equity Incentive Plan ("2013 Equity Plan") to replace the 2004 Equity Plan. The 2013 Equity Plan was approved by the Company's shareholders at the 2013 Annual Meeting. The purpose of the Equity Plan is to promote the long-term success of the Company and the creation of shareholder value. The Board of Directors believes that the availability of stock awards is a key factor in the ability of the Company to attract and retain qualified individuals to serve as directors, officers and employees. Under the 2013 Equity Plan incentives are provided through the grant of stock options and restricted stock awards. We are proposing an amendment to the 2013 Equity Plan to increase the number of share authorized under the 2013 Equity Plan from 3,000,000 (as amended) to 5,000,000. See "Proposal 2—Approval of Amendment to Heritage Commerce Corp 2013 Equity Incentive Plan."

In connection with its acquisition of Presidio Bank in October 2019, the Company assumed the Presidio Bank Amended and Restated 2006 Stock Option Plan and the Presidio Bank 2016 Equity Incentive Plan (collectively the "Presidio Equity Plans") and the options issued and outstanding at the time of the acquisition. The issued and outstanding options were exchange for options to acquire an aggregate of 1,176,757 shares of the Company's common stock at an adjusted weighted average exercise price of $5.05.

Management Incentive Plan. The Company maintains a Management Incentive Plan adopted by the Board of Directors in 2005. Executive officers are eligible for target bonuses which are expressed as a percentage of their respective base salaries which increase as the level of performance of established goals increases. The bonuses are tied directly to the satisfaction of overall Company performance for the year. See "Compensation Discussion and Analysis" for information about the Management Incentive Plan.

The following table provides information on the potential performance based awards available if defined performance objectives were achieved in 2019 for each of the Company's named executive officers under the Company's Management Incentive Plan, and stock options or other stock awards granted to the named executive officers for the year ended December 31, 2019:

Grants of Plan-Based Awards

Name (a)	Grant Date (b)	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($) (c)	Target ($) (d)	Maximum ($) (e)	Estimated Future Payouts Under Equity Incentive Plan Awards Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)	All Other Stock Awards: Number of Shares of Stock or Units (#) (i)(2)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards ($/Sh) (k)	Grant Date Fair Value of Stock And Options Awards (l)(3)
Keith A. Wilton	5/22/2019	—	—	—	—	—	—	20,000	—	—	$243,200
	1/24/2019	$50,000	$225,000	$375,000	—	—	—	—	—	—	—
Walter T. Kaczmarek	5/22/2019	—	—	—	—	—	—	25,000	—	—	$304,000
					—	—	—				
Michael E. Benito	5/22/2019	—	—	—	—	—	—	12,000	—	—	$145,920
	1/24/2019	$29,600	$118,400	$177,600	—	—	—	—	—	—	—
Margo G. Butsch	5/22/2019	—	—	—	—	—	—	12,000	—	—	$145,920
	1/24/2019	$29,000	$116,000	$174,000	—	—	—	—	—	—	—
Robertson Clay Jones	—	—	—	—	—	—	—	—	—	—	—
Lawrence D. McGovern	5/22/2019	—	—	—	—	—	—	15,000	—	—	$182,400
	1/24/2019	$34,000	$136,000	$204,000	—	—	—	—	—	—	—

(1) These potential performance-based awards were established under the Management Incentive Plan if the indicated level of performance was achieved in 2019 as described further in the "Compensation and Discussion Analysis" and in the discussion under "Plan Based Awards—Management Incentive Plan." They do not represent the actual payments made to the named executive officers. The payments made for actual performance in 2019 are reflected in column (g) in the Summary

Compensation Table. Mr. Wilton's potential performance-based award was adjusted when he assumed the positions of President and Chief Executive Officer effective August 8, 2019. As adjusted his potential performance-based award was Threshold ($50,000), Target ($300,000), and Maximum ($500,000) applied on a prorate basis for time served in his new positions.

(2) This column reflects restricted stock award granted in 2019 pursuant to the 2013 Equity Incentive Plan.

(3) The amounts shown in column (l) reflect the applicable full grant date fair values for restricted stock award in accordance with ASC 718 (excluding the effect of forfeitures), and are reported for the fiscal year during which the restricted stock awards were issued. The assumptions used in calculating the valuation for stock and options awards may be found in Note 13 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

Equity Compensation Plan Information

The following table shows the number and weighted-average exercise price of securities to be issued upon exercise of outstanding options, warrants and rights, and the number of securities remaining available for future issuance under equity compensation plans at December 31, 2019:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,712,846(1)	$ 8.80(2)	796,957(3)
Equity compensation plans not approved by security holders	N/A	N/A	N/A

(1) Consists of 313,659 options to acquire shares under the Company's 2004 Equity Incentive Plan, 1,389,709 options to acquired shares under the Company's 2013 Equity Incentive Plan, and the aggregate amount of stock options assumed under the Presidio Plans.

(2) Includes the options issued under the Presidio Equity Plans assumed by the Company which have a weighted average price of $5.02.

(3) Available under the Company's 2013 Equity Incentive Plan.

Outstanding Equity Awards

The following table shows the number of Company shares of common stock covered by exercisable and unexercisable stock options and the number of Company unvested shares of restricted common stock held by the Company's named executive officers as of December 31, 2019:

Outstanding Equity Awards at Year End

	Option Awards					Stock Awards			
Name (a)	Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) (d)	Options Exercise Price ($) (e)	Options Expiration Date (f)	Number of Shares or Units of Stock That Have Not Vested (#) (g)(1)	Market Value of Shares or Units of Stock That Have Not Vested ($) (h)(2)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) (i)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($) (j)
Keith A. Wilton	—	—	—	—	—	37,250	$477,918	—	—
Walter T. Kaczmarek	—	—	—	—	—	55,000	$705,650	—	—
Michael E. Benito	12,500	—	—	$ 8.07	02/27/2024	21,375	$274,241	—	—
	10,000	—	—	$ 6.57	04/30/2023	—	—	—	—
	4,500	—	—	$ 3.57	07/26/2020	—	—	—	—
Margo G. Butsch	5,177	2,823(3)	—	$14.48	05/02/2027	17,250	$221,318	—	—
	2,690	310(4)	—	$10.34	05/03/2026	—	—	—	—
Robertson Clay Jones(5) . .	49,399	—	—	$10.74	07/01/2028	—	—	—	—
	37,050	—	—	$ 4.92	01/29/2025	—	—	—	—
	37,050	—	—	$ 3.98	01/30/2024	—	—	—	—
	37,050	—	—	$ 2.79	01/10/2022	—	—	—	—
	61,750	—	—	$ 2.57	01/18/2021	—	—	—	—
Lawrence D. McGovern . .	15,000	—	—	$ 8.07	02/27/2024	28,300	$363,089	—	—
	15,000	—	—	$ 6.57	04/30/2023	—	—	—	—

(1) This column represents the unvested shares for restricted stock awards granted. Restricted stock awards vest 25% per year from the date of grants for the 2016, 2017, and 2018 grants. Restricted stock awards vest 33% per year from the date of grant for the 2019 grants.

(2) The market value of the shares of restricted stock that have not vested is calculated by multiplying the number of shares of stock that have not vested by the closing price of our common stock at December 31, 2019, as reported on The Nasdaq Global Select Market, which was $12.83.

(3) The options vest daily over 4 years beginning May 2, 2017, and have a term of 10 years.

(4) The options vest daily over 4 years beginning May 3, 2016, and have a term of 10 years

(5) Stock options granted by Presidio Bank under the Presidio Plans which the Company assumed at the effective time of the acquisition of Presidio Bank. The options were adjusted to reflect the acquisition exchange ratio. The options are fully vested.

Option Exercises and Vested Stock Awards

The following table sets forth information with regard to the exercise and vesting of stock options and vesting of shares of restricted stock for the year ended December 31, 2019, for each of the named executive officers:

Option Exercises and Stock Vested

	Option Awards		Stock Awards	
Name (a)	Number of Shares Acquired on Exercise (#) (b)	Value Realized upon Exercise ($) (c)	Number of Shares Acquired on Vesting (#) (d)	Value Realized on Vesting ($) (e)(1)
Keith A. Wilton	—	—	10,750	$133,410
Walter T. Kaczmarek	15,000	$61,350	15,731	$195,629
Michael E. Benito	4,500	$27,200	6,750	$ 83,798
Margo G. Butsch	—	—	1,750	$ 21,665
Robertson Clay Jones	—	—	—	—
Lawrence D. McGovern	—	—	9,050	$112,252

(1) The number of vested shares reflects the gross amount of shares, without netting any shares surrendered to pay taxes. The aggregate dollar amount realized upon vesting was calculated by multiplying the number of shares by the fair market value on the vesting date.

401(k) Plan

The Company has established a broad-based employee benefit plan under Section 401(k) of the Internal Revenue Code of 1986 ("401(k) Plan"). The purpose of the 401(k) Plan is to encourage employees to save for retirement. Eligible employees may make contributions to the plan subject to the limitations of Section 401(k). The 401(k) Plan trustees administer the Plan. The Company matched up to $3,000 of each employee's contributions in 2018. The 401(k) Plan allows highly compensated employees to contribute up to a maximum percentage of their base salary, up to the limits imposed by the Internal Revenue Code, on a pre-tax basis. Participants choose to invest their account balances from an array of investment options as selected by plan fiduciaries. The 401(k) Plan is designed to provide for distributions in a lump sum after termination of service. However, loans and in-service distributions under certain circumstances such as hardship, attainment of age 59½, or a disability are permitted. For named executive officers, these amounts are included in the Summary Compensation Table under "All Other Compensation."

Employee Stock Ownership Plan

In 1997, Heritage Bank of Commerce initiated a broad-based employee stock ownership plan ("Stock Ownership Plan"). The Stock Ownership Plan was subsequently adopted by the Company as the successor corporation to Heritage Bank of Commerce. The Stock Ownership Plan allows the Company, at its option, to purchase shares of the Company common stock on the open market. To be eligible to receive an award of shares under the Stock Ownership Plan, an employee must have worked at least 1,000 hours during the year and must be employed by the Company on December 31. The executive officers have the same eligibility to receive awards as other employees of the Company. Awards under the Stock Ownership Plan generally vest over four years. In addition, the value of a participant's account becomes fully vested upon reaching the age of 65 or termination of employment by death or disability. Since 2010, the Company has suspended contributions to the Stock Ownership Plan. The Plan was "frozen" as of January 1, 2019. The

amounts of contributions to the Stock Ownership Plan for named executive officers are included in the Summary Compensation Table in the column entitled "All Other Compensation."

Supplemental Retirement Plan for Executive Officers

The Company has established the 2005 Amended and Restated Supplemental Executive Retirement Plan (the "SERP" or the "Plan") covering key employees, including several of the named executive officers. The SERP is a nonqualified defined benefit plan and is unsecured and unfunded and there are no plan assets. When the Company offers key executives participation in the SERP, the supplemental retirement benefit awarded is based on the individual's position within the Company and a vesting schedule determined by the desirability of incentivizing the retention element of the program. Normally the participant is 100% vested in his or her benefit at retirement, upon termination within two years from a change in control, or upon disability. However, the participant's vested benefit is reduced for payment prior to retirement age in accordance with the Plan terms, should that be selected by the participant.

The Company has reduced its use of the SERP as a program to attract and retain executives and key employees. It has been more than seven years since the Company has offered SERP benefits to executives and key employees.

Normal Retirement. A participant whose employment terminates after normal retirement (as defined in the Plan) will receive 100% of his or her supplemental retirement benefit, payable monthly, commencing on the first of the month following retirement (unless selected otherwise by the participant and except executive officers who receive their benefit six months after retirement) and continuing until the death of the participant (unless the joint survivor option is selected).

Early Retirement. In order to be eligible for early retirement benefits, the plan requires the participant to terminate employment (for reasons other than for cause or within two years from a change of control) after the date that the participant is at least 55 years old but prior to normal retirement as defined in the participant's participation agreement. The participant will then receive the portion of the supplemental retirement benefit that has vested as of the actual early retirement date. However, for each year (or partial year) before normal retirement age the participant receives an early retirement benefit, the vested benefit is reduced by five percent. Unless otherwise selected by the participant, the early retirement benefit will be paid monthly, with payments to commence on the first day of the month following the participant's separation from service (except executive officers who receive their benefit six months from retirement) and continuing until the death of the participant (unless the joint survivor option is selected).

Termination Before Early Retirement. If a participant's employment is terminated without cause or the participant resigns, the participant shall be eligible to receive the portion of the supplemental retirement benefit that has vested as of the effective date of termination reduced by 5% for each year (or partial year) that the participant's benefits are paid prior to the participant's normal retirement age. Benefits are payable monthly commencing on the first of the month elected by the participant but not before the participant's early retirement age (except executive officers who receive their benefit six months from retirement), and continuing until the death of the participant (unless the joint survivor option is selected).

Disability. In the event a participant becomes disabled, the participant will receive the actuarial equivalent of his or her supplemental retirement benefit, payable monthly, commencing on the first of the month following determination that the participant is disabled and continuing until the death of the participant.

Cause. If a participant's employment is terminated for cause, the participant forfeits any rights the participant may have under the SERP.

Change of Control. If a participant's employment is terminated for any reason (except cause or after qualifying for normal retirement) within two years following a change of control, the participant will

receive 100% of his or her supplemental retirement benefit commencing at the later of the first month following the age selected by the participant or the first month following the participant's separation from service (except executive officers who receive their benefit six months from separation of service), and continuing until the death of the participant (unless the joint survivor option is selected). In the event payments commence prior to the participant's normal retirement age, then the benefit due to the participant will be reduced by 5% for each year (or partial year) that the participant's benefit is paid prior to the participant's normal retirement age.

The Company has purchased life insurance contracts on the participants in order to finance the cost of these benefits and it is anticipated that, because of the tax-advantaged effect of this life insurance investment, the return on the life insurance contracts will be approximately equal to the accrued benefits to the participants under the SERP, other than in the event of accelerated vesting because of the change of control.

The following table shows the present value of the accumulated benefit payable to each of the named executive officers that participate in the SERP, including the number of service years credited to each named executive officer at December 31, 2019:

Name (a)	Plan Name (b)	Number of Years Credited Service (#) (c)	Present Value of Accumulated Benefit(1)(2) ($) (d)	Payments During Last Fiscal Year ($) (e)
Walter T. Kaczmarek(3) . . .	Heritage Commerce Corp SERP	15	$4,354,600	—
Michael E. Benito(4)	Heritage Commerce Corp SERP	16	$1,103,300	—
Lawrence D. McGovern . .	Heritage Commerce Corp SERP	21	$1,496,400	—

(1) The amounts in column (d) were determined using interest rate and mortality rate assumptions consistent with those used in the Company's consolidated financial statements and include amounts which the named executive officer may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the fiscal year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

(2) The following vesting percentages apply to the named executive officers who participate in the SERP:

End of the year prior to termination	Walter T. Kaczmarek	Michael E. Benito(4)		Lawrence D. McGovern
12/31/2019	100%	100%	80%	100%
12/31/2020	100%	100%	90%	100%
12/31/2021	100%	100%	100%	100%
12/31/2022	100%	100%	100%	100%
12/31/2023	100%	100%	100%	100%

(3) On his retirement in August, 2019, Mr. Kaczmarek became entitled to $83,333 from the SERP which amount was accrued in 2019 and paid on February 25, 2020 pursuant to the terms of the SERP.

(4) Mr. Benito has two separate SERP agreements.

Deferred Compensation Plan

In January 2004, the Company adopted the Heritage Commerce Corp Nonqualified Deferred Compensation Plan for certain executive officers. The purpose of the plan is to offer those employees an opportunity to elect to defer the receipt of compensation in order to provide termination of employment and related benefits taxable pursuant to Section 451 of the Internal Revenue Code of 1986, as amended. The plan is intended to be a "top-hat" plan (i.e., an unfunded deferred compensation plan maintained for a select group of management or highly-compensated employees) under Sections 201(2), 301(a)(3) and

401(a)(1) of the Employee Retirement Income Security Act of 1974. The executive may elect to defer up to 100% of any bonus and 50% of any regular salary into the Deferred Compensation Plan. Amounts deferred are invested in a portfolio of approved investment choices as directed by the executive. Under the Deferred Compensation Plan, the Company may make discretionary contributions for the executive, but has not done so. Amounts deferred by executives to the plan will be distributed at a future date they have selected or upon termination of employment. The executive can select a distribution schedule of up to fifteen years. Mr. Benito and Ms. Butsch elected to participate in the plan during 2019.

Change of Control Arrangements and Termination of Employment

Equity Plans. Each of the named executive officers holds options granted under the 2004 Equity Plan and the 2013 Equity Plan. Under these plans, option holders will be given 30 days advance notice of the consummation of a change of control transaction during which time the option holders will have the right to exercise their options, and all outstanding options become immediately vested. The options terminate on the consummation of the change of control. In the event the option holder dies or becomes disabled, the option holder or his or her estate will have 12 months to exercise those options that have vested as of the date of termination of employment from a disability or death.

Restricted Stock. Several of the named executive officers hold shares of restricted stock subject to vesting requirement. Under the terms of the restricted stock awards the vesting of the shares will accelerated upon a change of control of the Company, or the holder's death or disability.

Supplemental Executive Retirement Plan. Several of the named executives are participants in the 2005 Amended and Restated Supplemental Executive Plan. If a participant's employment is terminated without cause or the participant resigns, the participant shall be eligible to receive the portion of the supplemental retirement benefit that has vested as of the effective date of termination reduced by 5% for each year (or partial year) that the participant's benefits are paid prior to the participant's normal retirement age. Benefits are payable monthly commencing on the first of the month elected by the participant (except executive officers who receive their benefits six months from separation from service), but not before the participant's early retirement age, and continuing until the death of the participant (unless the joint survivor option is selected). In the event a participant becomes disabled, the participant will receive the actuarial equivalent of his or her supplemental retirement benefit, payable monthly, commencing on the first of the month following determination that the participant is disabled and continuing until the death of the participant. If a participant's employment is terminated for cause, the participant forfeits any rights the participant may have under the plan. If a participant's employment is terminated for any reason (except cause or after qualifying for normal retirement) within two years following a change of control, the participant will receive 100% of his or her supplemental retirement benefits commencing at the later of the first month following the age selected by the participant, or the first month following the participant's separation from service (except executive officers who receive their benefits six months from separation from service), and continuing until the death of the participant (unless the joint survivor option is selected). In the event payments commence prior to the participant's normal retirement age, then the benefit due to the participant will be reduced by 5% for each year (or partial year) that the participant's benefit is paid prior to the participant's normal retirement age.

Mr. Wilton's Employment Agreement. If Mr. Wilton's employment is terminated without cause or he resigns for good reason (as defined in the agreement), he will be entitled to a lump sum payment equal to two times his base salary and his average annual bonus in the last three years. If Mr. Wilton's employment is terminated or he resigns for good reason 120 days before, or within two years after, a change of control (as defined in the agreement), he will be paid a lump sum of 2.75 times his base salary and average annual bonus in the last three years. If his employment is terminated by the Company without cause, or he resigns for good reason, or as a result of a change of control the Company terminates his employment or he resigns for good reason, his participation in group insurance coverages will continue on at least the same level as at the time of termination for a period of 36 months from the date of termination. Additionally, following the termination of his employment, Mr. Wilton has agreed to refrain from using trade secrets or proprietary information in certain activities that would be competitive with the Company.

Mr. Kaczmarek's Employment Agreement. Mr. Kaczmarek retired on August 8, 2019. Under his employment agreement if his employment was terminated without cause or he resigned for good reason, he would have been entitled to a lump sum payment equal to two times his base salary and his highest annual bonus in the last three years. If Mr. Kaczmarek's employment was terminated or he resigned for good reason 120 days before, or within two years after, a change of control, he would have been paid a lump sum of 2.75 times his base salary and highest annual bonus in the last three years. If his employment was terminated by the Company without cause, or he resigned for good reason, or as a result of a change of control the Company terminated his employment or he resigned for good reason, his participation in group insurance coverages would have been continued on at least the same level as at the time of termination for a period of 36 months from the date of termination. In the event that the amounts payable to Mr. Kaczmarek under the agreement constituted "excess parachute payments" under the Internal Revenue Code of 1986, as amended, that are subject to an excise or similar tax, the amounts payable to Mr. Kaczmarek would have been increased so that he received substantially the same economic benefit under the agreement had there been no such tax imposed. Additionally, following the termination of his employment, Mr. Kaczmarek has agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees and customers.

Mr. Benito's Employment Agreement. If Mr. Benito's employment agreement is terminated without cause, he will be entitled to a lump sum payment equal to one times his base salary and his average annual bonus during the last three years. If Mr. Benito's employment is terminated by the Company or he resigns for good reason 120 days before or within two years after a change in control, he will be entitled to a lump sum payment of two times his base salary and his average annual bonus during the last three years. If Mr. Benito's employment is terminated by the Company without cause, his participation in group insurance coverage will continue on at least the same level as at the time of termination for a period of 12 months from the date of termination. If Mr. Benito's employment is terminated by the Company as a result of a change in control, or he resigns for a good reason as a result of a change in control, these benefits will continue for an additional 24 months from the date of termination. In the event that the amounts payable to Mr. Benito under the agreement constituted "excess parachute payments" under the Internal Revenue Code of 1986, as amended, that are subject to an excise or similar tax, the amounts payable to Mr. Benito will be increased so that he receives substantially the same economic benefit under the agreement had there been no such tax imposed. Additionally, following the termination of his employment, Mr. Benito has agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees or customers.

Ms. Butsch's Employment Agreement. If Ms. Butsch's employment agreement is terminated without cause, she will be entitled to a lump sum payment equal to one times her base salary and her average annual bonus during the last three years. If Ms. Butsch's employment is terminated by the Company or she resigns for good reason 120 days before or within two years after a change in control, she will be entitled to a lump sum payment of two times her base salary and her average annual bonus during the last three years. If Ms. Butsch's employment is terminated by the Company without cause, her participation in group insurance coverage will continue on at least the same level as at the time of termination for a period of 12 months from the date of termination. If Ms. Butsch's employment is terminated by the Company as a result of a change in control, or she resigns for a good reason as a result of a change in control, these benefits will continue for an additional 24 months from the date of termination. Additionally, following the termination of her employment, Ms. Butsch has agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees or customers.

Mr. Jones Employment Agreement. If Mr. Jones employment agreement is terminated without cause, he will be entitled to a lump sum payment equal to one times his base salary and his average annual bonus during the last three years. If Mr. Jones' employment is terminated by the Company or he resigns for good reason 120 days before or within two years after a change in control, he will be entitled to a lump sum payment of two times his base salary and his average annual bonus during the last three years. If Mr. Jones' employment is terminated by the Company without cause, his participation in group insurance coverage will continue on at least the same level as at the time of termination for a period of 12 months from the date of termination. If Mr. Jones' employment is terminated by the Company as a result of a change in control, or he resigns for a good reason as a result of a change in control, these benefits will continue for an additional 24 months from the date of termination. Additionally, following the termination of his employment, Mr. Jones has agreed to refrain from using trade secrets or proprietary information in certain activities that would be competitive with the Company.

Mr. McGovern's Employment Agreement. If Mr. McGovern's employment is terminated without cause, he will be entitled to a lump sum payment equal to one times his base salary, his highest annual bonus in the last three years and his annual automobile allowance. If Mr. McGovern's employment is terminated by the Company or he resigns for good reason 120 days before, or within two years after, a change in control, he will be entitled to a lump sum payment of two times his base salary, his highest annual bonus in the last three years and his annual automobile allowance. If the employment agreement is terminated by the Company without cause, his participation in group insurance coverage will continue on at least the same level as at the time of termination for a period of 12 months from the date of termination. If Mr. McGovern's employment is terminated as a result of a change in control during the change of control period, or he resigns for a good reason as a result of a change in control, these benefits will continue for an additional 24 months from the date of termination. In the event that the amounts payable to Mr. McGovern under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986, as amended, that are subject to an excise or similar tax, the amounts payable to Mr. McGovern will be increased so that he receives substantially the same economic benefit under the agreement had there been no such tax imposed. Additionally, following the termination of his employment, Mr. McGovern has agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees or customers.

The following tables summarize the payments which would be payable to our named executive officers in the event of various termination scenarios as of December 31, 2019. This information is for illustrative purposes only. Regardless of the manner in which a named executive's employment terminates, the officer would be entitled to: (i) the vested portion of any stock option or restricted stock, and (ii) the vested portion of the officer's benefit under the Supplemental Executive Retirement Plan.

	Change in Control	Involuntary Termination Without Cause	Termination for Good Reason	Death	Disability
Keith A. Wilton					
Cash severance under employment agreement	$1,668,904	$1,213,748	$1,213,748	$ —	$ —
Health insurance premiums	106,248	106,248	106,248	—	—
Life insurance benefits	—	—	—	700,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested stock options (accelerated)	—	—	—	—	—
Unvested restricted stock awards (accelerated)	477,918	—	—	477,918	477,918
Total:	$2,253,069	$1,319,996	$1,319,996	$1,177,918	$729,918
Walter T. Kaczmarek(1)					
Cash severance under employment agreement	$1,888,766	$1,373,648	$1,373,648	$ —	$ —
Health insurance premiums	58,978	58,978	58,978	—	—
Life insurance benefits	—	—	—	700,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Supplemental executive retirement plan	—	—	—	—	—
Split-dollar death benefits (upon death)	—	—	—	3,285,574	—
Unvested stock options (accelerated)	—	—	—	—	—
Unvested restricted stock awards (accelerated)	705,650	—	—	705,650	705,650
Outplacement services (layoff)	5,000	—	—	—	—
IRC 280(G) excise tax gross-up	1,022,892	—	—	—	—
Total:	$3,681,286	$1,432,626	$1,432,626	$4,691,224	$957,650
Michael E. Benito					
Cash severance under employment agreement	$ 763,464	$ 381,732	$ —	$ —	$ —
Health insurance premiums	85,762	42,881	—	—	—
Life insurance benefits	—	—	—	592,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Supplemental executive retirement plan(2)(3)	33,082	33,098	—	—	25,664
Unvested stock options (accelerated)	—	—	—	—	—
Unvested restricted stock awards (accelerated)	274,241	—	—	274,241	274,241
Split-dollar death benefits (upon death)	—	—	—	742,554	—
IRC 280(G) excise tax gross-up	—	—	—	—	—
Total:	$1,156,549	$ 457,711	$ —	$1,608,795	$551,905

	Change in Control	Involuntary Termination Without Cause	Termination for Good Reason	Death	Disability
Margo G. Butsch					
Cash severance under employment agreement	$ 679,467	$ 339,734	$ —	$ —	$ —
Health insurance premiums	121,963	60,981	—	—	—
Life insurance benefits	—	—	—	580,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested stock options (accelerated)	772	—	—	—	—
Unvested restricted stock awards (accelerated)	221,318	—	—	221,318	221,318
Total:	$1,023,520	$ 400,715	$ —	$ 801,318	$473,318
Robertson Clay Jones					
Cash severance under employment agreement	$ 900,000	$ 450,000	$ —	$ —	$ —
Health insurance premiums	121,831	60,915	—	—	—
Life insurance benefits	—	—	—	630,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested stock options (accelerated)	—	—	—	—	—
Split-dollar death benefits (upon death)	—	—	—	630,000	—
Unvested restricted stock awards (accelerated)	—	—	—	—	—
Total:	$1,021,831	$ 510,915	$ —	$1,260,000	$252,000
Lawrence D. McGovern					
Cash severance under employment agreement	$ 898,462	$ 449,231	$ —	$ —	$ —
Health insurance premiums	85,762	42,881	—	—	—
Life insurance benefits	—	—	—	680,000	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested stock options (accelerated)	—	—	—	—	—
Unvested restricted stock awards (accelerated)	363,089	—	—	363,089	363,089
Split-dollar death benefits (upon death)	—	—	—	896,437	—
IRC 280(G) excise tax gross-up	—	—	—	—	—
Total:	$1,347,313	$ 492,112	$ —	$1,939,526	$615,089

(1) The amounts reported for Mr. Kaczmarek assume that he did not retire in August 2019, and are intended solely to disclose the hypothetical amounts had he remained in his position as of December 31, 2019.

(2) Assumes executive selected age 62 for commencement of the payment of this benefit.

(3) The amount reflected in the table is the incremental increase in the benefit payable to the named executive officer in addition to the benefit payable under the terms of the Supplemental Executive Retirement Plan. See "Supplemental Retirement Plan for Executive Officers" and the tables included therein for information about the value of the accumulated benefit payable to each named executive officer.

(4) This balance represents the annual payment of long-term disability for the named executive officers. This long-term payment would begin after an elimination period and a twenty-five week short term disability period. This long-term disability payment will increase by 3% (cost of living adjustment) over the first ten years of payments and cease at age 65.

Director Compensation

This section provides information regarding the compensation policies for non-employee directors and amounts paid to these directors in 2019. Mr. Kaczmarek retired as President and Chief Executive Officer of the Company effective August 8, 2019. He remained, however, as a non-employee director thereafter and was compensated the same as all other non-employee directors. Mr. Wilton did not receive any separate compensation for their service as a director.

The Company has a policy of compensating non-employee directors for their service on the Board and Board committees of the Company. On an annual basis, the Compensation Committee reviews director compensation, including the individual fees and retainers, the components of compensation, as well as the total amount of director compensation appropriate for the Company.

In 2019, each director received an annual retainer fee of $50,000. The chair of each standing committee of the Board received an additional $6,000 per year, and the Chairman of the Board receives an additional $17,500 per year. Board Members are not paid separate fees for attending Board or committee meetings.

The Compensation Committee has adopted a policy to grant directors restricted stock on an annual basis in lieu of stock options. Under this policy directors are entitled to awards of restricted stock with an economic value on the date of grant (or the expiration of any trading black out previous to these in effect) not to exceed the following:

Board Chairman	$34,375
Board members (non-chairman)	$27,500

In 2019, each of the directors received restricted stock in accordance with the above schedule.

The following table summarizes the compensation of non-employee directors for the year ended December 31, 2019:

Director Compensation Table

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)(2)	Options Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (f)(3)	Cash Dividend on Unvested Restricted Stock Award ($) (g)	All Other Compensation ($) (h)(4)	Total ($) (i)
Julianne Biagini-Komas	$56,000	$27,494	—	—	—	$ 685	—	$ 84,179
Frank G. Bisceglia	$56,000	$27,494	—	—	25,100	$ 738	$ 775(4)	$110,107
Bruce H. Cabral(1)	$11,156	—	—	—	—	—	—	$ 11,156
Jack W. Conner	$73,500	$34,364	—	—	20,300	$ 932	$1,324(4)	$130,420
Jason DiNapoli	$50,000	$27,494	—	—	—	$ 543	—	$ 78,036
Steven L. Hallgrimson(5)	$59,000	$27,494	—	—	—	$ 738	—	$ 87,232
Stephen G. Heitel(1)	$11,156	—	—	—	—	—	$1,079(4)	$ 12,235
Walter T. Kaczmarek(6)	$19,624	—	—	—	—	—	—	$ 19,624
Robert T. Moles	$50,000	$27,494	—	—	45,800	$ 738	—	$124,032
Laura Roden	$56,000	$27,494	—	—	—	$ 738	—	$ 84,232
Marina Park Sutton(1)	$11,156	—	—	—	—	—	—	$ 11,156
Ranson W. Webster	$56,000	$27,494	—	—	16,200	$ 738	$ 838(4)	$101,270

(1) Joined the Board of Directors in October 2019 in connection with the acquisition of Presidio Bank by the Company.

(2) The amounts shown in column (c) reflect the applicable full grant date value for stock awards in accordance with ASC 718 (excluding the effect of forfeitures). See Note 13 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

(3) The amounts shown in column (f) represent only the aggregate change in the actuarial present value of the accumulated benefit measured from December 31, 2018 to December 31, 2019, under the respective director compensation benefits agreements. The amounts in column (f) were determined using interest rate and mortality rate assumptions, consistent with those used in the Company's consolidated financial statements, and include amounts which the named director may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K filed with the SEC on March 11, 2020.

(4) The amounts shown reflect the annual income imputed to each director in connection with Company owned split-dollar life insurance policies for which the Company has fully paid the applicable premiums.

(5) Mr. Hallgrimson will retire from the Board at the Annual Meeting.

(6) Mr. Kaczmarek retired as President and Chief Executive Officer of the Company effective August 8, 2019. He remained, however, as a non-employee director thereafter and was compensated the same as all other non-employee directors.

Director Outstanding Stock Options and Stock Awards

Each of the non-employee directors owned the following stock options and stock awards as of December 31, 2019:

Director	Stock Options	Stock Awards
Julianne M. Biagini-Komas	—	2,261
Frank G. Bisceglia	21,500	2,261
Bruce H. Cabral(1)	34,580	—
Jack W. Conner	—	2,826
Jason DiNapoli	—	2,261
Steven L. Hallgrimson(2)	6,345	2,261
Stephen G. Heitel(1)	123,499	—
Walter T. Kaczmarek(3)	—	—
Robert T. Moles	21,500	2,261
Laura Roden	10,700	2,261
Marina Park Sutton(1)	34,580	—
Ranson W. Webster	21,500	2,261

(1) Joined the Board in October 2019 in connection with the acquisition of Presidio Bank by the Company.

(2) Mr. Hallgrimson will retire from the Board at the Annual Meeting.

(3) Mr. Kaczmarek became a non-employee director effective August 8, 2019, when he retired as President and Chief Executive Officer of the Company. For information on Mr. Kaczmmarek stock awards see "Outstanding Equity Awards". These stock awards were granted prior to him becoming a non-employee director.

Director Compensation Benefits Agreement

Prior to 2007, the Company entered into individual director compensation benefits agreements with each of its then directors. These agreements were amended and restated in December, 2008 ("Benefit Agreements"). The Benefit Agreements provide an annual benefit equal to a designated applicable percentage of $1,000 times each year served as a director, subject to a 2% increase each year from the date

of the commencement of payments. The applicable percentage increases over time and equals 100% after nine years of service. In the event of a disability, or a resignation or termination pursuant to a change of control, the director's applicable percentage will be accelerated to 100%. Payments of benefits will be made in equal monthly payments on the first day of each month, commencing on the later of the director's attaining the age of 62 or the month following the month in which the director separates from service on the Board and continuing until the director's death. If a director is removed from the Board for cause he or she will forfeit any benefits under the Benefit Agreement.

Company-owned split-dollar life insurance policies support the Company's obligations under the Benefit Agreements. The premiums on the policies are paid by the Company. The cash value accrued on the policies supports the payment of the supplemental benefits for each participant. In the case of death of the participant, the participant's designated beneficiaries will receive 80% of the net-at-risk insurance (which means the amount of the death benefit in excess of the cash value of the policy).

The following table shows the present value of the accumulated benefit payable to each director who has a director compensation benefit agreement, including the number of service years credited to each director under the Benefit Agreements:

Name (a)	Plan Name (b)	Number of Years Credited Service (#) (c)	Present Value of Accumulated Benefit(1)(2) ($) (d)	Payments During Last Fiscal Year ($) (e)
Frank G. Bisceglia	Heritage Commerce Corp SERP	26	$319,000	—
Jack W. Conner	Heritage Commerce Corp SERP	16	$139,700	—
Robert T. Moles	Heritage Commerce Corp SERP	16	$293,700	—
Ranson W. Webster	Heritage Commerce Corp SERP	16	$185,200	—

(1) The amounts in column (d) were determined using interest rate and mortality rate assumptions consistent with those used in the Company's consolidated financial statements and include amounts which the director may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2019, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 11, 2020.

(2) Each participant is fully vested.

PROPOSAL 1—ELECTION OF DIRECTORS

The Bylaws of the Company provide that the number of directors shall not be less than 9 nor more than 15. By resolution, the Board has fixed the number of directors at 12 effective on the date of and prior to the Annual Meeting. All of our directors serve one year terms that expire at the next following annual meeting. The Bylaws of the Company provide the procedure for nominations and election of the Board of Directors. For information on these procedures see "Corporate Governance and Board Matters—Nomination of Directors." Nominations not made in accordance with the procedures may be disregarded by the Chairman of the Annual Meeting and upon his instructions, the inspector of election will disregard all votes cast for such nominees.

The Board, upon the recommendation of the Corporate Governance and Nominating Committee, has recommended the nomination of 12 of the current members of the Board of Directors for one year terms that will expire at the Annual Meeting to be held in 2021. If any nominee should become unable or unwilling to serve as a director, the proxies will be voted at the Annual Meeting for substitute nominees designated by the Board. The Board presently has no knowledge that any of the nominees will be unable or unwilling to serve.

The following provides information with respect to each individual nominated and recommended to be elected to the Board. Each individual below is also a director on the Board of Heritage Bank of Commerce:

JULIANNE M. BIAGINI-KOMAS, age 57, was formerly a member on the Focus Business Bank board of directors and joined the Board of Directors of the Company in August 2015. Ms. Biagini-Komas is currently the Vice President, Finance and Human Resources of CNEX Labs, Inc., San Jose, California. She was the Chief Financial Officer of Quantumscape Corporation, San Jose, California, from 2011 to 2014. Previously, she was the Chief Financial Officer of Endwave Corporation, a Nasdaq-listed company, from 1994 to 2007. Ms. Biagini-Komas has a Bachelor of Science degree in Accounting from San Jose State University and a Masters in Business Administration degree from Santa Clara University. Ms. Biagini-Komas is a Certified Public Accountant. With over 20 years of human resource administration experience, Ms. Biagini-Komas is particularly suited to serve as Chair of the Compensation Committee. With her experience as a chief financial officer and her accounting background, Ms. Biagini-Komas provides valuable insight and perspective regarding accounting and tax issues and is particularly suited to serve as the Chair of the Board's Audit Committee and the Loan Committee.

FRANK G. BISCEGLIA, age 74, became a director of the Company in 1994. Mr. Bisceglia is a Senior Vice President—Investments, Advisory and Brokerage Services, Senior Portfolio Manager, Portfolio Management Program at UBS Financial Services, Inc., a full-service securities firm. Mr. Bisceglia has a Bachelor of Science degree in Industrial Management from San Jose State University. Mr. Bisceglia contributes to the Board a substantial understanding of finance and investments from over 41 years of experience as a financial advisor to corporate and high-wealth individuals. As a long-term member of the Board and Chair of the Loan Committee, he has a broad based understanding of the Company's business and he has developed a general knowledge of the Company's credit administration and loan underwriting process.

BRUCE H. CABRAL, age 65, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Mr. Cabral was a director of Presidio Bank. Mr. Cabral is the former Senior Executive Vice President and Chief Credit Officer of Union Bank, in San Francisco, California. Mr. Cabral retired from Union Bank in January, 2010 after a 32-year tenure which lasted from 1977 until his retirement. Mr. Cabral brings to the Board his previous experience and knowledge of the business of Presidio Bank including as a member of its asset-liability committee, and directors loan committee. He also adds a vast experience in the banking industry.

JACK W. CONNER, age 80, became a director of the Company in 2004. Mr. Conner was elected Chairman of the Board in July, 2006. Mr. Conner was Chairman and Chief Executive Officer of Comerica California from 1991 until his retirement in 1998, and remained a director until 2002. He was President and a director of Plaza Bank of Commerce from 1979 to 1991. Prior to joining Plaza Bank of Commerce, he held various positions with Union Bank of California (formerly Union Bank) where he began his banking career in 1964. Mr. Conner has a Bachelor of Arts degree from San Jose State University. Mr. Conner contributes to the Board over 20 years of executive leadership and substantial experience in the community banking industry. Having served as a Chief Executive Officer and President at several successful community banks in the Company's primary market, he brings a wide-ranging understanding of bank management, finance, operations and strategic planning. His demonstrated leadership ability, judgment and executive experience led the Board to elect him as Chairman of the Board.

JASON DINAPOLI, age 51, was one of the founders of 1st Century Bank, N.A., a wholly owned subsidiary of 1st Century Bancshares, Inc., headquartered in Los Angeles, California. In 2008, Mr. DiNapoli assumed the role of the President and Chief Executive Officer of 1st Century Bank and President of 1st Century Bancshares, Inc. He served in this role until July 1, 2016, when 1st Century Bancshares, Inc. was acquired by Midland Financial Co., a privately held bank holding company based in Oklahoma City, Oklahoma, as a division of MidFirst Bank, a subsidiary of Midland. Mr. DiNapoli presently serves as an Executive Vice President of MidFirst Bank and President and Chief Executive Officer of the 1st Century Bank division. Before joining 1st Century Bank, Mr. DiNapoli was vice president of finance for JP DiNapoli Companies Inc., a real estate investment, development and property management organization. Prior thereto, he served as a Vice President at Union Bank of California (formerly Union Bank). Mr. DiNapoli earned a bachelor's degree from the University of California, Berkeley. He is active in numerous community organizations. Mr. DiNapoli is the son of Philip DiNapoli, a former director of the Company who retired in 2018. Mr. DiNapoli brings to the Board his extensive experience and knowledge in banking and finance and management experience in the financial industry as well as experience as a board member of a publicly traded bank holding company.

STEPHEN G. HEITEL, age 61, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Mr. Heitel is the former Chief Executive Officer and director of Presidio Bank. Prior to joining Presidio Bank in October 2008, he served as President and Chief Executive Officer of Mid-Peninsula Bank based in Palo Alto, California. Mr. Heitel served in other senior positions at Greater Bay Bancorp, including President and Chief Executive Officer of San Jose National Bank from December 2003 to November 2005, and as Executive Vice President and Chief Operating Officer of Cupertino National Bank from August 2001 to December 2003. Mr. Heitel's additional experience also includes executive roles with Bank of America including serving as head of Commercial Banking activities for the Bay Area, focused on middle-market businesses. Mr. Heitel brings to the Board his understanding and knowledge of the business and personal of Presidio Bank as well as his previous executive experience and knowledge of the community banking industry.

WALTER T. KACZMAREK, age 68, has been a director since 2005. He was President and Chief Executive Officer of Heritage Commerce Corp and Chief Executive Officer and a director of Heritage Bank of Commerce until his retirement effective August 8, 2019. Prior to joining the Company in 2005, Mr. Kaczmarek was Executive Vice President of Comerica Bank and of Plaza Bank of Commerce from 1990. Prior to joining Plaza Bank of Commerce he served in various positions with Union Bank of California (formerly Union Bank) and also The Martin Group, a real estate investment development company. Mr. Kaczmarek has a Bachelor of Science in Commerce degree from Santa Clara University, and a Masters in Business Administration degree from San Jose State University. Mr. Kaczmarek's familiarity of the Company and its business as the former President and Chief Executive Officer and broad experience in the community banking industry brings a valuable perspective to the Board.

ROBERT T. MOLES, age 65, became a director of the Company in 2004. Mr. Moles has been the Chairman of the Board of Intero Real Estate Services, Inc., a full-service real estate firm since 2002. Prior

to joining Intero, he served as President and Chief Executive Officer of the Real Estate Franchise Group of Cendant Corporation, the largest franchiser of residential and commercial real estate brokerage offices in the world. Prior to joining Cendant, he served as President and Chief Executive Officer of Contempo Realty, Inc. in Santa Clara, California. Mr. Moles contributes to the Board a substantial expertise in the real estate industry in the Company's primary market. With over 33 years of experience in executive and managerial positions, he brings to the Board his skills in dealing with business and financial planning and personnel management. With his background, Mr. Moles is particularly suited to serve as a member of the Compensation Committee.

LAURA RODEN, age 61, is the founder and managing director of Capital Formation Consultants LLC, an advisor to alternative asset funds including venture capital, private equity, hedge and debt funds. Prior to founding Capital Formation Consultants LLC, Ms. Roden was the managing director for The Angels' Forum (Palo Alto, CA), an early stage angel and venture capital investing group for high net worth individuals. For most of Ms. Roden's prior career she was engaged as chief financial officer at both established and emerging corporations, including most notably Chronicle Broadcasting Company (San Francisco, CA) and PowerTV, Inc (acquired by Cisco Corporation, San Jose, CA). Ms. Roden has expertise in general management, finance, fundraising and marketing. Ms. Roden has taught courses on finance at San Jose State University, and is a frequent speaker for angel investment and venture capital groups and associations. Ms. Roden has a Bachelor of Arts degree from Harvard College and Masters in Business Administration degree from Harvard Business School. Ms. Roden has extensive management experience in a full range of business operations, strategic planning, marketing strategies and capital formation for entrepreneurial companies in the technology industry. In addition, with her prior experience as a chief financial officer, she is particularly suited to serve as Chair of the Board's Strategic Initiatives Committee, serve as a member of the Audit Committee and the Finance and Investment Committee.

MARINA PARK SUTTON, age 63, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Ms. Park Sutton was a director of Presidio Bank. Ms. Park Sutton is Chief Executive Officer of Girl Scouts of Northern California, which serves 19 counties in Northern California with almost 40,000 girls and 28,000 adults taking part in programs each year. Prior to joining Girl Scouts of Northern California in 2007, Ms. Park Sutton held a variety of progressively more senior positions at Pillsbury Winthrop Shaw Pittman LLP, an international law firm. The Board benefits from Ms. Park Sutton's experience as a director and member of the audit committee at Presidio Bank, as well as her valuable general business insight and legal experience.

RANSON W. WEBSTER, age 75, became a director of the Company in 2004. Mr. Webster founded Computing Resources, Inc. ("CRI") in 1978, a privately-held general purpose data processing service bureau specializing in payroll processing for small business nationwide. He served as CRI's Chief Executive Officer and Chief Financial Officer. In 1999, CRI merged with Intuit, Inc., the maker of QuickBooks and Quicken financial software. In 1998, Mr. Webster founded Evergreen Capital, LLC, an early stage investment company focused on Internet and biotech companies. In 2012, Mr. Webster became the Chief Executive Officer for Chargerback, Inc. a cloud based startup company dedicated to automating the lost and found process at hotels, airlines, rental car companies and other public spaces. Mr. Webster contributes to the Board substantial business acumen, executive strategic planning and financial experience developed through years of proven entrepreneurial success. Mr. Webster has a unique perspective of the Company from his long-standing service on the Board. He has a general understanding of corporate governance principles as Chairman of the Board's Nominating and Corporate Governance Committee.

KEITH A. WILTON, age 62, became a director as of February 2019. He is the President and Chief Executive Officer of the Company and Heritage Bank of Commerce effective August 8, 2019. Prior to assuming these positions, he served as President of Heritage Bank of Commerce from April 2017, as Executive Vice President and Chief Operating Officer of Heritage Commerce Corp from February 2014. Prior to joining Heritage Commerce Corp and Heritage Bank of Commerce, Mr. Wilton was an Executive Vice President with Pacific Capital Bancorp from 2010 through 2013. Mr. Wilton was a consultant from

2008 to 2010 for several private equity firms assisting with investment and acquisition opportunities in the financial industry. He was with Greater Bay Bancorp holding positions of Executive Vice President and President of the Specialty Finance Group from 2002 to 2007. Mr. Wilton has over 30 years experience with bank and finance companies. Mr. Wilton contributes to the Board his breadth of knowledge of the Company's business, markets, community and culture. He provides the Board with an overall perspective of all facets of the Company's business, financial condition and its strategic direction.

Recommendation of the Board of Directors

The Board of Directors recommends the election of each nominee. The proxy holders intend to vote all proxies they hold in favor of the election of each of the nominees. If no instruction is given, the proxy holders intend to vote FOR each nominee listed.

PROPOSAL 2—APPROVAL OF AMENDMENT TO HERITAGE COMMERCE CORP 2013 EQUITY INCENTIVE PLAN

In 2013, the Board of Directors approved the Heritage Commerce Corp 2013 Equity Incentive Plan ("2013 Equity Plan") to replace the 2004 Equity Plan. The 2013 Equity Plan was approved by the Company's shareholders at the 2013 Annual Meeting. When approved, the 2013 Equity Plan authorized the issuance of 1,750,000 shares of common stock for future issuance of stock awards granted under the 2013 Equity Plan. The 2013 Equity Plan was amended at the 2017 Annual Meeting to increase the number of shares available by an additional 1,250,000. As of March 31, 2020, 580,449 shares had been issued pursuant to stock awards granted and the exercise of stock options, and stock options to purchase an additional 1,376,359 shares were outstanding. As of March 31, 2020, 803,739 shares were available for further grant under the 2013 Equity Plan.

The Board upon recommendation of the Compensation Committee is proposing an amendment to increase the number of shares available for issuance under the 2013 Equity Plan from 3,000,000 to 5,000,000. At the time the 2013 Equity Plan was approved by the shareholders there were approximately 26,338,521 shares of common stock outstanding. At the time the amendment to increase the number of shares available under the 2013 Equity Plan was approved at the 2017 Annual Meeting there were approximately 38,102,124 shares outstanding. As of March 31, 2020, there were 59,568,219 shares of common stock outstanding.

The purpose of the 2013 Equity Plan is to promote the long-term success of the Company and the creation of shareholder value. The Board of Directors believes that the availability of stock awards is a key factor in the ability of the Company to attract, incentivize and retain qualified individuals to serve as directors, officers and employees. The Board believes that it would be in the best interest of the Company to replenish the number of shares available for issuance under the 2013 Equity Plan. The additional shares made available for issuance will increase the number available to 5,000,000 shares. As of March 31, 2020, this represents approximately 8.40% of our issued and outstanding shares. A copy of the 2013 Equity Plan and the proposed amendment is attached as Appendix A to this proxy statement. The following discussion is qualified in its entirety by reference to the text of the 2013 Equity Plan which is incorporated by reference herein.

Description of the 2013 Equity Incentive Plan

Under the 2013 Equity Plan incentives are provided through the grant of stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance shares, and performance units (individually, an "Award"). The 2013 Equity Plan is also intended to permit the Company to grant Awards that qualified as performance based compensation under former Section 162(m) of the Code. Prior to its amendment in 2017, Section 162(m) generally limits the allowable deduction for compensation of a publicly held corporation with respect to a "covered employee" to no more than $1 million per taxable year.

Shares Subject to 2013 Equity Plan

The 2013 Equity Plan, as amended, will set aside an additional 2,000,000 authorized, but unissued, shares of common stock for issuance.

Appropriate adjustments will be made in the number of authorized shares and in outstanding Awards to prevent dilution or enlargement of participants' rights in the event of a merger, consolidation, reorganization, reincorporation, recapitalization, reclassification, stock dividend, stock split, reverse stock split, split-up, split-off, spin-off, combination of shares, exchange of shares or other change in our capital structure that is effected without receipt of consideration by the Company. Shares subject to Awards that expire or are cancelled or forfeited will again become available for issuance under the 2013 Equity Plan. The shares available will not be reduced by Awards settled in cash or by shares withheld to satisfy tax

withholding obligations. Only the net number of shares issued upon the exercise of stock appreciation rights or options exercised by tender of previously owned shares will be deducted from the shares available under the 2013 Equity Plan.

Administration. The administrator of our 2013 Equity Plan will be the Compensation Committee. Subject to the provisions of the 2013 Equity Plan, the Compensation Committee determines in its discretion the persons to whom and the times at which Awards are granted, the types and sizes of such Awards, and all of their terms and conditions. All Awards must be evidenced by a written agreement between us and the participant. The Compensation Committee may amend, cancel or renew any Award, waive any restrictions or conditions applicable to any Award, and accelerate, continue, extend or defer the vesting of any Award. The Committee will not have the authority to reprice, adjust or amend the exercise price of options or the grant price of stock appreciation rights previously awarded to any participant, whether through amendment, cancellation and replacement grant, or any other means. The Compensation Committee has the authority to construe and interpret the terms of the 2013 Equity Plan and Awards granted under it.

Eligibility. Awards may be granted under the 2013 Equity Plan to our employees, officers, directors, or consultants or those of any present or future parent or subsidiary corporation or other affiliated entity. While we may grant "incentive stock options" within the meaning of Section 422 of the Code only to employees, we may grant nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance shares and performance units to any eligible participant. The actual number of individuals who will receive an Award under the 2013 Equity Plan cannot be determined in advance because the Compensation Committee has the discretion to select the participants. The maximum number of shares of stock with respect to an Award or Awards that may be granted to any participant may not exceed 5% of the total outstanding shares of common stock issued and outstanding.

Stock Options. The Compensation Committee may grant nonstatutory stock options, "incentive stock options,", or any combination of these. The number of shares of our common stock covered by each option will be determined by the Compensation Committee.

The exercise price of each option may not be less than the fair market value of a share of our common stock on the date of grant. Any incentive stock option granted to a person who owns stock possessing more than 10% of the total combined voting power of all classes of our stock or of any parent or subsidiary corporation must have an exercise price equal to at least 110% of the fair market value of a share of our common stock on the date of grant and a term not exceeding five years. In addition, the aggregate fair market value of the shares (determined on the grant date) covered by incentive stock options which first become exercisable by any participant during any calendar year may not exceed $100,000. The term of all options other than any incentive stock option granted to a person who owns stock possessing more than 10% of the total combined voting power of all classes of our stock or of any parent or subsidiary corporation may not exceed ten years.

Options vest and become exercisable at such times or upon such events and subject to such terms, conditions, performance criteria or restrictions as specified by the Compensation Committee. Unless a longer period is provided by the Compensation Committee, an option generally will remain exercisable for ninety days following the participant's termination of service, except that if service terminates as a result of the participant's death or disability, the option generally will remain exercisable for one year, but in any event not beyond the expiration of its term.

The exercise price of each option must be paid in full in cash (or cash equivalent) at the time of exercise, payment through the tender of shares of our common stock that are already owned by the participant, or through cashless exercise, or by any combination thereof. At the time of exercise, a participant who is an employee must pay any taxes that the Company is required to withhold.

Stock Appreciation Rights. A stock appreciation right gives a participant the right to receive the appreciation in the fair market value of our common stock between the date of grant of the Award and the date of its exercise. We may pay the appreciation either in cash or in shares of our common stock. We may make this payment in a lump sum, or payment may be deferred in accordance with the terms of the participant's Award agreement. The Compensation Committee may grant stock appreciation rights under the 2013 Equity Plan in tandem with a related stock option or as a freestanding Award. A tandem stock appreciation right is exercisable only at the time and to the same extent that the related option is exercisable, and its exercise causes the related option to be canceled. Freestanding stock appreciation rights vest and become exercisable at the times and on the terms established by the Compensation Committee. The maximum term of any stock appreciation right granted under the 2013 Equity Plan is five years.

Restricted Stock Awards. The Compensation Committee may grant Awards of restricted stock under the 2013 Equity Plan. Awards of restricted stock may vest subject to the attainment of performance goals similar to those described below or satisfaction of certain service-based or other vesting conditions as the Compensation Committee specifies, and the shares acquired may not be transferred by the participant until vested. Unless otherwise determined by the Compensation Committee, a participant will forfeit any unvested shares upon voluntary or involuntary termination of service with us for any reason, including death or disability. Except as otherwise provided in the 2013 Equity Plan or Award agreement, participants holding restricted stock will have the right to vote the shares and to receive any dividends paid, except that dividends or other distributions paid in shares will be subject to the same restrictions as the original Award.

Restricted Stock Units. Restricted stock units granted under the 2013 Equity Plan represent a right to receive shares of our common stock at a future date determined in accordance with the participant's Award agreement. The Compensation Committee may grant restricted stock units subject to the attainment of performance goals similar to those described below, or may make the Awards subject to service-based and other vesting conditions.

Performance Shares and Performance Units. The Compensation Committee may grant performance shares and performance units under the 2013 Equity Plan, which are Awards that will result in a payment to a participant only if specified performance goals are achieved during a specified performance period. Awards of performance shares are denominated in shares of our common stock, while Awards of performance units are denominated in dollars. In granting an Award of performance shares or units, the Compensation Committee establishes the applicable performance goals based on one or more measures of business performance enumerated in the 2013 Equity Plan and described in the performance goal section below.

To the extent earned, Awards of performance shares and units may be settled in cash, shares of our common stock or any combination thereof. Unless otherwise determined by the Compensation Committee, if a participant's service terminates due to death or disability prior to completion of the applicable performance period, the final Award value is determined at the end of the period on the basis of the performance goals attained during the entire period, but payment is prorated for the portion of the period during which the participant remained in service. Except as otherwise provided by the 2013 Equity Plan, if a participant's service terminates for any other reason, the participant's performance shares or units are forfeited.

Performance Goals. The Compensation Committee (in its discretion) may make performance goals applicable to a participant with respect to an Award, including but not limited to performance shares and performance units. At the Compensation Committee's discretion, one or more of the following performance goals may apply: revenue, costs, expenses (including expense efficiency ratios and other expense measures), earnings (including one or more of net profit after tax, gross profit, operating profit, earnings before interest and taxes, earnings before interest, taxes, depreciation and amortization and net earnings), earnings per share, earnings per share from continuing operations, operating income, pre-tax

income, operating income margin, net income, margins (including one or more of gross, operating and net income margins), returns (including one or more of return on actual assets, net assets, equity, investment, capital and net capital employed), shareholder return (including total shareholder return relative to an index or peer group), stock price, growth of loans and deposits, economic value added, cash generation, cash flow, unit volume, working capital, market share, cost reductions and strategic plan development and implementation. Such goals may reflect absolute entity or business unit performance or a relative comparison to the performance of a peer group of entities or other external measure of the selected performance criteria. Unless otherwise determined by the Compensation Committee at the time of establishment of the performance goals applicable to an Award, the performance measures shall be calculated in accordance with generally accepted accounting principles, but prior to the accrual or payment of any Award subject to performance goals and excluding the effect (whether positive or negative) of any change in accounting standards or any extraordinary, unusual or nonrecurring item, as determined by the Compensation Committee, occurring after the establishment of the performance goals applicable to the Award.

As discussed above, Section 162(m) of the Code generally limits the allowable deduction for compensation of a publicly held corporation with respect to a "covered employee" to no more than $1 million per taxable year. Federal tax legislation effective as of December 31, 2017, eliminated an exception to this $1 million limitation for performance-based compensation, subject to a transition rule applicable to certain arrangements provided pursuant to a written binding contract that was in effect on November 2, 2017 and not materially modified on or after such date. We intend to continue to administer arrangements and awards subject to this transition rule with a view towards preserving their eligibility for the performance-based compensation exemption to the extent practicable and consistent with the non-tax objectives of the Award.

Change in Control. Upon a change of control (as defined in the 2013 Equity Plan) the Company will notify each participant in writing, no less than 30 days prior to the change of control of participant's right to exercise all outstanding options, whether or not vested, and all outstanding options will vest and become immediately exercisable immediately prior to such change of control. All then outstanding options will terminate upon the change of control; provided, however, that any outstanding options not exercised as of the occurrence of the change of control will not terminate if there is a successor entity which assumes the outstanding options or substitutes for such options, new options covering the stock of the successor entity with appropriate adjustments as to the number and kind of shares and prices. Each restricted stock award will provide in the event of a change in control for the lapse of the restriction period applicable to restricted stock effective immediately prior to and conditioned upon the change in control. Each restricted stock unit award will provide that the settlement of the restricted stock unit effective immediately prior to and conditioned upon the change in control. The Committee, in its sole discretion, may provide in any stock appreciation right or performance award for the acceleration of the exercisability and vesting of the stock appreciation right or performance award in connection with a change in control.

Transferability. Awards granted under the 2013 Equity Plan shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the participant or the participant's beneficiary, except transfer by will or by the laws of descent and distribution.

Amendment and Termination. The 2013 Equity Plan shall continue in effect until the earlier of its termination by the Board of Directors or the date on which all of the shares of our common stock available for issuance under the 2013 Equity Plan have been issued and all restrictions on such shares under the terms of the 2013 Equity Plan and the agreements evidencing Awards granted under the 2013 Equity Plan have lapsed. However, no Awards will be granted under the 2013 Equity Plan after the tenth anniversary of the 2013 Equity Plan's effective date.

In addition, the Compensation Committee may amend, suspend or terminate the Equity Plan at any time, provided that without shareholder approval, the Equity Plan cannot be amended to increase the number of shares authorized, change the class of persons eligible to receive incentive stock options or effect any other change that would require shareholder approval under any applicable law or listing rule. Amendment, suspension or termination of the Equity Plan may not adversely affect any outstanding Award without the consent of the participant, unless such amendment, suspension or termination is necessary to comply with applicable law.

Number of Equity Awards Granted to Employees and Directors

The following table sets forth (i) the aggregate number of shares subject to options granted under the 2013 Plan during the year ended December 31, 2019, (ii) the average per share exercise price of such options, (iii) the aggregate number of shares subject to awards of restricted stocks granted under the 2013 Equity Plan during the year ended December 31, 2019, and (iv) the dollar value of such shares based on $12.83 per share, the closing price of a share of common stock on the Nasdaq Global Select Market on December 31, 2019.

Name of Individual or Group	Number of Options Granted (#)	Average Per Share Exercise Price ($)	Number of Shares Subject to Stock Awards (#)	Dollar Value of Stock Awards ($)
Keith A. Wilton* . . . . . President and Chief Executive Officer of Heritage Commerce Corp and President of Heritage Bank of Commerce	—	—	20,000	$ 256,600
Walter T. Kaczmarek* . . . . . President and Chief Executive Officer of Heritage Commerce Corp and Chief Executive Officer of Heritage Bank of Commerce	—	—	25,000	$ 320,750
Michael E. Benito . . . . . Executive Vice President/Business Banking Manager of Heritage Bank of Commerce	—	—	12,000	$ 153,960
Margo G. Butsch . . . . . Executive Vice President & Chief Credit Officer of Heritage Bank of Commerce	—	—	12,000	$ 153,960
Robertson Clay Jones** . . . . . Executive Vice President & President of Community Business Bank Group of Heritage Bank of Commerce	—	—	—	—
Lawrence D. McGovern . . . . . Executive Vice President & Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce	—	—	15,000	$ 192,450
All Executives as a Group	—	—	84,000	$1,077,720
Non-Executive Directors as a Group	—	—	18,653	$ 560,068
All other employees (including current officers who are not executive officers) as a Group	299,500	$12.16	32,000	$ 410,560

* Effective August 8, 2019, Mr. Kaczmarek retired and Mr. Wilton assumed the positions of President and Chief Executive Officer of the Company and Heritage Bank of Commerce.

** Mr. Jones joined the Company in October, 2019.

Certain United States Federal Income Tax Information

The following paragraphs are a summary of the certain federal income tax consequences to participants who are U.S. taxpayers and the Company of Awards granted under the 2013 Equity Plan. The information set forth below does not purport to be complete description of the applicable tax considerations. The information is based upon current federal income tax rules and therefore is subject to change, potentially retroactively. Moreover, the tax consequences to any particular participant may depend on the participant's particular situation. Accordingly, participants should consult their own tax advisors regarding the federal, state, local, and other tax consequences of the grant or exercise of an Award or the disposition of stock acquired as a result of an Award.

The following discussion assumes that the fair market value of our common stock on the date of exercise is greater than the per share exercise price.

Nonstatutory Stock Options. Income generally is not recognized by a participant upon the grant of a nonstatutory stock option with an exercise price that is equal to or greater than the fair market value of the underlying shares as of the grant date. Upon exercise of a nonstatutory stock option, the participant will recognize ordinary income in an amount equal to the excess of the fair market value (on the exercise date) of the purchased shares over the option's exercise price. Any income recognized in connection with an option exercised by an employee of the Company is subject to income tax withholding as a "supplemental wage payment."

A participant's tax basis in the shares received upon the exercise of a nonstatutory stock option will equal the fair market value of the shares on the date the option is exercised. Upon a subsequent sale or other disposition by a participant of these shares, any gain or loss recognized generally would be long-term or short-term capital gain or loss depending on whether the participant holds the shares for more than one year from the date of exercise.

Incentive Stock Options. Participants generally will not recognize income upon the grant or exercise of an "incentive stock option" that qualifies as such under Section 422 of the Code (although there may be alternative minimum tax consequences upon the exercise of the option to the extent the value of the option shares at the time of exercise exceeds the exercise price, unless the participant sells or disposes of the option shares in the same taxable year as the exercise.)

Participants who sell or dispose of a share received upon the exercise of an incentive stock option generally will recognize long-term capital gain or loss in an amount equal to the difference between the amount realized on the sale or disposition and the holder's tax basis in the disposed share, *provided* that (i) the disposition is more than two years after the option grant date *and* more than one year after the participant receives the share (the two year and one year periods, collectively, the "required holding period") and (ii) the participant is an employee at all times from the grant date until three months before the exercise date.

If a participant disposes of a share acquired on exercise of an incentive stock option before the end of the required holding period (a "disqualifying disposition"), then the participant generally will recognize ordinary compensation income in the year of the disqualifying disposition in an amount equal to the excess, if any, of the share's fair market value as of the option exercise date over the exercise price. If the amount realized on the disposition of the share exceeds (or is less than) the sum of the exercise price plus the amount of compensation income recognized on the disqualified disposition (as described in the prior sentence), then the character of any such additional gain or loss as capital or ordinary will depend on the circumstances.

Subject to certain exceptions for death or disability, if an option holder exercises an incentive stock option more than three months after termination of employment, the exercise of the option will be taxed in a manner similar to the exercise of a nonstatutory stock option.

Stock Appreciation Rights. Participants generally will not recognize income upon the grant of a stock appreciation right with an exercise price equal to the fair market value of the underlying stock on the grant date. Upon exercise, the participant will recognize ordinary income (subject to withholding taxes in the case of an employee) in an amount equal to the amount of cash and the fair market value of any shares received. Any gain or loss recognized upon any later disposition of the shares received pursuant to the stock appreciation rights would be long-term or short-term capital gain or loss depending on whether the holding period for the shares is more than one year.

