HERITAGE
COMMERCE CORP

2010 Notice of Annual Meeting
of Shareholders, May 27, 2010

2010 Proxy Statement of
Heritage Commerce Corp

2009 Annual Report
on Form 10-K

To our Shareholders

April 15, 2010

Dear Fellow Shareholders,

At this time last year, we were at the low point of the worst economic recession the world has seen since the Great Depression. While there are many that believe the recovery has already begun, we believe the banking industry may experience more distress before we see a rebound in our business. Real estate values, both residential and commercial, remain stressed; loan demand is constrained as businesses hold back on expansion plans; and employment has not started to improve. While these indicators are traditionally the last to rebound in an economic recovery, they are very important to the fundamentals of banking.

Our results in 2009 reflect the economic contraction as we posted a loss. The net loss applicable to common shareholders was $14.4 million, or ($1.21) per diluted common share. The loss was primarily attributed to $34 million in loan loss provisions.

Despite the net loss in 2009, by year-end we had built solid loan loss reserves, and still met all regularity definitions of a "well capitalized" institution. Our risk-based capital ratio was 12.9% and our tangible common equity to tangible assets was 6.63% at year-end. Loan loss reserves increased to 2.69% of total loans up from 2.00% a year earlier.

We felt the full impact of the economic downturn on our loan portfolio in 2009 with nonperforming assets increasing to $64.6 million, or 4.74% of total assets, compared to $41.1 million or 2.74% of total assets in 2008. Land and construction loans were the weakest performing segment of our loan portfolio in 2009, and we have reduced our exposure to land and construction loans to 17% of the loan portfolio compared to 21% a year ago.

As the economy improves, we believe our asset quality should stabilize. We have a strong management team, and our loan workout team has been working diligently to reduce problem loans. We believe our loan portfolio will generate stronger performance than it did last year, as we focus on growing our commercial and SBA loan portfolios. Our core banking operations continue to generate solid revenues, and we believe will improve as the economic recovery begins to take hold.

The investment by the U.S. Treasury's Capital Purchase Program of $40 million in new capital through the placement of preferred shares in 2008 has helped us weather this storm. As a Preferred SBA lender, we have continued to make loans to small businesses. In fact, Heritage Bank of Commerce was the third largest producer of SBA 7(a) loans (in terms of dollars loaned) in the San Francisco District Office. From October 1, 2008, through September 30, 2009, we ranked 54th among SBA lenders nationally, funding over $27 million in new SBA loans.

While 2009 was a difficult and disappointing year, we remain optimistic regarding our future and our ability to return to profitability. We greatly appreciate the hard work of our employees, the loyalty of our customers, and the perseverance and support of our shareholders.

We will be celebrating our 16th anniversary in May, and as we did last year, will not be hosting an annual anniversary party. However, we will use a portion of the funds to help those less fortunate through contributions to several local charities. Heritage employees have a strong desire to give back to their neighborhood communities. Recently, the employees held an internal fundraising campaign for the American Red Cross Haiti Relief Fund. We are very proud to have such compassionate and dedicated people at Heritage Bank.

We hope you will be able to join us for our annual meeting on May 27, 2010, at 1:00 p.m. Pacific time.

Sincerely,

Jack W. Conner
Chairman of the Board

Walter T. Kaczmarek
President and Chief Executive Officer

HERITAGE COMMERCE CORP

Notice of 2010 Annual Meeting and Proxy Statement

HERITAGE COMMERCE CORP

April 20, 2010

Dear Shareholder:

You are cordially invited to attend the 2010 Annual Meeting of Shareholders, which will be held at 1:00 p.m., Pacific time on Thursday, May 27, 2010, at Heritage Commerce Corp's offices, located at 150 Almaden Boulevard, San Jose, California, 95113.

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 2009 Annual Report on Form 10-K.

Your continued support is appreciated and we hope you will attend the Annual Meeting. Whether or not you are personally present, it is very important that your shares be represented at the meeting. Accordingly, please sign, date, and mail the enclosed proxy card promptly. You may also vote electronically over the Internet or by telephone by following the instructions on the proxy card. If you attend the meeting and prefer to vote in person, you may do so.

Sincerely,

Jack W. Conner
Chairman of the Board

Walter T. Kaczmarek
President and Chief Executive Officer

HERITAGE COMMERCE CORP

150 Almaden Boulevard
San Jose, California 95113

Notice of Annual Meeting of Shareholders

Date and Time: Thursday, May 27, 2010, at 1:00 p.m., Pacific time.

Place: Company's offices located at 150 Almaden Boulevard, San Jose, California 95113.

Items of Business:

1. To elect 10 members of the Board of Directors, each for a term of one year;
2. Approval of an advisory proposal on the Company's executive compensation;
3. Approval of an amendment to our Articles of Incorporation to increase the number of authorized shares of our common stock from 30,000,000 to 60,000,000;
4. Approval of an amendment to our Bylaws to reduce the range of the size of the Board of Directors;
5. Ratification of the selection of Crowe Horwath LLP as the Company's independent registered public accounting firm for the year ending December 31, 2010;
6. Approval of the adjournment of the Annual Meeting of Shareholders, if necessary, to allow for further solicitation of proxies in the event there are insufficient votes present at the meeting, in person or by proxy, to approve the amendment to our Articles of Incorporation to increase the number of authorized shares; and
7. 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 April 5, 2010.

Mailing Date: The proxy materials are being distributed to our shareholders on or about April 20, 2010, 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.

By Order of the Board of Directors,

Debbie Reuter
Corporate Secretary

April 20, 2010
San Jose, California

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Why did you send me this proxy statement?

We sent you this proxy statement and the enclosed proxy card because our Board of Directors is soliciting your proxy to vote at the 2010 Annual Meeting of Shareholders. This proxy statement summarizes the information you need to know to cast an informed vote at the Annual Meeting. However, you do not need to attend the Annual Meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card. You may also vote electronically by telephone or the Internet by following the instructions on the proxy card.

Along with this proxy statement, we are also sending you the Heritage Commerce Corp 2009 Annual Report on Form 10-K, which includes our consolidated financial statements. Heritage Commerce Corp is also referred to in this proxy statement as the "Company."

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 20, 2010 to all shareholders entitled to vote. Shareholders who were the record owners of the Company's common stock at the close of business on April 5, 2010 are entitled to vote. On this record date, there were 11,820,509 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 April 5, 2010, 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?" below). The proxy card indicates the number of votes that you have as of the record date.

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 electronically by telephone or over the Internet (see below). Returning the proxy card will not affect your right to attend 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 10 nominees for director;

- **“FOR”** the approval of the advisory proposal on the Company’s executive compensation;
- **“FOR”** the approval of the amendment to the Articles of Incorporation to increase the number of authorized shares;
- **“FOR”** the approval of the amendment to the Bylaws to reduce the range of the size of the Board of Directors;
- **“FOR”** the ratification of the selection of Crowe Horwath LLP as our independent registered public accounting firm for 2010; and
- **“FOR”** the authorization to adjourn the Annual Meeting.

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 so 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. Each of (i) the non-binding advisory vote on executive compensation, (ii) approval of the amendment to the Articles of Incorporation to increase the number of authorized shares, (iii) the approval of the amendment to reduce the range of the size of the Board of Directors, (iv) the ratification of the selection of the Company’s independent registered public accounting firm, and (v) authorization to adjourn the Annual Meeting, is a routine item. The election of directors is a proposal on which a broker may vote only if the beneficial owner has provided voting instructions.

How do I vote in person?

If you plan to attend the Annual Meeting and desire to vote in person, we will give you a ballot form when you arrive. However, if your shares are held in the name of your broker, bank or other nominee, you must bring a power of attorney from your nominee in order to vote at the Annual Meeting.

May I vote electronically 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 electronically 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 prior to the commencement of the voting and at least one shareholder has given notice 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 in person.
- 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 vote is required to approve each proposal?

Proposal 1:	
Election of Directors	The 10 nominees for director are elected by a plurality of votes cast. This means that the 10 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?" above. Broker non-votes will not count as a vote on the proposal and will not affect the outcome of the vote.
Proposal 2:	
Approval of an Advisory Proposal on the Company's Executive Compensation	The affirmative vote of a majority of the shares entitled to vote present in person or by proxy at the Annual Meeting voting on this proposal is required to approve this proposal. A properly executed proxy marked "abstain" and broker non-votes will have the same effect as a negative vote.
Proposal 3:	
Approval of an Amendment to the Company's Articles of Incorporation to Increase the Number of Authorized Shares	The affirmative vote of a majority of shares issued and outstanding on the Record Date is required to approve the amendment to the Articles of Incorporation to increase the number of authorized shares. A properly executed proxy marked "abstain" and broker non-votes will have the same effect as a negative vote.
Proposal 4:	
Approval of an Amendment to the Company's Bylaws to Reduce the Range of the Size of the Board of Directors	The affirmative vote of a majority of the shares entitled to vote present in person or by proxy at the Annual Meeting voting on this proposal is required to approve this proposal. A properly executed proxy marked "abstain" and broker non-votes will have the same effect as a negative vote.
Proposal 5:	
Ratification of Selection of Independent Registered Public Accounting Firm	The affirmative vote of a majority of the shares entitled to vote present in person or by proxy at the Annual Meeting voting on this proposal is required to ratify the selection of Crowe Horwath LLP as our independent registered public accounting firm for 2010. A properly executed proxy marked "abstain" and broker non-votes will have the same effect as a negative vote.

Proposal 6:

Authorization to Adjourn the Annual Meeting	The affirmative vote of a majority of the shares entitled to vote present in person or by proxy at the Annual Meeting voting on this proposal is required to approve the proposal. A properly executed proxy marked "abstain" and broker non-votes will have the same effect as a negative vote.

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 $3,500.

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

A copy of our 2009 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; however, expenses for copying and mailing them to you will be your responsibility. Please write to:

Heritage Commerce Corp
150 Almaden Boulevard
San Jose, California 95113
Attention: 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 15, 2010, pertaining to beneficial ownership of the Company's common stock by persons known to the Company to own five percent or more of the Company's common stock, current directors of the Company, 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 15, 2010 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)
Frank G. Bisceglia	Director	122,548(4)	17,203	1.04%
Jack W. Conner	Director & Chairman of the Board	96,048(5)	18,048	0.81%
William J. Del Biaggio, Jr.	Executive Vice President/ Marketing & Community Relations	155,220(6)(17)	20,253	1.31%
Celeste V. Ford	Director	4,351(7)	1,351	0.04%
John J. Hounslow	Director	123,395(8)	3,395	1.04%
Walter T. Kaczmarek	President, CEO and Director	193,151(9)(17)	99,697	1.62%
Mark E. Lefanowicz	Director	37,800(10)	3,395	0.32%
James A. Mayer	Former Executive Vice President/East Bay Division	37,832(11)	—	0.32%
Lawrence D. McGovern	Executive Vice President & CFO	72,041(12)(17)	44,818	0.61%
Robert T. Moles	Director	107,138(13)	16,834	0.91%
Michael R. Ong	Executive Vice President & Chief Credit Officer	10,256	10,256	0.09%
Raymond Parker	Executive Vice President/ Banking Division	125,116(17)	52,169	1.05%
Humphrey P. Polanen	Director	26,591(14)	12,203	0.22%
Charles J. Toeniskoetter	Director	37,103(15)	24,703	0.31%
Ranson W. Webster	Director	619,781	17,203	5.24%
All directors, and executive officers (15 individuals)		1,768,371		14.54%
Dimensional Fund Advisors LP		775,822(16)		6.56%

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 15, 2010, as shown in the "Exercisable Options" column), both directly and indirectly, together with associates.
4. Includes 12,784 shares held as trustee of the Edith Lico Simoni Trust, 89,895 shares as one of two trustees of the Bisceglia Family Trust, and 15,450 shares held by Mr. Bisceglia in a personal Individual Retirement Account.
5. Includes 300 shares held in a trust account, and 6,700 shares held by Mr. Conner's spouse.
6. Includes 77,949 shares held in a personal Individual Retirement Account, 49,000 shares held as one of two trustees of the Del Biaggio Family Trust, and 5,716 shares held in the name of his spouse.
7. Includes 3,000 shares in a trust account held by Ms. Ford.
8. Includes 120,000 shares in a trust account held by Mr. Hounslow.
9. Includes 25,500 restricted shares held by Mr. Kaczmarek and 41,000 shares held in a personal Individual Retirement Account. Mr. Kaczmarek individually owns 25,500 shares. Mr. Kaczmarek was awarded 51,000 restricted shares of the Company common stock pursuant to the terms of a Restricted Stock Agreement, dated March 17, 2005. Under the terms of the Restricted Stock Agreement, the restricted shares will vest 25% per year at the end of years three, four, five and six, provided Mr. Kaczmarek is still with the Company, subject to accelerated vesting upon termination without cause, change of control, termination by Mr. Kaczmarek for good reason (each as defined in his employment agreement), death or disability. Mr. Kaczmarek has the right to vote the shares prior to the time they vest.
10. Includes 5,726 shares held by Mr. Lefanowicz individually and 28,679 shares held by Mr. Lefanowicz in a personal Individual Retirement Account.
11. Mr. Mayer retired from the Company on May 1, 2009.
12. Includes 4,980 shares held for Mr. McGovern in a personal Individual Retirement Account.
13. Includes 18,295 shares held by Mr. Moles' spouse.
14. Includes 12,765 shares held by Mr. Polanen in a personal Individual Retirement Account and 1,623 shares held by his spouse.
15. Includes 150 shares held by Mr. Toeniskoetter's spouse, and 12,250 shares held by the Toeniskoetter & Breeding, Inc. Profit Sharing Plan.
16. Dimensional Fund Advisors LP ("Dimensional"), an investment advisor, furnishes investment advice to four investment companies and serves as investment manager to certain other commingled trusts and separate accounts. These investment companies, trusts and accounts are referred to as the "Funds." In its role as investment advisor or manager, Dimensional possesses investment and/or voting power over the securities of the shares held by the Funds. However, all securities reported in this table are owned by the Funds. The address for Dimensional is 6300 Bee Cave Road, Austin, Texas 78746. All of the foregoing information has been obtained from Schedule 13/G filed with the SEC on February 8, 2010.
17. The Company's Employee Stock Ownership Plan owns 142,000 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 included in the table for: Mr. Kaczmarek 1,454 shares, Mr. McGovern 4,723 shares, Mr. Del Biaggio, Jr. 2,302 shares, Mr. Parker 1,193 shares, Mr. Mayer 165 shares, and zero shares for Mr. Ong. Mr. Kaczmarek 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 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

A majority of the Board of Directors consists of independent directors, as defined by the applicable rules and regulations of The NASDAQ Stock Market, as follows:

Frank G. Bisceglia
Jack W. Conner, Chairman of the Board
Celeste V. Ford
Mark E. Lefanowicz
Robert T. Moles
Humphrey P. Polanen
Charles J. Toeniskoetter
Ranson W. Webster

The non-independent directors of the Board are Walter T. Kaczmarek and John J. Hounslow.

Board and Committee Meeting Attendance

During the fiscal year ended December 31, 2009, our Board of Directors held a total of 17 meetings. Each incumbent director who was a director during 2009 attended at least 75% of the aggregate of (a) the total number of such meetings; and (b) the total number of meetings held by all committees of the Board on which such director served, during 2009.

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 our current directors attended our Annual Meeting of Shareholders in 2009.

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 95113-9940. 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 stockholder 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.

The Corporate Governance and Nominating Committee will consider director nominees recommended by shareholders who adhere to the following procedure. The Company's Bylaws provide that any shareholder must give written notice to the President of the Company of an intention to nominate a director at a shareholder meeting. Notice of intention to make any nominations shall be made in writing and shall be delivered or mailed to the President of the Company not less than 21 days, nor more than 60 days, prior to any meeting of shareholders called for the election of directors; provided, however, that if less than 21 days' notice is given to shareholders, such notice of intention to nominate shall be mailed or delivered to the President of the Company no later than the close of business on the tenth day following the day on which the notice of such meeting is sent by third class mail (if permitted by law), and no notice of intention to make nominations shall be required. The notification must contain the following information to the extent known to the notifying shareholder: (i) the name and address of each proposed nominee; (ii) the principal occupation of each proposed nominee; (iii) the number of shares of capital stock of the corporation owned by each proposed nominee; (iv) the name and residence address of the notifying shareholder; (v) the number of shares of capital stock of the corporation owned by the notifying shareholder; (vi) 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 or by the notifying shareholder and the identities and locations of any such institutions; (vii) whether the proposed nominee has ever been convicted of or pleaded nolo contendere to any criminal offense involving dishonesty or breach of trust, filed a petition in bankruptcy or been adjudicated bankrupt; and (viii) a statement regarding the nominee's compliance with Section 2.3 of the Bylaws (see below).

Nominees for the Board of Directors must also meet certain qualifications set forth in Section 2.3 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 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.

Number and Composition of 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 six standing committees: Audit Committee, Corporate Governance and Nominating Committee, Compensation Committee, Loan Committee, Finance and Investment Committee and Strategic Issues 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. 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 top 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 objectives and performance.

Director Stock Ownership Guidelines

In 2009, the Board adopted a policy that each future member of the Board is expected to hold, at a minimum, 10,000 shares of the Company's common stock. Any director not meeting the minimum level as of the effective date of their election to the Board has three years to bring his or her holdings up to this minimum level.

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 Officers 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 Officers 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 of Directors 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 Chairman 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 Chairman of the Audit Committee will report the status and disposition of all complaints to the Board of Directors.

Executive Officers of the Company

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

Name	Age	Position	Officer Since
William J. Del Biaggio, Jr.	68	Executive Vice President/Marketing & Community Relations	2004
Margaret A. Incandela	45	Executive Vice President/Credit Risk Management	2009
Walter T. Kaczmarek	58	President and Chief Executive Officer	2005
Dan T. Kawamoto	59	Executive Vice President and Chief Administrative Officer	2009
Lawrence D. McGovern	55	Executive Vice President and Chief Financial Officer	1998
Michael R. Ong	59	Executive Vice President and Chief Credit Officer	2008
Raymond Parker	60	Executive Vice President/Banking Division	2005

William J. Del Biaggio, Jr. has been with the Company since 1994 serving in various executive positions, and, since 2006, Mr. Del Biaggio, Jr. has served as an Executive Vice President. He is a former member of the Board of Directors.

Margaret A. Incandela re-joined the Company in January 2009 as a Senior Vice President and was recently promoted to Executive Vice President/Credit Risk Management. She was the Senior Vice President and Chief Credit Officer of Diablo Valley Bank from 2006 through its acquisition by the Company, and continued in the role of Senior Credit Officer for the Diablo Valley region through 2008. From 2003 to 2005, Ms. Incandela was the Executive Vice President and Chief Credit Officer of CIB Bancshares, Inc. She has been working in the banking industry for over 22 years.

Biographical information for Walter T. Kaczmarek is found under “Proposal 1—Election of Directors.”

Dan T. Kawamoto has served as Executive Vice President and Chief Administrative Officer of the Company since July, 2009. He was the Executive Vice President and Chief Financial Officer of 1st Century Bancshares, Inc. from February, 2007 to July, 2009. Prior to that, he was at Comerica Bank—Western Market as its Executive Vice President—Personal Financial Services from 1997 to 2007, and as its Chief Financial Officer from 1991 to 2003. Mr. Kawamoto was an audit partner for six years with Ernst & Young LLP prior to joining Comerica Bank in 1991.

Lawrence D. McGovern has served as Executive Vice President and Chief Financial Officer of the Company since July, 1998.

Michael R. Ong has served as Executive Vice President and Chief Credit Officer since August, 2008. He has been working in the banking industry for over 35 years, having worked at First Bank from March, 2007 to August, 2008, Comerica Bank from 1991 to 2007, and Plaza Bank of Commerce from 1984 to 1991.

Raymond Parker has served as Executive Vice President of Heritage Bank of Commerce/Banking Division since May, 2005. From January, 2005 until joining Heritage Bank of Commerce, Mr. Parker served as a consultant and then a director to Exadel, Inc. From February, 2002 through May, 2002, Mr. Parker served as the President and Chief Executive Officer of Loan Excel, Inc. From 1974 through 1999, he was employed in various capacities by Union Bank of California, including Executive Vice President of the Banking Group.

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 11 to 21, leaving the Board authority to fix the exact number of directors within that range. The Board has currently fixed the number of directors at 11, and we currently have 10 directors with one vacancy. See our proposal to reduce the range of the size of the Board on page 60 of this proxy statement.

Board Leadership Structure

The Board of Directors is committed to maintaining an independent Board, and for many years a majority of the Board has been comprised of independent directors. It has further been the practice 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 ultimate authority and responsibility for overseeing risk management of the Company. The Board monitors, reviews and reacts to material enterprise risks identified by management. The Board receives specific reports from executive management on financial, credit, liquidity, interest rate, capital, operational, legal compliance and reputation risks and the 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 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 Risk Management Steering 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 approves the independent auditor and its annual audit plan. The Audit Committee reports periodically to the Board on the effectiveness of risk management processes in place 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 six standing committees: the Audit Committee, Corporate Governance and Nominating Committee, Compensation Committee, Loan Committee, Finance and Investment Committee, and Strategic Issues 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:

- Oversight of our financial, accounting and reporting process, our system of internal accounting and financial controls, and our compliance with related legal and regulatory requirements.
- 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. 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 Statement on 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.
- 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 Celeste V. Ford, Mark E. Lefanowicz and Humphrey P. Polanen, Committee Chair. The Audit Committee met 7 times during 2009.

The Board of Directors has determined that Mr. Mark E. Lefanowicz has: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves; (iii) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by our financial statements, or experience actively supervising one or more persons engaged in such activities; (iv) an understanding of internal control over financial reporting; and (v) an understanding of audit committee functions.

Therefore, the Board has determined that Mr. Lefanowicz 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 of Directors.

The Audit Committee Report for 2009 appears on page 61 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.
- 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.
- Review and approve general employee welfare benefit plans and other plans on an as needed basis.
- Retain advisors in its sole discretion to assist the Compensation Committee in the performance of its directors.
- Perform the various reviews required by the U.S. Treasury Capital Purchase Program.

The members of the Compensation Committee are Frank G. Bisceglia, Celeste V. Ford, Robert T. Moles, Committee Chair, and Ranson W. Webster. The Committee met 9 times in 2009.

Corporate Governance and Nominating Committee. The Company has a separately designated Corporate Governance and Nominating Committee, which consists of entirely independent directors under the applicable rules and regulations of The NASDAQ Stock Market. The Committee has 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.
- Recommending director appointments to Board committees.

The members of the Corporate Governance and Nominating Committee are Robert T. Moles, Humphrey P. Polanen, Charles J. Toeniskoetter, and Ranson W. Webster, Committee Chair. The Committee met 5 times in 2009.

Finance and Investment Committee. The Finance and Investment Committee is responsible for the development of policies and procedures related to liquidity and asset liability management, supervision of the Company's investments and preparation of the Company's annual budget. The members of the Finance and Investment Committee are Frank G. Bisceglia, Jack W. Conner, Committee Chair, John J. Hounslow, Walter T. Kaczmarek, and Mark E. Lefanowicz. The Finance and Investment Committee met 12 times during 2009.