Restricted Stock Awards, Restricted Stock Units, Performance Shares and Performance Units. A participant generally will not recognize income at the time an Award of restricted stock, restricted stock units, performance shares, or performance units is granted. Instead, he or she will recognize ordinary income in the first taxable year in which his or her interest in the shares underlying the Award becomes either: (i) freely transferable, or (ii) no longer subject to a substantial risk of forfeiture. However, the recipient of an Award of restricted stock may elect to recognize income at the time he or she receives the Award in an amount equal to the fair market value of the shares underlying the Award (less any cash paid for the shares) as of the Award is granted. A participant who makes an election under Section 83(b) of the Code within thirty days of the date of grant of the restricted stock will recognize ordinary income on the date of grant of the restricted shares equal to the excess of the fair market value of the such shares (determined without regard to the risk of forfeiture or restrictions on transfer) over any purchase price paid for the shares. If a Section 83(b) election has not been made, any dividends received with respect to restricted shares of stock that are subject at that time to a risk of forfeiture or restrictions on transfer generally will be treated as ordinary compensation income to the recipient.

Section 409A. Section 409A of the Code contains certain requirements for nonqualified deferred compensation arrangements, which may include Awards under the 2013 Equity Plan, with respect to an individual's deferral and distribution elections and permissible distribution events. Awards granted under the 2013 Equity Plan with a deferral feature will be subject to the requirements of Section 409A. If an Award is subject to and fails to satisfy the requirements of Section 409A, the recipient of that Award may recognize ordinary income on the amounts deferred under the Award, at the time of vesting, which may be prior to when the compensation is actually or constructively received. Also, if an Award that is subject to Section 409A fails to comply with Section 409A's provisions, Section 409A imposes an additional 20% federal income tax on compensation recognized as ordinary income, as well as interest on such deferred compensation. In addition, certain states (such as California) have laws similar to Section 409A and as a result, failure to comply with such similar laws may result in additional state income, penalty and interest charges.

Tax Consequences to the Company.

The Company generally will be entitled to a tax deduction in connection with an Award under the 2013 Equity Plan in an amount equal to the ordinary income realized by a participant and at the time the participant recognizes such income (for example, upon the exercise of a nonstatutory stock option). In the case of an incentive stock option, the Company generally will not be allowed a compensation deduction. However, if the participant makes a disqualified disposition of shares received upon the exercise of an incentive stock option, then the Company generally should be allowed a deduction in an amount equal to the fair market value of the option shares over the option exercise price. However, if the participant recognizes any additional income or gain on the disqualified disposition (as described under the heading "*—Incentive Stock Options*" above), the Company would not entitled to an additional corresponding deduction.

Section 162(m) of the Code generally limits the allowable deduction of publicly held corporations for compensation paid or accrued with respect to a "covered employee" to no more than $1 million per taxable year. A "covered employee" includes (i) an employee who is the corporation's principal executive officer or principal financial officer at any time during the taxable year (or who acts in such a capacity at

any time during the year), (ii) any other employee whose total compensation must be reported under the Securities Act of 1933 by reason of such employee being among the three highest compensated officers for the year (other than those listed in clause (i) above), and (iii) an employee was who a "covered employee" for any taxable year beginning after December 31, 2016. Federal tax legislation effective as of December 31, 2017 eliminated an exception to this $1 million limitation for performance-based compensation. However, the elimination of this exception is subject to a transition rule applicable to certain arrangements provided pursuant to a written binding contract in effect on November 2, 2017 that has not been materially modified on or after such date. We intend to continue to administer arrangements and Awards subject to this transition rule with a view towards preserving their eligibility for the performance-based compensation exemption to the extent practicable and consistent with the non-tax objectives of the Award.

The foregoing discussion is only a summary of some of the United States federal income tax considerations to participants and the Company with respect to the grant, exercise and/or vesting of Awards under the 2013 Equity Plan, and subsequent sale of shares received pursuant to such Awards. This discussion does not purport to be complete, and neither discusses the tax laws of any state, municipality, or foreign country nor any federal tax other than the federal income tax (including the federal gift and estate taxes).

Recommendation of the Board of Directors

The Board recommends a vote FOR the amendment to the Heritage Commerce Corp 2013 Equity Incentive Plan to increase the number of shares available for issuance. The proxy holders intend to vote all proxies in favor of this proposal. If no instruction is given, the proxy holders intend to vote FOR the proposal.

PROPOSAL 3—ADVISORY VOTE ON EXECUTIVE COMPENSATION

The Dodd-Frank Act requires, among other things, that we permit a non-binding, advisory vote on the 2019 compensation of our named executive officers, as described in the Compensation Discussion and Analysis, compensation tables and accompanying narrative discussion contained in this proxy statement.

As described in greater detail under the heading "Compensation Discussion and Analysis," we seek to closely align the interests of our named executive officers with the interests of our shareholders. Our compensation practices are designed to encourage and motivate our named executive officers to achieve superior performance on both a short-term and long-term basis while at the same time avoiding the encouragement of unnecessary or excessive risk-taking.

Accordingly, the Company is presenting this proposal, which gives you as a shareholder the opportunity to endorse or not endorse our executive pay program by voting for or against the following resolution:

"RESOLVED, that the shareholders approve the 2019 compensation of our named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosures required by Item 402 of Regulation S-K contained in the proxy statement."

As discussed in the Compensation Discussion and Analysis contained in this proxy statement, the Compensation Committee of the Board of Directors believes that the executive compensation for 2019 was reasonable and appropriate, and was the result of a carefully considered approach.

The vote on this resolution is not intended to address any specific item of compensation, but rather that overall compensation of our named executive officers and the policies and practices described in this proxy statement. In the event this non-binding proposal is not approved by our shareholders, such a vote shall not be construed as overruling a decision by the Board of Directors or Compensation Committee, nor create or imply any additional fiduciary duty of the Board of Directors or Compensation Committee, nor shall such a vote be construed to restrict or omit the ability of our shareholders to make proposals for inclusion in proxy materials related to executive compensation. Notwithstanding the foregoing, the Board of Directors and the Compensation Committee will consider the non-binding vote of our shareholders to this proposal when reviewing compensation policies and practices in the future.

Recommendation of the Board of Directors

The Board of Directors recommends a vote FOR the Advisory Proposal on Executive Compensation. The proxy holders intend to vote all proxies they hold in favor of this proposal. If no instruction is given, the proxy holders intend to vote FOR the proposal.

PROPOSAL 4—RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors, upon the recommendation of its Audit Committee, has ratified the selection of Crowe LLP to serve as our independent registered public accounting firm for 2020, subject to ratification by our shareholders. A representative of Crowe LLP will be present at the Annual Meeting to answer questions and will have the opportunity to make a statement if so desired.

We are asking our shareholders to ratify the selection of Crowe LLP as our independent registered public accounting firm. Although ratification is not required by our Bylaws, the SEC or the Nasdaq Stock Market, the Board is submitting the selection of Crowe LLP to our shareholders for ratification because we value our shareholders' views on the Company's independent registered public accounting firm and as a matter of good corporate practice. In the event that our shareholders fail to ratify the selection of Crowe LLP, however, we reserve the discretion to retain Crowe LLP as our independent registered public accounting firm for 2020. Even if the selection is ratified, the Audit Committee, in its discretion, may select a different independent registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and our shareholders.

Audit Committee Report

In accordance with its written charter adopted by the Company's Board of Directors, the Audit Committee assists the Board in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing, and financial reporting practices of the Company. During 2019, the Committee met 13 times. The Committee discussed the interim financial information contained in each quarterly earnings announcement with the Chief Financial Officer prior to public release. The Committee also discussed the interim financial statements with the Chief Financial Officer and the independent auditors prior, with and without management present, to the filing of each quarterly Form 10-Q and the annual report on Form 10-K.

In discharging its oversight responsibility as to the audit process, the Audit Committee obtained from the independent auditors a formal written statement describing all relationships between the auditors and the Company that might bear on the auditors' independence, discussed with the auditors any relationships that may impact their objectivity and independence and satisfied itself as to the auditors' independence. The Committee reviewed with both the independent auditors and the internal auditor's audit plans, scope, and results.

The Committee discussed and reviewed with the independent auditor all communications required by the standards of the Public Company Accounting Oversights Board ("PCAOB"), including those described in Auditing Standard No. 1301, *Communication with Audit Committees*, and discussed and reviewed the results of the independent auditor's audit of the consolidated financial statements. The Committee also reviewed and discussed the results of the internal audit examinations.

The Committee reviewed the audited financial statements of the Company as of and for the year ended December 31, 2019, with management and the independent auditors. The Committee has also reviewed "Management's Assessment over Financial Reporting" and the independent registered public accounting firm's opinion on the effectiveness of the Company's internal control over financial reporting, and discussed these reports and opinions with management and the independent registered public accounting firm prior to the Company's filing of its Annual Report on Form 10-K for the year ended December 31, 2019.

Based on the above mentioned review and discussion with management and the independent auditors, the Committee recommended to the Board of Directors that the Company's audited financial statements

be included in its Annual Report on Form 10-K for the year ended December 31, 2019, for filing with the SEC.

Heritage Commerce Corp
Audit Committee

Steve Hallgrimson, Chair
Bruce H. Cabral
Julianne M. Biagini-Komas
Laura Roden
Marina Park Sutton

March 5, 2020

The Audit Committee report shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement into any filing under the Securities Act of 1933 or the Securities Act of 1934, and shall not otherwise be deemed filed under these Acts.

Independent Registered Public Accounting Firm Fees

The following table summarizes the aggregate fees billed to the Company by its independent auditor:

Category of Services	Fiscal Year 2019	Fiscal Year 2018
Audit fees(1)	$ 625,000	$654,000
Audit-related fees(2)	162,500	48,080
Tax fees(3)	128,250	149,450
All other fees	97,500	17,500
Total accounting fees	$1,013,250	$869,030

(1) Fees for audit services for 2019 and 2018 consisted of the audit of the Company's annual financial statements, review of the consolidated financial statements included in the Company's Quarterly Reports on Form 10-Q, and the audit of the Company's internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002.

(2) Fees for audit related services for 2019 and 2018 consisted of financial accounting and reporting consultations, consents and other services related to SEC matters, and audits of the consolidated financial statements of the Company's employee benefit plans.

(3) Fees for tax services for 2019 and 2018 consisted of tax compliance and tax planning and advice.

- Fees for tax compliance services totaled $58,000 and $101,000 in 2019 and 2018, respectively. Tax compliance services are those rendered based upon facts already in existence or transactions that have already occurred to document, compute, and obtain government approval for amounts to be included in tax filings. Such services consisted primarily of preparation of the Company's consolidated federal and state income tax returns, trust preferred returns and a limited liability company tax return for a subsidiary entity.
- Tax planning and advice services are those rendered with respect to proposed transactions, assistance regarding the Internal Revenue Code Section 280(G) "excise tax gross-up" disclosures in the proxy statement for hypothetical events, and consultation with management regarding various internal control and accounting matters. Tax planning and advice services totaled $70,250 and $48,450 in 2019 and 2018, respectively.

(4) All other fees consisted primarily of consulting services for the Company's strategic objectives merger and acquisitions, and other discussions.

The ratio of tax planning and advice fees and all other fees to audit fees, audit-related fees and tax compliance fees was 19.84% for 2019 and 8.21% for 2018.

In considering the nature of the services provided by the independent registered public accounting firm, the Audit Committee determined that such services are compatible with the provision of independent audit services. The Audit Committee discussed these services with the independent registered public accounting firm and Company management to determine that they are permitted under the rules and regulations concerning auditor independence promulgated by the SEC and the Public Company Accounting Oversight Board.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm

Under applicable SEC rules, the Audit Committee is required to pre-approve the audit and non-audit services performed by the independent registered public accountants in order to ensure that they do not impair the auditors' independence. The SEC's rules specify the types of non-audit services that the independent registered public accountants may not provide to its audit client and establish the Audit Committee's responsibility for administration of the engagement of the independent registered public accountants.

Consistent with the SEC's rules, the Audit Committee Charter requires that the Audit Committee review and pre-approve all audit services and permitted non-audit services provided by the independent registered public accountants to the Company or any of its subsidiaries. The Audit Committee may delegate pre-approval authority to the Chair of the Audit Committee and if it does, the decisions of that member must be presented to the full Audit Committee at its next scheduled meeting.

Recommendation of the Audit Committee and the Board of Directors

The Audit Committee of the Board of Directors and the Board of Directors recommends approval of the ratification of the appointment of Crowe LLP as the Company's independent registered public accounting firm for the year ending December 31, 2020. The proxy holders intend to vote all proxies they hold in favor of the proposal. If no instruction is given, the proxy holders intend to vote FOR approval of the proposal.

OTHER BUSINESS

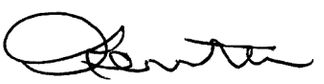
If any matters not referred to in this proxy statement come before the meeting, including matters incident to conducting the meeting, the proxy holders will vote the shares represented by proxies in accordance with their best judgment. Management is not aware of any other business to come before the meeting and, as of the date of the preparation of this proxy statement, no shareholder has submitted to management any proposal to be acted upon at the meeting.

SHAREHOLDER PROPOSALS

Any shareholder that intends to propose business to be considered at the 2020 Annual Meeting must comply with the Company's Bylaws including providing the required notice to the Company's Corporate Secretary not later than the close of business on February 20, 2021 nor earlier than January 21, 2021. If a shareholder gives notice of such a proposal before or after these deadlines, proxy holders will be allowed to use their discretionary voting authority to vote against the shareholder proposal without discussion when and if the proposal is raised at the 2021 Annual Meeting of Shareholders.

Proposals of shareholders intended to be presented for consideration at the 2021 Annual Meeting of Shareholders, and to be included in the Company's proxy statement for that meeting under SEC Rule 14a-8, must be received by the Company for inclusion in the proxy statement and form of proxy for that meeting no later than December 16, 2020, in a form that complies with applicable regulations.

HERITAGE COMMERCE CORP



Deborah Reuter
Executive Vice President
and Corporate Secretary

April 15, 2020
San Jose, California

Appendix A

AMENDMENT NO. 2 TO HERITAGE COMMERCE CORP
2013 EQUITY INCENTIVE PLAN

This Amendment No. 2 to the Heritage Commerce Corp 2013 Equity Incentive Plan is dated as of May 21, 2020.

RECITALS

1. The Heritage Commerce Corp 2013 Equity Incentive Plan (the "Plan") was approved by the Heritage Commerce Corp (the "Company") shareholders on May 23, 2013, and amended May 25, 2017. The Plan was amended on May 25, 2017 to increase the number of shares available under the Plan to 3,000,000 shares ("Amendment No. 1")

2. Pursuant to Section 15 of the Plan, the Board of Directors and shareholders may amend the Plan from time to time.

3. The Board of Directors, upon recommendation of the Compensation Committee, believes it is in the best interest of the Company and its shareholders to amend the Plan in accordance with the terms of this Amendment No. 2, the form of which has been approved by the Board of Directors and shareholders.

AMENDMENT

SECTION 1. The first sentence of Section 4.1 is amended and restated in full to read as follows:

"Subject to adjustment as provided in Section 4.2, the maximum aggregate number of shares of Stock that may be issued under the Plan shall be five million (5,000,000) and shall consist of authorized but unissued or reacquired shares of Stock or any combination thereof."

SECTION 2. This Amendment shall take effect as of May 21, 2020. Through May 21, 2020 the terms of the Plan as amended by Amendment No. 1 shall be applied without giving effect to this Amendment No. 2, subject to approval of the Amendment by the Board of Directors and shareholders.

SECTION 3. Except as provided in this Amendment No. 2, the provisions, terms and conditions of the Plan shall remain in full force and effect.

HERITAGE COMMERCE CORP
2013 Equity Incentive Plan

1. ESTABLISHMENT, PURPOSE AND TERM OF PLAN.

1.1 *Establishment.* The Heritage Commerce Corp 2013 Equity Incentive Plan (the "**Plan**") is hereby established effective as of May 23, 2013, the date of its approval by the shareholders of the Company (the "**Effective Date**").

1.2 *Purpose.* The purpose of the Plan is to advance the interests of the Company, its subsidiaries, and its shareholders by providing an incentive to attract, retain and reward persons performing services for the Company and its subsidiaries and by motivating such persons to contribute to the growth and profitability of the Company and its subsidiaries. The Plan seeks to achieve this purpose by providing for Awards in the form of Options, Stock Appreciation Rights, Restricted Stock, Performance Shares, Performance Units and Restricted Stock Units.

1.3 *Term of Plan.* The Plan shall continue in effect until the earlier of its termination by the Board or the date on which all of the shares of Stock available for issuance under the Plan have been issued and all restrictions on such shares under the terms of the Plan and the agreements evidencing Awards granted under the Plan have lapsed. However, all Awards shall be granted, if at all, within ten (10) years from the Effective Date.

2. DEFINITIONS AND CONSTRUCTION.

2.1 *Definitions.* Whenever used herein, the following terms shall have their respective meanings set forth below:

(a) "**Affiliate**" means (i) an entity, other than a Parent Corporation, that directly, or indirectly through one or more intermediary entities, controls the Company or (ii) an entity, other than a Subsidiary Corporation, that is controlled by the Company directly, or indirectly through one or more intermediary entities. For this purpose, the term "**control**" (including the term "**controlled by**") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the relevant entity, whether through the ownership of voting securities, by contract or otherwise; or shall have such other meaning assigned such term for the purposes of registration on Form S-8 under the Securities Act.

(b) "**Award**" means any Option, SAR, Restricted Stock, Performance Share, Performance Unit or Restricted Stock Unit granted under the Plan.

(c) "**Award Agreement**" means a written agreement between the Company and a Participant setting forth the terms, conditions and restrictions of the Award granted to the Participant. An Award Agreement may be an "Option Agreement," an "SAR Agreement," a "Restricted Stock Agreement," a "Performance Share Agreement," a "Performance Unit Agreement" or a "Restricted Stock Unit Agreement."

(d) "**Board**" means the Board of Directors of the Company.

(e) "**Cause**" means, unless otherwise defined by the Participant's Award Agreement or contract of employment or service, any of the following: (i) the Participant's theft, dishonesty, or falsification of any Participating Company documents or records; (ii) the Participant's improper use or disclosure of a Participating Company's confidential or proprietary information; (iii) any action by the Participant which has a detrimental effect on a Participating Company's reputation or business; (iv) the Participant's failure or inability to perform any reasonable assigned duties after written notice from a Participating Company of, and a reasonable opportunity to cure, such failure or inability; (v) any material breach by the Participant of any employment or service agreement between the Participant and a Participating Company, which breach is not cured

pursuant to the terms of such agreement; or (vi) the Participant's conviction (including any plea of guilty or nolo contendere) of any criminal act which impairs the Participant's ability to perform his or her duties with a Participating Company.

(f) "**Change of Control**" has the meaning set forth in *Section 12.1(b)*.

(g) "**Code**" means the Internal Revenue Code of 1986, as amended, and any applicable regulations promulgated thereunder.

(h) "**Committee**" means the Compensation Committee or other committee of the Board duly appointed to administer the Plan and having such powers as shall be specified by the Board. If no committee of the Board has been appointed to administer the Plan, the Board shall exercise all of the powers of the Committee granted herein, and, in any event, the Board may in its discretion exercise any or all of such powers.

(i) "**Company**" means Heritage Commerce Corp, a California corporation, or any successor corporation thereto.

(j) "**Consultant**" means a person engaged to provide consulting or advisory services (other than as an Employee or a member of the Board) to a Participating Company, provided that the identity of such person, the nature of such services or the entity to which such services are provided would not preclude the Company from offering or selling securities to such person pursuant to the Plan in reliance on registration on a Form S-8 Registration Statement under the Securities Act.

(k) "**Director**" means a member of the Board.

(l) "**Disability**" means the permanent and total disability of the Participant, within the meaning of Section 22(e)(3) of the Code.

(m) "**Dividend Equivalent**" means a credit, made at the discretion of the Committee or as otherwise provided by the Plan, to the account of a Participant in an amount equal to the cash dividends paid on one share of Stock for each share of Stock represented by an Award held by such Participant.

(n) "**Employee**" means any person treated as an employee (including an Officer or a member of the Board who is also treated as an employee) in the records of a the Company and, with respect to any Incentive Stock Option granted to such person, who is an employee for purposes of Section 422 of the Code; provided, however, that neither service as a member of the Board nor payment of a director's fee shall be sufficient to constitute employment for purposes of the Plan. The Company shall determine in good faith and in the exercise of its discretion whether an individual has become or has ceased to be an Employee and the effective date of such individual's employment or termination of employment, as the case may be. For purposes of an individual's rights, if any, under the Plan as of the time of the Company's determination, all such determinations by the Company shall be final, binding and conclusive, notwithstanding that the Company or any court of law or governmental agency subsequently makes a contrary determination.

(o) "**Exchange Act**" means the Securities Exchange Act of 1934, as amended.

(p) "**Fair Market Value**" means, as of any date, the value of a share of Stock or other property as determined by the Committee, in its discretion, or by the Company, in its discretion, if such determination is expressly allocated to the Company herein, subject to the following:

(i) If, on such date, the Stock is listed on a national or regional securities exchange or market system, the Fair Market Value of a share of Stock shall be the closing price of a share of Stock (or the mean of the closing bid and asked prices of a share of Stock if the Stock is so

quoted instead) as quoted on The Nasdaq Stock Market, the New York Stock Exchange or such other national or regional securities exchange or market system constituting the primary market for the Stock, as reported in The Wall Street Journal or such other source as the Company deems reliable. If the relevant date does not fall on a day on which the Stock has traded on such securities exchange or market system, the date on which the Fair Market Value shall be established shall be the last day on which the Stock was so traded prior to the relevant date, or such other appropriate day as shall be determined by the Committee, in its discretion.

(ii) If, on such date, the Stock is not readily tradable on an established securities market, the Fair Market Value of a share of Stock shall be as determined by the Committee by reasonable application of a reasonable valuation method, consistently applied. Notwithstanding the foregoing, no Award granted under the Plan is intended to provide for a deferral of compensation within the meaning of Section 409A such that the Fair Market Value of a share of Stock shall be determined in all respects in a manner that is consistent with that intention.

(q) "**Incentive Stock Option**" means an Option intended to be (as set forth in the Award Agreement) and which qualifies as an incentive stock option within the meaning of Section 422(b) of the Code.

(r) "**Insider**" means an Officer, a member of the Board or any other person whose transactions in Stock are subject to Section 16 of the Exchange Act.

(s) "**Nonstatutory Stock Option**" means an Option not intended to be (as set forth in the Award Agreement) an incentive stock option within the meaning of Section 422(b) of the Code.

(t) "**Officer**" means any person designated by the Board as an officer of the Company.

(u) "**Option**" means the right to purchase Stock at a stated price for a specified period of time granted to a Participant pursuant to *Section 6* of the Plan. An Option may be either an Incentive Stock Option or a Nonstatutory Stock Option.

(v) "**Ownership Change Event**" has the meaning set forth in *Section 12.1(a)*.

(w) "**Parent Corporation**" means any present or future "**parent corporation**" of the Company, as defined in Section 424(e) of the Code.

(x) "**Participant**" means any eligible person who has been granted one or more Awards.

(y) "**Participating Company**" means the Company or any Parent Corporation, Subsidiary Corporation or Affiliate.

(z) "**Participating Company Group**" means, at any point in time, all entities collectively which are then Participating Companies.

(aa) "**Performance Award**" means an Award of Performance Shares or Performance Units.

(bb) "**Performance Award Formula**" means, for any Performance Award, a formula or table established by the Committee pursuant to *Section 9.3* of the Plan which provides the basis for computing the value of a Performance Award at one or more threshold levels of attainment of the applicable Performance Goal(s) measured as of the end of the applicable Performance Period.

(cc) "**Performance Goal**" means a performance goal established by the Committee pursuant to *Section 9.3* of the Plan.

(dd) "**Performance Period**" means a period established by the Committee pursuant to *Section 9.3* of the Plan at the end of which one or more Performance Goals are to be measured.

(ee) "**Performance Share**" means a bookkeeping entry representing a right granted to a Participant pursuant to *Section 9* of the Plan to receive a payment equal to the value of a Performance Share, as determined by the Committee, based on performance.

(ff) "**Performance Unit**" means a bookkeeping entry representing a right granted to a Participant pursuant to *Section 9* of the Plan to receive a payment equal to the value of a Performance Unit, as determined by the Committee, based upon performance.

(gg) "**Restricted Stock Award**" means an Award of a Restricted Stock.

(hh) "**Restricted Stock Unit**" means a bookkeeping entry representing a right granted to a Participant pursuant to *Section 10* of the Plan to receive a share of Stock on a date determined in accordance with the provisions of *Section 10* and the Participant's Award Agreement.

(ii) "**Restriction Period**" means the period established in accordance with *Section 8.5* of the Plan during which shares subject to a Restricted Stock Award are subject to Vesting Conditions.

(jj) "**Rule 16b-3**" means Rule 16b-3 under the Exchange Act, as amended from time to time, or any successor rule or regulation.

(kk) "**SAR**" or "**Stock Appreciation Right**" means a bookkeeping entry representing, for each share of Stock subject to such SAR, a right granted to a Participant pursuant to *Section 7* of the Plan to receive payment of an amount equal to the excess, if any, of the Fair Market Value of a share of Stock on the date of exercise of the SAR over the exercise price.

(ll) "**Section 162(m)**" means Section 162(m) of the Code.

(mm) "**Securities Act**" means the Securities Act of 1933, as amended.

(nn) "**Service**" means a Participant's employment or service with the Participating Company Group, whether in the capacity of an Employee, a Director or a Consultant. A Participant's Service shall not be deemed to have terminated merely because of a change in the capacity in which the Participant renders such Service or a change in the Participating Company for which the Participant renders such Service, provided that there is no interruption or termination of the Participant's Service. Furthermore, a Participant's Service shall not be deemed to have terminated if the Participant takes any military leave, sick leave, or other bona fide leave of absence approved by the Company. However, if any such leave taken by a Participant exceeds ninety (90) days, then on the one hundred eighty-first (181st) day following the commencement of such leave any Incentive Stock Option held by the Participant shall cease to be treated as an Incentive Stock Option and instead shall be treated thereafter as a Nonstatutory Stock Option, unless the Participant's right to return to Service with the Participating Company Group is guaranteed by statute or contract. Notwithstanding the foregoing, unless otherwise designated by the Company or required by law, a leave of absence shall not be treated as Service for purposes of determining vesting under the Participant's Award Agreement. A Participant's Service shall be deemed to have terminated upon an actual termination of Service. Subject to the foregoing, the Company, in its discretion, shall determine whether the Participant's Service has terminated and the effective date of such termination.

(oo) "**Specified Employee"** means a specified employee as defined in Code Section 409A(a)(2)(B) of the Code or Treasury Regulations under Code Section 409A.

(pp) "**Stock**" means the common stock of the Company, as adjusted from time to time in accordance with *Section 4.2* of the Plan.

(qq) "**Subsidiary Corporation**" means any present or future "**subsidiary corporation**" of the Company, as defined in Section 424(f) of the Code.

(rr) "**Ten Percent Owner**" means a Participant who, at the time an Option is granted to the Participant, owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of a Participating Company (other than an Affiliate) within the meaning of Section 422(b)(6) of the Code.

(ss) "**Treasury Regulations**" means Proposed Temporary and Final Regulations of the United States Treasury Department issued under Title 26 of the Code of Federal Regulations.

(tt) "**Vesting Conditions**" mean those conditions established in accordance with *Section 6.2*, *Section 8.5* or *Section 10.3* of the Plan prior to the satisfaction of which Options, shares subject to a Restricted Stock Award or Restricted Stock Unit Award, respectively, remain subject to forfeiture in favor of the Company upon the Participant's termination of Service.

2.2 *Construction.* Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of the Plan. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term "or" is not intended to be exclusive, unless the context clearly requires otherwise. Reference to any statute, law, regulation or rule means such statute, law, regulation, rule as amended, modified, or replaced, in whole or in part, and in effect from time to time.

3. ADMINISTRATION.

3.1 *Administration by the Committee.* The Plan shall be administered by the Committee. All questions of interpretation of the Plan or of any Award shall be determined by the Committee, and such determinations shall be final and binding upon all persons having an interest in the Plan or such Award.

3.2 *Authority of Officers.* Any Officer shall have the authority to act on behalf of the Company with respect to any matter, right, obligation, determination or election which is the responsibility of or which is allocated to the Company herein, provided the Officer has apparent authority with respect to such matter, right, obligation, determination or election.

3.3 *Administration with Respect to Insiders.* With respect to participation by Insiders in the Plan, at any time that any class of equity security of the Company is registered pursuant to Section 12 of the Exchange Act, the Plan shall be administered in compliance with the requirements, if any, of Rule 16b-3.

3.4 *Committee Complying with Section 162(m).* If the Company is a "**publicly held corporation**" within the meaning of Section 162(m), the Board may establish a Committee of "**outside directors**" within the meaning of Section 162(m) to approve the grant of any Award which might reasonably be anticipated to result in the payment of employee remuneration that alone or when combined with other employee remuneration would otherwise exceed the limit on employee remuneration deductible for income tax purposes pursuant to Section 162(m).

3.5 *Powers of the Committee.* In addition to any other powers set forth in the Plan and subject to the provisions of the Plan, the Committee shall have the full and final power and authority, in its discretion:

(a) to determine the persons to whom, and the time or times at which, Awards shall be granted and the number of shares of Stock or units to be subject to each Award;

(b) to determine the type of Award granted and to designate Options as Incentive Stock Options or Nonstatutory Stock Options;

(c) to determine the Fair Market Value of shares of Stock or other property;

(d) to determine the terms, conditions and restrictions applicable to each Award (which need not be identical) and any shares acquired pursuant thereto, including, without limitation, (i) the exercise or purchase price of shares purchased pursuant to any Award, (ii) the method of payment for shares purchased pursuant to any Award, (iii) the method for satisfaction of any tax withholding obligation arising in connection with any Award, including by the withholding or delivery of shares of Stock, (iv) the timing, terms and conditions of the exercisability or vesting of any Award or any shares acquired pursuant thereto, (v) the Performance Award Formula and Performance Goals applicable to any Award and the extent to which such Performance Goals have been attained, (vi) the time of the expiration of any Award, (vii) the effect of the Participant's termination of Service on any of the foregoing, and (viii) all other terms, conditions and restrictions applicable to any Award or shares acquired pursuant thereto not inconsistent with the terms of the Plan;

(e) to determine whether an Award of SARs, Performance Shares or Performance Units will be settled in shares of Stock, cash, or in any combination thereof;

(f) to approve one or more forms of Award Agreement;

(g) to amend, modify, extend, cancel or renew any Award or to waive any restrictions or conditions applicable to any Award or any shares acquired pursuant thereto, except as otherwise permitted in connection with an event as provided under *Section 4.2*, the Committee shall not reprice, adjust or amend the exercise price of Options or the grant price of Stock Appreciation Rights previously awarded to any Participant, whether through amendment, cancellation and replacement grant, or any other means, nor shall the Committee have any authority to take such action with respect to any Award subject to and not exempt from Section 409A;

(h) to accelerate, continue, extend or defer the exercisability or vesting of any Award or any shares acquired pursuant thereto, including with respect to the period following a Participant's termination of Service, except that the Committee shall have no authority to take such action with respect to any Award that is subject to and is not exempt from the application of Section 409A;

(i) to amend, modify or correct any defect in the Plan or any Award in order to avoid the application of Sections 162(m), 280G or 409A of the Code to any Award or to the Plan;

(j) to prescribe, amend or rescind rules, guidelines and policies relating to the Plan, or to adopt sub-plans or supplements to, or alternative versions of, the Plan, including, without limitation, as the Committee deems necessary or desirable to comply with the laws or regulations of or to accommodate the tax policy, accounting principles or custom of, foreign jurisdictions whose citizens may be granted Awards; and

(k) to correct any defect, supply any omission or reconcile any inconsistency in the Plan or any Award Agreement and to make all other determinations and take such other actions with respect to the Plan or any Award as the Committee may deem advisable to the extent not inconsistent with the provisions of the Plan or applicable law.

3.6 *Indemnification.* In addition to such other rights of indemnification as they may have as members of the Board or the Committee or as officers or employees of the Participating Company Group, members of the Board or the Committee and any officers or employees of the Participating Company Group to whom authority to act for the Board, the Committee or the Company is delegated shall be indemnified by the Company against all reasonable expenses, including attorneys' fees, actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any

action taken or failure to act under or in connection with the Plan, or any right granted hereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by independent legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any such action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such person is liable for gross negligence, bad faith or intentional misconduct in duties; provided, however, that within sixty (60) days after the institution of such action, suit or proceeding, such person shall offer to the Company, in writing, the opportunity at its own expense to handle and defend the same.

4. SHARES SUBJECT TO PLAN.

4.1 *Maximum Number of Shares Issuable.* Subject to adjustment as provided in *Section 4.2*, the maximum aggregate number of shares of Stock that may be issued under the Plan shall be one million seven hundred and fifty thousand (1,750,000) and shall consist of authorized but unissued or reacquired shares of Stock or any combination thereof. If an outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if shares of Stock acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company at the Participant's purchase price, the shares of Stock allocable to the terminated portion of such Award or such forfeited or repurchased shares of Stock shall again be available for issuance under the Plan. Shares of Stock shall not be deemed to have been issued pursuant to the Plan (a) with respect to any portion of an Award that is settled in cash or (b) to the extent such shares are withheld in satisfaction of tax withholding obligations pursuant to *Section 14*. Upon payment in shares of Stock pursuant to the exercise of an SAR, the number of shares available for issuance under the Plan shall be reduced only by the number of shares actually issued in such payment. If the exercise price of an Option is paid by tender to the Company, or attestation to the ownership, of shares of Stock owned by the Participant, the number of shares available for issuance under the Plan shall be reduced by the net number of shares for which the Option is exercised.

4.2 *Adjustments for Changes in Capital Structure.* Subject to any required action by the shareholders of the Company, in the event of any change in the Stock effected without receipt of consideration by the Company, whether through merger, consolidation, reorganization, reincorporation, recapitalization, reclassification, stock dividend, stock split, reverse stock split, split-up, split-off, spin-off, combination of shares, exchange of shares, or similar change in the capital structure of the Company, or in the event of payment of a dividend or distribution to the shareholders of the Company in a form other than Stock (excepting normal cash dividends) that has a material effect on the Fair Market Value of shares of Stock, appropriate adjustments shall be made in the number and class of shares subject to the Plan and to any outstanding Awards, and in the exercise or purchase price per share under any outstanding Award in order to prevent dilution or enlargement of Participants' rights under the Plan. For purposes of the foregoing, conversion of any convertible securities of the Company shall not be treated as "**effected without receipt of consideration by the Company.**" Any fractional share resulting from an adjustment pursuant to this *Section 4.2* shall be rounded down to the nearest whole number, and in no event may the exercise or purchase price under any Award be decreased to an amount less than the par value, if any, of the stock subject to such Award. The adjustments determined by the Committee pursuant to this *Section 4.2* shall be final, binding and conclusive.

5. ELIGIBILITY AND AWARD LIMITATIONS.

5.1 *Persons Eligible for Awards.* Awards may be granted only to Employees, Consultants and Directors. For purposes of the foregoing sentence, "**Employees,**" "**Consultants**" and "**Directors**" shall include prospective Employees, prospective Consultants and prospective Directors to whom Awards are granted in connection with written offers of an employment or other service relationship with the Participating Company Group; provided, however, that no Stock subject to any such Award shall vest,

become exercisable or be issued prior to the date on which such person commences Service. The maximum number of shares of Stock with respect to an Award or Awards may be granted to any Participant under the Plan shall not exceed five percent (5%) of the total outstanding shares of Stock issued and outstanding.

5.2 *Participation.* Awards are granted solely at the discretion of the Committee. Eligible persons may be granted more than one (1) Award. However, eligibility in accordance with this Section shall not entitle any person to be granted an Award, or, having been granted an Award, to be granted an additional Award.

5.3 Incentive Stock Option Limitations.

(a) Persons Eligible. An Incentive Stock Option may be granted only to a person who, on the effective date of grant, is an Employee of the Company, a Parent Corporation or a Subsidiary Corporation (each being an "**ISO-Qualifying Corporation**"). Any person who is not an Employee of an ISO-Qualifying Corporation on the date of the grant of an Option to such person may be granted only a Nonstatutory Stock Option. An Incentive Stock Option granted to a prospective Employee upon the condition that such person become an Employee of an ISO-Qualifying Corporation shall be deemed granted effective on the date such person commences Service with an ISO-Qualifying Corporation, with an exercise price determined as of such date in accordance with *Section 6.1*.

(b) *Fair Market Value Limitation.* To the extent that options designated as Incentive Stock Options (granted under all stock option plans of the Participating Company Group, including the Plan) become exercisable by a Participant for the first time during any calendar year for stock having a Fair Market Value greater than One Hundred Thousand Dollars ($100,000), the portion of such options which exceeds such amount shall be treated as Nonstatutory Stock Options. For purposes of this Section, options designated as Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of stock shall be determined as of the time the option with respect to such stock is granted. If the Code is amended to provide for a different limitation from that set forth in this Section, such different limitation shall be deemed incorporated herein effective as of the date and with respect to such Options as required or permitted by such amendment to the Code. If an Option is treated as an Incentive Stock Option in part and as a Nonstatutory Stock Option in part by reason of the limitation set forth in this Section, the Participant may designate which portion of such Option the Participant is exercising. In the absence of such designation, the Participant shall be deemed to have exercised the Incentive Stock Option portion of the Option first. Upon exercise, shares issued pursuant to each such portion shall be separately identified.

6. *TERMS AND CONDITIONS OF OPTIONS.* Options shall be evidenced by Award Agreements specifying the number of shares of Stock covered thereby, in such form as the Committee shall from time to time establish. No Option or purported Option shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Options may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

6.1 *Exercise Price.* The exercise price for each Option shall be established in the discretion of the Committee; provided, however, that (a) the exercise price per share shall be not less than the Fair Market Value of a share of Stock on the date of grant of the Option and (b) no Incentive Stock Option granted to a Ten Percent Owner shall have an exercise price per share less than one hundred ten percent (110%) of the Fair Market Value of a share of Stock on the effective date of grant of the Option. Notwithstanding the foregoing, an Option (whether an Incentive Stock Option or a Nonstatutory Stock Option) may be substituted for another option or an Option may be assumed in a corporate transaction and not be treated as the grant of an Option if the substitution or modification

qualifies under the provisions of Section 424(a) of the Code and the Treasury Regulations issued thereunder or under Section 409A, as applicable.

6.2 *Exercisability and Term of Options.* Options shall be exercisable at such time or times, or upon such event or events, and subject to such terms, conditions, performance criteria and restrictions as shall be determined by the Committee and set forth in the Award Agreement evidencing such Option; provided, however, that (a) no Option shall be exercisable after the expiration of ten (10) years after the effective date of grant of such Option, (b) no Incentive Stock Option granted to a Ten Percent Owner shall be exercisable after the expiration of five (5) years after the effective date of grant of such Option, and (c) no Option granted to a prospective Employee, prospective Consultant or prospective Director may become exercisable prior to the date on which such person commences Service. Subject to the foregoing, unless otherwise specified by the Committee in the grant of an Option, any Option granted hereunder shall terminate ten (10) years after the effective date of grant of the Option, unless earlier terminated in accordance with its provisions.

6.3 Payment of Exercise Price.

(a) *Forms of Consideration Authorized.* Except as otherwise provided below, payment of the exercise price for the number of shares of Stock being purchased pursuant to any Option shall be made (i) in cash, by check or in cash equivalent, (ii) by tender to the Company, or attestation to the ownership, of shares of Stock owned by the Participant having a Fair Market Value not less than the exercise price, (iii) by delivery of a properly executed notice of exercise together with irrevocable instructions to a broker providing for the assignment to the Company of the proceeds of a sale or loan with respect to some or all of the shares being acquired upon the exercise of the Option (including, without limitation, through an exercise complying with the provisions of Regulation T as promulgated from time to time by the Board of Governors of the Federal Reserve System) (a "**Cashless Exercise**"), (iv) by such other consideration as may be approved by the Committee from time to time to the extent permitted by applicable law, or (v) by any combination thereof. The Committee may at any time or from time to time grant Options which do not permit all of the foregoing forms of consideration to be used in payment of the exercise price or which otherwise restrict one or more forms of consideration.

(b) Limitations on Forms of Consideration.

(i) *Tender of Stock.* Notwithstanding the foregoing, an Option may not be exercised by tender to the Company, or attestation to the ownership, of shares of Stock to the extent such tender or attestation would constitute a violation of the provisions of any law, regulation or agreement restricting the redemption of the Company's stock. Unless otherwise provided by the Committee, an Option may not be exercised by tender to the Company, or attestation to the ownership, of shares of Stock unless such shares either have been owned by the Participant for more than six (6) months (and not used for another Option exercise by attestation during such period) or were not acquired, directly or indirectly, from the Company.

(ii) *Cashless Exercise.* The Company reserves, at any and all times, the right, in the Company's sole and absolute discretion, to establish, decline to approve or terminate any program or procedures for the exercise of Options by means of a Cashless Exercise, including with respect to one or more Participants specified by the Company notwithstanding that such program or procedures may be available to other Participants.

6.4 Effect of Termination of Service.

(a) *Option Exercisability.* Subject to earlier termination of the Option as otherwise provided herein and unless otherwise provided by the Committee in the grant of an Option and set forth in the Award Agreement, an Option shall be exercisable after a Participant's termination

of Service only during the applicable time period determined in accordance with this Section and thereafter shall terminate:

(i) *Disability.* If the Participant's Service terminates because of the Disability of the Participant, the Option, to the extent unexercised and exercisable on the date on which the Participant's Service terminated, may be exercised by the Participant (or the Participant's guardian or legal representative) at any time prior to the expiration of one (1) year) (or such longer period of time as determined by the Committee, in its discretion) after the date on which the Participant's Service terminated, but in any event no later than the date of expiration of the Option's term as set forth in the Award Agreement evidencing such Option (the "**Option Expiration Date**").

(ii) *Death.* If the Participant's Service terminates because of the death of the Participant, the Option, to the extent unexercised and exercisable on the date on which the Participant's Service terminated, may be exercised by the Participant's legal representative or other person who acquired the right to exercise the Option by reason of the Participant's death at any time prior to the expiration of one (1) year) (or such longer period of time as determined by the Committee, in its discretion) after the date on which the Participant's Service terminated, but in any event no later than the Option Expiration Date. The Participant's Service shall be deemed to have terminated on account of death if the Participant dies within ninety (90) days (or such longer period of time as determined by the Committee, in its discretion) after the Participant's termination of Service.

(iii) *Termination for Cause.* Notwithstanding any other provision of the Plan to the contrary, if the Participant's Service is terminated for Cause, the Option shall terminate and cease to be exercisable immediately upon such termination of Service.

(iv) *Other Termination of Service.* If the Participant's Service terminates for any reason, except Disability, death or Cause, the Option, to the extent unexercised and exercisable by the Participant on the date on which the Participant's Service terminated, may be exercised by the Participant at any time prior to the expiration of ninety (90) days (or such longer period of time as determined by the Committee, in its discretion) after the date on which the Participant's Service terminated, but in any event no later than the Option Expiration Date.

(b) *Extension if Exercise Prevented by Law.* Notwithstanding the foregoing, other than termination of Service for Cause, if the exercise of an Option within the applicable time periods set forth in *Section 6.4(a)* is prevented by the provisions of *Section 13* below, the Option shall remain exercisable until ninety (90) days (or with respect to a Nonstatutory Option such longer period of time as determined by the Committee, in its discretion) after the date the Participant is notified by the Company that the Option is exercisable, but in any event no later than the Option Expiration Date.

(c) *Extension if Participant Subject to Section 16(b).* Notwithstanding the foregoing, other than termination of Service for Cause, if a sale within the applicable time periods set forth in *Section 6.4(a)* of shares acquired upon the exercise of a Nonstatutory Option would subject the Participant to suit under Section 16(b) of the Exchange Act, the Nonstatutory Option shall remain exercisable until the earliest to occur of (i) the tenth (10th) day following the date on which a sale of such shares by the Participant would no longer be subject to such suit, (ii) the one hundred and ninetieth (190th) day after the Participant's termination of Service, or (iii) the Option Expiration Date.

6.5 *Transferability of Options.* During the lifetime of the Participant, an Option shall be exercisable only by the Participant or the Participant's guardian or legal representative. Prior to the

issuance of shares of Stock upon the exercise of an Option, the Option shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution.

7. *TERMS AND CONDITIONS OF STOCK APPRECIATION RIGHTS.* Stock Appreciation Rights shall be evidenced by Award Agreements specifying the number of shares of Stock subject to the Award, in such form as the Committee shall from time to time establish. No SAR or purported SAR shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing SARs may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

7.1 *Types of SARs Authorized.* SARs may be granted in tandem with all or any portion of a related Option (a "**Tandem SAR**") or may be granted independently of any Option (a "**Freestanding SAR**").

7.2 *Exercise Price.* The exercise price for each SAR shall be established in the discretion of the Committee; provided, however, that (a) the exercise price per share subject to a Tandem SAR shall be the exercise price per share under the related Option and (b) the exercise price per share subject to a Freestanding SAR shall be not less than the Fair Market Value of a share of Stock on the effective date of grant of the SAR.

7.3 Exercisablity and Term of SARS.

(a) *Tandem SARs.* Tandem SARs shall be exercisable only at the time and to the extent, and only to the extent, that the related Option is exercisable, subject to such provisions as the Committee may specify where the Tandem SAR is granted with respect to less than the full number of shares of Stock subject to the related Option. The Committee may, in its discretion, provide in any Award Agreement evidencing a Tandem SAR that such SAR may not be exercised without the advance approval of the Company and, if such approval is not given, then the Option shall nevertheless remain exercisable in accordance with its terms. A Tandem SAR shall terminate and cease to be exercisable no later than the date on which the related Option expires or is terminated or canceled. Upon the exercise of a Tandem SAR with respect to some or all of the shares subject to such SAR, the related Option shall be canceled automatically as to the number of shares with respect to which the Tandem SAR was exercised. Upon the exercise of an Option related to a Tandem SAR as to some or all of the shares subject to such Option, the related Tandem SAR shall be canceled automatically as to the number of shares with respect to which the related Option was exercised.

(b) *Freestanding SARs.* Freestanding SARs shall be exercisable at such time or times, or upon such event or events, and subject to such terms, conditions, performance criteria and restrictions as shall be determined by the Committee and set forth in the Award Agreement evidencing such SAR; provided, however, that no Freestanding SAR shall be exercisable after the expiration of five (5) years after the effective date of grant of such SAR.

7.4 *Exercise of SARs.* Upon the exercise (or deemed exercise pursuant to *Section 7.5*) of an SAR, the Participant (or the Participant's legal representative or other person who acquired the right to exercise the SAR by reason of the Participant's death) shall be entitled to receive payment of an amount for each share with respect to which the SAR is exercised equal to the excess, if any, of the Fair Market Value of a share of Stock on the date of exercise of the SAR over the exercise price. Payment of such amount shall be made in cash, shares of Stock, or any combination thereof as determined by the Committee. Unless otherwise provided in the Award Agreement evidencing such SAR, payment shall be made in a lump sum as soon as practicable following the date of exercise of the SAR. The Award Agreement evidencing any SAR may provide for payment in a lump sum or deferred

payment in installments. When payment is to be made in shares of Stock, the number of shares to be issued shall be determined on the basis of the Fair Market Value of a share of Stock on the date of exercise of the SAR. For purposes of *Section 7*, an SAR shall be deemed exercised on the date on which the Company receives notice of exercise from the Participant.

7.5 *Deemed Exercise of SARs.* If, on the date on which an SAR would otherwise terminate or expire, the SAR by its terms remains exercisable immediately prior to such termination or expiration and, if so exercised, would result in a payment to the holder of such SAR, then any portion of such SAR which has not previously been exercised shall automatically be deemed to be exercised as of such date with respect to such portion and payment shall be made to the Participant (or such Participant's legal representative or other person who acquired the right to receive such payment by reason of the Participant's death).

7.6 *Effect of Termination of Service.* Subject to earlier termination of the SAR as otherwise provided herein and unless otherwise provided by the Committee in the grant of an SAR and set forth in the Award Agreement, an SAR shall be exercisable after a Participant's termination of Service only during the applicable time period determined in accordance with *Section 6.4* (treating the SAR as if it were an Option) and thereafter shall terminate.

7.7 *Nontransferability of SARs.* During the lifetime of the Participant, an SAR shall be exercisable only by the Participant or the Participant's guardian or legal representative. Prior to the exercise of an SAR, the SAR shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution.

8. *TERMS AND CONDITIONS OF RESTRICTED STOCK AWARDS.* Restricted Stock Awards shall be evidenced by Award Agreements specifying the number of shares of Stock subject to the Award, in such form as the Committee shall from time to time establish. No Restricted Stock Award or purported Restricted Stock Award shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Restricted Stock Awards may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

8.1 Restricted Stock Awards Authorized. Restricted Stock Awards may be granted upon such conditions as the Committee shall determine, including, without limitation, upon the attainment of one or more Performance Goals described in *Section 9.4*. If either the grant of a Restricted Stock Award or the lapsing of the Restriction Period is to be contingent upon the attainment of one or more Performance Goals, the Committee shall follow procedures substantially equivalent to those set forth in *Sections 9.3* through *9.5(a)*.

8.2 *Vesting and Restrictions on Transfer.* Shares issued pursuant to any Restricted Stock Award may or may not be made subject to Vesting Conditions based upon the satisfaction of such Service requirements, conditions, restrictions or performance criteria, including, without limitation, Performance Goals as described in *Section 9.4*, as shall be established by the Committee and set forth in the Award Agreement evidencing such Award. During any Restriction Period in which shares acquired pursuant to a Restricted Stock Award remain subject to Vesting Conditions, such shares may not be sold, exchanged, transferred, pledged, assigned or otherwise disposed of other than pursuant to an Ownership Change Event, as defined in *Section 13.1*, or as provided in *Section 8.5*. Upon request by the Company, each Participant shall execute any agreement evidencing such transfer restrictions prior to the receipt of shares of Restricted Stock and shall promptly present to the Company any and all certificates representing shares of Restricted Stock acquired hereunder for the placement on such certificates of appropriate legends evidencing any such transfer restrictions.

8.3 *Voting Rights; Dividends and Distributions.* Except as provided in this *Section 8.3* and any Award Agreement, during the Restriction Period applicable to shares subject to a Restricted Stock Award, the Participant shall have all of the rights of a shareholder of the Company holding shares of Stock, including the right to vote such shares and to receive all dividends and other distributions paid with respect to such shares. However, in the event of a dividend or distribution paid in shares of Stock or any other adjustment made upon a change in the capital structure of the Company as described in *Section 4.2*, then any and all new, substituted or additional securities or other property (other than normal cash dividends) to which the Participant is entitled by reason of the Participant's Restricted Stock Award shall be immediately subject to the same Vesting Conditions as the shares subject to the Restricted Stock Award with respect to which such dividends or distributions were paid or adjustments were made.

8.4 *Effect of Termination of Service.* Unless otherwise provided by the Committee in the grant of a Restricted Stock Award and set forth in the Award Agreement, if a Participant's Service terminates for any reason, whether voluntary or involuntary (including the Participant's death or disability), then the Participant shall forfeit to the Company any shares acquired by the Participant pursuant to a Restricted Stock Award which remain subject to Vesting Conditions as of the date of the Participant's termination of Service.

8.5 *Nontransferability of Restricted Stock Award Rights.* Prior to the issuance of shares of Stock pursuant to a Restricted Stock Award, rights to acquire such shares shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or the laws of descent and distribution. All rights with respect to a Restricted Stock Award granted to a Participant hereunder shall be exercisable during his or her lifetime only by such Participant or the Participant's guardian or legal representative.

8.6 *Issuance and Delivery of Shares.* Any Restricted Stock granted under the Plan shall be issued at the time such Awards are granted and may be evidenced in such manner as the Committee may deem appropriate, including book-entry registration or issuance of a stock certificate or certificates, which certificate or certificates shall be held by the Company (or in an escrow established by the Company). Such certificate or certificates shall be registered in the name of the Participant and shall bear an appropriate legend referring to the restrictions applicable to such Restricted Stock. Shares representing Restricted Stock that is no longer subject to restrictions shall be delivered to the Participant promptly after the applicable restrictions lapse or are waived.

9. *TERMS AND CONDITIONS OF PERFORMANCE AWARDS.* Performance Awards shall be evidenced by Award Agreements in such form as the Committee shall from time to time establish. No Performance Award or purported Performance Award shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Performance Awards may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

9.1 *Types of Performance Awards Authorized.* Performance Awards may be in the form of either Performance Shares or Performance Units. Each Award Agreement evidencing a Performance Award shall specify the number of Performance Shares or Performance Units subject thereto, the Performance Award Formula, the Performance Goal(s) and Performance Period applicable to the Award, and the other terms, conditions and restrictions of the Award.

9.2 *Initial Value of Performance Shares and Performance Units.* Unless otherwise provided by the Committee in granting a Performance Award, each Performance Share shall have an initial value equal to the Fair Market Value of one (1) share of Stock, subject to adjustment as provided in *Section 4.2*, on the effective date of grant of the Performance Share, and each Performance Unit shall have an initial value of one hundred dollars ($100). The final value payable to the Participant in

settlement of a Performance Award determined on the basis of the applicable Performance Award Formula will depend on the extent to which Performance Goals established by the Committee are attained within the applicable Performance Period established by the Committee.

9.3 *Establishment of Performance Period, Performance Goals and Performance Award Formula.* In granting each Performance Award, the Committee shall establish in writing the applicable Performance Period, Performance Award Formula and one or more Performance Goals which, when measured at the end of the Performance Period, shall determine on the basis of the Performance Award Formula the final value of the Performance Award to be paid to the Participant. Unless otherwise permitted in compliance with the requirements under Section 162(m) with respect to "**performance-based compensation,**" the Committee shall establish the Performance Goal(s) and Performance Award Formula applicable to each Performance Award no later than the earlier of (a) the date ninety (90) days after the commencement of the applicable Performance Period or (b) the date on which 25% of the Performance Period has elapsed, and, in any event, at a time when the outcome of the Performance Goals remains substantially uncertain. Once established, the Performance Goals and Performance Award Formula shall not be changed during the Performance Period. The Company shall notify each Participant granted a Performance Award of the terms of such Award, including the Performance Period, Performance Goal(s) and Performance Award Formula.

9.4 *Measurement of Performance Goals.* Performance Goals shall be established by the Committee on the basis of targets to be attained ("**Performance Targets**") with respect to one or more measures of business or financial performance (each, a "**Performance Measure**"), subject to the following:

(a) *Performance Measures.* Performance Measures shall have the same meanings as used in the Company's financial statements, or, if such terms are not used in the Company's financial statements, they shall have the meaning applied pursuant to generally accepted accounting principles, or as used generally in the financial banking industry. Performance Measures shall be calculated with respect to the Company and each Subsidiary Corporation consolidated therewith for financial reporting purposes or such division or other business unit as may be selected by the Committee. For purposes of the Plan, unless otherwise determined by the Committee at the time the Committee establishes the Performance Goal(s) and Performance Award Formula applicable to a Performance Award, the Performance Measures applicable to a Performance Award shall be calculated in accordance with generally accepted accounting principles, but prior to the accrual or payment of any Performance Award for the same Performance Period and excluding the effect (whether positive or negative) of any change in accounting standards or any extraordinary, unusual or nonrecurring item, as determined by the Committee, occurring after the establishment of the Performance Goals applicable to the Performance Award. Performance Measures may be one or more of the following, as determined by the Committee: revenue, costs, expenses (including expense efficiency ratios and other expense measures), earnings (including one or more of net profit after tax, gross profit, operating profit, earnings before interest and taxes, earnings before interest, taxes, depreciation and amortization and net earnings), earnings per share, earnings per share from continuing operations, operating income, pre-tax income, operating income margin, net income, margins (including one or more of gross, operating and net income margins), returns (including one or more of return on actual or proforma assets, net assets, equity, investment, capital and net capital employed), shareholder return (including total shareholder return relative to an index or peer group), stock price, growth of loans and deposits, economic value added, cash generation, cash flow, unit volume, working capital, market share, cost reductions and strategic plan development and implementation. Such goals may reflect absolute entity or business unit performance or a relative comparison to the performance of a peer group of entities or other external measure of the selected performance criteria. Pursuant to rules and conditions adopted by the Committee on or before the 90th day of the applicable

performance period for which Performance Goals are established, the Committee may appropriately adjust (provided the outcome remains substantially uncertain) any evaluation of performance under such goals to exclude the effect of certain events, including any of the following events: asset write-downs; litigation or claim judgments or settlements; changes in tax law, accounting principles or other such laws or provisions affecting reported results; severance, contract termination and other costs related to exiting certain business activities; and gains or losses from the disposition of businesses or assets or from the early extinguishment of debt.

(b) *Performance Targets.* Performance Targets may include a minimum, maximum, target level and intermediate levels of performance, with the final value of a Performance Award determined under the applicable Performance Award Formula by the level attained during the applicable Performance Period. A Performance Target may be stated as an absolute value or as a value determined relative to a standard selected by the Committee.

9.5 Settlement of Performance Awards.

(a) *Determination of Final Value.* As soon as practicable following the completion of the Performance Period applicable to a Performance Award, the Committee shall certify in writing the extent to which the applicable Performance Goals have been attained and the resulting final value of the Award earned by the Participant and to be paid upon its settlement in accordance with the applicable Performance Award Formula.

(b) *Discretionary Adjustment of Award Formula.* In its discretion, the Committee may, either at the time it grants a Performance Award or at any time thereafter, provide for the positive or negative adjustment of the Performance Award Formula applicable to a Performance Award granted to any Participant who is not a "**covered employee**" within the meaning of Section 162(m) (a "**Covered Employee**") to reflect such Participant's individual performance in his or her position with the Company or such other factors as the Committee may determine. If permitted under a Covered Employee's Award Agreement, the Committee shall have the discretion, on the basis of such criteria as may be established by the Committee, to reduce some or all of the value of the Performance Award that would otherwise be paid to the Covered Employee upon its settlement notwithstanding the attainment of any Performance Goal and the resulting value of the Performance Award determined in accordance with the Performance Award Formula. No such reduction may result in an increase in the amount payable upon settlement of another Participant's Performance Award.

(c) *Effect of Leaves of Absence.* Unless otherwise required by law, payment of the final value, if any, of a Performance Award held by a Participant who has taken in excess of thirty (30) days in leaves of absence during a Performance Period shall be prorated on the basis of the number of days of the Participant's Service during the Performance Period during which the Participant was not on a leave of absence.

(d) *Notice to Participants.* As soon as practicable following the Committee's determination and certification in accordance with *Sections 9.5(a)* and *(b)*, the Company shall notify each Participant of the determination of the Committee.

(e) *Payment in Settlement of Performance Awards.* As soon as practicable following the Committee's determination and certification in accordance with *Sections 9.5(a)* and *(b)*, payment shall be made to each eligible Participant (or such Participant's legal representative or other person who acquired the right to receive such payment by reason of the Participant's death) of the final value of the Participant's Performance Award. Payment of such amount shall be made in cash, shares of Stock, or a combination thereof as determined by the Committee. Unless otherwise provided in the Award Agreement evidencing a Performance Award, payment shall be made in a lump sum. In no event shall payment of a Performance Award be made later than the

15th day of the third month following the taxable year of the Participant in which the Participant has a legally binding right to the Performance Award.

(f) *Provisions Applicable to Payment in Shares.* If payment is to be made in shares of Stock, the number of such shares shall be determined by dividing the final value of the Performance Award by the Fair Market Value of a share of Stock. Shares of Stock issued in payment of any Performance Award may be fully vested and freely transferable shares or may be shares of Stock subject to Vesting Conditions as provided in *Section 8.2*. Any shares subject to Vesting Conditions shall be evidenced by an appropriate Award Agreement and shall be subject to the provisions of *Sections 8.2* through *8.5* above.

9.6 *Voting Rights; Dividend Equivalent Rights and Distributions.* Participants shall have no voting rights with respect to shares of Stock represented by Performance Share Awards until the date of the issuance of such shares, if any (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). However, the Committee, in its discretion, may provide in the Award Agreement evidencing any Performance Share Award that the Participant shall be entitled to receive Dividend Equivalents with respect to the payment of cash dividends on Stock having a record date prior to the date on which the Performance Shares are settled or forfeited. Such Dividend Equivalents, if any, shall be credited to the Participant in the form of additional whole Performance Shares as of the date of payment of such cash dividends on Stock. The number of additional Performance Shares (rounded to the nearest whole number) to be so credited shall be determined by dividing (a) the amount of cash dividends paid on such date with respect to the number of shares of Stock represented by the Performance Shares previously credited to the Participant by (b) the Fair Market Value per share of Stock on such date. Dividend Equivalents may be paid currently or may be accumulated and paid to the extent that Performance Shares become nonforfeitable, as determined by the Committee in the Award Agreement. Settlement of Dividend Equivalents may be made in cash, shares of Stock, or a combination thereof as determined by the Committee in the Award Agreement, and may be paid on the same basis as settlement of the related Performance Share as provided in *Section 9.5*. Dividend Equivalents shall not be paid with respect to Performance Units. In the event of a dividend or distribution paid in shares of Stock or any other adjustment made upon a change in the capital structure of the Company as described in *Section 4.2*, appropriate adjustments shall be made in the Participant's Performance Share Award so that it represents the right to receive upon settlement any and all new, substituted or additional securities or other property (other than normal cash dividends) to which the Participant would entitled by reason of the shares of Stock issuable upon settlement of the Performance Share Award, and all such new, substituted or additional securities or other property shall be immediately subject to the same Performance Goals as are applicable to the Award.

9.7 *Effect of Termination of Service.* Unless otherwise provided by the Committee in the grant of a Performance Award and set forth in the Award Agreement, the effect of a Participant's termination of Service on the Performance Award shall be as follows:

(a) Death or Disability. If the Participant's Service terminates because of the death or Disability of the Participant before the completion of the Performance Period applicable to the Performance Award, the final value of the Participant's Performance Award shall be determined by the extent to which the applicable Performance Goals have been attained with respect to the entire Performance Period and shall be prorated based on the number of months of the Participant's Service during the Performance Period. Payment shall be made following the end of the Performance Period within the time period specified by *Section 9.5(e)* in any manner permitted by *Section 9.5*.

(b) *Other Termination of Service.* If the Participant's Service terminates for any reason except death or Disability before the completion of the Performance Period applicable to the

Performance Award, such Award shall be forfeited in its entirety; provided, however, that in the event of an involuntary termination of the Participant's Service, the Committee, in its sole discretion, may waive the automatic forfeiture of all or any portion of any such Award.

9.8 *Nontransferability of Performance Awards.* Prior to settlement in accordance with the provisions of the Plan, no Performance Award shall be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. All rights with respect to a Performance Award granted to a Participant hereunder shall be exercisable during his or her lifetime only by such Participant or the Participant's guardian or legal representative.

10. *TERMS AND CONDITIONS OF RESTRICTED STOCK UNIT AWARDS.* Restricted Stock Unit Awards shall be evidenced by Award Agreements specifying the number of Restricted Stock Units subject to the Award, in such form as the Committee shall from time to time establish. No Restricted Stock Unit Award or purported Restricted Stock Unit Award shall be a valid and binding obligation of the Company unless evidenced by a fully executed Award Agreement. Award Agreements evidencing Restricted Stock Units may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

10.1 Grant of Restricted Stock Unit Awards. Restricted Stock Unit Awards may be granted upon such conditions as the Committee shall determine, including, without limitation, upon the attainment of one or more Performance Goals described in *Section 9.4*. If either the grant of a Restricted Stock Unit Award or the Vesting Conditions with respect to such Award is to be contingent upon the attainment of one or more Performance Goals, the Committee shall follow procedures substantially equivalent to those set forth in *Sections 9.3* through *9.5(a)*.

10.2 *Purchase Price.* No monetary payment (other than applicable tax withholding, if any) shall be required as a condition of receiving a Restricted Stock Unit Award.

10.3 *Vesting.* Restricted Stock Units may or may not be made subject to Vesting Conditions based upon the satisfaction of such Service requirements, conditions, restrictions or performance criteria, including, without limitation, Performance Goals as described in *Section 9.4*, as shall be established by the Committee and set forth in the Award Agreement evidencing such Award.

10.4 *Voting Rights, Dividend Equivalent Rights and Distributions.* Participants shall have no voting rights with respect to shares of Stock represented by Restricted Stock Units until the date of the issuance of such shares (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). However, the Committee, in its discretion, may provide in the Award Agreement evidencing any Restricted Stock Unit Award that the Participant shall be entitled to receive Dividend Equivalents with respect to the payment of cash dividends on Stock having a record date prior to date on which Restricted Stock Units held by such Participant are settled. Such Dividend Equivalents, if any, shall be paid by crediting the Participant with additional whole Restricted Stock Units as of the date of payment of such cash dividends on Stock. The number of additional Restricted Stock Units (rounded to the nearest whole number) to be so credited shall be determined by dividing (a) the amount of cash dividends paid on such date with respect to the number of shares of Stock represented by the Restricted Stock Units previously credited to the Participant by (b) the Fair Market Value per share of Stock on such date. Such additional Restricted Stock Units shall be subject to the same terms and conditions and shall be settled in the same manner and at the same time (or as soon thereafter as practicable) as the Restricted Stock Units originally subject to the Restricted Stock Unit Award. In the event of a dividend or distribution paid in shares of Stock or any other adjustment made upon a change in the capital structure of the Company as described in *Section 4.2*, appropriate adjustments shall be made in the Participant's Restricted Stock Unit Award so that it represents the right to receive upon settlement any and all new, substituted or additional

securities or other property (other than normal cash dividends) to which the Participant would entitled by reason of the shares of Stock issuable upon settlement of the Award, and all such new, substituted or additional securities or other property shall be immediately subject to the same Vesting Conditions as are applicable to the Award.

10.5 *Effect of Termination of Service.* Unless otherwise provided by the Committee in the grant of a Restricted Stock Unit Award and set forth in the Award Agreement, if a Participant's Service terminates for any reason, whether voluntary or involuntary (including the Participant's death or disability), then the Participant shall forfeit to the Company any Restricted Stock Units pursuant to the Award which remain subject to Vesting Conditions as of the date of the Participant's termination of Service.

10.6 *Settlement of Restricted Stock Unit Awards.* The Company shall issue to a Participant on the earlier of the date on which Restricted Stock Units subject to the Participant's Restricted Stock Unit Award satisfy applicable Vesting Conditions or on such other date determined by the Committee, in its discretion and set forth in the Award Agreement but no later than the 15th day of the third month following the taxable year of the Participant in which the Participant has satisfied the applicable Vesting Conditions, one (1) share of Stock (and/or any other new, substituted or additional securities or other property pursuant to an adjustment described in *Section 10.4*) for each Restricted Stock Unit then becoming vested or otherwise to be settled on such date, subject to the withholding of applicable taxes.

10.7 *Nontransferability of Restricted Stock Unit Awards.* Prior to the issuance of shares of Stock in settlement of a Restricted Stock Unit Award, the Award shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. All rights with respect to a Restricted Stock Unit Award granted to a Participant hereunder shall be exercisable during his or her lifetime only by such Participant or the Participant's guardian or legal representative.

11. STANDARD FORMS OF AWARD AGREEMENT.

11.1 *Award Agreements.* Each Award shall comply with and be subject to the terms and conditions set forth in the appropriate form of Award Agreement approved by the Committee and as amended from time to time. Any Award Agreement may consist of an appropriate form of Notice of Grant and a form of Agreement incorporated therein by reference, or such other form or forms as the Committee may approve from time to time.

11.2 *Authority to Vary Terms.* The Committee shall have the authority from time to time to vary the terms of any standard form of Award Agreement either in connection with the grant or amendment of an individual Award or in connection with the authorization of a new standard form or forms; provided, however, that the terms and conditions of any such new, revised or amended standard form or forms of Award Agreement are not inconsistent with the terms of the Plan.

12. CHANGE IN CONTROL.

12.1 Definitions.

(a) An "**Ownership Change Event**" shall be deemed to have occurred if any of the following occurs with respect to the Company: (i) the direct or indirect sale or exchange in a single or series of related transactions by the shareholders of the Company of more than fifty percent (50%) of the voting stock of the Company; (ii) a merger, reorganization or consolidation in which the Company is a party; (iii) the sale, exchange, or transfer of all or substantially all of the assets of the Company (other than a sale, exchange or transfer to one or more subsidiaries of the Company); or (iv) a liquidation or dissolution of the Company.

(b) A "**Change in Control**" shall mean (i) an Ownership Change Event or series of related Ownership Change Events (collectively, a "**Transaction**") in which the shareholders of the Company immediately before the Transaction do not retain immediately after or acquire in the Transaction, in substantially the same proportions as their ownership of shares of the Company's voting stock immediately before the Transaction, direct or indirect beneficial ownership of more than fifty percent (50%) of the total combined voting power of the outstanding voting securities of the Company, or in the case of an Ownership Change Event described in *Section 12.1(a)(iii)*, the entity to which the assets of the Company were transferred (the "**Transferee**"), (ii) a sale of equity securities of the Company representing more than fifty percent (50%) of the total combined voting power of the outstanding voting securities of the Company, or (iii) a liquidation or dissolution of the Company. For purposes of the preceding sentence, indirect beneficial ownership shall include, without limitation, an interest resulting from ownership of the voting securities of one or more corporations or other business entities which own the Company or the Transferee, as the case may be, either directly or through one or more subsidiary corporations or other business entities. The Committee shall have the right to determine whether multiple sales or exchanges of the voting securities of the Company or multiple Ownership Change Events are related, and its determination shall be final, binding and conclusive. Notwithstanding the foregoing, in the case of an Award that is not exempt from Section 409A but rather is subject to Section 409A, (A) the exercise of the Committee's discretion shall be strictly ministerial and not involve the exercise of any discretionary authority, and (B) in no event shall a Transaction be treated as a Change in Control unless such event also qualifies as a change in ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation within the meaning of Treasury Regulations Section 1.409A-3(i)(5).

12.2 *Effect of Change in Control on Options.* Upon a Change of Control (i) the Company shall deliver to each Participant, no less than thirty (30) days prior to the consummation of the Change of Control, written notification of the proposed Change of Control and the Participant's right to exercise all Options granted pursuant to this Plan, whether or not vested under the Plan or applicable Option Award Agreement, and (ii) all outstanding Options granted pursuant to the Plan shall completely vest and become immediately exercisable as to all shares granted pursuant to the Option immediately prior to such Change of Control. This right of exercise shall be conditional upon consummation of the Change of Control. Upon the occurrence of the Change of Control all then outstanding Options shall terminate; provided, however, that any outstanding Options not exercised as of the occurrence of the Change of Control shall not terminate if there is a successor corporation which assumes the outstanding Options or substitutes for such Options, new options covering the stock of the successor corporation with appropriate adjustments as to the number and kind of shares and prices. Notwithstanding anything to the contrary herein, each adjustment made to an Incentive Stock Option shall comply with the rules of Section 424(a) of the Code, and no adjustment shall be made that would cause any Incentive Stock Option to become a Nonstatutory Stock Option.

12.3 *Effect of Change of Control on SAR Awards.* Notwithstanding any other provision of the Plan to the contrary, the Committee, in its sole discretion, may provide in any Award Agreement or, in the event of a Change in Control, may take such actions as it deems appropriate to provide for the acceleration of the exercisability and vesting in connection with such Change in Control of any or all outstanding SARs and shares acquired upon the exercise of such SARs upon such conditions and to such extent as the Committee shall determine.

12.4 *Effect of Change in Control on Restricted Stock Awards.* Each Award Agreement evidencing a Restricted Stock Award shall provide in the event of a Change in Control for the lapse of the Restriction Period applicable to the shares subject to the Restricted Stock Award held by a Participant whose Service has not terminated prior to the Change in Control, effective immediately prior to and conditioned upon the Change in Control.

12.5 *Effect of Change in Control on Performance Awards.* The Committee may, in its discretion, provide in any Award Agreement evidencing a Performance Award that, in the event of a Change in Control, the Performance Award held by a Participant whose Service has not terminated prior to the Change in Control shall become payable effective as of the date of the Change in Control to such extent as specified in such Award Agreement.

12.6 *Effect of Change in Control on Restricted Stock Unit Awards.* Each Award Agreement evidencing a Restricted Stock Unit Award shall provide that the Restricted Stock Unit Award held by a Participant whose Service has not terminated prior to the Change in Control shall be settled effective immediately prior to and conditioned upon the Change in Control.

13. *COMPLIANCE WITH SECURITIES LAW.* The grant of Awards and the issuance of shares of Stock pursuant to any Award shall be subject to compliance with all applicable requirements of federal, state and foreign law with respect to such securities and the requirements of any stock exchange or market system upon which the Stock may then be listed. In addition, no Award may be exercised or shares issued pursuant to an Award unless (a) a registration statement under the Securities Act shall at the time of such exercise or issuance be in effect with respect to the shares issuable pursuant to the Award or (b) in the opinion of legal counsel to the Company, the shares issuable pursuant to the Award may be issued in accordance with the terms of an applicable exemption from the registration requirements of the Securities Act. The inability of the Company to obtain from any regulatory body having jurisdiction the authority, if any, deemed by the Company's legal counsel to be necessary to the lawful issuance and sale of any shares hereunder shall relieve the Company of any liability in respect of the failure to issue or sell such shares as to which such requisite authority shall not have been obtained. As a condition to issuance of any Stock, the Company may require the Participant to satisfy any qualifications that may be necessary or appropriate, to evidence compliance with any applicable law or regulation and to make any representation or warranty with respect thereto as may be requested by the Company.

14. TAX WITHHOLDING.

14.1 *Tax Withholding in General.* The Company shall have the right to deduct from any and all payments made under the Plan, or to require the Participant, through payroll withholding, cash payment or otherwise, including by means of a Cashless Exercise of an Option, to make adequate provision for, the federal, state, local and foreign taxes, if any, required by law to be withheld by the Participating Company Group with respect to an Award or the shares acquired pursuant thereto. The Company shall have no obligation to deliver shares of Stock, to release shares of Stock from an escrow established pursuant to an Award Agreement, or to make any payment in cash under the Plan until the Participating Company Group's tax withholding obligations have been satisfied by the Participant.

14.2 *Withholding in Shares.* The Company shall have the right, but not the obligation, to deduct from the shares of Stock issuable to a Participant upon the exercise or settlement of an Award, or to accept from the Participant the tender of, a number of whole shares of Stock having a Fair Market Value, as determined by the Company, equal to all or any part of the tax withholding obligations of the Participating Company Group. The Fair Market Value of any shares of Stock withheld or tendered to satisfy any such tax withholding obligations shall not exceed the amount determined by the applicable minimum statutory withholding rates.

15. *AMENDMENT OR TERMINATION OF PLAN.* The Committee may amend, suspend or terminate the Plan at any time. However, without the approval of the Company's shareholders, there shall be (a) no increase in the maximum aggregate number of shares of Stock that may be issued under the Plan (except by operation of the provisions of *Section 4.2*), (b) no change in the class of persons eligible to receive Incentive Stock Options, and (c) no other amendment of the Plan that would require approval of the Company's shareholders under any applicable law, regulation or rule. No amendment, suspension or termination of the Plan shall affect any then outstanding Award unless expressly provided by the Committee. In any event, no amendment, suspension or termination of the Plan may adversely affect any

then outstanding Award without the consent of the Participant unless necessary to comply with any applicable law, regulation or rule.

16. MISCELLANEOUS PROVISIONS.

16.1 *Provision of Information.* Each Participant shall be given access to information concerning the Company equivalent to that information generally made available to the Company's common shareholders.

16.2 *Rights as Employee, Consultant or Director.* No person, even though eligible pursuant to *Section 5*, shall have a right to be selected as a Participant, or, having been so selected, to be selected again as a Participant. Nothing in the Plan or any Award granted under the Plan shall confer on any Participant a right to remain an Employee, Consultant or Director or interfere with or limit in any way any right of a Participating Company to terminate the Participant's Service at any time. To the extent that an Employee of a Participating Company other than the Company receives an Award under the Plan, that Award shall in no event be understood or interpreted to mean that the Company is the Employee's employer or that the Employee has an employment relationship with the Company.

16.3 *Rights as a Shareholder.* A Participant shall have no rights as a shareholder with respect to any shares covered by an Award until the date of the issuance of such shares (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such shares are issued, except as provided in *Section 4.2* or another provision of the Plan.

16.4 *Section 409A Provisions.* Notwithstanding anything in the Plan or any Award Agreement to the contrary, to the extent that any amount or benefit that constitutes "deferred compensation" to a Participant under Section 409A of the Code and applicable guidance thereunder is otherwise payable or distributable to a Participant under the Plan or any Award Agreement solely by reason of the occurrence of a Change in Control or due to the Participant's disability or "separation from service" (as such term is defined under Section 409A), such amount or benefit will not be payable or distributable to the Participant by reason of such circumstance unless the Committee determines in good faith that (i) the circumstances giving rise to such Change in Control, disability or separation from service meet the definition of a change in ownership or control, disability, or separation from service, as the case may be, in Section 409A(a)(2)(A) of the Code and Treasury Regulations, or (ii) the payment or distribution of such amount or benefit would be exempt from the application of Section 409A by reason of the short-term deferral exemption or otherwise. Any payment or distribution that otherwise would be made to a Participant who is a Specified Employee (as determined by the Committee in good faith) on account of separation from service may not be made before the date which is six (6) months after the date of the Specified Employee's separation from service unless the payment or distribution is exempt from the application of Section 409A by reason of the short term deferral exemption or otherwise.

16.5 *Fractional Shares.* The Company shall not be required to issue fractional shares upon the exercise or settlement of any Award.

16.6 *Severability.* If any one or more of the provisions (or any part thereof) of this Plan shall be held invalid, illegal or unenforceable in any respect, such provision shall be modified so as to make it valid, legal and enforceable, and the validity, legality and enforceability of the remaining provisions (or any part thereof) of the Plan shall not in any way be affected or impaired thereby.

16.7 *Beneficiary Designation.* Subject to applicable laws and procedures, each Participant may file with the Company a written designation of a beneficiary who is to receive any benefit under the Plan to which the Participant is entitled in the event of such Participant's death before he or she receives any or all of such benefit. Each designation will revoke all prior designations by the same

Participant, shall be in a form prescribed by the Company, and will be effective only when filed by the Participant in writing with the Company during the Participant's lifetime. If a married Participant designates a beneficiary other than the Participant's spouse, the effectiveness of such designation may be subject to the consent of the Participant's spouse. If a Participant dies without an effective designation of a beneficiary who is living at the time of the Participant's death, the Company will pay any remaining unpaid benefits to the Participant's legal representative.

HERITAGE COMMERCE CORP

2019 Annual Report on Form 10-K

Annual Report

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(MARK ONE)

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

or the fiscal year ended December 31, 2019

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission file number 000-23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

California	**77-0469558**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification Number)*

150 Almaden Boulevard
San Jose, California 95113
(Address of Principal Executive Offices including Zip Code)

(408) 947-6900
(Registrant's Telephone Number, Including Area Code)

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

Title of Each Class	Trading Symbol	Name of each exchange on which Registered
Common Stock, No Par Value	HTBK	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

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

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

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

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

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

Indicate by check mark 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 ☒ Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth 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 or 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 ☒

The aggregate market value of the common stock held by non-affiliates of the Registrant as of June 28, 2019, based upon the closing price on that date of $12.25 per share as reported on the NASDAQ Global Select Market, and 30,368,287 shares held, was approximately $372.0 million.

As of February 14, 2020, there were 59,548,859 shares of the Registrant's common stock (no par value) outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's finitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2020 Annual Meeting of Shareholders to be held on May 21, 2020 are incorporated by reference into Part III of this Report. The proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the Registrant's fiscal year ended December 31, 2019.

HERITAGE COMMERCE CORP

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FOR YEAR ENDED DECEMBER 31, 2019

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Cautionary Note Regarding Forward-Looking Statements

This Report on Form 10-K contains various statements that may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, Rule 3b-6 promulgated thereunder and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These forward-looking statements often can be, but are not always, identified by the use of words such as "assume," "expect," "intend," "plan," "project," "believe," "estimate," "predict," "anticipate," "may," "might," "should," "could," "goal," "potential" and similar expressions. We base these forward-looking statements on our current expectations and projections about future events, our assumptions regarding these events and our knowledge of facts at the time the statements are made. These statements include statements relating to our projected growth, anticipated future financial performance, and management's long-term performance goals, as well as statements relating to the anticipated effects on results of operations and financial condition.

These forward looking statements are subject to various risks and uncertainties that may be outside our control and our actual results could differ materially from our projected results. Risks and uncertainties that could cause our financial performance to differ materially from our goals, plans, expectations and projections expressed in forward-looking statements include those set forth in our filings with the Securities and Exchange Commission ("SEC"), Item 1A of this Annual Report on Form 10-K, and the following listed below:

- current and future economic and market conditions in the United States generally or in the communities we serve, including the effects of declines in property values and overall slowdowns in economic growth should these events occur;
- effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;
- our ability to anticipate interest rate changes and manage interest rate risk;
- changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources;
- volatility in credit and equity markets and its effect on the global economy;
- competition and innovation with respect to financial products and services by banks, financial institutions and non-traditional providers including retail businesses and technology companies;
- our ability to achieve loan growth and attract deposits;
- risks associated with concentrations in commercial and real estate related loans;
- the relative strength or weakness of the commercial and real estate markets where our borrowers are located;
- changes in the financial performance and/or condition of our borrowers, depositors, key vendors or counterparties;
- other than temporary impairment charges to our securities portfolio;
- changes in the level of nonperforming assets and charge offs and other credit quality measures, and their impact on the adequacy of the Company's allowance for loan losses and the Company's provision for loan losses;
- increased capital requirements for our continued growth or as imposed by banking regulators, which may require us to raise capital at a time when capital is not available on favorable terms if at all;
- regulatory limits on Heritage Bank of Commerce's ability to pay dividends to the holding company;

- changes in our capital management policies, including those regarding business combinations, dividends, and share repurchases;

- operational issues stemming from, and/or capital spending necessitated by, the potential need to adapt to industry changes in information technology systems, on which we are highly dependent;

- our inability to attract, recruit, and retain qualified officers and other personnel could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, and results of operations;

- the potential increase in reserves and allowance for loan loss as a result of the transition to the current expected credit loss standard ("CECL") established by the Financial Accounting Standards Board to account for future expected credit losses;

- possible impairment of our goodwill and other intangible assets;

- possible adjustment of the valuation of our deferred tax assets;

- our ability to keep pace with technological changes, including our ability to identify and address cyber-security risks such as data security breaches, "denial of service" attacks, "hacking" and identity theft;

- inability of our framework to manage risks associated with our business, including operational risk and credit risk;

- risks of loss of funding of Small Business Administration or SBA loan programs, or changes in those programs;

- compliance with governmental and regulatory requirements, including the Dodd-Frank Act and others relating to banking, consumer protection, securities , accounting and tax matters;

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

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

- availability and competition for acquisition opportunities;

- political developments, uncertainties or instability, catastrophic events, acts of war or terrorism, or natural disasters, such as earthquakes, drought, pandemic diseases or extreme weather events, any of which may affect services we use or affect our customers, employees or third parties with which we conduct business;

- our ability to realize the expected cost savings, synergies and other business or financial benefits from the Presidio Bank acquisition completed on October 11, 2019 within the expected time frames or at all; or higher than estimated merger related transactional costs; and

- our success in managing the risks involved in the foregoing factors.

Forward-looking statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events. *You should consider any forward looking statements in light of this explanation, and we caution you about relying on forward-looking statements.*

PART I

ITEM 1 — *BUSINESS*

General

Heritage Commerce Corp, a California corporation organized in 1997, is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. We provide a wide range of banking services through Heritage Bank of Commerce, our wholly-owned subsidiary. Heritage Bank of Commerce is a California state-chartered bank headquartered in San Jose, California and has been conducting business since 1994.

Heritage Bank of Commerce is a multi-community independent bank that offers a full range of commercial banking services to small and medium-sized businesses and their owners, managers and employees. We operate through 19 full service branch offices located entirely in the general San Francisco Bay Area of California in the counties of Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara. Our market includes the headquarters of a number of technology based companies in the region commonly known as "Silicon Valley."

Our lending activities are diversified and include commercial, real estate, construction and land development, consumer and Small Business Administration ("SBA") guaranteed loans. We generally lend in markets where we have a physical presence through our branch offices. We attract deposits throughout our market area with a customer-oriented product mix, competitive pricing, and convenient locations. We offer a wide range of deposit products for business banking and retail markets. We offer a multitude of other products and services to complement our lending and deposit services. In addition, Bay View Funding provides factoring financing throughout the United States.

As a bank holding company, Heritage Commerce Corp is subject to the supervision of the Board of Governors of the Federal Reserve System (the "Federal Reserve"). We are required to file with the Federal Reserve reports and other information regarding our business operations and the business operations of our subsidiaries. As a California chartered bank, Heritage Bank of Commerce is subject to primary supervision, periodic examination, and regulation by the Department of Business Oversight — Division of Financial Institutions ("DBO"), and by the Federal Reserve, as its primary federal regulator.

Our principal executive office is located at 150 Almaden Boulevard, San Jose, California 95113, telephone number: (408) 947-6900.

At December 31, 2019, we had consolidated assets of $4.11 billion, deposits of $3.41 billion and shareholders' equity of $576.7 million.

When we use "we", "us", "our" or the "Company", we mean the Company on a consolidated basis with Heritage Bank of Commerce. When we refer to "HCC" or the "holding company", we are referring to Heritage Commerce Corp on a standalone basis. When we use "HBC", we mean Heritage Bank of Commerce on a standalone basis.

The Internet address of the Company's website is "http://www.heritagecommercecorp.com," and the Bank's website is "http://www.heritagebankofcommerce.com." The Company makes available free of charge through the Company's website, the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports. The Company makes these reports available on its website on the same day they appear on the SEC website.

Presidio Bank Merger

The Company completed its merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with Presidio Bank ("Presidio") effective October 11, 2019. The merger, which was first announced on May 16, 2019, was concluded following receipt of approval from both the Company's and Presidio shareholders and all required regulatory approvals. Presidio's results of operations have been included in the Company's results of operations beginning October 12, 2019.

Presidio was a full-service California state-chartered commercial bank headquartered in San Francisco with branches in Palo Alto, San Francisco, San Mateo, San Rafael, and Walnut Creek, California.

At October 11, 2019, Presidio had approximately $904.5 million in assets, $686.0 million in net loans and $774.3 million in deposits, at fair value. Merger-related costs for the merger totaled $11.1 million for the year ended December 31, 2019.

Tri-Valley Bank and United American Bank Mergers

The Company completed the merger of Tri-Valley Bank ("Tri-Valley") into Heritage Bank of Commerce, the Company's wholly-owned subsidiary, on April 6, 2018. Tri-Valley's results of operations have been included in the Company's results of operations beginning April 7, 2018. Tri-Valley was a full-service California state-chartered commercial bank with branches in San Ramon and Livermore, California and served businesses and individuals primarily in Contra Costa and Alameda counties in Northern California. The Company closed the San Ramon office on July 13, 2018 and incurred $110,000 of lease termination expense.

The Company completed the merger of United American Bank ("United American") with Heritage Bank of Commerce on May 4, 2018. United American's results of operations have been included in the Company's results of operations beginning May 5, 2018. United American was a full-service commercial bank located in San Mateo County with full-service branches located in San Mateo, Redwood City and Half Moon Bay, California and serviced businesses, professionals and individuals. The Company closed the Half Moon Bay office on August 10, 2018 and incurred $34,000 of lease termination expense.

Merger-related costs for the two mergers totaled $9.2 million for the year ended December 31, 2018, and $671,000 for the year ended December 31, 2017.

Heritage Bank of Commerce

HBC is a California state-chartered bank headquartered in San Jose, California. It was incorporated in November 1993 and opened for business in June 1994. HBC operates through nineteen full service branch offices. The locations of HBC's current offices and the administrative office of CSNK Working Capital Finance Corp. d/b/a Bay View Funding ("Bay View Funding") are:

San Jose:	Administrative Office Main Branch 150 Almaden Boulevard San Jose, CA 95113	Los Altos:	Branch Office 419 South San Antonio Road Los Altos, CA 94022
Danville:.	Branch Office 387 Diablo Road Danville, CA 94526	Los Gatos:.	Branch Office 15575 Los Gatos Boulevard Building B Los Gatos, CA 95032
Fremont:.	Branch Office 3137 Stevenson Boulevard Fremont, CA 94538	Morgan Hill:.	Branch Office 18625 Sutter Boulevard Suite 100 Morgan Hill, CA 95037
Gilroy:	Branch Office 7598 Monterey Street Suite 110 Gilroy, CA 95020	Palo Alto:	Branch Office 325 Lytton Avenue Suite 100 Palo Alto, CA 94301

Hollister:	Branch Office 351 Tres Pinos Road Suite 102A Hollister, CA 95023
Livermore.	Branch Office 1987 First Street Livermore, CA 94550
San Francisco:	Branch Office 120 Kearny Street Suite 2300 San Francisco, CA 94108
San Mateo:	Branch Office 101 S. Ellsworth Ave Suite 110 San Mateo, CA 94401
San Mateo:	Branch Office 400 S. El Camino Real Suite 150 San Mateo, CA 94402
San Rafael:	Branch Office 999 5th Avenue Suite 100 San Rafael, CA 94901
Pleasanton:	Branch Office 300 Main Street Pleasanton, CA 94566
Redwood City:	Branch Office 2400 Broadway Suite 100 Redwood City, CA 94063
Sunnyvale:	Branch Office 333 W. El Camino Real Suite 150 Sunnyvale, CA 94087
Walnut Creek:	Branch Office 1990 N. California Boulevard Suite 100 Walnut Creek, CA 94596
Walnut Creek:	Loan Production Office 101 Ygnacio Valley Road Suite 108 Walnut Creek, CA 94596
Bay View Funding:	Administrative Office 2933 Bunker Hill Lane Suite 210 Santa Clara, CA 95054

Lending Activities

We offer a diversified mix of business loans encompassing the following loan products: (i) commercial and industrial loans; (ii) commercial real estate loans; (iii) construction loans; and (iv) SBA loans. We also offer home equity lines of credit ("HELOCS"), to accommodate the needs of business owners and individual clients, as well as consumer loans (both secured and unsecured). In the event creditworthy loan customers' borrowing needs exceed our legal lending limit, we have the ability to sell participations in those loans to other banks. We encourage relationship banking, obtaining a substantial portion of each borrower's banking business, including deposit accounts.

As of December 31, 2019, the percentage of our total loans for each of the principal areas in which we directed our lending activities were as follows: (i) commercial and industrial loans 25% (including SBA loans, asset-based lending, and factored receivables); (ii) commercial real estate loans 59%; (iii) land and construction loans 6%; (iv) residential mortgage loans 2%; and (v) consumer loans (including home equity loans) 8%. While no specific industry concentration is considered significant, our lending operations are located in market areas dependent on technology and real estate industries and their supporting companies.

Commercial and Industrial Loans. Our commercial loan portfolio is comprised of operating secured and unsecured loans advanced for working capital, equipment purchases and other business purposes. Generally short-term loans have maturities ranging from thirty days to one year, and "term loans" have maturities ranging from one to five years. Short-term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans generally provide for floating or fixed interest rates, with monthly payments of both principal and interest. Repayment of secured and unsecured commercial loans depends substantially on the borrower's underlying business, financial condition and cash flows, as well as the sufficiency of the collateral. Compared to real estate, the collateral may be more difficult to monitor, evaluate and sell. It may also depreciate more rapidly than real estate. Such risks can be significantly affected by economic conditions.

Our factored receivables portfolio is originated by Bay View Funding. Factored receivables are receivables that have been acquired from the originating company and typically have not been subject to previous collection efforts. These receivables are acquired from a variety of companies, including but not limited to service providers, transportation companies, manufacturers, distributors, wholesalers, apparel companies, advertisers, and temporary staffing companies. The average life of the factored receivables is 37 days.

HBC's commercial loans, except for the asset-based lending and the factored receivables at Bay View Funding, are primarily originated from locally-oriented commercial activities in communities where HBC has a physical presence through its branch offices.

Commercial Real Estate Loans. The commercial real estate ("CRE") loan portfolio is comprised of loans secured by commercial real estate. These loans are generally advanced based on the borrower's cash flow, and the underlying collateral provides a secondary source of payment. HBC generally restricts real estate term loans to no more than 75% of the property's appraised value or the purchase price of the property, depending on the type of property and its utilization. HBC offers both fixed and floating rate loans. Maturities on such loans are generally restricted to between five and ten years (with amortization ranging from fifteen to twenty-five years and a balloon payment due at maturity); however, SBA and certain real estate loans that can be sold in the secondary market may be advanced for longer maturities. CRE loans typically involve large balances to single borrowers or groups of related borrowers. Since payments on these loans are often dependent on the successful operation or management of the properties, as well as the business and financial condition of the borrower, repayment of such loans may be subject to adverse conditions in the real estate market, adverse economic conditions or changes in applicable government regulations. If the cash flow from the project decreases, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired.

Construction Loans. We make commercial construction loans for rental properties, commercial buildings and homes built by developers on speculative, undeveloped property. We also make construction loans for homes and commercial buildings built by owner occupants. The terms of commercial construction loans are made in accordance with our loan policy. Advances on construction loans are made in accordance with a schedule reflecting the cost of construction, but are generally limited to a 70% loan-to-value ratio, as completed. Repayment of construction loans on non-residential properties is normally expected from the property's eventual rental income, income from the borrower's operating entity or the sale of the subject property. In the case of income-producing property, repayment is usually expected from permanent financing upon completion of construction. At times we provide the permanent mortgage financing on our construction loans on income-producing property. Construction loans are interest-only loans during the construction period, which typically do not exceed 18 months. If HBC provides permanent financing the short-term loan converts to permanent, amortizing financing following the completion of construction. Generally, before making a commitment to fund a construction loan, we require an appraisal of the property by a state-certified or state-licensed appraiser. We review and inspect properties before disbursement of funds during the term of the construction loan. The repayment of construction loans is dependent upon the successful and timely completion of the construction of the subject property, as well as the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. Construction loans expose us to the risk that improvements will not be completed on time, and in accordance with specifications and projected costs. Construction delays, the financial impairment of the builder, interest rate increases or economic downturn may further impair the borrower's ability to repay the loan. In addition, the borrower may not be able to obtain permanent financing or ultimate sale or rental of the property may not occur as anticipated. HBC utilizes underwriting guidelines to assess the likelihood of repayment from sources such as sale of the property or permanent mortgage financing prior to making the construction loan.

SBA Loans. SBA loans are made through programs designed by the federal government to assist the small business community in obtaining financing from financial institutions that are given government guarantees as an incentive to make the loans. HBC has been designated as an SBA Preferred Lender. Our SBA loans fall into three categories: loans originated under the SBA's 7a Program ("7a Loans"); loans originated under the SBA's 504 Program ("504 Loans"); and SBA "Express" Loans. SBA 7a Loans are commercial business loans generally made for the purpose of purchasing real estate to be occupied by the business owner, providing working capital, and/or purchasing equipment or inventory. SBA 504 Loans are collateralized by commercial real estate and are generally made to business owners for the purpose of purchasing or improving real estate for their use and for equipment used in their business. The SBA "Express" Loans or lines of credit are for businesses that want to improve cash flow, refinance debt, or fund improvements, equipment, or real estate. It features an abbreviated SBA application process and accelerated approval times, plus it can offer longer terms and lower down payment requirements than conventional loans.

SBA lending is subject to federal legislation that can affect the availability and funding of the program. From time to time, this dependence on legislative funding causes limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

Home Equity Loans. Our home equity line portfolio is comprised of home equity lines of credit to customers in our markets. Home equity lines of credit are underwritten in a manner such that they result in credit risk that is substantially similar to that of residential mortgage loans. Nevertheless, home equity lines of credit have greater credit risk than residential mortgage loans because they are often secured by mortgages that are subordinated to the existing first mortgage on the property, which we do not hold, and they are not covered by private mortgage insurance coverage.

Residential Mortgage Loans. From time to time the Company has purchased single family residential mortgage loans. During the year ended December 31, 2016, the Company purchased jumbo single family residential mortgage loans totaling $57.5 million, all of which are domiciled in California, with an average loan principal amount of approximately $834,000, and weighted average yield of 3.00%, net of servicing fees to the servicer. There were no purchases of residential mortgage loans during the years ended December 31, 2019, 2018 and 2017. Residential mortgage loans outstanding at December 31, 2019 totaled $46.3 million, which included $33.4 million of purchased residential mortgage loans, and $12.9 million of residential mortgage loans from United American. HBC does not originate first trust deed home mortgage loans or home improvement loans, other than HELOCS.

Consumer Loans. The consumer loan portfolio is composed of miscellaneous consumer loans including loans for financing automobiles, various consumer goods and other personal purposes. Consumer loans are generally secured. Repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan, and the remaining deficiency may not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continued financial stability, which can be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Deposit Products

As a full-service commercial bank, we focus deposit generation on relationship accounts, encompassing non-interest bearing demand, interest bearing demand, and money market. In order to facilitate generation of non-interest bearing demand deposits, we require, depending on the circumstances and the type of relationship, our borrowers to maintain deposit balances with us as a typical condition of granting loans. We also offer certificates of deposit and savings accounts. We offer a "remote deposit capture" product that allows deposits to be made via computer at the customer's business location. We also offer customers "e-statements" that allows customers to receive statements electronically, which is more convenient and secure than receiving paper statements.

For customers requiring full Federal Deposit Insurance Corporation ("FDIC") insurance on certificates of deposit in excess of $250,000, we offer the Certificate of Deposit Account Registry Service ("CDARS") program, which allows HBC to place the certificates of deposit with other participating banks to maximize the customers' FDIC insurance. HBC also receives reciprocal deposits from other participating financial institutions.

Electronic Banking

While personalized, service-oriented banking is the cornerstone of our business plan, we use technology and the Internet as a secondary means for servicing customers, to compete with larger banks and to provide a convenient platform for customers to review and transact business. We offer sophisticated electronic or "internet banking" opportunities that permit commercial customers to conduct much of their banking business remotely from their home or business. However, our customers will always have the opportunity to personally discuss specific banking needs with knowledgeable bank officers and staff who are directly accessible in the branches and offices as well as by telephone and email.

HBC offers multiple electronic banking options to its customers. It does not allow the origination of deposit accounts through online banking, nor does it accept loan applications through its online services. All of HBC's electronic banking services allow customers to review transactions and statements, review images of paid items, transfer funds between accounts at HBC, place stop orders, pay bills and export to various business and personal software applications. HBC online commercial banking also allows customers to initiate domestic wire transfers and ACH transactions, with the

added security and functionality of assigning discrete access and levels of security to different employees of the client and division of functions to allow separation of duties, such as input and release.

We also offer our internet banking customers an additional third party product designed to assist in mitigating fraud risk to both the customer and the Bank in internet banking and other internet activities conducted by the customer, at no cost to the customer.

Other Banking Services

We offer a multitude of other products and services to complement our lending and deposit services. These include cashier's checks, bank by mail, night depositories, safe deposit boxes, direct deposit, automated payroll services, electronic funds transfers, online bill pay, homeowner association services, and other customary banking services. HBC currently operates ATMs at six different locations. In addition, we have established a convenient customer service group accessible by toll free telephone to answer questions and promote a high level of customer service. HBC does not have a trust department. In addition to the traditional financial services offered, HBC offers remote deposit capture, automated clearing house origination, electronic data interchange and check imaging. HBC continues to investigate products and services that it believes addresses the growing needs of its customers and to analyze other markets for potential expansion opportunities.

Investments

Our investment policy is established by the Board of Directors. The general investment strategies are developed and authorized by our Finance and Investment Committee of the Board of Directors. The investment policy is reviewed annually by the Finance and Investment Committee, and any changes to the policy are subject to approval by the full Board of Directors. The overall objectives of the investment policy are to maintain a portfolio of high quality investments to maximize interest income over the long term and to minimize risk, to provide collateral for borrowings, and to provide additional earnings when loan production is low. The policy dictates that investment decisions take into consideration the safety of principal, liquidity requirements and interest rate risk management. All securities transactions are reported to the Board of Directors' Finance and Investment Committee on a monthly basis.

Sources of Funds

Deposits traditionally have been our primary source of funds for our investment and lending activities. We also are able to borrow from the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco to supplement cash flow needs. Our additional sources of funds are scheduled loan payments, maturing investments, loan repayments, income on other earning assets, and the proceeds of loan sales and securities sales.

Interest rates, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market interest rates, liquidity requirements and our deposit growth goals.

On May 26, 2017, the Company completed an underwritten public offering of $40,000,000 aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium. It is anticipated that the LIBOR index will be phased out by the end of 2021 and the Secured Overnight Financing Rate ("SOFR") has been recommended as an alternative to LIBOR.

Correspondent Banks

Correspondent bank deposit accounts are maintained to enable the Company to transact types of activity that it would otherwise be unable to perform or would not be cost effective due to the size of the Company or volume of activity. The Company has utilized several correspondent banks to process a variety of transactions.

Competition

The banking and financial services business in California generally, and in the Company's market areas specifically, is highly competitive. The industry continues to consolidate and unregulated competitors have entered banking markets with products targeted at highly profitable customer segments. Many larger unregulated competitors are able to compete across geographic boundaries, and provide customers with meaningful alternatives to most significant banking services and products. These consolidation trends are likely to continue. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the consolidation among financial service providers.

With respect to commercial bank competitors, the business is dominated by a relatively small number of major banks that operate a large number of offices within our geographic footprint. For the combined Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara county region, the seven counties within which the Company operates, the top three institutions are all multi-billion dollar entities with an aggregate of 425 offices that control a combined 56.44% of deposit market share based on June 30, 2019 FDIC market share data. HBC ranks sixteenth with 0.63% share of total deposits based on June 30, 2019 market share data, including the five branches acquired from Presidio on October 11, 2019. Larger institutions have, among other advantages, the ability to finance wide-ranging advertising campaigns and to allocate their resources to regions of highest yield and demand. Larger banks are seeking to expand lending to small businesses, which are traditionally community bank customers. They can also offer certain services that we do not offer directly, but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, these banks also have substantially higher lending limits than we do. For customers whose needs exceed our legal lending limit, we arrange for the sale, or "participation," of some of the balances to financial institutions that are not within our geographic footprint.

In addition to other large regional banks and local community banks, our competitors include savings institutions, securities and brokerage companies, asset management groups, mortgage banking companies, credit unions, finance and insurance companies, internet-based companies, and money market funds. In recent years, we have also witnessed increased competition from specialized companies that offer wholesale finance, credit card, and other consumer finance services, as well as services that circumvent the banking system by facilitating payments via the internet, wireless devices, prepaid cards, or other means. Technological innovations have lowered traditional barriers of entry and enabled many of these companies to compete in financial services markets. Such innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously were considered traditional banking products. In addition, many customers now expect a choice of delivery channels, including telephone and smart phones, mail, personal computer, ATMs, self-service branches, and/or in-store branches.

Strong competition for deposits and loans among financial institutions and non-banks alike affects interest rates and other terms on which financial products are offered to customers. Mergers between financial institutions have placed additional pressure on other banks within the industry to remain competitive by streamlining operations, reducing expenses, and increasing revenues. Competition has also intensified due to Federal and state interstate banking laws enacted in the mid-1990's, which permit banking organizations to expand into other states. The relatively large and expanding California market has been particularly attractive to out of state institutions. The Gramm-Leach-Bliley Act of 1999 has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, and has also intensified competitive conditions.

In order to compete with the other financial service providers, the Company principally relies upon community-oriented, personalized service, local promotional activities, personal relationships established by officers, directors, and employees with its customers, and specialized services tailored to meet its customers' needs. Our "preferred lender" status with the Small Business Administration allows us to approve SBA loans faster than many of our competitors. In those instances where the Company is unable to accommodate a customer's needs, the Company seeks to arrange for such loans on a participation basis with other financial institutions or to have those services provided in whole or in part by its correspondent banks. See Item 1 — *"Business — Correspondent Banks."*

Employees

Full-time equivalent employees were 357, 302, and 278 at December 31, 2019, 2018, and 2017, respectively.

Supervision and Regulation

General

Financial institutions, their holding companies and their affiliates are extensively regulated under U.S. federal and state law. As a result, the growth and earnings performance of the Company and its subsidiaries may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the DBO, the Federal Reserve, the FDIC, and the Consumer Financial Protection Bureau ("CFPB"). Furthermore, tax laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the FASB, securities laws administered by the SEC and state securities authorities, anti-money laundering laws enforced by the Treasury have an impact on our business. The effect of these statutes, regulations, regulatory policies and rules are significant to the financial condition and results of operations of the Company and its subsidiaries, including HBC, and the nature and extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of financial institutions, their holding companies and affiliates intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than their shareholders. These federal and state laws, and the related regulations of the bank regulatory agencies, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that, while not publicly available, can affect the conduct and growth of their businesses. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and its subsidiaries, including HBC. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

Financial Regulatory Reform

Legislation and regulations enacted and implemented since 2008 in response to the U.S. economic downturn and financial industry instability continue to impact most institutions in the banking sector. Certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which was enacted in 2010, are now effective and have been fully implemented, including revisions to the deposit insurance assessment base for FDIC insurance and a permanent increase in coverage to $250,000; the permissibility of paying interest on business checking accounts; the removal of barriers to interstate branching; and, required disclosures and shareholder advisory votes on executive compensation. Additional actions taken to implement Dodd-Frank provisions include (i) final capital rules, (ii) a final rule to implement the so called Volcker rule restrictions on certain proprietary trading and investment activities, and (iii) final rules and increased enforcement action by the Consumer Finance Protection Bureau.

Some aspects of Dodd-Frank are still subject to rulemaking, making it difficult to anticipate the ultimate financial impact on the Company, its customers or the financial services industry more generally. However, many provisions of Dodd-Frank are already affecting our operations and expenses, including but not limited to changes in FDIC assessments, the permitted payment of interest on demand deposits, and enhanced compliance requirements. Some of the rules and regulations promulgated or yet to be promulgated under Dodd-Frank will apply directly only to institutions much larger than ours, but could indirectly impact smaller banks, either due to competitive influences or because certain required practices for larger institutions may subsequently become expected "best practices" for smaller institutions. We could see continued attention and resources devoted by the Company to ensure compliance with the statutory and regulatory requirements engendered by Dodd-Frank.

Regulatory Capital Requirements

The federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations, both for transactions reported on the balance sheet as assets and for transactions, such as letters of credit and recourse arrangements, that are recorded as off-balance sheet items. In 2013, the Federal Reserve, FDIC, and Office of the Comptroller of the Currency issued final rules (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework, commonly referred to as Basel III, for strengthening international capital standards, as well as implementing certain provisions of the Dodd-Frank Act.

The Basel III Capital Rules became effective for the Company and HBC on January 1, 2015 (subject to phase-in periods for some of their components). The Basel III Capital Rules: (i) introduce a new capital measure called Common Equity Tier 1 ("CET1"), and a related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments, which are instruments treated as Tier 1 instruments under the prior capital rules that meet certain revised requirements; (iii) mandate that most deductions or adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital, as compared to existing regulations. Under the Basel III Capital Rules, for most banking organizations, the most common form of additional Tier 1 capital is noncumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allowance for loan and lease losses, in each case, subject to the Basel III Capital Rules' specific requirements.

The Basel III Capital Rules also introduced a "capital conservation buffer," composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and was phased in over a three-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019). In 2017, banking organizations, including the Company and HBC, were required to maintain a CET1 capital ratio of at least 5.75%, a Tier 1 capital ratio of at least 7.25%, and a total capital ratio of at least 9.25% to avoid limitations on capital distributions and certain discretionary incentive compensation payments. During 2018, banking organizations, including the Company and HBC, were required to maintain a CET1 capital ratio of at least 6.375%, a Tier 1 capital ratio of at least 7.875%, and a total capital ratio of at least 9.875% to avoid limitations on capital distributions and certain discretionary incentive compensation payments. As of January 1, 2019, the Company and HBC must maintain the following fully phased-in minimum capital ratios:

4.0% Tier 1 leverage ratio;

4.5% CET1 to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%;

6.0% Tier 1 capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum Tier 1 capital ratio of at least 8.5%; and

8.0% total capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum total capital ratio of at least 10.5%.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that: (i) mortgage servicing rights; (ii) deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks; and (iii) significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and were phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive income or loss items are not excluded for the purposes of determining regulatory capital ratios; however, non-advanced approaches banking organizations (i.e., banking organizations with less than $250 billion in total consolidated assets or with less than $10 billion of on-balance sheet foreign exposures), including the Company and HBC, may make a one-time permanent election to exclude these items. The Company and HBC made this election in the first quarter of 2015's call reports in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of its available-for-sale investment securities portfolio.

The Basel III Capital Rules prescribe a new standardized approach for risk weightings that expands the risk weighting categories from the previous four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, generally ranging from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, depending on the nature of the assets. The new capital rules generally result in higher risk weights for a variety of asset classes, including certain CRE mortgages. Additional aspects of the Basel III Capital Rules that are relevant to the Company and HBC include:

- consistent with the Basel I risk-based capital rules, assigning exposures secured by single-family residential properties to either a 50% risk weight for first-lien mortgages that meet prudent underwriting standards or a 100% risk weight category for all other mortgages;
- providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (set at 0% under the Basel I risk-based capital rules);
- assigning a 150% risk weight to all exposures that are nonaccrual or 90 days or more past due (set at 100% under the Basel I risk-based capital rules), except for those secured by single-family residential properties, which will be assigned a 100% risk weight, consistent with the Basel I risk-based capital rules;
- applying a 150% risk weight instead of a 100% risk weight for certain high volatility CRE acquisition, development and construction loans; and
- applying a 250% risk weight to the portion of mortgage servicing rights and deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks that are not deducted from CET1 capital (set at 100% under the Basel I risk-based capital rules).

As of December 31, 2019, the Company's and HBC's capital ratios exceeded the minimum capital adequacy guideline percentage requirements of the federal banking agencies for "well capitalized" institutions under the Basel III capital rules on a fully phased-in basis.

With respect to HBC, the Basel III Capital Rules also revise the prompt corrective action ("PCA"), regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under "Prompt Corrective Action."

On September 17, 2019, the federal bank regulatory agencies adopted a final rule implementing Section 201 of the Economic Growth Act that provides for an optional simplified measure of capital adequacy. The final rule provides certain community banking organizations the ability to opt into a new community bank leverage ratio ("CBLR") intended to simplify regulatory capital requirements. Under the final rule, community banking organizations with less than $10 billion in total consolidated assets may elect the new community banking leverage framework if they have a CBLR of greater than 9 percent, and hold 25 percent or less of assets in off-balance sheet exposures and 5 percent or less of assets in trading assets and liabilities. The CBLR is determined by dividing a banking organization's tangible equity capital by its average total consolidated assets. Upon opt into the community banking leverage framework, a qualifying community banking organization would not be subject to other risk-based and capital leverage requirements (including the Basel III and Basel IV requirements) and would be considered to have met the well capitalized ratio requirements. Opting into the community banking leverage framework could greatly ease the process of determining the Company and HBC's capital requirements starting on January 1, 2020, when the final rule became effective. The Company determined not to opt in to the community banking leverage framework as of January 1, 2020.

Prompt Corrective Action

The Federal Deposit Insurance Act, as amended ("FDIA"), requires federal banking agencies to take PCA in respect of depository institutions that do not meet minimum capital requirements. The FDIA includes the following five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The Basel III Capital Rules, revised the PCA requirements effective January 1, 2015. Under the revised PCA provisions of the FDIA, an insured depository institution generally will be classified in the following categories based on the capital measures indicated:

PCA Category	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	CET1 Risk-Based Ratio	Tier 1 Leverage Ratio
Well capitalized	10 %	8.0 %	6.5 %	5.0 %
Adequately capitalized	8 %	6.0 %	4.5 %	4.0 %
Undercapitalized	< 8 %	< 6 %	< 4.5 %	< 4 %
Significantly undercapitalized	< 6 %	< 4 %	< 3.0 %	< 3 %

The institution is considered "critically undercapitalized" if the institution's tangible equity (defined as Tier 1 equity plus non-Tier 1 perpetual preferred stock) is equal to or less than 2.0% of average quarterly tangible assets.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios, if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying PCA regulations and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company, if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit capital restoration plans. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." "Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The capital classification of a bank holding company and a bank affects the frequency of regulatory examinations, the bank holding company's and the bank's ability to engage in certain activities and the deposit insurance premium paid by the bank. As of December 31, 2019, we met the requirements to be "well-capitalized" based upon the aforementioned ratios for purposes of the prompt corrective action regulations, as currently in effect.

The appropriate federal banking agency may determine (after notice and opportunity for a hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice. The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

Heritage Commerce Corp

General. As a bank holding company, HCC is subject to regulation and supervision by the Federal Reserve under the Bank Holding Company Act of 1956, as amended, or the BHCA. Under the BHCA, HCC is subject to periodic examination by the Federal Reserve. HCC is required to file with the Federal Reserve periodic reports of its operations and such additional information as the Federal Reserve may require. In accordance with Federal Reserve policy, and as

now codified by the Dodd-Frank Act, HCC is legally obligated to act as a source of financial strength to HBC and to commit resources to support HBC in circumstances where HCC might not otherwise do so.

HCC is also a bank holding company within the meaning of Section 1280 of the California Financial Code. Consequently, HCC is subject to examination by, and may be required to file reports with, the DBO.

SEC and Nasdaq. HCC's stock is traded on the NASDAQ Global Select Market (under the trading symbol "HTBK"), and HCC is subject to rules and regulations of The NASDAQ Stock Market, including those related to corporate governance. HCC is also subject to the periodic reporting requirements of Section 13 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which requires HCC to file annual, quarterly and other current reports with the SEC. HCC is subject to additional regulations including, but not limited to, the proxy and tender offer rules promulgated by the SEC under Sections 13 and 14 of the Exchange Act, the reporting requirements of directors, executive officers and principal shareholders regarding transactions in HCC's common stock and short swing profits rules promulgated by the SEC under Section 16 of the Exchange Act, and certain additional reporting requirements by principal shareholders of HCC promulgated by the SEC under Section 13 of the Exchange Act.

The Sarbanes Oxley Act of 2002. HCC is subject to the accounting oversight and corporate governance requirements of the Sarbanes Oxley Act of 2002, as amended (the "Sarbanes-Oxley Act"). These include, for example: (i) required executive certification of financial presentations; (ii) increased requirements for board audit committees and their members; (iii) enhanced disclosure of controls and procedures and internal control over financial reporting; (iv) enhanced controls over and reporting of insider trading; and (v) increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances.

Permitted Activities. The BHCA generally prohibits HCC from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be "so closely related to banking as to be a proper incident thereto." This authority would permit HCC to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage. The BHCA generally does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies. The Federal Reserve has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the Federal Reserve has reasonable grounds to believe that continuing such activity, ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

Bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. HCC has not elected to be a financial holding company, and we have not engaged in any activities determined by the Federal Reserve to be financial in nature or incidental or complementary to activities that are financial in nature.

Capital Requirements. Bank holding companies are required to maintain capital in accordance with Federal Reserve capital adequacy requirements, as affected by the Dodd-Frank Act and Basel III. For a discussion of capital requirements, see "Regulatory Capital Requirements" above.

Source of Strength Doctrine. Federal Reserve policy historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement HCC is expected to commit resources to support HBC, including at times when HCC may not be in a financial position to provide it. HCC must stand ready to use its available resources to provide adequate capital to the subsidiary bank during periods of financial stress or adversity. HCC must also maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting HBC. HCC's failure to meet its source

of strength obligations may constitute an unsafe and unsound practice or a violation of the Federal Reserve's regulations or both. The source of strength doctrine most directly affects bank holding companies where a bank holding company's subsidiary bank fails to maintain adequate capital levels. In such a situation, the subsidiary bank will be required by the bank's federal regulator to take "prompt corrective action." Any capital loans by a bank holding company to HBC are subordinate in right of payment to deposits and to certain other indebtedness of HBC. The BHCA provides that in the event of HCC's bankruptcy any commitment by a bank holding company to a federal bank regulatory agency to maintain the capital of its subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Dividend Payments, Stock Redemptions and Repurchases. HCC's ability to pay dividends to its shareholders is affected by both general corporate law considerations and the policies of the Federal Reserve applicable to bank holding companies. As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to shareholders if: (i) the bank holding company's net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the bank holding company's capital needs and overall current and prospective financial condition; or (iii) the bank holding company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. If HCC's fails to adhere to these policies, the Federal Reserve could find that HCC is operating in an unsafe and unsound manner. In addition, under the Basel III Rule, institutions that seek to pay dividends must maintain 2.5% in CET1 attributable to the capital conservation buffer, which was being phased in over a three year period and is fully phased in as of January 1, 2019. See "Supervision and Regulation—Regulatory Capital Requirements" above.

Subject to exceptions for well-capitalized and well-managed holding companies, Federal Reserve regulations also require approval of holding company purchases and redemptions of its securities if the gross consideration paid exceeds 10 percent of consolidated net worth for any 12-month period. In addition, under Federal Reserve policies, bank holding companies must consult with and inform the Federal Reserve in advance of (i) redeeming or repurchasing capital instruments when experiencing financial weakness and (ii) redeeming or repurchasing common stock and perpetual preferred stock if the result will be a net reduction in the amount of such capital instruments outstanding for the quarter in which the reduction occurs.

As a California corporation, HCC is subject to the limitations of California law, which allows a corporation to distribute cash or property to shareholders, including a dividend or repurchase or redemption of shares, if the corporation meets either a retained earnings test or a "balance sheet" test. Under the retained earnings test, HCC may make a distribution from retained earnings to the extent that its retained earnings exceed the sum of (i) the amount of the distribution plus (ii) the amount, if any, of dividends in arrears on shares with preferential dividend rights. HCC may also make a distribution if, immediately after the distribution, the value of its assets equals or exceeds the sum of (a) its total liabilities plus (b) the liquidation preference of any shares which have a preference upon dissolution over the rights of shareholders receiving the distribution. Indebtedness is not considered a liability if the terms of such indebtedness provide that payment of principal and interest thereon are to be made only if, and to the extent that, a distribution to shareholders could be made under the balance sheet test. In addition, HCC may not make distributions if it is, or as a result of the distribution would be, likely to be unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature. A California corporation may specify in its articles of incorporation that distributions under the retained earnings test or balance sheet test can be made without regard to the preferential rights amount. HCC's articles of incorporation do not address distributions under either the retained earnings test or the balance sheet test.

Acquisitions, Activities and Change in Control. The BHCA generally requires the prior approval by the Federal Reserve for any merger involving a bank holding company or any of bank holding company's acquisition of more than 5% of a class of voting securities of any additional bank or bank holding company or to acquire all or substantially all, the assets of any additional bank or bank holding company. In reviewing applications seeking approval of merger and acquisition transactions, Federal Reserve considers, among other things, the competitive effect and public benefits of the transactions, the capital position and managerial resources of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act of 1977, as amended ("CRA"), the applicant's compliance with fair housing and other consumer protection laws and the effectiveness of all organizations involved in combating money laundering activities. In addition, failure to implement or maintain adequate compliance programs could cause bank regulators not to approve an acquisition where regulatory approval is required or to prohibit an acquisition even if approval is not required.

Subject to certain conditions (including deposit concentration limits established by the BHCA and the Dodd-Frank Act), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its insured depository institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state depository institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to complete interstate mergers or acquisitions. For a discussion of the capital requirements, see "— Regulatory Capital Requirements" above.

Federal law also prohibits any person or company from acquiring "control" of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. "Control" is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 5% and 24.99% ownership.

Under the California Financial Code, any proposed acquisition of "control" of HBC by any person (including a company) must be approved by the Commissioner of the DBO. The California Financial Code defines "control" as the power, directly or indirectly, to direct HBC's management or policies or to vote 25% or more of any class of HBC's outstanding voting securities. Additionally, a rebuttable presumption of control arises when any person (including a company) seeks to acquire, directly or indirectly, 10% or more of any class of HBC's outstanding voting securities.

Heritage Bank of Commerce

General. As a California commercial bank whose deposits are insured by the FDIC, HBC is subject to regulation, supervision, and regular examination by the DBO and by the Federal Reserve Bank as HBC's primary Federal regulators. The regulations of these agencies govern most aspects of a bank's business.

Pursuant to the FDIA, and the California Financial Code, California state chartered commercial banks may generally engage in any activity permissible for national banks. Therefore, HBC may form subsidiaries to engage in the many so called "closely related to banking" or "nonbanking" activities commonly conducted by national banks in operating subsidiaries or subsidiaries of bank holding companies. Further, California banks may conduct certain "financial" activities in a subsidiary to the same extent as may a national bank, provided the bank is and remains "well capitalized," "well managed" and in satisfactory compliance with the CRA.

HBC is a member of the Federal Home Loan Bank ("FHLB") of San Francisco. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region and makes available loans or advances to its members. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. As an FHLB member HBC is required to own a certain amount of capital stock in the FHLB. At December 31, 2019, HBC was in compliance with the FHLB's stock ownership requirement. FHLB stock is carried at cost and classified as a restricted security. Both cash and stock dividends are reported as income.

HBC is a member of the Federal Reserve Bank ("FRB") of San Francisco. As a member of the FRB, the Bank is required to own stock in the FRB of San Francisco based on a specified ratio relative to our capital. FRB stock is carried at cost and may be sold back to the FRB at its carrying value. Cash dividends received are reported as income.

Depositor Preference. In the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors along with the FDIC, will have priority in payment ahead of unsecured, non deposit creditors including the parent bank holding company with respect to any extensions of credit they have made to such insured depository institution.

Brokered Deposit Restrictions. Well capitalized institutions are not subject to limitations on brokered deposits, while an adequately capitalized institution is able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are generally

not permitted to accept, renew, or roll over brokered deposits. As of December 31, 2019, HBC was eligible to accept brokered deposits without limitations.

Loans to One Borrower. With certain limited exceptions, the maximum amount that a California bank may lend to any borrower at any one time (including the obligations to the bank of certain related entities of the borrower) may not exceed 25% (and unsecured loans may not exceed 15%) of the bank's shareholders' equity, allowance for loan loss, and any capital notes and debentures of the bank.

Tie in Arrangements. Federal law prohibits a bank holding company and any subsidiary banks from engaging in certain tie in arrangements in connection with the extension of credit. For example, HBC may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer must obtain or provide some additional credit, property or services from or to HBC other than a loan, discount, deposit or trust services; (ii) the customer must obtain or provide some additional credit, property or service from or to HCC or HBC; or (iii) the customer must not obtain some other credit, property or services from competitors, except reasonable requirements to assure soundness of credit extended.

Deposit Insurance. As an FDIC-insured institution, HBC is required to pay deposit insurance premium assessments to the FDIC. The premiums fund the Deposit Insurance Fund ("DIF"). The FDIC assesses a quarterly deposit insurance premium on each insured institution based on risk characteristics of the institution and may also impose special assessments in emergency situations. Effective July 1, 2016, the FDIC changed the deposit insurance assessment system for banks, such as HBC, with less than $10 billion in assets that have been federally insured for at least five years. Among other changes, the FDIC eliminated risk categories for such banks and now uses the "financial ratios method" to determine assessment rates for all such banks. Under the financial ratios method, the FDIC determines assessment rates based on a combination of financial data and supervisory ratings that estimate a bank's probability of failure within three years. The assessment rate determined by considering such information is then applied to the amount of the institution's average assets minus average tangible equity to determine the institution's insurance premium.

The Dodd-Frank Act requires the FDIC to ensure that the DIF reserve ratio reaches 1.35% by September 3, 2020. The DIF reserve ratio is the amount in the DIF as a percentage of DIF-insured deposits. The Dodd-Frank Act also altered the minimum designated reserve ratio by the DIF, increasing the minimum from 1.15% to 1.35%, and eliminated the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, may increase or decrease the assessment rates, following notice and comment on proposed rulemaking if required. As a result, HBC's FDIC deposit insurance premiums could increase.

The FDIC may terminate deposit insurance of any insured institution if the FDIC finds that the insured institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or any other regulatory agency.

FICO Assessments. In addition to paying basic deposit insurance assessments, insured depository institutions must pay Financing Corporation assessments ("FICO Assessments"). Financing Corporation is a mixed-ownership governmental corporation chartered by the former FHLB Board pursuant to the Competitive Equality Banking Act of 1987 to function as a financing vehicle for the recapitalization of the former Federal Savings and Loan Insurance Corporation. Financing Corporation issued 30-year noncallable bonds of approximately $8.1 billion that mature in 2017 through 2019. Financing Corporation's authority to issue bonds ended on December 12, 1991. Since 1996, federal legislation has required that all FDIC-insured depository institutions pay assessments to cover interest payments on Financing Corporation's outstanding obligations. The FDIC Assessment rate is adjusted quarterly and was approximately .0000750% of average total assets less average tangible equity for the third quarter of 2019. During the year ended December 31, 2019, HBC paid $8,800 in aggregate FICO Assessments.

Supervisory Assessments. California-chartered banks are required to pay supervisory assessments to the DBO to fund its operations. The amount of the assessment paid by a California bank to the DBO is calculated on the basis of the institution's total assets, including consolidated subsidiaries, as reported to the DBO. During the year ended December 31, 2019, HBC paid supervisory assessments to the DBO totaling $214,000.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see "—Regulatory Capital Requirements" above.

Dividend Payments. The primary source of funds for HCC is dividends from HBC. Under the California Financial Code, HBC is permitted to pay a dividend in the following circumstances: (i) without the consent of either the DBO or HBC's shareholders, in an amount not exceeding the lesser of (a) the retained earnings of HBC; or (b) the net income of HBC for its last three fiscal years, less the amount of any distributions made during the prior period; (ii) with the prior approval of the DBO, in an amount not exceeding the greatest of: (a) the retained earnings of HBC; (b) the net income of HBC for its last fiscal year; or (c) the net income for HBC for its current fiscal year; and (iii) with the prior approval of the DBO and HBC's shareholders (i.e., HCC) in connection with a reduction of its contributed capital.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. In addition, in order to pay a dividend, the Basel III Capitals Rules' capital conservation buffer generally requires that must maintain over a 2.5% in CET1 attributable to the Capital Conservation Buffer, which is to be phased in over a three-year period that began on January 1, 2016. See "—Regulatory Capital Requirements" above. As described above, HBC exceeded its minimum capital requirements under applicable regulatory guidelines as of December 31, 2019.

Transactions with Affiliates. Transactions between depository institutions and their affiliates, including transactions between HBC and HCC, are governed by Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve's Regulation W promulgated thereunder. Generally, Section 23A limits the extent to which a depository institution and its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of the depository institution's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates of an amount equal to 20% of the depository institution's capital stock and surplus. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, acceptances or letters of credit issued on behalf of, an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or at least as favorable to the depository institution and its subsidiaries, as those for similar transactions with non-affiliates.

Loans to Directors, Executive Officers and Principal Shareholders. The authority of HBC to extend credit to its directors, executive officers and principal shareholders, including their immediate family members and corporations and other entities that they control, is subject to substantial restrictions and requirements under the Federal Reserve's Regulation O, as well as the Sarbanes-Oxley Act. These laws and regulations impose limits on the amount of loans HBC may make to directors and other insiders and require, among other things, that: (i) the loans must be made on substantially the same terms, including interest rates and collateral, as prevailing at the time for comparable transactions with persons not affiliated with HCC or HBC; (ii) HBC follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with HCC or HBC; and (iii) the loans not involve a greater-than-normal risk of non-payment or include other features not favorable to HBC. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

Safety and Soundness Standards/Risk Management. The federal banking agencies have adopted guidelines establishing operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the financial institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If a financial institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the financial institution's rate of growth, require the financial institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with the standards established by the safety and soundness guidelines may also constitute grounds for other enforcement action by the federal bank regulatory agencies, including cease and desist orders and civil money penalty assessments.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the financial institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. New products and services, third-party risk management and cybersecurity are critical sources of operational risk that financial institutions are expected to address in the current environment. HBC is expected to have active board and senior management oversight; adequate policies, procedures, and limits; adequate risk measurement, monitoring, and management information systems; and comprehensive internal controls.

Branching Authority. California banks, such as HBC, may, under California law, establish a banking office so long as the bank's board of directors approves the banking office and the DBO is notified of the establishment of the banking office. Deposit-taking banking offices must be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate power. The Dodd-Frank Act permits insured state banks to engage in de novo interstate branching if the laws of the state where the new banking office is to be established would permit the establishment of the banking office if it were chartered by such state. Finally, we may also establish banking offices in other states by merging with banks or by purchasing banking offices of other banks in other states, subject to certain regulatory restrictions.

Community Reinvestment Act. The CRA is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal bank regulatory agencies, in examining insured depository institutions, to assess their record of helping to meet the credit needs of their entire community, including low and moderate income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions or holding company formations.

The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance based evaluation system. This system bases CRA ratings on an institution's actual lending service and investment performance rather than the extent to which the institution conducts needs assessments, documents community outreach or complies with other procedural requirements. The ratings range from "outstanding" to a low of "substantial noncompliance." HBC had a CRA rating of "satisfactory" as of its most recent regulatory examination.

Anti-Money Laundering and Office of Foreign Assets Control Regulation. The Patriot Act, is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to have policies and procedures with respect to measures designed to address any or all of the following matters: (i) customer identification programs; (ii) money laundering; (iii) terrorist financing; (iv) identifying and reporting suspicious activities and currency transactions; (v) currency crimes; and (vi) cooperation between financial institutions and law enforcement authorities. Regulatory authorities routinely examine financial institutions for compliance with these obligations, and failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required. Regulatory authorities have imposed cease and desist orders and civil money penalties against institutions found to be violating these obligations.

Treasury's Office of Foreign Assets Control ("OFAC"), administers and enforces economic and trade sanctions against targeted foreign countries and regimes under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. Financial Institutions are responsible for, among other things, blocking accounts of and transactions with such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Banking regulators examine banks for compliance with the economic sanctions regulations administered by OFAC and failure of a

financial institution to maintain and implement adequate OFAC programs, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Concentrations in Commercial Real Estate. Concentration risk exists when financial institutions deploy too many assets to any one industry or segment. Concentration stemming from commercial real estate is one area of regulatory concern. The Commercial Real Estate Concentration Guidance provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Concentration Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. As of December 31, 2019, using regulatory definitions in the CRE Concentration Guidance, our CRE loans represented 282% of HBC total risk-based capital, as compared to 242% as of December 31, 2018. If the FDIC become concerned about our CRE loan concentrations, it could limit our ability to grow by restricting its approvals for the establishment or acquisition of branches, or approvals of mergers or other acquisition opportunities.