Loan Committee. The 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 Frank G. Bisceglia, Committee Chair, John J. Hounslow, Walter T. Kaczmarek, Robert T. Moles, and Charles J. Toeniskoetter. The Loan Committee met 23 times during 2009.

Strategic Issues Committee. The principal duties of the Strategic Issues Committee are to provide oversight and guidance to senior management regarding the strategic direction of the Company, including development of overall strategic business plan. The members of the Strategic Issues Committee are Jack W. Conner, John J. Hounslow, Walter T. Kaczmarek, Charles J. Toeniskoetter, Committee Chair, and Ranson W. Webster. The Strategic Issues Committee met 7 times during 2009.

Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's directors, executive officers and persons who own more than ten percent of a registered class of the Company's equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities. They are required by SEC rules and regulations to furnish the Company with copies of all Section 16(a) forms they file.

To the Company's knowledge, based solely on review of the copies of such reports furnished to the Company and written representations that no other reports were required, all Section 16(a) filing requirements applicable to our executive officers and directors were complied with during the year ended December 31, 2009, except for a late filing by Raymond Parker due to an administrative oversight, and late filings by John J. Hounslow, Mark E. Lefanowicz, Robert T. Moles, and Charles J. Toeniskoetter, due to a system upgrade that resulted in a longer than expected filing time.

Transactions with Management

John J. Hounslow Agreements. In June 2007, the Company completed the acquisition of Diablo Valley Bank. In connection with this transaction, the Company entered into a consulting agreement with Mr. Hounslow, a member of the Board of Directors, pursuant to which Mr. Hounslow provided consulting regarding post-acquisition transition issues, including retention and transition of employees and customers, marketing the "Heritage" brand name and such other services as were assigned to him from time to time by the President of Heritage Bank of Commerce. The agreement became effective on the effective date of the merger and extended for a term that expired on December 31, 2007. Mr. Hounslow received a consulting fee of $400,000 payable to him pro rata over a 30 month period that commenced in July 2007. Mr. Hounslow also agreed to enter into a 3 year non-competition, non-solicitation and confidentiality agreement with the Company which paid him $200,000 payable pro rata over 30 months commencing in July 2007. In consideration of entering into those agreements, Mr. Hounslow agreed to forgo an amount equal to 12 months of salary due to him for severance under his employment agreement with Diablo Valley Bank and agreed to terminate the employment agreement.

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 had 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 Heritage Bank of Commerce's Board of Directors is required for all loans advanced to directors and executive officers. As of December 31, 2009, Heritage Bank of Commerce had no loans outstanding to directors, executive officers and other related persons.

Policies and Procedures for Approving Related Party Transactions

The Board of Directors 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 between the Company and any related person (including any transaction requiring disclosure under Item 404 of Regulation S-K under the Securities Exchange Act of 1934).

The Board of Directors has determined that the Audit Committee is best suited to review and approve related party transactions. Accordingly, at each calendar year's first regularly scheduled Audit Committee meeting, management shall recommend related party transactions to be entered into by the Company for that calendar year, including the proposed aggregate value of such transactions if applicable. After review, the Committee shall approve or disapprove such transactions and, at each subsequently scheduled meeting, management shall update the Committee as to any material change to those proposed transactions. The Committee shall consider all of the relevant facts and circumstances available to the

Committee, including (if applicable) but not limited to: the benefits to the Company; 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; the availability of other sources for comparable products or services; the terms of the transaction; and 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 stockholders, as the Committee determines in good faith. The Audit Committee shall convey the decision to the Chief Executive Officer, who shall convey the decision to the appropriate persons within the Company. In the event management recommends any further related party transactions subsequent to the first calendar year meeting, such transactions may be presented to the Audit Committee for approval or preliminarily entered into by management subject to ratification by the Audit Committee; provided that if ratification shall not be forthcoming, management shall make all reasonable efforts to cancel or annul such transaction.

Compensation Discussion and Analysis

The Compensation Committee of the Board of Directors has responsibility for establishing, implementing and continually monitoring the compensation structure, policies and programs of the Company. The Compensation Committee is responsible for assessing and approving the total compensation structure paid to the Chief Executive Officer and the other executive officers. Thus, the Compensation Committee is responsible for determining whether the compensation paid to each of these executive officers is fair, reasonable and competitive, and whether it serves the interests of the Company's shareholders.

The individuals who served as the Company's Chief Executive Officer and Chief Financial Officer during 2009, as well as the other individuals included in the Summary Compensation Table, are referred to as the "named executive officers." 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 of the named executive officers.

Overview

Like most companies in the financial services sector, the deteriorating economy had a significant negative impact on the Company's 2009 results of operations and on the price of the Company's common stock. The effect of these events and concerns that the economy may be recovering for some period of time were reflected in the compensation of the Company's named executive officers for 2009 and in a number of executive compensation-related actions that have been taken by the Company and the Compensation Committee with respect to 2010.

The objectives of the Company's executive compensation program are to align a portion of each executive officer's total compensation with the annual and long-term performance of the Company and the interests of the Company's shareholders. The Company's Management Incentive Plan, which plays a key role in fulfilling this objective, is designed specifically to establish a direct correlation between the annual incentives awarded to the participants and the financial performance of the Company.

The Company and the Compensation Committee believe our compensation philosophy, policies and objectives outlined within this Compensation Discussion and Analysis are appropriately designed to allow us to effectively compensate our employees both during times of positive performance and in times of weak performance. Consistent with our performance-based philosophy and objectives, and in view of the poor and deteriorating general economic conditions that began in 2008, no bonuses were paid or stock awards issued to the named executive officers in 2008 or 2009 (except stock options issued to one named executive officer who joined the Company in 2008), and none of our named executive officers received salary increases in 2009.

In 2010, the Compensation Committee has taken a number of additional actions in response to the adverse economic conditions, including a freeze on named executive officers' base salaries for 2010. Given concerns about performance targets and long-range forecasting during these uncertain times, the Compensation Committee, with the assistance of its compensation consultant, is reviewing our compensation program to assure goals will result in shareholder value and continue to motivate and retain our senior management. Upon recommendation of our Chief Executive Officer, the Compensation Committee has frozen the salaries of each of our named executive officers for 2010. The Compensation Committee will review the compensation consultant report as it considers further actions for 2010.

Effect of the Emergency Economic Stabilization Act of 2008 and American Recovery and Reinvestment Act of 2009

In October, 2008, the Department of the Treasury ("U.S. Treasury") established the Troubled Asset Relief Program ("TARP") under the Emergency Economic Stabilization Act of 2008, as amended ("EESA"). EESA provided immediate authority and facilities that the Secretary of the U.S. Treasury could use to restore liquidity and stability to the financial system. Section 101(a) of EESA authorizes the U.S. Treasury to establish the TARP. The U.S. Treasury implemented the Capital Purchase Program under TARP to make preferred stock investments in participating financial institutions.

On February 13, 2009, Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA"), which the President signed into law on February 17, 2009. Among other things, ARRA amended in its entirety Section 111 of EESA. Section 111 of EESA provides that certain entities that receive financial assistance from the U.S. Treasury under the TARP will be subject to specified executive compensation and corporate governance standards to be established by the U.S. Treasury.

We participated in the Capital Purchase Program in November 2008 by selling preferred stock and common stock purchase warrants to the U.S. Treasury. We participated in the Capital Purchase Program so that we could continue to lend and support our current and prospective customers and further strengthen our capital base. As a result, we became subject to certain executive compensation requirements under EESA, U.S. Treasury regulations, and the contract pursuant to which we sold such preferred stock. On October 20, 2008, the U.S. Treasury issued an interim final rule under Section 111 of EESA (prior to its later amendment by ARRA) ("October 2008 Interim Final Rule"). The October 2008 Interim Final Rule established the original executive compensation standards for financial institutions participating in the Capital Purchase Program. These standards generally applied to our senior executive officers ("SEOs"). For these purposes our SEOs are the same individuals who are our named executive officers.

On June 15, 2009, the U.S. Treasury issued its Interim Final Rule promulgated pursuant to Section 111 of EESA as amended by ARRA ("Interim Final Rule"). The provisions of ARRA and the Interim Final Rule supersede the October 2008 Interim Final Rule as well as several notices of guidance issued by the U.S. Treasury before the enactment of ARRA or the Final Interim Rule. ARRA prescribes new executive compensation standards, and requires the U.S. Treasury to establish these standards by promulgating regulations to implement Section 111. The Interim Final Rule complies with this statutory requirement to promulgate standards that implement ARRA provisions, consolidates all of the executive compensation related provisions that are specifically directed at TARP recipients into a single rule (superseding all prior rules and guidance), and utilizes the discretion granted to the U.S. Treasury under ARRA to adopt additional standards.

Key features of ARRA and the Interim Final Rule as they apply to the Company are:

- *Prohibition on Bonuses.* A prohibition of the payment of any "bonus, retention award, or incentive compensation" to the five most highly compensated employees for as long as any Capital Purchase Program related obligations are outstanding. A "bonus" under the rules includes the issuance of stock options.

- *Restricted Stock with Cliff Vesting.* "Long-term" restricted stock is excluded from ARRA's bonus prohibition, but only to the extent the value of the stock does not exceed one-third of the total amount of annual compensation of the employee receiving the stock. The stock may "fully vest" only as the Capital Purchase Program obligations have been satisfied, subject to several exemptions, and the stock must be forfeited if the employee does not continue performing substantial services for the Company for at least two years from the date of grant.

- *Golden Parachutes.* Prohibition on making any severance/golden parachute payments (defined as any payment without regard to the amount of such payment) to any SEO or any of the next five most highly compensated employees upon termination of employment for any reason (except death or disability) or any payment due to a change in control. A golden parachute payment does not include any payment made for services performed or benefits accrued.

- *Clawback.* Recovery of any bonus or other incentive payments paid to any SEO or the next 20 most highly compensated employees that were made based on financial statements or other criteria that are later found to be materially inaccurate.

- *Tax Gross-Ups.* Prohibition on the payment of any "gross-up" to any SEO or the next twenty most highly compensated employees. A gross-up means any reimbursement of taxes owed with respect to any compensation (except for a tax equalization agreement relating to foreign compensation).

- *SEO Compensation Plans that Encourage Unnecessary Risk-Taking.* Prohibition on executive compensation plans that encourage SEOs to take unnecessary and excessive risks that threaten the Company's value. Every six months the Compensation Committee must discuss, evaluate and review SEO compensation plans to identify and take action to limit risks that encourage focus on short-term results over long-term results.

- *Perquisites.* Annually disclose to the U.S. Treasury and Federal Reserve Board any perquisites whose total value exceeds $25,000 for the fiscal year paid to any of the five highest compensated employees.

- *Earnings Manipulation.* Prohibition on compensation plans that encourage earnings manipulation. Every six months, the Compensation Committee must discuss, evaluate and review employee compensation plans to ensure they do not encourage manipulation of reported earnings to enhance employee compensation.

- *Certifications of CEO and CFO.* A requirement that the Company's Chief Executive Officer and Chief Financial Officer provide a written certification of compliance with the executive compensation restrictions in ARRA in the Company's annual report on Form 10-K filed with the SEC.

- *Excessive Expenditures.* Implementation of a company-wide policy regarding excessive or luxury expenditures.

The Committee believes that the foregoing restrictions on executive compensation and any further restrictions on executive compensation which may be adopted could adversely affect the Company's ability to hire, retain or motivate its executive management and other key employees, and the Committee believes the Company may face increased competition for such employees from financial institutions that are not participants in the Capital Purchase Program.

Overview of Compensation Philosophy

The Compensation Committee believes that the most effective executive compensation programs are those that align the interests of the executive with those of the Company's shareholders. The Compensation Committee believes that a properly structured compensation program will attract and retain talented individuals and motivate them to achieve specific short-term and long-term strategic objectives. The Compensation Committee believes that a reasonable percentage of executive pay should be based on the principles of pay-for-performance. However, the Compensation Committee also recognizes that the Company must maintain its ability to attract and retain highly talented executives. For this reason, an important objective of the Compensation Committee is to ensure the compensation programs of the named executive officers are competitive as compared to similar positions within our peer group companies ("Compensation Peer Group").

The Compensation Committee believes executive compensation packages provided by the Company to its executives, including the named executive officers, should include base salary, variable performance-based cash/stock awards and stock-based compensation. We believe we should balance each of those elements. In part, we reviewed our Compensation Peer Group and other comparative survey data to determine an appropriate mix of each element. We also use our Compensation Peer Group and other comparative survey data to assess appropriate compensation levels as discussed in more detail later in this report.

We provide our executives the opportunity to significantly increase their annual cash compensation through our variable performance-based cash/stock awards incentive program by improving the Company's performance in each of the relevant financial areas on an annual basis. We also expect that as those improvements are maintained and built upon, the Company's stock price will reflect these improvements. We use stock 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. We also consider other forms of executive pay, including our supplemental executive retirement plan and severance arrangements (including change of control provisions) as a means to attract and retain our executive officers including the named executive officers.

Compensation Program Objectives and Rewards

The Company's compensation and benefits programs are driven by our business environment and are designed to enable us to achieve our mission and adhere to Company 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 future success;
- Motivate and inspire employee behavior that fosters a high performance culture;
- Support a one company culture;
- 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; and
- Balance our compensation costs with our desire to provide value to employees and shareholders.

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; and
- Employee understanding and perceptions that ensure program value equals or exceeds program cost.

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 who will engage in the behaviors necessary to enable us to succeed in creating shareholder value in a highly competitive marketplace. Beyond that, different elements have specific purposes designed to reward different behaviors.

- *Base salary and benefits* are designed to:
    - Reward core competence in the executive role relative to skills, position and contributions to the Company; and
    - Provide fixed cash compensation with merit increases competitive with the market place.
- *Annual incentive variable cash and stock 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 and stock 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:
    - Link compensation rewards to the creation of shareholder wealth;
    - 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 with the Company.
- *A supplemental executive retirement plan* facilitates our ability to attract and retain executives as we compete for talented employees in a marketplace where these plans are commonly offered.
- *Change of control and separation benefits with certain officers:*
    - Individual employment contracts with certain executives provide for 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.
    - 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.

The use of these programs enables us to reinforce our pay-for-performance philosophy, as well as 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.

Total compensation is generally targeted at the 75th percentile of our Compensation Peer Group. We target above the median of our Compensation Peer Group because of 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.

Our programs and our ability to attract, retain and incentivize executive talent have been materially adversely affected by the requirements of EESA and ARRA and regulations by the U.S. Treasury implementing these statutes. Our inability to offer and/or pay (i) any bonus or incentive compensation (including stock options), except for cliff vesting restricted stock for only up to one third of base salary; or (ii) any severance or so-called "golden parachute" payments, regardless of the amount of the payment or reasons for termination of employment, will make it more difficult to compete for and retain executive talent in our market areas where other banks and companies in the financial services industry do not participate in the Capital Purchase Program.

Role of Compensation Committee in Determining Compensation

The Compensation Committee has overall responsibility and authority for approving and evaluating the compensation programs and policies pertaining to our executives, including the named executive officers. The Compensation Committee is also responsible for reviewing and submitting to the Board of Directors recommendations concerning Board of Director compensation.

When making individual compensation decisions for named executive officers, the Compensation Committee takes many factors into account, 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.

The Compensation Committee relies significantly on the input and recommendations of our Chief Executive Officer when evaluating these factors relative to the compensation of executive officers, excluding his own compensation, which is set according to the terms of his employment agreement and annual review by the Board of Directors. 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. Our 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. 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 discusses our Chief Executive Officer's recommendations and then approves or modifies the recommendations in collaboration with the Chief Executive Officer.

Our Chief Executive Officer's compensation is determined solely by the Compensation Committee. Our Chief Executive Officer attends portions of the Compensation Committee meetings. Decisions relating to the Chief Executive Officer's pay are made by the Compensation Committee, without management present. The Compensation Committee reports its activities to our Board of Directors.

Role of Compensation Consultants

Generally every two years, the Compensation Committee retains the services of executive compensation consultants 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 2007 and again in 2009, the Compensation Committee retained Carl D. Jacobs Group LLC ("Jacobs Group") to assist the Compensation Committee and management in the review and assessment of multiple aspects of our compensation programs, including equity compensation practices, and short-term and long-term incentive design. In 2007 and 2009 the Jacobs Group provided an independent analysis of the Company's executive compensation policies and practices and provided analyses on the pay practices of the Compensation Peer Group and other comparable market data. The Jacobs Group reports directly to the Compensation Committee, while collaborating with management, including our Chief Executive Officer, on behalf of the Compensation Committee, to develop programs which are supportive of our business strategy and needs.

Our compensation programs for executive management and our Board of Directors in 2009 took into account the review and assessment presented in the Jacobs Group 2007 report. The Compensation Committee will use the results of the 2009 report (completed in December, 2009) in its review and deliberations about executive and Board of Director compensation issues and recommendations for 2010.

The Company Compensation Program

Market Positioning and Pay Benchmarking

The Compensation Committee targets base salary close to the 60th percentile of the Compensation Peer Group data for the base salaries of the Chief Executive Officer and executive officers including the other named executive officers. The actual positioning of each named executive officer's compensation is dependent on considerations of the executive's performance, the performance of the Company and the individual business or corporate function for which the executive is responsible, the nature and importance of the position and role within the Company, the scope of the executive's responsibility (including risk management and corporate strategic initiatives), and the individual's success in promoting our core values and demonstrating leadership.

In 2007, the Compensation Committee undertook a comprehensive review of the Company's compensation programs for executive officers, other elected officers, selected staff and the Board of Directors. The Jacobs Group, in consultation with the Compensation Committee, selected a peer group of financial institutions to establish a Compensation Peer Group for the 2007 report. The companies included in the Compensation Peer Group were selected from publicly traded banks in California and several from neighboring states based on: (i) compatibility of the Company based on size as measured through total assets between one and four billion dollars; (ii) similarity of their product lines and business focus; and (iii) the competitive market for executive talent. The Compensation Peer Group consisted of 16 publicly-traded independent community banks with the majority located in California. In addition to the Compensation Peer Group, the Jacobs Group also assembled, reviewed and compiled data from nine recognized published compensation surveys. Published surveys included California banks located in our service areas as well as local area data drawn from national surveys. The Comparative Peer Group and the comparative survey data were used to benchmark executive compensation levels against banks that have executive positions with responsibilities similar in breadth and scope to ours and that compete with us for executive talent. With such information, the Compensation Committee reviewed and analyzed compensation for each executive and made adjustments as appropriate. The Compensation Peer Group component companies used in the evaluation of the Company's compensation programs in the 2007 report for executive officers and the Board of Directors were as follows:

Bank of Marin Bancorp	First Mutual Bancshares
Beverly Hills Bancorp	First Regional Bancorp
Bridge Capital Holdings	Imperial Capital Bancorp
Capital Corp of the West	Nara Bancorp
Cascade Financial Corporation	Pacific Mercantile Bancorp
Center Financial Corporation	TriCo Bancshares
Farmers & Merchants Bancorp	Vineyard National Bancorp
First California Financial Group	Wilshire Bancorp

In the 2009 report, the Jacobs Group revised the Compensation Peer Group used in the evaluation of the Company's compensation program with the same general criteria that were used in 2007, because several organizations were no longer independent and operating. The Compensation Peer Group component companies for the 2009 report were as follows:

Bank of Marin Bancorp	Pacific Mercantile Bancorp
Bridge Capital Holdings	PacWest Bancorp*
Cascade Financial Corporation	Preferred Bank*
Center Financial Corporation	Premier West Bancorp*
Farmers & Merchants Bancorp	Provident Financial Holdings*
First California Financial Group	Sierra Bancorp*
First Regional Bancorp	TriCo Bancshares
Heritage Oaks Bancorp*	WestAmerica Bancorp*
Nara Bancorp	Wilshire Bancorp
North Valley Bancorp*	

* Denotes new to peer group for 2009 report.

Pay Mix

We do not allocate between cash and non-cash compensation and short-term versus long-term compensation based on specific percentages. Instead, we believe that the compensation package for our executives should be generally in line with the prevailing market, consistent with each executive's level of impact and responsibility.

Chief Executive Officer Compensation

The Compensation Committee meets with the other independent directors each year in an executive session to evaluate the performance of the Chief Executive Officer. The Compensation Committee also confers with the Chief Executive Officer when setting his base salary. In 2009, the Compensation Committee considered management's continuing achievement of its short- and long-term goals versus its strategic objectives as well as financial targets. Emphasis was also placed on performance factors of the Company's business units, along with the results of the independent consultant's analysis of the pay practices of the 2007 Compensation Peer Group, comparative survey data used for the 2007 report, and personal performance goals established annually by the Compensation Committee. In view of the 2007 report, the Compensation Committee determined that the Chief Executive Officer's base salary in 2009 was aligned with the Company's compensation philosophy to pay at the 60th percentile of the 2007 Compensation Peer Group. The results of the 2009 report indicate that the Chief Executive Officer's base salary is 77% of the 60th percentile and his total compensation falls below the desired 75th percentile.

The Compensation Committee accepted the Chief Executive Officer's recommendation that his salary should be frozen for 2009 in response to the current economic conditions adversely affecting the Company and the financial services industry. Consequently, the Chief Executive Officer's base salary remained at $333,700. The Chief Executive Officer has again recommended that his salary should remain flat for 2010, and the Compensation Committee has accepted his recommendation.

Base Salary

In accordance with our compensation objectives, salaries are set and administered to reflect the value of the position in the marketplace, the career experience of the individual, 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 evaluations and recommendations of the other named executives officers as well as the Compensation Committee's evaluation of the Company's overall compensation programs and policies.

For 2009, the Compensation Committee considered the pay practices of the 2007 Compensation Peer Group and the analyses and recommendations provided by its independent consultant. In its review of base salaries for executive officers, the Compensation Committee concluded that the base salaries of the named executive officers were generally positioned near the 60th percentile. In evaluation of the base salaries in 2009 for the named executive officers, the Compensation Committee also considers the minimum, mid-range and maximum salaries paid to similarly situated positions at companies in the 2007 Compensation Peer Group as well as the performance levels of the named executive officer.

In response to the current economic conditions adversely affecting the Company and the financial services industry, the Chief Executive Officer recommended that his base salary and the salaries of the other named executive officers should be frozen for 2009. The Compensation Committee accepted the recommendation. The Chief Executive Officer has again recommended that his salary and the salaries of the other named executive officers should remain flat for 2010 and the Committee has accepted the recommendation.

Base salary drives the formula used in the Management Incentive Plan as discussed below under "Management Incentive Plan." Base salary is the only element of compensation that is used in determining the amount of contributions permitted under the Company's 401(k) plan.

Management Incentive Plan

We believe that annual incentive compensation for named executive officers should be based on performance against pre-defined financial metrics and performance objectives. In 2009, each of our named executive officers was eligible to receive a bonus under the Company's Management Incentive Plan ("Incentive Plan"). Annual performance bonuses are designed to focus participants on, and reward them for, the achievement of specific annual financial, strategic and/or operational objectives of the Company.

The incentive levels (as a percent of salary) are designed to provide for the achievement of threshold, target and maximum performance objectives. The financial metrics, performance objectives, and the formula for computing the performance bonus are established by the Compensation Committee early in each fiscal year.

The award opportunities under the Incentive Plan were derived in part from comparative data provided by our independent consultant and in part by the Compensation Committee's judgment on internal equity of the positions, their relative value to the Company and the desire to maintain a consistent annual incentive target for the Chief Executive Officer and the other named executive officers.

The payouts for executives under the Incentive Plan are targeted at the 75th percentile of comparative data provided by our independent consultant in years when we reach our target annual financial performance. If we reach, but do not exceed, the financial plan for any given year, the incentive payout, given current salary levels, should approximate the 70th percentile of comparative data.

The incentive levels assigned as a percentage of base salary for 2009 were as follows:

	As a percent of base salary	
Position	**Threshold**	**Target**
Walter T. Kaczmarek	15%	33%
Lawrence D. McGovern	15%	33%
William J. Del Biaggio, Jr.	15%	33%
James A. Mayer*	15%	33%
Michael R. Ong	15%	33%
Raymond Parker	15%	33%

* James A. Mayer retired from the Company on May 1, 2009.

Management recommends, and the Compensation Committee reviews and approves, the financial metrics for each plan year that must be met in order for awards to be paid. These financial metrics are weighted and are intended to motivate and reward eligible executives to strive for continued financial improvement of the Company, consistent with performance-based compensation and increasing shareholder value. The Compensation Committee typically identifies from three to five financial metrics which may be revised from year to year to reflect current business situations.

The financial metrics selected for 2009 were net income, return on equity, non-performing assets and loan/deposit ratio. The Compensation Committee believes net income is a valid measurement in assessing how the Company is performing from a financial standpoint. Net income is an accepted accounting measure that drives earnings per share and shareholder returns over the long term. Return on equity is an accepted measure of growth and efficient use of capital. In addition, the Compensation Committee, in consultation with the Chief Executive Officer, concluded that, in view of the continual deterioration of the economy expected to occur in 2009, management should focus on credit quality and liquidity and deposit growth.

The Compensation Committee believes that non-performing assets are an effective measure to monitor the Company's progress in improving its credit quality. The Company's loan to deposit ratio is a commonly used measure in the banking industry that measures liquidity as well as an indication of the Company's success in growing its deposit base.

The Compensation Committee determines the weighting of financial metrics each year based upon recommendations from the senior management. For 2009, the Compensation Committee weighted the financial metrics as follow:

Net Income	25%
Return on Equity	25%
Non-Performing Assets	25%
Loan to Deposit Ratio	25%

For 2009 as compared to 2008, the Company decreased the weighting for net income from 55% to 25% and added non-performing assets and the loan to deposit ratio in order to underscore management of credit quality, liquidity and deposit growth as primary objectives for the year. Return on equity was also added for 2009 because the Compensation Committee wanted to focus on the efficient use of the Company's capital. In 2009, the Committee added a further requirement for payment under the Incentive

Plan. Because the Committee believed that the Incentive Plan should balance risk-taking with performance, the Committee added a risk-based capital element to the plan. If the total risk-based capital ratio is below 11% at year-end 2009, bonus payments will be reduced by 50%, and if the ratio is below 10%, then bonuses would be reduced to zero.

Performance objectives were generally identified through our annual financial planning and budget process. Senior management developed a financial plan for 2009, and the financial plan was reviewed and approved by the Board of Directors. The Compensation Committee received recommendations from senior management for financial performance objective ranges. The "target" level equated to the approved financial plan. The "threshold" performance level was set at 90% of the target level. In making the determination of the threshold and target levels, the Compensation Committee considered specific circumstances anticipated to be encountered by the Company during the coming year. Generally, the Compensation Committee sets the threshold and target levels such that the relative difficulty of achieving the target level is consistent from year to year. The Compensation Committee believed that targets established for the Incentive Plan in 2009 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 2009, performance was assessed relative to performance objectives for net income, return on equity, nonperforming assets and loan to deposit ratio. These performance objectives are shown below:

	Threshold	Target
Net Income (Loss)	<$3,133,900>	<$2,849,000>
Return on Equity	−1.77%	−1.61%
Non-Performing Assets	$ 38,500,000	$ 35,000,000
Loan/Deposit Ratio	93.1%	84.6%

Upon completion of the 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 up or down 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.

The Company did not reach the "threshold" or "target" performance objectives for any of the financial metrics in 2009. Therefore, none of the named executive officers received a stock award bonus under the Incentive Plan for 2009 performance.

Impact of Capital Purchase Program. The Incentive Plan was initially established as a cash award performance-based plan. As discussed above, however, the Company's participation in the U.S. Treasury Capital Program subjects it to various limitations on executive compensation. Among these limitations is a prohibition on the payment of bonuses to the Company's five highest paid employees. Because of these limitations, bonuses, if earned, under the Incentive Plan for 2009, are payable solely in long-term restricted stock as defined by the U.S. Treasury. Moreover, no bonus may exceed 33% of the named executive officer's annual compensation.

Equity-Based Compensation

We believe 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. Historically, equity compensation has been delivered primarily in the form of stock options.

Under the U.S. Treasury executive compensation restrictions for U.S. Treasury Capital Purchase Program participants, the issuance of stock options is prohibited under the general prohibitions on bonuses for the five highest paid employees of the Company. As such, the Company will utilize long-term restricted stock as necessary and where appropriate to comply with the restrictions. Long-term restricted stock is permitted under the U.S. Treasury restrictions so long as it vests no sooner than in proportion to the Company's redemption of its Series A Preferred Stock held by the U.S. Treasury.

The Compensation Committee is responsible for determining equity grants to all staff members, including named executive officers, and in doing so considers past grants, corporate and individual performance, and recommendations of our Chief Executive Officer for staff members other than himself.

The Company's Amended and Restated 2004 Equity Plan (the "Plan") (approved by our shareholders at the 2008 annual meeting) provides for the grant of non-qualified and incentive stock options, and restricted stock. The Compensation Committee approves all awards under the Plan and acts as the administrator of this Plan.

Stock options provide for financial gain derived from the potential appreciation in stock price from the date that the option is granted until the date that the option is exercised. The exercise price of stock option grants is set at fair market value on the grant date. Under the stockholder-approved Plan, we may not grant stock options at a discount to fair market value or reduce the exercise price of outstanding stock options except in the case of a stock split or other similar event. 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. Stock options vest at a rate not less than 20% per year over five years from the date of grant and expire ten years from the grant date. Generally, options vest over four years. Our long-term performance ultimately determines the value of stock options, because gains from stock option exercises are entirely dependent on the long-term appreciation of our stock price.

The Compensation Committee has established a stock option policy which recognizes that stock options 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 are given the same consideration as any other form of compensation. In consultation with the Jacobs Group and its 2007 report, 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. Stock award levels with the established ranges were determined based on market data. The Compensation Committee has targeted the 75th percentile of the comparative data with respect to these long-term incentive awards. More recently within the last several years, the Compensation Committee has approved 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 do not backdate options or grant options retroactively. In addition, we do not plan to coordinate grants of options so that they are made before announcement of favorable information, or after announcement of unfavorable information. The Company's options 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 its exercise price fairly reflects all material information,without regard to whether the information seems positive or negative, every grant of options 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.

The Company's general practice has been to grant options only on the annual grant date at the Compensation Committee and Board of Directors' regular March meeting for 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. Because of the economic downturn, particularly in the financial services industry, the Committee did not award stock options to the named executive officers in 2008 and 2009, except to Michael Ong, who received stock options when he joined the Company in June 2008.

We believe grants of stock awards encourages executives and other employees to focus on behaviors and initiatives that should lead to an increase in the price of our common stock, which benefits our shareholders.

Retirement Plans

Our Amended and Restated Supplemental Retirement Plan ("SERP") is an important element of our compensation program. We compete for executive talent in our market area where many of our competitors offer supplemental retirement plans. These types of plans have 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 offers key executives participation in the SERP, including some but not all of the named executive officers, the supplemental retirement benefit awarded is 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 is 100% vested in his or her benefit at normal retirement (as defined in the plan). 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 continuing until the death of the participant. For information on the plan, see "Supplemental Retirement Plan for Executive Officers."

Prohibition on Speculation in Company Stock

Our stock trading guidelines prohibit executives 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

The Compensation Committee believes that a change in control transaction, or potential change in control transaction, would create uncertainty regarding the continued employment of our executives. This is because many change in control transactions result in significant organizational changes, particularly at the senior executive level. In order to encourage our executives to remain employed with us during an important time when their continued employment in connection with or following a transaction is often uncertain and to help keep our executives focused on our business rather than on their personal financial security, we believe that providing certain of our executives with severance benefits upon certain terminations of employment is in the best interests of our Company and our shareholders.

The Company does not have company-wide change of control agreements with its executive officers. Instead, the Chief Executive Officer and most of the other named executive officers have specific change of control and severance provisions in their respective employment agreements. 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 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 Messrs. Kaczmarek, McGovern, Ong and Parker 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, in the case of Mr. Kaczmarek vesting of restricted stock, upon a change of control.

Impact of Capital Purchase Program. The change of control provisions along with the other severance arrangements provided in the employment agreements with the named executive officers have been materially adversely affected by the provisions of EESA and ARRA. Each of the named executive officers with employment agreements requires the Company to comply with the provisions of EESA and ARRA, including the limitation on the payment of golden parachute and other severance payments. We have shown 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, 2009 in the "Change in Control Arrangements and Termination of Employment" section in this Proxy Statement.

Tax Considerations

Section 162(m) ("Section 162(m)") of the Internal Revenue Code of 1986, as amended, limits the allowable deduction for compensation paid or accrued with respect to the Chief Executive Officer and each of the four other most highly compensated executive officers of a publicly held corporation to no more than $1 million per year. Certain compensation is exempt from this deduction limitation, including performance-based compensation paid under a plan administered by a committee of outside directors, which has been approved by shareholders. The Company has not previously obtained shareholder approval of performance standards for its compensation plans or arrangements because its executives generally do not have compensation arrangements that would exceed $1 million per year.

In light of Section 162(m), it is the policy of the Compensation Committee to modify, where necessary, 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.

Section 409A ("Section 409A") of the Internal Revenue Code of 1986, as amended, 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 Internal Revenue 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 or 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.

Impact of Capital Purchase Program. While we are a participant in the Capital Purchase Program, no deduction will be claimed for federal income tax purposes for executive compensation that would not be deductible if Section 162(m)(5) were to apply to the Company. This requirement effectively limits deductible compensation paid to the named executive officers to $500,000.

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.

Compensation Committee Report

Compensation Discussion and Analysis. 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.

Risk Assessment of Incentive Compensation Arrangements. In connection with its participation in the U.S. Treasury Capital Purchase Program, the Compensation Committee is required to meet at least every six months with the Company's senior risk officers to discuss and review the relationship between the Company's risk management policies and practices and its SEOs incentive compensation arrangements, identifying and making reasonable efforts to limit any features in such compensation arrangements that might lead to the SEOs taking unnecessary or excessive risks that could threaten the value of the Company. The Compensation Committee, on behalf of the Company, must certify that it has completed the review and taken any necessary actions.

In response to this requirement, the Compensation Committee meets with the senior risk managers of the Company (including its internal auditor, President of Heritage Bank of Commerce, Chief Financial Officer, Chief Credit Officer and Executive Vice President/Credit Risk Management). The Compensation Committee discusses the overall risk structure and the significant risks identified within the Company, and discusses the process by which those present at the meeting analyze the risks associated with the executive compensation program. This process includes, among other things, a review of the Company's programs and discussions with the Compensation Committee's independent compensation consultant about the structure of the Company's overall executive compensation program. This review includes the compensation potential under the Company's incentive plans, the long-term view encouraged by the design and vesting features of the Company's long-term incentive arrangements, and the extent to which the Compensation Committee and the Company's management monitor the program. The Compensation Committee also identifies areas of enterprise risk of the Company and evaluates the degree to which participants in a plan perform functions that have the potential to significantly affect overall enterprise risk. The Compensation Committee then analyzes the extent to which design features have the potential to encourage behaviors that could significantly contribute to enterprise risk.

Our SEOs participate in the following two incentive compensation plans:

- Management Incentive Plan; and
- Amended and Restated 2004 Equity Plan.

Based on its review (the most recent in March 2010), the Compensation Committee has determined that the Company's executive compensation program does not encourage the SEOs to take unnecessary and excessive risks that threaten the value of the Company, and that no changes to these plans were required for this purpose.

- Among the factors the Compensation Committee considered were the following:
  - Our Management Incentive Plan in 2009 imposed a specific dollar maximum amount for each participant, did not rely on a single financial measure in awarding bonuses, and imposed minimum capital ratios that must be satisfied before any bonuses may be paid. To the extent bonuses are earned, they are payable only in long-term restricted stock and are subject to "clawback" provisions.
  - Our 2004 Equity Plan imposes specific ranges of stock option grant limits that apply on an individual basis, and each option grant vests over four years. Vesting has historically been tied to tenure of employment and not tied to Company or individual performance. Stock options are subject to "clawback" provisions.
  - The Compensation Committee generally targets the 75th percentile of peer practice to limit total direct compensation.

In addition to the incentive plans in which the SEO's participate, the Company has incentive plans for other officers and branch employees which reward performance. The Compensation Committee reviewed all non-SEO plans, and concluded that none of them, considered individually or as a group, presented any material threat to our capital or earnings, encouraged taking undue or excessive risks, or encouraged manipulation of financial data in order to increase the size of an award. Under one bonus plan the rewards offered are based on subjective criteria and are not tied directly to Company performance. Another plan that rewards bonuses for cost savings suggested by branch employees that are actually implemented is also not based on Company performance. Several other plans reward loan production, and internal controls with different levels of review and approvals are designed to prevent manipulation to increase an award. Moreover, employees eligible for production bonuses do not have loan approval authority.

Certification. As required by the U.S. Treasury Capital Purchase Program, the Compensation Committee certifies that it has (i) reviewed with senior risk officers the SEO compensation plans and has made all reasonable efforts to ensure that these plans do not encourage SEOs to take unnecessary and excessive risks that threaten the value of the Company; (ii) reviewed with senior risk officers the Company's employee compensation plans and has made all reasonable efforts to limit any unnecessary risks these plans pose to the Company; and (iii) reviewed the Company's employee compensation plans to eliminate any features of these plans that would encourage the manipulation of reported earnings of the Company to enhance the compensation of any employee.

Compensation Committee of the Board

Frank G. Bisceglia
Celeste V. Ford
Robert T. Moles, Chairman
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, one former executive officer who would have been included among the three highest executive officers if the executive had not retired during 2009, 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 2009 (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 ($) (e)	Option Awards ($) (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)
Walter T. Kaczmarek	2009	$333,700	—	—	—	—	$376,600	$ 28,879	$739,179
President & Chief	2008	$332,083	—	—	—	—	$366,800	$ 40,862	$739,745
Executive Officer	2007	$322,217	—	—	$167,750	$115,000	$146,900	$ 45,148	$797,015
Lawrence D. McGovern	2009	$222,000	—	—	—	—	$ 57,100	$ 13,107	$292,207
Executive Vice	2008	$220,833	—	—	—	—	$ 91,800	$ 15,542	$328,175
President & Chief	2007	$213,667	—	—	$100,650	$ 64,000	$ 24,400	$ 19,388	$422,105
Financial Officer									
William J. Del Biaggio, Jr.	2009	$166,800	—	—	—	—	—	$ 14,767	$181,567
Executive Vice	2008	$166,000	—	—	—	—	$ 19,600	$ 16,158	$201,758
President/Marketing &	2007	$161,125	—	—	$ 46,970	$ 46,000	$ 10,800	$ 19,039	$283,934
Community Relations									
James A. Mayer	2009	$ 80,923	—	—	—	—	—	$313,489	$394,412
Executive Vice	2008	$230,449	—	—	—	—	—	$ 22,057	$252,506
President/East Bay Division(6)									
Michael Ong	2009	$240,000	—	—	—	—	—	$ 10,619	$250,619
Executive Vice	2008	$ 84,615	—	—	$ 70,250	—	—	$ 35,290	$190,155
President/Chief Credit Officer(7)									
Raymond Parker	2009	$250,300	—	—	—	—	$249,300	$ 16,418	$516,018
Executive Vice	2008	$249,083	—	—	—	—	$129,100	$ 16,464	$394,647
President/	2007	$241,667	—	—	$100,650	$ 75,000	$ 92,500	$ 20,725	$530,542
Banking Division									

(1) The amounts in column (c) include amounts voluntarily deferred by each of the named executive officers into their 401(k) plan accounts. For 2009, Mr. Kaczmarek deferred $22,000, Mr. Ong deferred $22,000, and Mr. Parker deferred $20,500. Mr. Mayer and Mr. McGovern did not defer any amount in 2009.

(2) No option awards were issued to the named executive officers in 2008 or 2009, except Mr. Ong who received stock options when he joined the Company in 2008. The amounts shown in column (f) reflect the grant date fair value for stock options issued under the Company's 2004 Equity Plan, and are reported for the fiscal year during which the stock options were issued, as determined pursuant to generally accepted accounting principles. The assumptions used in calculating the valuation for option awards may be found in Note 9 to the Company's consolidated financial statements for the year ended

December 31, 2009, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 17, 2010.

(3) No cash awards were paid to the named executive officers for 2008 or 2009 performance. The amounts in column (g) reflect cash awards paid to named executive officers for performance in 2007 under the Management Incentive Plan.

(4) The Company did not adopt or award any new pension or retirement benefits to the named executive officers in 2009. The amounts shown in column (h) for 2009 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, 2008 to December 31, 2009. 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 11 to the Company's consolidated financial statements for the fiscal year ended December 31, 2009 included in the Company's Annual Report on Form 10-K filed with the SEC on March 17, 2010.

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

	Common Stock Dividends Paid on Unvested Restricted Stock	Economic Value of Death Benefit of Life Insurance for Beneficiaries	401(k) Plan Company Matching Contributions	Other Insurance Benefit	Employee Stock Ownership Plan Company Contributions	Vacation	Severance	Auto Compensation
Walter T. Kaczmarek	$510	$14,047	—	$2,322	—	—	—	$12,000
Lawrence D. McGovern . .	—	$ 1,706	—	$1,132	—	$ 4,269	—	$ 6,000
William J. Del Biaggio, Jr.	—	$ 1,057	—	$4,502	—	$ 3,208	—	$ 6,000
James A. Mayer	—	—	—	$2,457	—	$11,032	$300,000	—
Michael R. Ong	—	—	—	$2,219	—	—	—	$ 8,400
Raymond Parker	—	$ 4,454	—	$3,564	—	—	—	$ 8,400

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."

(6) Mr. Mayer retired from the Company effective May 1, 2009. The amount shown in column (i) for Mr. Mayer also includes $300,000 due to Mr. Mayer and payable pro rata over 18 months from the date of termination under the terms of his employment agreement, of which $117,036 had been paid as of December 31, 2009. See "Executive Contracts—James A. Mayer."

(7) Mr. Ong joined the Company in August, 2008.

Executive Contracts

Walter T. Kaczmarek—On October 17, 2007, the Company entered into an Amended and Restated Employment Agreement with Walter T. Kaczmarek. The employment contract is for three years and is automatically renewed each month for three additional years. Under the agreement, Mr. Kaczmarek receives an annual salary of $333,700 with annual increases, if any (last increased in 2008), as determined by the Board of Directors' annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Kaczmarek participates in the Company's 401(k) plan, under which he may receive matching contributions up to $1,000. He also participates in the Company's Employee Stock Ownership Plan. The Company provides Mr. Kaczmarek, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Kaczmarek is provided with life insurance coverage in the amount of two times his then current salary but no more than $700,000. He is provided with long-term care insurance, with a lifetime benefit of up to $432,000. The

Company reimburses Mr. Kaczmarek for up to $1,200 of expenses incurred by him for tax consultation and preparation of tax returns and any excess of insurance coverage for an annual physical examination. Mr. Kaczmarek is reimbursed for monthly dues for one country club 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. Kaczmarek 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 October 17, 2007, the Company entered into an Amended and Restated 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 $222,000 with annual increases, if any (last increased in 2008), as determined by the Company's Chief Executive Officer and Board of Directors' 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 $1,000. 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 more than $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."

James A. Mayer—The Company entered into a three year employment agreement with Mr. Mayer that became effective on the effective date of the acquisition of Diablo Valley Bank. On May 1, 2009, Mr. Mayer retired from the Company. His employment agreement provided for an annual base salary of $220,000 for the first 12 months, $240,000 for the second 12 months and $250,000 for the third 12 months. The agreement provided that, at the end of 18 months, Mr. Mayer had the opportunity for a 30 day period to terminate the agreement and his employment with 30 days prior written notice and, from the effective date of termination, he would receive a severance amount of $300,000 payable pro rata over the next following 18 months. On December 11, 2008, the Company and Mr. Mayer modified the employment agreement to provide that the agreement would be in effect until May 1, 2009 and upon termination Mr. Mayer would receive the severance amount set forth in his original agreement of $300,000 payable in 18 monthly payments commencing June 1, 2009. In addition to his salary, Mr. Mayer was eligible to participate in the Management Incentive Plan. Mr. Mayer also participated in other benefit programs offered to executives of the Company. Mr. Mayer has also entered into a three year non-competition, non-solicitation and confidentiality agreement with the Company that commenced upon the acquisition of Diablo Valley Bank on June 20, 2007. Mr. Mayer agreed to forgo an amount equal to 12 months of his salary due to him for severance under his employment agreement with Diablo Valley Bank and agreed to terminate the employment agreement.

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

Michael R. Ong—On August 12, 2008, the Company entered into an Employment Agreement with Michael R. Ong. The employment contract is for one year and is automatically renewed annually for one year terms. Under the Agreement, Mr. Ong receives an annual salary of $240,000 with annual increases, if any, as determined by the Company's Chief Executive Officer and Board of Directors' annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Ong participates in the Company's 401(k) plan, under which he may receive a matching contribution up to $1,000. He also participates in the Company's Employee Stock Ownership Plan. The Company provides to Mr. Ong, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Ong is also reimbursed for monthly dues for one country club membership. He also receives an automobile allowance in the amount of $700 per month, together with reimbursements for gasoline expenditures. Mr. Ong is provided with life insurance coverage in the amount of two times his salary but no more than $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. Ong 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."

Raymond Parker—On October 17, 2007, the Company entered into an Amended and Restated Employment Agreement with Raymond Parker. The employment contract is for one year and is automatically renewed for one year terms. Under the agreement, Mr. Parker receives an annual salary of $250,300 with annual increases, if any (last increased in 2008), as determined by the Company's Chief Executive Officer and Board of Directors' annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Parker participates in the Company's 401(k) plan, under which he may receive matching contributions up to $1,000. He also participates in the Company's Employee Stock Ownership Plan. The Company provides to Mr. Parker, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Parker is also reimbursed for monthly dues for membership at one country club. He also receives an automobile allowance in the amount of $700 per month, together with reimbursements for gasoline expenditures. Mr. Parker 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. Parker 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."

Executive Employment Agreements and Emergency Economic Act of 2008 and American Recovery and Reinvestment Act of 2009. All of the executive officer employment agreements provide that the payment of any amounts under the agreement are subject to the requirements of EESA and ARRA and any regulations promulgated thereunder by the U.S. Treasury so long as the U.S. Treasury owns the Company's Series A Preferred Stock.

Plan Based Awards

Stock Based Plans. In 1994, the Board of Directors adopted the Heritage Bank of Commerce 1994 Tandem Stock Option Plan (the "1994 Stock Option Plan") in order to promote the long-term success of the Company and the creation of shareholder value. The 1994 Stock Option Plan expired on June 8, 2004. 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 1994 Stock Option Plan and 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.