Consumer Financial Services

We are subject to a number of federal and state consumer protection laws that extensively govern our relationship with our customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, the Military Lending Act, and these laws' respective state law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict our ability to raise interest rates and subject us to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys' fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, action by the state and local attorneys general in each jurisdiction in which we operate and civil money penalties. Failure to comply with consumer protection requirements may also result in our failure to obtain any required bank regulatory approval for merger or acquisition transactions we may wish to pursue or our prohibition from engaging in such transactions even if approval is not required.

Many states and local jurisdictions have consumer protection laws analogous to those listed above. These federal, state and local laws regulate the manner in which financial institutions deal with customers when taking deposits, making loans or conducting other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission rights, action by state and local attorneys general and civil or criminal liability.

The consumer protection provisions of the Dodd-Frank Act and the examination, supervision and enforcement of those laws and implementing regulations by the CFPB have created a more intense and complex environment for consumer finance regulation. The CFPB has significant authority to implement and enforce federal consumer protection laws and new requirements for financial services products provided for in the Dodd-Frank Act, as well as the authority to identify and prohibit unfair, deceptive or abusive acts and practices. It could also result in increased costs related to regulatory oversight, supervision and examination, additional remediation efforts and possible penalties. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like HBC, will continue to be examined by their applicable bank regulators.

Mortgage and Mortgage-Related Products. Because abuses in connection with home mortgages were a significant factor contributing to the financial crisis, many new rules issued by the CFPB and required by the Dodd-Frank Act address mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks and savings

associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages."

Ability-to-Repay Requirement and Qualified Mortgage Rules. On January 10, 2013, the CFPB issued a final rule implementing the Dodd-Frank Act's ability-to-repay requirements. Under the final rule, lenders, in assessing a borrower's ability to repay a mortgage-related obligation, must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. The final rule also includes guidance regarding the application of and methodology for evaluating these factors.

Further, the final rules require that qualified mortgages cannot include "no-doc" loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the rules mandate that the monthly payment be calculated on the highest payment that will occur in the first five years of the loan, and require that the borrower's total debt-to-income ratio generally may not be more than 43%. The final rules also provide that certain mortgages that satisfy the general product feature requirements for qualified mortgages and that also satisfy the underwriting requirements of Fannie Mae and Freddie Mac (while they operate under federal conservatorship or receivership), the U.S. Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture or the Rural Housing Service are also considered to be qualified mortgages. This second category of qualified mortgages will phase out as the aforementioned federal agencies issue their own rules regarding qualified mortgages, the conservatorship of Fannie Mae and Freddie Mac ends, and, in any event, will invest in January 2021.

As set forth in the Dodd-Frank Act, subprime (or higher-priced) mortgage loans are subject to the ability-to-repay requirement, and the final rules provide for a rebuttable presumption of lender compliance for those loans. The final rule also applied the ability-to-repay requirement to prime loans, while also providing a conclusive presumption of compliance (i.e., a safe harbor) for prime loans that are also qualified mortgages. Additionally, the final rule generally prohibits prepayment penalties (subject to certain exceptions) and sets forth a 3-year record retention period with respect to documenting and demonstrating the ability-to-repay requirement and other provisions.

Incentive Compensation Guidance and Proposed Restrictions

The federal bank regulatory agencies have issued comprehensive guidance intended to ensure that the incentive compensation policies do not undermine the safety and soundness of those organizations by encouraging excessive risk-taking. The incentive compensation guidance sets expectations for banking organizations concerning their incentive compensation arrangements and related risk-management, control and governance processes. The incentive compensation guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon three primary principles: (i) balanced risk-taking incentives; (ii) compatibility with effective controls and risk management; and (iii) strong corporate governance. Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or take other actions. In addition, under the incentive compensation guidance, a banking organization's federal supervisor may initiate enforcement action if the organization's incentive compensation arrangements pose a risk to the safety and soundness of the organization.

In 2016, several federal financial agencies (including the Federal Reserve and FDIC) proposed restrictions on incentive-based compensation pursuant to Section 956 of the Dodd-Frank Act for financial institutions with $1 billion or more in total consolidated assets. For institutions with at least $1 billion but less than $50 billion in total consolidated assets, the proposal would impose principles-based restrictions that are broadly consistent with existing interagency guidance on incentive-based compensation. Such institutions would be prohibited from entering into incentive compensation arrangements that encourage inappropriate risks by the institution (i) by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits, or (ii) that could lead to material financial loss to the institution. The comment period for these proposed regulations has closed, but a final rule has not been published. Depending upon the outcome of the rule making process, the application of this rule to us could require us to revise our compensation strategy, increase our administrative costs and adversely affect our ability to recruit and retain qualified employees.

Further, as discussed above, the Basel III Capital Rules limit discretionary bonus payments to bank executives if the institution's regulatory capital ratios fail to exceed certain thresholds. See "—Regulatory Capital Requirements" above.

The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future.

Financial Privacy

The federal bank regulatory agencies have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through financial services companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

Cybersecurity

The federal bank regulatory agencies have issued multiple statements regarding cybersecurity. This guidance requires financial institutions to design multiple layers of security controls to establish lines of defense and ensure that their risk management processes address the risk posed by compromised customer credentials and include security measures to authenticate customers accessing internet-based services of the financial institution. The management of a financial institution is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of operations in the event of a cyber-attack. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to a cyber-attack. If we fail to observe the regulatory guidance, we could be subject to various regulatory sanctions, including financial penalties.

State regulators have also been increasingly active in implementing privacy and cybersecurity standards and regulations. Recently, several states, notably including California where we conduct substantially all our banking business, have adopted laws and/or regulations requiring certain financial institutions to implement cybersecurity programs and providing detailed requirements with respect to these programs, including data encryption requirements. Many such states (including California) have also recently implemented or modified their data breach notification and data privacy requirements. We expect this trend of state-level activity in those areas to continue, and we continue to monitor relevant legislative and regulatory developments in California where nearly all our customers are located.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ a layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not detected a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A - *"Risk Factors*" for a further discussion of risks related to cybersecurity.

Impact of Monetary Policy

The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence

overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

Enforcement Powers of Federal and State Banking Agencies

The federal bank regulatory agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver for financial institutions. Failure to comply with applicable laws and regulations could subject us and our officers and directors to administrative sanctions and potentially substantial civil money penalties. The DBO also has broad enforcement powers over us, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

ITEM 1A — *RISK FACTORS*

Our business, financial condition and results of operations are subject to various risks, including those discussed below. The risks discussed below are those that we believe are the most significant risks, although additional risks not presently known to us or that we currently deem less significant may also adversely affect our business, financial condition and results of operations, perhaps materially.

Risks Relating to Our Business

Our Business could be adversely affected by unfavorable economic and market conditions.

Our business and operations are sensitive to general business and economic conditions in the United States, generally, and particularly the state of California and our market area. Unfavorable or uncertain economic and market conditions could lead to credit quality concerns related to borrower repayment ability and collateral protection as well as reduced demand for the products and services we offer. Unlike larger banks that are more geographically diversified, we provide banking services to customers primarily in the southern and eastern regions of the general San Francisco Bay Area of California. During 2019, the U.S. economy has continued to grow across a wide range of industries and regions in the U.S. There are continuing concerns related to the level of U.S. government debt and fiscal actions that may be taken to address that debt. In addition, geopolitical developments, such as existing and potential trade wars and other events beyond our control, such as the Coronavirus epidemic, can increase levels of political and economic unpredictability globally and increase the volatility of global financial markets. Concerns about the performance of international economies, especially in Europe and emerging markets, and economic conditions in Asia, can impact the economy and financial markets here in the United States. If the national, regional and local economies experience worsening economic conditions, including high levels of unemployment, our growth and profitability could be constrained. Weak economic conditions are characterized by, among other indicators, deflation, elevated levels of unemployment, fluctuations in debt and equity capital markets, increased delinquencies on mortgage, commercial and consumer loans, residential and commercial real estate price declines, and lower home sales and commercial activity. Various market conditions may also negatively affect our operating results. Real estate market conditions directly affect performance of our loans secured by real estate. Debt markets affect the availability of credit, which affects the rates and terms at which we offer loans and leases. Stock market downturns affect businesses' ability to raise capital and invest in business expansion. Stock market downturns often signal broader economic deterioration and/or a downward trend in business earnings, which adversely affects businesses' ability to service their debts.

There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and saving habits. Such conditions could have a material adverse effect on the credit quality of our loans or our business, financial condition or results of operations.

An economic recession or a downturn in various markets could have one or more of the following adverse effects on our business:

- a decrease in the demand for our loan or other products and services offered by us;
- a decrease in our deposit balances due to an overall reduction in customer accounts;

- a decrease in the value of our investment securities and loans;
- an increase in the level of nonperforming and classified loans;
- an increase in the provision for credit losses and loan and lease charge-offs;
- a decrease in net interest income derived from our lending and deposit gathering activities;
- a decrease in the Company's stock price;
- an increase in our operating expenses associated with attending to the effects of the above-listed circumstances; and/or
- a decrease in real estate values or a general decrease in capital available to finance real estate transactions, which could have a negative impact on borrowers' ability to pay off their loans as they mature.

Changes in U.S. trade policies and other factors beyond our Company's control, including the imposition of tariffs and retaliatory tariffs, may adversely impact our business, financial condition and results of operations.

There have been changes and discussions with respect to U.S. trade policies, legislation, treaties and tariffs, including trade policies and tariffs affecting other countries, including China, the European Union, Canada and Mexico and retaliatory tariffs by such countries. Tariffs and retaliatory tariffs have been imposed, and additional tariffs and retaliation tariffs have been proposed. Such tariffs, retaliatory tariffs or other trade restrictions on products and materials that our customers import or export, including among others, agricultural products, could cause the prices of our customers' products to increase which could reduce demand for such products, or reduce our customer margins, and adversely impact their revenues, financial results and ability to service debt; which, in turn, could adversely affect our financial condition and results of operations. In addition, to the extent changes in the political environment have a negative impact on us or on the markets in which we operate our business, results of operations and financial condition could be materially and adversely impacted in the future. It remains unclear what the U.S. Administration or foreign governments will or will not do with respect to tariffs already imposed, additional tariffs that may be imposed, or international trade agreements and policies. On October 1, 2018, the United States, Canada and Mexico agreed to a new trade deal to replace the North American Free Trade Agreement. While ratified by Mexico and the U.S., the trade deal is subject to ratification by Canada which may or may not be approved by the end of 2020. The full impact of this agreement on us, our customers and on the economic conditions in our states is currently unknown. A trade war or other governmental action related to tariffs or international trade agreements or policies has the potential to negatively impact ours and/or our customers' costs, demand for our customers' products, and/or the U.S. economy or certain sectors thereof and, thus, adversely impact our business, financial condition and results of operations.

Fluctuations in interest rates may reduce net interest income and otherwise negatively affect our financial condition and results of operations.

Shifts in short-term interest rates may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. When interest rates rise, the rate of interest we earn on our assets, such as loans, typically rises more quickly than the rate of interest that we pay on our interest-bearing liabilities, such as deposits, which may cause our profits to increase. When interest rates decrease, the rate of interest we earn on our assets, such as loans, typically declines more quickly than the rate of interest that we pay on our interest-bearing liabilities, such as deposits, which may cause our profits to decrease. Interest rates are volatile and highly sensitive to many factors beyond our control, including governmental monetary policies, inflation, recession, changes in unemployment, the money supply and international disorder and instability in domestic and foreign financial markets.

Interest rate increases often result in larger payment requirements for our borrowers, which increases the potential for default. At the same time, the marketability of the underlying property may be adversely affected by any reduced demand resulting from higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their mortgages and other indebtedness at lower rates.

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income.

Rising interest rates result in a decline in value of fixed-rate debt securities we hold in our investment securities portfolio. The unrealized losses resulting from holding these securities will be recognized in accumulated other comprehensive income (loss) and reduce total shareholders' equity. Unrealized losses do not negatively affect our regulatory capital ratios; however, tangible common equity and the associated ratios would be reduced. If unrealized loss debt securities are sold, such realized losses will reduce our regulatory capital ratios.

Changes in interest rates can also affect the level of loan refinancing activity, which impacts the amount of prepayment penalty income we receive on loans we hold. Because prepayment penalties are recorded as interest income when received, the extent to which they increase or decrease during any given period could have a significant impact on the level of net interest income and net income we generate during that time. A decrease in our prepayment penalty income resulting from any change in interest rates or as a result of regulatory limitations on our ability to charge prepayment penalties could therefore adversely affect our net interest income, net income or results of operations.

If short-term interest rates decline, and assuming longer term interest rates fall faster, we could experience net interest margin compression as our interest-earning assets would continue to reprice downward while our interest-bearing liability rates could fail to decline in tandem. This would have a material adverse effect on our net interest income, financial condition, and results of operations.

We could recognize losses on securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.

As of December 31, 2019, the fair value of our securities portfolio was approximately $772.9 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities or our own analysis of the value of the security, defaults by the issuer or individual mortgagors with respect to the underlying securities, and continued instability in the credit markets. Any of the foregoing factors could cause other-than-temporary impairment in future periods and result in realized losses. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

Liquidity risks could affect operations and jeopardize our business, financial condition, and results of operations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and/or investment securities and from other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of our customer deposits. Such deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments, we could lose a relatively low cost source of funds, thereby increasing our funding costs.

Other primary sources of funds consist of cash from deposits. Additional liquidity is provided by our ability to borrow from the Federal Reserve Bank of San Francisco and the Federal Home Loan Bank of San Francisco. We also may borrow from third-party lenders from time to time. Our access to funding sources in amounts adequate to finance or capitalize our activities on terms that are acceptable to us could be impaired by factors that affect us directly or the financial

services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

Any decline in available funding could adversely impact our ability to continue to implement our strategic plan, including our ability to originate loans, invest in securities, meet our expenses, or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

Competition among U.S. banks for customer deposits is intense, may increase the cost of retaining current deposits or procuring new deposits, and may otherwise negatively affect our ability to grow our deposit base.

Competition among U.S. banks for customer deposits is intense, may increase the cost of retaining current deposits or procuring new deposits, and may otherwise negatively affect our ability to grow our deposit base. Maintaining and attracting new deposits is integral to our business and a major decline in deposits or failure to attract deposits in the future, including any such decline or failure related to an increase in interest rates paid by our competitors on interest-bearing accounts, could have an adverse effect on our results of operations and financial condition. Interest-bearing accounts earn interest at rates established by management based on competitive market factors. The demand for the deposit products we offer may also be reduced due to a variety of factors, such as demographic patterns, changes in customer preferences, reductions in consumers' disposable income, regulatory actions that decrease customer access to particular products, or the availability of competing products.

Our business depends on our ability to successfully manage credit risk.

The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we significantly increase our allowance for loan losses, each of which could adversely affect our net income. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations.

An important feature of our credit risk management system is our use of an internal credit risk rating and control system through which we identify, measure, monitor and mitigate existing and emerging credit risk of our customers. As this process involves detailed analysis of the customer or credit risk, taking into account both quantitative and qualitative factors, it is subject to human error. In exercising their judgment, our employees may not always be able to assign an accurate credit rating to a customer or credit risk, which may result in our exposure to higher credit risks than indicated by our risk rating and control system. Although our management seeks to address possible credit risk proactively, it is possible that the credit risk rating and control system will not identify credit risk in our loan portfolio and that we may fail to manage credit risk effectively.

Some of our tools and metrics for managing credit risk and other risks are based upon our use of observed historical market behavior and assumptions. We rely on quantitative models to measure risks and to estimate certain financial values. Models may be used in such processes as determining the pricing of various products, grading loans and extending credit, measuring interest rates and other market risks, predicting losses, assessing capital adequacy and calculating regulatory capital levels, as well as estimating the value of financial instruments and balance sheet items. Poorly designed or implemented models present the risk that our business decisions based on information incorporating such models will be adversely affected due to the inadequacy of that information. Moreover, our models may fail to predict future risk exposures if the information used in the model is incorrect, obsolete or not sufficiently comparable to actual events as they occur, or if our model assumptions prove incorrect. We seek to incorporate appropriate historical data in our models, but the range of market values and behaviors reflected in any period of historical data is not at all times predictive of future developments in any particular period and the period of data we incorporate into our models may turn

out to be inappropriate for the future period being modeled. In such case, our ability to manage risk would be limited and our risk exposure and losses could be significantly greater than our models indicated.

Risks Related to Our Loans

Because a significant portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.

Real estate lending (including commercial, land development and construction, and purchased residential mortgage loans) is a large portion of our loan portfolio. At December 31, 2019, approximately $1.83 billion, or 72% of our loan portfolio, was comprised of loans with real estate as a primary or secondary component of collateral. Included in the loans secured by real estate were $507.1 million or 34% of owner occupied loans. The real estate securing our loan portfolio is concentrated in California.

As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, the rate of unemployment, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature, such as earthquakes and natural disasters. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which could result in losses that would adversely affect profitability. Such declines and losses would have a material adverse impact on our business, financial condition, and results of operations. In addition, if hazardous or toxic substances are found on properties pledged as collateral, the value of the real estate could be impaired. If we foreclose on and take title to such properties, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property.

Our construction and land development loans are based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate and we may be exposed to more losses on these projects than on other loans.

At December 31, 2019, land and construction loans, (including land acquisition and development loans) totaled $150.6 million or 6% of our portfolio. Of these loans, 43% were comprised of owner occupied and 57% non-owner occupied construction and land loans. These loans involve additional risks because funds are advanced upon the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of project construction. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it.

The risks inherent in construction lending may affect adversely our results of operations. Such risks include, among other things, the possibility that contractors may fail to complete, or complete on a timely basis, construction of the relevant properties; substantial cost overruns in excess of original estimates and financing; market deterioration during construction; and lack of permanent take-out financing. Loans secured by such properties also involve additional risks because they have no operating history. In these construction loans, loan funds are advanced upon the security of the project under construction (which is of uncertain value prior to completion of construction) and the estimated operating cash flow to be generated by the completed project. Such properties may not be sold or leased so as to generate the cash

flow anticipated by the borrower. A general decline in real estate sales and prices across the U.S. or locally in the relevant real estate market, a decline in demand for residential property, economic weakness, high rates of unemployment and reduced availability of mortgage credit are some of the factors that can adversely affect the borrowers' ability to repay their obligations to us and the value of our security interest in collateral, and thereby adversely affect our results of operations and financial results.

Supervisory guidance on commercial real estate concentrations could restrict our activities and impose financial requirements or limits on the conduct of our business.

As a part of their regulatory oversight, in 2006 federal bank regulators issued guidance titled, "Concentrations in Commercial Real Estate Lending, Sound Risk Management," which we refer to as the CRE Concentration Guidance. Additional guidance which focused on CRE lending, including an Interagency Statement titled, "Statement on Prudent Risk Management for Commercial Real Estate Lending," has been issued from time to time since 2006 and CRE lending continues to be a significant focus of federal and state bank regulators. These various guidelines and pronouncements were issued in response to the agencies' concerns that rising CRE concentrations might expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the commercial real estate market. The CRE Concentration Guidance identifies certain concentration levels that, if exceeded, will expose the institution to additional supervisory analysis with regard to the institution's CRE concentration risk. The CRE Concentration Guidance is designed to promote appropriate levels of capital and sound loan and risk management practices for institutions with a concentration of CRE loans. In general, the CRE Concentration Guidance establishes the following supervisory criteria as preliminary indications of possible CRE concentration risk: (i) the institution's total construction, land development and other land loans represent 100% or more of total risk-based capital; or (ii) total CRE loans as defined in the regulatory guidelines represent 300% or more of total risk-based capital, and the institution's CRE loan portfolio has increased by 50% or more during the prior 36-month period. Pursuant to the CRE Concentration Guidelines, loans secured by owner-occupied commercial real estate are not included for purposes of CRE Concentration calculation. As of December 31, 2019, using regulatory definitions in the CRE Concentration Guidance, our CRE loans increased to 282% of HBC total risk-based capital, as compared to 242% as of December 31, 2018, primarily due to CRE loans acquired from Presidio. If the FDIC became concerned about our CRE loan concentrations, they could inhibit our organic growth by restricting our ability to execute on our strategic plan.

Our use of appraisals in deciding whether to make a loan on or secured by real property does not ensure the value of the real property collateral.

In considering whether to make a loan secured by real property we generally require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is conducted, and an error in fact or judgment could adversely affect the reliability of an appraisal. In addition, events occurring after the initial appraisal may cause the value of the real estate to decrease. As a result of any of these factors the value of collateral securing a loan may be less than estimated, and if a default occurs we may not recover the outstanding balance of the loan.

Many of our loans are to commercial borrowers, which may have a higher degree of risk than other types of borrowers.

At December 31, 2019, commercial loans totaled $631.5 million or 25% of our loan portfolio (including SBA loans, asset-based lending, and factored receivables). Commercial loans often involve risks that are different from other types of lending. Because payments on such loans are often dependent on the successful operation or development of the property or business involved, repayment of such loans is often more sensitive than other types of loans to adverse conditions in the real estate market or the general business climate and economy. Accordingly, a downturn in the real estate market and a challenging business and economic environment may increase our risk related to commercial loans. Unlike residential property loans, which generally are made on the basis of the borrowers' ability to make repayment from their employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. Most often, this collateral consists of accounts receivable, inventory and equipment. Inventory and equipment may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. Due to the larger average size of each commercial loan, as well as collateral that is generally less readily-marketable, losses incurred on a small number of commercial loans could have a material adverse impact on our financial condition and results of operations.

The small and medium-sized businesses that we lend to may have fewer resources to weather adverse business developments, which may impair a borrower's ability to repay a loan, and such impairment could adversely affect our results of operations and financial condition.

We target our business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small and medium-sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could have a material adverse impact on the business and its ability to repay its loan. If general economic conditions negatively impact the markets in which we operate and small to medium-sized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be adversely affected.

We may suffer losses in our loan portfolio despite our underwriting practices.

We mitigate the risks inherent in our loan portfolio by adhering to sound and proven underwriting practices, managed by experienced and knowledgeable credit professionals. These practices include analysis of a borrower's prior credit history, financial statements, tax returns, and cash flow projections, valuations of collateral based on reports of independent appraisers and verifications of liquid assets. Nonetheless, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan loss.

Risks Related to our SBA Loan Program

Small Business Administration lending is an important part of our business. Our SBA lending program is dependent upon the U.S. federal government, and we face specific risks associated with originating SBA loans.

At December 31, 2019, SBA loans totaled $50.7 million, which are included in the commercial loan portfolio, and SBA loans held-for-sale totaled $1.1 million. Our SBA lending program is dependent upon the U.S. federal government. As an approved participant in the SBA Preferred Lender's Program (an "SBA Preferred Lender"), we enable our clients to obtain SBA loans without being subject to the potentially lengthy SBA approval process necessary for lenders that are not SBA Preferred Lenders. The SBA periodically reviews the lending operations of participating lenders to assess, among other things, whether the lender exhibits prudent risk management. When weaknesses are identified, the SBA may request corrective actions or impose enforcement actions, including revocation of the lender's SBA Preferred Lender status. If we lose our status as an SBA Preferred Lender, we may lose some or all of our customers to lenders who are SBA Preferred Lenders, and as a result we could experience a material adverse effect to our financial results. Any changes to the SBA program, including but not limited to changes to the level of guarantee provided by the federal government on SBA loans, changes to program specific rules impacting volume eligibility under the guaranty program, as well as changes to the program amounts authorized by Congress may also have a material adverse effect on our business. In addition, any default by the U.S. government on its obligations or any prolonged government shutdown could, among other things, impede our ability to originate SBA loans or sell such loans in the secondary market, which could materially adversely affect our business, results of operations and financial condition.

The SBA's 7(a) Loan Program is the SBA's primary program for helping start-up and existing small businesses, with financing guaranteed for a variety of general business purposes. Generally, we sell the guaranteed portion of our SBA 7(a) loans in the secondary market. These sales result in premium income for us at the time of sale and create a stream of future servicing income, as we retain the servicing rights to these loans. For the reasons described above, we may not be able to continue originating these loans or sell them in the secondary market. Furthermore, even if we are able to continue to originate and sell SBA 7(a) loans in the secondary market, we might not continue to realize premiums upon the sale of the guaranteed portion of these loans or the premiums may decline due to economic and competitive factors. When we originate SBA loans, we incur credit risk on the non-guaranteed portion of the loans, and if a customer defaults on a loan, we share any loss and recovery related to the loan pro-rata with the SBA. If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by us, the SBA may seek recovery of the principal loss related to the deficiency from us. Generally, we do not

maintain reserves or loss allowances for such potential claims and any such claims could materially adversely affect our business, financial condition or results of operations.

The laws, regulations and standard operating procedures that are applicable to SBA loan products may change in the future. We cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies and especially our organization, changes in the laws, regulations and procedures applicable to SBA loans could adversely affect our ability to operate profitably.

The recognition of gains on the sale of loans and servicing asset valuations reflect certain assumptions.

We expect that gains on the sale of U.S. government guaranteed loans will contribute to noninterest income. The gains on such sales recognized for the year ended December 31, 2019 was $689,000. The determination of these gains is based on assumptions regarding the value of unguaranteed loans retained, servicing rights retained and deferred fees and costs, and net premiums paid by purchasers of the guaranteed portions of U.S. government guaranteed loans. The value of retained unguaranteed loans and servicing rights are determined based on market derived factors such as prepayment rates, current market conditions and recent loan sales. Deferred fees and costs are determined using internal analysis of the cost to originate loans. Significant errors in assumptions used to compute gains on sale of loans or servicing asset valuations could result in material revenue misstatements, which may have a material adverse effect on our business, results of operations and profitability.

The non-guaranteed portion of SBA loans that we retain on our balance sheet as well as the guaranteed portion of SBA loans that we sell could expose us to various credit and default risks.

We originated $27.3 million of SBA loans for the year ended December 31, 2019. We sold $9.2 million of the guaranteed portion of our SBA loans for the year ended December 31, 2019. We generally retain the non-guaranteed portions of the SBA loans that we originate. Consequently, as of December 31, 2019, we held $51.6 million of SBA loans on our balance sheet, $32.8 million of which consisted of the non-guaranteed portion of SBA loans and $1.1 million, or 2.0%, consisted of the guaranteed portion of SBA loans which we intend to sell in 2020. The non-guaranteed portion of SBA loans have a higher degree of credit risk and risk of loss as compared to the guaranteed portion of such loans and make up a substantial majority of our remaining SBA loans.

When we sell the guaranteed portion of SBA loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the SBA loans and the manner in which they were originated. Under these agreements, we may be required to repurchase the guaranteed portion of the SBA loan if we have breached any of these representations or warranties, in which case we may record a loss. In addition, if repurchase and indemnity demands increase on loans that we sell from our portfolios, our liquidity, results of operations and financial condition could be adversely affected. Further, we generally retain the non-guaranteed portions of the SBA loans that we originate and sell, and to the extent the borrowers of such loans experience financial difficulties, our financial condition and results of operations could be adversely impacted.

Risks Related to our Credit Quality

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

As of December 31, 2019, our nonperforming loans (which consist of nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings) totaled $9.8 million, or 0.39% of our loan portfolio, and our nonperforming assets (which include nonperforming loans plus other real estate owned) totaled $9.8 million, or 0.24% of total assets. In addition, we had $7.0 million in accruing loans that were 30-89 days delinquent as of December 31, 2019.

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our net interest income, net income and returns on assets and equity, and our loan administration costs increase, which together with reduced interest income adversely affects our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These nonperforming loans and other real estate owned

also increase our risk profile and the level of capital our regulators believe is appropriate for us to maintain in light of such risks. The resolution of nonperforming assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in nonperforming loans and nonperforming assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which would have an adverse effect on our net income and related ratios, such as return on assets and equity.

Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.

A significant source of risk arises from the possibility that losses could be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans and leases. The underwriting and credit monitoring policies and procedures that we have adopted to address this risk may not prevent unexpected losses and such losses could have a material adverse effect on our business, financial condition, results of operations and cash flows. These unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond our ability to predict, influence or control.

Like all financial institutions, we maintain an allowance for loan losses to provide for loan defaults and non-performance. This allowance, expressed as a percentage of loans, was 0.92%, at December 31, 2019. Allowance for loan losses is funded from a provision for loan losses, which is a charge to our income statement. Our provision for loan losses was $846,000 for the year ended December 31, 2019.

Our allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses could materially and adversely affect our business, financial condition, results of operations and cash flows. The allowance for loan losses reflects our estimate of the probable incurred losses in our loan portfolio at the relevant balance sheet date. Our allowance for loan losses is based on our prior experience, as well as an evaluation of the known risks in the current portfolio, composition and growth of the loan portfolio and economic factors. The determination of an appropriate level of loan loss allowance is an inherently difficult and subjective process, requiring complex judgments, and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic and other conditions, including changes in interest rates, changes in the financial condition of borrowers, and deteriorating values of collateral that may be beyond our control, and these losses may exceed current estimates. If our allowance for loan losses is inaccurate, for any of the reasons discussed above (or other reasons), and is inadequate to cover the loan losses that we actually experience, the resulting losses could have a material and adverse impact on our business, financial condition, and results of operations.

We also evaluate all loans identified as impaired loans and allocate an allowance based upon our estimation of the potential loss associated with those problem loans. While we strive to carefully manage and monitor credit quality and to identify loans that may be deteriorating, at any time there are loans in our loan portfolio that may result in losses, but that have not yet been identified as non-performing or potential problem loans. Through established credit practices, we attempt to identify deteriorating loans and adjust the allowance for loan losses accordingly. However, because future events are uncertain and because we may not successfully identify all deteriorating loans in a timely manner, there may be loans that deteriorate in an accelerated time frame. We cannot be certain that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that have been so identified.

The application of the acquisition method of accounting in our acquisitions has impacted our allowance for loan and lease losses. Under the acquisition method of accounting, loans we acquired were recorded in our consolidated financial statements at their fair value at the time of acquisition and the related allowance for loan and lease loss was eliminated because credit quality, among other factors, was considered in the determination of fair value. We make various assumptions and judgments about the collectability of acquired loan portfolios, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. To the extent that the estimates we make at the time of acquisition prove to be inadequate based on changing facts and circumstances arising from reporting period to reporting period, we may incur losses associated with the acquired loans.

Although management believes that the allowance for loan losses is adequate to absorb losses on any existing loans that may become uncollectible, we may be required to take additional provisions for loan losses in the future to further supplement the allowance for loan losses, either due to management’s decision to do so or because our banking regulators require us to do so. Our bank regulatory agencies will periodically review our allowance for loan losses and the value attributed to nonaccrual loans or to real estate acquired through foreclosure and may require us to adjust our

determination of the value for these items. These adjustments may adversely affect our business, financial condition and results of operations.

New accounting standards may require us to increase our allowance for loan and lease losses.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 replaces the incurred loss model with an expected loss model, which is referred to as the current expected credit loss ("CECL") model. The CECL model is applicable to the measurement of credit losses on the financial assets measured at amortized cost, including but not limited to loan receivables and held-to-maturity securities. 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. For all assets within the scope of CECL, a 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 and April 2019, the FASB issued ASUs that provided codification improvements and clarification to Topic 326. These ASUs are effective for public business entities for fiscal years after December 15, 2019, including interim periods within those fiscal years. This update became effective for the Company on January 1, 2020. The Company is finalizing the economic forecasts and certain other key assumptions used in our CECL model and methodologies, and the required financial reporting disclosures are being further refined and internally validated. Internal controls related to CECL have been designed and are being evaluated; however, all internal controls related to CECL implementation are not operational. As of the implementation date, Management expects to recognize an increase of up to $12.0 million to its allowance for credit losses for loans. The majority of this increase is related to the acquired loan portfolios. Once finalized, the cumulative-effect adjustment as a result of the adoption of this guidance will be recorded, net of tax, as an adjustment to retained earnings effective January 1, 2020. This estimate is subject to change based on continued refinement and validation of the model and methodologies as well as changes in forecasted macroeconomic conditions. Ongoing impacts of the CECL methodology will be dependent upon changes in economic conditions and forecasts, originated and acquired loan portfolio composition, portfolio duration, and other factors. Management is currently assessing the potential impact on the CECL model results due to an economic downturn caused by the Coronavirus.

Uncertainty relating to LIBOR calculation process and potential phasing out of LIBOR may adversely affect us.

On July 27, 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calibration of LIBOR to the administrator of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based securities and variable rate loans, debentures, or other securities or financial arrangements, given LIBOR's role in determining market interest rates globally. Uncertainty as to the nature of alternative reference rates and as to potential changes or other reforms to LIBOR may adversely affect LIBOR rates and the value of LIBOR-based loans and securities in our portfolio and may impact the availability and cost of hedging instruments and borrowings. If LIBOR rates are no longer available, and we are required to implement substitute indices for the calculation of interest rates under our loan agreements with our borrowers, we may incur significant expenses in effecting the transition, and may be subject to disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute indices, which could have a material adverse effect on our financial condition or results of operations.

Real estate market volatility and future changes in our disposition strategies could result in net proceeds that differ significantly from our other real estate owned fair value appraisals.

As of December 31, 2019 we had no other real estate owned ("OREO") on our financial statements, but in the ordinary course of our business we expect to hold some level of OREO from time to time. OREO typically consists of properties that we obtain through foreclosure or through an in-substance foreclosure in satisfaction of an outstanding loan. OREO properties are valued on our books at the lesser of the recorded investment in the loan for which the property previously served as collateral or the property's "fair value," which represents the estimated sales price of the property on the date acquired less estimated selling costs. Generally, in determining "fair value," an orderly disposition of the property is assumed, unless a different disposition strategy is expected. Significant judgment is required in estimating the fair value

of OREO property, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility.

In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our OREO disposition strategy, such as immediate liquidation sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from the appraisals, comparable sales and other estimates used to determine the fair value of our OREO properties.

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

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

Risks Related to Growth Strategy

There are risks related to acquisitions.

We plan to continue to grow our business organically. However, from time to time, we may consider opportunistic strategic acquisitions that we believe support our long-term business strategy. We face significant competition from numerous other financial services institutions, many of which will have greater financial resources than we do, when considering acquisition opportunities. Accordingly, attractive acquisition opportunities may not be available to us. We may not be successful in identifying or completing any future acquisitions. Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect our organization.

If we complete any future acquisitions, we may not be able to successfully integrate the operations, management, products and services of the entities that we acquire and eliminate redundancies. The integration process could result in the loss of key employees or disruption of the combined entity's ongoing business or inconsistencies in standards, controls, procedures, and policies that adversely affect our ability to maintain relationships with customers and employees or achieve the anticipated benefits of the transaction. The integration process may also require significant time and attention from our management that they would otherwise direct at servicing existing business and developing new business. We may not be able to realize any projected cost savings, synergies or other benefits associated with any such acquisition we complete. We cannot determine all potential events, facts and circumstances that could result in loss and our investigation or mitigation efforts may be insufficient to protect against any such loss.

In addition, we must generally satisfy a number of meaningful conditions prior to completing any acquisition, including, in certain cases, federal and state bank regulatory approval. Bank regulators consider a number of factors when determining whether to approve a proposed transaction, including the effect of the transaction on financial stability and the ratings and compliance history of all institutions involved, including the CRA, examination results and anti-money laundering and Bank Secrecy Act compliance records of all institutions involved. The process for obtaining required regulatory approvals has become substantially more difficult, which could affect our future business. We may fail to pursue, evaluate or complete strategic and competitively significant business opportunities as a result of our inability, or our perceived inability, to obtain any required regulatory approvals in a timely manner or at all.

Issuing additional shares of our common stock to acquire other banks and bank holding companies may result in dilution for existing shareholders and may adversely affect the market price of our stock.

In connection with our growth strategy, we have issued, and may issue in the future, shares of our common stock to acquire additional banks or bank holding companies that may complement our organizational structure. Resales of

substantial amounts of common stock in the public market and the potential of such sales could adversely affect the prevailing market price of our common stock and impair our ability to raise additional capital through the sale of equity securities. We sometimes must pay an acquisition premium above the fair market value of acquired assets for the acquisition of banks or bank holding companies. Paying this acquisition premium, in addition to the dilutive effect of issuing additional shares, may also adversely affect the prevailing market price of our common stock.

If the goodwill that we recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on our financial condition and results of operations.

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in connection with the purchase. We review goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that the carrying value of the asset might be impaired. We determine impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. Estimates of fair value are determined based on a complex model using cash flows, the fair value of our Company as determined by our stock price, and company comparisons. If management's estimates of future cash flows are inaccurate, fair value determined could be inaccurate and impairment may not be recognized in a timely manner. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. As of December 31, 2019, our goodwill totaled $167.4 million, compared to $83.8 million at December 31, 2018. There can be no assurance that our future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on our financial condition and results of operations.

Our decisions regarding the fair value of assets acquired could be different than initially estimated, which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

In business combinations, we acquire significant portfolios of loans that are marked to their estimated fair value. There is no assurance that the acquired loans will not suffer deterioration in value. The fluctuations in national, regional and local economic conditions, including those related to local residential, commercial real estate and construction markets, may increase the level of charge offs in the loan portfolio that we acquire and correspondingly reduce our net income. These fluctuations are not predictable, cannot be controlled and may have a material adverse impact on our operations and financial condition, even if other favorable events occur.

We must effectively manage our branch growth strategy.

We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of our business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without increasing interest rate risk or compressing our net interest margin, maintaining sufficient capital, maintaining proper system and controls, and recruiting, training and retaining qualified professionals. We also may experience a lag in profitability associated with new branch openings. As part of our general growth strategy we may expand into additional communities or attempt to strengthen our position in our current markets by opening new offices, subject to any regulatory constraints on our ability to open new offices. To the extent that we are able to open additional offices, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations for a period of time which would have an adverse effect on our levels of reported net income, return on average equity and return on average assets.

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

From time to time, we may implement or may acquire new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and new products and services we may invest significant time and resources. We may not achieve target timetables for the introduction and development of new lines of business and new products or services and price and profitability targets may not prove feasible. External factors, such as regulatory compliance obligations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of

new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

Risks Related to Our Capital

As a result of the Dodd-Frank Act and rulemaking, we are subject to more stringent capital requirements.

In July 2013, the U.S. federal banking authorities approved the implementation of the Basel III regulatory capital reforms, or Basel III, and issued rules affecting certain changes required by the Dodd-Frank Act. Basel III is applicable to all U.S. banks that are subject to minimum capital requirements as well as to bank and saving and loan holding companies, other than "small bank holding companies" (generally bank holding companies with consolidated assets of less than $3.0 billion). Basel III not only increases most of the required minimum regulatory capital ratios, it introduces a new common equity Tier 1 capital ratio and the concept of a capital conservation buffer. Basel III also expands the current definition of capital by establishing additional criteria that capital instruments must meet to be considered additional Tier 1 and Tier 2 capital. In order to be a "well-capitalized" depository institution under the new regime, an institution must maintain a common equity Tier 1 capital ratio of 6.5% or more; a Tier 1 capital ratio of 8% or more; a total capital ratio of 10% or more; and a Tier 1 leverage ratio of 5% or more. The Basel III capital rules became effective as applied to the Company and HBC on January 1, 2015 with a phase-in period that extended through January 1, 2019 for many of the changes.

The failure to meet applicable regulatory capital requirements could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial conditions, generally.

We may need to raise additional capital in the future, and if we fail to maintain sufficient capital, whether due to losses, an inability to raise additional capital or otherwise, our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance, would be adversely affected.

We face significant capital and other regulatory requirements as a financial institution. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, which could include the possibility of financing acquisitions. In addition, the Company, on a consolidated basis, and HBC, on a stand-alone basis, must meet certain regulatory capital requirements and maintain sufficient liquidity. Regulatory capital requirements could increase from current levels, which could require us to raise additional capital or contract our operations. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Any occurrence that may limit our access to the capital markets may adversely affect our capital costs and our ability to raise capital. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. Accordingly, we cannot assure you that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to maintain capital to meet regulatory requirements, our financial condition, liquidity and results of operations would be materially and adversely affected.

Risks Related to our Management

We are highly dependent on our management team, and the loss of our senior executive officers or other key employees could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, results of operations and growth prospects.

Our success depends, in large degree, on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. Our senior management team has significant industry experience, and their knowledge and relationships would be difficult to replace. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the financial services and banking industry is intense, which means the cost of hiring, paying incentives and retaining skilled personnel may continue to increase. We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. In addition, as a provider of relationship-based commercial

banking services, we must attract and retain qualified banking personnel to continue to grow our business, and competition for such personnel can be intense. Our ability to effectively compete for senior executives and other qualified personnel by offering competitive compensation and benefit arrangements may be restricted by applicable banking laws and regulations as discussed in "*Supervision and Regulation—Incentive Compensation Guidance and Proposed Restrictions*." The loss of the services of any senior executive or other key personnel, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on our business, financial condition or results of operations. In addition, to attract and retain personnel with appropriate skills and knowledge to support our business, we may offer a variety of benefits, which could reduce our earnings or have a material adverse effect on our business, financial condition or results of operations.

Risks Related to Our Reputation and Operations

Our ability to maintain our reputation is critical to the success of our business, and the failure to do so may materially adversely affect our business and the value of our common stock.

We are a community bank, and our reputation is one of the most valuable components of our business. Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased governmental regulation. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our common stock may be materially adversely affected.

Our risk management framework may not be effective in mitigating risks and/or losses to us.

Our risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate and compliance. Our framework also includes financial or other modeling methodologies that involve management assumptions and judgment. Our risk management framework may not be effective under all circumstances and may not adequately mitigate any risk or loss to us. If our risk management framework is not effective, we could suffer unexpected losses and our business, financial condition, results of operations or growth prospects could be materially and adversely affected. We may also be subject to potentially adverse regulatory consequences.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to hardware and cyber-security issues. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. We could also experience a breach by intentional or negligent conduct on the part of employees or other internal or external sources, including our third-party vendors. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us, including our internet banking activities, against damage from physical break-ins, cyber-security breaches and other disruptive problems caused by the internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability, damage our reputation and inhibit the use of our internet banking services by current and potential customers.

We rely heavily on communications, information systems (both internal and provided by third-parties) and the internet to conduct our business. Our business is dependent on our ability to process and monitor large numbers of daily transactions in compliance with legal, regulatory and internal standards and specifications. In addition, a significant portion of our operations relies heavily on the secure processing, storage and transmission of personal and confidential information, such as the personal information of our customers and clients. In recent periods, several governmental agencies and large corporations, including financial service organizations and retail companies, have suffered major data breaches, in some cases exposing not only their confidential and proprietary corporate information, but also sensitive financial and other personal information of their clients or clients and their employees or other third-parties, and subjecting

those agencies and corporations to potential fraudulent activity and their clients, clients and other third-parties to identity theft and fraudulent activity in their credit card and banking accounts. Therefore, security breaches and cyber-attacks can cause significant increases in operating costs, including the costs of compensating clients and customers for any resulting losses they may incur and the costs and capital expenditures required to correct the deficiencies in and strengthen the security of data processing and storage systems. These risks may increase in the future as we continue to increase mobile payments and other internet-based product offerings and expand our internal usage of web-based products and applications.

In addition to well-known risks related to fraudulent activity, which take many forms, such as check "kiting" or fraud, wire fraud, and other dishonest acts, information security breaches and cyber-security related incidents have become a material risk in the financial services industry. For example, several U.S. financial institutions have recently experienced significant distributed denial-of-service attacks, some of which involved sophisticated and targeted attacks intended to disable or degrade service, or sabotage systems. Other potential attacks have attempted to obtain unauthorized access to confidential information, steal money, or manipulate or destroy data, often through the introduction of computer viruses or malware, cyber-attacks and other means. Other threats of this type may include fraudulent or unauthorized access to data processing or data storage systems used by us or by our clients, electronic identity theft, "phishing," account takeover, and malware or other cyber-attacks. To date, none of these type of attacks have had a material effect on our business or operations. Such security attacks can originate from a wide variety of sources, including persons who are involved with organized crime or who may be linked to terrorist organizations or hostile foreign governments. Those same parties may also attempt to fraudulently induce employees, customers or other users of our systems to disclose sensitive information in order to gain access to our data or that of our customers or clients.

We are also subject to the risk that our employees may intercept and transmit unauthorized confidential or proprietary information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a customer or third-party could result in legal liabilities, remediation costs, regulatory actions and reputational harm.

Unfortunately, it is not always possible to anticipate, detect, or recognize these threats to our systems, or to implement effective preventative measures against all breaches, whether those breaches are malicious or accidental. Cyber-security risks for banking organizations have significantly increased in recent years and have been difficult to detect before they occur because of the following, among other reasons:

- the proliferation of new technologies, and the use of the Internet and telecommunications technologies to conduct financial transactions;

- these threats arise from numerous sources, not all of which are in our control, including among others human error, fraud or malice on the part of employees or third-parties, accidental technological failure, electrical or telecommunication outages, failures of computer servers or other damage to our property or assets, natural disasters or severe weather conditions, health emergencies or pandemics, or outbreaks of hostilities or terrorist acts;

- the techniques used in cyber-attacks change frequently and may not be recognized until launched or until well after the breach has occurred;

- the increased sophistication and activities of organized crime groups, hackers, terrorist organizations, hostile foreign governments, disgruntled employees or vendors, activists and other external parties, including those involved in corporate espionage;

- the vulnerability of systems to third-parties seeking to gain access to such systems either directly or using equipment or security passwords belonging to employees, customers, third-party service providers or other users of our systems; and

- our frequent transmission of sensitive information to, and storage of such information by, third-parties, including our vendors and regulators, and possible weaknesses that go undetected in our data systems notwithstanding the testing we conduct of those systems.

Our investments in systems and processes that are designed to detect and prevent security breaches and cyber-attacks and our conduct of periodic tests of our security systems and processes, may not succeed in anticipating or adequately protecting against or preventing all security breaches and cyber-attacks from occurring. Even the most advanced internal control environment may be vulnerable to compromise. Targeted social engineering attacks are becoming more sophisticated and are extremely difficult to prevent. Additionally, the existence of cyber-attacks or security breaches at third-parties with access to our data, such as vendors, may not be disclosed to us in a timely manner. As cyber-threats continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any information security vulnerabilities or incidents. We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. If our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

As is the case with non-electronic fraudulent activity, cyber-attacks or other information or security breaches, whether directed at us or third-parties, may result in a material loss or have material consequences. Furthermore, the public perception that a cyber-attack on our systems has been successful, whether or not this perception is correct, may damage our reputation with customers and third-parties with whom we do business. A successful penetration or circumvention of system security could cause us negative consequences, including loss of customers and business opportunities, disruption to our operations and business, misappropriation or destruction of our confidential information and/or that of our customers, or damage to our customers' and/or third-parties' computers or systems, and could expose us to additional regulatory scrutiny and result in a violation of applicable privacy laws and other laws, litigation exposure, regulatory fines, penalties or intervention, loss of confidence in our security measures, reputational damage, reimbursement or other compensatory costs, additional compliance costs, and could adversely impact our results of operations, liquidity and financial condition.

Our operations could be interrupted by our third-party service providers experiencing difficulty in providing their services, terminate their services or fail to comply with banking regulations.

We depend to a significant extent on relationships with third party service providers. Specifically, we utilize third party core banking services and receive credit card and debit card services, branch capture services, Internet banking services and services complementary to our banking products from various third party service providers. These types of third party relationships are subject to increasingly demanding regulatory requirements and attention by our federal bank regulators. Recent regulation requires us to enhance our due diligence, ongoing monitoring and control over our third party vendors and other ongoing third party business relationships. In certain cases, we may be required to renegotiate our agreements with these vendors to meet these enhanced requirements, which could increase our costs. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships, which could result in enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect on our business, financial condition or results of operations. In addition, if these third party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted. It may be difficult for us to replace some of our third party vendors, particularly vendors providing our core banking, credit card and debit card services, in a timely manner if they were unwilling or unable to provide us with these services in the future for any reason. If an interruption were to continue for a significant period of time, it could have a material adverse effect on our business, financial condition or results of operations. Even if we are able to replace them, it may be at higher cost to us, which could have a material adverse effect on our business, financial condition or results of operations. In addition, if a third party provider fails to provide the services we require, fails to meet contractual requirements, such as compliance with applicable laws and regulations, or suffers a cyber-attack or other security breach, our business could suffer economic and reputational harm that could have a material adverse effect on our business, financial condition or results of operations.

Employee misconduct could expose us to significant legal liability and reputational harm.

We are vulnerable to reputational harm because we operate in an industry in which integrity and the confidence of our customers are of critical importance. Our employees could engage in fraudulent, illegal, wrongful or suspicious activities, and/or activities resulting in consumer harm that adversely affects our customers and/or our business. The precautions we take to detect and prevent such misconduct may not always be effective and regulatory sanctions and/or penalties, serious harm to our reputation, financial condition, customer relationships and ability to attract new customers.

In addition, improper use or disclosure of confidential information by our employees, even if inadvertent, could result in serious harm to our reputation, financial condition and current and future business relationships. If our internal controls against operational risks fail to prevent or detect an occurrence of such employee error or misconduct, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

We depend on the accuracy and completeness of information provided by customers and counterparties and any misrepresented information could adversely affect our business, financial condition and results of operations.

In deciding whether to extend credit or to enter into other transactions with customers and counterparties, we may rely on information furnished to us by or on behalf of customers and counterparties, including financial statements and other financial information. Some of the information regarding customers provided to us is also used in our proprietary credit decisioning and scoring models, which we use to determine whether to do business with customers and the risk profiles of such customers which are subsequently utilized by counterparties who lend us capital to fund our operations. We may also rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, we may rely upon our customers' representations that their financial statements conform to GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. We also may rely on customer representations and certifications, or other audit or accountants' reports, with respect to the business and financial condition of our customers. Our financial condition, results of operations, financial reporting and reputation could be negatively affected if those representations are misleading, false, inaccurate or fraudulent and we rely on that materially misleading, false, inaccurate or fraudulent information.

Other Risks Related to Our Business

We face strong competition from financial services companies and other companies that offer commercial banking services, which could harm our business.

We face substantial competition in all phases of our operations from a variety of different competitors. Our competitors, including larger commercial banks, community banks, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, insurance companies, securities dealers, brokers, mortgage bankers, investment advisors, money market mutual funds and other financial institutions, compete with lending and deposit gathering services offered by us. Many of these competing institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale and may offer a broader range of products and services than we can. If we are unable to offer competitive products and services, our business may be negatively affected. Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions or are not subject to increased supervisory oversight arising from regulatory examinations. As a result, these non-bank competitors have certain advantages over us in accessing funding and in providing various services.

We anticipate intense competition will continue for the coming year due to the recent consolidation of many financial institutions and more changes in legislature, regulation and technology. Further, we expect loan demand to continue to be challenging due to the uncertain economic climate and the intensifying competition for creditworthy borrowers, both of which could lead to loan rate concession pressure and could impact our ability to generate profitable loans. We expect we may see tighter competition in the industry as banks seek to take market share in the most profitable customer segments, particularly the small business segment and the mass affluent segment, which offers a rich source of deposits as well as more profitable and less risky customer relationships. Further, with the rebound of the equity markets our deposit customers may perceive alternative investment opportunities as providing superior expected returns. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. The current low interest rate environment could increase such transfers of deposits to higher yielding deposits or other investments. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When our customers move money into higher yielding deposits or in favor of alternative investments, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

New technology and other changes are allowing parties to effectuate financial transactions that previously required the involvement of banks. For example, consumers can maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills

and transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and access to lower cost deposits as a source of funds could have a material adverse effect on our business, results of operations and financial condition.

Increased competition in our markets may result in reduced loans, deposits and commissions and brokers' fees, as well as reduced net interest margin and profitability. Ultimately, we may not be able to compete successfully against current and future competitors. If we are unable to attract and retain banking customers and expand our sales market for such loans, then we may be unable to continue to grow our business and our financial condition and results of operations may be adversely affected.

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology or we may experience operational challenges when implementing new technology.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new, technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements than we do. We may not be able to effectively implement new, technology-driven products and services or be successful in marketing these products and services to our customers. In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. Failure to successfully keep pace with technological change affecting the financial services industry and avoid interruptions, errors and delays could have a material adverse effect on our business, financial condition or results of operations.

We expect that new technologies and business processes applicable to the consumer credit industry will continue to emerge, and these new technologies and business processes may be better than those we currently use. Because the pace of technological change is high and our industry is intensely competitive, we may not be able to sustain our investment in new technology as critical systems and applications become obsolete or as better ones become available. A failure to maintain current technology and business processes could cause disruptions in our operations or cause our products and services to be less competitive, all of which could have a material adverse effect on our business, financial condition or results of operations.

Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, a risk exists that we will not be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

The costs and effects of litigation, investigations or similar matters, or adverse facts and developments related thereto, could materially affect our business, operating results and financial condition.

We may be involved from time to time in a variety of litigation, investigations or similar matters arising out of our business. It is inherently difficult to assess the outcome of these matters, and we may not prevail in any proceedings or litigation. Our insurance may not cover all claims that may be asserted against us and indemnification rights to which we are entitled may not be honored, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation or investigation significantly exceed our insurance coverage, they could have a material adverse effect on our business, financial condition and results of operations. In addition, premiums for insurance covering the financial and banking sectors are rising. We may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms or at historic rates, if at all.

We currently hold a significant amount of company-owned life insurance.

At December 31, 2019, we held company-owned life insurance ("COLI") on current and former senior employees and executives, with a cash surrender value of $76.0 million, as compared with a cash surrender value of $61.9 million at

December 31, 2018. The eventual repayment of the cash surrender value is subject to the ability of the various insurance companies to pay death benefits or to return the cash surrender value to us if needed for liquidity purposes. We continually monitor the financial strength of the various companies with whom we carry these policies. However, any one of these companies could experience a decline in financial strength, which could impair its ability to pay benefits or return our cash surrender value. If we need to liquidate these policies for liquidity purposes, we would be subject to taxation on the increase in cash surrender value and penalties for early termination, both of which would materially adversely impact earnings.

Our ability to access markets for funding and acquire and retain customers could be adversely affected by the deterioration of other financial institutions or the financial service industry's reputation.

Reputation risk is the risk to liquidity, earnings and capital arising from negative publicity regarding us or the financial services industry generally. The financial services industry was featured in negative headlines about the global and national credit crisis which commenced in 2007 and the resulting stabilization legislation enacted by the U.S. federal government. These reports, and subsequent negative press regarding systemic fee-churning problems at other institutions, continue to be damaging to the industry's image and potentially erode confidence in insured financial institutions, such as our banking subsidiary.

In addition, our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. These losses or defaults could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Additionally, if our competitors were extending credit on terms we found to pose excessive risks, or at interest rates which we believed did not warrant the credit exposure, we may not be able to maintain our business volume and could experience deteriorating financial performances.

Severe weather, natural disasters, pandemics, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters (including fires and earthquakes), wide spread disease or pandemics, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, our primary market areas in California are subject to earthquakes, fires, and droughts. Operations in our market could be disrupted by both the evacuation of large portions of the population as well as damage to and/or lack of access to our banking and operation facilities. While we have not experienced such events to date, other severe weather or natural disasters, acts of war or terrorism or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such events could have a material adverse effect on our business financial condition and results of operations.

Finance and Accounting Risks

Accounting estimates and risk management processes rely on analytical models that may prove inaccurate resulting in a material adverse effect on our business, financial condition and results of operations.

The processes we use to estimate probable incurred loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models using those assumptions may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we

could realize upon sale or settlement of such financial instruments. Any such failure in our analytical models could result in losses that could have a material adverse effect on our business, financial condition and results of operations.

Changes in accounting standards could materially impact our financial statements.

From time to time, the FASB or the SEC, may change the financial accounting and reporting standards that govern the preparation of our financial statements. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting standards (such as banking regulators or outside auditors) may change their interpretations or positions on how these standards should be applied. These changes may be beyond our control, can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, in each case resulting in our needing to revise or restate prior period financial statements. Restating or revising our financial statements may result in reputational harm or may have other adverse effects on us.

Failure to maintain effective internal controls over financial reporting could have a material adverse effect on our business and stock price.

We are required to comply with the SEC's rules implementing Sections 302 and 404 of the Sarbanes-Oxley Act, which will require management to certify financial and other information in our quarterly and annual reports and provide an annual management report on the effectiveness of controls over financial reporting. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act, which requires us to furnish annually a report by management on the effectiveness of our internal control over financial reporting and our independent registered public accounting firm is required to report on the effectiveness of our internal control over financial reporting.

If we identify any material weaknesses in our internal control over financial reporting or are unable to comply with the requirements of Section 404 in a timely manner or assert that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors, counterparties and customers may lose confidence in the accuracy and completeness of our financial statements and reports; our liquidity, access to capital markets and perceptions of our creditworthiness could be adversely affected; and the market price of our common stock could decline. In addition, we could become subject to investigations by the stock exchange on which our securities are listed, the SEC, the Federal Reserve, the FDIC, the DBO or other regulatory authorities, which could require additional financial and management resources. These events could have an adverse effect on our business, financial condition and results of operations.

We have significant deferred tax assets and cannot assure that it will be fully realized.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax basis of assets and liabilities computed using enacted tax rates. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax assets will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At December 31, 2019, we had a net deferred tax assets of $24.3 million. If we were to determine at some point in the future that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we would be required, under generally accepted accounting principles, to establish a full or partial valuation allowance which would require us to incur a charge to operations for the period in which the determination was made.

Risks Related to Legislative and Regulatory Developments

We are subject to extensive government regulation that could limit or restrict our activities, which in turn may adversely impact our ability to increase our assets and earnings.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Federal Reserve, the DBO and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels, and

other aspects of our operations. These bank regulators possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. The laws and regulations applicable to the banking industry could change at any time and we cannot predict the effects of these changes on our business, profitability or growth strategy. Increased regulation could increase our cost of compliance and adversely affect profitability. Moreover, certain of these regulations contain significant punitive sanctions for violations, including monetary penalties and limitations on a bank's ability to implement components of its business plan, such as expansion through mergers and acquisitions or the opening of new branch offices. In addition, changes in regulatory requirements may add costs associated with compliance efforts. Furthermore, government policy and regulation, particularly as implemented through the Federal Reserve System, significantly affect credit conditions. Negative developments in the financial industry and the impact of new legislation and regulation in response to those developments could negatively impact our business operations and adversely impact our financial performance.

Legislative and regulatory actions taken now or in the future may impact our business, governance structure, financial condition or results of operations. Proposed legislative and regulatory actions, including changes to financial regulation and the corporate tax law, may not occur on the timeframe that is expected, or at all, which could result in additional uncertainty for our business.

We are subject to extensive regulation by multiple regulatory bodies. These regulations may affect the manner and terms of delivery of our services. If we do not comply with governmental regulations, we may be subject to fines, penalties, lawsuits or material restrictions on our businesses in the jurisdiction where the violation occurred, which may adversely affect our business operations. Changes in these regulations can significantly affect the services that we provide as well as our costs of compliance with such regulations. In addition, adverse publicity and damage to our reputation arising from the failure or perceived failure to comply with legal, regulatory or contractual requirements could affect our ability to attract and retain customers.

Current and recent-past economic conditions, particularly in the financial markets, have resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act and the regulations thereunder affect large and small financial institutions, including several provisions that will affect how community banks, thrifts and small bank and thrift holding companies will be regulated in the future.

The Dodd-Frank Act, among other things, imposed new capital requirements on bank holding companies; changed the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than upon its deposit base; and permanently raised the current standard deposit insurance limit to $250,000 and expanded the FDIC's authority to raise insurance premiums. The Dodd-Frank Act established the Consumer Financial Protection Bureau (the "CFPB") as an independent entity within the Federal Reserve, which has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, home mortgages, home-equity loans and credit cards, and contains provisions on mortgage-related matters, such as steering incentives, determinations as to a borrower's ability to repay and prepayment penalties. Although the applicability of certain elements of the Dodd-Frank Act is limited to institutions with more than $10 billion in assets, there can be no guarantee that such applicability will not be extended in the future or that regulators or other third parties will not seek to impose such requirements on institutions with less than $10 billion in assets, such as HBC. Compliance with the Dodd-Frank Act and its implementing regulations has and will continue to result in additional operating and compliance costs that could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

New proposals for legislation continue to be introduced in the U.S. Congress that could substantially increase regulation of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

Certain aspects of current or proposed regulatory or legislative changes, including to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads, and could expose us to additional costs, including increased compliance costs. These changes also may require us to invest significant management attention and resources to make

any necessary changes to operations to comply and could have a material adverse effect on our business, financial condition and results of operations. In addition, any proposed legislative or regulatory changes, including those that could benefit our business, financial condition and results of operations, may not occur on the timeframe that is proposed, or at all, which could result in additional uncertainty for our business.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Federal and state regulators periodically examine our business, and we may be required to remediate adverse examination findings.

The Federal Reserve, the FDIC, and the DBO periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

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

The Bank Secrecy Act, the USA Patriot Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. The federal banking agencies and Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have recently engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

The Federal Reserve may require us to commit capital resources to support HBC.

As a matter of policy, the Federal Reserve expects a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. The Dodd-Frank Act codified the Federal Reserve's policy on serving as a source of financial strength. Under the "source of strength" doctrine,

the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the bank holding company may not have the resources to provide it and therefore may be required to borrow the funds or raise capital. Any loans by a bank holding company to its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be incurred by us to make a required capital injection to HBC becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

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

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose non-discriminatory lending and other requirements on financial institutions. The U.S. Department of Justice and other federal agencies, including the FDIC and CFPB, are responsible for enforcing these laws and regulations. A successful challenge to an institution's performance under the Community Reinvestment Act, fair lending and other compliance laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. The costs of defending, and any adverse outcome from, any such challenge could damage our reputation or could have a material adverse effect on our business, financial condition or results of operations.

Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorney's fees. Federal bank regulators, state attorney generals and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights and civil money penalties in the jurisdictions in which we operate. Failure to comply with consumer protection requirements may also result in delays or restrictions on mergers and acquisitions and expansionary activities we may wish to pursue.

We may be subject to liability for potential violations of predatory lending laws, which could adversely impact our results of operations, financial condition and business.

Various U.S. federal, state and local laws have been enacted that are designed to discourage predatory lending practices. The U.S. Home Ownership and Equity Protection Act of 1994 ("HOEPA") prohibits inclusion of certain provisions in mortgages that have interest rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. Some states have enacted, or may enact, similar laws or regulations, which in some cases impose restrictions and requirements greater than those in HOEPA. In addition, under the anti-predatory lending laws of some states, the origination of certain mortgages, including loans that are not classified as "high-cost" loans under applicable law, must satisfy a net tangible benefit test with respect to the related borrower. Such tests may be highly subjective and open to interpretation. As a result, a court may determine that a home mortgage, for example, does not meet the test even if the related originator reasonably believed that the test was satisfied. If any of our mortgages are found to have been originated in violation of predatory or abusive lending laws, we could incur losses, which could adversely impact our results of operations, financial condition and business.

In addition, federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered "predatory." These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is our policy not to make predatory loans, but these laws create the potential for liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

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

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively impacted by these laws. For example, our business is subject to the Gramm-Leach-Bliley Act of 1999 which, among other things: (i) imposes certain limitations on our ability to share nonpublic personal information about our customers with nonaffiliated third parties; (ii) requires that we provide certain disclosures to customers about our information collection, sharing and security practices and afford customers the right to "opt out" of any information sharing by us with nonaffiliated third parties (with certain exceptions); and (iii) requires we develop, implement and maintain a written comprehensive information security program containing safeguards appropriate based on our size and complexity, the nature and scope of our activities, and the sensitivity of customer information we process, as well as plans for responding to data security breaches. Various state and federal banking regulators and states have also enacted data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the United States are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information, and some of our current or planned business activities. This could also increase our costs of compliance and business operations and could reduce income from certain business initiatives. This includes increased privacy-related enforcement activity at the federal level, by the Federal Trade Commission, as well as at the state level, such as with regard to mobile applications.

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

Potential limitations on incentive compensation contained in proposed federal agency rulemaking may adversely affect our ability to attract and retain our highest performing employees.

During the second quarter of 2016, the Federal Reserve and the FDIC, along with other U.S. regulatory agencies, jointly published proposed rules designed to implement provisions of the Dodd-Frank Act prohibiting incentive compensation arrangements that would encourage inappropriate risk taking at covered financial institutions, which includes a bank or bank holding company with $1 billion or more in assets. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will substantially affect the manner in which we structure compensation for our executives and other employees. Depending on the nature and application of the final rules, we may not be able to compete successfully with certain financial institutions and other companies that are not subject to some or all of the rules to retain and attract executives and other high performing employees. If this were to occur, relationships that we have established with our customers may be impaired and our business, financial condition and results of operations could be materially adversely affected.

Risks Related to Our Common Stock

An investment in our common stock is not an insured deposit.

An investment in our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described herein, and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you could lose some or all of your investment.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above under "Cautionary Note Regarding Forward Looking Statements" and "Risk Factors" contained in this report. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock some of which are out of our control. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in business and economic condition;
- actual occurrence of one or more of the risk factors outlined above;
- recommendations by securities analysts or failure to meet, securities analysts' estimates of our financial and operating performance, or lack of research reports by industry analysts or ceasing of coverage;
- speculation in the press or investment community generally or relating to our reputation, our operations, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- actions by institutional investors;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity related or debt securities;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings, or litigation that involve or affect us;
- the level and extent to which we do or are allowed to pay dividends;
- trading activities in our common stock, including short selling;
- deletion from well-known index or indices;
- domestic and international economic factors unrelated to our performance; and
- general market conditions and, in particular, developments related to market conditions for the financial services industry.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the Nasdaq, its trading volume is generally less than that of other, larger financial services companies, and investors are not assured that a liquid market will exist at any given time for our common stock. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace at any given time of willing buyers and sellers of our common stock. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

Our dividend policy may change without notice, and our future ability to pay dividends is subject to restrictions.

Historically, our board of directors has declared quarterly dividends on our common stock. However, we have no obligation to continue doing so and may change our dividend policy at any time without notice to holders of our common stock. Holders of our common stock are only entitled to receive such cash dividends as our board of directors, in its discretion, may declare out of funds legally available for such payments. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs, and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely impact the amount of dividends paid to holders of our common stock.

We are a separate and distinct legal entity from HBC. We receive substantially all of our revenue from dividends paid to us by HBC, which we use as the principal source of funds to pay our expenses and to pay dividends to our shareholders, if any. Various federal and/or state laws and regulations limit the amount of dividends that HBC may pay us. If the HBC does not receive regulatory approval or does not maintain a level of capital sufficient to permit it to make dividend payments to us while maintaining adequate capital levels, our ability to pay our expenses and our business, financial condition or results of operations could be materially and adversely impacted.

As a bank holding company, we are subject to regulation by the Federal Reserve. The Federal Reserve has indicated that bank holding companies should carefully review their dividend policy in relation to the organization's overall asset quality, current and prospective earnings and level, composition and quality of capital. The guidance provides that we inform and consult with the Federal Reserve prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to our capital structure, including interest on our debt obligations. If required payments on our debt obligations are not made or are deferred, or dividends on any preferred stock we may issue are not paid, we will be prohibited from paying dividends on our common stock.

The Basel III capital rules also introduced a new capital conservation buffer on top of the minimum risk-based capital ratios. Failure to maintain a capital conservation buffer above certain levels will result in restrictions on HCC's ability to make dividend payments, redemptions or other capital distributions. These requirements, and any other new regulations or capital distribution constraints, could adversely affect the ability of HBC to pay dividends to HCC and, in turn, affect our ability to pay dividends on our common stock.

We have limited the circumstances in which our directors will be liable for monetary damages.

We have included in our articles of incorporation a provision to eliminate the liability of directors for monetary damages to the maximum extent permitted by California law. The effect of this provision will be to reduce the situations in which we or our shareholders will be able to seek monetary damages from our directors.

Our bylaws also have a provision providing for indemnification of our directors and executive officers and advancement of litigation expenses to the fullest extent permitted or required by California law, including circumstances in which indemnification is otherwise discretionary. Also, we have entered into agreements with our officers and directors in which we similarly agreed to provide indemnification that is otherwise discretionary. Such indemnification may be available for liabilities arising in connection with future offerings.

Future equity issuances could result in dilution, which could cause our common stock price to decline.

We are generally not restricted from issuing additional shares of our common stock, up to the 100 million shares of voting common stock and 10 million shares of preferred stock authorized in our articles of incorporation (subject to Nasdaq shareholder approval rules), which in each case could be increased by a vote of a majority of our shares. We may issue additional shares of our common stock in the future pursuant to current or future equity compensation plans, upon conversions of preferred stock or debt, upon exercise of warrants or in connection with future acquisitions or financings. If we choose to raise capital by selling shares of our common stock for any reason, the issuance would have a dilutive effect on the holders of our common stock and could have a material negative effect on the market price of our common stock.

We may issue shares of preferred stock in the future, which could make it difficult for another company to acquire us or could otherwise adversely affect holders of our common stock, which could depress the price of our common stock.

Although there are currently no shares of our preferred stock issued and outstanding, our articles of incorporation authorize us to issue up to 10 million shares of one or more series of preferred stock. The board also has the power, without shareholder approval (subject to Nasdaq shareholder approval rules), to set the terms of any series of preferred stock that may be issued, including voting rights, dividend rights, preferences over our common stock with respect to dividends or in the event of a dissolution, liquidation or winding up and other terms. In the event that we issue preferred stock in the future that has preference over our common stock with respect to payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of the holders of our common stock or the market price of our common stock could be adversely affected. In addition, the ability of our board of directors to issue shares of preferred stock without any action on the part of our shareholders may impede a takeover of us and prevent a transaction perceived to be favorable to our shareholders.

The holders of our debt obligations and preferred stock, if any, will have priority over our common stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of interest and dividends.

The holders of our debt obligations and preferred stock, if any, will have priority over our common stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of interest and dividends.

In any liquidation, dissolution or winding up of the Company, our common stock would rank below all claims of the holders of outstanding debt issued by the Company. As of December 31, 2019, we had $40.0 million principal amount of subordinated notes outstanding due June 1, 2027. In such event, holders of our common stock would not be entitled to receive any payment or other distribution of assets upon the liquidation, dissolution or winding up of the Company until after all of the Company's obligations to the debt holders were satisfied and holders of the subordinated debt had received any payment or distribution due to them. In addition, we are required to pay interest on the subordinated notes and if we are in default in the payment of interest we would not be able to pay any dividends on our common stock.

Provisions in our charter documents and California law may have an anti-takeover effect, and there are substantial regulatory limitations on changes of control of bank holding companies.

Our articles of incorporation and bylaws contain a number of provisions relating to corporate governance and rights of shareholders that might discourage future takeover attempts. As a result, shareholders who might desire to participate in such transactions may not have an opportunity to do so. In addition, these provisions will also render the removal of our board of directors or management more difficult. Such provisions include a requirement that shareholder approval for any action proposed by the Company must be obtained at a shareholders meeting and may not be obtained by written consent. Our bylaws provide that shareholders seeking to make nominations of candidates for election as directors, or to bring other business before an annual meeting of the shareholders, must provide timely notice of their intent in writing and follow specific procedural steps in order for nominees or shareholder proposals to be brought before an annual meeting.

Provisions of our charter documents and the California General Corporation Law, or the CGCL, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial by our shareholders. Furthermore, with certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve. Under the California Financial Code, no person may, directly or indirectly, acquire control of a California state bank or its holding company unless the DBO has approved such acquisition of control. A person would be deemed to have acquired control of HBC if such person, directly or indirectly, has the power (i) to vote 25% or more of the voting power of HBC or (ii) to direct or cause the direction of the management and policies of HBC. For purposes of this law, a person who directly or indirectly owns or controls 10% or more of our outstanding common stock would be presumed to control HBC. Accordingly, prospective investors need to be aware of and comply with these requirements, if applicable, in connection with any purchase of shares of our common stock. Moreover, the combination of these provisions effectively inhibits certain mergers or other business combinations, which, in turn, could adversely affect the market price of our common stock.

ITEM 1B — *UNRESOLVED STAFF COMMENTS*

None.

ITEM 2 — *PROPERTIES*

The main and executive offices of HCC and HBC are located at 150 Almaden Boulevard in San Jose, California 95113, with branch offices located at 15575 Los Gatos Boulevard in Los Gatos, California 95032, at 3137 Stevenson Boulevard in Fremont, California 94538, at 387 Diablo Road in Danville, California 94526, at 300 Main Street in Pleasanton, California 94566, at 1990 N. California Boulevard in Walnut Creek, California 94596, at 1987 First Street in Livermore, California 94550, at 18625 Sutter Boulevard in Morgan Hill, California 95037, at 7598 Monterey Street in Gilroy, California 95020, at 351 Tres Pinos Road in Hollister, California 95023, at 419 S. San Antonio Road in Los Altos, California 94022, at 333 W. El Camino Real in Sunnyvale, California 94087, at 101 S. Ellsworth Avenue in

San Mateo, California 94401, at 400 S. El Camino Real in San Mateo, California, 94402, at 325 Lytton Avenue in Palo Alto, California 94301, at 120 Kearny Street in San Francisco, California 94108, at 999 5th Avenue in San Rafael, California 94901 and at 2400 Broadway in Redwood City, California 94063. The Company has a loan production office at 101 Ygnacio Valley Road in Walnut Creek, California 94596. Bay View Funding's administrative offices are located at 2933 Bunker Hill Lane, Santa Clara, CA 95054.

Main Offices

The main office of HBC is located at 150 Almaden Boulevard in San Jose, California on the first three floors in a fifteen-story Class-A type office building. All three floors, consisting of approximately 35,547 square feet, are subject to a direct lease dated April 13, 2000, as amended, which expires on June 30, 2020. As stated in the 8th Amendment to the lease dated June 25, 2019, there is no monthly rent due for the remainder of the term.

In November of 2014, the Company extended its lease for approximately 1,255 square feet (referred to as the "Kiosk") located next to the primary operating area at 150 Almaden Boulevard in San Jose, California to be used for meetings, staff training and marketing events. The lease expires on June 30, 2020 and, as stated in the 5th Amendment to the lease dated June 25, 2019, there is no monthly rent due for the remainder of the term.

In June of 2015, the Company amended its primary lease at 150 Almaden Boulevard in San Jose, California to include 4,484 square feet of expansion space in a five-story Class-B type office building located at 100 W. San Fernando Street in San Jose, California, adjacent to the main office. The lease expires on June 30, 2020 and, as stated in the 8th Amendment to the lease dated June 25, 2019, there is no monthly rent due for the remainder of the term. In June of 2019, the Company entered into a lease agreement for 54,910 square feet of office space at 224 Airport Parkway in San Jose, California 95110. This lease commences on February 1, 2020 and expires on July 31, 2030. The monthly rent for the first year of the lease is $197,676 subject to annual increases of 3% until the lease expires. The Company has reserved the right to extend the term of the lease for one additional period of five years. The Company intends to move the San Jose branch and administrative offices as well as its Bay View Funding office to this new location in the first half of 2020 when the current leases expire.

Branch Offices

In June of 2007, as part of the acquisition of Diablo Valley Bank, the Company took ownership of an 8,285 square foot one-story commercial office building, including the land, located at 387 Diablo Road in Danville, California.

In February 2020, the Company renewed its lease for approximately 3,172 square feet in a one-story multi-tenant multi-use building located at 3137 Stevenson Boulevard in Fremont, California. The monthly rent payment is $9,833, subject to annual increases of 3% until the lease expires on February 29, 2024. The Company has reserved the right to extend the term of the lease for one additional period of four years, which management intends on exercising prior to the expiration in the first quarter of 2020, and another additional period of three years.

In August of 2014, the Company amended and extended its lease for approximately 4,716 square feet in a one-story multi-tenant office building located at 18625 Sutter Boulevard in Morgan Hill, California. The current monthly rent payment is $6,509, subject to annual increases of 2% until the lease expires on October 31, 2021. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In July of 2017, the Company extended its lease for approximately 5,213 square feet on the first floor in a two-story multi-tenant office building located at 419 S. San Antonio Road in Los Altos, California. The current monthly rent payment is $29,256, subject to annual increases of 3% until the lease expires on April 30, 2023. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In March of 2018, the Company extended its lease for approximately 3,022 square feet on the first floor of a three-story multi-tenant office building located at 333 West El Camino Real in Sunnyvale, California. The current monthly rent payment is $17,210, subject to annual increases of 3% until the lease expires on May 31, 2023.

In May of 2018, as part of the acquisition of United American Bank, the Company assumed a lease for approximately 11,566 square feet on the first and second floors in a five-story multi-tenant office building located at 101 S. Ellsworth Avenue in San Mateo, California. The current monthly rent payment is $41,419, subject to annual increases

of 3% until the lease expires on December 31, 2020. As a result of the merger with Presidio Bank and the overlapping branches in San Mateo, the Company intends to close the branch at 101 S. Ellsworth Avenue on May 29, 2020 and consolidate its operations with the branch located at 400 S. El Camino Real in San Mateo.

In May of 2018, as part of the acquisition of United American Bank, the Company assumed a lease for approximately 2,369 square feet on the first floor of a two-story multi-tenant multi-use building located at 2400 Broadway in Redwood City, California. The current monthly rent payment is $13,059, subject to annual increases of 5% until the lease expires on October 31, 2022. The Company has reserved the right to extend the lease for one additional period of two years.

In November of 2018, the Company extended its lease for approximately 1,920 square feet in a one-story stand-alone building located in an office complex at 15575 Los Gatos Boulevard in Los Gatos, California. The current monthly rent payment is $6,922, subject to annual increases of 3% until the lease expires on November 30, 2023. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In May of 2019, the Company amended its lease for approximately 4,096 square feet in a one-story stand-alone office building located at 300 Main Street in Pleasanton, California. The current monthly rent payment is $20,480, subject to 3% annual increases until the lease expires on April 30, 2026. The Company has reserved the right to extend the term of the lease for two additional periods of five years.

In June of 2019, the Company exercised its right to extend the lease term for an additional five years for approximately 3,391 square feet in a two-story multi-tenant commercial center located at 351 Tres Pinos in Hollister, California. The current monthly rent payment is $4,771 subject to 3% annual increases until the lease expires on June 30, 2024.

In August of 2019, the Company extended its lease for approximately 2,505 square feet on the first floor in a three-story multi-tenant multi-use building located at 7598 Monterey Street in Gilroy, California. The current monthly rent payment is $5,754 until the lease expires on September 30, 2021.

In August of 2019, the Company renewed a lease for approximately 3,772 square feet on the first and second floors in a two-story multi-tenant multi-use building located at 1987 First Street in Livermore, California. The current monthly rent payment is $9,045, subject to annual increases of 3% until the lease expires on September 30, 2024. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In October of 2019, as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 8,565 square feet on the twenty third floor in a multi-tenant office building located at 120 Kearny Street in San Francisco, California. The current monthly rent payment is $58,499, subject to annual increases of 3% until the lease expires on March 31, 2021.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 4,188 square feet on the first floor in a multi-tenant office building located at 999 5th Avenue in San Rafael, California. The current monthly rent payment is $18,543, subject to annual increases of 3% until the lease expires on November 30, 2022. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 4,154 square feet on the first floor in a multi-tenant office building located at 325 Lytton Avenue in Palo Alto, California. The current monthly rent payment is $37,489, subject to annual increases of 3% until the lease expires January 31, 2025. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 7,029 square feet on the first floor in a multi-tenant office building located at 1990 N. California Boulevard in Walnut Creek, California. The current monthly rent payment is $27,202, subject to annual increases of 3% until the lease expires December 31, 2027. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 3,063 square feet on the first floor in a multi-tenant office building located at 400 S. Camino Real in San

Mateo, California. The current monthly rent payment is $17,754, subject to annual increases of 3% until the lease expires October 31, 2024. The Company has reserved the right to extend the lease for one additional period of five years.

In January of 2020, as a result of the merger with Presidio Bank, the company entered into a lease agreement effective as of May 1, 2020 for approximately 5,023 square feet of office space located at 400 S. El Camino Real in San Mateo, California. The monthly rent payment at the beginning of the term will be $36,417, subject to annual increases of 3% until the lease expires on April 30, 2030. The Company intends to use this space to consolidate its operations with the office located at 101 S. Ellsworth in San Mateo, California when it closes on May 29, 2020. The Company has reserved the right to extend the lease for two additional periods of five years.

Loan Production Office

As a result of the merger with Presidio Bank and the closing of its Walnut Creek Branch at 101 S. Ygnacio Valley Road in Walnut Creek California, the Company retained approximately 1,461 square feet of office space at 101 S. Ygnacio Valley Road to use as a loan production office. The current monthly rent payment is $4,821, subject to annual increases of 3% until the lease expires on August 15, 2021.

Bay View Funding Office

In October of 2019, Bay View Funding extended its lease for approximately 7,440 square feet in a two-story multi-tenant office building located at 2933 Bunker Hill Lane, Santa Clara, CA 95054. The current monthly rent payment is $26,836 until the lease expires on March 31, 2020. The Company intends to move this office to the leased location at 224 Airport Parkway in San Jose, California 95110 in March of 2020.

For additional information on operating leases and rent expense, refer to Note 7 to the Consolidated Financial Statements following "Item 15 — *Exhibits and Financial Statement Schedules*."

ITEM 3 — *LEGAL PROCEEDINGS*

The Company is involved in certain legal actions arising from normal business activities. Management, based upon the advice of legal counsel, believes the ultimate resolution of all pending legal actions will not have a material effect on the financial statements of the Company.

ITEM 4 — *MINE SAFETY DISCLOSURES*

Not Applicable.

PART II

ITEM 5 — *MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES*

Market Information

The Company's common stock is listed on the NASDAQ Global Select Market under the symbol "HTBK."

The information in the following table for 2019 and 2018 indicates the high and low closing prices for the common stock, based upon information provided by the NASDAQ Global Select Market and cash dividend payment for each quarter presented.

Quarter	Stock Price High	Stock Price Low	Dividend Per Share
Year ended December 31, 2019:			
Fourth quarter	$ 13.05	$ 11.14	$ 0.12
Third quarter	$ 12.43	11.16	$ 0.12
Second quarter	$ 12.84	11.80	$ 0.12
First quarter	$ 14.43	11.57	$ 0.12
Year ended December 31, 2018:			
Fourth quarter	$ 15.63	$ 11.01	$ 0.11
Third quarter	$ 17.41	$ 14.71	$ 0.11
Second quarter	$ 18.05	$ 16.21	$ 0.11
First quarter	$ 17.13	$ 15.27	$ 0.11

The closing price of our common stock on February 14, 2020 was $11.67 per share as reported by the NASDAQ Global Select Market.

As of February 14, 2020, there were approximately 859 holders of record of common stock. There are no other classes of common equity outstanding.

Dividend Policy

The amount of future dividends will depend upon our earnings, financial condition, capital requirements and other factors, and will be determined by our board of directors on a quarterly basis. It is Federal Reserve policy that bank holding companies generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also Federal Reserve policy that bank holding companies not maintain dividend levels that undermine the holding company's ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. Under the federal Prompt Corrective Action regulations, the Federal Reserve or the FDIC may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as undercapitalized.

As a holding company, our ability to pay cash dividends is affected by the ability of our bank subsidiary, HBC, to pay cash dividends. The ability of HBC (and our ability) to pay cash dividends in the future and the amount of any such cash dividends is and could be in the future further influenced by bank regulatory requirements and approvals and capital guidelines.

The decision whether to pay dividends will be made by our board of directors in light of conditions then existing, including factors such as our results of operations, financial condition, business conditions, regulatory capital requirements and covenants under any applicable contractual arrangements, including agreements with regulatory authorities.

For information on the statutory and regulatory limitations on the ability of the Company to pay dividends and on HBC to pay dividends to HCC see "*Item 1 — Business — Supervision and Regulation — Heritage Commerce Corp – Dividend Payments, Stock Redemptions, and Repurchases and – Heritage Bank or Commerce – Dividend Payments.*"

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2019 regarding equity compensation plans under which equity securities of the Company were authorized for issuance:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,712,846 (1)	$ 8.80 (2)	796,957 (3)
Equity compensation plans not approved by security holders	N/A	N/A	N/A

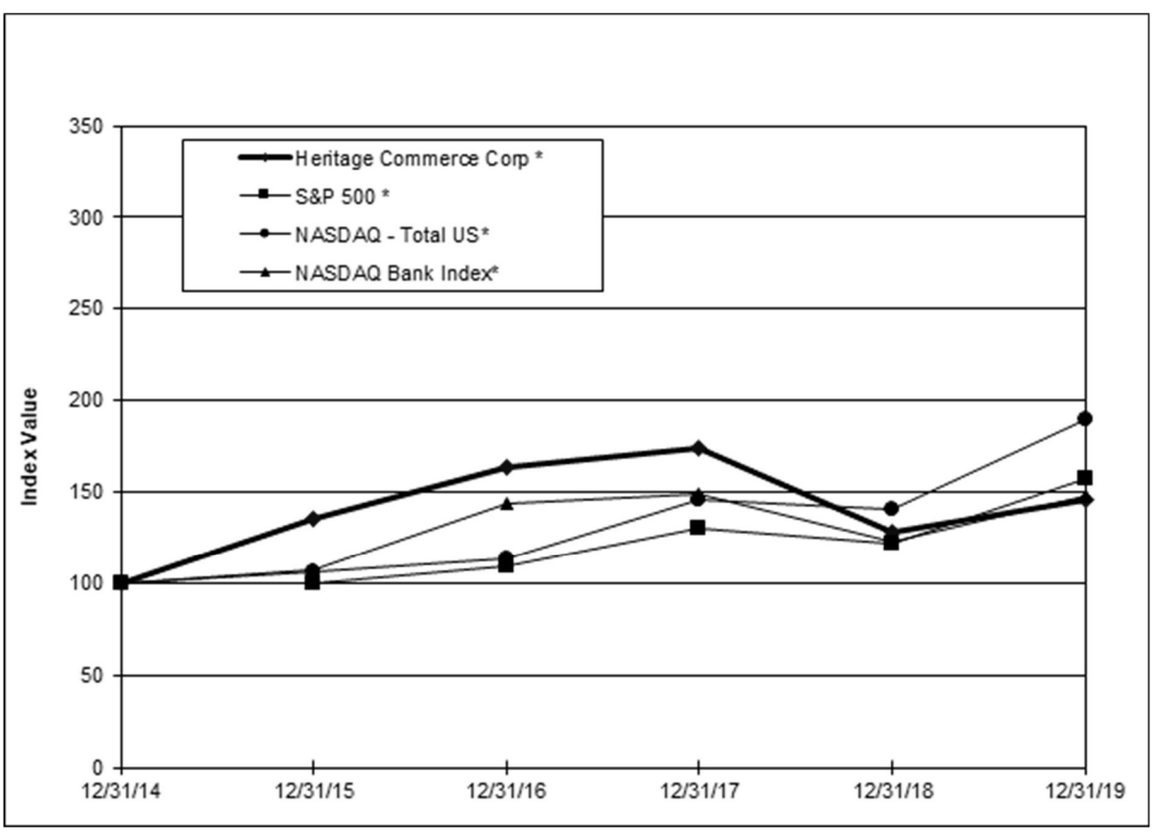
(1) Consists of 313,659 options to acquire shares under the Company's Amended and Restated 2004 Equity Plan, 1,389,709 options to acquire shares under the Company's 2013 Equity Incentive Plan, and the aggregate amount of stock options assumed from the Presidio stock option and equity incentive plans.

(2) Includes options assumed by the Company in connection with the acquisition of Presidio Bank, which options have a weighted average price of $5.02.

(3) Available under the Company's 2013 Equity Incentive Plan.

Performance Graph

The following graph compares the stock performance of the Company from December 31, 2014 to December 31, 2019, to the performance of several specific industry indices. The performance of the S&P 500 Index, NASDAQ Stock Index and NASDAQ Bank Stocks were used as comparisons to the Company's stock performance. Management believes that a performance comparison to these indices provides meaningful information and has therefore included those comparisons in the following graph.



The following chart compares the stock performance of the Company from December 31, 2014 to December 31, 2019, to the performance of several specific industry indices. The performance of the S&P 500 Index, NASDAQ Stock Index and NASDAQ Bank Stocks were used as comparisons to the Company's stock performance.

	Period Ending					
Index	**12/31/14**	**12/31/15**	**12/31/16**	**12/31/17**	**12/31/18**	**12/31/19**
Heritage Commerce Corp *	100	135	163	173	128	146
S&P 500 *	100	99	109	130	122	157
NASDAQ - Total US*	100	106	114	146	140	189
NASDAQ Bank Index*	100	107	144	149	122	148

* Source: SNL Financial Bank Information Group — (434) 977-1600

ITEM 6 — *SELECTED FINANCIAL DATA*

The following table presents a summary of selected financial information that should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto following Item 15 — *Exhibits and Financial Statement Schedules.*

SELECTED FINANCIAL DATA

	AT OR FOR YEAR ENDED DECEMBER 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands, except per share data)				
INCOME STATEMENT DATA:					
Interest income	$ 142,659	$ 129,845	$ 106,911	$ 94,431	$ 78,743
Interest expense	10,847	7,822	5,387	3,211	2,422
Net interest income before provision for loan losses	131,812	122,023	101,524	91,220	76,321
Provision for loan losses	846	7,421	99	1,237	32
Net interest income after provision for loan losses	130,966	114,602	101,425	89,983	76,289
Noninterest income	10,244	9,574	9,612	11,625	8,985
Noninterest expense	84,898	75,521	60,738	57,639	58,673
Income before income taxes	56,312	48,655	50,299	43,969	26,601
Income tax expense	15,851	13,324	26,471	16,588	10,104
Net income	40,461	35,331	23,828	27,381	16,497
Dividends and discount accretion on preferred stock	—	—	—	(1,512)	(1,792)
Net income available to common shareholders	40,461	35,331	23,828	25,869	14,705
Less: undistributed earnings allocated to Series C Preferred Stock	—	—	—	(1,278)	(912)
Distributed and undistributed earnings allocated to common shareholders	$ 40,461	$ 35,331	$ 23,828	$ 24,591	$ 13,793
PER COMMON SHARE DATA:					
Basic net income(1)	$ 0.87	$ 0.85	$ 0.63	$ 0.72	$ 0.48
Diluted net income(2)	$ 0.84	$ 0.84	$ 0.62	$ 0.72	$ 0.48
Book value per common share(3)	$ 9.71	$ 8.49	$ 7.10	$ 6.85	$ 7.03
Tangible book value per common share(4)	$ 6.55	$ 6.28	$ 5.76	$ 5.46	$ 5.35
Pro forma book value per common share assuming Series C Preferred Stock was converted into common stock(5)	$ —	$ —	$ —	$ —	$ 6.51
Pro forma tangible book value per share, assuming Series C Preferred Stock was converted into common stock(6)	$ —	$ —	$ —	$ —	$ 5.07
Dividend payout ratio(7)	56.16 %	52.26 %	63.95 %	49.77 %	65.09 %
Weighted average number of shares outstanding — basic	46,684,384	41,469,211	38,095,250	33,933,806	28,567,213
Weighted average number of shares outstanding — diluted	47,906,229	42,182,939	38,610,815	34,219,121	28,786,078
Common shares outstanding at period end	59,368,156	43,288,750	38,200,883	37,941,007	32,113,479
Pro forma common shares outstanding at period end, assuming Series C Preferred Stock was converted into common stock(8)	—	—	—	—	37,714,479
BALANCE SHEET DATA:					
Securities (available-for sale and held-to-maturity)	$ 771,385	$ 836,241	$ 790,193	$ 630,599	$ 494,390
Net loans	$ 2,510,559	$ 1,858,557	$ 1,563,009	$ 1,483,518	$ 1,339,790
Allowance for loan losses	$ 23,285	$ 27,848	$ 19,658	$ 19,089	$ 18,926
Goodwill and other intangible assets	$ 187,835	$ 95,760	$ 51,253	$ 52,614	$ 54,182
Total assets	$ 4,109,463	$ 3,096,562	$ 2,843,452	$ 2,570,880	$ 2,361,579
Total deposits	$ 3,414,768	$ 2,637,532	$ 2,482,989	$ 2,262,140	$ 2,062,775
Subordinated debt, net of issuance costs	$ 39,554	$ 39,369	$ 39,183	$ —	$ —
Short-term borrowings	$ 328	$ —	$ —	$ —	$ 3,000
Total shareholders' equity	$ 576,708	$ 367,466	$ 353,566	$ 259,850	$ 245,436
SELECTED PERFORMANCE RATIOS:(9)					
Return on average assets	1.21 %	1.16 %	0.86 %	1.13 %	0.86 %
Return on average tangible assets	1.25 %	1.19 %	0.88 %	1.15 %	0.88 %
Return on average equity	9.51 %	10.79 %	8.86 %	10.71 %	8.04 %
Return on average tangible equity	13.09 %	14.41 %	10.98 %	13.55 %	9.41 %
Net interest margin (fully tax equivalent)	4.28 %	4.31 %	3.99 %	4.12 %	4.41 %
Efficiency ratio (10)	59.76 %	57.39 %	54.65 %	56.04 %	68.78 %
Average net loans (excludes loans held-for-sale) as a percentage of average deposits	69.65 %	67.35 %	62.65 %	66.25 %	70.82 %
Average total shareholders' equity as a percentage of average total assets	12.69 %	10.72 %	9.76 %	10.54 %	10.73 %
SELECTED ASSET QUALITY DATA:(11)					
Net charge-offs (recoveries) to average loans	0.27 %	(0.04)%	(0.03)%	0.08 %	(0.04)%
Allowance for loan losses to total loans	0.92 %	1.48 %	1.24 %	1.27 %	1.39 %
Nonperforming loans to total loans	0.39 %	0.79 %	0.16 %	0.20 %	0.47 %
Nonperforming assets	$ 9,828	$ 14,887	$ 2,485	$ 3,288	$ 6,742
HERITAGE COMMERCE CORP CAPITAL RATIOS:					
Total risk-based	14.6 %	15.0 %	14.4 %	12.5 %	12.5 %
Tier 1 risk-based	12.5 %	12.0 %	11.4 %	11.5 %	11.4 %
Common equity Tier 1 risk-based capital	12.5 %	12.0 %	11.4 %	11.5 %	10.4 %
Leverage	9.7 %	8.9 %	8.0 %	8.5 %	8.6 %

Notes:

(1) Represents distributed and undistributed earnings allocated to common shareholders, divided by the average number of shares of common stock outstanding for the respective period. See Note 17 to the consolidated financial statements.

(2) Represents distributed and undistributed earnings allocated to common shareholders, divided by the average number of shares of common stock and common stock-equivalents outstanding for the respective period. See Note 17 to the consolidated financial statements.

(3) Represents shareholders' equity minus preferred stock divided by the number of shares of common stock outstanding at December 31, 2015.

(4) Represents shareholders' equity minus preferred stock, minus goodwill and other intangible assets divided by the number of shares of common stock outstanding at December 31, 2015.

(5) Represents shareholders' equity minus preferred stock divided by the number of shares of common stock outstanding at December 31, 2015, assuming 21,004 shares of Series C Preferred Stock were converted into 5,601,000 shares of common stock.

(6) Represents shareholders' equity minus preferred stock, minus goodwill and other intangible assets divided by the number of shares of common stock outstanding at December 31, 2015, assuming 21,004 shares of Series C Preferred Stock were converted into 5,601,000 shares of common stock.

(7) Percentage is calculated based on dividends paid on common stock and Series C Preferred Stock for the year ended December 31, 2016, and 2015 (on an as converted basis) divided by net income.

(8) Assumes 21,004 shares of Series C Preferred Stock were converted into 5,601,000 shares of common stock at December 31, 2015.

(9) Average balances used in this table and throughout this Annual Report are based on daily averages.

(10) The efficiency ratio is calculated by dividing noninterest expenses by the sum of net interest income before provision for loan losses and noninterest income.

(11) Average loans and total loans exclude loans held-for-sale.

ITEM 7 — *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of Heritage Commerce Corp (the "Company" or "HCC"), its wholly-owned subsidiary, Heritage Bank of Commerce (the "Bank" or "HBC"), and HBC's wholly-owned subsidiary, CSNK Working Capital Finance Corp, a California Corporation, dba Bay View Funding. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our consolidated financial statements and the accompanying notes presented elsewhere in this report. Unless we state otherwise or the context indicates otherwise, references to the "Company," "Heritage," "we," "us," and "our," in this Report on Form 10-K refer to Heritage Commerce Corp and its subsidiaries.

The Company completed its acquisition of Bay View Funding on November 1, 2014. The Company completed its merger with Focus Business Bank ("Focus") on August 20, 2015. The Company completed its merger with Tri-Valley Bank ("Tri-Valley") on April 6, 2018, and the Company completed its merger with United American Bank ("United American") on May 4, 2018. The Company completed its merger with Presidio Bank ("Presidio") on October 11, 2019 (the "Presidio merger date"). These mergers are discussed in more detail below, and in Notes 1, 8, and 9 to the consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expense in the financial statements. Various elements of our accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those we applied, which might have produced different results that could have had a material effect on the financial statements.

We have identified the following accounting policies and estimates that, due to the inherent judgments and assumptions and the potential sensitivity of the financial statements to those judgments and assumptions, are critical to an understanding of our financial statements. We believe that the judgments, estimates and assumptions used in the preparation of the Company's financial statements are appropriate. For a further description of our accounting policies, see Note 1 — *Summary of Significant Accounting Policies* in the financial statements included in this Form 10-K.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses in our loan portfolio. The allowance is only an estimate of the inherent loss in the loan portfolio and may not represent actual losses realized over time, either of losses in excess of the allowance or of losses less than the allowance. Our accounting for estimated loan losses is discussed under the heading "*Allowance for Loan Losses*" and disclosed primarily in Notes 1 and 4 to the consolidated financial statements.

Executive Summary

This summary is intended to identify the most important matters on which management focuses when it evaluates the financial condition and performance of the Company. When evaluating financial condition and performance management looks at certain key metrics and measures. The Company's evaluation includes comparisons with peer group financial institutions and its own performance objectives established in the internal planning process.

The primary activity of the Company is commercial banking. The Company's operations are located in the general San Francisco Bay Area of California in the counties of Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara. The Company's market includes the cities of San Francisco and San Jose and the headquarters of a number of technology based companies in the region known commonly as Silicon Valley. The Company's customers are primarily closely held businesses and professionals.

Performance Overview

For the year ended December 31, 2019, net income was $40.5 million, or $0.84 per average diluted common share, compared to $35.3 million, or $0.84 per average diluted common share, for the year ended December 31, 2018, and $23.8 million or $0.62 per average diluted common share for the year ended December 31, 2017. The Company's annualized return on average tangible assets was 1.25% and annualized return on average tangible equity was 13.09% for the year ended December 31, 2019, compared to 1.19% and 14.41%, respectively, for the year ended December 31, 2018, and 0.88% and 10.98%, respectively, for the year ended December 31, 2017.

Earnings for the year ended December 31, 2019 were reduced by pre-tax merger-related costs of $11.1 million, related to the merger with Presidio. Pre-tax earnings for the year ended December 31, 2019 were further reduced by an additional $2.0 million of provision for loan losses for certain non-impaired loans acquired at a premium from Presidio. Earnings for the years ended December 31, 2018 and 2017 were reduced by pre-tax merger-related costs of $9.2 million and $671,000, respectively, for the mergers with Tri-Valley and United American. Earnings for the year ended December 31, 2017 were also impacted by a $7.1 million income tax expense adjustment due to the remeasurement of the Company's net deferred tax assets ("DTA").

Presidio Merger

The Company completed the merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with Presidio effective as of October 11, 2019 (the "Presidio merger date"). Presidio's results of operations have been included in the Company's results of operations beginning October 12, 2019. Presidio was a full-service California state-chartered commercial bank headquartered in San Francisco with branches in Palo Alto, San Francisco, San Mateo, San Rafael, and Walnut Creek, California. The Company successfully completed its systems conversion and integration of Presidio during the first quarter of 2020.

Tri-Valley Bank and United American Bank Mergers

The Company completed the merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with Tri-Valley effective as of April 6, 2018. Tri-Valley's results of operations have been included in the Company's results of operations beginning April 7, 2018. Tri-Valley was a full-service California state-chartered commercial bank with branches in San Ramon and Livermore, California and served businesses and individuals primarily in Contra Costa and Alameda counties in Northern California. The Company closed the San Ramon office on July 13, 2018.

The Company completed the merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with United American effective as of May 4, 2018. United American's results of operations have been included in the Company's results of operations beginning May 5, 2018. United American was a full-service commercial bank located in San Mateo County with full-service branches located in San Mateo, Redwood City and Half Moon Bay, California and serviced businesses, professionals and individuals. The Company closed the Half Moon Bay office on August 10, 2018.

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act (the "Tax Act") was signed into law on December 22, 2017, which among other things reduced the federal corporate tax rate to 21% from 35%, effective January 1, 2018. The enactment of the Tax Act caused our net DTA to be revalued using the new lower tax rate with the resulting tax impact accounted for in the fourth quarter of 2017. The Company performed an analysis and determined the value of the net DTA was reduced by $7.1 million, which was recognized as a one-time, non-cash, incremental income tax expense for the fourth quarter of 2017 and for the year ended December 31, 2017.

Factoring Activities - Bay View Funding

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Total factored receivables	$ 45,980	$ 53,590
Average factored receivables		
For the year ended	$ 46,710	$ 59,220
Total full time equivalent employees	34	38

2019 Highlights

The following are major factors that impacted the Company's results of operations:

- Net interest income before provision for loan losses increased 8% to $131.8 million for the year ended December 31, 2019, compared to $122.0 million for the year ended December 31, 2018.

- The fully tax equivalent ("FTE") net interest margin contracted three basis points to 4.28% for the year ended December 31, 2019, compared to 4.31% for the year ended December 31, 2018, primarily due to a higher cost of deposits, a decrease in the average balance of Bay View Funding's factored receivables, partially offset by an increase in the average balance of loans and securities, and an increase in the accretion of the loan purchase discount into loan interest income from a merger during the year ended December 31, 2019.

- The average yield on the loan portfolio decreased to 5.86% for the year ended December 31, 2019, compared to 5.87% for the year ended December 31, 2018, primarily due to a decrease in the average balance of Bay View Funding's factored receivables, partially offset by the increasing prime rate on loans over the course of 2018 (prior to the prime rate decreasing in the latter part of 2019), and an increase in the accretion of the loan purchase discount into loan interest income from a merger.

- The total net purchase discount on loans from the Focus loan portfolio was $5.4 million on the acquisition date of August 20, 2015, of which $418,000 remains outstanding as of December 31, 2019. The total net purchase discount on loans from Tri-Valley loan portfolio was $2.6 million on the acquisition date of April 6, 2018, of which $1.6 million remains outstanding as of December 31, 2019. The total net purchase discount on loans from United American loan portfolio was $4.7 million on the acquisition date of May 4, 2018, of which $2.7 million remains outstanding as of December 31, 2019. The total net purchase discount on loans from the Presidio loan portfolio was $12.5 million on the Presidio merger date, of which $11.6 million at remains outstanding as of December 31, 2019.

- The total cost of deposits was 0.29% for the year ended December 31, 2019, compared to 0.21% for the year ended December 31, 2018.

- There was an $846,000 provision for loan losses for the year ended December 31, 2019, compared to a $7.4 million provision for loan losses for the year ended December 31, 2018. The higher provision for loan losses for the year ended December 31, 2018 included a $7.0 million specific reserve for a lending relationship that was placed on nonaccrual during the second quarter of 2018.

- Noninterest income increased to $10.2 million for the year ended December 31, 2019, compared to $9.6 million for the year ended December 31, 2018. The increase in noninterest income for the year ended December 31, 2019, was primarily due to higher service charges and fees on deposit accounts, an increase in the cash surrender value of life insurance, and an increase in the gain on sale of securities, partially offset by proceeds from a legal settlement in the year ended December 31, 2018. The Company received $1.3 million in proceeds from a legal settlement during the second quarter of 2018, of which $377,000 was recorded in other noninterest income, and $922,000 was credited to professional fees for recaptured legal fees previously paid by the Company.

- Noninterest expense for the year ended December 31, 2019 increased to $84.9 million, compared to $75.5

million for the year ended December 31, 2018, primarily due to higher merger-related costs, and a full year of additional operating costs of Tri-Valley and United American, in addition to the operating costs of Presidio for the fourth quarter of 2019. Total noninterest expense for the year ended December 31, 2019 included total merger-related costs of $11.1 million for the Presidio merger of which $6.6 million was included in salaries and employee benefits, and $4.5 million was included in other noninterest expense. Total merger-related costs were $9.2 million for the year ended December 31, 2018 for the Tri-Valley and United American acquisitions, of which $3.6 million was included in salaries and employee benefits and $5.6 million was included in other noninterest expense. Professional fees for the year ended December 31, 2018 included a recovery of $922,000 from a legal settlement.

- The efficiency ratio for the year ended December 31, 2019 increased to 59.76%, compared to 57.39% for the year ended December 31, 2018, primarily due to higher merger-related costs.

- Income tax expense for the year ended December 31, 2019 was $15.9 million, compared to $13.3 million for the year ended December 31, 2018. The effective tax rate for the year ended December 31, 2019 was 28.1%, compared to 27.4% for the year ended December 31, 2018.

The following are important factors in understanding our current financial condition and liquidity position:

- Cash, interest bearing deposits in other financial institutions and securities available-for-sale increased 38% to $862.2 million at December 31, 2019, from $623.6 million at December 31, 2018.

- Securities held-to-maturity, at amortized cost, totaled $366.6 million, at December 31, 2019, compared to $377.2 million at December 31, 2018.

- Loans, excluding loans held-for-sale, increased $647.4 million, or 34%, to $2.53 billion at December 31, 2019, compared to $1.89 billion at December 31, 2018, which included $669.5 million in loans from Presidio, at fair value, a decrease of $11.3 million in the Company's legacy portfolio, a decrease of $6.5 million in purchased CRE loans, and a decrease of $4.3 million in purchased residential loans.

- Nonperforming assets ("NPAs") were $9.8 million, or 0.24% of total assets at December 31, 2019, compared to $14.9 million, or 0.48% of total assets at December 31, 2018.

- Classified assets were $32.6 million at December 31, 2019, compared to $23.4 million at December 31, 2018. The increase in classified assets for the fourth quarter of 2019 was primarily due to classified assets acquired from Presidio. There were no foreclosed assets at December 31, 2019 and December 31, 2018.

- Net charge-offs totaled $5.4 million for the year ended December 31, 2019, compared to net recoveries of $769,000 for the year ended December 31, 2018. Net charge-offs of $5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling $5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling $5.5 million in net charge-offs had a total of $4.7 million in specific reserves.

- The allowance for loan losses ("ALLL") at December 31, 2019, was $23.3 million, or 0.92% of total loans, representing 236.93% of nonperforming loans. The allowance for loan losses at December 31, 2018 was $27.8 million, or 1.48% of total loans, representing 187.06% of nonperforming loans. The loans acquired from Presidio are included in total loans. Due to the addition of the Presidio loans at fair value with no allowance, the ALLL to total loans decreased at December 31, 2019.

- Total deposits increased $777.2 million, or 29%, to $3.41 billion at December 31, 2019, compared to $2.64 billion at December 31, 2018, which included $723.0 million in deposits from Presidio, at fair value, and an increase of $54.2 million in the Company's legacy deposits.

- Deposits, excluding all time deposits and CDARS deposits, increased $753.8 million, or 30%, to $3.23 billion at December 31, 2019, compared to $2.48 billion at December 31, 2018, which included $699.4 million in deposits from Presidio, at fair value, and an increase of $54.4 million in the Company's legacy deposits.

- The ratio of noncore funding (which consists of time deposits of $250,000 and over, CDARS deposits, brokered deposits, securities under agreement to repurchase, subordinated debt and short-term borrowings) to total assets was 4.10% at December 31, 2019, compared to 4.53% at December 31, 2018.

- The loan to deposit ratio was 74.20% at December 31, 2019, compared to 71.52% at December 31, 2018.

- The Company's consolidated capital ratios exceeded regulatory guidelines and the Bank's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2019.

Capital Ratios	Heritage Commerce Corp	Heritage Bank of Commerce	Well-capitalized Financial Institution Basel III PCA Regulatory Guidelines	Basel III Minimum Regulatory Requirement(1)
Total Risk-Based	14.6 %	13.9 %	10.0 %	10.5 %
Tier 1 Risk-Based	12.5 %	13.1 %	8.0 %	8.5 %
Common Equity Tier 1 Risk-based	12.5 %	13.1 %	6.5 %	7.0 %
Leverage	9.7 %	10.2 %	5.0 %	4.0 %

(1) Requirements for both the Company and the Bank include a 2.5% capital conservation buffer, except leverage ratio.

Deposits

The composition and cost of the Company's deposit base are important in analyzing the Company's net interest margin and balance sheet liquidity characteristics. Except for brokered time deposits, the Company's depositors are generally located in its primary market area. Depending on loan demand and other funding requirements, the Company also obtains deposits from wholesale sources including deposit brokers. HBC is a member of the Certificate of Deposit Account Registry Service ("CDARS") program. The CDARS program allows customers with deposits in excess of Federal Deposit Insurance Corporation ("FDIC") insured limits to obtain coverage on time deposits through a network of banks within the CDARS program. Deposits gathered through this program are considered brokered deposits under regulatory guidelines. The Company has a policy to monitor all deposits that may be sensitive to interest rate changes to help assure that liquidity risk does not become excessive due to concentrations.

Total deposits increased $777.2 million, or 29%, to $3.41 billion at December 31, 2019, compared to $2.64 billion at December 31, 2018, which included $723.0 million in deposits from Presidio, at fair value, and an increase of $54.2 million in the Company's legacy deposits. Deposits, excluding all time deposits and CDARS deposits, increased $753.8 million, or 30%, to $3.23 billion at December 31, 2019, compared to $2.48 billion at December 31, 2018, which included $699.4 million in deposits from Presidio, at fair value, and an increase of $54.4 million in the Company's legacy deposits.

Liquidity

Our liquidity position refers to our ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely fashion. The Company manages liquidity to be able to meet unexpected sudden changes in levels of its assets or deposit liabilities without maintaining excessive amounts of balance sheet liquidity. Excess balance sheet liquidity can negatively impact the Company's interest margin. At December 31, 2019, we had $457.4 million in cash and cash equivalents and approximately $721.5 million in available borrowing capacity from various sources including the Federal Home Loan Bank ("FHLB"), the Federal Reserve Bank of San Francisco ("FRB"), Federal funds facilities with several financial institutions, and a line of credit with a correspondent bank. The Company also had $738.9 million (at fair value) in unpledged securities available at December 31, 2019. Our loan to deposit ratio increased to 74.20% at December 31, 2019, compared to 71.52% at December 31, 2018.

Lending

Our lending business originates primarily through our branch offices located in our primary markets. In addition, Bay View Funding provides factoring financing and our Corporate Financing Group provides asset-based lending throughout the United States. Total loans, excluding loans held-for-sale, increased $647.4 million, or 34%, to $2.53 billion at December 31, 2019, compared to $1.89 billion at December 31, 2018, which included $669.5 million in loans from Presidio, at fair value, a decrease of $11.3 million in the Company's legacy portfolio, a decrease of $6.5 million in purchased CRE loans, and a decrease of $4.3 million in purchased residential loans. The total loan portfolio remains well diversified with commercial and industrial ("C&I") loans accounting for 25% of the portfolio at December 31, 2019, which included $46.0 million of factored receivables at Bay View Funding. CRE loans accounted for 59% of the total loan portfolio at December 31, 2019, of which approximately 34% was secured by owner-occupied real estate. Consumer and home equity loans accounted for 8% of total loans, land and construction loans accounted for 6% of total loans, and residential mortgage loans accounted for the remaining 2% of total loans at December 31, 2019. The commercial loan line usage was 35% at December 31, 2019, compared to 36% at December 31, 2018.

Net Interest Income

The management of interest income and expense is fundamental to the performance of the Company. Net interest income, the difference between interest income and interest expense, is the largest component of the Company's total revenue. Management closely monitors both total net interest income and the net interest margin (net interest income divided by average earning assets). Net interest income, before the provision for loan losses, increased 8% to $131.8 million for the year ended December 31, 2019, compared to $122.0 million for the year ended December 31, 2018, primarily due to the impact of the increase in loans and deposits from the Tri-Valley, United American, and Presidio mergers.

The Company seeks to maximize net interest income without exposing the Company to an excessive level of interest rate risk through its asset and liability policies and practices. Interest rate risk is managed by monitoring the pricing, maturity and repricing options of all classes of interest bearing assets and liabilities. This is discussed in more detail under *"Liquidity and Asset/Liability Management."* In addition, we believe there are measures and initiatives we can take to improve the net interest margin, including increasing loan rates, adding floors on floating rate loans, reducing nonperforming assets, managing deposit interest rates, and reducing higher cost deposits.

The net interest margin is also adversely impacted by the reversal of interest on nonaccrual loans and the reinvestment of loan payoffs into lower yielding investment securities and other short-term investments.

Management of Credit Risk

We continue to proactively identify, quantify, and manage our problem loans. Early identification of problem loans and potential future losses helps us to resolve credit issues with potentially reduced ultimate risk and ultimate losses. We maintain an allowance for loan losses in an amount that we believe is adequate to absorb probable incurred losses in the portfolio. While we strive to carefully manage and monitor credit quality and to identify loans that may be deteriorating, circumstances can change at any time for loans included in the portfolio that may result in future losses that, as of the date of the financial statements, have not yet been identified as potential problem loans. Through established credit practices, we adjust the allowance for loan losses accordingly. However, because future events are uncertain, there may be loans that deteriorate, some of which could occur in an accelerated time frame. As a result, future additions to the allowance for loan losses may be necessary. Because the loan portfolio contains a number of commercial loans, commercial real estate loans, construction and land development loans with relatively large balances, deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required based on changes in the financial condition of borrowers, such as have resulted due to the current, and potentially worsening, economic conditions. Additionally, Federal and State banking regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses would have an adverse effect, which may be material, on our financial condition and results of operation. Further discussion of the management of credit risk appears under *"Provision for Loan Losses"* and *"Allowance for Loan Losses."*

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses: Measurement of Credit

Losses on Financial Instruments. The standard is the final guidance on the new current expected credit loss ("CECL") model. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held-to-maturity debt securities. This update became effective for the Company on January 1, 2020. The Company is finalizing the economic forecasts and certain other key assumptions used in our CECL model and methodologies, and the required financial reporting disclosures are being further refined and internally validated. Internal controls related to CECL have been designed and are being evaluated; however, all internal controls related to CECL implementation are not operational. As of the-implementation date, Management expects to recognize an increase of up to $12.0 million to its allowance for credit losses for loans. The majority of this increase is related to the acquired loan portfolios. Once finalized, the cumulative-effect adjustment as a result of the adoption of this guidance will be recorded, net of tax, as an adjustment to retained earnings effective January 1, 2020. This estimate is subject to change based on continued refinement and validation of the model and methodologies as well as changes in forecasted macroeconomic conditions. Ongoing impacts of the CECL methodology will be dependent upon changes in economic conditions and forecasts, originated and acquired loan portfolio composition, portfolio duration, and other factors. Management is currently assessing the potential impact on the CECL model results due to an economic downturn caused by the Coronavirus. See *"Coronavirus."*

Management does not expect a material allowance for credit losses to be recorded on its available-for-sale debt securities under the newly codified available-for-sale debt security impairment model, as the majority of these securities are U.S. government agency-backed securities for which the risk of loss is minimal.

Noninterest Income

While interest income remains the largest single component of total revenues, noninterest income is an important component. A portion of the Company's noninterest income is associated with its Small Business Administration ("SBA") lending activity, consisting of gains on the sale of loans sold in the secondary market and servicing income from loans sold with servicing retained. Noninterest income from our SBA lending activity may be affected by lower premiums and accelerated pre-payments. Other sources of noninterest income include loan servicing fees, service charges and fees, cash surrender value from company owned life insurance policies, and gains on the sale of securities.

Noninterest Expense

Management considers the control of operating expenses to be a critical element of the Company's performance. Noninterest expense for the year ended December 31, 2019 increased to $84.9 million, compared to $75.5 million for the year ended December 31, 2018. The increase year over year was primarily due to higher merger-related costs, a full year of additional operating costs of Tri-Valley and United American, and the operating costs of Presidio in the fourth quarter of 2019. Noninterest expense for the year ended December 31, 2018 increased to $75.5 million, compared to $60.7 million for the year ended December 31, 2017, primarily due to higher merger-related costs and operating costs of the Tri-Valley and United American acquisitions, partially offset by lower professional fees. Professional fees for the year ended December 31, 2018 included a recovery of $922,000 from a legal settlement. The following table presents the merger-related costs for the periods indicated:

	For the Year Ended		
	December 31, 2019	December 31, 2018	December 31, 2017
	(Dollars in thousands)		
Salaries and employee benefits	$ 6,580	$ 3,569	$ —
Other	4,500	5,598	671
Total merger-related costs	$ 11,080	$ 9,167	$ 671

Noninterest expense, excluding merger-related costs, increased to $73.8 million for the year ended December 31, 2019, compared to $66.4 million for the year ended December 31, 2018, and $60.1 million for the year ended December 31, 2017.

Capital Management

As part of its asset and liability management process, the Company continually assesses its capital position to take into consideration growth, expected earnings, risk profile and potential strategic activities that it may choose to pursue.

Coronavirus

In December 2019, a novel strain of Coronavirus was reported in Wuhan, China. The World Health Organization has declared the outbreak to constitute a "Public Health Emergency of International Concern." The coronavirus outbreak is disrupting supply chains and affecting production and sales across a range of industries. The extent of the impact of the Coronavirus on our operational and financial performance will depend on certain developments, including the duration and spread of the outbreak, impact on our customers, employees and vendors all of which are uncertain and cannot be predicted. At this point, the extent to which the Coronavirus may impact our financial condition or results of operations is uncertain.

RESULTS OF OPERATIONS

The Company earns income from two primary sources. The first is interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of gains on the sale of loans, loan servicing fees, customer service charges and fees, the increase in cash surrender value of life insurance, and gains on the sale of securities. The majority of the Company's noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

Net Interest Income and Net Interest Margin

The level of net interest income depends on several factors in combination, including growth in earning assets, yields on earning assets, the cost of interest-bearing liabilities, the relative volumes of earning assets and interest-bearing liabilities, and the mix of products that comprise the Company's earning assets, deposits, and other interest-bearing liabilities. Net interest income can also be impacted by the reversal of interest on loans placed on nonaccrual status, and recovery of interest on loans that have been on nonaccrual and are either sold or returned to accrual status. To maintain its net interest margin, the Company must manage the relationship between interest earned and paid.

The following Distribution, Rate and Yield table presents for each of the past three years, the average amounts outstanding for the major categories of the Company's balance sheet, the average interest rates earned or paid thereon, and

the resulting net interest margin on average interest earning assets for the periods indicated. Average balances are based on daily averages.

	Year Ended December 31,								
	2019			2018			2017		
	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate
	(Dollars in thousands)								
Assets:									
Loans, gross [1][2]	$ 1,994,917	$ 116,808	5.86 %	$ 1,801,015	$ 105,635	5.87 %	$ 1,531,922	$ 86,346	5.64 %
Securities — taxable	682,602	15,836	2.32 %	669,994	15,211	2.27 %	636,160	13,724	2.16 %
Securities — exempt from Federal tax [3]	84,165	2,720	3.23 %	87,639	2,817	3.21 %	89,762	3,471	3.87 %
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	332,905	7,867	2.36 %	285,702	6,774	2.37 %	318,025	4,585	1.44 %
Total interest earning assets [3]	3,094,589	143,231	4.63 %	2,844,350	130,437	4.59 %	2,575,869	108,126	4.20 %
Cash and due from banks	40,070			38,665			33,542		
Premises and equipment, net	7,395			7,298			7,553		
Goodwill and other intangible assets	116,481			82,398			51,932		
Other assets	95,235			82,925			86,722		
Total assets	$ 3,353,770			$ 3,055,636			$ 2,755,618		
Liabilities and shareholders' equity:									
Deposits:									
Demand, noninterest-bearing	$ 1,131,098			$ 1,029,860			$ 944,275		
Demand, interest-bearing	712,186	2,401	0.34 %	658,386	1,885	0.29 %	586,778	1,208	0.21 %
Savings and money market	811,266	4,298	0.53 %	777,749	2,701	0.35 %	653,636	1,534	0.23 %
Time deposits — under $100	19,448	94	0.48 %	21,375	80	0.37 %	19,789	57	0.29 %
Time deposits — $100 and over	130,856	1,359	1.04 %	130,548	830	0.64 %	187,298	1,188	0.63 %
CDARS — interest-bearing demand, money market and time deposits	15,078	7	0.05 %	15,369	10	0.07 %	13,941	4	0.03 %
Total interest-bearing deposits	1,688,834	8,159	0.48 %	1,603,427	5,506	0.34 %	1,461,442	3,991	0.27 %
Total deposits	2,819,932	8,159	0.29 %	2,633,287	5,506	0.21 %	2,405,717	3,991	0.17 %
Subordinated debt, net of issuance costs	41,278	2,686	6.51 %	39,270	2,314	5.89 %	23,266	1,394	5.99 %
Short-term borrowings	208	2	0.96 %	106	2	1.89 %	75	2	2.67 %
Total interest-bearing liabilities	1,730,320	10,847	0.63 %	1,642,803	7,822	0.48 %	1,484,783	5,387	0.36 %
Total interest-bearing liabilities and demand, noninterest-bearing / cost of funds	2,861,418	10,847	0.38 %	2,672,663	7,822	0.29 %	2,429,058	5,387	0.22 %
Other liabilities	66,678			55,416			57,670		
Total liabilities	2,928,096			2,728,079			2,486,728		
Shareholders' equity	425,674			327,557			268,890		
Total liabilities and shareholders' equity	$ 3,353,770			$ 3,055,636			$ 2,755,618		
Net interest income [3] / margin		132,384	4.28 %		122,615	4.31 %		102,739	3.99 %
Less tax equivalent adjustment [3]		(572)			(592)			(1,215)	
Net interest income		$ 131,812			$ 122,023			$ 101,524	

(1) Includes loans held-for-sale. Nonaccrual loans are included in average balance.

(2) Yield amounts earned on loans include fees and costs. The accretion (amortization) of deferred loan fees (costs) into loan interest income was $580,000 for the year ended December 31, 2019, compared to $375,000 for the year ended December 31, 2018, and $533,000 for the year ended December 31, 2017.

(3) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the years ended December 31, 2019 and 2018, and a 35% tax rate for the years ended December 31, 2017.

The Volume and Rate Variances table below sets forth the dollar difference in interest earned and paid for each major category of interest-earning assets and interest-bearing liabilities for the noted periods, and the amount of such change attributable to changes in average balances (volume) or changes in average interest rates. Volume variances are equal to the increase or decrease in the average balance multiplied by prior period rates and rate variances are equal to the increase or decrease in the average rate multiplied by the prior period average balance. Variances attributable to both rate

and volume changes are equal to the change in rate multiplied by the change in average balance and are included below in the average volume column.

	Year Ended December 31, 2019 vs. 2018			Year Ended December 31, 2018 vs. 2017		
	Increase (Decrease) Due to Change in:			Increase (Decrease) Due to Change in:		
	Average Volume	Average Rate	Net Change	Average Volume	Average Rate	Net Change
	(Dollars in thousands)					
Income from the interest earning assets:						
Loans, gross	$ 11,269	$ (96)	$ 11,173	$ 15,711	$ 3,578	$ 19,289
Securities — taxable	292	333	625	770	717	1,487
Securities — exempt from Federal tax [1]	(111)	14	(97)	(64)	(590)	(654)
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	1,124	(31)	1,093	(763)	2,952	2,189
Total interest income on interest-earning assets	12,574	220	12,794	15,654	6,657	22,311
Expense from the interest-bearing liabilities:						
Demand, interest-bearing	162	354	516	183	494	677
Savings and money market	176	1,421	1,597	413	754	1,167
Time deposits — under $100	(9)	23	14	7	16	23
Time deposits — $100 and over	1	528	529	(369)	11	(358)
CDARS — interest-bearing demand, money market and time deposits	(1)	(2)	(3)	—	6	6
Subordinated debt, net of issuance costs	130	242	372	944	(24)	920
Short-term borrowings	1	(1)	—	1	(1)	—
Total interest expense on interest-bearing liabilities	460	2,565	3,025	1,179	1,256	2,435
Net interest income	$ 12,114	$ (2,345)	9,769	$ 14,475	$ 5,401	19,876
Less tax equivalent adjustment			20			623
Net interest income			$ 9,789			$ 20,499

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the years ended December 31, 2019 and 2018, and a 35% tax rate for the year ended December 31, 2017.

The Company's net interest margin (FTE), expressed as a percentage of average earning assets, contracted three basis points to 4.28% for the year ended December 31, 2019, compared to 4.31% for the year ended December 31, 2018, primarily due to a higher cost of deposits, and a decrease in the average balance of Bay View Funding's factored receivables, partially offset by an increase in the average balance of loans and securities and an increase in the accretion of the loan purchase discount into loan interest income from a merger during the year ended December 31, 2019.

The Company's net interest margin (FTE), expressed as a percentage of average earning assets, increased 32 basis points to 4.31% for the year ended December 31, 2018, compared to 3.99% for the year ended December 31, 2017, primarily due to a higher average balance of loans and securities, an increase in the accretion of the loan purchase discount into loan interest income from the Tri-Valley and United American acquisitions in the second quarter of 2018, and the impact of increases in the prime rate and the rate on overnight funds.

The following tables present the average balance of loans outstanding, interest income, and the average yield for the periods indicated:

	Year Ended December 31,								
	2019			2018			2017		
	Average Balance	Interest Income	Average Yield	Average Balance	Interest Income	Average Yield	Average Balance	Interest Income	Average Yield
	(Dollars in thousands)								
Loans, core bank and asset-based lending	$ 1,890,079	$ 100,380	5.31 %	$ 1,670,065	$ 86,610	5.19 %	$ 1,402,628	$ 71,011	5.06 %
Bay View Funding factored receivables	46,710	11,688	25.02 %	59,220	14,698	24.82 %	45,794	11,884	25.95 %
Residential mortgages	35,343	951	2.69 %	40,998	1,118	2.73 %	48,266	1,294	2.68 %
Purchased CRE loans	30,936	1,107	3.58 %	36,080	1,257	3.48 %	36,807	1,292	3.51 %
Loan credit mark / accretion	(8,151)	2,682	0.14 %	(5,348)	1,952	0.12 %	(1,573)	865	0.06 %
Total loans (includes loans held-for-sale)	$ 1,994,917	$ 116,808	5.86 %	$ 1,801,015	$ 105,635	5.87 %	$ 1,531,922	$ 86,346	5.64 %

The average yield on the total loan portfolio decreased to 5.86% for the year ended December 31, 2019, compared to 5.87% for the year ended December 31, 2018, primarily due to a decrease in the average balance of Bay View Funding's factored receivables, partially offset by the impact of the increasing prime rate on loans over the course of 2018 (prior to the prime rate decreasing in the latter part of 2019), and an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions. The average yield on the total loan portfolio increased to 5.87% for the year ended December 31, 2018, compared to 5.64% for the year ended December 31, 2017, primarily due to an increase in accretion of the loan purchase discount into loan interest income from the acquisitions, and increases in the prime rate.

The total net purchase discount on loans from Focus loan portfolio was $5.4 million on the acquisition date of August 20, 2015, of which $418,000 remains outstanding as of December 31, 2019. The total net purchase discount on loans from Tri-Valley loan portfolio was $2.6 million on the acquisition date of April 6, 2018, of which $1.6 million remains outstanding as of December 31, 2019. The total net purchase discount on loans from United American loan portfolio was $4.7 million on the acquisition date of May 4, 2018, of which $2.7 million remains outstanding as of December 31, 2019. The total net purchase discount on loans from Presidio loan portfolio was $12.5 million on the Presidio merger date, of which $11.6 million remains outstanding as of December 31, 2019.

The total cost of deposits was 0.29% for the year ended December 31, 2019, compared to 0.21% for the year ended December 31, 2018, and 0.17% for the year ended December 31, 2017.

Net interest income, before provision for loan losses, for the year ended December 31, 2019 increased 8% to $131.8 million, compared to $122.0 million for the year ended December 31, 2018, primarily due to the impact of the increase in loans and deposits from the Presidio merger, in addition to the full year impact of the Tri-Valley and United American mergers. Net interest income, before provision for loan losses, for the year ended December 31, 2018 increased 20% to $122.0 million, compared to $101.5 million for the year ended December 31, 2017, primarily due to the impact of the increase in loans and deposits from the Tri-Valley and United American acquisitions, in addition to organic loan growth and the positive impact of rising interest rates.

Provision for Loan Losses

Credit risk is inherent in the business of making loans. The Company establishes an allowance for loan losses through charges to earnings, which are shown in the statements of operations as the provision for loan losses. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for loan losses is determined by conducting a quarterly evaluation of the adequacy of the Company's allowance for loan losses and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to the Company's earnings. The provision for loan losses and level of allowance for each period are dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in the Company's market area.

There was an $846,000 provision for loan losses for the year ended December 31, 2019, compared to $7.4 million provision for loan losses for the year ended December 31, 2018, and a $99,000 provision for loan losses for the year ended December 31, 2017. The higher provision for loan losses for the year ended December 31, 2018 included a $7.0 million specific reserve for a lending relationship that was placed on nonaccrual during the second quarter of 2018. Provisions for loan losses are charged to operations to bring the allowance for loan losses to a level deemed appropriate by the Company based on the factors discussed under *"Allowance for Loan Losses."*

The allowance for loan losses totaled $23.3 million, or 0.92% of total loans at December 31, 2019 compared to $27.8 million, or 1.48% of total loans at December 31, 2018, and $19.7 million, or 1.24% of total loans at December 31, 2017. The allowance for loan losses to total nonperforming loans was 236.93% at December 31, 2019, compared to 187.06% at December 31, 2018, and 791.07% at December 31, 2017. The loans acquired from Presidio are included in total loans. Due to the addition of the Presidio loans at fair value with no allowance, the ALLL to total loans decreased at December 31, 2019. However, the Company provided an additional $2.0 million in provision for loan losses to increase the ALLL at December 31, 2019 for certain non-impaired loans acquired at a premium from Presidio. This premium was due to higher interest rates on the loans versus market interest rates at the time of the merger. Due to the net premium on these loans, a provision for loan losses was required and it was not due to credit deterioration since the merger date.

Net charge-offs totaled $5.4 million for the year ended December 31, 2019, compared to net recoveries of $769,000 for the year ended December 31, 2018, and net recoveries of $470,000 for the year ended December 31, 2017. Net charge-offs of $5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling $5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling $5.5 million in net charge-offs had a total of $4.7 million in specific reserves.