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. No bonuses were paid to the named executive officers for 2008 or 2009 performance. 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 2009 for each of the Company's named executive officers under the Company's Management Incentive Plan. No stock options or other stock awards were granted to the named executive officers in 2009.

Grants of Plan-Based Awards

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)			Estimated Future Payouts Under Equity Incentive Plan Awards						
Name (a)	Grant Date (b)	Threshold ($) (c)	Target ($) (d)	Maximum ($) (e)	Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)	All Other Stock Awards: Number of Shares of Stock or Units (#) (i)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards ($/Sh) (k)	Grant Date Fair Value of Stock and Options Awards (l)
Walter T. Kaczmarek	3/26/2009	$50,055	$110,121	—	—	—	—	—	—	—	—
Lawrence D. McGovern	3/26/2009	$33,300	$ 73,260	—	—	—	—	—	—	—	—
William J. Del Biaggio, Jr.	3/26/2009	$25,020	$ 55,044	—	—	—	—	—	—	—	—
James A. Mayer(2)	3/26/2009	$36,000	$ 79,200	—	—	—	—	—	—	—	—
Michael R. Ong	3/26/2009	$36,000	$ 79,200	—	—	—	—	—	—	—	—
Raymond Parker	3/26/2009	$37,545	$ 82,599	—	—	—	—	—	—	—	—

(1) These potential performance-based awards were established under the Management Incentive Plan if the indicated level of performance was achieved in 2009 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. No payments were paid in 2009 to the named executive officers for 2009 performance.

(2) Mr. Mayer retired from the Company effective May 1, 2009.

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, 2009:

Plan Category	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	1,110,056(1)	$16.93	778,508
Equity compensation plans not approved by security holders	25,500(2)	$18.15	N/A
Equity compensation plans not approved by security holders	462,963(3)	$12.96	N/A

(1) Consists of 150,969 options to acquire shares of common stock issued under the Company's 1994 Stock Option Plan, and 959,087 options to acquire shares under the Company's 2004 Equity Plan.

(2) Consists of restricted stock issued to the Company's Chief Executive Officer pursuant to a restricted stock agreement dated March 17, 2005.

(3) Consists of warrant issued to the U.S. Treasury on November 21, 2008 to purchase 462,963 shares of the Company's common stock. The warrant is immediately exercisable and has a 10 year term with an initial exercise price of $12.96.

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, 2009.

Outstanding Equity Awards at Year End

Name (a)	Option Awards: Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Option Awards: Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Option Awards: Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) (d)	Option Awards: Options Exercise Price ($) (e)	Option Awards: Options Expiration Date (f)	Stock Awards: Number of Shares or Units of Stock That Have Not Vested (#) (g)(1)	Stock Awards: Market Value of Shares or Units of Stock That Have Not Vested ($) (h)(2)	Stock Awards: Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) (i)	Stock Awards: Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($) (j)
Walter T. Kaczmarek	—	—	—	—	—	25,500	$102,510	—	—
	50,000	—	—	$18.15	3/17/2015	—	—	—	—
	17,054	2,946(3)	—	$23.85	8/3/2016	—	—	—	—
	16,626	8,374(4)	—	$23.89	5/4/2017	—	—	—	—
Lawrence D. McGovern	9,000	—	—	$ 9.51	4/25/2012	—	—	—	—
	7,500	—	—	$14.11	5/27/2014	—	—	—	—
	8,000	—	—	$20.00	8/11/2015	—	—	—	—
	8,527	1,473(5)	—	$23.85	8/3/2016	—	—	—	—
	9,976	5,024(6)	—	$23.89	5/4/2017	—	—	—	—
William J. Del Biaggio, Jr.	7,500	—	—	$ 8.50	10/24/2012	—	—	—	—
	2,500	—	—	$18.01	5/26/2015	—	—	—	—
	4,689	811(7)	—	$23.85	8/3/2016	—	—	—	—
	4,656	2,344(8)	—	$23.89	5/4/2017	—	—	—	—
James A. Mayer	—	—	—	—	—	—	—	—	—
Michael R. Ong	8,441	16,559(9)	—	$11.15	8/25/2018	—	—	—	—
Raymond Parker	25,000	—	—	$18.65	5/16/2015	—	—	—	—
	5,000	—	—	$20.00	8/11/2015	—	—	—	—
	10,232	1,768(10)	—	$23.85	8/3/2016	—	—	—	—
	9,976	5,024(11)	—	$23.89	5/4/2017	—	—	—	—

(1) Restricted stock issued to Mr. Kaczmarek pursuant to a restricted stock agreement dated March 17, 2005 entered into when Mr. Kaczmarek joined the Company. The restricted stock shares vest 25% per year at the end of years three, four, five and six.

(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, 2009 as reported on The NASDAQ Global Select Market, which was $4.02.

(3) The options vest daily over 4 years beginning 8/3/2006 and have a term of 10 years.

(4) The options vest daily over 4 years beginning 5/4/2007 and have a term of 10 years.

(5) The options vest daily over 4 years beginning 8/3/2006 and have a term of 10 years.

(6) The options vest daily over 4 years beginning 5/4/2007 and have a term of 10 years.

(7) The options vest daily over 4 years beginning 8/3/2006 and have a term of 10 years.

(8) The options vest daily over 4 years beginning 5/4/2007 and have a term of 10 years.

(9) The options vest daily over 4 years beginning 8/25/2008 and have a term of 10 years.

(10) The options vest daily over 4 years beginning 8/3/2006 and have a term of 10 years.

(11) The options vest daily over 4 years beginning 5/4/2007 and have a term of 10 years.

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, 2009, 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)
Walter T. Kaczmarek	—	—	12,750	$63,495
Lawrence D. McGovern	—	—	—	—
William J. Del Biaggio, Jr.	—	—	—	—
James A. Mayer(1)	—	—	—	—
Michael R. Ong	—	—	—	—
Raymond Parker	—	—	—	—

(1) Mr. Mayer retired from the Company effective May 1, 2009.

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 may match up to $1,000 of each employee's contributions. 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 59-1/2, 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. The Company may discontinue its contributions at any time. 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 executives, 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. The participant is 100% vested in his or her benefit at normal 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 normal retirement age in accordance with the Plan terms.

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 continuing until the death of the participant.

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 and continuing until the death of the participant.

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 five percent 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, and continuing until the death of the participant.

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, and continuing until the death of the participant. In the event payments commence prior to the participant's normal retirement age, then the benefit due to the participant will be reduced by five percent for each year (or partial year) that the participant's benefit is paid prior to the participant's normal retirement age.

Company-owned split-dollar life insurance policies support the Company's obligations under the SERP. 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 of the named executive officers, including the number of service years credited to each named executive officer under the supplemental executive retirement plan:

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	Heritage Commerce Corp SERP	5	$1,292,700	—
Lawrence D. McGovern	Heritage Commerce Corp SERP	11	$ 401,200	—
William J. Del Biaggio, Jr. . . .	Heritage Commerce Corp SERP	16	$ 152,700	$15,150
James A. Mayer(3)	Heritage Commerce Corp SERP	—	—	—
Michael R. Ong(4)	Heritage Commerce Corp SERP	—	—	—
Raymond Parker	Heritage Commerce Corp SERP	5	$ 674,000	—

(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 11 to the Company's consolidated financial statements for the fiscal year ended December 31, 2009, included in the Company's Annual Report on Form 10-K filed with the SEC on March 17, 2010.

(2) The following vesting percentages apply to the named executive officers:

End of the year prior to termination	Walter T. Kaczmarek	Lawrence D. McGovern	William J. Del Biaggio, Jr.	James A. Mayer	Michael R. Ong	Raymond Parker
12/31/2009	48%	100%	100%	N/A	N/A	75%
12/31/2010	60%	100%	100%	N/A	N/A	90%
12/31/2011	72%	100%	100%	N/A	N/A	100%
12/31/2012	84%	100%	100%	N/A	N/A	100%
12/31/2013	100%	100%	100%	N/A	N/A	100%

(3) Mr. Mayer retired from the Company effective May 1, 2009 and did not participate in the SERP.

(4) Mr. Ong does not participate in the SERP.

Management Deferral 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 "Code"). 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 ("ERISA"). The executive may elect to defer up to 100% of any bonus and 50% of any regular salary into the Management Deferral Plan. Amounts deferred are invested in a portfolio of approved investment choices as directed by the executive. Under the Management Deferral 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. To date, none of the Company executive officers have elected to participate in the plan.

Change of Control Arrangements and Termination of Employment

In connection with the Company's participation in the U.S. Treasury's Capital Purchase Program, the Company agreed that, until such time as the U.S. Treasury ceases to own the Series A Preferred Stock acquired under the program, the Company will take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply with Section 111(b) of EESA and agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with EESA. The subsequent enactment of ARRA, and issuance of rules and regulations issued by the U.S. Treasury in June, 2009, has amended, and in some cases expanded upon, provisions of Section 111(b) of EESA. These provisions prohibit any payment of golden parachutes (as defined by the U.S. Treasury regulation) to the named executive officers or the five next highly-compensated employees for departure from our Company for any reason, except for death, disability or payments for services performed or benefits accrued.

The descriptions that follow reflect the post-termination benefits that the named executive officers would otherwise be entitled to, but for, in the case of some, the restrictions under EESA and ARRA.

Stock Option Plans. Each of the named executives holds options granted under the 2004 Equity Plan and/or the 1994 Stock Option 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.

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 five percent 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, and continuing until the death of the participant. 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, and continuing until the death of the participant. In the event payments commence prior to the participant's normal retirement age, then the benefit due to the participant will be reduced by five percent for each year (or partial year) that the participant's benefit is paid prior to the participant's normal retirement age.

Mr. Kaczmarek's Employment Agreement. If Mr. Kaczmarek's employment is terminated without cause or he resigns for good reason, he will be entitled to a lump sum payment equal to two times his base salary and his highest annual bonus in the last three years. If he is terminated or he resigns for good reason 120 days before, or within two years after, a change of control, he will be paid a lump sum of 2.75 times his base salary and highest 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, 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. In the event that the amounts payable to Mr. Kaczmarek under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986 that are subject to an excise or similar tax, the amounts payable to Mr. Kaczmarek 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. 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. 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. In the event that 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 1.5 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, or as a result of a change of control the Company terminates his employment or he resigns, 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. In the event that the amounts payable to Mr. McGovern under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986 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.

Mr. Mayer's Employment Agreement. On May 1, 2009, Mr. Mayer retired from the Company. On December 11, 2008, the Company and Mr. Mayer modified his employment agreement which provided that the employment agreement would remain in effect until May 1, 2009, at which time Mr. Mayer's employment would terminate. Under the terms of the modification, Mr. Mayer receives the severance amount set forth in his original employment agreement of $300,000 payable in 18 equal monthly payments of $16,666 per month. If Mr. Mayer was otherwise terminated before May 1, 2009 without cause or terminated in connection with a change in control, he would have been entitled to accrued salary and benefits and a lump sum severance payment equal to the greater of (x) 12 months of base salary then in effect, plus the highest annual bonus paid or payable during the term of the agreement (not to exceed $100,000), and (y) an amount equal to the number of months remaining on the term of the agreement at the time of termination multiplied by the base salary in effect at the time of termination. Additionally, following the termination of his employment, Mr. Mayer agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located at its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees or customers.

Mr. Ong's Employment Agreement. If Mr. Ong's employment agreement is terminated without cause, he will be entitled to a lump sum payment equal to one times each of his base salary and his highest annual bonus in the last three years. In the event that Mr. Ong'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 highest annual bonus in the last three years. If the employment agreement is terminated by the Company without cause, his participation in group insurance coverage would 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. Ong's employment is terminated as a result of a change in control, or he resigns, these benefits will continue for an additional 24 months from the date of termination. In the event that the amounts payable to Mr. Ong under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986 that are subject to an excise or similar tax, the amounts payable to Mr. Ong 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. Ong 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. Parker's Employment Agreement. If Mr. Parker's employment is terminated without cause, he will be entitled to a lump sum payment equal to one times his base salary and his highest annual bonus in the last three years. In the event that Mr. Parker'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 highest annual bonus in the last three years. If the 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. Parker's employment is terminated by the Company as a result of a change in control, or he resigns, these benefits will continue for an additional 24 months from the date of termination. In the event that the amounts payable to Mr. Parker under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986 that are subject to an excise or similar tax, the amounts payable to Mr. Parker 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. Parker 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. Kaczmarek's Restricted Stock Agreement. On March 17, 2005, the Company entered into a restricted stock agreement pursuant to which Mr. Kaczmarek was granted 51,000 shares of common stock. The restricted stock vests 25% each year at the end of years three, four, five and six, provided Mr. Kaczmarek is still with the Company. The restricted stock becomes fully vested upon a change of control, disability, death, termination of employment by the Company without cause, or termination of employment by Mr. Kaczmarek for good reason.

The following tables summarize the payments which would be payable to our named executive officers in the event of various termination scenarios. 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.

In accordance with the executive compensation limitations under ARRA, a portion of the payments reflected in the tables may fall within the U.S. Treasury's definition of a prohibited "golden parachute payment", and would therefore not be payable (and therefore have no value) in the event of a named executive officer's covered termination so long as we are participating in the U.S. Treasury Capital Purchase Program.

	Change in Control	Involuntary Termination Without Cause	Termination for Good Reason	Death	Disability
Walter T. Kaczmarek					
Cash severance under employment agreement	$1,448,425	$1,053,400	$1,053,400	$ —	$ —
Health and life insurance premiums	50,129	50,129	50,129	—	—
Health and life insurance benefits	—	—	—	667,400	180,000(4)
Long-term care insurance benefits	—	—	—	—	72,000
Supplemental executive retirement plan(1)(2)(3)	1,405,821	648,841	648,841	—	1,237,672
Unvested restricted stock awards (accelerated)	102,510	102,510	102,510	102,510	102,510
Split-dollar death benefits (upon death)	—	—	—	2,701,276	—
Outplacement services (layoff)	5,000	—	—	—	—
IRC 280(g) excise tax gross-up	1,424,100	—	—	—	—
Total:	$4,435,985	$1,854,880	$1,854,880	$3,471,186	$1,592,182

	Change in Control	Involuntary Termination Without Cause	Termination for Good Reason	Death	Disability
Lawrence D. McGovern					
Cash severance under employment agreement	$ 492,000	$ 328,000	$ —	$ —	$ —
Health and life insurance premiums	24,021	24,021	—	—	—
Health and life insurance benefits	—	—	—	444,000	147,984(4)
Long-term care insurance benefits	—	—	—	—	72,000
Split-dollar death benefits (upon death)	—	—	—	1,058,068	—
Total:	$ 516,021	$ 352,021	$ —	$1,502,068	$ 219,984
William J. Del Biaggio, Jr.					
Health and life insurance benefits	$ —	$ —	$ —	$ 333,600	$ 111,192(5)
Long-term care insurance benefits	—	—	—	—	72,000
Split-dollar death benefits (upon death)	—	—	—	105,779	—
Total:	$ —	$ —	$ —	$ 439,379	$ 183,192
James A. Mayer(6)					
Cash severance under employment agreement	$ 330,000	$ 330,000	$ —	$ —	$ —
Health and life insurance benefits	—	—	—	480,000	159,984(5)
Long-term care insurance benefits	—	—	—	—	72,000
Total:	$ 330,000	$ 330,000	$ —	$ 480,000	$ 231,984
Michael R. Ong					
Cash severance under employment agreement	$ 480,000	$ 240,000	$ 480,000	$ —	$ —
Health and life insurance premiums	33,420	16,710	—	—	—
Health and life insurance benefits	—	—	—	480,000	159,984(4)
Long-term care insurance benefits	—	—	—	—	72,000
Split-dollar death benefits (upon death)	—	—	—	—	—
Total:	$ 513,420	$ 256,710	$ 480,000	$ 480,000	$ 231,984

	Change in Control	Involuntary Termination Without Cause	Termination for Good Reason	Death	Disability
Raymond Parker					
Cash severance under employment agreement	$ 760,600	$ 380,300	$ —	$ —	$ —
Health and life insurance premiums	33,420	16,710	—	—	
Health and life insurance benefits	—	—	—	500,600	166,848(4)
Long-term care insurance benefits	—	—	—	—	72,000
Supplemental executive retirement plan(1)(3)	227,939	—	—	—	213,351
Split-dollar death benefits (upon death)	—	—	—	684,213	—
IRC 280(g) excise tax gross-up	412,342	—	—	—	—
Total:	$1,434,301	$ 397,010	$ —	$1,184,813	$ 452,199

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

(2) If Mr. Kaczmarek terminates his employment for good reason or he is terminated without cause, he is entitled to be credited with two additional years of service.

(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 if necessary. This long-term payment would begin after an elimination period and a twelve week short-term disability period. This long-term disability payment will increase by 6% (cost of living adjustment) over the first five years of payments and cease at age 65.

(5) This payment represents one year of benefits. The second year would increase 6% (cost of living adjustment). Only two years of payments are granted since the executive is currently over 65 years old.

(6) Mr. Mayer retired from the Company effective May 1, 2009. The information in the table assumes Mr. Mayer’s employment ended December 31, 2009. Under the terms of his employment agreement, he is entitled to a severance payment of $300,000 payable in 18 equal monthly payments commencing June 1, 2009.

Director Compensation

This section provides information regarding the compensation policies for non-employee directors and amounts paid to these directors in 2009. Mr. Kaczmarek does not receive any separate compensation for his service as 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 2009, each Board member received an annual retainer of $27,000. The chairman of the Board and the chairmen of the Board's various committees received an additional retainer, as follows:

Audit Committee, Investment Committee and Loan Committee	$3,500
Compensation Committee	$3,000
All other committees	$2,500
Chairman of the Board	$8,500

In 2009, committee members and committee chairmen received meeting fees for each meeting attended as follows:

	Chairman	In Person	Telephonic
Audit Committee, Investment Committee and Loan Committee	$1,100	$1,000	$500
Compensation Committee	$1,000	$ 900	$450
All other committees	$ 900	$ 800	$400

For 2010, the Board of Directors approved the recommendation of the Compensation Committee to restructure the cash compensation paid to directors. In 2010, each director will receive an annual retainer fee of $45,000. The chairman of each standing committee of the Board will receive an additional $3,000 per year, and the Chairman of the Board will receive an additional $5,000 per year. Fees will no longer be paid for attending Board or committee meetings.

In addition to providing cash compensation, the Compensation Committee also believes in granting equity compensation to non-employee directors in order to further align their interests with those of shareholders and has adopted a policy of granting stock options to directors.

Directors are entitled to annual grants of stock options as follows:

Board Chairman	4,500 - 5,500
Committee Chairman	3,500 - 4,500
Board members (non-chairman)	3,000 - 4,000

In 2009, each of the directors received stock options in accordance with the above schedule, except Celeste V. Ford who received a grant of 7,500 stock options in view of her first year on the Board.

Director Fee Deferral Plan

Directors may defer their fees through deferred compensation agreements ("Deferral Agreements"). Under the Deferral Agreements, a participating director may defer up to 100% of his or her board fees into a deferred account. In 2008, amounts deferred earned interest at the rate of 8% per annum. For 2009 and each year thereafter, the applicable rate of interest will be the prime rate published by the Wall Street Journal on the immediately preceding December 31st. For 2009, the rate of interest was 3.25%. A participating director is eligible to begin receiving benefits upon termination of service on the Board for any reason including death or disability.

The Company has purchased life insurance policies on the lives of directors who have Deferral Agreements. It is expected that the earnings on these policies will offset the cost of the agreements. In addition, the Company will receive death benefit payments upon the death of the director. The proceeds will permit the Company to make the deferred payment as originally intended if the director dies prior to the completion of the Deferral Agreement.

To date, one of our former directors, James R. Blair (who resigned effective January 1, 2010) is the only director who had a Deferral Agreement. For the years 2007, 2008, and 2009 the Company accrued expenses of $78,000, $83,000, and $54,000, respectively, to account for its obligation to pay deferred fees and related interests under Mr. Blair's agreement.

The following table summarizes the compensation of non-employee directors for the year ended December 31, 2009.

Director Compensation Table

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Options Awards ($) (d)(1)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (f)(2)	All Other Compensation ($) (g)	Total ($) (h)
Frank G. Bisceglia	$69,704	—	$11,305	—	—	$ 731(3)	$ 81,740
James R. Blair(4)	$28,500	—	$11,305	—	$ 8,100	$ 800(3)	$ 48,705
Jack W. Conner	$52,800	—	$17,765	—	$ 9,300	$ 3,119	$ 82,984
Celeste V. Ford	$24,750	—	$11,400	—	—	—	$ 36,150
John J. Hounslow	$56,650	—	$ 9,690	—	—	$244,987(5)	$311,327
Mark E. Lefanowicz	$40,500	—	$ 9,690	—	—	—	$ 50,190
Robert T. Moles	$53,550	—	$11,305	—	$11,900	—	$ 76,755
Humphrey P. Polanen	$39,304	—	$11,305	—	$22,500	$ 680(3)	$ 73,789
Charles J. Toeniskoetter	$51,296	—	$11,305	—	—	$ 705(3)	$ 63,306
Ranson W. Webster	$42,088	—	$11,305	—	$ 7,800	$ 307(3)	$ 61,500

(1) The amounts shown in column (d) reflect the grant date fair value for stock options issued under the Company's 2004 Equity Plan in 2009, as determined pursuant to generally accepted accounting principles. See Note 9 to the Company's consolidated financial statements for the year ended December 31, 2009, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 17, 2010.

(2) The amounts shown in column (f) represent only the aggregate change in the actuarial present value of the accumulated benefit measured from December 31, 2008 to December 31, 2009 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 includes 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 11 to the Company's consolidated financial statements for the year ended December 31, 2009, included in the Company's Annual Report on Form 10-K filed with the SEC on March 17, 2010.

(3) 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.

(4) Mr. Blair resigned from the Board effective January 1, 2010.

(5) Includes $160,000 paid to Mr. Hounslow under his consulting agreement and $79,986 under his non-competition, non-solicitation and confidentiality agreement with the Company in 2009. See "Transactions with Management—John J. Hounslow Agreements" for discussions of these agreements. Also includes $5,001 for leased automobile payments in 2009.

Director Outstanding Stock Options

Each of the non-employee directors owned the following stock options granted under the 1994 Stock Option Plan and/or 2004 Equity Plan as of December 31, 2009:

Director	Stock Options
Frank G. Bisceglia	21,300
James R. Blair(1)	12,800
Jack W. Conner	23,800
Celeste V. Ford	7,500
John J. Hounslow	7,000
Mark E. Lefanowicz	7,000
Humphrey P. Polanen	16,300
Charles J. Toeniskoetter	28,800
Ranson W. Webster	21,300

(1) Mr. Blair resigned from the Board effective January 1, 2010, and, subsequent to December 31, 2009, the terms of the stock options issued to Mr. Blair expired.

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 Benefits 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. All of the participating directors are fully vested, except Jack W. Conner, Robert T. Moles, Charles J. Toeniskoetter, and Ranson W. Webster.

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).