Noninterest Income

The following table sets forth the various components of the Company's noninterest income:

	Year Ended December 31,			Increase (decrease) 2019 versus 2018		Increase (Decrease) 2018 versus 2017	
	2019	2018	2017	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Service charges and fees on deposit accounts	$ 4,510	$ 4,113	$ 3,231	$ 397	10 %	$ 882	27 %
Increase in cash surrender value of life insurance	1,404	1,045	1,666	359	34 %	(621)	(37)%
Gain (loss) on sales of securities	661	266	(6)	395	148 %	272	4,533 %
Gain on sales of SBA loans	689	698	1,108	(9)	(1)%	(410)	(37)%
Servicing income	636	709	973	(73)	(10)%	(264)	(27)%
Other	2,344	2,743	2,640	(399)	(15)%	103	4 %
Total	$ 10,244	$ 9,574	$ 9,612	$ 670	7 %	$ (38)	0 %

For the year ended December 31, 2019, noninterest income was $10.2 million, compared to $9.6 million for the year ended December 31, 2018. The increase in noninterest income for the year ended December 31, 2019, was primarily due to higher service charges and fees on deposit accounts, an increase in the cash surrender value of life insurance, and an increase in the gain on sale of securities, partially offset by proceeds from a legal settlement in the year ended December 31, 2018.

For the year ended December 31, 2018, noninterest income remained relatively flat at $9.6 million, compared to the year ended December 31, 2017. The Company received $1.3 million in proceeds from a legal settlement during the second quarter of 2018, of which $377,000 was recorded in other noninterest income, and $922,000 was credited to professional fees for recaptured legal fees previously paid by the Company. The proceeds from a legal settlement during the second quarter of 2018, higher service charges and fees on deposit accounts and gain on sales of securities, were offset by a lower increase in cash surrender value of life insurance proceeds, servicing income, and gain on sale of SBA loans for the year ended December 31, 2018, compared to the year ended December 31, 2017.

A portion of the Company's noninterest income is associated with its SBA lending activity, as gain on sales of loans sold in the secondary market and servicing income from loans sold with servicing rights retained. During 2019, SBA loan sales resulted in a $689,000 gain, compared to a $698,000 gain on sales of SBA loans in 2018, and a $1.1 million gain on sales of SBA loans in 2017.

The servicing assets that result from the sales of SBA loans with servicing retained are amortized over the expected term of the loans using a method approximating the interest method. Servicing income generally declines as the respective loans are repaid.

Noninterest Expense

The following table sets forth the various components of the Company's noninterest expense:

	Year Ended December 31,			Increase (Decrease) 2019 versus 2018		Increase (Decrease) 2018 versus 2017	
	2019	2018	2017	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Salaries and employee benefits, excluding merger-related costs	$ 44,174	$ 40,193	$ 35,719	$ 3,981	10 %	$ 4,474	13 %
Occupancy and equipment	6,647	5,411	4,578	1,236	23 %	833	18 %
Professional fees	3,259	2,891	2,982	368	13 %	(91)	(3)%
Data processing	2,890	1,978	1,483	912	46 %	495	33 %
Amortization of intangible assets	2,739	1,943	1,361	796	41 %	582	43 %
Software subscriptions	2,397	2,343	1,831	54	2 %	512	28 %
Insurance expense	1,864	1,685	1,529	179	11 %	156	10 %
Recovery of legal fees (1)	—	(922)	—	922	(100)%	(922)	N/A
Other, excluding merger-related costs	9,848	10,832	10,584	(984)	(9)%	248	2 %
Total noninterest expense, excluding merger-related costs	73,818	66,354	60,067	7,464	11 %	6,287	10 %
Salaries and employee benefits merger-related costs (2)	6,580	3,569	—	3,011	84 %	3,569	N/A
Other merger-related costs (3)	4,500	5,598	671	(1,098)	(20)%	4,927	734 %
Total merger-related costs	11,080	9,167	671	1,913	21 %	8,496	1,266 %
Total noninterest expense, including merger-related costs	$ 84,898	$ 75,521	$ 60,738	$ 9,377	12 %	$ 14,783	24 %

The following table indicates the percentage of noninterest expense in each category:

	Year Ended December 31,					
	2019		2018		2017	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
Salaries and employee benefits, excluding merger-related costs	$ 44,174	52 %	$ 40,193	53 %	$ 35,719	59 %
Occupancy and equipment	6,647	8 %	5,411	7 %	4,578	8 %
Professional fees	3,259	4 %	2,891	4 %	2,982	5 %
Data processing	2,890	3 %	1,978	3 %	1,483	2 %
Amortization of intangible assets	2,739	3 %	1,943	3 %	1,361	2 %
Software subscriptions	2,397	3 %	2,343	3 %	1,831	3 %
Insurance expense	1,864	2 %	1,685	2 %	1,529	3 %
Recovery of legal fees (1)	—	— %	(922)	(1)%	—	0 %
Other, excluding merger-related costs	9,848	12 %	10,832	14 %	10,584	17 %
Total noninterest expense, excluding merger-related costs	73,818	87 %	66,354	88 %	60,067	99 %
Salaries and employee benefits merger-related costs (2)	6,580	8 %	3,569	5 %	—	0 %
Other merger-related costs (3)	4,500	5 %	5,598	7 %	671	1 %
Total merger-related costs	11,080	13 %	9,167	12 %	671	1 %
Total noninterest expense, including merger-related costs	$ 84,898	100 %	$ 75,521	100 %	$ 60,738	100 %

(1) Included in the "Professional fees" category in the Consolidated Statements of Income.

(2) Included in "Salaries and employee benefits" category in the Consolidated Statements of Income.

(3) Included in the "Other noninterest expense" category in the Consolidated Statements of Income.

Noninterest expense for the year ended December 31, 2019 increased 12% to $84.9 million, compared to $75.5 million for the year ended December 31, 2018, primarily due to higher merger-related costs, a full year of additional operating costs of Tri-Valley and United American, and the operating costs of Presidio for most of the fourth quarter of 2019. Total noninterest expense for the year ended December 31, 2019 included total merger-related costs of $11.1 million for the Presidio acquisition of which $6.6 million was included in salaries and employee benefits, and $4.5 million was included in other noninterest expense. Total merger-related costs were $9.2 million for the year ended December 31, 2018 for the Tri-Valley and United American acquisitions, of which $3.6 million was included in salaries and employee benefits and $5.6 million was included in other noninterest expense. Professional fees for the year ended December 31, 2018

included a recovery of $922,000 from a legal settlement. Full-time equivalent employees were 357, 302, and 278 at December 31, 2019, 2018, and 2017, respectively.

Noninterest expense for the year ended December 31, 2018 increased 24% to $75.5 million, compared to $60.7 million for the year ended December 31, 2017, primarily due to due to costs related to the merger transactions and higher salaries and employee benefits as a result of annual salary increases, and additional employees and operating costs of the Tri-Valley and United American acquisitions, partially offset by lower professional fees.

Income Tax Expense

The Company computes its provision for income taxes on a monthly basis. The effective tax rate is determined by applying the Company's statutory income tax rates to pre-tax book income as adjusted for permanent differences between pre-tax book income and actual taxable income. These permanent differences include, but are not limited to increases in the cash surrender value of life insurance policies, interest on tax-exempt securities, certain expenses that are not allowed as tax deductions, and tax credits.

The Tax Act was signed into law on December 22, 2017, which among other things reduced the federal corporate tax rate to 21% from 35%, effective January 1, 2018. The enactment of the Tax Act caused our net DTA to be revalued at the new lower tax rate with resulting tax effects accounted for in the reporting period of enactment. The Company performed an analysis and determined the value of the net DTA was reduced by $7.1 million, which was recognized as a one-time, non-cash, incremental income tax expense for the fourth quarter of 2017 and for the year ended December 31, 2017.

Also on December 22, 2017, the SEC issued Staff Accounting Bulletin ("SAB") 118, which addresses the situations where the accounting for changes in tax laws is complete, incomplete but can be reasonably estimated, and incomplete and cannot be reasonably estimated. SAB 118 also permits a measurement period up to one year from the date of enactment to refine the provisional accounting. There were no items for which the Company was unable to make a reasonable estimate for the effects of the tax law change. The Company has completed its accounting for the effects of the Tax Act on its deferred tax assets and liabilities.

The following table shows the effective income tax rates for the dates indicated:

	Year Ended December 31,		
	2019	2018	2017
Effective income tax rate	28.1%	27.4%	52.6%

The Company's Federal and state income tax expense in 2019 was $15.9 million, compared to $13.3 million in 2018, and $26.5 million in 2017. The effective tax rate for the year ended December 31, 2018 decreased compared to the year ended December 31, 2017, primarily due to lower federal corporate tax rate for 2018 and the $7.1 million DTA adjustment in the fourth quarter of 2017.

The difference in the effective tax rate for the periods reported compared to the combined Federal and state statutory tax rate of 29.6% for the year ended December 31, 2019 and December 31, 2018, and 42% for the year ended December 31, 2017, is primarily the result of the Company's investment in life insurance policies whose earnings are not subject to taxes, tax credits related to investments in low income housing limited partnerships (net of low income housing investment losses), and tax-exempt interest income earned on municipal bonds.

In March 2016, the FASB issued new guidance intended to simplify several areas of accounting for share-based compensation programs, including the income tax impact, classification on the statement of cash flows, and forfeitures. The Company adopted the new guidance on share-based compensation during the first quarter of 2017. All excess tax benefits and tax deficiencies (including tax benefits of dividends on share based payment awards) are recognized as income tax expense or benefit on the income statement. The tax effects of exercised or vested awards are treated as discrete items in the reporting period in which they occur. The adoption of this guidance resulted in a reduction to income tax expense of $146,000 for the year ended December 31, 2019, compared to a reduction of $424,000 for the year ended December 31, 2018, and a reduction of $146,000 for the year ended December 31, 2017.

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles leading to timing differences between the Company's actual tax liability, and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient future taxable income to obtain benefit from the reversal of net deductible temporary differences and the utilization of tax credit carryforwards and the net operating loss carryforwards for Federal and state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles a valuation allowance is required to be recognized if it is "more likely than not" that the deferred tax assets will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

The Company had the net deferred tax assets of $24.3 million and $27.1 million at December 31, 2019, and December 31, 2018, respectively. After consideration of the matters in the preceding paragraph, the Company determined that it is more likely than not that the net deferred tax assets at December 31, 2019 and December 31, 2018 will be fully realized in future years.

Business Segment Information

The following presents the Company's operating segments. Transactions between segments consist primarily of borrowed funds. Intersegment interest expense is allocated to the Factoring segment based on the Company's prime rate and funding costs. The provision for loan loss is allocated based on the segment's allowance for loan loss determination which considers the effects of charge-offs. Noninterest income and expense directly attributable to a segment are assigned to it. Taxes are paid on a consolidated basis and allocated for segment purposes. The Factoring segment includes only factoring originated by Bay View Funding.

	Year Ended December 31, 2019		
	Banking [1]	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 130,971	$ 11,688	$ 142,659
Intersegment interest allocations	1,182	(1,182)	—
Total interest expense	10,847	—	10,847
Net interest income	121,306	10,506	131,812
Provision for loan losses	517	329	846
Net interest income after provision	120,789	10,177	130,966
Noninterest income	9,643	601	10,244
Noninterest expense [2]	78,159	6,739	84,898
Intersegment expense allocations	547	(547)	—
Income before income taxes	52,820	3,492	56,312
Income tax expense	14,819	1,032	15,851
Net income	$ 38,001	$ 2,460	$ 40,461
Total assets	$ 4,045,801	$ 63,662	$ 4,109,463
Loans, net of deferred fees	$ 2,487,864	$ 45,980	$ 2,533,844
Goodwill	$ 154,376	$ 13,044	$ 167,420

(1) Includes the holding company's results of operations

(2) The banking segment's noninterest expense includes acquisition costs of $11.1 million.

	Year Ended December 31, 2018		
	Banking [1]	Factoring	Consolidated
		(Dollars in thousands)	
Interest income	$ 115,147	$ 14,698	$ 129,845
Intersegment interest allocations	1,856	(1,856)	—
Total interest expense	7,822	—	7,822
Net interest income	109,181	12,842	122,023
Provision for loan losses	7,224	197	7,421
Net interest income after provision	101,957	12,645	114,602
Noninterest income	8,662	912	9,574
Noninterest expense [2]	69,164	6,357	75,521
Intersegment expense allocations	753	(753)	—
Income before income taxes	42,208	6,447	48,655
Income tax expense	11,418	1,906	13,324
Net income	$ 30,790	$ 4,541	$ 35,331
Total assets	$ 3,028,721	$ 67,841	$ 3,096,562
Loans, net of deferred fees	$ 1,832,815	$ 53,590	$ 1,886,405
Goodwill	$ 70,709	$ 13,044	$ 83,753

(1) Includes the holding company's results of operations

(2) The banking segment's noninterest expense includes acquisition costs of $9.2 million

	Year Ended December 31, 2017		
	Banking [1]	Factoring	Consolidated
		(Dollars in thousands)	
Interest income	$ 95,027	$ 11,884	$ 106,911
Intersegment interest allocations	1,126	(1,126)	—
Total interest expense	5,387	—	5,387
Net interest income	90,766	10,758	101,524
Provision (credit) for loan losses	102	(3)	99
Net interest income after provision	90,664	10,761	101,425
Noninterest income	8,559	1,053	9,612
Noninterest expense [2]	53,860	6,878	60,738
Intersegment expense allocations	528	(528)	—
Income before income taxes	45,891	4,408	50,299
Income tax expense [3]	24,266	2,205	26,471
Net income	$ 21,625	$ 2,203	$ 23,828
Total assets	$ 2,780,286	$ 63,166	$ 2,843,452
Loans, net of deferred fees	$ 1,533,841	$ 48,826	$ 1,582,667
Goodwill	$ 32,620	$ 13,044	$ 45,664

(1) Includes the holding company's results of operations

(2) Includes $671,000 pre-tax acquisition costs related to the Tri-Valley and United American proposed mergers in the banking segment.

(3) Includes $7.1 million of expense associated with remeasurement of the net DTA, of which $6.7 million was in the banking segment, and $354,000 was in the factoring segment

Banking. Our banking segment's net income increased to $38.0 million for the year ended December 31, 2019, compared to net income of $30.8 million for the year ended December 31, 2018. The banking segment's earnings for the year ended December 31, 2019 were reduced by merger-related costs of $11.8 million for the merger with Presidio

completed on October 11, 2019. The increase in net interest income for the year ended December 31, 2019, compared to the year ended December 31, 2018, was primarily due to the impact of the increase in loans and deposits from the acquisitions and the positive impact of rising interest rates over the course of 2018 (prior to the prime rate decreasing in the latter part of 2019), and an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions, partially offset by an increase in the cost of deposits. The decrease in the provision for loan losses for year ended December 31, 2019, compared to the year ended December 31, 2018, was primarily due to the $7.0 million specific reserve for a lending relationship that was placed on nonaccrual during the second quarter of 2018. Noninterest income was $9.6 million for the year ended December 31, 2019, compared to $8.7 million the year ended December 31, 2018. For the year ended December 31, 2019, noninterest expense increased to $78.2 million, compared to $69.2 million for the year ended December 31, 2018, primarily due to higher merger-related costs, and a full year of additional operating costs of Tri-Valley and United American, in addition to the operating costs of Presidio for the fourth quarter of 2019.

For the year ended December 31, 2018, our banking segment's net income increased to $30.8 million compared to net income of $21.6 million for the year ended December 31, 2017, primarily due to the impact of the increase in loans and deposits from the Tri-Valley and United American acquisitions, in addition to organic loan growth and the positive impact of rising interest rates. The provision for loan losses increased to $7.2 million for the year ended December 31, 2018, compared to a provision for loan losses of $102,000 for the year ended December 31, 2017, primarily due to a single large lending relationship that was placed on nonaccrual during the second quarter of 2018. Noninterest income remained relatively flat for the year ended December 31, 2018, compared to the year ended December 31, 2017. For the year ended December 31, 2018, noninterest expense increased to $69.2 million, compared to $53.9 million for the year ended December 31, 2017, primarily due to costs related to the merger transactions and higher salaries and employee benefits as a result of annual salary increases, and additional employees and operating costs of the Tri-Valley and United American acquisitions, partially offset by lower professional fees. Income tax expense of $24.3 million for the year ended December 31, 2017 included a non-cash additional tax expense of $6.7 million, which resulted from the remeasurement of our net DTA.

Factoring. Bay View Funding's primary business operation is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. In a factoring transaction Bay View Funding directly purchases the receivables generated by its clients at a discount to their face value. The transactions are structured to provide the clients with immediate working capital when there is a mismatch between payments to the client for a good and service and the payment of operating costs incurred to provide such good or service. The average life of the factored receivables was 37 days for the year ended December 31, 2019, and 36 days for the years ended December 31, 2018 and 2017. Net interest income for the year ended December 31, 2019 decreased to $10.5 million, compared to $12.8 million for the year ended December 31, 2018, primarily due to a decrease in the average balance of factored receivables outstanding, partially offset by an increase in the average yield on the factored receivables portfolio. For the year ended December 31, 2018, net interest income increased to $12.8 million, compared to $10.8 million for the year ended December 31, 2017, primarily due to an increase in the average balance of factored receivables outstanding, partially offset by a decrease in the average yield on the factored receivables portfolio. Income tax expense for the year ended December 31, 2017, included a $354,000 remeasurement of the net DTA due to enactment of the Tax Act.

FINANCIAL CONDITION

As of December 31, 2019, total assets increased 33% to $4.11 billion, compared to $3.10 billion at December 31, 2018. Securities available-for-sale, at fair value, were $404.8 million at December 31, 2019, a decrease of (12%) from $459.0 million at December 31, 2018. Securities held-to-maturity, at amortized cost, were $366.6 million at December 31, 2019, a decrease of (3%) from $377.2 million at December 31, 2018. Total loans, excluding loans held-for-sale, increased $647.4 million, or 34%, to $2.53 billion at December 31, 2019, compared to $1.89 billion at December 31, 2018, which included $669.5 million in loans from Presidio, at fair value, a decrease of $11.3 million in the Company's legacy portfolio, a decrease of $6.5 million in purchased CRE loans, and a decrease of $4.3 million in purchased residential loans.

Total deposits increased $777.2 million, or 29%, to $3.41 billion at December 31, 2019, compared to $2.64 billion at December 31, 2018, which included $723.0 million in deposits from Presidio, at fair value, and an increase of $54.2 million in the Company's legacy deposits. Deposits, excluding all time deposits and CDARS deposits, increased $753.8 million, or 30%, to $3.23 billion at December 31, 2019, from $2.48 billion at December 31, 2018, which included $699.4 million in deposits from Presidio, at fair value, and an increase of $54.4 million in the Company's legacy deposits.

Securities Portfolio

The following table reflects the balances for each category of securities at year-end:

	December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Securities available-for-sale (at fair value):			
Agency mortgage-backed securities	$ 284,361	$ 302,854	$ 374,733
U.S. Treasury	120,464	148,753	—
U.S. Government sponsored entities	—	7,436	—
Trust preferred securities	—	—	17,119
Total	$ 404,825	$ 459,043	$ 391,852
Securities held-to-maturity (at amortized cost):			
Agency mortgage-backed securities	$ 285,344	$ 291,241	$ 309,616
Municipals — exempt from Federal tax	81,216	85,957	88,725
	$ 366,560	$ 377,198	$ 398,341

The table below summarizes the weighted average life and weighted average yields of securities as of December 31, 2019:

	Weighted Average Life									
	Within One Year or Less		After One and Within Five Years		After Five and Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(Dollars in thousands)									
Securities available-for-sale (at fair value):										
Agency mortgage-backed securities	$ —	N/A	$ 172,914	2.26 %	$ 96,261	2.56 %	$ 15,186	2.64 %	$ 284,361	2.38 %
U.S. Treasury	55,085	2.77 %	65,379	2.86 %	—	N/A	—	N/A	120,464	2.82 %
Total	$ 55,085	2.77 %	$ 238,293	2.42 %	$ 96,261	2.56 %	$ 15,186	2.64 %	$ 404,825	2.51 %
Securities held-to-maturity (at amortized cost):										
Agency mortgage-backed securities	$ —	N/A	$ 219,393	2.07 %	$ 18,911	2.65 %	$ 47,040	2.89 %	$ 285,344	2.24 %
Municipals — exempt from Federal tax (1)	19,528	3.13 %	58,823	3.24 %	1,375	3.45 %	1,490	3.22 %	81,216	3.22 %
Total	$ 19,528	3.13 %	$ 278,216	2.32 %	$ 20,286	2.70 %	$ 48,530	2.90 %	$ 366,560	2.46 %

(1) Reflects tax equivalent yield based on a 21% Federal tax rate.

The securities portfolio is the second largest component of the Company's interest-earning assets, and the structure and composition of this portfolio is important to an analysis of the financial condition of the Company. The portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Company; and (iv) it is an alternative interest-earning use of funds when loan demand is weak or when deposits grow more rapidly than loans.

The Company's portfolio may include: (i) U.S. Treasury securities and U.S. Government sponsored entities' debt securities for liquidity and pledging; (ii) mortgage-backed securities, which in many instances can also be used for pledging, and which generally enhance the yield of the portfolio; (iii) municipal obligations, which provide tax free income and limited pledging potential; (iv) single entity issue trust preferred securities, which generally enhance the yield on the portfolio; (v) corporate bonds, which also enhance the yield on the portfolio; (vi) money market mutual funds; (vii) certificates of deposit; (viii) commercial paper; (ix) bankers acceptances; (x) repurchase agreements; (xi) collateralized mortgage obligations; and (xii) asset-backed securities.

The Company classifies its securities as either available-for-sale or held-to-maturity at the time of purchase. Accounting guidance requires available-for-sale securities to be marked to fair value with an offset to accumulated other

comprehensive income (loss), a component of shareholders' equity. Monthly adjustments are made to reflect changes in the fair value of the Company's available-for-sale securities.

The investment securities available-for-sale portfolio totaled $404.8 million at December 31, 2019, a decrease of (12%) from $459.0 million at December 31, 2018. At December 31, 2019, the Company's securities available-for-sale portfolio, at fair value, was comprised of $284.4 million of agency mortgage-backed securities (all issued by U.S. Government sponsored entities), and $120.4 million of U.S. Treasury securities. The pre-tax unrealized gain on securities available-for-sale at December 31, 2019 was $2.3 million, compared to a pre-tax unrealized loss on securities available-for-sale of ($7.7) million at December 31, 2018. All other factors remaining the same, when market interest rates are rising, the Company will experience a lower unrealized gain (or a higher unrealized loss) on the securities portfolio.

Investment securities available-for-sale acquired from Presidio totaled $45.1 million, at fair value, at the Presidio merger date. During the year ended December 31, 2019, the Company purchased $112.0 million of investment securities available for sale, with an average book yield of 2.40%. During the year ended December 31, 2019, the Company sold $166.9 million of investment securities available-for-sale for a net gain of $661,000.

At December 31, 2019, investment securities held-to-maturity totaled $366.6 million, a decrease of (3%) from $377.2 million at December 31, 2018. At December 31, 2019, the Company's investment securities held-to-maturity portfolio, at amortized cost, was comprised of $285.4 million agency mortgage-backed securities, and $81.2 million tax-exempt municipal bonds.

Investment securities held-to-maturity acquired from Presidio totaled $463,000, at fair value, at the Presidio merger date. During the year ended December 31, 2019, the Company purchased $50.0 million of investment securities held-to-maturity, which consisted of $20.5 million FHLMC securities, with an average book yield of 2.56%, and $29.5 million of FNMA securities, with an average book yield of 2.54%.

The Company has not used interest rate swaps or other derivative instruments to hedge fixed rate loans or securities to otherwise mitigate interest rate risk.

Loans

The Company's loans represent the largest portion of earning assets, substantially greater than the securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when reviewing the Company's financial condition. Gross loans, excluding loans held-for-sale, represented 62% of total assets at December 31, 2019 and 61% at December 31, 2018. The ratio of loans to deposits increased to 74.20% at December 31, 2019 from 71.52% at December 31, 2018.

Loan Distribution

The Loan Distribution table that follows sets forth the Company's gross loans outstanding, excluding loans held-for-sale, and the percentage distribution in each category at the dates indicated.

	December 31,									
	2019	% to Total	2018	% to Total	2017	% to Total	2016	% to Total	2015	% to Total
	(Dollars in thousands)									
Commercial	$ 631,547	25 %	$ 597,763	32 %	$ 573,296	36 %	$ 604,331	40 %	$ 556,522	41 %
Real estate:										
CRE	1,510,592	59 %	994,067	52 %	772,867	49 %	662,228	44 %	625,665	46 %
Land and construction	150,634	6 %	122,358	6 %	100,882	6 %	81,002	5 %	84,428	6 %
Home equity	175,252	7 %	109,112	6 %	79,176	5 %	82,459	6 %	76,833	6 %
Residential mortgages	46,256	2 %	50,979	3 %	44,561	3 %	52,887	4 %	—	0 %
Consumer	19,882	1 %	12,453	1 %	12,395	1 %	20,460	1 %	16,010	1 %
Total Loans	2,534,163	100 %	1,886,732	100 %	1,583,177	100 %	1,503,367	100 %	1,359,458	100 %
Deferred loan fees, net	(319)	—	(327)	—	(510)	—	(760)	—	(742)	—
Loans, net of deferred fees	2,533,844	100 %	1,886,405	100 %	1,582,667	100 %	1,502,607	100 %	1,358,716	100 %
Allowance for loan losses	(23,285)		(27,848)		(19,658)		(19,089)		(18,926)	
Loans, net	$ 2,510,559		$ 1,858,557		$ 1,563,009		$ 1,483,518		$ 1,339,790	

The Company's loan portfolio is concentrated in commercial (primarily manufacturing, wholesale, and services oriented entities) and commercial real estate, with the remaining balance in land development and construction and home equity, purchased residential mortgages, and consumer loans. The Company does not have any concentrations by industry

or group of industries in its loan portfolio, however, 74% of its gross loans were secured by real property as of December 31, 2019, compared to 67% as of December 31, 2018. While no specific industry concentration is considered significant, the Company's lending operations are located in areas that are dependent on the technology and real estate industries and their supporting companies.

The Company has established concentration limits in its loan portfolio for commercial real estate loans, commercial loans, construction loans and unsecured lending, among others. All loan types are within established limits. The Company uses underwriting guidelines to assess the borrowers' historical cash flow to determine debt service, and we further stress test the debt service under higher interest rate scenarios. Financial and performance covenants are used in commercial lending to allow the Company to react to a borrower's deteriorating financial condition, should that occur.

The Company's commercial loans are made for working capital, financing the purchase of equipment or for other business purposes. Commercial loans include loans with maturities ranging from thirty days to one year and "term loans" with maturities normally ranging from one to five years. Short-term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest.

The Company is an active participant in the SBA and U.S. Department of Agriculture guaranteed lending programs, and has been approved by the SBA as a lender under the Preferred Lender Program. The Company regularly makes such loans conditionally guaranteed by the SBA (collectively referred to as "SBA loans"). The guaranteed portion of these loans is typically sold in the secondary market depending on market conditions. When the guaranteed portion of an SBA loan is sold the Company retains the servicing rights for the sold portion. During 2019, loans were sold resulting in a gain on sales of SBA loans of $689,000, compared to a gain on sales of SBA loans of $698,000 for 2018, and $1.1 million for 2017.

The Company's factoring receivables are from the operations of Bay View Funding whose primary business is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. These receivables are acquired from a variety of companies, including, but not limited to, service providers, transportation companies, manufacturers, distributors, wholesalers, apparel companies, advertisers, and temporary staffing companies. The portfolio of factored receivables is included in the Company's commercial loan portfolio. The average life of the factored receivables was 37 days for the year ended December 31, 2019 and 36 days for the years ended December 31, 2018 and 2017. The balance of the purchased receivables as of December 31, 2019 and 2018 was $46.0 million and $53.6 million, respectively.

The commercial loan portfolio increased $33.8 million, or 6%, to $631.5 million at December 31, 2019, from $597.8 million at December 31, 2018, which included $124.7 million of loans added from Presidio, partially offset by a decrease of $90.9 million in the Company's legacy portfolio. The commercial loan line usage was 35% at December 31, 2019, compared to 36% at December 31, 2018.

The Company's CRE loans consist primarily of loans based on the borrower's cash flow and are secured by deeds of trust on commercial property to provide a secondary source of repayment. The Company generally restricts real estate term loans to no more than 75% of the property's appraised value or the purchase price of the property depending on the type of property and its utilization. The Company offers both fixed and floating rate loans. Maturities on CRE loans are generally between five and ten years (with amortization ranging from fifteen to twenty-five years and a balloon payment due at maturity), however, SBA, and certain other real estate loans that can be sold in the secondary market, may be granted for longer maturities.

The CRE loan portfolio increased $516.5 million, or 52%, to $1.5 billion at December 31, 2019, compared to $994.1 million at December 31, 2018, which included $416.6 million of loans added from Presidio, and an increase of $106.4 million, or 11%, in the Company's legacy portfolio, partially offset by a decrease of $6.5 million in purchased CRE loans. At December 31, 2019, approximately 34% of the CRE loan portfolio was secured by owner-occupied real estate.

The Company's land and construction loans are primarily to finance the development/construction of commercial and single family residential properties. The Company utilizes underwriting guidelines to assess the likelihood of repayment from sources such as sale of the property or availability of permanent mortgage financing prior to making the construction loan. Construction loans are provided primarily in our market area, and we have extensive controls for the disbursement process. Land and construction loans increased $28.3 million, or 23%, to $150.6 million at December 31,

2019, compared to $122.4 million at December 31, 2018, primarily due to $50.9 million of loans added from Presidio, partially offset by a decrease of $22.6 million in the Company's legacy portfolio.

The Company makes home equity lines of credit available to its existing customers. Home equity lines of credit are underwritten initially with a maximum 75% loan to value ratio. Home equity lines of credit increased $66.1 million, or 61%, to $175.3 million at December 31, 2019, compared to $109.1 million at December 31, 2018, which included $66.4 million of loans added from Presidio.

Residential mortgage loans decreased $4.7 million, or (9%), at December 31, 2019, compared to $51.0 million at December 31, 2018, primarily due to a decrease in purchased residential mortgage loans.

Additionally, the Company makes consumer loans for the purpose of financing automobiles, various types of consumer goods, and other personal purposes. Consumer loans generally provide for the monthly payment of principal and interest. Most of the Company's consumer loans are secured by the personal property being purchased or, real property in the instances of home equity loans or lines of credit.

With certain exceptions, state chartered banks are permitted to make extensions of credit to any one borrowing entity up to 15% of the bank's capital and reserves for unsecured loans and up to 25% of the bank's capital and reserves for secured loans. For HBC, these lending limits were $92.7 million and $154.5 million at December 31, 2019, respectively.

Loan Maturities

The following table presents the maturity distribution of the Company's loans (excluding loans held-for-sale), as of December 31, 2019. The table shows the distribution of such loans between those loans with predetermined (fixed) interest rates and those with variable (floating) interest rates. Floating rates generally fluctuate with changes in the prime rate as reflected in the Western Edition of The Wall Street Journal. As of December 31, 2019, approximately 44% of the Company's loan portfolio consisted of floating interest rate loans.

	Due in One Year or Less	Over One Year But Less than Five Years	Over Five Years	Total
		(Dollars in thousands)		
Commercial	$ 471,408	139,055	21,084	$ 631,547
Real estate:				
CRE	178,199	553,569	778,824	1,510,592
Land and construction	146,171	3,583	880	150,634
Home equity	103,756	38,218	33,278	175,252
Residential mortgages	321	11,173	34,762	46,256
Consumer	12,735	5,916	1,231	19,882
Loans	$ 912,590	$ 751,514	$ 870,059	$ 2,534,163
Loans with variable interest rates	$ 795,049	219,436	91,235	$ 1,105,720
Loans with fixed interest rates	117,541	532,078	778,824	1,428,443
Loans	$ 912,590	$ 751,514	$ 870,059	$ 2,534,163

Loan Servicing

As of December 31, 2019, 2018, and 2017 there were $87.8 million, $104.0 million, and $139.1 million, respectively, of SBA loans that were serviced by the Company for others. Activity for loan servicing rights was as follows:

	2019	2018	2017
	(Dollars in thousands)		
Beginning of period balance	$ 871	$ 1,373	$ 1,854
Additions	157	200	278
Amortization	(445)	(702)	(759)
End of period balance	$ 583	$ 871	$ 1,373

Loan servicing rights are included in accrued interest receivable and other assets on the consolidated balance sheets and reported net of amortization. There was no valuation allowance as of December 31, 2019 and 2018, as the fair market value of the assets was greater than the carrying value.

Activity for the I/O strip receivable was as follows:

	2019	2018	2017
	(Dollars in thousands)		
Beginning of period balance	$ 568	$ 968	$ 1,067
Unrealized holding loss	(65)	(400)	(99)
End of period balance	$ 503	$ 568	$ 968

Management reviews the key economic assumptions used to estimate the fair value of I/O strip receivables on a quarterly basis. The fair value of the I/O strip can be adversely impacted by a significant increase in either the prepayment speed of the portfolio or the discount rate. At December 31, 2019, key economic assumptions and the sensitivity of the fair value of the I/O strip receivables to immediate changes to the CPR assumption of 10% and 20%, and changes to the discount rate assumption of 1% and 2%, are as follows:

Carrying amount/fair value of Interest-Only (I/O) strip	$ 503
Prepayment speed assumption (annual rate)	13.5%
Impact on fair value of 10% adverse change in prepayment speed (CPR 14.8%)	$ (7)
Impact on fair value of 20% adverse change in prepayment speed (CPR 16.2%)	$ (13)
Residual cash flow discount rate assumption (annual)	15.9%
Impact on fair value of 1% adverse change in discount rate (17.5% discount rate)	$ (14)
Impact on fair value of 2% adverse change in discount rate (19.1% discount rate)	$ (27)

Credit Quality

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company's management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines as a result of customers' inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies and declines in overall asset values including real estate. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor's financial capacity to repay deteriorates.

The Company's policies and procedures identify market segments, set goals for portfolio growth or contraction, and establish limits on industry and geographic credit concentrations. In addition, these policies establish the Company's underwriting standards and the methods of monitoring ongoing credit quality. The Company's internal credit risk controls

are centered in underwriting practices, credit granting procedures, training, risk management techniques, and familiarity with loan customers as well as the relative diversity and geographic concentration of our loan portfolio.

The Company's credit risk may also be affected by external factors such as the level of interest rates, employment, general economic conditions, real estate values, and trends in particular industries or geographic markets. As an independent community bank serving a specific geographic area, the Company must contend with the unpredictable changes in the general California market and, particularly, primary local markets. The Company's asset quality has suffered in the past from the impact of national and regional economic recessions, consumer bankruptcies, and depressed real estate values.

Nonperforming assets are comprised of the following: loans for which the Company is no longer accruing interest; restructured loans which have been current under six months; loans 90 days or more past due and still accruing interest (although they are generally placed on nonaccrual when they become 90 days past due, unless they are both well-secured and in the process of collection); and foreclosed assets. Past due loans 30 days or greater totaled $15.3 million and $8.9 million at December 31, 2019 and December 31, 2018, respectively, of which $7.4 million and $430,000 were on nonaccrual. There were also $1.3 million and $13.3 million loans less than 30 days past due included in nonaccrual loans held-for-investment, at December 31, 2019 and December 31, 2018, respectively.

Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt. The loans may or may not be collateralized, and collection efforts are pursued. Loans may be restructured by management when a borrower has experienced some change in financial status causing an inability to meet the original repayment terms and where the Company believes the borrower will eventually overcome those circumstances and make full restitution. Foreclosed assets consist of properties and other assets acquired by foreclosure or similar means that management is offering or will offer for sale.

The following table summarizes the Company's nonperforming assets at the dates indicated:

	December 31,				
	2019	2018	2017	2016	2015
	(Dollars in thousands)				
Nonaccrual loans — held-for-investment	$ 8,675	$ 13,699	$ 2,250	$ 3,059	$ 4,716
Restructured and loans 90 days past due and still accruing	1,153	1,188	235	—	1,662
Total nonperforming loans	9,828	14,887	2,485	3,059	6,378
Foreclosed assets	—	—	—	229	364
Total nonperforming assets	$ 9,828	$ 14,887	$ 2,485	$ 3,288	$ 6,742
Nonperforming assets as a percentage of loans plus foreclosed assets	0.39 %	0.79 %	0.16 %	0.22 %	0.50 %
Nonperforming assets as a percentage of total assets	0.24 %	0.48 %	0.09 %	0.13 %	0.29 %

Nonperforming assets were $9.8 million, or 0.24% of total assets, at December 31, 2019 compared to $14.9 million, or 0.48% of total assets, at December 31, 2018.

The following table presents nonperforming loans by class at year end:

	December 31, 2019			December 31, 2018		
	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)					
Commercial	$ 3,444	$ 1,153	$ 4,597	$ 8,279	$ 963	$ 9,242
Real estate:						
CRE	5,094	—	5,094	5,094	—	5,094
Home equity	137	—	137	326	225	551
Total	$ 8,675	$ 1,153	$ 9,828	$ 13,699	$ 1,188	$ 14,887

Loans with a well-defined weakness, which are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected, are categorized as "classified." Classified loans include all loans considered as substandard, substandard-nonaccrual, and doubtful and may result from problems specific to a borrower's business or from economic downturns that affect the borrower's ability to repay or that cause a decline in the value of the underlying collateral (particularly real estate). The principal balance of classified loans was $32.6 million at December 31, 2019, and $23.4 million at December 31, 2018. There were no loans held-for-sale included in classified loans at December 31, 2019 and December 31, 2018. Loans held-for-sale are carried at the lower of cost or estimated fair value, and are not allocated an allowance for loan losses.

The following table provides a summary of the loan portfolio by loan type and credit quality classification at the dates indicated:

	December 31, 2019			December 31, 2018		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(Dollars in thousands)					
Commercial	$ 623,768	$ 7,779	$ 631,547	$ 584,845	$ 12,918	$ 597,763
Real estate:						
CRE	1,492,126	18,466	1,510,592	985,193	8,874	994,067
Land and construction	147,553	3,081	150,634	122,358	—	122,358
Home equity	171,999	3,253	175,252	107,495	1,617	109,112
Residential mortgages	46,256	—	46,256	50,979	—	50,979
Consumer	19,882	—	19,882	12,453	—	12,453
Total	$ 2,501,584	$ 32,579	$ 2,534,163	$ 1,863,323	$ 23,409	$ 1,886,732

Classified loans were $32.6 million, or 0.79% of total assets, at December 31, 2019, compared to $23.4 million, or 0.76% of total assets, at December 31, 2018. The increase in classified assets at December 31, 2019 was primarily due to classified assets acquired from Presidio. 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. This evaluation is performed in accordance with the Company's underwriting policy.

The following provides a rollforward of troubled debt restructurings ("TDRs"):

	Year Ended December 31, 2019		
	Performing TDRs	Nonperforming TDRs	Total
	(Dollars in thousands)		
Balance at January 1, 2019	$ 613	$ 36	$ 649
Additions	2	589	591
Principal repayments	(166)	(35)	(201)
Balance at December 31, 2019	$ 449	$ 590	$ 1,039

	Year Ended December 31, 2018		
	Performing TDRs	Nonperforming TDRs	Total
	(Dollars in thousands)		
Balance at January 1, 2018	$ 309	$ 16	$ 325
Additions	316	20	336
Principal repayments	(12)	—	(12)
Balance at December 31, 2018	$ 613	$ 36	$ 649

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable incurred losses in the loan portfolio. Loans are charged-off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses. Management's methodology for estimating the allowance balance consists of several key elements, which include specific allowances on individual impaired loans and the formula driven allowances on pools of loans with similar risk characteristics. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

Specific allowances are established for impaired loans. Management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement, including scheduled interest payments. Loans for which the terms have been modified with a concession granted, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. When a loan is considered to be impaired, the amount of impairment is measured based on the fair value of the collateral, less costs to sell, if the loan is collateral dependent or on the present value of expected future cash flows or values that are observable in the secondary market. If the measure of the impaired loans is less than the investment in the loan, the deficiency will be charged off against the allowance for loan losses if the amount is a confirmed loss, or, alternatively, a specific allocation within the allowance will be established. Loans that are considered impaired are specifically excluded from the formula portion of the allowance for loan loss analysis.

The estimated loss factors for pools of loans that are not impaired are based on determining the probability of default and loss given default for loans within each segment of the portfolio, adjusted for significant factors that, in management's judgment, affect collectibility as of the evaluation date. The Company's historical delinquency experience and loss experience are utilized to determine the probability of default and loss given default for segments of the portfolio where the Company has experienced losses in the past. For segments of the portfolio where the Company has no significant prior loss experience, the Company uses quantifiable observable industry data to determine the probability of default and loss given default.

The following provides a summary of the risks associated with various segments of the Company's loan portfolio, which are factors management regularly considers when evaluating the adequacy of the allowance:

- Commercial loans consist primarily of commercial and industrial loans (business lines of credit), and other commercial purpose loans. Repayment of commercial and industrial loans is generally provided from the cash flows of the related business to which the loan was made. Adverse changes in economic conditions may result in a decline in business activity, which may impact a borrower's ability to continue to make scheduled payments. The factored receivables at Bay View Funding are included in the Company's commercial loan portfolio; however, they are evaluated for risk primarily based on the agings of the receivables. Faster turning receivables imply less risk and therefore warrant a lower associated allowance. Should the overall aging for the portfolio increase, this structure will by formula increase the allowance to reflect the increasing risk. Should the portfolio turn more quickly, it would reduce the associated allowance to reflect the reducing risk.

- Real estate loans consist primarily of loans secured by commercial and residential real estate. Also included in this segment are land and construction loans and home equity lines of credit secured by real estate. As the majority of this segment is comprised of commercial real estate loans, risks associated with this segment lay primarily within these loan types. Adverse economic conditions may result in a decline in business activity and increased vacancy rates for commercial properties. These factors, in conjunction with a decline in real estate prices, may expose the Company to the potential for losses if a borrower cannot continue to service the loan with operating revenues, and the value of the property has declined to a level such that it no longer fully covers the Company's recorded investment in the loan.

- Consumer loans consist primarily of a large number of small loans and lines of credit. The majority of installment loans are made for consumer and business purchases. Weakened economic conditions may result in an increased level of delinquencies within this segment, as economic pressures may impact the capacity of such borrowers to repay their obligations.

As a result of the matters mentioned above, changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the condition of the various markets in which collateral may be sold, may all affect the required level of the allowance for loan losses and the associated provision for loan losses.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the loan portfolio. On an ongoing basis, we have engaged an outside firm to perform independent credit reviews of our loan portfolio. The Federal Reserve Board and the California Department of Business Oversight — Division of Financial Institutions also review the allowance for loan losses as an integral part of their examination process. Based on information currently available, management believes that the allowance for loan losses is adequate. However, the loan portfolio can be adversely affected if California economic conditions and the real estate market in the Company's market area were to weaken. Also, any weakness of a prolonged nature in the technology industry would have a negative impact on the local market. The effect of such events, although uncertain at this time, could result in an increase in the level of nonperforming loans and increased loan losses, which could adversely affect the Company's future growth and profitability. No assurance of the ultimate level of credit losses can be given with any certainty.

The following table summarizes the Company's loan loss experience, as well as provisions and charges to the allowance for loan losses and certain pertinent ratios for the periods indicated:

	2019	2018	2017	2016	2015
	(Dollars in thousands)				
Beginning of year balance	$ 27,848	$ 19,658	$ 19,089	$ 18,926	$ 18,379
Charge-offs:					
Commercial	(6,609)	(2,002)	(2,239)	(1,966)	(527)
Real estate:					
CRE	—	—	—	—	(2)
Home equity	—	—	—	—	—
Consumer	(14)	(24)	—	(41)	(9)
Total charge-offs	(6,623)	(2,026)	(2,239)	(2,007)	(538)
Recoveries:					
Commercial	1,045	2,645	1,585	365	877
Real estate:					
CRE	169	150	859	—	9
Land and construction	—	—	244	568	127
Home equity	—	—	21	—	10
Consumer	—	—	—	—	30
Total recoveries	1,214	2,795	2,709	933	1,053
Net (charge-offs) recoveries	(5,409)	769	470	(1,074)	515
Provision (credit) for loan losses	846	7,421	99	1,237	32
End of year balance	$ 23,285	$ 27,848	$ 19,658	$ 19,089	$ 18,926

The following table provides a summary of the allocation of the allowance for loan losses by class at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for loan losses

will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each category represents the total amount available for charge-offs that may occur within these classes.

	December 31,									
	2019		2018		2017		2016		2015	
	Allowance	Percent of Loans in each category to total loans	Allowance	Percent of Loans in each category to total loans	Allowance	Percent of Loans in each category to total loans	Allowance	Percent of Loans in each category to total loans	Allowance	Percent of Loans in each category to total loans
	(Dollars in thousands)									
Commercial	$ 10,453	25 %	$ 17,061	32 %	$ 10,608	36 %	$ 10,656	40 %	$ 10,748	41 %
Real estate:										
CRE	7,642	59 %	6,737	52 %	5,909	49 %	5,181	44 %	4,980	46 %
Land and construction	2,621	6 %	2,008	6 %	1,441	6 %	1,221	5 %	1,504	6 %
Home equity	2,244	7 %	1,609	6 %	1,390	5 %	1,639	6 %	1,592	6 %
Residential mortgages	243	2 %	317	3 %	210	3 %	286	4 %	—	0 %
Consumer	82	1 %	116	1 %	100	1 %	106	1 %	102	1 %
Total	$ 23,285	100 %	$ 27,848	100 %	$ 19,658	100 %	$ 19,089	100 %	$ 18,926	100 %

The allowance for loan losses totaled $23.3 million, or 0.92% of total loans at December 31, 2019, compared to $27.8 million, or 1.48% of total loans at December 31, 2018. The allowance for loan losses to total nonperforming loans increased to 236.93% at December 31, 2019, compared to 187.06% at December 31, 2018. The loans acquired from Presidio are included in total loans. Due to the addition of the Presidio loans at fair value with no allowance, the ALLL to total loans decreased at December 31, 2019. However, the Company provided an additional $2.0 million in provision for loan losses to increase the ALLL at December 31, 2019 for certain non-impaired loans acquired at a premium from Presidio. The Company had net charge-offs of $5.4 million, or 0.27% of average loans, for the year ended December 31, 2018, compared to net recoveries of $769,000, or (0.04%) of average loans, for the year ended December 31, 2018. Net charge-offs of $5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling $5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling $5.5 million in net charge-offs had a total of $4.7 million in specific reserves.

The allowance for loan losses related to the commercial portfolio decreased $6.6 million at December 31, 2019 from December 31, 2018, primarily due to net charge-offs of $5.6 million, as described above, and a credit to the provision for loan losses of $1.0 million. The allowance for loan losses related to the real estate portfolio increased $2.1 million at December 31, 2019 from December 31, 2018, primarily due to increasing market risk associated with risk factors for real estate loans, resulting in a $1.9 million provision for loan losses and net recoveries of $169,000.

As previously discussed under *"Management of Credit Risk,"* the standard on the new CECL model became effective for the Company on January 1, 2020. As of the implementation date, Management expects to recognize an increase of up to $12.0 million to its allowance for credit losses for loans. Once finalized, the cumulative-effect adjustment as a result of the adoption of this guidance will be recorded, net of tax, as an adjustment to retained earnings effective January 1, 2020. Management is currently assessing the potential impact on the CECL model results due to an economic downturn caused by the Coronavirus.

Leases

On January 1, 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842). Under the new guidance, the Company recognizes the following for all leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use ("ROU") asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. While the new standard impacts lessors and lessees, the Company is impacted as a lessee of the offices and real estate used for operations. The Company's lease agreements include options to renew at the Company's discretion. The extensions are not reasonably certain to be exercised, therefore it was not considered in the calculation of the ROU asset and lease liability. Total assets were $12.2 million and total liabilities were $13.0 million on its consolidated statement of financial condition at December 31, 2019, as a result of recognizing right-of-use assets, included in other assets, and lease liabilities, included in other liabilities, related to non-cancelable operating lease agreements for office space.

In June of 2019, the Company entered in to a lease agreement for 54,910 square feet of office space in San Jose, California, which commenced on February 1, 2020. The Company intends to move its Bay View Funding office during the first quarter of 2020, and move the main office of HBC during the second quarter of 2020, to this new location.

The merger with Presidio resulted in the Company operating overlapping branch locations in the cities of Walnut Creek and San Mateo, California. Management intends to consolidate these branches in 2020 by vacating the HBC leased locations prior to the lease termination date, and moving the operations to the Presidio branch locations. The consolidation of these two branches into the Presidio locations resulted in the impairment of both leases at December 31, 2019. The lease impairment and write-off of fixed assets and tenant improvements totaled $434,000 for the Walnut Creek location, and $625,000 for the San Mateo location during the fourth quarter of 2019.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. The fair values of assets acquired and liabilities assumed are subject to adjustment during the first twelve months after the acquisition date if additional information becomes available to indicate a more accurate or appropriate value for an asset or liability. Total goodwill was $167.4 million at December 31, 2019, which consisted of, $13.0 million related to the Bay View Funding acquisition, $32.6 million related to the Focus acquisition, $13.8 million related to the Tri-Valley acquisition, $24.3 million related to the United American acquisition, and $83.7 million from the Presidio merger. Total goodwill was $83.8 million at December 31, 2018, which consisted of, $13.0 million related to the Bay View Funding acquisition, $32.6 million related to the Focus acquisition, $13.8 million related to the Tri-Valley acquisition, and $24.3 million related to the United American acquisition

On April 6, 2018, the Company completed its acquisition of Tri-Valley for a transaction value of $32.3 million. At closing, the Company issued 1,889,613 shares of the Company's common stock with an aggregate market value of $30.7 million on the date of closing. The number of shares issued was based on a fixed exchange ratio of 0.0489 of a share of the Company's common stock for each outstanding share of Tri-Valley common stock. In addition, at closing the Company paid cash to the holder of a stock warrant and holders of outstanding stock options and related fees and fractional shares totaling $1.6 million. The Company recorded goodwill of $13.8 million for the Tri-Valley acquisition.

On May 4, 2018, the Company completed its acquisition of United American for a transaction value of $56.4 million. At closing, the Company issued 2,826,032 shares of the Company's common stock with an aggregate market value of $47.3 million on the date of closing. The number of shares issued was based on a fixed exchange ratio of 2.1644 of a share of the Company's common stock for each outstanding share of United American common stock and each common stock equivalent underlying the United American Series D Preferred Stock and Series E Preferred Stock. The shareholders of the United American Series A Preferred Stock and the Series B Preferred Stock received $1,000 cash for each share totaling $8.7 million and $435,000, respectively. In addition, the Company paid $2,000 in cash for fractional shares, for total cash consideration of $9.1 million. The Company recorded goodwill of $24.3 million for the United American acquisition.

On October 11, 2019, the Company completed its merger with Presidio for an aggregate transaction value of $185.6 million. Shareholders of Presidio received a fixed exchange ratio at closing of 2.47 shares of the Company's common stock for each share of Presidio common stock. Upon closing of the transaction, the Company issued 15,684,064 shares of the Company's common stock to Presidio shareholders and holders of restricted stock units for a total value of $178.2 million based on the Company's closing stock price of $11.36 on the closing date of October 11, 2019. In addition, the consideration for Presidio stock options exchanged for the Company's stock options totaled $7.4 million and cash-in-lieu of fractional shares totaled $1,000 on October 11, 2019. The Company recorded goodwill of $83.7 million for the Presidio merger at December 31, 2019.

The Company completed its annual goodwill impairment analysis as of November 30, 2019 with the assistance of an independent valuation firm. The goodwill related to the acquisition of Bay View Funding was tested separately for impairment under this analysis. No events or circumstances since the November 30, 2019 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists, for either the Company's banking segment or the factoring segment.

The following table summarizes the carrying amount of goodwill by segment at December 31, 2019 and 2018:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Banking	$ 154,376	$ 70,709
Factoring	13,044	13,044
Total Goodwill	$ 167,420	$ 83,753

Other intangible assets increased to $20.4 million at December 31, 2019, compared to $12.0 million at December 31, 2018, primarily due to the Presidio merger. The customer relationship and brokered relationship and intangible assets arising from the acquisition of Bay View Funding were $919,000 at December 31, 2019 and $1.1 million at December 31, 2018, net of accumulated amortization. The core deposit intangible assets arising from the acquisition of Focus was $2.8 million at December 31, 2019 and $3.5 million at December 31, 2018, net of accumulated amortization. The core deposit intangible and below market lease intangible assets arising from the Tri-Valley acquisition were $1.5 million at December 31, 2019 and $1.8 million at December 31, 2018, net of accumulated amortization. The core deposit intangible and below market lease intangible assets arising from the United American acquisition were $4.6 million at December 31, 2019 and $5.6 million at December 31, 2018, net of accumulated amortization. The core deposit intangible assets and above market lease arising from the acquisition of Presidio were $10.6 million at December 31, 2019, net of accumulated amortization

Deposits

The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections in this report. The Company's liquidity is impacted by the volatility of deposits from the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions weaken in California, and the Company's market area in particular. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following table summarizes the distribution of deposits and the percentage of distribution in each category of deposits for the periods indicated:

	December 31, 2019		December 31, 2018		December 31, 2017	
	Balance	% to Total	Balance	% to Total	Balance	% to Total
	(Dollars in thousands)					
Demand, noninterest-bearing	$ 1,450,873	42 %	$ 1,021,582	39 %	$ 989,753	40 %
Demand, interest-bearing	798,375	23 %	702,000	27 %	601,929	24 %
Savings and money market	982,430	29 %	754,277	28 %	684,131	27 %
Time deposits — under $250	54,361	2 %	58,661	2 %	51,710	2 %
Time deposits — $250 and over	99,882	3 %	86,114	3 %	138,634	6 %
CDARS — interest-bearing demand, money market and time deposits	28,847	1 %	14,898	1 %	16,832	1 %
Total deposits	$ 3,414,768	100 %	$ 2,637,532	100 %	$ 2,482,989	100 %

The Company obtains deposits from a cross-section of the communities it serves. The Company's business is not generally seasonal in nature. Public funds were less than 1% of deposits at December 31, 2019 and December 31, 2018.

Total deposits increased $777.2 million, or 29%, to $3.41 billion at December 31, 2019, compared to $2.64 billion at December 31, 2018, which included $723.0 million in deposits from Presidio, at fair value, and an increase of $54.2 million in the Company's legacy deposits. Deposits, excluding all time deposits and CDARS deposits, increased $753.8 million, or 30%, to $3.23 billion at December 31, 2019, compared to $2.48 billion at December 31, 2018, which included $699.4 million in deposits from Presidio, at fair value, and an increase of $54.4 million in the Company's legacy deposits.

At December 31, 2019, the $28.8 million CDARS deposits were comprised of $12.9 million of interest-bearing demand deposits, $2.1 million of money market accounts and $13.8 million of time deposits. At December 31, 2018, the $14.9 million CDARS deposits were comprised of $8.7 million of interest-bearing demand deposits, $3.4 million of

money market accounts and $2.8 million of time deposits.

The following table indicates the contractual maturity schedule of the Company's time deposits of $250,000 and over, and all CDARS time deposits as of December 31, 2019:

	Balance	% of Total
	(Dollars in thousands)	
Three months or less	$ 50,446	45 %
Over three months through six months	24,878	22 %
Over six months through twelve months	32,256	28 %
Over twelve months	6,093	5 %
Total	$ 113,673	100 %

The Company focuses primarily on providing and servicing business deposit accounts that are frequently over $250,000 in average balance per account. As a result, certain types of business clients that the Company serves typically carry average deposits in excess of $250,000. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Company to ensure its ability to fund deposit withdrawals.

Return on Equity and Assets

The following table indicates the ratios for return on average assets and average equity, and average equity to average assets for the periods indicated:

	2019	2018	2017
Return on average assets	1.21 %	1.16 %	0.86 %
Return on average tangible assets	1.25 %	1.19 %	0.88 %
Return on average equity	9.51 %	10.79 %	8.86 %
Return on average tangible equity	13.09 %	14.41 %	10.98 %
Average equity to average assets ratio	12.69 %	10.72 %	9.76 %

Off-Balance Sheet Arrangements

In the normal course of business, the Company makes commitments to extend credit to its customers as long as there are no violations of any conditions established in contractual arrangements. These commitments are obligations that represent a potential credit risk to the Company, yet are not reflected in any form within the Company's consolidated balance sheets. Total unused commitments to extend credit were $1.1 billion at December 31, 2019, as compared to $740.4 million at December 31, 2018. Unused commitments represented 44% and 39% of outstanding gross loans at December 31, 2019 and 2018, respectively.

The effect on the Company's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted, because there is no certainty that the lines of credit will ever be fully utilized. For more information regarding the Company's off-balance sheet arrangements, see Note 16 to the consolidated financial statements located elsewhere herein.

The following table presents the Company's commitments to extend credit for the periods indicated:

	December 31,					
	2019			2018		
	Fixed Rate	Variable Rate	Total	Fixed Rate	Variable Rate	Total
	(Dollars in thousands)					
Unused lines of credit and commitments to make loans	$ 147,372	$ 951,206	$ 1,098,578	$ 130,871	$ 593,839	$ 724,710
Standby letters of credit	11,445	10,615	22,060	2,770	12,899	15,669
	$ 158,817	$ 961,821	$ 1,120,638	$ 133,641	$ 606,738	$ 740,379

Contractual Obligations

The contractual obligations of the Company, summarized by type of obligation and contractual maturity, at December 31, 2019, are as follows:

	Less Than One Year	One to Three Years	Three to Five Years	After Five Years	Total
	(Dollars in thousands)				
Deposits(1)	$ 3,402,875	$ 11,773	$ 120	$ —	$ 3,414,768
Subordinated debt	—	—	—	40,000	40,000
Operating leases	3,812	5,430	3,329	1,618	14,189
Other long-term liabilities(2)	1,509	3,580	3,985	49,183	58,257
Total contractual obligations	$ 3,408,196	$ 20,783	$ 7,434	$ 90,801	$ 3,527,214

(1) Deposits with indeterminate maturities, such as demand, savings and money market accounts, are reflected as obligations due in less than one year.

(2) Includes maximum payments related to employee benefit plans, assuming all future vesting conditions are met. Additional information is provided in Note 14 to the consolidated financial statements.

In addition to those obligations listed above, in the normal course of business, the Company will make cash distributions for the payment of interest on interest-bearing deposit accounts and debt obligations, payments for quarterly income tax estimates and contributions to certain employee benefit plans.

Liquidity and Asset/Liability Management

Liquidity refers to the Company's ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely and cost effective fashion. At various times the Company requires funds to meet short-term cash requirements brought about by loan growth or deposit outflows, the purchase of assets, or liability repayments. An integral part of the Company's ability to manage its liquidity position appropriately is the Company's large base of core deposits, which are generated by offering traditional banking services in its service area and which have historically been a stable source of funds. To manage liquidity needs properly, cash inflows must be timed to coincide with anticipated outflows or sufficient liquidity resources must be available to meet varying demands. The Company manages liquidity to be able to meet unexpected sudden changes in levels of its assets or deposit liabilities without maintaining excessive amounts of balance sheet liquidity. Excess balance sheet liquidity can negatively impact the Company's interest margin. In order to meet short-term liquidity needs the Company may utilize overnight Federal funds purchase arrangements and other borrowing arrangements with correspondent banks, solicit brokered deposits if cost effective deposits are not available from local sources, and maintain collateralized lines of credit with the FHLB and FRB. In addition, the Company can raise cash for temporary needs by selling securities under agreements to repurchase and selling securities available-for-sale.

One of the measures of liquidity is our loan to deposit ratio. Our loan to deposit ratio was 74.20% at December 31, 2019, compared to 71.52% at December 31, 2018.

FHLB and FRB Borrowings and Available Lines of Credit

The Company has off-balance sheet liquidity in the form of Federal funds purchase arrangements with correspondent banks, and lines of credit from the FHLB and FRB. The Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. The Company had no overnight borrowings from the FHLB at December 31, 2019 and December 31, 2018. The Company had $272.9 million of loans pledged to the FHLB as collateral on an available line of credit of $228.1 million at December 31, 2019.

The Company can also borrow from FRB's discount window. The Company had $726.7 million of loans pledged to the Federal Reserve as collateral on an available line of credit of $408.4 million at December 31, 2019, none of which was outstanding.

At December 31, 2019 and 2018, the Company had Federal funds purchase arrangements available of $80.0 million and $55.0 million, respectively. There were no Federal funds purchased outstanding at December 31, 2019 or 2018.

The Company has a $5.0 million line of credit with a correspondent bank, of which none was outstanding at December 31, 2019 or 2018.

The Company may also utilize securities sold under repurchase agreements to manage our liquidity position. There were no securities sold under agreements to repurchase at December 31, 2019 or 2018.

Capital Resources

The Company uses a variety of measures to evaluate capital adequacy. Management reviews various capital measurements on a regular basis and takes appropriate action to ensure that such measurements are within established internal and external guidelines. The external guidelines, which are issued by the Federal Reserve and the FDIC, establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures.

On May 26, 2017, the Company completed an underwritten public offering of $40.0 million aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium.

It is understood that after December 31, 2021, the administrator in the United Kingdom with authority over the agency that currently publishes LIBOR (commonly known as the Intercontinental Exchange "ICE"), will no longer support that published index as a generally representative rate. Due to this, standardized contract language addressing the replacement of LIBOR has been published by the Alternative Rate Reference Committee (commonly known as "ARRC") convened by, among others, the Federal Reserve Board. It is also understood that ARRC generally supports using the Secured Overnight Financing Rate ("SOFR") as a replacement index (with an adjustment mechanism), although one version of the ARRC's proposed language does not require implementation of SOFR immediately. With respect to new financings tied to LIBOR going forward, it is expected to consider the implementation of the ARRC's proposed language (with variations as appropriate) into the documentation thereof. With respect to existing financings tied to LIBOR, the existing terms of the documentation thereof will be the primary driver of how all issues related to LIBOR are dealt with, which necessarily means each will be evaluated and responded to on a case-by-case basis as necessary. Efforts are underway to coordinate with the counter-parties under such financings to address the issues, subject to the terms of the existing documentation and any mutually agreeable amendments thereto.

The Company acquired $10.0 million of subordinated debt from the Presidio transaction, which was redeemed on December 19, 2019. As a result of the redemption of the Presidio subordinated debt, the Company paid a pre-payment penalty of $300,000 during the fourth quarter of 2019.

The following table summarizes risk based capital, risk weighted assets, and risk based capital ratios of the consolidated Company under the Basel III requirements for the periods indicated:

	December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Capital components:			
Common equity Tier 1 capital	$ 393,432	$ 276,675	$ 229,656
Additional Tier 1 capital	—	—	—
Tier 1 Capital	393,432	276,675	229,656
Tier 2 Capital	63,726	67,922	59,575
Total risk-based capital	$ 457,158	$ 344,597	$ 289,231
Risk-weighted assets	$ 3,136,252	$ 2,303,941	$ 1,986,488
Average assets for capital purposes	$ 4,041,927	$ 3,118,150	$ 2,783,219
Capital ratios:			
Total risk-based capital	14.6 %	15.0 %	14.4 %
Tier 1 risk-based capital	12.5 %	12.0 %	11.4 %
Common equity Tier 1 risk-based capital	12.5 %	12.0 %	11.4 %
Leverage(1)	9.7 %	8.9 %	8.0 %

(1) Tier 1 capital divided by quarterly average assets (excluding intangible assets and disallowed deferred tax assets).

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of HBC under the Basel III requirements for the periods indicated:

	December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Capital components:			
Common equity Tier 1 capital	$ 411,585	$ 293,730	$ 244,790
Additional Tier 1 capital	—	—	—
Tier 1 Capital	411,585	293,730	244,790
Tier 2 Capital	24,172	28,553	20,312
Total risk-based capital	$ 435,757	$ 322,283	$ 265,102
Risk-weighted assets	$ 3,134,848	$ 2,302,751	$ 2,002,736
Average assets for capital purposes	$ 4,040,265	$ 3,116,645	$ 2,873,102
Capital ratios:			
Total risk-based capital	13.9 %	14.0 %	13.2 %
Tier 1 risk-based capital	13.1 %	12.8 %	12.2 %
Common equity Tier 1 risk-based capital	13.1 %	12.8 %	12.2 %
Leverage(1)	10.2 %	9.4 %	8.5 %

(1) Tier 1 capital divided by quarterly average assets (excluding intangible assets and disallowed deferred tax assets).

The following table presents the applicable well-capitalized regulatory guidelines and the standards for minimum capital adequacy requirements under Basel III:

	Minimum Regulatory Requirement(1)	Well-capitalized Financial Institution PCA Regulatory Guidelines
Capital ratios:		
Total risk-based capital	10.5 %	10.0 %
Tier 1 risk-based capital	8.5 %	8.0 %
Common equity Tier 1 risk-based capital	7.0 %	6.5 %
Leverage	4.0 %	5.0 %

(1) Includes 2.5% capital conservation buffer, except the leverage ratio.

The Basel III capital rules introduce a new "capital conservation buffer," for banking organizations to maintain a common equity Tier 1 ratio more than 2.5% above these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

At December 31, 2019, the Company's consolidated capital ratio exceeded regulatory guidelines and HBC's capital ratios exceed the highest regulatory capital requirement of "well-capitalized" under Basel III prompt corrective action provisions. Quantitative measures established by regulation to help ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios of total risk-based capital, Tier 1 capital, and common equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2019, December 31, 2018, and December 31, 2017, the Company and HBC met all capital adequacy guidelines to which they were subject. There are no conditions or events since of December 31, 2019, that management believes have changed the categorization of the Company or HBC as well-capitalized.

At December 31, 2019, the Company had total shareholders' equity of $576.7 million, compared to $367.5 million at December 31, 2018. At December 31, 2019, total shareholders' equity included $489.7 million in common stock, $96.7 million in retained earnings, and ($9.7) million of accumulated other comprehensive loss. The book value per common share was $9.71 at December 31, 2019, compared to $8.49 at December 31, 2018. The tangible book value per common share was $6.55 at December 31, 2019, compared to $6.28 at December 31, 2018. The increase in total shareholders' equity was primarily from the issuance of common stock in the Presidio acquisition in which an aggregate of 15,684,064 shares of stocks were issued at an aggregate market value at the time of issuance of $178.2 million, and consideration for Presidio stock options exchanged for the Company's stock options totaling $7.4 million.

The following table reflects the components of accumulated other comprehensive loss, net of taxes, for the periods indicated:

ACCUMULATED OTHER COMPREHENSIVE LOSS (in $000's, unaudited)	December 31, 2019	December 31, 2018
Unrealized gain (loss) on securities available-for-sale	$ 1,242	$ (5,412)
Remaining unamortized unrealized gain on securities available-for-sale transferred to held-to-maturity	297	343
Split dollar insurance contracts liability	(4,835)	(3,722)
Supplemental executive retirement plan liability	(6,842)	(3,995)
Unrealized gain on interest-only strip from SBA loans	360	405
Total accumulated other comprehensive loss	$ (9,778)	$ (12,381)

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company's market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Company does not engage in the trading of financial instruments, nor does the Company have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Company in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity GAP report may not provide a complete assessment of the exposure to changes in interest rates.

The Company uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Company's net interest margin, and to calculate the estimated fair values of the Company's financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Company's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Company's investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

The following table sets forth the estimated changes in the Company's annual net interest income that would result from the designated instantaneous parallel shift in interest rates noted, as of December 31, 2019. Computations of

prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

	Increase/(Decrease) in Estimated Net Interest Income	
	Amount	Percent
	(Dollars in thousands)	
Change in Interest Rates (basis points)		
+400	$ 189,732	23.3 %
+300	$ 180,826	17.5 %
+200	$ 171,835	11.7 %
+100	$ 162,821	5.8 %
0	$ —	— %
−100	$ 141,311	(8.2)%
−200	$ 128,343	(16.6)%

This data does not reflect any actions that we may undertake in response to changes in interest rates such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on net interest income, if any.

As with any method of gauging interest rate risk, there are certain shortcomings inherent to the methodology noted above. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. Additionally, the methodology noted above does not reflect the full impact of annual and lifetime restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan borrowers' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

ITEM 7A ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities and the market value of all interest-earning assets, other than those which have a short term to maturity. Based upon the nature of the Company's operations, the Company is not subject to foreign exchange or commodity price risk. The Company has no market risk sensitive instruments held for trading purposes. As of December 31, 2019, the Company did not use interest rate derivatives to hedge its interest rate risk.

The information concerning quantitative and qualitative disclosure or market risk called for by Item 305 of Regulation S-K is included as part of Item 7 of this report.

ITEM 8 ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

The financial statements and report of the Independent Registered Public Accounting Firm are set forth on pages 102 through 154.

ITEM 9 ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES***

None.

ITEM 9A *CONTROLS AND PROCEDURES*

Disclosure Control and Procedures

The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2019. As defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported on a timely basis. Disclosure controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls were effective as of December 31, 2019, the period covered by this report.

Management's Annual Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Rule 13a-15(f) under the Exchange Act, internal control over financial reporting is a process designed by, or under the supervision of, a company's principal executive and principal financial officers and effected by a company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. It includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of a company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of a company are being made only in accordance with authorizations of management and the board of directors of the company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on its financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management has used the criteria established in the 2013 *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to evaluate the effectiveness of the Company's internal control over financial reporting. Management has selected the COSO framework for its evaluation as it is a control framework recognized by the SEC and the Public Company Accounting Oversight Board, that is free from bias, permits reasonably consistent qualitative and quantitative measurement of the Company's internal controls, is sufficiently complete so that relevant controls are not omitted and is relevant to an evaluation of internal controls over financial reporting.

In accordance with guidance issued by the Securities and Exchange Commission, companies are permitted to exclude acquisitions from their final assessment of internal control over financial reporting for the first fiscal year in which the acquisition occurred. Our management's evaluation of internal control over financial reporting excluded the internal control activities of Presidio, which we acquired on October 11, 2019, as discussed in Note 8 — "*Business Combinations*," of our Notes to the Consolidated Financial Statements. We have included the financial results of Presidio in the consolidated financial statements since the date of the acquisition.

Based on our assessment, management has concluded that our internal control over financial reporting, based on criteria established in the 2013 *Internal Control — Integrated Framework* issued by COSO was effective as of December 31, 2019.

The independent registered public accounting firm of Crowe LLP, as auditors of our consolidated financial statements, has issued an audit report on the effectiveness of the Company's internal control over financial reporting based on criteria established in the 2013 "*Internal Control — Integrated Framework*," issued by COSO.

Inherent Limitations on Effectiveness of Controls

The Company's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the year ended December 31, 2019 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B *OTHER INFORMATION*

None.

PART III

ITEM 10 *DIRECTORS AND EXECUTIVE OFFICERS OF REGISTRANT*

Information required by this item will be contained in our Definitive Proxy Statement for our 2020 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2019. Such information is incorporated herein by reference.

We have adopted a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, and to our other principal financial officers. The code of ethics is available at the Governance Documents section of our website at *www.heritagecommercecorp.com.* We intend to disclose future amendments to, or waivers from, certain provisions of our code of ethics on the above website within four business days following the date of such amendment or waiver.

ITEM 11 *EXECUTIVE COMPENSATION*

Information required by this item will be contained in our Definitive Proxy Statement for our 2020 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2019. Such information is incorporated herein by reference.

ITEM 12 *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Information required by this item will be contained in our Definitive Proxy Statement for our 2020 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2019. Such information is incorporated herein by reference.

ITEM 13 *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE*

Information required by this item will be contained in our Definitive Proxy Statement for our 2020 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2019. Such information is incorporated herein by reference.

ITEM 14 *PRINCIPAL ACCOUNTANT FEES AND SERVICES*

Information required by this item will be contained in our Definitive Proxy Statement for our 2020 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2019. Such information is incorporated herein by reference.

PART IV

ITEM 15 *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(1) FINANCIAL STATEMENTS

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages 102 through 154.

(2) FINANCIAL STATEMENT SCHEDULES

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(3) EXHIBITS

The exhibits listed below are filed or incorporated by reference as part of this Annual Report on Form 10-K.

Exhibit Number	Description
2.1	Agreement and Plan of Merger and Reorganization, dated April 23, 2015, by and among Heritage Commerce Corp, Heritage Bank of Commerce and Focus Business Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on April 23, 2015)
2.2	Agreement and Plan of Merger and Reorganization, dated December 20, 2017, by and among Heritage Commerce Corp, Heritage Bank of Commerce and Tri-Valley Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on December 20, 2017)
2.3	Agreement and Plan of Merger and Reorganization, dated January 10, 2018, by and among Heritage Commerce Corp, Heritage Bank of Commerce, AT Bancorp and United American Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on January 10, 2018)
2.4	Agreement and Plan of Merger, dated May 16, 2019, by and among Heritage Commerce Corp, Heritage Bank of Commerce, and Presidio Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 17, 2019)
3.1	Restated Articles of Incorporation of Heritage Commerce Corp (incorporated by reference from the Registrant's Annual Report on Form 10-K filed on March 16, 2009)
3.2	Certificate of Amendment of Articles of Incorporation of Heritage Commerce Corp, as filed with the California Secretary of State on June 1, 2010 (incorporated by reference from the Registration Statement on Form S-1 filed July 23, 2010)

Exhibit Number	Description
3.3	Bylaws, as amended, of Heritage Commerce Corp (incorporated by reference from the Registrant's Current Report Form 8-K filed June 28, 2013)
3.4	Certificate of Amendment of Articles of Incorporation of Heritage Commerce Corp, as filed with the Secretary of State on August 29, 2019 (incorporated by reference from Registrant's Quarterly Report on Form 10-Q filed November 11, 2019)
3.5	Certificate of Determination of the Articles of Incorporation (Revocation of Series A Preferred), as filed with the Secretary of State on April 5, 2019
3.6	Certificate of Determination of the Articles of Incorporation (Revocation of Series B Preferred), as filed with the Secretary of State on April 5, 2019
3.7	Certificate of Determination of the Articles of Incorporation (Revocation of Series C Preferred), as filed with the Secretary of State on April 5, 2019
4.1	Subordinated Indenture, dated as of May 26, 2017, by and between Heritage Commerce Corp and Wilmington Trust, National Association, as Trustee (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.2	First Supplemental Indenture, dated as of May 26, 2017, by and between Heritage Commerce Corp and Wilmington Trust, National Association, as Trustee (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.3	Form of 5.25% Fixed-to-Floating Rate Subordinated Notes due 2027 (included in Exhibit 4.2) (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.4	Description of Securities Registered under Section 12 of the Securities Exchange Act of 1934
*10.1	Heritage Commerce Corp Management Incentive Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed May 3, 2005)
*10.2	Amended and Restated 2004 Equity Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed June 2, 2009)
*10.3	Non-qualified Deferred Compensation Plan (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 31, 2005)
*10.4	Amended and Restated Employment Agreement with Walter Kaczmarek, dated October 17, 2007 (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed October 22, 2007)
*10.5	Amended and Restated Employment Agreement with Lawrence McGovern, dated July 21, 2011 (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed July 21, 2011)
*10.6	Employment Agreement with Michael E. Benito, dated February 1, 2012 (incorporated by reference from the Registrant's Current Report on Form 8-K filed February 1, 2012)
*10.7	Employment Agreement with Margo Butsch, dated June 26, 2017 (incorporated by reference from the Registrant's Current Report on Form 8-K filed June 26, 2017)
*10.8	Employment Agreement with Keith Wilton, dated August 8, 2019 (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 12, 2019)
*10.9	Employment Agreement with Robertson Clay Jones, effective October 11, 2019
*10.10	Form of Stock Option Agreement For Amended and Restated 2004 Equity Plan (incorporated by reference from the Registrant's Annual Report on Form 10-K filed March 9, 2012)
*10.11	Form of Restricted Stock Agreement For Amended and Restated 2004 Equity Plan (incorporated by reference from the Registrant's Annual Report on Form 10-K filed March 9, 2012)
*10.12	2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)
*10.13	Form of Restricted Stock Agreement For 2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)
*10.14	Form of Stock Option Agreement for 2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)
*10.15	2005 Amended and Restated Heritage Commerce Corp Supplemental Retirement Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed September 30, 2008)
*10.16	Form of Endorsement Method Split Dollar Plan Agreement for Executive Officers (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 17, 2008)
*10.17	Form of Endorsement Method Split Dollar Plan Agreement for Directors (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 17, 2008)

Exhibit Number	Description
*10.18	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Jack Conner and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.19	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Frank Bisceglia and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.20	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Robert Moles and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.21	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Ranson Webster and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
10.22	Form of Indemnification Agreement between the Registrant and its directors and executive officers (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed December 23, 2009)
10.23	Stock Purchase Agreement, between Heritage Bank of Commerce, BVF Acquisition Corp and the stockholders named therein dated October 8, 2014 (incorporated herein from the Registrant's Current Report on Form 8-K, as filed October 9, 2014)
10.24	Presidio Bank Amended and Restated 2006 Stock Options Plan (incorporated herein by reference from the Registrant's Statement on Form S-8 filed October 15, 2019)
10.25	Presidio Bank 2016 Equity Incentive Plan (incorporated herein by reference from the Registrant's Statement on Form S-8 filed October 15, 2019)
21.1	Subsidiaries of the Registrant (incorporated herein from the Registrant's 2016 Annual Report on Form 10-K, as filed March 3, 2017)
23.1	Consent of Crowe LLP
31.1	Certification of Registrant's Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Registrant's Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Registrant's Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Registrant's Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document, filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document, filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document, filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document, filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document, filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document, filed herewith

* Management contract or compensatory plan or arrangement.

ITEM 16 ***FORM 10-K SUMMARY***

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

HERITAGE COMMERCE CORP

BY: /s/ KEITH A. WILTON
Keith A. Wilton
Chief Executive Officer

DATE: March 11, 2020

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

Signature	Title	Date
/s/ JULIANNE M. BIAGINI-KOMAS Julianne M. Biagini-Komas	Director	March 11, 2020
/s/ FRANK G. BISCEGLIA Frank G. Bisceglia	Director	March 11, 2020
/s/ BRUCE H. CABRAL Bruce H. Cabral	Director	March 11, 2020
/s/ JACK W. CONNER Jack W. Conner	Director and Chairman of the Board	March 11, 2020
/s/ JASON DINAPOLI Jason DiNapoli	Director	March 11, 2020
/s/ STEVEN L. HALLGRIMSON Steven L. Hallgrimson	Director	March 11, 2020
/s/ STEPHEN G. HEITEL Stephen G. Heitel	Director	March 11, 2020
/s/ WALTER T. KACZMAREK Walter T. Kaczmarek	Director	March 11, 2020
/s/ LAWRENCE D. MCGOVERN Lawrence D. McGovern	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 11, 2020
/s/ ROBERT T. MOLES Robert T. Moles	Director	March 11, 2020
/s/ MARINA H. PARK SUTTON Marina H. Park Sutton	Director	March 11, 2020
/s/ LAURA RODEN Laura Roden	Director	March 11, 2020
/s/ RANSON W. WEBSTER Ranson W. Webster	Director	March 11, 2020
/s/ KEITH A. WILTON Keith A. Wilton	Director and Chief Executive Officer (Principal Executive Officer)	March 11, 2020

HERITAGE COMMERCE CORP

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DECEMBER 31, 2019

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
Heritage Commerce Corp
San Jose, California

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Heritage Commerce Corp (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. As permitted, the Company has excluded the operations of Presidio Bank acquired during 2019, which is described in Note 8 of the consolidated financial statements, from the scope of management's report on internal control over financial reporting. As such, it has also been excluded from the scope of our audit of internal control over financial reporting. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the

transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ CROWE LLP

Crowe LLP

We have served as the Company's auditor since 2005.

Sacramento, California
March 11, 2020

HERITAGE COMMERCE CORP

CONSOLIDATED BALANCE SHEETS

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 49,447	$ 30,273
Other investments and interest-bearing deposits in other financial institutions	407,923	134,295
Total cash and cash equivalents	457,370	164,568
Securities available-for-sale, at fair value	404,825	459,043
Securities held-to-maturity, at amortized cost (fair value of $368,107 at December 31, 2019 and $366,175 at December 31, 2018)	366,560	377,198
Loans held-for-sale - SBA, at lower of cost or fair value, including deferred costs	1,052	2,649
Loans, net of deferred fees	2,533,844	1,886,405
Allowance for loan losses	(23,285)	(27,848)
Loans, net	2,510,559	1,858,557
Federal Home Loan Bank, Federal Reserve Bank stock and other investments, at cost	29,842	25,216
Company-owned life insurance	76,027	61,859
Premises and equipment, net	8,250	7,137
Goodwill	167,420	83,753
Other intangible assets	20,415	12,007
Accrued interest receivable and other assets	67,143	44,575
Total assets	$ 4,109,463	$ 3,096,562
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	$ 1,450,873	$ 1,021,582
Demand, interest-bearing	798,375	702,000
Savings and money market	982,430	754,277
Time deposits - under $250	54,361	58,661
Time deposits - $250 and over	99,882	86,114
CDARS - interest-bearing demand, money market and time deposits	28,847	14,898
Total deposits	3,414,768	2,637,532
Subordinated debt, net of issuance costs	39,554	39,369
Other short-term borrowings	328	—
Accrued interest payable and other liabilities	78,105	52,195
Total liabilities	3,532,755	2,729,096
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; none issued and outstanding at December 31, 2019 and December 31, 2018	—	—
Common stock, no par value; 100,000,000 shares authorized at December 31, 2019 and 60,000,000 shares authorized at December 31, 2018; 59,368,156 shares issued and outstanding at December 31, 2019 and 43,288,750 shares issued and outstanding at December 31, 2018	489,745	300,844
Retained earnings	96,741	79,003
Accumulated other comprehensive loss	(9,778)	(12,381)
Total shareholders' equity	576,708	367,466
Total liabilities and shareholders' equity	$ 4,109,463	$ 3,096,562

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands, except per share data)		
Interest income:			
Loans, including fees	$ 116,808	$ 105,635	$ 86,346
Securities, taxable	15,836	15,211	13,724
Securities, exempt from Federal tax	2,148	2,225	2,256
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	7,867	6,774	4,585
Total interest income	142,659	129,845	106,911
Interest expense:			
Deposits	8,159	5,506	3,991
Subordinated debt	2,686	2,314	1,394
Short-term borrowings	2	2	2
Total interest expense	10,847	7,822	5,387
Net interest income before provision for loan losses	131,812	122,023	101,524
Provision for loan losses	846	7,421	99
Net interest income after provision for loan losses	130,966	114,602	101,425
Noninterest income:			
Service charges and fees on deposit accounts	4,510	4,113	3,231
Increase in cash surrender value of life insurance	1,404	1,045	1,666
Gain (loss) on sales of securities	661	266	(6)
Gain on sales of SBA loans	689	698	1,108
Servicing income	636	709	973
Other	2,344	2,743	2,640
Total noninterest income	10,244	9,574	9,612
Noninterest expense:			
Salaries and employee benefits	50,754	43,762	35,719
Occupancy and equipment	6,647	5,411	4,578
Professional fees	3,259	1,969	2,982
Other	24,238	24,379	17,459
Total noninterest expense	84,898	75,521	60,738
Income before income taxes	56,312	48,655	50,299
Income tax expense	15,851	13,324	26,471
Net income	$ 40,461	$ 35,331	$ 23,828
Earnings per common share:			
Basic	$ 0.87	$ 0.85	$ 0.63
Diluted	$ 0.84	$ 0.84	$ 0.62

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Net income	$ 40,461	$ 35,331	$ 23,828
Other comprehensive income (loss):			
Change in net unrealized holding (losses) gains on available-for-sale securities and I/O strips	10,620	(6,383)	417
Deferred income taxes	(3,545)	1,925	(175)
Change in net unamortized unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	(65)	(44)	(51)
Deferred income taxes	19	13	22
Reclassification adjustment for (gains) losses realized in income	(661)	(266)	6
Deferred income taxes	195	79	(3)
Change in unrealized gains (losses) on securities and I/O strips, net of deferred income taxes	6,563	(4,676)	216
Change in net pension and other benefit plan liability adjustment	(5,622)	2,196	(923)
Deferred income taxes	1,662	(649)	388
Change in pension and other benefit plan liability, net of deferred income taxes	(3,960)	1,547	(535)
Other comprehensive income (loss)	2,603	(3,129)	(319)
Total comprehensive income	$ 43,064	$ 32,202	$ 23,509

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Year Ended December 31, 2019, 2018, and 2017				
	Common Stock		Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Earnings	Loss	Equity
	(Dollars in thousands, except per share data)				
Balance, January 1, 2017	37,941,007	$ 215,237	$ 52,527	$ (7,914)	$ 259,850
Net income	—	—	23,828	—	23,828
Other comprehensive loss	—	—	—	(319)	(319)
Issuance of restricted stock awards, net	64,136	—	—	—	—
Amortization of restricted stock awards, net of forfeitures	—	912	—	—	912
Cash dividend declared $0.40 per share	—	—	(15,238)	—	(15,238)
Reclassification associated with the adoption of ASU 2018-02	—	—	1,019	(1,019)	—
Stock option expense, net of forfeitures	—	838	—	—	838
Stock options exercised	195,740	1,368	—	—	1,368
Balance, December 31, 2017	38,200,883	218,355	62,136	(9,252)	271,239
Net income	—	—	35,331	—	35,331
Other comprehensive loss	—	—	—	(3,129)	(3,129)
Issuance of common shares to acquire Tri-Valley Bank	1,889,613	30,725	—	—	30,725
Issuance of common shares to acquire United American Bank	2,826,032	47,280	—	—	47,280
Issuance of restricted stock awards, net	95,378	—	—	—	—
Amortization of restricted stock awards, net of forfeitures	—	1,109	—	—	1,109
Cash dividend declared $0.44 per share	—	—	(18,464)	—	(18,464)
Stock option expense, net of forfeitures	—	708	—	—	708
Stock options exercised	276,844	2,667	—	—	2,667
Balance, December 31, 2018	43,288,750	300,844	79,003	(12,381)	367,466
Net income	—	—	40,461	—	40,461
Other comprehensive income	—	—	—	2,603	2,603
Issuance of common shares to acquire Presidio Bank, net of offering costs of $246	15,684,064	177,926	—	—	177,926
Consideration for Presidio stock options exchanged for Heritage Commerce Corp stock options	—	7,426	—	—	7,426
Issuance of restricted stock awards, net	128,653	—	—	—	—
Amortization of restricted stock awards, net of forfeitures	—	1,283	—	—	1,283
Cash dividend declared $0.48 per share	—	—	(22,723)	—	(22,723)
Stock option expense, net of forfeitures	—	640	—	—	640
Stock options exercised	266,689	1,626	—	—	1,626
Balance, December 31, 2019	59,368,156	$ 489,745	$ 96,741	$ (9,778)	$ 576,708

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 40,461	$ 35,331	$ 23,828
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of discounts and premiums on securities	2,590	3,788	4,344
(Gain) loss on sale of securities available-for-sale	(661)	(266)	6
(Gain) on sale of SBA loans	(689)	(698)	(1,108)
Proceeds from sale of SBA loans originated for sale	10,096	11,765	14,733
SBA loans originated for sale	(8,504)	(15,214)	(13,730)
Provision for loan losses	846	7,421	99
Increase in cash surrender value of life insurance	(1,404)	(1,045)	(1,666)
Depreciation and amortization	846	753	786
Amortization of other intangible assets	2,739	1,943	1,361
Stock option expense, net	640	708	838
Amortization of restricted stock awards, net	1,283	1,109	912
Amortization of subordinated debt issuance costs	185	186	110
Effect of changes in:			
Accrued interest receivable and other assets	8,407	1,572	10,497
Accrued interest payable and other liabilities	(6,492)	1,219	348
Net cash provided by operating activities	50,343	48,572	41,358
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of securities available-for-sale	(111,954)	(162,806)	(144,898)
Purchase of securities held-to-maturity	(50,041)	(31,496)	(120,505)
Maturities/paydowns/calls of securities available-for-sale	53,566	57,142	57,862
Maturities/paydowns/calls of securities held-to-maturity	59,361	50,773	44,277
Proceeds from sales of securities available-for-sale	167,551	94,291	6,536
Net change in loans	33,810	38,394	(77,199)
Changes in Federal Home Loan Bank stock and other investments	1,161	(4,483)	(2,715)
Purchase of premises and equipment	(203)	(187)	(649)
Cash received in bank acquisition, net of cash paid	117,988	36,028	—
Net cash provided by (used in) investing activities	271,239	77,656	(237,291)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	2,977	(262,085)	220,849
Issuance of subordinated debt, net of issuance costs	—	—	39,073
Redemption of subordinated debt	(10,000)	—	—
Payment for early debt extinguishment penalty	(300)	—	—
Net change in short-term borrowings	(114)	—	—
Exercise of stock options	1,626	2,667	1,368
Common stock offering costs	(246)	—	—
Payment of cash dividends	(22,723)	(18,464)	(15,238)
Net cash provided by (used in) financing activities	(28,780)	(277,882)	246,052
Net increase (decrease) in cash and cash equivalents	292,802	(151,654)	50,119
Cash and cash equivalents, beginning of period	164,568	316,222	266,103
Cash and cash equivalents, end of period	$ 457,370	$ 164,568	$ 316,222
Supplemental disclosures of cash flow information:			
Interest paid	$ 9,935	$ 7,528	$ 5,166
Income taxes paid	17,730	12,838	17,256
Supplemental schedule of non-cash activity:			
Recording of right to use assets in exchange for lease obligations	9,566	—	—
Transfer of loans held-for-sale to loan portfolio	694	4,917	2,391
Summary of assets acquired and liabilities assumed through acquisitions:			
Cash and cash equivalents, net of cash paid	117,988	36,028	—
Securities available-for-sale	45,069	63,723	—
Securities held-to-maturity	463	—	—
Net loans	685,964	336,446	—
Premises and equipment	1,756	350	—
Goodwill	83,667	38,089	—
Other intangible assets	11,147	8,361	—
Company owned life insurance	12,764	—	—
Other assets, net	29,397	14,736	—
Deposits	(774,259)	(416,628)	—
Subordinated debt	(10,000)	—	—
Other borrowings	(442)	(62)	—
Other liabilities	(17,916)	(3,038)	—
Common stock issued and stock options exchanged to acquire Presidio Bank, net of offering costs	185,598	—	—
Common stock issued to acquire Tri-Valley Bank and United American Bank	—	78,005	—

See notes to consolidated financial statements

1) Summary of Significant Accounting Policies

Description of Business and Basis of Presentation

Heritage Commerce Corp ("HCC") operates as a registered bank holding company for its wholly-owned subsidiary Heritage Bank of Commerce ("HBC" or the "Bank"), collectively referred to as the "Company". HBC was incorporated on November 23, 1993 and commenced operations on June 8, 1994. HBC is a California state chartered bank which offers a full range of commercial and personal banking services to residents and the business/professional community in Santa Clara, Alameda, and Contra Costa counties of California.

CSNK Working Capital Finance Corp. a California corporation, dba Bay View Funding ("Bay View Funding") is a wholly owned subsidiary of HBC. Bay View Funding's primary business operation is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. In a factoring transaction Bay View Funding directly purchases the receivables generated by its clients at a discount to their face value. The transactions are structured to provide the clients with immediate working capital when there is a mismatch between payments to the client for a good and service and the payment of operating costs incurred to provide such good or service.

The Company acquired Tri-Valley Bank ("Tri-Valley") on April 6, 2018. Tri-Valley was merged with HBC, with HBC as the surviving bank. Tri-Valley's results of operations have been included in the Company's results of operations beginning April 7, 2018.

The Company acquired United American Bank ("United American") on May 4, 2018. United American was merged with HBC, with HBC as the surviving bank. United American's results of operations have been included in the Company's results of operations beginning May 5, 2018.

The Company acquired Presidio Bank ("Presidio") on October 11, 2019. Presidio was merged with HBC, with HBC as the surviving bank. Presidio's results of operations have been included in the Company's results of operations beginning October 12, 2019.

The consolidated financial statements are prepared in accordance with accounting policies generally accepted in the United States of America and general practices in the banking industry. The financial statements include the accounts of the Company. All inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, amounts held at the Federal Reserve Bank, and Federal funds sold. The Company is required to maintain reserves against certain of the deposit accounts with the Federal Reserve Bank. Federal funds are generally sold and purchased for one-day periods.

Cash Flows

Net cash flows are reported for customer loan and deposit transactions, notes payable, repurchase agreements and other short-term borrowings.

Securities

The Company classifies its securities as either available-for-sale or held-to-maturity at the time of purchase. Debt securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of taxes.

A decline in the fair value of any available-for-sale or held-to-maturity security below amortized cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security. In estimating other-than-temporary losses, management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the fair value decline was affected by macroeconomic conditions, and (4) whether the Company has the intention to sell the security or more likely than not will be required to sell the security before any anticipated recovery in fair value.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts are amortized, or accreted, over the life of the related security as an adjustment to income using a method that approximates the interest method. Realized gains and losses are recorded on the trade date and determined using the specific identification method for the cost of securities sold.

Loan Sales and Servicing

The Company holds for sale the conditionally guaranteed portion of certain loans guaranteed by the Small Business Administration or the U.S. Department of Agriculture (collectively referred to as "SBA loans"). These loans are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Gains or losses on SBA loans held-for-sale are recognized upon completion of the sale, based on the difference between the selling price and the carrying value of the related loan sold.

SBA loans are sold with servicing retained. Servicing assets recognized separately upon the sale of SBA loans consist of servicing rights and, for loans sold prior to 2009, interest-only strip receivables ("I/O strips"). The Company accounts for the sale and servicing of SBA loans based on the financial and servicing assets it controls and liabilities it has incurred, reversing recognition of financial assets when control has been surrendered, and reversing recognition of liabilities when extinguished. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sale of loans. Servicing rights are amortized in proportion to and over the period of net servicing income and are assessed for impairment on an ongoing basis. Impairment is determined by stratifying the servicing rights based on interest rates and terms. Any servicing assets in excess of the contractually specified servicing fees are reclassified at fair value as an I/O strip receivable and treated like an available for sale security. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance. The servicing rights, net of any required valuation allowance, and I/O strip receivable are included in other assets on the consolidated balance sheets.

Servicing income, net of amortization of servicing rights, is recognized as noninterest income. The initial fair value of I/O strip receivables is amortized against interest income on loans.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the principal amount outstanding, net of deferred loan origination fees and costs on originated loans, or unamortized premiums or discounts on purchased or acquired loans, and an allowance for loan losses. Interest on loans is accrued on the unpaid principal balance and is credited to income using the effective yield interest method. Interest on purchased or acquired loans and the accretion (amortization) of the related purchase discount (premium) is also credited to income using the effective yield interest method.

A loan portfolio segment is defined as the level at which the Company uses a systematic methodology to determine the allowance for loan losses. A loan portfolio class is defined as a group of loans having similar risk characteristics and methods for monitoring and assessing risk.

For all loan classes, when a loan is classified as nonaccrual, the accrual of interest is discontinued, any accrued and unpaid interest is reversed, and the amortization of deferred loan fees and costs is discontinued. For all loan classes, loans are classified as nonaccrual when the payment of principal or interest is 90 days past due, unless the loan is well secured and in the process of collection. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. In certain circumstances, loans that are under 90 days past due may also be classified as nonaccrual. Any interest or principal payments received on nonaccrual loans are applied toward reduction of principal. Nonaccrual loans generally are not returned to performing status until the obligation is brought current, the loan has performed in accordance with the contract terms for a reasonable period of time, and the ultimate collectability of the contractual principal and interest is no longer in doubt.

Non-refundable loan fees and direct origination costs are deferred and recognized over the expected lives of the related loans using the effective yield interest method.

Acquired Loans

Loans acquired through purchase or through a business combination are recorded at their fair value at the acquisition date. Credit discounts or premiums are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date. Should the Company's allowance for loan losses methodology indicate that the credit discount associated with acquired, non-purchased credit impaired loans, is no longer sufficient to cover probable losses inherent in those loans, the Company will establish an allowance for those loans through a charge to provision for loan losses. Acquired loans are evaluated upon acquisition for evidence of deterioration in credit quality since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. Such loans are classified as purchased credit impaired loans ("PCI loans"), while all other acquired loans are classified as non-PCI loans.

The Company has elected to account for PCI loans on an individual loan level. The Company estimates the amount and timing of expected cash flows for each loan. The expected cash flow in excess of the loan's carrying value, which is fair value on the date of acquisition, is referred to as the accretable yield, and is recorded as interest income over the remaining expected life of the loan. The excess of the loan's contractual principal and interest over expected cash flows is referred to as the non-accretable difference, and is not recorded in the Company's Consolidated Financial Statements.

Quarterly, management performs an evaluation of expected future cash flows for PCI loans. If current expectations of future cash flows are less than management's previous expectations, other than due to decreases in interest rates and prepayment assumptions, an allowance for loan losses is recorded with a charge to current period earnings through provision for loan losses. If there has been a probable and significant increase in expected future cash flows over that which was previously expected, the Company would first reduce any previously established allowance for loan and lease losses, and then record an adjustment to interest income through a prospective increase in the accretable yield. There were no PCI loans at December 31, 2019 and December 31, 2018.

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable incurred losses in the loan portfolio. Loans are charged-off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses. Management’s methodology for estimating the allowance balance consists of several key elements, which include specific allowances on individual impaired loans and the formula driven allowances on pools of loans with similar risk characteristics. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged off.

Specific allowances are established for impaired loans. Management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement, including scheduled interest payments. Loans for which the terms have been modified with a concession

granted, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. When a loan is considered to be impaired, the amount of impairment is measured based on the fair value of the collateral, less costs to sell, if the loan is collateral dependent, or on the present value of expected future cash flows or values that are observable in the secondary market if the loan is not collateral dependent. The amount of any impairment will be charged off against the allowance for loan losses if the amount is a confirmed loss or, alternatively, a specific allocation within the allowance will be established. Loans that are considered impaired are specifically excluded from the formula portion of the allowance for loan losses analysis.

The formula driven allowance on pools of loans covers all loans that are not impaired and is based on historical losses of each loan segment adjusted for current factors. In calculating the historical component of our allowance, we aggregate our loans into one of three loan segments: Commercial, Real Estate and Consumer. Each segment of loans in the portfolio possess varying degrees of risk, based on, among other things, the type of loan being made, the purpose of the loan, the type of collateral securing the loan, and the sensitivity the borrower has to changes in certain external factors such as economic conditions. The following provides a summary of the risks associated with various segments of the Company's loan portfolio, which are factors management regularly considers when evaluating the adequacy of the allowance:

- Commercial loans consist primarily of commercial and industrial ("C&I") loans (business lines of credit), and other commercial purpose loans. Repayment of commercial and industrial loans is generally provided from the cash flows of the related business to which the loan was made. Adverse changes in economic conditions may result in a decline in business activity, which may impact a borrower's ability to continue to make scheduled payments. The factored receivables at Bay View Funding are included in the Company's commercial loan portfolio; however, they are evaluated for risk primarily based on the agings of the receivables. Faster turning receivables imply less risk and therefore warrant a lower associated allowance. Should the overall aging for the portfolio increase, this structure will by formula increase the allowance to reflect the increasing risk. Should the portfolio turn more quickly, it would reduce the associated allowance to reflect the reducing risk.

- Real estate loans consist primarily of loans secured by commercial real estate ("CRE") and residential real estate. Also included in this segment are land and construction loans and home equity lines of credit secured by real estate. As the majority of this segment is comprised of commercial real estate loans, risks associated with this segment lay primarily within these loan types. Adverse economic conditions may result in a decline in business activity and increased vacancy rates for commercial properties. These factors, in conjunction with a decline in real estate prices, may expose the Company to the potential for losses if a borrower cannot continue to service the loan with operating revenues, and the value of the property has declined to a level such that it no longer fully covers the Company's recorded investment in the loan.

- Consumer loans consist primarily of a large number of small loans and lines of credit. The majority of installment loans are made for consumer and business purchases. Weakened economic conditions may result in an increased level of delinquencies within this segment, as economic pressures may impact the capacity of such borrowers to repay their obligations.

As a result of the matters mentioned above, changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for loan losses and the associated provision for loan losses.

The estimated loss factors for pools of loans that are not impaired are based on determining the probability of default and loss given default for loans within each segment of the portfolio, adjusted for significant factors that, in management's judgment, affect collectibility as of the evaluation date. The Company's historical delinquency experience and loss experience are utilized to determine the probability of default and loss given default for segments of the portfolio where the Company has experienced losses since the first quarter of 2009. For segments of the portfolio where the Company has no significant prior loss experience, the Company uses quantifiable observable industry data to determine the probability of default and loss given default. Risk factors impacting loans in each of the portfolio segments include broad deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. The historical loss experience is adjusted for management's estimate of the impact of other factors based on the risks present for each portfolio segment. These other factors include consideration of the following: the overall level of concentrations and trends of

classified loans; loan concentrations within a portfolio segment or division of a portfolio segment; identification of certain loan types with higher risk than other loans; existing internal risk factors; and management's evaluation of the impact of local and national economic conditions on each of our loan types.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Federal Home Loan Bank and Federal Reserve Bank Stock

As a member of the Federal Home Loan Bank ("FHLB") system, the Bank is required to own common stock in the FHLB based on the Bank's level of borrowings and outstanding FHLB advances. FHLB stock is carried at cost and classified as a restricted security. Both cash and stock dividends from the FHLB are reported as income.

As a member of the Federal Reserve Bank ("FRB") of San Francisco, the Bank is required to own stock in the FRB of San Francisco based on a specified ratio relative to our capital. FRB stock is carried at cost and may be sold back to the FRB at its carrying value. Cash dividends received from the FRB are reported as income.

Company-Owned Life Insurance and Split-Dollar Life Insurance Benefit Plan

The Company has purchased life insurance policies on certain directors and officers. Company-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for charges or other amounts due that are probable at settlement. The purchased insurance is subject to split-dollar insurance agreements with the insured participants, which continues after the participant's employment and retirement.

Accounting guidance requires that a liability be recorded primarily over the participant's service period when a split-dollar life insurance agreement continues after a participant's employment or retirement. The required accrued liability is based on either the post-employment benefit cost for the continuing life insurance or the future death benefit depending on the contractual terms of the underlying agreement.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation and amortization are computed on the straight-line basis over the lesser of the respective lease terms or estimated useful lives. The Company owns one building which is being depreciated over 40 years. Furniture, equipment, and leasehold improvements are depreciated over estimated useful lives generally ranging from five to fifteen years. The Company evaluates the recoverability of long-lived assets on an ongoing basis.

Business Combinations

The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques including discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill and Other Intangible Assets

Goodwill resulted from the acquisition of Presidio on October 11, 2019, Tri-Valley on April 6, 2018 and United American on May 4, 2018, and from acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified.

Other intangible assets consist of a core deposit intangible assets from the Focus Business Bank ("Focus") acquisition in August 2015, the Tri-Valley acquisition in April 2018, the United American acquisition in May 2018, and the Presidio merger in October 2019, and below market value lease intangible assets from the Tri-Valley and United American acquisitions, and an above market lease liability from the Presidio merger. In addition, a customer relationship and brokered relationship intangible assets arising from the Bay View Funding acquisition in November 2014 are included in other intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives. The core deposits intangible assets from the acquisitions are being amortized on an accelerated method over ten years. The below market value lease intangible assets are being amortized on the straight line method over three years for United American and eleven years for Tri-Valley. The above market lease adjustment is being amortized on the straight line method over 60 months for Presidio. The customer relationship and brokered relationship intangible assets from the Bay View Funding acquisition are being amortized over ten years.

Foreclosed Assets

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through operations. Operating costs after acquisition are expensed. Gains and losses on disposition are included in noninterest expense. There were no foreclosed assets at December 31, 2019 and 2018.

Retirement Plans

Expenses for the Company's non-qualified, unfunded defined benefits plan consists of service and interest cost and amortization of gains and losses not immediately recognized. Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. The Company's accounting policy for legal costs related to loss contingencies is to accrue for the probable fees that can be reasonably estimated. The Company's accounting policy for uncertain recoveries is to recognize the anticipated recovery when realization is deemed probable.

Income Taxes

The Company files consolidated Federal and combined and separate state income tax returns. Income tax expense is the total of the current year income tax payable or refunded, the change in deferred tax assets and liabilities, and low income housing investment losses, net of tax benefits received. Some items of income and expense are recognized in different years for tax purposes when applying generally accepted accounting principles, leading to timing differences between the Company's actual tax liability and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient taxable income to obtain benefit from the reversal of net deductible temporary differences and utilization of tax credit carryforwards for Federal and California state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

In March 2016, the FASB issued new guidance intended to simplify several areas of accounting for share-based compensation programs, including the income tax impact, classification on the statement of cash flows, and forfeitures. The Company adopted the new guidance on share-based compensation during the first quarter of 2017. All excess tax

benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) are recognized as income tax expense or benefit on the income statement. The tax effects of exercised or vested awards are treated as discrete items in the reporting period in which they occur. The adoption of this guidance resulted in a reduction to tax expense of $146,000 and $424,000 and $146,000 for the years ended December 31, 2019, 2018, and 2017 respectively.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act"), was signed into law, which among other things reduces the federal corporate tax rate to 21% from 35%, effective January 1, 2018. When tax rates change, U.S. generally accepted accounting principles requires companies to remeasure certain tax-related assets and liabilities as of the date of enactment of the new legislation with the resulting tax effects accounted for as a discrete item recorded as a component of tax expense or benefit in the reporting period.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company recognizes interest and penalties related to uncertain tax positions as income tax expense.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. Compensation cost recognized reflects estimated forfeitures, adjusted as necessary for actual forfeitures.

Comprehensive Income (Loss)

Total comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) refers to gains and losses that are included in comprehensive income (loss) but are excluded from net income (loss) because they have been recorded directly in equity, net of tax, under the provisions of certain accounting guidance. The Company's sources of other comprehensive income (loss) are unrealized gains and losses on securities available-for-sale, and I/O strips, which are treated like available-for-sale securities, and the liabilities related to the Company's defined benefit pension plan and the split-dollar life insurance benefit plan. Reclassification adjustments result from gains or losses that were realized and included in net income (loss) of the current period that also had been included in other comprehensive income as unrealized holding gains and losses.

Segment Reporting

HBC is a commercial bank serving customers located in Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara counties of California. Bay View Funding provides business essential working capital factoring financing to various industries throughout the United States. No customer accounts for more than 10 percent of revenue for HBC or the Company. With the previous acquisition of Bay View Funding, the Company has two reportable segments consisting of Banking and Factoring.

Reclassifications

Certain items in the consolidated financial statements for the years ended December 31, 2018 and 2017 were reclassified to conform to the 2019 presentation. These reclassifications did not affect previously reported net income or shareholders' equity.

Adoption of New Accounting Standards

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)". The pronouncement affects all entities that are party to leasing agreements. The ASU requires a lessee to recognize assets and liabilities on the balance sheet for leases. The ASU permits a lessee to elect to opt out of recognizing lease assets and lease liabilities for short-term leases with a term of twelve months or less.

The Company has made this short-term lease election. Lessee's recognition, measurement, and presentation of income, expenses and cash flows arising from a lease remain similar to current GAAP. Lessee and lessors have additional quantitative and qualitative disclosures to help users better understand the amount, timing, and uncertainty of cash flows arising from leases. ASU No. 2016-02 is effective for fiscal years beginning after December 31, 2018, and interim periods within those fiscal years. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.

In July 2018, the FASB issued ASU No. 2018-11, "Leases (Topic 842) - Targeted Improvements" to provide entities with relief from the costs of implementing certain aspects of the new leasing standard. Specifically, under the amendments in ASU No. 2018-11 entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and lessors may elect not to separate lease and non-lease components when certain conditions are met. As the Company elected the transition option provided in ASU No. 2018-11, the modified retrospective approach was applied on January 1, 2019 (as opposed to January 1, 2017). The Company also elected certain practical expedients provided under ASU No. 2016-02 whereby we will not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. In December 2018, the FASB issued ASU No. 2018-20, "Leases (Topic 842): Narrow-Scope Improvements for Lessors," which provides targeted improvements and clarification to guidance with FASB ASC Topic 842 specific to lessors. The amendments of ASU No. 2018-20 have the same effective date as ASU 2016-02 and may be applied either retrospectively or prospectively to all new and existing leases. The Company obtained a third-party software application which provides lease accounting under the guidelines of FASB ASC Topic 842.

The amendments of ASU No. 2016-02 and subsequently issued ASUs, which provided additional guidance and clarifications to various aspects of FASB ASC Topic 842, became effective for the Company on January 1, 2019. At December 31, 2019, the Company reported increased assets of $12.2 million and increased liabilities of $13.0 million on its consolidated balance sheet as a result of recognizing right-of-use assets and lease liabilities related to non-cancellable operating lease agreements for office space. The adoption of this guidance did not have a material impact to its Consolidated Statements of Income or Cash Flows. See Note 7 – *Leases* for more information.

In March 2017, the FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities. This update shortens the amortization period of certain callable debt securities held at a premium to the earliest call date. The amendments in this update were effective for the Company on January 1, 2019. The amendments are applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and the Company is required to provide change in accounting principle disclosures. The Company adopted the new guidance on January 1, 2019, and there was no material impact to the financial statements and no cumulative adjustments were made.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments. The standard is the final guidance on the new current expected credit loss ("CECL") model. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held-to-maturity debt securities. This update became effective for the Company on January 1, 2020. The Company is finalizing the economic forecasts and certain other key assumptions used in our CECL model and methodologies, and the required financial reporting disclosures are being further refined and internally validated. Internal controls related to CECL have been designed and are being evaluated; however, all internal controls related to CECL implementation are not operational. As of the implementation date, Management expects to recognize an increase of up to $12,000,000 to its allowance for credit losses for loans. The majority of this increase is related to the acquired loan portfolios. Once finalized, the cumulative-effect adjustment as a result of the adoption of this guidance will be recorded, net of tax, as an adjustment to retained earnings effective January 1, 2020. This estimate is subject to change based on continued refinement and validation of the model and methodologies as well as changes in forecasted macroeconomic conditions. Ongoing impacts of the CECL methodology will be dependent upon changes in economic conditions and forecasts, originated and acquired loan portfolio composition, portfolio duration, and other factors.

Management does not expect a material allowance for credit losses to be recorded on its available-for-sale debt

securities under the newly codified available-for-sale debt security impairment model, as the majority of these securities are U.S. government agency-backed securities for which the risk of loss is minimal.

In January 2017, the FASB issued accounting standards ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net remaining amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. The amendments of the update became effective for the Company on January 1, 2020. The requirements of this update did not have a material impact on the Company's financial position, results of operations or cash flows.

2) Accumulated Other Comprehensive Income ("AOCI")

The following table reflects the changes in AOCI by component for the periods indicated:

	Year Ended December 31, 2019 and 2018			
	Unrealized Gains (Losses) on Available-for-Sale Securities and I/O Strips	Unamortized Unrealized Gain on Available-for-Sale Securities Reclassified to Held-to-Maturity	Defined Benefit Pension Plan Items	Total
	(Dollars in thousands)			
Beginning balance January 1, 2019, net of taxes	$ (5,007)	$ 344	$ (7,718)	$ (12,381)
Other comprehensive income (loss) before reclassification, net of taxes	7,075	—	(4,022)	3,053
Amounts reclassified from other comprehensive income (loss), net of taxes	(466)	(46)	62	(450)
Net current period other comprehensive income (loss), net of taxes	6,609	(46)	(3,960)	2,603
Ending balance December 31, 2019, net of taxes	$ 1,602	$ 298	$ (11,678)	$ (9,778)
Beginning balance January 1, 2018, net of taxes	$ (362)	$ 375	$ (9,265)	$ (9,252)
Other comprehensive (loss) before reclassification, net of taxes	(4,458)	—	1,387	(3,071)
Amounts reclassified from other comprehensive income (loss), net of taxes	(187)	(31)	160	(58)
Net current period other comprehensive income (loss), net of taxes	(4,645)	(31)	1,547	(3,129)
Ending balance December 31, 2018, net of taxes	$ (5,007)	$ 344	$ (7,718)	$ (12,381)

Details About AOCI Components	Amounts Reclassified from AOCI(1) Year Ended December 31, 2019	2018	2017	Affected Line Item Where Net Income is Presented
	(Dollars in thousands)			
Unrealized gains on available-for-sale securities and I/O strips	$ 661	$ 266	$ (6)	Gain (loss) on sales of securities
	(195)	(79)	3	Income tax expense
	466	187	(3)	Net of tax
Amortization of unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	65	44	51	Interest income on taxable securities
	(19)	(13)	(22)	Income tax expense
	46	31	29	Net of tax
Amortization of defined benefit pension plan items (1)				
Prior transition obligation	96	65	71	
Actuarial losses	(184)	(292)	(276)	
	(88)	(227)	(205)	Other noninterest expense
	26	67	86	Income tax benefit
	(62)	(160)	(119)	Net of tax
Total reclassification from AOCI for the period	$ 450	$ 58	$ (93)	

(1) This AOCI component is included in the computation of net periodic benefit cost (see Note 14 — *Benefit Plans*).

3) Securities

The amortized cost and estimated fair value of securities at year-end were as follows:

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
		(Dollars in thousands)		
Securities available-for-sale:				
Agency mortgage-backed securities	$ 283,598	$ 934	$ (171)	$ 284,361
U.S. Treasury	118,939	1,525	—	120,464
Total	$ 402,537	$ 2,459	$ (171)	$ 404,825
Securities held-to-maturity:				
Agency mortgage-backed securities	$ 285,344	$ 1,206	$ (968)	$ 285,582
Municipals - exempt from Federal tax	81,216	1,313	(4)	82,525
Total	$ 366,560	$ 2,519	$ (972)	$ 368,107

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
		(Dollars in thousands)		
Securities available-for-sale:				
Agency mortgage-backed securities	$ 311,523	$ 98	$ (8,767)	$ 302,854
U.S. Treasury	147,823	930	—	148,753
U.S. Government sponsored entities	7,433	4	(1)	7,436
Total	$ 466,779	$ 1,032	$ (8,768)	$ 459,043
Securities held-to-maturity:				
Agency mortgage-backed securities	$ 291,241	$ 59	$ (9,153)	$ 282,147
Municipals - exempt from Federal tax	85,957	312	(2,241)	84,028
Total	$ 377,198	$ 371	$ (11,394)	$ 366,175

Securities with unrealized losses at year end, aggregated by investment category and length of time that individual securities have been in an unrealized loss position are as follows:

	Less Than 12 Months		12 Months or More		Total	
December 31, 2019	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
			(Dollars in thousands)			
Securities available-for-sale:						
Agency mortgage-backed securities	$ 100,816	$ (105)	$ 27,534	$ (66)	$ 128,350	$ (171)
Total	$ 100,816	$ (105)	$ 27,534	$ (66)	$ 128,350	$ (171)
Securities held-to-maturity:						
Agency mortgage-backed securities	$ 50,060	$ (178)	$ 88,128	$ (790)	$ 138,188	$ (968)
Municipals - exempt from Federal tax	1,556	(4)	—	—	1,556	(4)
Total	$ 51,616	$ (182)	$ 88,128	$ (790)	$ 139,744	$ (972)

	Less Than 12 Months		12 Months or More		Total	
December 31, 2018	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
			(Dollars in thousands)			
Securities available-for-sale:						
Agency mortgage-backed securities	$ 3,868	$ (21)	$ 281,082	$ (8,746)	$ 284,950	$ (8,767)
U.S. Government sponsored entities	3,974	(1)	—	—	3,974	(1)
Total	$ 7,842	$ (22)	$ 281,082	$ (8,746)	$ 288,924	$ (8,768)
Securities held-to-maturity:						
Agency mortgage-backed securities	$ 16,088	$ (103)	$ 255,917	$ (9,050)	$ 272,005	$ (9,153)
Municipals - exempt from Federal tax	5,019	(27)	57,301	(2,214)	62,320	(2,241)
Total	$ 21,107	$ (130)	$ 313,218	$ (11,264)	$ 334,325	$ (11,394)

There were no holdings of securities of any one issuer, other than the U.S. Government and its sponsored entities, in an amount greater than 10% of shareholders' equity. At December 31, 2019, the Company held 463 securities (141 available-for-sale and 322 held-to-maturity), of which 86 had fair values below amortized cost. At December 31, 2019, there were $27,534,000 of agency mortgage-backed securities available-for-sale, and $88,128,000 of agency mortgage-backed securities held-to-maturity, carried with an unrealized loss for 12 months or greater. The total unrealized loss for securities 12 months or greater was $856,000 at December 31, 2019. The unrealized losses were due to higher interest rates. The issuers are of high credit quality and all principal amounts are expected to be paid when securities mature. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline. The Company does not believe that it is more likely than not that the Company will be required to sell a security in an unrealized loss position prior to recovery in value. The Company does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

The proceeds from sales of securities and the resulting gains and losses are listed below:

	2019	2018	2017
	(Dollars in thousands)		
Proceeds	$ 167,551	$ 94,291	$ 6,536
Gross gains	1,094	1,243	—
Gross losses	(433)	(977)	(6)

The amortized cost and fair value of debt securities as of December 31, 2019, by contractual maturity, are shown below. The expected maturities will differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Available-for-sale	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due after 3 months through one year	$ 54,649	55,085
Due after one through five years	64,290	65,379
Agency mortgage-backed securities	283,598	284,361
Total	$ 402,537	$ 404,825

	Held-to-maturity	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due 3 months or less	$ 125	125
Due after 3 months through one year	1,449	1,457
Due after one through five years	5,206	5,358
Due after five through ten years	31,698	32,279
Due after ten years	42,738	43,306
Agency mortgage-backed securities	285,344	285,582
Total	$ 366,560	$ 368,107

Securities with amortized cost of $32,773,000 and $36,229,000 as of December 31, 2019 and 2018 were pledged to secure public deposits and for other purposes as required or permitted by law or contract.

4) Loans

Loans at year-end were as follows:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Loans held-for-investment:		
Commercial	$ 631,547	$ 597,763
Real estate:		
CRE	1,510,592	994,067
Land and construction	150,634	122,358
Home equity	175,252	109,112
Residential mortgages	46,256	50,979
Consumer	19,882	12,453
Loans	2,534,163	1,886,732
Deferred loan fees, net	(319)	(327)
Loans, net of deferred fees	2,533,844	1,886,405
Allowance for loan losses	(23,285)	(27,848)
Loans, net	$ 2,510,559	$ 1,858,557

Changes in the allowance for loan losses were as follows:

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	Year Ended December 31, 2019			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 17,061	$ 10,671	$ 116	$ 27,848
Charge-offs	(6,609)	—	(14)	(6,623)
Recoveries	1,045	169	—	1,214
Net (charge-offs) recoveries	(5,564)	169	(14)	(5,409)
Provision (credit) for loan losses	(1,044)	1,910	(20)	846
End of period balance	$ 10,453	$ 12,750	$ 82	$ 23,285

	Year Ended December 31, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 10,608	$ 8,950	$ 100	$ 19,658
Charge-offs	(2,002)	—	(24)	(2,026)
Recoveries	2,645	150	—	2,795
Net (charge-offs) recoveries	643	150	(24)	769
Provision for loan losses	5,810	1,571	40	7,421
End of period balance	$ 17,061	$ 10,671	$ 116	$ 27,848

	Year Ended December 31, 2017			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 10,656	$ 8,327	$ 106	$ 19,089
Charge-offs	(2,239)	—	—	(2,239)
Recoveries	1,585	1,124	—	2,709
Net (charge-offs) recoveries	(654)	1,124	—	470
Provision (credit) for loan losses	606	(501)	(6)	99
End of period balance	$ 10,608	$ 8,950	$ 100	$ 19,658

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment, based on the impairment method as follows at year-end:

	December 31, 2019			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 1,835	$ —	$ —	$ 1,835
Collectively evaluated for impairment	8,618	12,750	82	21,450
Total allowance balance	$ 10,453	$ 12,750	$ 82	$ 23,285
Loans:				
Individually evaluated for impairment	$ 4,810	$ 5,454	$ —	$ 10,264
Collectively evaluated for impairment	626,737	1,877,280	19,882	2,523,899
Total loan balance	$ 631,547	$ 1,882,734	$ 19,882	$ 2,534,163

	December 31, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 6,944	$ —	$ —	$ 6,944
Collectively evaluated for impairment	10,117	10,671	116	20,904
Total allowance balance	$ 17,061	$ 10,671	$ 116	$ 27,848
Loans:				
Individually evaluated for impairment	$ 9,495	$ 5,645	$ —	$ 15,140
Collectively evaluated for impairment	588,268	1,270,871	12,453	1,871,592
Total loan balance	$ 597,763	$ 1,276,516	$ 12,453	$ 1,886,732

The following table presents loans held-for-investment individually evaluated for impairment by class of loans as of December 31, 2019 and December 31, 2018. The recorded investment included in the following table represents loan principal net of any partial charge-offs recognized on the loans. The unpaid principal balance represents the recorded balance prior to any partial charge-offs.

	December 31, 2019			December 31, 2018		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
	(Dollars in thousands)					
With no related allowance recorded:						
Commercial	$ 2,113	$ 2,113	$ —	$ 1,849	$ 1,849	$ —
Real estate:						
CRE	5,094	5,094	—	5,094	5,094	—
Home Equity	360	360	—	551	551	—
Total with no related allowance recorded	7,567	7,567	—	7,494	7,494	—
With an allowance recorded:						
Commercial	2,697	2,697	1,835	7,646	7,646	6,944
Total with an allowance recorded	2,697	2,697	1,835	7,646	7,646	6,944
Total	$ 10,264	$ 10,264	$ 1,835	$ 15,140	$ 15,140	$ 6,944

The following table presents interest recognized and cash-basis interest earned on impaired loans for the periods indicated:

	Year Ended December 31, 2019					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 8,048	$ 6,433	$ —	$ 440	$ —	$ 14,921
Interest income during impairment	$ —	$ —	$ —	$ —	$ —	$ —
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

	Year Ended December 31, 2018					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 10,744	$ 3,507	$ 24	$ 487	$ —	$ 14,762
Interest income during impairment	$ —	$ —	$ —	$ —	$ —	$ —
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

Nonperforming loans include both smaller dollar balance homogenous loans that are collectively evaluated for impairment and individually classified loans. Nonperforming loans were as follows at year-end:

	2019	2018
	(Dollars in thousands)	
Nonaccrual loans - held-for-investment	$ 8,675	$ 13,699
Restructured and loans over 90 days past due and still accruing	1,153	1,188
Total nonperforming loans	9,828	14,887
Other restructured loans	436	253
Total impaired loans	$ 10,264	$ 15,140

The following table presents the nonperforming loans by class at year-end:

	December 31, 2019			December 31, 2018		
	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
			(Dollars in thousands)			
Commercial	$ 3,444	$ 1,153	$ 4,597	$ 8,279	$ 963	$ 9,242
Real estate:						
CRE	5,094	—	5,094	5,094	—	5,094
Home equity	137	—	137	326	225	551
Total	$ 8,675	$ 1,153	$ 9,828	$ 13,699	$ 1,188	$ 14,887

The following table presents the aging of past due loans at year-end by class of loans:

	December 31, 2019					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
			(Dollars in thousands)			
Commercial	$ 4,770	$ 2,097	$ 3,217	$ 10,084	$ 621,463	$ 631,547
Real estate:						
CRE	—	—	5,094	5,094	1,505,498	1,510,592
Land and construction	—	—	—	—	150,634	150,634
Home equity	—	137	—	137	175,115	175,252
Residential mortgages	—	—	—	—	46,256	46,256
Consumer	—	—	—	—	19,882	19,882
Total	$ 4,770	$ 2,234	$ 8,311	$ 15,315	$ 2,518,848	$ 2,534,163

	December 31, 2018					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
			(Dollars in thousands)			
Commercial	$ 5,698	$ 1,916	$ 1,258	$ 8,872	$ 588,891	$ 597,763
Real estate:						
CRE	—	—	—	—	994,067	994,067
Land and construction	—	—	—	—	122,358	122,358
Home equity	—	—	—	—	109,112	109,112
Residential mortgages	—	—	—	—	50,979	50,979
Consumer	1	—	—	1	12,452	12,453
Total	$ 5,699	$ 1,916	$ 1,258	$ 8,873	$ 1,877,859	$ 1,886,732

Past due loans 30 days or greater totaled $ 15,315,000 and $8,873,000 at December 31, 2019 and December 31, 2018, respectively, of which $7,413,000 and $430,000 were on nonaccrual. At December 31, 2019, there were also

$1,262,000 loans less than 30 days past due included in nonaccrual loans held-for-investment. At December 31, 2018, there were also $13,269,000 loans less than 30 days past due included in nonaccrual loans held-for-investment. Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt. The loans may or may not be collateralized, and collection efforts are pursued.

Credit Quality Indicators

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The Company's loan portfolio is concentrated in commercial (primarily manufacturing, wholesale, and service) and real estate lending, with the balance in consumer loans. While no specific industry concentration is considered significant, the Company's lending operations are located in the Company's market areas that are dependent on the technology and real estate industries and their supporting companies. Thus, the Company's borrowers could be adversely impacted by a continued downturn in these sectors of the economy which could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans.

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; credit documentation; public information; and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loans terms. Classified loans are those loans that are assigned a substandard, substandard-nonaccrual, or doubtful risk rating using the following definitions:

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

Substandard-Nonaccrual. Loans classified as substandard-nonaccrual are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any, and it is probable that the Company will not receive payment of the full contractual principal and interest. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. In addition, the Company no longer accrues interest on the loan because of the underlying weaknesses.

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. Loans classified as loss are considered uncollectable. In addition, loans of so little value that their continuance as assets is not warranted are classified as loss. This classification does not necessarily mean that a loan has no recovery or salvage value; but rather, there is much doubt about whether, how much, or when the recovery will occur. Loans classified as loss are immediately charged off against the allowance for loan losses. Therefore, there is no balance to report at December 31, 2019 or 2018.

The following table provides a summary of the loan portfolio by loan type and credit quality classification for the periods indicated:

	December 31, 2019			December 31, 2018		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(Dollars in thousands)					
Commercial	$ 623,768	7,779	$ 631,547	$ 584,845	$ 12,918	$ 597,763
Real estate:						
CRE	1,492,126	18,466	1,510,592	985,193	8,874	994,067
Land and construction	147,553	3,081	150,634	122,358	—	122,358
Home equity	171,999	3,253	175,252	107,495	1,617	109,112
Residential mortgages	46,256	—	46,256	50,979	—	50,979
Consumer	19,882	—	19,882	12,453	—	12,453
Total	$ 2,501,584	$ 32,579	$ 2,534,163	$ 1,863,323	$ 23,409	$ 1,886,732

The increase in classified assets at December 31, 2019 was primarily due to classified assets acquired from Presidio. 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. This evaluation is performed in compliance with the Company's underwriting policy.

The book balance of troubled debt restructurings at December 31, 2019 was $1,039,000, which included $590,000 of nonaccrual loans and $449,000 of accruing loans. The book balance of troubled debt restructurings at December 31, 2018 was $649,000, which included $36,000 of nonaccrual loans and $613,000 of accruing loans. Approximately $20,000 and $38,000 in specific reserves were established with respect to these loans as of December 31, 2019 and December 31, 2018. As of December 31, 2019 and December 31, 2018, the Company had no additional amounts committed on any loan classified as a troubled debt restructuring.

The following table presents loans by class modified as troubled debt restructurings:

	During the Year Ended December 31, 2019		
Troubled Debt Restructurings:	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
		(Dollars in thousands)	
Commercial	3	$ 591	$ 591
Total	3	$ 591	$ 591

	During the Year Ended December 31, 2018		
Troubled Debt Restructurings:	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
		(Dollars in thousands)	
Commercial	2	$ 112	$ 112
Equity	1	224	224
Total	3	$ 336	$ 336

During the twelve months ended December 31, 2019, there were no troubled debt restructurings in which the amount of principal or accrued interest owed from the borrower was forgiven or which resulted in a charge-off or change to the allowance for loan losses.

A loan is considered to be in payment default when it is 30 days contractually past due under the modified terms. There were no defaults on troubled debt restructurings, within twelve months following the modification, during the years ended December 31, 2019 and 2018.

A loan that is a troubled debt restructuring on nonaccrual status may return to accruing status after a period of at least six months of consecutive payments in accordance with the modified terms.

HBC makes loans to executive officers, directors, and their affiliates. The following table presents the loans outstanding to these related parties for the periods indicated:

	2019	2018
	(Dollars in thousands)	
Beginning of year balance	$ —	$ 531
Repayment on loans during the year	—	(531)
End of year balance	$ —	$ —

5) Loan Servicing

At December 31, 2019, 2018, and 2017, the Company serviced SBA loans sold to the secondary market of approximately $87,835,000, $104,016,000, and $139,086,000, respectively.

Servicing assets represent the servicing spread generated from the sold guaranteed portions of SBA loans. The weighted average servicing rate for all loans serviced was 1.16%, 1.12%, and 1.13% at December 31, 2019, 2018, and 2017, respectively.

Servicing rights are included in "accrued interest receivable and other assets" on the consolidated balance sheets. Activity for loan servicing rights follows:

	2019	2018	2017
	(Dollars in thousands)		
Beginning of year balance	$ 871	$ 1,373	$ 1,854
Additions	157	200	278
Amortization	(445)	(702)	(759)
End of year balance.	$ 583	$ 871	$ 1,373

There was no valuation allowance for servicing rights at December 31, 2019, 2018, and 2017, because the estimated fair value of the servicing rights was greater than the carrying value. The estimated fair value of loan servicing rights was $1,295,000, $1,651,000, and $2,594,000, at December 31, 2019, 2018, and 2017, respectively. The fair value of servicing rights at December 31, 2019, was estimated using a weighted average constant prepayment rate ("CPR") assumption of 13.50%, and a weighted average discount rate assumption of 15.90%. The fair value of servicing rights at December 31, 2018, was estimated using a weighted average CPR assumption of 10.89%, and a weighted average discount rate assumption of 16.40%. The fair value of servicing rights at December 31, 2017, was estimated using a weighted average CPR assumption of 8.13%, and a weighted average discount rate assumption of 13.86%.

The weighted average discount rate and CPR assumptions used to estimate the fair value of the I/O strip receivables are the same as for the servicing rights. Management reviews the key economic assumptions used to estimate the fair value of I/O strip receivables on a quarterly basis. The fair value of the I/O strip can be adversely impacted by a significant increase in either the prepayment speed of the portfolio or the discount rate.