Proxy Statement

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	Director Benefit Agreement	16	$182,200	$—
James R. Blair(3)	Director Benefit Agreement	16	$186,400	$—
Jack W. Conner	Director Benefit Agreement	5	$ 33,800	$—
Robert T. Moles	Director Benefit Agreement	5	$ 50,800	$—
Humphrey P. Polanen	Director Benefit Agreement	16	$194,600	$—
Charles J. Toeniskoetter	Director Benefit Agreement	8	$ 77,600	$—
Ranson W. Webster	Director Benefit Agreement	6	$ 44,100	$—

(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 11 to the Company's consolidated financial statements for the fiscal year ended December 31, 2009 included in the Company's Annual Report on Form 10-K filed with the SEC on March 17, 2010.

(2) The following vesting percentages apply to the directors:

End of the year prior to termination	Frank G. Bisceglia	James R. Blair	Jack W. Conner	Robert T. Moles	Humphrey P. Polanen	Charles J. Toeniskoetter	Ranson W. Webster
12/31/2009	100%	100%	60%	60%	100%	80%	60%
12/31/2010	100%	100%	70%	70%	100%	90%	70%
12/31/2011	100%	100%	80%	80%	100%	100%	80%
12/31/2012	100%	100%	90%	90%	100%	100%	90%
12/31/2013	100%	100%	100%	100%	100%	100%	100%

(3) Mr. Blair resigned from the Board effective January 1, 2010.

PROPOSAL 1—ELECTION OF DIRECTORS

The Bylaws of the Company provide that the number of directors shall not be less than 11 nor more than 21. By resolution, the Board of Directors has fixed the number of directors at 11. 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 of Directors, upon the recommendation of the Corporate Governance and Nominating Committee, has recommended the nomination of the 10 current members of the Board of Directors for one year terms that will expire at the Annual Meeting to be held in 2011. The Board has one vacancy which the Corporate Governance and Nominating Committee and Board of Directors may fill before the 2011 Annual Meeting.

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 person nominated and recommended to be elected to the Board of Directors:

FRANK G. BISCEGLIA, age 64, 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 Investment Management from San Jose State University. Mr. Bisceglia contributes to the Board a substantial understanding of finance and investments from over 31 years of experience as a financial advisor to corporate and high-wealth individuals. As a long-term member of the Board and its 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.

JACK W. CONNER, age 70, 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 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.

CELESTE V. FORD, age 53, became a director of the Company in 2009. Since 1995, Ms. Ford has served as the Chief Executive Officer of Stellar Solutions, Inc., a professional aerospace engineering services firm she formed. In 2000, she founded Stellar Ventures, a venture investment company for investment in early-stage technology development and market applications. In 2000, Ms. Ford co-founded QuakeFinder, LLC to research, develop and market technology to enable global forecasts of seismic activity. In 2004, she organized Stellar Solutions Aerospace Ltd., based in London, to serve overseas markets. Ms. Ford has received wide recognition in her field, having served on congressional commissions in the aerospace industry as well as on business panels focusing on entrepreneurship and women in business. She previously served as a member of the Boards of Directors of Foundry Networks, Bay Microsystems, Women’s High Tech Coalition, and California Space Authority. Ms. Ford has a Bachelor of

Science degree from the University of Notre Dame, and a Masters of Science degree from Stanford University. Ms. Ford contributes to the Board her demonstrated executive leadership and general business knowledge developed from her substantial success as an entrepreneur. Her engineering background, industry standing and government service bring a unique perspective to the Board.

JOHN J. HOUNSLOW, age 79, became a director of the Company in 2007. Mr. Hounslow is the former Chairman of the Board of Diablo Valley Bank. Mr. Hounslow is a former director of Greater Bay Bank (2000-2003), and was the founding Chairman and Chief Administration Officer of Mount Diablo National Bank (1995-2000). Mr. Hounslow also has over 40 years of senior management experience at various computer, natural resources and energy companies. Mr. Hounslow has a Bachelor of Science degree from State University of New York, and a Masters in Business Administration degree from Syracuse University Graduate School of Business. Mr. Hounslow contributes to the Board a depth of knowledge of the community banking industry and board practices of other community banks developed as a founder, executive, chairman and director at several financial institutions. His knowledge and involvement in the East Bay community are of particular value to the Board.

WALTER T. KACZMAREK, age 58, became President, Chief Executive Officer and a director of the Company in 2005. Mr. Kaczmarek was Executive Vice President of Comerica Bank and of Plaza Bank of Commerce from 1990 to 2005. Prior to joining Plaza Bank of Commerce he served in various positions with Union Bank of California and also The Martin Group, a real estate investment development company. Mr. Kaczmarek contributes to the Board his breadth of knowledge of the Company's business, industry and strategy. Mr. Kaczmarek has a Bachelor of Science degree from Santa Clara University, and a Masters in Business Administration degree from San Jose State University. He brings to the Board a full understanding of the Company's banking 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. Mr. Kaczmarek's leadership, communication, and decision-making skills are of particular value to the Board.

MARK E. LEFANOWICZ, age 53, became a director of the Company in 2007. Mr. Lefanowicz is the Chief Financial Officer for Provident Funding Associates, a national direct mortgage lender. From 2004 through 2008, he was the President of E-Loan. From June 2001 through June 2004, Mr. Lefanowicz was the Chief Executive Officer of Bay View Franchise Mortgage Acceptance Co., a commercial loan servicing company. From July 2000 to June 2001, Mr. Lefanowicz was the Executive Vice President and Chief Financial Officer for Bay View Capital Corporation, a diversified financial services company and holding company for Bay View Bank. Mr. Lefanowicz held positions of increasing responsibility with Coopers & Lybrand, now part of PricewaterhouseCoopers, for 12 years, including the position of National Partner of Internal Audit Services. Mr. Lefanowicz is a former director of Diablo Valley Bank. Mr. Lefanowicz has a Bachelor of Science degree from the University of Wyoming. Mr. Lefanowicz contributes to the Board a breadth of knowledge of accounting and auditing, and the preparation of financial statements developed over 30 years as a certified public accountant, partner in a major accounting firm, and Chief Financial Officer for various financial institutions. His executive experience in Internet lending and mortgage lending servicing brings added perspective to the Board. With his background, the Board has designated Mr. Lefanowicz as the "financial expert" on the Audit Committee.

ROBERT T. MOLES, age 55, 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, the Board elected him as Chairman of the Compensation Committee.

HUMPHREY P. POLANEN, age 60, became a director of the Company in 1994. Mr. Polanen is the managing member of Sand Hill Management Partners LLC and Sand Hill Security LLC and the general partner of Dynamic Technology Ventures LP, each a private equity investment fund. Since 1999, Mr. Polanen has been actively involved as an investor and director in various venture capital-backed companies in the technology industry, and has served as a director of various private equity funds. He was the Managing Director of Internet Venture Partners BV, an investment firm, from 2000 to 2004. Prior to joining Internet Ventures he served in various executive positions with Sun Microsystems and Tandem Computers. Mr. Polanen is a director (and former Chairman of the Board) of St. Bernard Software, a publicly traded Internet security company. Mr. Polanen practiced corporate law for over 10 years at the beginning of his career. He has a Bachelor of Arts degree from Hamilton College and a Juris Doctorate degree from Harvard University. Mr. Polanen contributes to the Board a sophisticated knowledge and effective leadership perspective of general business, finance, investments and financial reporting developed over 30 years of experience as an executive, investor, director and business manager with advanced technology companies and private equity firms. He provides the Board with an important perspective on the technology industry. With his background, the Board elected him as Chairman of the Audit Committee.

CHARLES J. TOENISKOETTER, age 65, became a director of the Company in 2002. Mr. Toeniskoetter is Chairman of the Board of Toeniskoetter & Breeding, Inc., Development, a Silicon Valley real estate development and investment company. He is a member of the Board of Directors of Redwood Trust, Inc. and SJW Corp. (both New York Stock Exchange companies). Mr. Toeniskoetter has a Bachelor of Science degree from the University of Notre Dame and a Master of Business Administration degree from Stanford University. Mr. Toeniskoetter contributes to the Board his entrepreneurial skills and substantial experience as a successful real estate owner, developer and investor, and his executive and financial experience as the owner of several businesses in the Company's primary market. Mr. Toeniskoetter's involvement in local and community affairs, and his service on the boards of two other publicly traded companies provide valuable insight and perspective to the Board.

RANSON W. WEBSTER, age 65, became a director of the Company in 2004. Mr. Webster founded Computing Resources, Inc. ("CRI") in 1978, a privately-held general purpose service bureau specializing in automating accounting functions. 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. Mr. Webster contributes to the Board a 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 as one of its founders and 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.

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—ADVISORY VOTE ON EXECUTIVE COMPENSATION

The Company's executive compensation program is intended to attract, motivate, reward and retain the senior management talent required to achieve our corporate objectives and increase shareholder value. We believe that our compensation policies and procedures are centered on a pay-for-performance philosophy and are strongly aligned with the long-term interests of our shareholders. See "Executive Compensation—Compensation Discussion and Analysis."

Under the American Recovery and Reinvestment Act of 2009, as a participant in the Capital Purchase Program we are required to provide shareholders with the right to cast an advisory vote on our compensation program at each annual meeting of shareholders. As a result, 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 compensation of our executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosures contained in the proxy statement."

The Board of Directors recommends that shareholders endorse the compensation program for our executive officers by voting FOR the above resolution. 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 2009 was reasonable and appropriate, and was the result of a carefully considered approach.

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 by 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 Compensation Committee will consider the non-binding vote of our shareholders to this proposal when reviewing compensation policies and practices in the future.

Required Shareholder Vote

The proposal must be approved by a majority of the shares present and voting in person or by proxy at the Annual Meeting.

Recommendation of the Board of Directors

The Board of Directors recommends a vote for this Advisory Proposal on Executive Compensation. 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—AMENDMENT TO ARTICLES OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK FROM 30,000,000 TO 60,000,000

The Board of Directors has adopted resolutions to amend our Articles of Incorporation to increase the number of authorized shares of our common stock from 30,000,000 to 60,000,000. The Board of Directors is proposing the amendment to our shareholders for their approval at the Annual Meeting.

The form of the proposed amendment to our Articles of Incorporation to effect the increase in our authorized shares of common stock is attached to this proxy statement as Exhibit A.

Background and Reasons for the Amendment

Our Articles of Incorporation currently authorize the issuance of 30,000,000 shares of common stock and 10,000,000 shares of preferred stock. As of April 5, 2010, the record date for this meeting, there were 11,820,509 shares of common stock and 40,000 shares of preferred stock issued and outstanding. Of the remaining 18,179,491 authorized but unissued shares of common stock, 1,888,564 shares were reserved for issuance upon the exercise of outstanding stock options issued under the 1994 Stock Option Plan (which terminated in 2004) and for issuance upon exercise of outstanding stock options and future issuances of stock awards under our 2004 Equity Plan, and 462,963 shares were reserved for issuance upon conversion of outstanding warrants. As a result, we had 15,827,964 shares of common stock and 9,960,000 shares of preferred stock unreserved and available for future issuance as of April 5, 2010.

We have been evaluating a broad range of strategic alternatives to further strengthen our capital base. Among the alternatives under consideration are the issuance of common stock and/or preferred stock. We do not currently have any agreements or commitments with respect to the issuance of any of the Company's securities. However, the Board of Directors believes that it is advisable to increase the number of authorized shares of common stock to ensure that we will have a sufficient number of shares to assure flexibility for the issuance of additional shares in the future. We may use the additional shares in connection with raising additional capital, merger and acquisition opportunities, the issuance of shares under current or future equity incentive plans for our directors, officers and employees, the issuance of stock dividends or stock splits, and other corporate purposes.

If the authorization to increase the number of authorized shares was deferred until a specific need arose, the time and expense required to obtain necessary shareholder approval could prevent the Company from taking advantage of favorable strategic, business or financing opportunities. Historically, the Company has issued its common stock in moderation. Except for the shares authorized for the 2004 Equity Plan which has been approved by shareholders (including all subsequent amendments), the last instance in which the Company issued shares in the prior three years was in connection with the strategic acquisition of Diablo Valley Bank.

Although an increase in the authorized shares of our common stock could, under certain circumstances, also be construed as having an anti-takeover effect (for example, by permitting easier dilution of the stock ownership of a person seeking to effect a change in the composition of the Board of Directors or contemplating a tender offer or other transaction resulting in our acquisition by another company), the proposed increase in authorized shares of common stock is not in response to any effort by any person or group to accumulate our common stock or to obtain control of us by any means. In addition, the proposal is not part of any plan by our Board of Directors to recommend or implement a series of anti-takeover measures.

Procedure for Implementing the Authorized Share Increase

The amendment to increase the authorized shares, if approved by our shareholders, would become effective upon the filing of a certificate of amendment to our Articles of Incorporation with the Secretary of State of the State of California. If the amendment is approved by our shareholders, we expect to file the certificate of amendment effecting the increase in the authorized shares promptly upon such approval.

Authority of the Board of Directors to Issue Additional Shares of Common Stock

If this amendment is approved and we are authorized to issue additional shares of common stock, the Board of Directors will determine whether, when, and on what terms to issue the additional shares of common stock without further action by our shareholders, unless shareholder approval is required by applicable law or securities exchange listing requirements in connection with a particular transaction.

Dilution to Existing Shareholders

Our shareholders do not have preemptive rights. Therefore, if we decide to issue additional shares of common stock, we would have the discretion to determine to whom we offer these additional shares and would not be obligated to first offer these shares to our existing shareholders. Except for a stock split or stock dividend, issuances of common shares will dilute the voting power and ownership of our existing shareholders and will dilute earnings or loss per share of common stock. Depending on the price at which the shares are issued, an issuance may reduce the per share book value of the Company's common shares.

No Appraisal Rights

Under California law and our Articles of Incorporation, holders of our common stock will not be entitled to dissenter's rights or appraisal rights with respect to the authorized share increase.

Vote Required to Approve the Amendment and Recommendation

Under California law and our Articles of Incorporation, the affirmative vote of holders of a majority of the shares of common stock outstanding as of April 5, 2010, the record date for this meeting, is required to approve the amendment to the Articles of Incorporation.

Recommendation of the Board of Directors

The Board of Directors recommends approval of the amendment to our Articles of Incorporation to increase the number of shares of common stock. The proxy holders intend to vote all proxies they hold in favor of the amendment. If no instruction is given, the proxy holders intend to vote FOR approval of the amendment to increase the number of authorized shares of common stock.

PROPOSAL 4—AMENDMENT TO BYLAWS TO REDUCE THE RANGE OF THE SIZE OF THE BOARD OF DIRECTORS

The Board of Directors has adopted resolutions to amend our Bylaws to reduce the range of the size of our Board from a range of 11 to 21 persons to a range of 9 to 15 persons.

The form of the proposed amendment to our Bylaws to effect the change in the range of the size of our Board is attached to this proxy statement as Exhibit B.

Background and Reasons for the Amendment

Section 2.2 of the Company's Bylaws provide for a Board of Directors in a range of 11 to 21 persons, with the exact number fixed and determined, from time to time, by resolution of the Board. The Board has proposed, subject to shareholder approval, an amendment to Section 2.2 to change the range of the size of the Board to a range of 9 to 15 persons. The Board is recommending this amendment because it believes that the work of the Board may be better managed and the full participation of all Board members increased by maintaining a smaller Board. The Board believes at this time that a Board consisting of 10 persons is appropriate for the Board and the business of the Company. Decreasing the range will provide flexibility to reduce the size of the Board in the future and to ensure that the maximum number in the range remains reasonable. Maintaining a reasonable size of the Board also reduces payments of director retainers and travel cost reimbursements. If the shareholders approve the amendment, the Board will maintain for the present time an authorized Board of 10 persons. If the shareholders do not approve the amendment, the Board will maintain the number of authorized persons for the Board at 11, with 10 persons being elected at the 2010 Annual Shareholders meeting and one vacancy to be filled by the Board later in the year.

When the Company entered into its agreement with the U.S. Treasury to participate in the U.S. Treasury Capital Purchase Program in November 2008, the Board of Directors amended Section 2.2 to provide that in the event dividends payable on the shares of our Series A Preferred Stock have not been paid for an aggregate of six quarterly dividend periods or more, whether or not consecutive, the authorized number of directors shall automatically be increased by two (but shall in no event be increased to a number of directors that is greater than the maximum number of directors set forth in Section 2.2). These provisions of Section 2.2 will not be affected by the proposed amendment.

Section 14.2 of the Company's Bylaws requires that any change in the authorized number of directors must be approved by the shareholders. The amendment requires the affirmative vote of a majority of the shares represented and voting at the meeting.

If the Bylaw amendment is approved, it will become effective immediately.

Recommendation of the Board of Directors

The Board of Directors recommends approval of the amendment to the Bylaws to reduce the range of the size of the Board to 9 to 15 persons. The proxy holders intend to vote all proxies they hold in favor of the amendment to the Bylaws. If no instruction is given, the proxy holders intend to vote FOR approval of the amendment to the Bylaws.

PROPOSAL 5—RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors, upon the recommendation of its Audit Committee, has ratified the selection of Crowe Horwath LLP to serve as our independent registered public accounting firm for 2010, subject to ratification by our shareholders. A representative of Crowe Horwath 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 Horwath 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 Horwath 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 Horwath LLP, however, we reserve the discretion to retain Crowe Horwath LLP as our independent registered public accounting firm for 2010. 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 2009, the Committee met 7 times, and the Committee chair, as representative of the Audit Committee, discussed the interim financial information contained in each quarterly earnings announcement with the Chief Financial Officer prior to public release. The Committee discussed the interim financial statements with the Chief Financial Officer and the independent auditors prior to the filing of each quarterly Form 10-Q.

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 auditors their audit plans and scope.

The Committee discussed and reviewed with the independent auditors all communications required by generally accepted auditing standards, including those described in Statement on Auditing Standards No. 61, as amended, "Communication with Audit Committees," and discussed and reviewed the results of the independent auditors' 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, 2009 with management and the independent auditors. The Committee has also reviewed "Management's Report on Internal Control 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, 2009.

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, 2009, for filing with the SEC.

Heritage Commerce Corp
Audit Committee

Humphrey P. Polanen, Chairman
Celeste V. Ford
Mark E. Lefanowicz

March 11, 2010

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 2009	Fiscal Year 2008
Audit fees(1)	$684,028	$566,435
Audit-related fees(2)	105,180	89,870
Tax fees(3)	66,750	110,550
All other fees(4)	9,800	22,245
Total accounting fees	$865,758	$789,100

(1) Fees for audit services for 2009 and 2008 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, consents and other services related to SEC matters, and the audit of the Company's internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002. Fees for 2009 include services related to the Company's two shelf registration statements filed with the SEC in 2009.

(2) Fees for audit-related services for 2009 and 2008 consisted of financial accounting and reporting consultations and audits of the consolidated financial statements of the Company's employee benefit plans.

(3) Fees for tax services for 2009 and 2008 consisted of tax compliance and tax planning and advice.

- Fees for tax compliance services totaled $43,000 and $110,550 in 2009 and 2008, 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 (in 2008, tax compliance services also included preparation of income tax returns and a federal loss carryback claim for Diablo Valley Bank for its tax year ended June 20, 2007, analysis of merger costs incurred by both the Company and Diablo Valley Bank, and analysis of depreciable lives for tax return purposes of various costs incurred for the construction of a new branch office building), assistance with state tax credits, and assistance regarding audits of the Company's California state tax returns.

- Tax planning and advice services are those rendered with respect to proposed transactions. Tax planning and advice services totaled $23,750 in 2009. No tax planning and advice services were provided in 2008.

(4) Fees for all other services in 2009 and 2008 consisted of 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.

The ratio of tax planning and advice fees and all other fees to audit fees, audit-related fees and tax compliance fees was approximately 4% and 3% for 2009 and 2008, respectively.

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 Horwath LLP as the Company's independent registered public accounting firm for the year ended December 31, 2010. 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.

PROPOSAL 6—AUTHORIZATION TO ADJOURN THE ANNUAL MEETING

If the Annual Meeting is convened and a quorum is present, but there are not sufficient votes to approve the amendment to our Articles of Incorporation to increase the number of authorized shares of common stock, we may move to adjourn the Annual Meeting at that time to solicit additional proxies. In order to allow proxies that we have received by the time of the Annual Meeting to be voted for an adjournment, if necessary, we have submitted the question of adjournment to our shareholders as a separate matter for their consideration. If it is necessary to adjourn the Annual Meeting, no notice of the adjourned meeting is required to be given to shareholders, other than an announcement at the Annual Meeting of the time and place to which the Annual Meeting is adjourned, so long as the meeting is adjourned for 45 days or less and no new record date is fixed for the adjourned meeting. At the adjourned meeting we may transact any business which might have been transacted at the original meeting.

Recommendation of the Board of Directors

The Board of Directors recommends approval of the authorization to adjourn the Annual Meeting if required to solicit additional proxies to approve the amendment to our Articles of Incorporation to increase the number of authorized shares. 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

Under certain circumstances, shareholders are entitled to present proposals at shareholders' meetings, provided that the proposal is presented in a timely manner and in a form that complies with applicable regulations. Any shareholder proposals intended to be presented for consideration at the 2011 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 21, 2010 in a form that complies with applicable regulations. If the date of next year's Annual Meeting is moved more than 30 days before or after the anniversary of this year's Annual Meeting, the deadline for inclusion is instead a reasonable time before the Company begins to print and mail its proxy materials.

For a shareholder proposal to be presented at the Annual Meeting that is not intended to be included in the Company's proxy statement under SEC Rule 14a-8, the proposal must be submitted at least 45 days before the date this proxy statement and form of proxy is first mailed to shareholders. If the date of next year's Annual Meeting is more than 30 days before or after the anniversary of this year's Annual Meeting, the deadline for submitting a proposal is instead a reasonable time before the Company begins to print and mail its proxy materials.

HERITAGE COMMERCE CORP

Debbie Reuter
Corporate Secretary

April 20, 2010
San Jose, California

Exhibit A

**Proposed Amendment to the Articles of Incorporation
to Increase the Number of
Authorized Shares of Common Stock**

ARTICLE III

a. The total number of shares of stock that the corporation shall have authority to issue is 70,000,000 shares, which shall be divided into two classes as follows: (a) 60,000,000 shares of Common Stock, and (b) 10,000,000 shares of Preferred Stock (hereinafter "Preferred Shares") of which 40,000 Preferred Shares shall be designated as "Fixed Rate Cumulative Perpetual Preferred Stock, Series A."

Exhibit B

Proposed Amendment to the Bylaws to Reduce the Range of the Size of the Board of Directors

2.2 Number. The number of the corporation's directors shall be not less than nine nor more than fifteen, the exact number within such minimum and maximum limits to be fixed and determined from time to time by resolution of a majority of the full Board or by resolution of a majority of the shareholders at any meeting thereof. Notwithstanding anything in these bylaws to the contrary, for so long as the corporation's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Designated Preferred Stock") is outstanding: (i) whenever, at any time or times, dividends payable on the shares of Designated Preferred Stock have not been paid for an aggregate of six quarterly Dividend Periods (as defined in the Certificate of Determination for the Designated Preferred Stock) or more, whether or not consecutive, the authorized number of directors shall automatically be increased by two (but shall in no event be increased to a number of directors that is greater than the maximum number of directors set forth in Section 2.2 of these bylaws); and (ii) this sentence may not be modified, amended or repealed by the corporation's board or directors (or any committee thereof) or without the affirmative vote and approval of (x) the stockholders and (y) the holders of at least a majority of the shares of Designated Preferred Stock outstanding at the time of such vote and approval.

Annual Report

HERITAGE COMMERCE CORP

2009 Annual Report on Form 10-K

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**

For the fiscal year ended December 31, 2009

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	Name of Each Exchange on which Registered
Common Stock, no par value	The NASDAQ Stock 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 I5(d) of the Act. Yes ☐ No ☒

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ☐ No ☐

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

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

Large accelerated filer ☐	Accelerated filer ☐	Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☒

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

The aggregate market value of the common stock held by non-affiliates of the Registrant, based upon the closing price of its common stock as of June 30, 2009 $3.73 per share, as reported on the NASDAQ Global Select Market, was approximately $38 million.

As of March 10, 2010, there were 11,820,509 shares of the Registrant's common stock (no par value) outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2010 Annual Meeting to be held on May 27, 2010 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, 2009.

HERITAGE COMMERCE CORP

INDEX TO ANNUAL REPORT ON FORM 10-K FOR YEAR ENDED DECEMBER 31, 2009

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, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act, 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. In addition, our past results of operations do not necessarily indicate our future results. The forward-looking statements could be affected by many factors, including but not limited to:

- Our ability to attract new deposits and loans;
- Local, regional, and national economic conditions and events and the impact they may have on us and our customers;
- Risks associated with concentrations in real estate related loans;
- Increasing levels of classified assets, including nonperforming assets, which could adversely affect our earnings and liquidity;
- Market interest rate volatility;
- Stability of funding sources and continued availability of borrowings;
- Changes in legal or regulatory requirements or the results of regulatory examinations that could restrict growth and constrain our activities, including the terms of our written agreement entered into by the Company and the Board of Governors of the Federal Reserve System and the California Department of Financial Institutions;
- Changes in accounting standards and interpretations;
- Significant decline in the market value of the Company that could result in an impairment of goodwill;
- Our ability to raise capital or incur debt on reasonable terms;
- Regulatory limits on Heritage Bank of Commerce's ability to pay dividends to the Company;
- Effectiveness of the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009 and other legislative and regulatory efforts to help stabilize the U.S. financial markets;
- Future legislative or administrative changes to the U.S. Treasury Capital Purchase Program enacted under the Emergency Economic Stabilization Act of 2008;
- The impact of the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009 and related rules and regulations on our business operations and competitiveness, including the impact of executive compensation restrictions, which may affect our ability to retain and recruit executives in competition with other firms who do not operate under those restrictions; and

• Our success in managing the risks involved in the foregoing items.

We are not able to predict all the factors that may affect future results. You should not place undue reliance on any forward-looking statement, which speaks only as of the date of this Report on Form 10-K. Except as required by applicable laws or regulations, we do not undertake any obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

PART I

ITEM 1 — *BUSINESS*

General

Heritage Commerce Corp ("HCC") is registered with the Board of Governors of the Federal Reserve System as a Bank Holding Company under the Bank Holding Company Act of 1956. HCC was organized in 1997 to be the holding company for Heritage Bank of Commerce ("HBC"). Subsequent to 1997, HCC became the holding company for Heritage Bank East Bay, Heritage Bank South Valley, and Bank of Los Altos. On January 1, 2003, these banks were merged into HBC and now operate as branch offices serving their local markets. In June 2007, HCC acquired Diablo Valley Bank which merged into HBC.

HCC's only other direct subsidiaries are Heritage Capital Trust I (formed 2000), Heritage Statutory Trust I (formed 2000), Heritage Statutory Trust II (formed 2001) and Heritage Statutory Trust III (formed 2002) (collectively, "Subsidiary Trusts"), which were formed solely to facilitate the issuance of capital trust pass-through securities to enhance regulatory capital and liquidity. Pursuant to accounting guidance on variable interest entities, the Subsidiary Trusts are not reflected on a consolidated basis in the financial statements of HCC.

HCC's principal source of income is dividends from HBC. The expenditures of HCC, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, the cost of servicing debt, legal fees, audit fees, and shareholder costs, will generally be paid from dividends paid to HCC by HBC.

At December 31, 2009, HCC had consolidated assets of $1.36 billion, deposits of $1.09 billion and shareholders' equity of $172.3 million. HCC's liabilities include $23.7 million in debt obligations due to the Subsidiary Trusts related to capital trust pass-through securities issued by those entities.

References herein to the "Company" "we", "us", and "our" refer to HCC and its consolidated subsidiary, unless the context indicates otherwise.

The Internet address of the Company's website is "http://www.heritagecommercecorp.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's website.

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 January 1994. HBC is a multi-community independent bank that offers a full range of banking services to small to medium sized businesses and their owners, managers and employees residing in Santa Clara, Alameda, and Contra Costa counties in California. We operate ten full service branch offices throughout this geographic footprint. The locations of HBC's current offices are:

San Jose:	Administrative Office Main Branch 150 Almaden Boulevard San Jose, CA 95113

Fremont:	Branch Office 3077 Stevenson Boulevard Fremont, CA 94538
Danville:	Branch Office 387 Diablo Road Danville, CA 94526
Gilroy:	Branch Office 7598 Monterey Street Suite 110 Gilroy, CA 95020
Los Altos:	Branch Office 419 South San Antonio Road Los Altos, CA 95032
Los Gatos:	Branch Office 15575 Los Gatos Boulevard Los Gatos, CA 95032
Morgan Hill:	Branch Office 18625 Sutter Boulevard Morgan Hill, CA 95037
Mountain View:	Branch Office 175 E. El Camino Real Mountain View, CA 94040
Pleasanton:	Branch Office 300 Main Street Pleasanton, CA 94566
Walnut Creek:	Branch Office 101 Ygnacio Valley Road Suite 100 Walnut Creek, CA 94596

HBC's gross loan balances, excluding loans held-for-sale at the end of 2009 totaled $1.07 billion. HBC's lending activities are diversified and include commercial, real estate, construction and consumer loans. HBC's commercial loans are made for working capital, financing the purchase of equipment or for other business purposes. Such 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 or fixed interest rates, with monthly payments of both principal and interest. HBC's commercial loans are centered in locally-oriented commercial activities in markets where HBC has a physical presence through its branch offices and loan production offices.

HBC's real estate term loans consist primarily of loans made based on the borrower's cash flow and are secured by deeds of trust on commercial and residential property to provide a secondary source of repayment. HBC generally restricts real estate term loans to no more than 80% 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 granted for longer maturities.

HBC's real estate land and construction loans are primarily short-term interim loans to finance the construction of commercial and single family residential properties. 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.

HBC makes consumer loans for the purpose of financing automobiles, various types of consumer goods, and other personal purposes. Additionally, HBC makes home equity lines of credit available to its clientele. Consumer loans generally provide for the monthly payment of principal and interest. Most of HBC's consumer loans are secured by the personal property being purchased or, in the instances of home equity loans or lines, real property.

HBC also actively engages in Small Business Administration ("SBA") lending. HBC have been designated as an SBA Preferred Lender since 1999.

As of December 31, 2009, the percentage of our total loans for each of the principal areas in which we directed our lending activities were as follows: (i) commercial 40% (including SBA loans), (ii) real estate secured loans 37%, (iii) land and construction loans 17%, and (iv) consumer (including home equity) 6%. 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.

In addition to loans, HBC offers a wide range of deposit products for retail and business banking markets including checking accounts, interest-bearing transaction accounts, savings accounts, time deposits and retirement accounts. HBC attracts deposits from throughout our market area with a customer-oriented product mix, competitive pricing, and convenient locations. At December 31, 2009, HBC had approximately 15,700 deposit accounts totaling $1.09 billion, including brokered deposits, compared to 17,200 deposit accounts totaling approximately $1.15 billion as of December 31, 2008.

HBC offers a multitude of other products and services to complement our lending and deposit services. These include cashier's checks, traveler's checks, bank-by-mail, ATM, night depository, safe deposit boxes, direct deposit, automated payroll services, electronic funds transfers, online banking, 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 address the growing needs of its customers and to analyze other markets for potential expansion opportunities.

Diablo Valley Bank

In June 2007, the Company acquired Diablo Valley Bank. The transaction was valued at approximately $65 million, including payments for cancellation of options for Diablo Valley Bank common stock. Diablo Valley Bank shareholders received a per share consideration of $23.00. Accordingly, the Company paid approximately $24 million in cash and issued 1,732,298 shares of the Company's common stock in exchange for all outstanding Diablo Valley Bank shares and stock options. Prior to closing, Diablo Valley Bank redeemed all of its outstanding Series A Preferred Stock for an aggregate of approximately $6.7 million in cash (including dividend payments).

U.S Treasury Capital Purchase Program

On November 21, 2008, the Company entered into a Securities Purchase Agreement Standard Terms with the U.S. Treasury pursuant to the U.S. Treasury Capital Purchase Program authorized under the Emergency Economic Stabilization Act. In accordance with the Purchase Agreement the Company sold to the U.S. Treasury for an aggregate purchase price of $40 million, Series A Preferred Stock and a warrant to purchase 462,963 shares of our common stock. Under the terms of the Capital Purchase Program, the Company is prohibited from increasing dividends above $0.08 per share on its common stock, and from making certain repurchases of equity securities, including its common stock, without the U.S. Treasury's consent. Furthermore, as long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including the Company's common stock, are prohibited until all accrued and unpaid dividends are paid on the Series A Preferred Stock. In November 2009, the Company announced that it had suspended the payment of dividends on its Series A Preferred Stock.

Recent Regulatory Action

On February 17, 2010 HCC and HBC entered into a written agreement with the Federal Reserve Bank of San Francisco, and the California Department of Financial Institutions ("DFI"). Under the terms of the written agreement, the Company must obtain the prior written approval of the Federal Reserve and DFI before it may (i) declare or pay any dividends, (ii) make any distributions of principal or interest on the Company's outstanding trust preferred securities and related subordinated debt, (iii) incur, increase or guarantee any debt, (iv) redeem any outstanding stock, or (v) take dividends or any other form of payment that represents a reduction in capital from HBC. The written agreement also requires the Company to (i) submit a written plan to strengthen credit risk management practices, (ii) submit a written capital plan for sufficient capitalization of both HCC and HBC , (iii) submit a written business plan for 2010 to improve the Company's earnings and overall financial condition, (iv) comply with notice and approval requirements related to the appointment of directors and senior executive officers or change in the responsibility of any current senior executive officer, (v) comply with restrictions on paying or agreeing to pay certain indemnification and severance payments without prior written approval, (vi) submit a written plan to improve management of the Company's liquidity position and funds management practices, (vii) notify the Federal Reserve and DFI no more than 30 days after the end of any quarter in which the capital ratios of HCC or HBC fall below approved capital plan's minimum ratios, together with an acceptable plan to increase capital ratios above the approved capital plan's minimum levels, (viii) comply with specified procedures for board (or a committee of the board) approval for the extension, renewal or restructure of any "criticized loan", (ix) submit plans to improve the Company's position on outstanding past due and other problem loans in excess of $2 million, (x) maintain policies and procedures and submit a plan for the maintenance of an adequate allocation for loan and lease losses, and (xi) provide quarterly progress reports to the Federal Reserve and DFI.

Prior to entering into the written agreement in February 2010, the Company had already ceased paying dividends on its common stock (in the second quarter of 2009), suspended interest payments on its trust preferred securities and related subordinated debt (in the fourth quarter of 2009), and suspended dividend payments on its preferred stock (also in the fourth quarter of 2009).

The Company is addressing the requirements of the written agreement, including efforts and plans to improve asset quality and credit risk management, improve profitability and liquidity management, and maintain capital at a level sufficient for the respective risk profiles of HCC (on a consolidated basis) and HBC. A committee of outside directors has been formed to monitor and coordinate compliance with the written agreement.

Failure to comply with the written agreement may subject HCC and HBC to additional supervisory actions and orders.

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 Santa Clara, Alameda and Contra Costa county region, the three counties within which the Company operates, the top three institutions are all multi-billion dollar entities with an aggregate of 377 offices that control a combined 52.37% of deposit market share based on June 30, 2009 FDIC market share data. HBC ranks fourteenth with 1.06% share of total deposits based on June 30, 2009 market share data. These banks have, among other advantages, the ability to finance wide-ranging advertising campaigns and to allocate their resources to regions of highest yield and demand. 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, mortgage companies, credit unions, finance 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, mail, personal computer, ATMs, self-service branches, and/or in-store branches. Competitors offering such products include traditional banks and savings associations, credit unions, brokerage firms, asset management groups, finance and insurance companies, internet-based companies, and mortgage banking firms.

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. *See Item 1 — "Business — Supervision and Regulation — Heritage Commerce Corp — The Gramm-Leach-Bliley Act of 1999".*

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."*

Economic Conditions, Government Policies, Legislation, and Regulation

The Company's profitability, like most financial institutions, is primarily dependent on interest rate differentials. In general, the difference between the interest rates paid by the HBC on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by HBC on interest-earning assets, such as loans extended to customers and securities held in the investment portfolio, will comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors that are beyond the control of the Company and HBC, such as inflation, recession and unemployment, and the impact which future changes in domestic and foreign economic conditions might have on the Company and HBC cannot be predicted.

The Company's business is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Federal Reserve Board. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating recession) through its open-market operations in U.S. Government securities by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target federal funds and discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest earned on interest-earning assets and paid on interest-bearing liabilities. The nature and impact of any future changes in monetary and fiscal policies on the Company cannot be predicted.

From time to time, federal and state legislation is enacted which may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. In addition, the various bank regulatory agencies often adopt new rules and regulations and policies to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations or changes in policy may be enacted or the extent to which the business of the Bank would be affected thereby. The Company cannot predict whether or when potential legislation will be enacted and, if enacted, the effect that it, or any implemented regulations and supervisory policies, would have on our financial condition or results of operations. In addition, the outcome of examinations, any litigation or any investigations initiated by state or federal authorities may result in necessary changes in our operations and increased compliance costs.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 was enacted to restore confidence and stabilize the volatility in the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Initially introduced as the Troubled Asset Relief Program, the Emergency Economic Stabilization Act authorized the U.S. Treasury to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program. Initially, $350 billion or half of the $700 billion was made immediately available to the U.S. Treasury. On January 15, 2009, the remaining $350 billion was released to the U.S. Treasury.

On October 14, 2008, the U.S. Treasury announced its intention to inject capital into nine large U.S. financial institutions under the U.S. Treasury Capital Purchase Program, and since has injected capital into many other financial institutions, including the Company. On November 21, 2008, the Company entered into a Letter Agreement and Securities Purchase Agreement — Standard Terms, pursuant to which the Company issued and sold preferred stock and a common stock warrant for $40 million.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law. The American Recovery and Reinvestment Act includes various programs intended to stimulate the economy. In addition, the American Recovery and Reinvestment Act imposes certain new executive compensation and corporate governance requirements on all current and future Capital Purchase Program recipients, including the Company, until the institution has repaid the U.S. Treasury, which is permitted under the American Recovery and Reinvestment Act without penalty and without the need to raise new capital, subject to the U.S. Treasury's consultation with the recipient's appropriate regulatory agency.

See Item 1 — "*Business — Supervision and Regulation — U.S. Treasury Capital Purchase Program*" for further discussion of the requirement under the Capital Purchase Program.

Supervision and Regulation

Introduction

Banking is a complex, highly regulated industry. The primary goals of the regulatory scheme are to maintain a safe and sound banking system, protect depositors and the Federal Deposit Insurance Corporation's ("FDIC") insurance fund, and facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress and the states have created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the financial services industry. Consequently, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statues, regulations and the policies of various governmental regulatory authorities, including the Federal Reserve Board, FDIC, and the DFI.

The system of supervision and regulation applicable to financial services businesses governs most aspects of the business of the Company, including: (i) the scope of permissible business; (ii) investments; (iii) reserves that must be maintained against deposits; (iv) capital levels that must be maintained; (v) the nature and amount of collateral that may be taken to secure loans; (vi) the establishment of new branches; (vii) mergers and consolidations with other financial institutions; and (viii) the payment of dividends.

From time to time laws or regulations are enacted which have the effect of increasing the cost of doing business, limiting or expanding the scope of permissible activities, or changing the competitive balance between banks and other financial and non-financial institutions. Proposals to change the laws and regulations governing the operations of banks and bank holding companies are frequently made in Congress, in the California legislature and by various bank and other regulatory agencies. Future changes in the laws, regulations or polices that impact the Company cannot necessarily be predicted, but they may have a material effect on the business and earnings of the Company.

Heritage Commerce Corp

General. As a bank holding company, HCC is registered under the Bank Holding Company Act of 1956, as amended ("BHCA"), and is subject to regulation by the Federal Reserve Board. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve Board. HCC is also required to file periodic reports of its operations and any additional information regarding its activities and those of its subsidiaries, as may be required by the Federal Reserve Board.

The Company is also a bank holding company within the meaning of Section 3700 of the California Financial Code. Consequently, HCC and HBC are subject to examination by, and may be required to file reports with, the DFI. Regulations have not yet been proposed or adopted or steps otherwise taken to implement the DFI's powers under this statute.

The Federal Reserve Board has a policy that bank holding companies must serve as a source of financial and managerial strength to their subsidiary banks. It is the Federal Reserve Board's position that bank holding companies should stand ready to use their available resources to provide adequate capital to their subsidiary banks during periods of financial stress or adversity. Bank holding companies must also maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting their subsidiary bank.

HCC's stock is traded on the NASDAQ Global Select Market, and as such the Company is subject to rules and regulations of the NASDAQ Stock Market, including those related to corporate governance. The Company is also subject to the periodic reporting requirements of Section 13 of the Securities Exchange Act of 1934 (the "Exchange Act") which requires the Company to file annual, quarterly and other current reports with the Securities and Exchange Commission (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 the 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 the Company promulgated by the SEC under Section 13 of the Exchange Act.

Bank Holding Company Liquidity. HCC is a legal entity, separate and distinct from HBC. HCC has the ability to raise capital on its own behalf or borrow from external sources. The Company may also obtain additional funds from dividends paid by, and fees charged for services provided to, HBC. However, regulatory constraints on HBC may restrict or totally preclude the payment of dividends by HBC to HCC.

HCC is entitled to receive dividends, when and as declared by HBC's Board of Directors. Those dividends may come from funds legally available for those dividends, as specified and limited by the California Financial Code. Under the California Financial Code, funds available for cash dividends by a California-chartered bank are restricted to the lesser of: (i) the bank's retained earnings; or (ii) the bank's net income for its last three fiscal years (less any distributions to shareholders made during such period). With the prior approval of the DFI, cash dividends may also be paid out of the greater of: (a) the bank's retained earnings; (b) net income for the bank's last preceding fiscal year; or (c) net income of the bank's current fiscal year.

If the DFI determines that the shareholders' equity of the bank paying the dividend is not adequate or that the payment of the dividend would be unsafe or unsound for the bank, the DFI may order the bank not to pay the dividend. Since HBC is an FDIC-insured institution, it is also possible, depending upon its financial condition and other factors, that the FDIC could assert that the payment of dividends or other payments might, under some circumstances, constitute an unsafe or unsound practice and thereby prohibit such payments.

Transactions With Affiliates. HCC and any subsidiaries it may purchase or organize are deemed to be affiliates of HBC within the meaning of Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve Board's Regulation W. Under Sections 23A and 23B and Regulation W, loans by HBC to affiliates, investments by them in affiliates' stock, and taking affiliates' stock as collateral for loans to any borrower is limited to 10% of HBC's capital, in the case of any one affiliate, and is limited to 20% of HBC's capital, in the case of all affiliates. In addition, transactions between HBC and other affiliates must be on terms and conditions that are consistent with safe and sound banking practices; in particular, a bank and its subsidiaries generally may not purchase from an affiliate a low-quality asset, as defined in the Federal Reserve Act. These restrictions also prevent a bank holding company and its other affiliates from borrowing from a banking subsidiary of the bank holding company, unless the loans are secured by marketable collateral of designated amounts. HCC and HBC are also subject to certain restrictions with respect to engaging in the underwriting, public sale and distribution of securities.

Limitations on Business and Investment Activities. Under the BHCA, a bank holding company must obtain the Federal Reserve Board's approval before: (i) directly or indirectly acquiring more than 5% ownership or control of any voting shares of another bank or bank holding company; (ii) acquiring all or substantially all of the assets of another bank; or (iii) merging or consolidating with another bank holding company.

Bank holding companies may own subsidiaries engaged in certain businesses that the Federal Reserve Board has determined to be "so closely related to banking as to be a proper incident thereto." HCC, therefore, is permitted to engage in a variety of banking-related businesses. Some of the activities that the Federal Reserve Board has determined, pursuant to its Regulation Y, to be related to banking are: (i) making or acquiring loans or other extensions of credit for its own account or for the account of others; (ii) servicing loans and other extensions of credit; (iii) performing functions or activities that may be performed by a trust company in the manner authorized by federal or state law under certain circumstances; (iv) leasing personal and real property or acting as agent, broker, or adviser in leasing such property in accordance with various restrictions imposed by Federal Reserve Board regulations; (v) acting as investment or financial advisor; (vi) providing management consulting advice under certain circumstances; (vii) providing support services, including courier services and printing and selling MICR-encoded items; (viii) acting as a principal, agent, or broker for insurance under certain circumstances; (ix) making equity and debt investments in corporations or projects designed primarily to promote community welfare or jobs for residents; (x) providing financial, banking, or economic data processing and data transmission services; (xi) owning, controlling, or operating a savings association under certain circumstances; (xii) selling money orders, travelers' checks and U.S. Savings Bonds; (xiii) providing securities brokerage services, related securities credit activities pursuant to Regulation T, and other incidental activities; and (xiv) underwriting dealing in obligations of the U.S., general obligations of states and their political subdivisions, and other obligations authorized for state member banks under federal law.

Additionally, under the Gramm-Leach-Bliley Act of 1999, qualifying bank holding companies making an appropriate election to the Federal Reserve Board may engage in a full range of financial activities, including insurance, securities and merchant banking. The Company has not elected to qualify for these financial activities.

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. Thus, 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 the Company or any subsidiaries; or (iii) the customer must not obtain some other credit, property or services from competitors, except reasonable requirements to assure soundness of credit extended.

The Federal Reserve Board also possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations.

Interstate Banking and Branching. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking Act") regulates the interstate activities of banks and bank holding companies and establishes a framework for nationwide interstate banking and branching. Since June 1, 1997, a bank has generally been permitted to merge with a bank in another state without state law authorization. However, states were given the ability to prohibit interstate mergers with banks in their own state by “opting out” (enacting state legislation applying equality to all out of state banks prohibiting such mergers) prior to June 1, 1997.

Since 1995, adequately capitalized and managed bank holding companies have been permitted to acquire banks located in any state, subject to two exceptions: first, any state may still prohibit bank holding companies from acquiring a bank which is less than five years old; and second, no interstate acquisition can be consummated by a bank holding company if the acquirer would control more than 10% of the deposits held by insured depository institutions nationwide or 30% percent or more of the deposits held by insured depository institutions in any state in which the target bank has branches. A bank may establish and operate de novo branches in any state in which the bank does not already maintain a branch if that state has enacted legislation to expressly permit all out of state banks to establish branches in that state.