I/O strip receivables are included in "accrued interest receivable and other assets" on the consolidated balance sheets. Activity for I/O strip receivables follows:

	2019	2018	2017
	(Dollars in thousands)		
Beginning of year balance	$ 568	$ 968	$ 1,067
Unrealized loss	(65)	(400)	(99)
End of year balance.	$ 503	$ 568	$ 968

6) Premises and Equipment

Premises and equipment at year-end were as follows:

	2019	2018
	(Dollars in thousands)	
Building	$ 3,508	$ 3,508
Land	2,900	2,900
Furniture and equipment	10,067	9,584
Leasehold improvements	7,372	5,645
	23,847	21,637
Accumulated depreciation and amortization	(15,597)	(14,500)
Premises and equipment, net	$ 8,250	$ 7,137

Depreciation and amortization expense was $846,000, $753,000, and $786,000 in 2019, 2018, and 2017, respectively.

7) Leases

On January 1, 2019, the Company adopted ASU No. 2016-02, Leases (Topic 842). Under the new guidance, the Company recognizes the following for all leases, at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use ("ROU") asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The Company is impacted as a lessee of the offices and real estate used for operations. The Company's lease agreements include options to renew at the Company's option. No lease extensions are reasonably certain to be exercised, therefore it was not considered in the calculation of the ROU asset and lease liability. As of December 31, 2019, operating lease ROU assets, included in other assets totaled $12,173,000, and lease liabilities, included in other liabilities, totaled $13,032,000.

The following table presents the quantitative information for the Company's leases:

	December 31, 2019
	(Dollars in thousands)
Operating Lease Cost (Cost resulting from lease payments)	$ 1,490
Operating Lease - Operating Cash Flows (Fixed Payments)	$ 1,519
Operating Lease - ROU assets	$ 12,173
Operating Lease - Liabilities	$ 13,032
Weighted Average Lease Term - Operating Leases	4.79 years
Weighted Average Discount Rate - Operating Leases	3.86%

The following maturity analysis shows the undiscounted cash flows due on the Company's operating lease liabilities:

	(Dollars in thousands)
2020	$ 3,812
2021	2,852
2022	2,578
2023	1,855
2024	1,474
Thereafter	1,618
Total undiscounted cash flows	14,189
Discount on cash flows	(1,157)
Total lease liability	$ 13,032

The merger with Presidio resulted in the Company operating overlapping branch locations in the cities of Walnut Creek and San Mateo, California. Management has approved the consolidation of these branches in 2020 by vacating the HBC leased locations prior to the lease termination date, and moving the operations to the Presidio branch locations. The consolidation of these two branches into the Presidio locations resulted in the impairment of both leases at December 31, 2019. The lease impairment and write-off of fixed assets and tenant improvements totaled $434,000 for the Walnut Creek

location, and $625,000 for the San Mateo location during the fourth quarter of 2019.

In June of 2019, the Company entered in to a lease agreement for 54,910 square feet of office space in San Jose, California, commencing on February 1, 2020. The Company intends to move its Bay View Funding office during the first quarter of 2020, and move the main office of HBC during the second quarter of 2020, to this new location.

8) Business Combinations

On April 6, 2018, the Company completed its acquisition of Tri-Valley for a transaction value of $32,320,000. At closing the Company issued 1,889,613 shares of the Company's common stock with an aggregate market value of $30,725,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 0.0489 of a share of the Company's common stock for each outstanding share of Tri-Valley common stock. In addition, at closing the Company paid cash to the holder of a stock warrant and holders of outstanding stock options and related fees and fractional shares totaling $1,595,000. Tri-Valley's results of operations have been included in the Company's results of operations beginning April 7, 2018.

On May 4, 2018, the Company completed its acquisition of United American for a transaction value of $56,417,000. At closing the Company issued 2,826,032 shares of the Company's common stock with an aggregate market value of $47,280,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 2.1644 of a share of the Company's common stock for each outstanding share of United American common stock and each common stock equivalent underlying the United American Series D Preferred Stock and Series E Preferred Stock. The shareholders of the United American Series A Preferred Stock and Series B Preferred Stock received $1,000 cash for each share totaling $8,700,000 and $435,000, respectively. In addition, the Company paid $2,000 in cash for fractional shares, for total cash consideration of $9,137,000. United American's results of operations have been included in the Company's results of operations beginning May 5, 2018.

On October 11, 2019, the Company completed its merger with Presidio for an aggregate transaction value of $185,598,000. Shareholders of Presidio received a fixed exchange ratio at closing of 2.47 shares of the Company's common stock for each share of Presidio common stock. Upon closing of the transaction, the Company issued 15,684,064 shares of the Company's common stock to Presidio shareholders and holders of restricted stock units for a total value of $178,171,000 based on the Company's closing stock price of $11.36 on the closing date of October 11, 2019. In addition, the consideration for Presidio stock options exchanged for the Company's stock options totaled $7,426,000 and cash-in-lieu of fractional shares totaled $1,000 on October 11, 2019. The following table summarizes the consideration paid for Presidio:

	(Dollars in thousands)	
Issuance of 15,684,064 shares of common stock to Presidio shareholders and holders of restricted stock (stock price = $11.36 on October 11, 2019)	$	178,171
Consideration for Presidio stock options exchanged for Heritage Commerce Corp stock options		7,426
Cash paid for fractional shares		1
Total consideration	$	185,598

The following table summarizes the estimated fair values of the Presidio assets acquired and liabilities assumed at the date of the merger.

	As Recorded by Presidio	Fair Value Adjustments		As Recorded at Acquisition
		(Dollars in thousands)		
Assets acquired:				
Cash and cash equivalents	$ 117,989	$ (1)	(a)	$ 117,988
Securities available-for-sale	44,647	422	(b)	45,069
Securities held-to-maturity	463	—		463
Loans	698,493	(12,529)	(c)	685,964
Allowance for loan losses	(7,463)	7,463	(d)	—
Premises and equipment, net	1,756	—		1,756
Other intangible assets	—	11,147	(e)	11,147
Other assets, net	43,539	(1,378)	(f)	42,161
Total assets acquired	$ 899,424	$ 5,124		904,548
Liabilities assumed:				
Deposits	$ 774,260	$ (1)	(g)	774,259
Subordinated Debt	10,000	—	(h)	10,000
Other borrowings	442	—		442
Other liabilities	17,916	—		17,916
Total liabilities assumed	$ 802,618	$ (1)		802,617
Net assets acquired				101,931
Purchase price				185,598
Goodwill recorded in the merger				$ 83,667

Explanation of certain fair value related adjustments for the Presidio merger:

(a) Represents cash paid for fractional shares in the transaction.

(b) Represents the fair value adjustment on investment securities available-for-sale.

(c) Represents the fair value adjustment to the net book value of loans includes an interest rate mark and credit mark adjustment.

(d) Represents the elimination of Presidio's allowance for loan losses.

(e) Represents intangible assets recorded to reflect the fair value of core deposits and an above market lease. The core deposit asset was recorded as an identifiable intangible asset and is amortized on an accelerated basis over the estimated average life of the deposit base. The above market lease liability will be accreted on the straight line method over 60 months.

(f) Represents an adjustment to net deferred tax assets resulting from the fair value adjustments related to the acquired assets, liabilities assumed and identifiable intangible assets recorded.

(g) Represents the fair value adjustment on time deposits, which was amortized as interest expense.

(h) The Company acquired $10,000,000 of subordinated debt from the Presidio transaction. The Presidio subordinated debt was redeemed on December 19, 2019.

Presidio's results of operations have been included in the Company's results of operations beginning October 12, 2019.

The following table presents pro forma financial information as if the merger had occurred on January 1, 2018, which includes the pre-acquisition period for Presidio. The historical unaudited pro forma financial information has been adjusted to reflect supportable items that are directly attributable to the acquisition and expected to have a continuing impact on consolidated results of operations, as such, one-time acquisition costs are not included. The unaudited pro forma financial information is provided for informational purposes only. The unaudited pro forma financial information is not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the acquisition been completed as of the dates indicated or that may be achieved in the future. The preparation of the unaudited pro forma

combined consolidated financial statements and related adjustments required management to make certain assumptions and estimates.

UNAUDITED	For the Year Ended December 31, 2019	December 31, 2018
	(Dollars in thousands, except per share amounts)	
Net interest income	$ 163,555	$ 160,044
Provision (credit) for loan losses	870	7,694
Noninterest income	11,291	10,795
Noninterest expense	92,709	97,563
Income before income taxes	81,268	65,582
Income tax expense	23,730	17,549
Net income	$ 57,538	$ 48,033
Net income per share - basic	$ 0.98	$ 0.84
Net income per share - diluted	$ 0.96	$ 0.83

The Company believes the mergers provide the opportunity to combine independent business banking franchises with similar philosophies and cultures into a combined $4.1 billion business bank based in San Jose, California. The pooling of the three banks' resources and knowledge enhance the Company's capabilities, operational efficiencies, and community outreach. The Company also believes the combined bank will be much better positioned to meet the needs of the Company's customers, shareholders and the community. The following table summarizes the pre-tax merger-related costs for the year ended December 31, 2019 for the Presidio merger, and the pre-tax merger-related costs for the years ended December 31, 2018 and 2017 for the Tri-Valley and United American acquisitions:

	For the Year Ended December 31, 2019	December 31, 2018	December 31, 2017
	(Dollars in thousands)		
Salaries and employee benefits	$ 6,580	$ 3,569	$ —
Other	4,500	5,598	671
Total merger-related costs	$ 11,080	$ 9,167	$ 671

The fair value of net assets acquired includes fair value adjustments to certain receivables of which some were considered impaired and some were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows, adjusted for expected losses and prepayments, where appropriate. The receivables that were not considered impaired at the acquisition date were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination. There were no PCI loans at December 31, 2019 and December 31, 2018.

Goodwill of $13,819,000 arising from the Tri-Valley acquisition, $24,270,000 from the United American acquisition and $83,667,000 from the Presidio merger is largely attributable to synergies and cost savings resulting from combining the operations of the companies. As these transactions were structured as tax-free exchanges, the goodwill will not be deductible for tax purposes. As of April 6, 2019 and May 4, 2019 the Company finalized its valuation of all assets acquired and liabilities assumed in its acquisition of Tri-Valley and United American, respectively, resulting in no material changes to acquisition accounting adjustments. Management's preliminary valuation of the tangible and intangible assets acquired and liabilities assumed from the Presidio merger, which are based on assumptions that are subject to change, and the resulting allocation of the consideration paid for the allocation is reflected in the tables above. Prior to the end of the one-year measurement period for finalizing the consideration paid allocation, if information becomes available which would indicate adjustments are required to the allocation, such adjustments will be included in the allocation in the reporting period in which the adjustment amounts are determined. Loan valuations may be adjusted based on new information obtained by the Company in future periods that may reflect conditions or events that existed on the acquisition date. Deferred tax assets may be adjusted for purchase accounting adjustments on open areas such as loans or upon filing final "stub" period tax returns for October 11, 2019 for Presidio.

9) Goodwill and Other Intangible Assets

Goodwill

Goodwill impairment exists when a reporting unit's carrying value exceeds its fair value, which is determined through a qualitative assessment whether it is more likely than not that the fair value of equity of the reporting unit exceeds the carrying value ("Step Zero"). If the qualitative assessment indicates it is more likely than not that the fair value of equity of a reporting unit is less than book value, then a quantitative two-step impairment test is required. Step 1 includes the determination of the carrying value of the Company's single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, the Company is required to perform a second step to the impairment test. Step 2 requires that the implied fair value of the reporting unit goodwill be compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

The Company completed its annual goodwill impairment analysis as of November 30, 2019 with the assistance of an independent valuation firm. The goodwill related to the acquisition of Bay View Funding was tested separately for impairment under this analysis. No events or circumstances since the November 30, 2019 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists, for either the Company's banking segment or the factoring segment.

The following table summarizes the carrying amount of goodwill by segment at December 31, 2019 and 2018:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Banking	$ 154,376	$ 70,709
Factoring	13,044	13,044
Total Goodwill	$ 167,420	$ 83,753

Other Intangible Assets

Other intangible assets acquired in the merger with Presidio in October 2019 included a core deposit intangible asset of $11,247,000, amortized on an accelerated method over its estimated useful life of 10 years, and an above market value lease liability of ($100,000), amortized over its estimated useful life of 60 months. Accumulated amortization of the core deposit intangible and above market lease was $524,000 at December 31, 2019.

Other intangible assets acquired in the acquisition of United American in May 2018 included a core deposit intangible asset of $5,723,000, amortized on an accelerated method over its estimated useful life of 10 years, and a below market value lease intangible asset of $660,000, amortized over its estimated useful life of 3 years. Accumulated amortization of the core deposit intangible and below market lease was $1,788,000, and $756,000 at December 31, 2019 and December 31, 2018, respectively.

Other intangible assets acquired in the acquisition of Tri-Valley in April 2018 include a core deposit intangible asset of $1,768,000, amortized on an accelerated method over its estimated useful life of 10 years, and a below market value lease intangible asset of $210,000, amortized over its estimated useful life of 11 years. Accumulated amortization of the core deposit intangible and below market lease was $480,000 and $222,000 at December 31, 2019 and December 31, 2018, respectively.

The core deposit intangible asset acquired in the acquisition of Focus in August 2015 was $6,285,000. This asset is amortized on an accelerated method over its estimated useful life of 10 years. Accumulated amortization of this intangible asset was $ 3,504,000 and $2,770,000 at December 31, 2019 and December 31, 2018, respectively.

Other intangible assets acquired in the acquisition of Bay View Funding in November 2014 included a below market value lease intangible assets of $109,000, a non-compete agreement intangible asset of $250,000, and a customer relationship and brokered relationship intangible assets of $1,900,000, amortized over the 10 year estimated useful lives. Accumulated amortization of these intangible assets was $981,000 and $791,000 at December 31, 2019 and December 31,

2018, respectively. The below market lease and non-compete agreement intangible assets were fully amortized at December 31, 2017.

Estimated amortization expense for each of the next five years and thereafter is as follows:

Year	Presidio Core Deposit Intangible	Presidio Above Market Lease	United American Core Deposit Intangible	United American Below Market Lease	Tri-Valley Core Deposit Intangible	Tri-Valley Below Market Lease	Focus Core Deposit Intangible	Bay View Funding Customer & Brokered Relationship Intangible	Total Amortization Expense
					(Dollars in thousands)				
2020	$ 1,719	(20)	$ 665	$ 235	$ 208	$ 18	$ 716	$ 190	$ 3,731
2021	1,447	(20)	602	—	184	18	596	190	3,017
2022	1,225	(20)	553	—	167	18	502	190	2,635
2023	1,118	(20)	521	—	158	18	420	190	2,405
2024	1,026	(14)	499	—	152	18	347	159	2,187
Thereafter. .	4,181	—	1,520	—	451	88	200	—	6,440
	$ 10,716	$ (94)	$ 4,360	$ 235	$ 1,320	$ 178	$ 2,781	$ 919	$ 20,415

Impairment testing of the intangible assets is performed at the individual asset level. Impairment exists if the carrying amount of the asset is not recoverable and exceeds its fair value at the date of the impairment test. For intangible assets, estimates of expected future cash flows (cash inflows less cash outflows) that are directly associated with an intangible asset are used to determine the fair value of that asset. Management makes certain estimates and assumptions in determining the expected future cash flows from core deposit and customer relationship intangibles including account attrition, expected lives, discount rates, interest rates, servicing costs and other factors. Significant changes in these estimates and assumptions could adversely impact the valuation of these intangible assets. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is then amortized over the remaining useful life of the asset. Based on its assessment, management concluded that there was no impairment of intangible assets at December 31, 2019 and December 31, 2018.

10) Deposits

The following table presents the scheduled maturities of all time deposits for the next five years:

	(Dollars in thousands)
2020	$ 156,141
2021	9,658
2022	2,115
2023	54
2024	66
Total	$ 168,034

Time deposits of $250,000 and over were $99,882,000 and $86,114,000 at December 31, 2019 and 2018, respectively. At December 31, 2019, time deposits within Certificate of Deposit Account Registry Service ("CDARS") deposits totaled $28,847,000, which were comprised of money market deposits of $2,171,000, and interest-bearing demand deposits of $12,885,000, (which have no scheduled maturity date, and therefore, are excluded from the table above), and time deposits of $13,791,000, (which are included in the table above). At December 31, 2018, CDARS deposits totaled $14,898,000, which comprised money market deposits of $3,366,000, and interest-bearing demand deposits of $8,747,000, (which have no scheduled maturity date, and therefore, are excluded from the table above), and time deposits of $2,785,000. The CDARS program allows customers with deposits in excess of FDIC-insured limits to obtain full coverage on time deposits through a network of banks within the CDARS program. Deposits gathered through these programs are not considered brokered deposits under current regulatory reporting guidelines.

Deposits from executive officers, directors, and their affiliates were $12,636,000 and $21,752,000 at December 31, 2019 and 2018, respectively.

11) Borrowing Arrangements

Federal Home Loan Bank Borrowings, Federal Reserve Bank Borrowings, and Available Lines of Credit

HBC maintains a collateralized line of credit with the FHLB of San Francisco. Under this line, the Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. As of December 31, 2019, and December 31, 2018, HBC had no overnight borrowings from the FHLB. HBC had $272,879,000 of loans and no securities pledged to the FHLB as collateral on a line of credit of $228,103,000 at December 31, 2019. HBC had $228,152,000 of loans and no securities pledged to the FHLB as collateral on a line of credit of $178,560,000 at December 31, 2018.

HBC can also borrow from the FRB's discount window. HBC had approximately $726,709,000 of loans pledged to the FRB as collateral on an available line of credit of approximately $408,401,000 at December 31, 2019, none of which was outstanding. HBC had approximately $739,830,000 of loans pledged to the FRB as collateral on an available line of credit of approximately $418,399,000 at December 31, 2018, none of which was outstanding.

At December 31, 2019, HBC had Federal funds purchase arrangements available of $80,000,000. There were no Federal funds purchased outstanding at December 31, 2019 and 2018.

HCC has a $5,000,000 line of credit with a correspondent bank, of which none was outstanding at December 31, 2019 and 2018.

HBC may also utilize securities sold under repurchase agreements to manage our liquidity position. There were no securities sold under agreements to repurchase at December 31, 2019, and 2018.

Subordinated Debt

On May 26, 2017, the Company completed an underwritten public offering of $40,000,000 aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium. Unamortized debt issuance cost totaled $446,000 at December 31, 2019.

It is understood that after December 31, 2021, the administrator in the United Kingdom with authority over the agency that currently publishes LIBOR (commonly known as the Intercontinental Exchange "ICE"), will no longer support that published index as a generally representative rate. Due to this, standardized contract language addressing the replacement of LIBOR has been published by the Alternative Rate Reference Committee (commonly known as "ARRC") convened by, among others, the Federal Reserve Board. It is also understood that ARRC generally supports using the Secured Overnight Financing Rate ("SOFR") as a replacement index (with an adjustment mechanism), although one version of the ARRC's proposed language does not require implementation of SOFR immediately. With respect to new financings tied to LIBOR going forward, it is expected to consider the implementation of the ARRC's proposed language (with variations as appropriate) into the documentation thereof. With respect to existing financings tied to LIBOR, the existing terms of the documentation thereof will be the primary driver of how all issues related to LIBOR are dealt with, which necessarily means each will be evaluated and responded to on a case-by-case basis as necessary. Efforts are underway to coordinate with the counter-parties under such financings to address the issues, subject to the terms of the existing documentation and any mutually agreeable amendments thereto.

The Company acquired $10,000,000 of subordinated debt from the Presidio transaction with an interest rate of 8%, which was redeemed on December 19, 2019. As a result of the redemption of the Presidio subordinated debt, the Company paid a pre-payment penalty of $300,000 during the fourth quarter of 2019.

12) Income Taxes

On December 22, 2017, the Tax Act was signed into law, which among other things reduces the federal corporate tax rate to 21% from 35%, effective January 1, 2018. The enactment of the Tax Act caused our net deferred tax assets to be revalued at the new lower tax rate with resulting tax effects accounted for in the fourth quarter of 2017. The Company performed an analysis and determined the value of the net DTA was reduced by $7,103,000, which was recognized as a one-time, non-cash, incremental income tax expense for the fourth quarter of 2017.

Also on December 22, 2017, the SEC issued Staff Accounting Bulletin ("SAB") 118, which addresses the situations where the accounting for changes in tax laws is complete, incomplete but can be reasonably estimated, and incomplete and cannot be reasonably estimated. SAB 118 also permits a measurement period up to one year from the date of enactment to refine the provisional accounting. There were no items for which the Company was unable to make a reasonable estimate for the effects of the tax law change. The Company has completed its accounting for the effects of the Tax Act on its deferred tax assets and liabilities.

Income tax expense (benefit) consisted of the following for the year ended December 31, as follows:

	2019	2018	2017
	(Dollars in thousands)		
Currently payable tax:			
Federal	$ 7,631	$ 9,187	$ 12,948
State	4,689	5,416	4,653
Total currently payable	12,320	14,603	17,601
Deferred tax expense (benefit):			
Federal	2,200	(1,133)	1,193
Due to enactment of Tax Reform	—	—	7,103
State	1,331	(146)	574
Total deferred tax	3,531	(1,279)	8,870
Income tax expense	$ 15,851	$ 13,324	$ 26,471

The effective tax rate differs from the Federal statutory rate for the years ended December 31, as follows:

	2019	2018	2017
Statutory Federal income tax rate	21.0 %	21.0 %	35.0 %
State income taxes, net of federal tax benefit	8.5 %	8.5 %	6.8 %
Low income housing credits, net of investment losses	(0.5)%	(0.8)%	(0.5)%
Increase in cash surrender value of life insurance	(0.5)%	(0.5)%	(1.2)%
Stock option/restricted stock windfall tax benefit	(0.3)%	(0.9)%	(0.3)%
Non-taxable interest income	(0.8)%	(0.9)%	(1.5)%
Split-dollar term insurance	0.1 %	0.1 %	0.1 %
Merger cost	0.5 %	0.5 %	— %
Due to enactment of Tax Reform	— %	— %	14.1 %
Other, net	0.1 %	0.4 %	0.1 %
Effective tax rate	28.1 %	27.4 %	52.6 %

Deferred tax assets and liabilities that result from the tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes at December 31, are as follows:

	2019	2018
	(Dollars in thousands)	
Deferred tax assets:		
Defined postretirement benefit obligation	$ 9,901	$ 7,877
Allowance for loan losses	7,231	7,697
Federal net operating loss carryforwards	3,662	5,093
Accrued expenses	2,562	1,939
Lease accounting	1,647	—
Stock compensation	1,636	1,244
California net operating loss carryforwards	1,489	2,128
State income taxes	954	1,117
Premises and equipment	695	642
Split-dollar life insurance benefit plan	75	80
Nonaccrual interest	61	55
Tax credit carryforwards	57	71
Securities available-for-sale	—	2,184
Other	654	716
Total deferred tax assets	30,624	30,843
Deferred tax liabilities:		
Intangible liabilities	(1,321)	(1,671)
Loan fees	(1,842)	(1,089)
Prepaid expenses	(289)	(554)
Securities available-for-sale	(772)	—
Lease accounting	(1,647)	—
I/O strips	(144)	(163)
FHLB stock	(177)	(174)
Other	(130)	(103)
Total deferred tax liabilities	(6,322)	(3,754)
Net deferred tax assets	$ 24,302	$ 27,089

At December 31, 2019, the Company's federal net operating loss ("NOL") carryforwards were $17,438,000 and the Company's California net operating loss carryforwards were $17,372,000. These amounts are attributable to the Focus, Tri-Valley and United American transactions. The realization of these NOL carryforwards for Federal and State tax purposes are limited on the amount of net operating losses that can be utilized annually under the current tax law. The Company does not believe that its annual limitation on each acquisition will impact the ultimate deductibility of the NOL carry-forwards. The State tax credit carryforwards, net of Federal tax effects, were $57,328 as of December 31, 2019, which will begin to expire in 2022. Since the Company will be able to fully utilize the net operating loss carryforwards before they begin to expire in 2029, no valuation allowance is required against the deferred tax assets.

Under generally accepted accounting principles, a valuation allowance is required if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions. As of December 31, 2019 and 2018 the Company's recorded amount of uncertain tax positions was not considered significant for financial reporting and the Company does not expect this amount to significantly increase or decrease in the next twelve months.

At December 31, 2019, and December 31, 2018, the Company had net deferred tax assets of $24,302,000 and $27,089,000, respectively. At December 31, 2019, the Company determined that a valuation allowance for deferred tax assets was not necessary.

The Company and its subsidiaries are subject to U.S. Federal income tax as well as income tax of the State of California. The Company is no longer subject to examination by Federal and state taxing authorities for years before 2016, and by the State of California taxing authority for years before 2015.

The following table reflects the carrying amounts of the low income housing investments included in accrued interest receivable and other assets, and the future commitments included in accrued interest payable and other liabilities for the periods indicated:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Low income housing investments	$ 6,126	$ 3,172
Future commitments	$ 625	$ 273

The Company expects $28,000 of the future commitments to be paid in 2020, and $597,000 in 2021 through 2025.

For tax purposes, the Company recognized low income housing tax credits of $511,000 and $425,000 for the years ended December 31, 2019 and December 2018, respectively, and low income housing investment expense of $520,000 and $437,000, respectively. The Company recognizes low income housing investment expenses as a component of income tax expense.

13) Equity Plan

The Company maintained an Amended and Restated 2004 Equity Plan (the "2004 Plan") for directors, officers, and key employees. The 2004 Plan was terminated on May 23, 2013. The Company's shareholders approved the 2013 Equity Incentive Plan (the "2013 Plan"). The equity plans provide for the grant of incentive and nonqualified stock options and restricted stock. The equity plans provide that the option price for both incentive and nonqualified stock options will be determined by the Board of Directors at no less than the fair value at the date of grant. Options granted vest on a schedule determined by the Board of Directors at the time of grant. Generally options vest over four years. All options expire no later than ten years from the date of grant. Restricted stock is subject to time vesting. In 2019, the Company granted 299,500 shares of nonqualified stock options and 134,653 shares of restricted stock subject to time vesting requirements. There were 796,957 shares available for the issuance of equity awards under the 2013 Plan as of December 31, 2019.

The Presidio equity plans were assumed by the Company and the outstanding options issued under the Presidio equity plans were converted into the right to receive the Company's shares at the exercise price pursuant to the formula defined in the merger agreement. Consideration for the assumed Presidio stock options exchanged for 1,176,757 shares of the Company's stock options totaled $7,426,000.

Stock option activity under the equity plans is as follows:

Total Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2019	1,570,603	$ 10.76		
Granted	299,500	$ 12.16		
Assumed Presidio Bank stock options exchanged for Heritage Commerce Corp stock options	1,176,757	$ 5.05		
Exercised	(266,689)	$ 6.10		
Forfeited or expired	(67,325)	$ 14.31		
Outstanding at December 31, 2019	2,712,846	$ 8.80	5.62	$ 12,369,413
Vested or expected to vest	2,550,075		5.62	$ 11,627,248
Exercisable at December 31, 2019	2,206,775		4.93	$ 12,151,054

Information related to the equity plans for each of the last three years:

	December 31,		
	2019	2018	2017
Intrinsic value of options exercised	$ 1,618,615	$ 1,844,909	$ 1,342,794
Cash received from option exercise	$ 1,626,113	$ 2,667,305	$ 1,368,673
Tax benefit realized from option exercises	$ 258,037	$ 534,638	$ 547,817
Weighted average fair value of options granted	$ 1.91	$ 3.03	$ 2.66

As of December 31, 2019, there was $ 1,156,000 of total unrecognized compensation cost related to nonvested stock options granted under the equity plans. That cost is expected to be recognized over a weighted-average period of approximately 2.64 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table, including the weighted average assumptions for the option grants in each year.

	December 31,		
	2019	2018	2017
Expected life in months(1)	72	72	72
Volatility(1)	24 %	21 %	24 %
Weighted average risk-free interest rate(2)	2.23 %	2.88 %	1.94 %
Expected dividends(3)	3.95 %	2.64 %	2.78 %

(1) The expected life of employee stock options represents the weighted average period the stock options are expected to remain outstanding based on historical experience. Volatility is based on the historical volatility of the stock price over the same period of the expected life of the option.

(2) Based on the U.S. Treasury constant maturity interest rate with a term consistent with the expected life of the option granted.

(3) Each grant's dividend yield is calculated by annualizing the most recent quarterly cash dividend and dividing that amount by the market price of the Company's common stock as of the grant date

The Company estimates the impact of forfeitures based on historical experience. Should the Company's current estimate change, additional expense could be recognized or reversed in future periods. The Company issues authorized shares of common stock to satisfy stock option exercises.

Restricted stock activity under the equity plans is as follows:

Total Restricted Stock Award	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares at January 1, 2019	193,298	$ 11.04
Granted	134,653	$ 12.16
Vested	(82,498)	$ 12.37
Forfeited or expired	(6,000)	$ 17.11
Nonvested shares at December 31, 2019	239,453	$ 11.23

As of December 31, 2019, there was $2,340,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted under the 2013 Plan. The cost is expected to be recognized over a weighted-average period of approximately 2.11 years.

The Company has two share based compensation plans. Total compensation cost has been charged against income for those plans was $1,924,000, $1,817,000, $1,750,000, for 2019, 2018, and 2017, respectively. The total income tax benefit was $239,000, $424,000, and $146,000 for 2019, 2018, and 2017, respectively.

14) Benefit Plans

401(k) Savings Plan

The Company offers a 401(k) savings plan that allows employees to contribute up to a maximum percentage of their compensation, as established by the Internal Revenue Code. The Company made a discretionary matching contribution of up to $3,000 and $2,500 for each employee's contributions in 2019 and 2018, respectively. Contribution expense was $934,000, $749,000, and $535,000 in 2019, 2018 and 2017, respectively.

Employee Stock Ownership Plan

The Company sponsors a non-contributory employee stock ownership plan. To participate in this plan, an employee must have worked at least 1,000 hours during the year and must be employed by the Company at year-end. Employer contributions to the ESOP are discretionary. The Company has suspended contributions to the ESOP since 2010. The Plan was "frozen" as of January 1, 2019. At December 31, 2019, the ESOP owned 102,834 shares of the Company's common stock.

Deferred Compensation Plan

The Company has a nonqualified deferred compensation plan for some of its employees. Under the deferred compensation plan, an employee may defer up to 100% of his or her bonus and 50% of their regular salary into a deferred account. Amounts deferred are invested in a portfolio of approved investment choices as directed by the employee. Amounts deferred by employees to the deferred compensation plan will be distributed at a future date they have selected or upon termination of employment. There were five and seven employees who elected to participate in the deferred compensation plan during 2019 and 2018, respectively.

Nonqualified Defined Benefit Pension Plan

The Company has a supplemental retirement plan ("SERP") covering some current and some former key executives and directors. The SERP is an unfunded, nonqualified defined benefit plan. The combined number of active and retired/terminated participants in the SERP was 60 at December 31, 2019. The defined benefit represents a stated amount for key executives and directors that generally vests over nine years and is reduced for early retirement. The projected benefit obligation is included in "Accrued interest payable and other liabilities" on the consolidated balance sheets. The SERP has no assets and the projected benefit obligation is unfunded. The measurement date of the SERP is December 31.

The following table sets forth the SERP's status at December 31:

	2019	2018
	(Dollars in thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	$ 26,781	$ 28,510
Projected benefit obligation of SERP agreements acquired from Presidio	2,541	—
Service cost	263	249
Actuarial loss (gain)	4,182	(1,885)
Interest cost	1,059	947
Benefits paid	(1,137)	(1,040)
Projected benefit obligation at end of year	$ 33,689	$ 26,781
Amounts recognized in accumulated other comprehensive loss:		
Net actuarial loss	$ 9,670	$ 5,672

Weighted-average assumptions used to determine the benefit obligation at year-end:

	2019	2018
Discount rate	3.01 %	4.03 %
Rate of compensation increase	N/A	N/A

Estimated benefit payments over the next ten years, which reflect anticipated future events, service and other assumptions, are as follows:

Year	Estimated Benefit Payments
	(Dollars in thousands)
2020	$ 1,509
2021	1,717
2022	1,863
2023	1,974
2024	2,011
2025 to 2029	11,366
	$ 20,440

The components of pension cost for the SERP follow:

	2019	2018
	(Dollars in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 263	$ 249
Interest cost	1,059	947
Amortization of net actuarial loss	184	292
Accelerated benefits for Presidio SERP agreements due to change in control	1,465	—
Net periodic benefit cost	$ 2,971	$ 1,488
Amount recognized in other comprehensive income	$ 2,847	$ 1,577

The components of net periodic benefit cost other than the service cost component are included in the line item "other noninterest expense" in the Consolidated Statements of Income. The estimated net actuarial loss and prior service cost for the SERP that will be amortized from Accumulated Other Comprehensive Loss into net periodic benefit cost over the next fiscal year are $387,000 and $183,000 as of December 31, 2019 and 2018, respectively.

Net periodic benefit cost for the years ended December 31, 2019 and 2018 were determined using the following assumption:

	2019	2018
Discount rate	4.03 %	3.38 %
Rate of compensation increase	N/A	N/A

Split-Dollar Life Insurance Benefit Plan

The Company maintains life insurance policies for some current and some former directors and officers that are subject to split-dollar life insurance agreements, some of which continues after the participant's employment and retirement. The policies acquired from Focus and Presidio do not include a post retirement benefit. All participants are fully vested in their split-dollar life insurance benefits. The accrued benefit liability for the split-dollar insurance agreements represents either the present value of the future death benefits payable to the participants' beneficiaries or the present value of the estimated cost to maintain life insurance, depending on the contractual terms of the participant's underlying agreement.

The split-dollar life insurance projected benefit obligation is included in "Accrued interest payable and other liabilities" on the consolidated balance sheets. The measurement date of the split-dollar life insurance benefit plan is December 31.

The following sets forth the funded status of the split dollar life insurance benefits:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	$ 6,903	$ 6,711
Interest cost	278	227
Actuarial loss (gain)	1,017	(35)
Projected benefit obligation at end of period	$ 8,198	$ 6,903

Amounts recognized in accumulated other comprehensive loss at December 31 consist of:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Net actuarial loss	$ 3,776	$ 2,573
Prior transition obligation	1,059	1,149
Accumulated other comprehensive loss	$ 4,835	$ 3,722

Weighted-average assumption used to determine the benefit obligation at year-end follow:

	2019	2018
Discount rate	3.01 %	4.03 %

Components of net periodic benefit cost during the year are:

	2019	2018
	(Dollars in thousands)	
Amortization of prior transition obligation	$ (96)	$ (65)
Interest cost	278	227
Net periodic benefit cost	$ 182	$ 162
Amount recognized in other comprehensive income	$ 1,113	$ (30)

The estimated net actuarial loss and prior transition obligation for the split-dollar life insurance benefit plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year are $90,000 as of December 31, 2019 and 2018.

Weighted-average assumption used to determine the net periodic benefit cost:

	2019	2018
Discount rate	4.03 %	3.38 %

15) Fair Value

Accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. 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 other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data (for example, interest rates and yield curves observable at commonly quoted intervals, prepayment speeds, credit risks, and default rates).

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

Financial Assets and Liabilities Measured on a Recurring Basis

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

The fair value of interest-only ("I/O") strip receivable assets is based on a valuation model used by a third party. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

		Fair Value Measurements Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets at December 31, 2019				
Available-for-sale securities:				
Agency mortgage-backed securities	$ 284,361	—	$ 284,361	—
U.S. Treasury	120,464	120,464	—	—
I/O strip receivables	503	—	503	—
Assets at December 31, 2018				
Available-for-sale securities:				
Agency mortgage-backed securities	$ 302,854	—	$ 302,854	—
U.S. Treasury	148,753	148,753	—	—
U.S. Government sponsored entities	7,436	—	7,436	—
I/O strip receivables	568	—	568	—

There were no transfers between Level 1 and Level 2 during the year for assets measured at fair value on a recurring basis.

Financial Assets and Liabilities Measured on a Non-Recurring Basis

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. The appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

	Balance	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets at December 31, 2019				
Impaired loans - held-for-investment:				
Commercial	$ 862	—	—	$ 862
	$ 862	—	—	$ 862
Assets at December 31, 2018				
Impaired loans - held-for-investment:				
Commercial	$ 702	—	—	$ 702
	$ 702	—	—	$ 702

The following table shows the detail of the impaired loans held-for-investment and the impaired loans held-for-investment carried at fair value for the periods indicated:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Impaired loans held-for-investment:		
Book value of impaired loans held-for-investment carried at fair value	$ 2,697	$ 7,646
Book value of impaired loans held-for-investment carried at cost	7,567	7,494
Total impaired loans held-for-investment	$ 10,264	$ 15,140
Impaired loans held-for-investment carried at fair value:		
Book value of impaired loans held-for-investment carried at fair value	$ 2,697	$ 7,646
Specific valuation allowance	(1,835)	(6,944)
Impaired loans held-for-investment carried at fair value, net	$ 862	$ 702

Impaired loans held-for-investment were $10,264,000 at December 31, 2019. In addition, these loans had a specific valuation allowance of $1,835,000 at December 31, 2019. Impaired loans held-for-investment totaling $2,697,000 at December 31, 2019 were carried at fair value as a result of partial charge-offs and specific valuation allowances at year-end. The remaining $7,567,000 of impaired loans were carried at cost at December 31, 2019, as the fair value of the collateral exceeded the cost basis of each respective loan. Partial charge-offs and changes in specific valuation allowances during 2019 on impaired loans held-for-investment carried at fair value at December 31, 2019 resulted in an additional credit to provision for loan losses of $2,128,000.

At December 31, 2019, there were no foreclosed assets.

Impaired loans held-for-investment were $15,140,000 at December 31, 2018. In addition, these loans had a specific valuation allowance of $6,944,000 at December 31, 2018. Impaired loans held-for-investment totaling $7,646,000 at December 31, 2018 were carried at fair value as a result of partial charge-offs and specific valuation allowances at year-end. The remaining $7,494,000 of impaired loans were carried at cost at December 31, 2018, as the fair value of the collateral exceeded the cost basis of each respective loan. Partial charge-offs and changes in specific valuation allowances during 2018 on impaired loans held-for-investment carried at fair value at December 31, 2018 resulted in an additional provision for loan losses of $7,042,000.

At December 31, 2018, there were no foreclosed assets.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis, at December 31, 2019 and 2018:

	December 31, 2019			
	Fair Value	Valuation Techniques	Unobservable Inputs	Range (Weighted Average)
	(Dollars in thousands)			
Impaired loans - held-for-investment:				
Commercial	$ 862	Market Approach	Discount adjustment for differences between comparable sales	Less than 1%

	December 31, 2018			
	Fair Value	Valuation Techniques	Unobservable Inputs	Range (Weighted Average)
	(Dollars in thousands)			
Impaired loans - held-for-investment:				
Commercial	$ 702	Market Approach	Discount adjustment for differences between comparable sales	0% to 1%

The Company obtains third party appraisals on collateral for its impaired loans held-for-investment and foreclosed assets to determine fair value. Generally, the third party appraisals apply the "market approach," which is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (that is, similar) assets, liabilities, or a group of assets and liabilities, such as a business. Adjustments are then made based on the type of property, age of appraisal, current status of property and other related factors to estimate the current value of collateral.

The carrying amounts and estimated fair values of financial instruments at December 31, 2019 are as follows:

		Estimated Fair Value			
	Carrying Amounts	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)				
Assets:					
Cash and cash equivalents	$ 457,370	$ 457,370	$ —	$ —	$ 457,370
Securities available-for-sale	404,825	120,464	284,361	—	404,825
Securities held-to-maturity	366,560	—	368,107	—	368,107
Loans (including loans held-for-sale), net	2,511,611	—	1,052	2,512,277	2,513,329
FHLB stock, FRB stock, and other investments	29,842	—	—	—	N/A
Accrued interest receivable	10,915	446	2,218	8,251	10,915
I/O strips receivables	503	—	503	—	503
Liabilities:					
Time deposits	$ 168,034	$ —	$ 158,704	$ —	$ 158,704
Other deposits	3,246,734	—	3,246,734	—	3,246,734
Subordinated debt	39,554	—	40,404	—	40,404
Accrued interest payable	707	—	707	—	707

The carrying amounts and estimated fair values of financial instruments at December 31, 2018 are as follows:

	Carrying Amounts	Estimated Fair Value: Quoted Prices in Active Markets for Identical Assets (Level 1)	Estimated Fair Value: Significant Other Observable Inputs (Level 2)	Estimated Fair Value: Significant Unobservable Inputs (Level 3)	Estimated Fair Value: Total
		(Dollars in thousands)			
Assets:					
Cash and cash equivalents	$ 164,568	$ 164,568	$ —	$ —	$ 164,568
Securities available-for-sale	459,043	148,753	310,290	—	459,043
Securities held-to-maturity	377,198	—	366,175	—	366,175
Loans (including loans held-for-sale), net	1,861,206	—	2,649	1,826,654	1,829,303
FHLB stock, FRB stock, and other investments	25,216	—	—	—	N/A
Accrued interest receivable	9,577	597	2,274	6,706	9,577
I/O strips receivables	568	—	568	—	568
Liabilities:					
Time deposits	$ 147,560	$ —	$ 147,916	$ —	$ 147,916
Other deposits	2,489,972	—	2,489,972	—	2,489,972
Subordinated debt	39,369	—	38,969	—	38,969
Accrued interest payable	497	—	497	—	497

In accordance with our adoption of ASU 2016-01 in 2018, the methods utilized to measure the fair value of financial instruments at December 31, 2018 represent an approximation of exit price, however, an actual exit price may differ.

16) Commitments and Contingencies

Financial Instruments with Off-Balance Sheet Risk

HBC is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets.

HBC's exposure to credit loss in the event of non-performance of the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. HBC uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Credit risk is the possibility that a loss may occur because a party to a transaction failed to perform according to the terms of the contract. HBC controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures. Management does not anticipate any significant losses as a result of these transactions.

Commitments to extend credit were as follows:

	December 31, 2019 Fixed Rate	2019 Variable Rate	2019 Total	December 31, 2018 Fixed Rate	2018 Variable Rate	2018 Total
	(Dollars in thousands)					
Unused lines of credit and commitments to make loans	$ 147,372	$ 951,206	$ 1,098,578	$ 130,871	$ 593,839	$ 724,710
Standby letters of credit	11,445	10,615	22,060	2,770	12,899	15,669
	$ 158,817	$ 961,821	$ 1,120,638	$ 133,641	$ 606,738	$ 740,379

Commitments generally expire within one year.

Standby letters of credit are written with conditional commitments issued by HBC to guarantee the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients.

The Company is required to maintain interest-bearing reserves. Reserve requirements are based on a percentage of certain deposits. As of December 31, 2019, the Company maintained reserves of $48,717,000 in the form of vault cash and balances at the Federal Reserve Bank of San Francisco, which satisfied the regulatory requirements.

Loss Contingencies

The Company is involved in certain legal actions arising from normal business activities. Management, based upon the advice of legal counsel, believes the ultimate resolution of all pending legal actions will not have a material effect on the financial statements of the Company.

17) Shareholders' Equity and Earnings Per Share

Authorized Shares of Common Stock — At a Special Meeting of Shareholders on August 27, 2019, the Company's shareholders approved an amendment to the Company's articles of incorporation to increase the number of authorized shares of common stock from 60,000,000 to 100,000,000 shares of common stock.

Earnings Per Share — Basic earnings per common share is computed by dividing net income, less dividends and discount accretion on preferred stock, by the weighted average common shares outstanding. Diluted earnings per share reflect potential dilution from outstanding stock options using the treasury stock method. There were 789,065, 534,106, and 346,500 stock options for the years ended December 31, 2019, 2018 and 2017, respectively, considered to be antidilutive and excluded from the computation of diluted earnings per share. A reconciliation of these factors used in computing basic and diluted earnings per common share is as follows:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands, except per share amounts)		
Net income	$ 40,461	$ 35,331	$ 23,828
Weighted average common shares outstanding for basic earnings per common share	46,684,384	41,469,211	38,095,250
Dilutive potential common shares	1,221,845	713,728	515,565
Shares used in computing diluted earnings per common share	47,906,229	42,182,939	38,610,815
Basic earnings per share	$ 0.87	$ 0.85	$ 0.63
Diluted earnings per share	$ 0.84	$ 0.84	$ 0.62

18) Capital Requirements

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the 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 direct material effect on the Company's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and HBC must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. There are no conditions or events since December 31, 2019, that management believes have changed the categorization of the Company or HBC as "well-capitalized."

As of January 1, 2015, HCC and HBC along with other community banking organizations became subject to new capital requirements and certain provisions of the new rules were phased in from 2015 through 2019. The Federal Banking regulators approved the new rules to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and addressed relevant provisions of The Dodd Frank Wall Street Reform and

Consumer Protection Act of 2010, as amended. The new capital rules established a "capital conservation buffer," which must consist entirely of common equity Tier 1 capital. The capital conservation buffer is 2.5% of risk-weighted assets for 2019 and 1.875% for 2018. The Company and HBC must maintain a capital conservation buffer above the minimum risk-based capital requirements in order to avoid certain limitations on capital distributions, stock repurchases and discretionary bonus payments to executive officers. The Company's consolidated capital ratios and the Bank's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2019.

Quantitative measures established by regulation to help ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios (set forth in the tables below) of total, Tier 1 capital, and common equity Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2019 and December 31, 2018, the Company and HBC met all capital adequacy guidelines to which they were subject.

The Company's consolidated capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of December 31, 2019, and December 31, 2018.

	Actual		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio [1]
	(Dollars in thousands)			
As of December 31, 2019				
Total Capital (to risk-weighted assets)	$ 457,158	14.6 %	$ 329,306	10.5 %
Tier 1 Capital (to risk-weighted assets)	$ 393,432	12.5 %	$ 266,581	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 393,432	12.5 %	$ 219,538	7.0 %
Tier 1 Capital (to average assets)	$ 393,432	9.7 %	$ 161,677	4.0 %

(1) Includes 2.5% capital conservation buffer, effective January 1, 2019, except the Tier 1 Capital to average assets ratio.

	Actual		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio [1]
	(Dollars in thousands)			
As of December 31, 2018				
Total Capital (to risk-weighted assets)	$ 344,597	15.0 %	$ 227,514	9.875 %
Tier 1 Capital (to risk-weighted assets)	$ 276,675	12.0 %	$ 181,435	7.875 %
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 276,675	12.0 %	$ 146,876	6.375 %
Tier 1 Capital (to average assets)	$ 276,675	8.9 %	$ 124,726	4.000 %

(1) Includes 1.875% capital conservation buffer, effective January 1, 2018, except the Tier 1 Capital to average assets ratio.

HBC's actual capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of December 31, 2019, and December 31, 2018.

	Actual		To Be Well-Capitalized Under Basel III PCA Regulatory Requirements		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio	Amount	Ratio [1]
	(Dollars in thousands)					
As of December 31, 2019						
Total Capital (to risk-weighted assets)	$ 435,757	13.9 %	$ 313,485	10.0 %	$ 329,159	10.5 %
Tier 1 Capital (to risk-weighted assets)	$ 411,585	13.1 %	$ 250,788	8.0 %	$ 266,462	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 411,585	13.1 %	$ 203,765	6.5 %	$ 219,439	7.0 %
Tier 1 Capital (to average assets)	$ 411,585	10.2 %	$ 202,013	5.0 %	$ 161,611	4.0 %

(1) Includes 2.5% capital conservation buffer, effective January 1, 2019, except the Tier 1 Capital to average assets ratio.

	Actual		To Be Well-Capitalized Under Basel III PCA Regulatory Requirements		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio	Amount	Ratio [1]
	(Dollars in thousands)					
As of December 31, 2018						
Total Capital (to risk-weighted assets)	$ 322,283	14.0 %	$ 230,275	10.0 %	$ 227,397	9.875 %
Tier 1 Capital (to risk-weighted assets)	$ 293,730	12.8 %	$ 184,220	8.0 %	$ 181,342	7.875 %
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 293,730	12.8 %	$ 149,679	6.5 %	$ 146,800	6.375 %
Tier 1 Capital (to average assets)	$ 293,730	9.4 %	$ 155,832	5.0 %	$ 124,666	4.000 %

(1) Includes 1.875% capital conservation buffer, effective January 1, 2018, except the Tier 1 Capital to average assets ratio.

The Subordinated Debt, net of unamortized issuance costs, totaled $39,554,000 at December 31, 2019, and qualifies as Tier 2 capital for the Company under the guidelines established by the Federal Reserve Bank.

Under California General Corporation Law, the holders of common stock are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available. The California Financial Code provides that a state licensed bank may not make a cash distribution to its shareholders in excess of the lesser of the following: (i) the bank's retained earnings; or (ii) the bank's net income for its last three fiscal years, less the amount of any distributions made by the bank to its shareholders during such period. However, a bank, with the prior approval of the Commissioner of the California Department of Business Oversight—Division of Financial Institutions ("DBO") may make a distribution to its shareholders of an amount not to exceed the greater of (i) a bank's retained earnings; (ii) its net income for its last fiscal year; or (iii) its net income for the current fiscal year. Also with the prior approval of the Commissioner of the DBO and the shareholders of the bank, the bank may make a distribution to its shareholders, as a reduction in capital of the bank. In the event that the Commissioner determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by a bank would be unsafe or unsound, the Commissioner may order a bank to refrain from making such a proposed distribution. As of December 31, 2019, HBC would not be required to obtain regulatory approval, and the amount available for cash dividends is $20,636,000. Similar restrictions applied to the amount and sum of loan advances and other transfers of funds from HBC to the parent company. HBC distributed dividends totaling $22,500,000 and $17,000,000 for the years ended December 31, 2019 and 2018, respectively.

19) Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09 *(Topic 606)* and all subsequent ASUs that modified Topic 606. Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, gain on sale of securities, bank-owned life insurance, gain on sales of SBA loans, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. The following noninterest income revenue streams are in-scope of Topic 606:

Service charges and fees on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. We sometimes charge customers fees that are not specifically related to the customer accessing its funds, such as account maintenance or dormancy fees. The amount of deposit fees assessed varies based on a number of factors, such as the type of customer and account, the quantity of transactions, and the size of the deposit balance. We charge, and in some circumstances do not charge, fees to earn additional revenue and influence certain customer behavior. An example would be where we do not charge a monthly service fee, or do not charge for certain transactions, for customers that have a high deposit balance. Deposit fees are considered either transactional in nature (such as wire transfers, nonsufficient fund fees, and stop payment orders) or non-transactional (such as account maintenance and dormancy fees). These fees are recognized as earned or as transactions occur and services are provided. Check orders and other deposit account related fees are largely transactional based and, therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the periods indicated:

	Year Ended December 31,	
	2019	2018
	(Dollars in thousands)	
Noninterest Income In-scope of Topic 606:		
Service charges and fees on deposit accounts	$ 4,510	$ 4,113
Noninterest Income Out-of-scope of Topic 606	5,734	5,461
Total noninterest income	$ 10,244	$ 9,574

20) Noninterest Expense

The following table indicates the various components of the Company's noninterest expense in each category for the periods indicated:

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Salaries and employee benefits	$ 50,754	$ 43,762	$ 35,719
Occupancy and equipment	6,647	5,411	4,578
Professional fees	3,259	1,969	2,982
Data processing	2,890	1,978	1,483
Amortization of intangible assets	2,739	1,943	1,361
Software subscriptions	2,397	2,343	1,831
Insurance expense	1,864	1,685	1,529
Other	14,348	16,430	11,255
Total noninterest expense	$ 84,898	$ 75,521	$ 60,738

The following table presents the merger-related costs by category for the periods indicated:

	For the Year Ended		
	December 31, 2019	December 31, 2018	December 31, 2017
	(Dollars in thousands)		
Salaries and employee benefits	$ 6,580	$ 3,569	$ —
Other	4,500	5,598	671
Total merger-related costs	$ 11,080	$ 9,167	$ 671

21) Business Segment Information

The following presents the Company's operating segments. The Company operates through two business segments: Banking segment and Factoring segment. Transactions between segments consist primarily of borrowed funds. Intersegment interest expense is allocated to the Factoring segment based on the Company's prime rate and funding costs. The provision for loan loss is allocated based on the segment's allowance for loan loss determination which considers the effects of charge-offs. Noninterest income and expense directly attributable to a segment are assigned to it. Taxes are paid on a consolidated basis and allocated for segment purposes. The Factoring segment includes only factoring originated by Bay View Funding.

	Year Ended December 31, 2019		
	Banking [1]	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 130,971	$ 11,688	$ 142,659
Intersegment interest allocations	1,182	(1,182)	—
Total interest expense	10,847	—	10,847
Net interest income	121,306	10,506	131,812
Provision for loan losses	517	329	846
Net interest income after provision	120,789	10,177	130,966
Noninterest income	9,643	601	10,244
Noninterest expense [2]	78,159	6,739	84,898
Intersegment expense allocations	547	(547)	—
Income before income taxes	52,820	3,492	56,312
Income tax expense	14,819	1,032	15,851
Net income	$ 38,001	$ 2,460	$ 40,461
Total assets	$ 4,045,801	$ 63,662	$ 4,109,463
Loans, net of deferred fees	$ 2,487,864	$ 45,980	$ 2,533,844
Goodwill	$ 154,376	$ 13,044	$ 167,420

(1) Includes the holding company's results of operations.

(2) The banking segment's noninterest expense includes acquisition costs of $11,080,000.

	Year Ended December 31, 2018		
	Banking [1]	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 115,147	$ 14,698	$ 129,845
Intersegment interest allocations	1,856	(1,856)	—
Total interest expense	7,822	—	7,822
Net interest income	109,181	12,842	122,023
Provision for loan losses	7,224	197	7,421
Net interest income after provision	101,957	12,645	114,602
Noninterest income	8,662	912	9,574
Noninterest expense [2]	69,164	6,357	75,521
Intersegment expense allocations	753	(753)	—
Income before income taxes	42,208	6,447	48,655
Income tax expense	11,418	1,906	13,324
Net income	$ 30,790	$ 4,541	$ 35,331
Total assets	$ 3,028,721	$ 67,841	$ 3,096,562
Loans, net of deferred fees	$ 1,832,815	$ 53,590	$ 1,886,405
Goodwill	$ 70,709	$ 13,044	$ 83,753

(1) Includes the holding company's results of operations.

(2) The banking segment's noninterest expense includes acquisition costs of $9,167,000.

	Year Ended December 31, 2017		
	Banking [1]	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 95,027	$ 11,884	$ 106,911
Intersegment interest allocations	1,126	(1,126)	—
Total interest expense	5,387	—	5,387
Net interest income	90,766	10,758	101,524
Provision (credit) for loan losses	102	(3)	99
Net interest income after provision	90,664	10,761	101,425
Noninterest income	8,559	1,053	9,612
Noninterest expense [2]	53,860	6,878	60,738
Intersegment expense allocations	528	(528)	—
Income before income taxes	45,891	4,408	50,299
Income tax expense [3]	24,266	2,205	26,471
Net income	$ 21,625	$ 2,203	$ 23,828
Total assets	$ 2,780,286	$ 63,166	$ 2,843,452
Loans, net of deferred fees	$ 1,533,841	$ 48,826	$ 1,582,667
Goodwill	$ 32,620	$ 13,044	$ 45,664

(1) Includes the holding company's results of operations.

(2) Includes $671,000 pre-tax acquisition costs related to the Tri-Valley and United American proposed mergers in the banking segment.

(3) Includes $7,103,000 of expense associated with remeasurement of the net DTA, of which $6,749,000 was in the banking segment, and $354,000 was in the factoring segment.

22) Parent Company only Condensed Financial Information

The condensed financial statements of Heritage Commerce Corp (parent company only) are as follows:

Condensed Balance Sheets

	December 31,	
	2019	2018
	(Dollars in thousands)	
Assets		
Cash and cash equivalents	$ 20,260	$ 21,358
Investment in subsidiary bank	594,868	384,516
Other assets	1,761	1,194
Total assets	$ 616,889	$ 407,068
Liabilities and Shareholders' Equity		
Subordinated debt, net of issuance costs	39,554	39,369
Other liabilities	627	233
Shareholders' equity	576,708	367,466
Total liabilities and shareholders' equity	$ 616,889	$ 407,068

Condensed Statements of Operations

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Dividend from subsidiary bank	$ 22,500	$ 17,000	$ 16,000
Other income	121	—	114
Interest expense	(2,314)	(2,315)	(1,394)
Other expenses	(3,084)	(3,030)	(2,270)
Income before income taxes and equity in net income of subsidiary bank	17,223	11,655	12,450
Equity in undistributed net income of subsidiary bank	21,757	22,161	10,078
Income tax benefit	1,481	1,515	1,300
Net income	$ 40,461	$ 35,331	$ 23,828

Condensed Statements of Cash Flows

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Cash flows from operating activities:			
Net Income	$ 40,461	$ 35,331	$ 23,828
Adjustments to reconcile net income to net cash provided by operations:			
Amortization of restricted stock awards, net	1,283	1,109	912
Equity in undistributed net income of subsidiary bank	(21,757)	(22,161)	(10,078)
Net change in other assets and liabilities	12	(64)	224
Net cash provided by operating activities	19,999	14,215	14,886
Cash flows from financing activities:			
Equity investment in subsidiary bank	—	—	(20,000)
Payment of cash dividends	(22,723)	(18,464)	(15,238)
Proceeds from issuance of subordinated debt, net of issuance costs	—	—	39,073
Proceeds from exercise of stock options	1,626	2,667	1,368
Net cash provided by (used in) financing activities	(21,097)	(15,797)	5,203
Net increase (decrease) in cash and cash equivalents	(1,098)	(1,582)	20,089
Cash and cash equivalents, beginning of year	21,358	22,940	2,851
Cash and cash equivalents, end of year	$ 20,260	$ 21,358	$ 22,940

23) Quarterly Financial Data (Unaudited)

The following table discloses the Company's selected unaudited quarterly financial data:

	Quarter Ended			
	12/31/2019	9/30/2019	6/30/2019	3/31/2019
	(Dollars in thousands, except per share amounts)			
Interest income	$ 42,471	$ 33,250	$ 33,489	$ 33,449
Interest expense	3,242	2,625	2,573	2,407
Net interest income	39,229	30,625	30,916	31,042
Provision (credit) for loan losses	3,223	(576)	(740)	(1,061)
Net interest income after provision for loan losses	36,006	31,201	31,656	32,103
Noninterest income	2,393	2,618	2,765	2,468
Noninterest expense (1)	30,626	17,909	18,445	17,918
Income before income taxes	7,773	15,910	15,976	16,653
Income tax expense	2,088	4,633	4,623	4,507
Net income	$ 5,685	$ 11,277	$ 11,353	$ 12,146
Earnings per common share				
Basic	$ 0.10	$ 0.26	$ 0.26	$ 0.28
Diluted	$ 0.10	$ 0.26	$ 0.26	$ 0.28

(1) Includes $9,879,000, $661,000, and $540,000 pre-tax acquisition costs in the fourth, third, and second quarters of 2019, respectively, related to the Presidio merger.

	Quarter Ended			
	12/31/2018	9/30/2018	6/30/2018	3/31/2018
	(Dollars in thousands, except per share amounts)			
Interest income	$ 35,378	$ 34,610	$ 31,980	$ 27,877
Interest expense	2,318	2,159	1,816	1,529
Net interest income	33,060	32,451	30,164	26,348
Provision for loan losses	142	(425)	7,198	506
Net interest income after provision for loan losses	32,918	32,876	22,966	25,842
Noninterest income	2,393	2,206	2,780	2,195
Noninterest expense (1)	16,941	17,728	24,862	15,990
Income before income taxes	18,370	17,354	884	12,047
Income tax expense	5,138	4,979	(31)	3,238
Net income	$ 13,232	$ 12,375	$ 915	$ 8,809
Earnings per common share				
Basic	$ 0.31	$ 0.29	$ 0.02	$ 0.23
Diluted	$ 0.30	$ 0.28	$ 0.02	$ 0.23

(1) Includes $139,000, $199,000, $8,214,000, and $615,000 pre-tax acquisition costs in the fourth, third, second and first quarters of 2018, respectively, related to the Tri-Valley and United American mergers.

24) Subsequent Events

On January 23, 2020, the Company announced that its Board of Directors declared a $0.13 per share quarterly cash dividend to holders of common stock. The dividend will be paid on February 19, 2020 to shareholders of record on February 5, 2020.

Exhibit 31.1

CERTIFICATIONS UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
REGARDING THE ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2019

I, Keith A. Wilton, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2019 of Heritage Commerce Corp;

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 statements 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 report;

4. The registrant's other certifying officer(s) 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(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(s) 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.

/s/ KEITH A. WILTON
Keith A. Wilton
President and Chief Executive Officer
Heritage Commerce Corp

Date: March 11, 2020

Exhibit 31.2

CERTIFICATIONS UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
REGARDING THE ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2019

I, Lawrence D. McGovern, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2019 of Heritage Commerce Corp;

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 statements 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 report;

4. The registrant's other certifying officer(s) 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(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(s) 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.

/s/ LAWRENCE D. MCGOVERN
Lawrence D. McGovern
Executive Vice President and Chief Financial Officer
Heritage Commerce Corp

Date: March 11, 2020

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
REGARDING THE ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2019

In connection with the Annual Report of Heritage Commerce Corp (the "Company") on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Keith A. Wilton, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(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.

/s/ KEITH A. WILTON
Keith A. Wilton
President and Chief Executive Officer
Heritage Commerce Corp

March 11, 2020

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
REGARDING THE ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2019

In connection with the Annual Report of Heritage Commerce Corp (the "Company") on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lawrence D. McGovern, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(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.

/s/ LAWRENCE D. MCGOVERN
Lawrence D. McGovern
Executive Vice President and Chief Financial Officer
Heritage Commerce Corp

March 11, 2020

Corporate Information

Board of Directors

Jack W. Conner, Chair
Ranson W. Webster, Vice Chair
Julianne M. Biagini-Komas
Frank G. Bisceglia
Bruce H. Cabral
Jason DiNapoli
Stephen G. Heitel
Walter T. Kaczmarek
Robert T. Moles
Marina H. Park Sutton
Laura Roden
Keith A. Wilton

Executive Management

Keith A. Wilton
President and Chief Executive Officer

Michael E. Benito
Executive Vice President
Business Banking Manager

Margo G. Butsch
Executive Vice President
Chief Credit Officer

Jeffrey Javits
Executive Vice President
Chief Information Officer

Robertson Clay Jones
Executive Vice President
President of Community Business Banking

Lawrence D. McGovern
Executive Vice President
Chief Financial Officer

Teresa L. Powell
Executive Vice President
HOA & Deposit Services

Deborah K. Reuter
Executive Vice President
Chief Risk Officer and Corporate Secretary

Glen E. Shu
Executive Vice President
President of Specialty Finance Group

May K. Y. Wong
Executive Vice President
Controller

Subsidiary Bank Offices
Heritage Bank of Commerce

San Jose Main
150 Almaden Boulevard
San Jose, CA 95113
408.947.6900

Danville
387 Diablo Road
Danville, CA 94526
925.314.2851

Fremont
3137 Stevenson Boulevard
Fremont, CA 94538
510.445.0400

Gilroy
7598 Monterey Street. Suite 110
Gilroy, CA 95020
408.842.8310

Hollister
351 Tres Pinos Road, Suite 102A
Hollister, CA 95023
831.637.2152

Livermore
1987 First Street
Livermore, CA 94550
925.791.4360

Los Altos
419 S. San Antonio Road
Los Altos, CA 94022
650.941.9300

Los Gatos
15575 Los Gatos Boulevard
Building B
Los Gatos, CA 95032
408.356.6190

Morgan Hill
18625 Sutter Boulevard, Suite 100
Morgan Hill, CA 95037
408.778.2320

Palo Alto
325 Lytton Avenue, Suite 100
Palo Alto, CA 94301
650.321.0500

Pleasanton
300 Main Street
Pleasanton, CA 94566
925.314.2876

Redwood City
2400 Broadway, Suite 100
Redwood City, CA 94063
650.298.7000

Sunnyvale
333 W. El Camino Real, Suite 150
Sunnyvale, CA 94087
650.919.2159

San Francisco
120 Kearny St., Suite 2300
San Francisco, CA 94108
415.229.8400

San Mateo
101 South Ellsworth Avenue, Suite 110
San Mateo, CA 94401
650.579.1500

San Mateo
400 S. EL Camino, Suite 150
San Mateo, CA 94402
650.645.6480

San Rafael
999 Fifth Ave., Suite 100
San Rafael, CA 94901
415.456.6000

Walnut Creek
1990 N. California Boulevard, Suite 100
Walnut Creek, CA 94596
925.287.4818

Walnut Creek
Loan Production Office
101 Ygnacio Valley Road, Suite 108
Walnut Creek, CA 94596
925.930.9287

Bay View Funding

Administrative Office
224 Airport Parkway Suite 200
San Jose, CA 95110
650.294.6600

Heritage Commerce Corp
Investor Relations Contact

Deborah K. Reuter
Executive Vice President
Chief Risk Officer & Corporate Secretary

Transfer Agent

Equiniti Trust Company
EQ Shareowner Services
1110 Centre Pointe Curve, Suite 101
Mendota Heights, MN 55120
1.800.468.9716

Independent Auditors

Crowe LLP
400 Capitol Mall, Suite 1400
Sacramento, CA 95814
916.441.1000

Corporate Counsel

Buchalter
A Professional Corporation
1000 Wilshire Boulevard, Suite 1500
Los Angeles, CA 90017
213.891.0700

To get further information on Heritage Commerce Corp, or to receive regular financial updates, please visit our web site at **HeritageCommerceCorp.com** and **click on "Information Request."**

Member FDIC

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HeritageCommerceCorp.com