In 1995, California enacted legislation to implement important provisions of the Interstate Banking Act discussed above and to repeal California’s previous interstate banking laws, which were largely preempted by the Interstate Banking Act.

The changes effected by the Interstate Banking Act and California laws have increased competition in the environment in which the Company operates to the extent that out of state financial institutions directly or indirectly enter the Company’s market areas. It appears that the Interstate Banking Act has contributed to accelerated consolidation within the banking industry.

Capital Adequacy. Bank holding companies must maintain minimum levels of capital under the Federal Reserve Board’s risk-based capital adequacy guidelines. If capital falls below minimum guideline levels, a bank holding company, among other things, may be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve Board’s risk-based capital adequacy guidelines, discussed in more detail below in the section entitled *“Supervision and Regulation — Heritage Bank of Commerce — Regulatory Capital Guidelines,”* assign various risk percentages to different categories of assets, and capital is measured as a percentage of risk-weighted assets. Under the terms of the guidelines, bank holding companies are expected to meet capital adequacy guidelines based both on total risk-weighted assets and on total assets, without regard to risk weights.

The risk-based guidelines are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual organizations. For example, the Federal Reserve Board’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Moreover, any banking organization experiencing or anticipating significant growth or expansion into new activities, particularly under the expanded powers under the Gramm-Leach-Bliley Act, would be expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

Limitations on Dividend Payments. The California General Corporation Law prohibits HCC from paying dividends on the common stock unless: (i) its retained earnings, immediately prior to the dividend payment, equals or exceeds the amount of the dividend or (ii) immediately after giving effect to the dividend, the sum of HCC’s assets (exclusive of goodwill and deferred charges) would be at least equal to 125% of its liabilities (not including deferred taxes, deferred income and other deferred credits) and the current assets of HCC would be at least equal to its current liabilities, or, if the average of its earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of its interest expense for the two preceding fiscal years, at least equal to 125% of its current liabilities. Additionally, the Federal Reserve Board’s policy regarding dividends provides that a bank holding company should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company’s financial health, such as by borrowing.

The Gramm-Leach-Bliley Act of 1999. On November 12, 1999, the Gramm-Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") was signed into law. The Financial Services Modernization Act is intended to modernize the banking industry by removing barriers to affiliation among banks, insurance companies, the securities industry and other financial service providers. It provides financial organizations with the flexibility to structure such affiliations through a holding company structure or through a financial subsidiary of a bank, subject to certain limitations. The Financial Services Modernization Act establishes a new type of bank holding company, known as a "financial holding company", that may engage in an expanded list of activities that are "financial in nature," which include securities and insurance brokerage, securities underwriting, insurance underwriting and merchant banking.

The Company does not expect to elect financial holding company status unless and until it intends to engage in any of the expanded activities under the Financial Services Modernization Act which require such status. Unless and until it elects such status, the Company will only be permitted to engage in non-banking activities that were permissible for bank holding companies as of the date of the enactment of the Financial Services Modernization Act.

The Financial Services Modernization Act also sets forth a system of functional regulation that makes the Federal Reserve Board the "umbrella supervisor" for holding companies, while providing for the supervision of the holding company's subsidiaries by other federal and state agencies. A bank holding company may not become a financial holding company if any of its subsidiary financial institutions are not "well-capitalized" and "well-managed." Further, each bank subsidiary of the holding company must have received at least a satisfactory Community Reinvestment Act ("CRA") rating. The Financial Services Modernization Act also expands the types of financial activities a national bank may conduct through a financial subsidiary, addresses state regulation of insurance, generally prohibits unitary thrift holding companies organized after May 4, 1999 from participating in new financial activities, provides privacy protection for nonpublic customer information of financial institutions, modernizes the Federal Home Loan Bank system and makes miscellaneous regulatory improvements. The Federal Reserve Board and the Secretary of the Treasury must coordinate their supervision regarding approval of new financial activities to be conducted through a financial holding company or through a financial subsidiary of a bank. While the provisions of the Financial Services Modernization Act regarding activities that may be conducted through a financial subsidiary directly apply only to national banks, those provisions indirectly apply to state-chartered banks.

In addition, HBC is subject to other provisions of the Financial Services Modernization Act, including those relating to CRA, privacy and the safe-guarding of confidential customer information, regardless of whether the Company elects to become a financial holding company or to conduct activities through a financial subsidiary of HBC.

HCC and HBC do not believe that the Financial Services Modernization Act has had thus far, or will have in the near term, a material adverse effect on their operations. However, to the extent that it permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The Financial Services Modernization Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis. Nevertheless, this act may have the result of increasing the amount of competition that HCC and HBC face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than HCC and HBC.

The Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 ("SOX") became effective on July 30, 2002, and represents the most far reaching corporate and accounting reform legislation since the enactment of the Securities Act of 1933 and the Exchange Act of 1934. SOX is intended to provide a permanent framework that improves the quality of independent audits and accounting services, improves the quality of financial reporting, strengthens the independence of accounting firms and increases the responsibility of management for corporate disclosures and financial statements.

SOX's provisions are significant to all companies that have a class of securities registered under Section 12 of the Exchange Act, or are otherwise reporting to the SEC (or the appropriate federal banking agency) pursuant to Section 15(d) of the Exchange Act, including HCC (collectively, ''public companies''). In addition to SEC rulemaking to implement SOX, the NASDAQ Stock Market has adopted corporate governance rules intended to allow shareholders to more easily and effectively monitor the performance of companies and directors. The principal provisions of SOX, provide for and include, among other things: (i) the creation of an independent accounting oversight board; (ii) auditor independence provisions that restrict non-audit services that accountants may provide to their audit clients; (iii) additional corporate governance and responsibility measures, including the requirement that the chief executive officer and chief financial officer of a public company certify financial statements; (iv) the forfeiture of bonuses or other incentive-based compensation and profits from the sale of a public company's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement; (v) an increase in the oversight of, and enhancement of certain requirements relating to, audit committees of public companies and how they interact with the public company's independent auditors; (vi) requirements that audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the public company; (vii) requirements that public companies disclose whether at least one member of the audit committee is a ''financial expert' (as such term is defined by the SEC) and if not discuss, why the audit committee does not have a financial expert; (viii) expanded disclosure requirements for corporate insiders, including accelerated reporting of stock transactions by insiders and a prohibition on insider trading during pension blackout periods; (ix) a prohibition on personal loans to directors and officers, except certain loans made by insured financial institutions on non-preferential terms and in compliance with other bank regulatory requirements; (x) disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code; (xi) a range of enhanced penalties for fraud and other violations; and (xii) expanded disclosure and certification relating to a public company's disclosure controls and procedures and internal controls over financial reporting.

The Company has not experienced any significant difficulties in complying with SOX.

Heritage Bank of Commerce

General. As a California chartered bank, HBC is subject to supervision, periodic examination, and regulation by the DFI and by the Federal Reserve Board, as HBC's primary federal regulator. As a member bank, HBC is a stockholder of the Federal Reserve Bank of San Francisco. If, as a result of an examination, the DFI or the Federal Reserve Board should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of HBC's operations are unsatisfactory or that HBC or its management is violating or has violated any law or regulation, the DFI and the Federal Reserve Board, and separately the FDIC as insurer of HBC's deposits, have residual authority to: (i) require affirmative action to correct any conditions resulting from any violation or practice; (ii) direct an increase in capital; (iii) restrict HBC's growth geographically, by products and services or by mergers and acquisitions; (iv) enter into informal nonpublic or formal public memoranda of understanding or written agreements; (v) enjoin unsafe and unsound practices and issue cease and desist orders to take corrective action; (vi) remove officers and directors and assess civil monetary penalties; and (vii) take possession and close and liquidate HBC.

California law permits state chartered commercial banks to 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, and further, pursuant to the Financial Services Modernization Act, HBC may conduct certain ''financial'' activities in a subsidiary to the same extent as may a national bank, provided HBC 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, 2009, HBC was in compliance with the FHLB's stock ownership requirement.

Regulatory Capital Guidelines. The federal banking agencies have established minimum capital standards known as risk-based capital guidelines. These guidelines are intended to provide a measure of capital that reflects the degree of risk associated with a bank's operations. The risk-based capital guidelines include both a definition of capital and a framework for calculating the amount of capital that must be maintained against a bank's assets and off-balance sheet items. The amount of capital required to be maintained is based upon the credit risks associated with the various types of a bank's assets and off-balance sheet items. A bank's assets and off-balance sheet items are classified under several risk categories, with each category assigned a particular risk weighting from 0% to 100%. The following table sets forth the regulatory capital guidelines and the actual capitalization levels for HBC and the Company as of December 31, 2009:

	Adequately Capitalized	Well Capitalized	HBC	Company (consolidated)
	(greater than or equal to)			
Total risk-based capital	8.00%	10.00%	12.7%	12.9%
Tier 1 risk-based capital ratio	4.00%	6.00%	11.4%	11.6%
Tier 1 leverage capital ratio	4.00%	5.00%	9.9%	10.1%

As of December 31, 2009, the Company's capital levels met all minimum regulatory requirements and HBC was considered "well capitalized" under the regulatory framework for prompt corrective action. Except for terms of the written agreement with the FRB and DFI, there are no conditions or events since December 31, 2009 that management believes has changed HBC's category. However, as discussed under "Recent Regulatory Action," the written agreement signed in February 2010 requires the Company to submit a written plan to the FRB and DFI for sufficient capitalization of both HCC (on a consolidated basis) and HBC, based on their respective risk profiles.

To enhance regulatory capital and to provide liquidity, the Company, through unconsolidated subsidiary grantor trusts, issued $23.7 million of trust preferred securities. These securities are currently included in our Tier 1 capital for purposes of determining the Company's Tier 1 and total risk-based capital ratios. The Federal Reserve Board has promulgated a modification of the capital regulations affecting trust preferred securities. Under this modification, effective March 31, 2011, the Company will be required to use a more restrictive formula to determine the amount of trust preferred securities that can be included in regulatory Tier 1 capital. When the new regulations become effective, the Company may include in Tier 1 capital an amount of trust preferred securities equal to no more than 25% of the sum of all core capital elements, which is generally defined as shareholders' equity excluding accumulated other comprehensive income/loss, less goodwill and other intangible assets and any related deferred income tax liability. The regulations currently in effect through March 31, 2011, limit the amount of trust preferred securities that can be included in Tier 1 capital to 25% of the sum of core capital elements without a deduction for goodwill. Management has determined that the Company's Tier 1 capital ratios would be substantially the same had the modification of the capital regulations been in effect at December 31, 2009.

Prompt Corrective Action. The federal banking agencies possess broad powers to take prompt corrective action to resolve the problems of insured banks. Each federal banking agency has issued regulations defining five capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." Under the regulations, a bank shall be deemed to be:

- "well capitalized" if it has a total risk-based capital ratio of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a leverage capital ratio of 5.0% or more, and is not subject to specified requirements to meet and maintain a specific capital level for any capital measure;
- "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 4.0% or more, and a leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized";
- "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 4.0%, or a leverage capital ratio that is less than 4.0% (3.0% under certain circumstances);
- "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 3.0% or a leverage capital ratio that is less than 3.0%; and
- "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Banks are prohibited from paying dividends or management fees to controlling persons or entities if, after making the payment the bank would be "undercapitalized," that is, the bank fails to meet the required minimum level for any relevant capital measure. Asset growth and branching restrictions apply to "undercapitalized" banks. Banks classified as "undercapitalized" are required to submit acceptable capital plans guaranteed by its holding company, if any. Broad regulatory authority was granted with respect to "significantly undercapitalized" banks, including forced mergers, growth restrictions, ordering new elections for directors, forcing divestiture by its holding company, if any, requiring management changes, and prohibiting the payment of bonuses to senior management. Even more severe restrictions are applicable to "critically undercapitalized" banks, those with capital at or less than 2%. Restrictions for these banks include the appointment of a receiver or conservator. All of the federal banking agencies have promulgated substantially similar regulations to implement this system of prompt corrective action.

A bank, based upon its capital levels, that is classified as "well capitalized," "adequately capitalized" or "undercapitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment. At each successive lower capital category, an insured bank is subject to more restrictions. The federal banking agencies, however, may not treat an institution as "critically undercapitalized" unless its capital ratios actually warrant such treatment.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential enforcement actions by the federal banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, and the issuance of removal and prohibition orders against "institution-affiliated" parties. The enforcement of such actions through injunctions or restraining orders may be based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. For information on the Company's recent regulatory action see "*Business — Recent Regulatory Action.*"

Safety and Soundness Standards. The federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designated to assist the federal banking agencies in identifying and addressing problems at insured depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan and institute enforcement proceedings if an acceptable compliance plan is not submitted.

FDIC Insurance and Insurance Assessments. The FDIC is an independent federal agency that insures deposits, up to prescribed statutory limits, of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The FDIC insures HBC's customer deposits through the Deposit Insurance Fund ("DIF") up to prescribed limits to each depositor. Pursuant to the Emergency Economic Stabilization Act, the maximum deposit insurance was increased from $100,000 to $250,000. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. Pursuant to the Federal Deposit Insurance Reform Act of 2005, the FDIC is authorized to set the reserve ratio for the DIF annually at between 1.15% and 1.50% of estimated insured deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. In an effort to restore capitalization levels and to ensure the DIF will adequately cover projected losses from future bank failures, the FDIC, in October 2008, proposed a rule to alter the way in which it differentiates for risk in the risk-based assessment system and to revise deposit insurance assessment rates, including base assessment rates. First quarter 2009 assessment rates were increased to between 12 and 50 cents for every $100 of domestic deposits, with most banks paying between 12 and 14 cents.

On May 22, 2009, the FDIC approved the final rule to establish a special assessment of five basis points on each FDIC-insured depository institution's assets minus Tier 1 capital, as of June 30, 2009. As a result, the FDIC levied a special assessment of $652,000, which was paid by HBC on September 30, 2009.

On September 29, 2009, the FDIC adopted an Amended Restoration Plan to allow the DIF to return to a reserve ratio of 1.15 percent within eight years, as mandated by statute. While the Amended Restoration Plan and higher assessment rates address the need to return the DIF reserve ratio to 1.15 percent, the FDIC must also consider its need for cash to pay for projected bank failures. On November 17, 2009, the FDIC amended its regulation requiring insured institutions to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012. The FDIC waived these requirements for HBC.

If the DIF's reserves exceed the designated reserve ratio, the FDIC is required to pay out all or, if the reserve ratio is less than 1.5%, a portion of the excess as a dividend to insured depository institutions based on the percentage of insured deposits held on December 31, 1996 adjusted for subsequently paid premiums. Insured depository institutions that were in existence on December 31, 1996 and paid assessments prior to that date (or their successors) were entitled to a one-time credit against future assessments based on their past contributions to the predecessor to the DIF.

Additionally, by participating in the FDIC's Temporary Liquidity Guarantee Program, banks temporarily become subject to an additional assessment on deposits in excess of $250,000 in certain transaction accounts and additionally for assessments from 50 basis points to 100 basis points per annum depending on the initial maturity of the debt. Further, all FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation ("FICO"), an agency of the Federal government established to recapitalize the predecessor to the DIF. These assessments will continue until the FICO bonds mature in 2017.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of depositors. The termination of deposit insurance for a bank would also result in the revocation of the bank's charter by the DFI.

Community Reinvestment Act ("CRA"). 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.

Other Consumer Protection Laws and Regulations. The bank regulatory agencies are increasingly focusing attention on compliance with consumer protection laws and regulations. Banks have been advised to carefully monitor compliance with various consumer protection laws and regulations. The federal Interagency Task Force on Fair Lending issued a policy statement on discrimination in home mortgage lending describing three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. In addition to CRA and fair lending requirements, HBC is subject to numerous other federal consumer protection statutes and regulations. Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, HBC may incur additional compliance costs or be required to expend additional funds for investments in the local communities it serves.

Environmental Regulation. Federal, state and local laws and regulations regarding the discharge of harmful materials into the environment may have an impact on HBC. Since HBC is not involved in any business that manufactures, uses or transports chemicals, waste, pollutants or toxins that might have a material adverse effect on the environment, HBC's primary exposure to environmental laws is through its lending activities and through properties or businesses HBC may own, lease or acquire. Based on a general survey of HBC's loan portfolio, conversations with local appraisers and the type of lending currently and historically done by HBC, management is not aware of any potential liability for hazardous waste contamination that would be reasonably likely to have a material adverse effect on the Company as of December 31, 2009.

Safeguarding of Customer Information and Privacy. The Federal Reserve Board and other bank regulatory agencies have adopted guidelines for safeguarding confidential, personal customer information. These guidelines require financial institutions to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. HBC has adopted a customer information security program to comply with such requirements.

Financial institutions are also required to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to non-affiliated third parties. In general, financial institutions must provide explanations to consumers on policies and procedures regarding the disclosure of such nonpublic personal information, and, except as otherwise required by law, prohibits disclosing such information except as provided in HBC's policies and procedures. HBC has implemented privacy policies addressing these restrictions which are distributed regularly to all existing and new customers of HBC.

USA Patriot Act of 2001. On October 26, 2001, President Bush signed the USA Patriot Act of 2001 (the "Patriot Act"). Enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. on September 11, 2001, the Patriot Act is intended to strengthen the ability of U.S. law enforcement agencies and intelligence communities to work cohesively to combat terrorism on a variety of fronts. The impact of the Patriot Act on financial institutions of all kinds has been significant and wide-ranging. The Patriot Act substantially enhanced existing anti-money laundering and financial transparency laws, and required appropriate regulatory authorities to adopt rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. Under the Patriot Act, financial institutions are subject to prohibitions regarding specified financial transactions and account relationships, as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transactions;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

The Patriot Act also requires all financial institutions to establish anti-money laundering programs, which must include, at a minimum:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and
- an independent audit function to test the programs.

Material deficiencies in anti-money laundering compliance can result in public enforcement actions by the banking agencies, including the imposition of civil money penalties and supervisory restrictions on growth and expansion. Such enforcement actions could also have serious reputation consequences for HCC and HBC.

HBC has incorporated the requirements of the Patriot Act into its operating procedures, and while these requirements have resulted in an additional time burden the financial impact on HBC is difficult to quantify.

Other Aspects of Banking Law. HBC is also subject to federal statutory and regulatory provisions covering, among other things, security procedures, insider and affiliated party transactions, management interlocks, electronic funds transfers, funds availability, and truth-in-savings.

U.S. Treasury Capital Purchase Program

On November 21, 2008, HCC entered into a Securities Purchase Agreement Standard Terms with the U.S. Treasury pursuant to the U.S. Treasury Capital Purchase Program authorized under the Emergency Economic Stabilization Act. In accordance with the Purchase Agreement HCC sold to the U.S. Treasury, for an aggregate purchase price of $40 million, Series A Preferred Stock and a warrant to purchase 462,963 shares of our common stock. Under the terms of the Capital Purchase Program, HCC is prohibited from increasing dividends on its common stock, and from making certain repurchases of equity securities, including its common stock, without the U.S. Treasury's consent. Furthermore, as long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including HCC's common stock, are prohibited until all accrued and unpaid dividends are paid on such preferred stock. In order to participate in the Capital Purchase Program, financial institutions were required to adopt certain standards for executive compensation and corporate governance. These standards generally apply to the chief executive officer, chief financial officer and the three next most highly compensated senior executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive.

The bank regulatory agencies, U.S. Treasury and the Office of Special Inspector General, also created by the Emergency Economic Stabilization Act, have issued guidance and requests to the financial institutions that participate in the Capital Purchase Program to document their plans and use of the proceeds from the sale of the preferred stock and their plans for addressing the executive compensation requirements associated with the Capital Purchase Program.

In addition, the American Recovery and Reinvestment Act imposes certain new executive compensation and corporate expenditure limits on all current and future Capital Purchase Program recipients, including the Company, until the institution has repaid the U.S. Treasury, which is permitted under the American Recovery Reinvestment Act without penalty and without the need to raise new capital, subject to the U.S. Treasury's consultation with the recipient's appropriate regulatory agency. The executive compensation standards are more stringent than those in effect under the Emergency Economic Stabilization Act. The new standards include (but are not limited to) (i) prohibitions on bonuses, retention awards and other incentive compensation, other than restricted stock grants which do not fully vest until the preferred stock issued to the U.S. Treasury is no longer outstanding up to one-third of an employee's total annual compensation, (ii) prohibitions on golden parachute payments for departure from a company, (iii) an expanded clawback of bonuses, retention awards, and incentive compensation if payment is based on materially inaccurate statements of earnings, revenues, gains or other criteria, (iv) prohibitions on compensation plans that encourage manipulation of reported earnings, (v) retroactive review of bonuses, retention awards and other compensation previously provided by Capital Purchase Program recipients if found by the U.S. Treasury to be inconsistent with the purposes of the Emergency Economic Stabilization Act or otherwise contrary to public interest, (vi) required establishment of a company-wide policy regarding "excessive or luxury expenditures," and (vii) inclusion in a participant's proxy statements for annual shareholder meetings of a nonbinding "say on pay" shareholder vote on the compensation of executives.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect HCC, HBC and the banking industry in general are pending, and additional initiatives may be proposed or introduced before the United States Congress, the California legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject HCC or HBC to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of HCC or HBC would be affected thereby.

Employees

At December 31, 2009, the Company had 206 full-time equivalent employees. The Company's employees are not represented by any union or collective bargaining agreement and the Company believes its employee relations are satisfactory.

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 Recent Economic Conditions and Governmental Response Efforts

Difficult economic and market conditions have adversely affected our industry.

The global and U.S. economies continue to experience a protracted slowdown in business activity. Dramatic declines in the housing market, with decreasing home prices and increasing delinquencies and foreclosures, have negatively impacted the credit performance of mortgage, land development and construction loans and resulted in significant write-downs of assets by many financial institutions. General downward economic trends, reduced availability of commercial credit and increasing unemployment have negatively impacted the credit performance of commercial and consumer credit, resulting in additional write-downs. Negative economic trends have led to increased commercial and consumer loan deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. The resulting economic pressure on consumers and businesses may continue to adversely affect our business, financial condition, results of operations and stock price. We do not expect that the difficult conditions in the financial and real estate markets are likely to improve in the near future. Moreover, the commercial real estate market may continue to decline, which could adversely affect a substantial portion of our loan portfolio. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry. In particular, we may face the following risks in connection with these events:

- We potentially face increased regulation of our industry which may increase our costs and limit our ability to pursue business opportunities. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.
- The process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including assessments of economic conditions. The level of uncertainty concerning economic conditions may adversely affect the accuracy of our estimates which may, in turn, impact the reliability of the process.
- Our borrowers may be unable to make timely repayments of their loans, and the decrease in value of real estate collateral securing the payment of such loans could result in significant credit losses, increased delinquencies, foreclosures and customer bankruptcies, any of which could have a material adverse effect on our operating results.
- The value of our securities portfolio may be adversely affected.
- Changes and volatility in interest rates may negatively impact yields on earning assets and may increase the costs of interest-bearing liabilities.

- Monetary and fiscal policies of the Federal Reserve and the U.S. Government and other government initiatives taken in response to economic conditions may adversely affect our profitability.
- We have been and may be required to pay significantly higher FDIC premiums because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits.

If current negative economic trends continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our business, financial condition and results of operations.

Recent legislative and regulatory initiatives may not be successful.

Recent legislative and regulatory initiatives to address difficult market and economic conditions may not stabilize the U.S. banking system. On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008, or the Emergency Economic Stabilization Act, in response to the crisis in the financial sector in 2008. The U.S. Treasury and banking regulators have implemented a number of programs under this legislation to address capital and liquidity issues in the banking system. On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009, or the American Recovery and Reinvestment Act. There can be no assurance, however, as to the actual impact that the Emergency Economic Stabilization Act or the American Recovery and Reinvestment Act will have on the financial markets, including the levels of volatility and limited credit availability currently being experienced. The failure of the Emergency Economic Stabilization Act or American Recovery and Reinvestment Act to help stabilize the financial markets and a continuation or worsening of current financial market conditions could have a material adverse effect on our business, financial condition, results of operations, access to credit or the value of our securities.

The FDIC has increased insurance premiums to rebuild and maintain the federal deposit insurance fund.

The FDIC has adopted a final rule revising its risk-based assessment system, effective April 1, 2009. The changes to the assessment system involve adjustments to the risk-based calculation of an institution's unsecured debt, secured liabilities and brokered deposits. The revisions effectively result in a range of possible assessments under the risk-based system of 7 to 77.5 basis points. As a result of the recent revisions, we anticipate paying higher FDIC insurance premiums, which will add to our cost of operations and, thus, adversely affect our results of operations. Depending on any future losses that the FDIC insurance fund may suffer due to failed institutions, there can be no assurance that there will not be additional premium increases in order to replenish the fund.

The FDIC has imposed a special Deposit Insurance assessment of 5 basis points on all insured institutions. This emergency assessment was calculated based on each insured institution's total assets minus Tier 1 capital at June 30, 2009, and was collected on September 30, 2009. Future special assessments imposed by the FDIC will further increase our cost of operations and, as a result, could have a significant impact on us.

U.S. and international financial markets and economic conditions could adversely affect our liquidity, results of operations and financial condition.

The turmoil and downward economic trends in 2009 were particularly acute in the financial sector and these trends may continue in 2010. Although we have not suffered any significant liquidity issues as a result of these recent events, the cost and availability of funds may be adversely affected by illiquid credit markets and the demand for our products and services may decline as our borrowers and customers realize the impact of an economic slowdown and recession. In view of the concentration of our operations and the collateral securing our loan portfolio in California, we may be particularly susceptible to the adverse economic conditions in California and, particularly, the San Francisco Bay area where our business is concentrated. In addition, the severity and duration of these adverse conditions is unknown and may exacerbate our exposure to credit risk and adversely affect the ability of borrowers to perform under the terms of their lending arrangements with us.

Risks Related to Our Market and Business

We are subject to a written agreement with the Federal Reserve and the California Department of Financial Institutions, and in the future may become subject to additional supervisory actions and/or enhanced regulation that could have a material adverse effect on our business, operating flexibility, financial condition and the value of our common stock.

Under federal and state laws and regulations pertaining to the safety and soundness of insured depository institutions, various state regulators (for state chartered-banks), the Federal Reserve (for bank holding companies and state member banks), the California Department of Financial Institutions (for California state-chartered banks) ("DFI") and separately the FDIC as the insurer of bank deposits, each have the authority to compel or restrict certain actions on our part if they determine that we have insufficient capital or are otherwise operating in a manner that may be deemed to be inconsistent with safe and sound banking practices. Under their respective authority, our bank regulators can require us to enter into informal or formal enforcement orders, including board resolutions, memoranda of understanding, written agreements and consent or cease and desist orders, pursuant to which we may be required to take identified corrective actions to address cited concerns and to refrain from taking certain actions.

As a result of the Company's losses in 2009, primarily due to higher provisions for loan losses because of credit quality deterioration, the Company entered into a written agreement on February 17, 2010 with the Federal Reserve and DFI. Among other things, the written agreement provides that the Company and HBC shall submit to the Federal Reserve and the DFI their continuing plans to enhance credit risk and administration functions, to maintain policies and procedures for the maintenance of an adequate allowance for loan and lease losses, to improve earnings for 2010, to improve HBC's liquidity position and funds management practices, and to update the Company's capital plan in order to maintain capital at or above sufficient levels based on the respective risk profiles of the consolidated Company and HBC. The written agreement also restricts the payment of dividends and any payments on trust preferred securities and related subordinated debt, or any reduction in capital or the purchase or redemption of stock without the prior approval of the Federal Reserve and the DFI. The written agreement requires the Company to comply with restrictions on indemnification and golden parachute payments, and to comply with notice and approval requirements related to the appointment of directors and senior executive officers. Progress reports detailing the form and manner of all actions taken to secure compliance with the written agreement must be submitted to the Federal Reserve and DFI at least quarterly. See Item 1 — "*Business — Recent Regulatory Action*."

If we are unable to comply with the terms of the written agreement with the Federal Reserve and DFI, or if we are unable to comply with the terms of any future regulatory orders to which we may become subject, then we could become subject to additional supervisory actions and orders, including cease and desist orders, prompt corrective action and/or other regulatory enforcement actions. If our regulators were to take such additional supervisory actions, then we could, among other things, become subject to significant restrictions on our ability to develop any new business, as well as restrictions on our existing business, and we could be required to raise additional capital, dispose of certain assets and liabilities within a prescribed period of time, or both. Failure to implement the measures in the time frames provided, or at all, could result in additional orders or penalties from the Federal Reserve and the State of California, which could include further restrictions on the Company's business, assessment of civil money penalties on the Company, as well as its directors, officers and other affiliated parties, termination of deposit insurance, removal of one or more officers and/or directors and the liquidation or other closure of the Company. The terms of any such supervisory action and the consequences associated with any failure to comply therewith could have a material negative effect on our business, operating flexibility, financial condition and the value of our common stock.

Our allowance for loan losses may not be adequate to cover actual loan losses, which could adversely affect our earnings.

We maintain an allowance for loan losses for probable incurred losses in the portfolio. The allowance is established through a provision for loan losses based on our management's evaluation of the risks inherent in our loan portfolio and the general economy. The allowance is also appropriately increased for new loan growth. The allowance is based upon a number of factors, including the size of the loan portfolio, asset classifications, economic trends, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience and loan underwriting policies.

In addition, we evaluate all loans identified as problem 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 included in the portfolio that may result in losses, but that have not yet been identified as 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. As a result, future additions to the allowance may be necessary. Further, because the loan portfolio contains a number of commercial real estate, construction, and land development loans with relatively large balances, a 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 changes resulting from the current, and potentially worsening, economic conditions or as a result of incorrect assumptions by management in determining the allowance for loan losses. 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.

Loan losses in excess of our allowance for loan losses could have an adverse effect on our results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

At December 31, 2009, nonperforming loans were 5.83% of the loan portfolio. At December 31, 2009, nonperforming assets were 4.74% of total assets. Nonperforming assets adversely affect our earnings in various ways. Until economic and market conditions improve, we expect to continue to incur losses relating to an increase in nonperforming assets. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our income, and increasing our loan administration costs. Upon foreclosure or similar proceedings, we record the repossessed asset at the estimated fair value, less costs to sell, which may result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the increased risk profile. While we reduce problem assets through collection efforts, asset sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition.

In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. If the current economic and market conditions persist or worsen, it is likely that we will experience future increases in nonperforming assets, particularly if we are unsuccessful in our efforts to reduce our classified assets, which would have a significant adverse effect on our business.

We may be required to make additional provisions for loan losses and charge off additional loans in the future, which could adversely affect our results of operations.

For the year ended December 31, 2009, we recorded a $33.9 million provision for loan losses, charged-off $31.5 million of loans, and recovered $1.4 million of loans. There has been a significant slowdown in the real estate markets in portions of counties in California where a majority of our loan customers, including our largest borrowing relationships, are based. This slowdown reflects declining prices in real estate, excess inventories of homes and increasing vacancies in commercial and industrial properties, all of which have contributed to financial strain on real estate developers and suppliers. At December 31, 2009, we had $400.7 million in real estate loans and $182.9 million in construction and land development loans, of which $43.3 million are greater than 90 days past due at December 31, 2009. Construction loans and commercial real estate loans comprise a substantial portion of our non-performing assets. Continuing deterioration in the real estate market could affect the ability of our loan customers to service their debt, which could result in additional loan charge-offs and provisions for loan losses in the future, which could have a material adverse effect on our financial condition, results of operations and capital.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

If we lost a significant portion of our low-cost deposits, it would negatively impact our liquidity and profitability.

Our profitability depends in part on our success in attracting and retaining a stable base of low-cost deposits. At December 31, 2009, 24% of our deposit base was comprised of noninterest-bearing deposits. While we generally do not believe these core deposits are sensitive to interest rate fluctuations, the competition for these deposits in our markets is strong and customers are increasingly seeking investments that are safe, including the purchase of U.S. Treasury securities and other government-guaranteed obligations, as well as the establishment of accounts at the largest, most-well capitalized banks. If we were to lose a significant portion of our low-cost deposits, it would negatively impact our liquidity and profitability.

HBC is a participant in the FDIC's Transaction Account Guarantee Program ("TAGP"), which provides HBC's depositors with unlimited FDIC insurance coverage for certain noninterest-bearing transaction accounts. Unless extended by the FDIC, the TAGP will expire on June 30, 2010, at which time the amount of coverage for each depositor will be limited to $250,000. The impact of the TAGP expiration in June 2010 could have an adverse effect on HBC's deposit base.

We borrow from the Federal Home Loan Bank and the Federal Reserve, and there can be no assurance these programs will continue in their current manner.

We at times utilize the Federal Home Loan Bank of San Francisco for overnight borrowings and term advances; we also borrow from the Federal Reserve Bank of San Francisco and from correspondent banks under our Federal funds lines of credit. The amount loaned to us is generally dependent on the value of the collateral pledged. These lenders could reduce the percentages loaned against various collateral categories, could eliminate certain types of collateral and could otherwise modify or even terminate their loan programs, particularly to the extent they are required to do so because of capital adequacy or other balance sheet concerns. Any change or termination of the programs under which we borrow from the Federal Home Loan Bank of San Francisco, the Federal Reserve Bank of San Francisco or correspondent banks could have an adverse effect on our liquidity and profitability.

Our results of operations may be adversely affected by other-than-temporary impairment charges relating to our securities portfolio.

We may be required to record future impairment charges on our securities, including our stock in the Federal Home Loan Bank of San Francisco, if they suffer declines in value that we consider other-than-temporary. Numerous factors, including the lack of liquidity for re-sales of certain securities, the absence of reliable pricing information for securities, adverse changes in the business climate, adverse regulatory actions or unanticipated changes in the competitive environment, could have a negative effect on our securities portfolio in future periods. Significant impairment charges could also negatively impact our regulatory capital ratios and result in HBC not being classified as "well-capitalized" for regulatory purposes.

We may need to raise additional capital in the future and such capital may not be available when needed or at all.

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. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and our financial performance. The ongoing liquidity crisis and the loss of confidence in financial institutions may increase our cost of funding and limit our access to some of our customary sources of capital, including, but not limited to, inter-bank borrowings, repurchase agreements and borrowings from the discount window of the Federal Reserve Bank.

We cannot assure you that such capital will be available to us on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of HBC or counterparties participating in the capital markets may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, financial condition and results of operations.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Changes in interest rates affect interest income, the primary component of our gross revenue, as well as interest expense. Our earnings depend largely on the relationship between the cost of funds, primarily deposits and borrowings, and the yield on earning assets, primarily loans and securities. This relationship, known as the interest rate spread, is subject to fluctuation and is affected by the monetary policies of the Federal Reserve, the shape of the yield curve, and the international interest rate environment, as well as by economic, regulatory and competitive factors which influence interest rates, the volume and mix of interest-earning assets and interest-bearing liabilities, and the level of nonperforming assets. Many of these factors are beyond our control. In addition, loan origination volumes are affected by market interest rates.

Higher interest rates, generally, are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Conversely, in rising interest rate environments, loan repayment rates may decline and in falling interest rate environments, loan repayment rates may increase. In addition, in a rising interest rate environment, we may need to accelerate the pace of rate increases on our deposit accounts as compared to the pace of future increases in short-term market rates. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality and loan origination volume. Given the current volume, mix, and re-pricing characteristics of our interest-bearing liabilities and interest-earning assets, our interest rate spread is expected to increase in a rising rate environment, and decrease in a declining interest rate scenario. However, there are scenarios where fluctuations in interest rates in either direction could have a negative effect on our profitability. For example, if funding rates rise faster than asset yields in a rising rate environment, or if we do not actively manage certain loan rates in a declining rate environment, our profitability would be negatively impacted.

Our profitability is dependent upon the economic conditions of the markets in which we operate.

We operate primarily in Santa Clara County, Contra Costa County and Alameda County and, as a result, our financial condition and results of operations are subject to changes in the economic conditions in those areas. Our success depends upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our customers' business and financial interests may extend well beyond these market areas, adverse economic conditions that affect these market areas could reduce our growth rate, affect the ability of our customers to repay their loans to us and generally affect our financial condition and results of operations. Our lending operations are located in market areas dependent on technology and real estate industries and their supporting companies. Thus, our borrowers could be adversely impacted by a downturn in these sectors of the economy that could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans, which would, in turn, increase our nonperforming assets. Because of our geographic concentration, we are less able than regional or national financial institutions to diversify our credit risks across multiple markets.

Our loan portfolio has a large concentration of real estate loans in California, which involve risks specific to real estate values.

A further downturn in our real estate markets could adversely affect our business because many of our loans are secured by real estate. Real estate lending (including commercial, land development and construction) is a large portion of our loan portfolio. At December 31, 2009, approximately $635.0 million, or 59% of our loan portfolio, was secured by various forms of real estate, including residential and commercial real estate. The real estate securing our loan portfolio is concentrated in California which has experienced a significant decline in real estate values. There have been adverse developments affecting real estate values in one or more of our markets that could increase the credit risk associated with our 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, 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 particular to California. Additionally, commercial real estate lending typically involves larger loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. If real estate values, including values of land held for development, continue to decline, the value of real estate collateral securing our loans could be significantly reduced. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished and we would be more likely to suffer losses on defaulted loans.

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, 2009, land and construction loans, including land acquisition and development total $182.9 million or 17% of our loan portfolio. This amount was comprised of 21% owner-occupied and 79% non-owner occupied construction and land loans. Risk of loss on a construction loan depends largely upon whether our initial estimate of the property's value at completion of construction equals or exceeds the cost of the property construction (including interest) and the availability of permanent take-out financing. During the construction phase, a number of factors can result in delays and cost overruns. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project, 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 primarily on the completion of the project and the ability of the borrower to sell the property, rather than the ability of the borrower or guarantor to repay principal and interest. If estimates of value are inaccurate or if actual construction costs exceed estimates, the value of the property securing the loan may be insufficient to ensure full repayment. If our appraisal of the value of the completed project proves to be overstated, our collateral may be inadequate for the repayment of the loan upon completion of construction of the project. If we are forced to foreclose on a project prior to or at completion due to a default, there can be no assurance that we will 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.

We must effectively manage our growth strategy.

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 may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Our current growth strategies involve internal growth from our current offices and, subject to any regulatory constraints on our ability to open new branch offices, the addition of new offices over time, so that the additional overhead expenses associated with these openings are absorbed prior to opening other new offices.

We have a significant deferred tax asset 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 asset will be recovered. At December 31, 2009, we had a net deferred tax asset of $22.4 million. We did not establish a valuation allowance as it is more likely than not that we will have sufficient future earnings to utilize this asset to offset future income tax liabilities. 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. 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. If we determine that a valuation allowance is necessary, it would require us to incur a charge to operations.

If the goodwill we have recorded in connection with acquisitions becomes impaired, our earnings and capital could be adversely affected.

Accounting standards require that we account for acquisitions using the purchase method of accounting. Under the purchase method of accounting, if the purchase price of an acquired company exceeds the fair value of its net assets, the excess is carried on the acquirer's balance sheet as goodwill. In accordance with generally accepted accounting principles, our goodwill is evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of common stock of other banking organizations, common stock trading multiples, discounted cash flows and, when appropriate, data from control sale transactions. There can be no assurance that future evaluations of goodwill will not result in impairment and ensuing write-downs, which could be material, resulting in an adverse impact on our earnings and shareholders' equity.

We face strong competition from financial service companies and other companies that offer banking services.

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. Increased competition in our markets may result in reduced loans and deposits.

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. The banking business in our primary market areas is very competitive, and the level of competition facing us may increase further, which may limit our asset growth and financial results.

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 DFI 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 and profitability. 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. As a result of the negative financial market and general economic trends, there is a potential for new federal or state laws and regulation regarding lending and funding practices and liquidity standards, and bank regulatory agencies have been and are expected to be aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. 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. We are also subject to supervision, regulation and investigation by the U.S. Treasury and the Office of the Special Inspector General under the Emergency Economic Stabilization Act and the American Recovery and Reinvestment Act by virtue of our participation in the U.S. Treasury Capital Purchase Program.

Technology is continually changing and we must effectively implement new technologies.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables us to reduce costs. Our future success will depend 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 for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market areas. In order to anticipate and develop new technology, we employ a qualified staff of internal information system specialists and consider this area a core part of our business. We do not develop our own software products, but have been able to respond to technological changes in a timely manner through association with leading technology vendors. We must continue to make substantial investments in technology which may affect our results of operations. If we are unable to make such investments, or we are unable to respond to technological changes in a timely manner, our operating costs may increase which could adversely affect our results of operations.

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 unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. We employ external auditors to conduct auditing and testing for weaknesses in our systems, controls, firewalls and encryption to reduce the likelihood of any security failures or breaches. Although we, with the help of third-party service providers and auditors, intend to continue to implement security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

We are exposed to the risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, when a borrower defaults on a loan secured by real property, we generally purchase the property in foreclosure or accept a deed to the property surrendered by the borrower. We may also take over the management of properties when owners have defaulted on loans. While we have guidelines intended to exclude properties with an unreasonable risk of contamination, hazardous substances may exist on some of the properties that we own, manage or occupy and unknown hazardous risks could impact the value of real estate collateral. 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 and exceed the value of the property. 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 prospects could be adversely affected.

Managing operational risk is important to attracting and maintaining customers, investors and employees.

Operational risk represents the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside the Company, the execution of unauthorized transactions by employees, transaction processing errors and breaches of the internal control system and compliance requirements. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation and customer attrition due to potential negative publicity. Operational risk is inherent in all business activities and the management of this risk is important to the achievement of our business objectives. In the event of a breakdown in our internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action and suffer damage to our reputation. We have policies and procedures in place to protect our reputation and promote ethical conduct, but these policies and procedures may not be fully effective. 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.

Potential acquisitions may disrupt our business and adversely affect our results of operations.

We have in the past and, subject to any regulatory constraints on our ability to undertake any acquisitions, we may in the future seek to grow our business by acquiring other businesses. We cannot predict the frequency, size or timing of our acquisitions, and we typically do not comment publicly on a possible acquisition until we have signed a definitive agreement. There can be no assurance that our acquisitions will have the anticipated positive results, including results related to the total cost of integration, the time required to complete the integration, the amount of longer-term cost savings, continued growth, or the overall performance of the acquired company or combined entity. Integration of an acquired business can be complex and costly. If we are not able to successfully integrate future acquisitions, there is a risk that our results of operations could be adversely affected. In addition, if goodwill recorded in connection with our prior or potential future acquisitions was determined to be impaired, then we would be required to recognize a charge against operations, which could materially and adversely affect our results of operations during the period in which the impairment was recognized.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. In addition, the Emergency Economic Stabilization Act and the American Recovery and Reinvestment Act have imposed significant limitations on executive compensation for recipients, such as us, of funds under the U.S. Treasury Capital Purchase Program, which may make it more difficult for us to retain and recruit key personnel. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our Chief Executive Officer and certain other key employees.

The terms of our Series A Preferred Stock limit our ability to pay dividends on and repurchase our common stock.

The Purchase Agreement between us and the U.S. Treasury, pursuant to which we sold $40 million of our Series A Preferred Stock and issued a warrant to purchase up to 462,963 shares of our common stock, provides that prior to the earlier of (1) November 21, 2011 and (2) the date on which all of the shares of the Series A Preferred Stock have been redeemed by us or transferred by the U.S. Treasury to third parties, we may not, without the consent of the U.S. Treasury, (a) increase our quarterly cash dividend on our common stock above $0.08 per share, the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series A Preferred Stock. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series A Preferred Stock. In November 2009, we suspended the payment of dividends on the Series A Preferred Stock, and until the accumulated unpaid dividends on the Series A Preferred Stock are paid, we are not permitted to pay any dividends on our common stock. These restrictions, together with the potentially dilutive impact of the warrant issued to the U.S. Treasury, could have a negative effect on the value of our common stock.

Our outstanding Series A Preferred Stock impacts net income allocable to our common shareholders and earnings per common share, and the warrant issued to the U.S. Treasury may be dilutive to holders of our common stock.

The dividends declared and the accretion on our Series A Preferred Stock reduce the net income available to common shareholders and our earnings per common share. Our Series A Preferred Stock will also receive preferential treatment in the event of our liquidation, dissolution or winding up. Additionally, the ownership interest of the existing holders of our common stock will be diluted to the extent the warrant issued to the U.S. Treasury is exercised. The shares of common stock underlying the warrant represent approximately 4% of the shares of our common stock outstanding as of December 31, 2009. Although the U.S. Treasury has agreed to not vote any of the common shares it receives upon exercise of the warrant, a transferee of any portion of the warrant or of any common shares acquired upon exercise of the warrant is not bound by this restriction. The terms of the warrant include an anti-dilution adjustment which provides that, if we issue common shares or securities convertible or exercisable into, or exchangeable for, common shares at a price that is less than 90% of the market price of such shares on the last trading day preceding the date of the agreement to sell such shares, the number of common shares to be issued would increase and the per share price of common shares to be purchased pursuant to the warrant would decrease.

Because of our participation in the U.S. Treasury Capital Purchase Program, we are subject to various restrictions, including restrictions on compensation paid to our executives.

Pursuant to the terms of the Purchase Agreement we entered into with the U.S. Treasury, we adopted certain standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds the equity issued pursuant to the Purchase Agreement. These standards generally apply to our chief executive officer, chief financial officer, and the three next most highly compensated senior executive officers. The standards include (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate; (3) prohibition on making golden parachute payments to senior executives; and (4) agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. In addition, the American Recovery and Reinvestment Act imposes certain new executive compensation and corporate governance requirements on all current and future Capital Purchase Program recipients, including the Company. The executive compensation standards are more stringent than those in effect under the Emergency Economic Stabilization Act. The new standards include (but are not limited to) (i) prohibitions on bonuses, retention awards and other incentive compensation, other than restricted stock grants which do not fully vest until the preferred stock issued to the U.S. Treasury is no longer outstanding up to one-third of an employee's total annual compensation, (ii) prohibitions on golden parachute payments for departure from a company, (iii) an expanded clawback of bonuses, retention awards, and incentive compensation if payment is based on materially inaccurate statements of earnings, revenues, gains or other criteria, (iv) prohibitions on compensation plans that encourage manipulation of reported earnings, (v) retroactive review of bonuses, retention awards and other compensation previously provided by Capital Purchase Program recipients if found by the U.S. Treasury to be inconsistent with the purposes of the Emergency Economic Stabilization Act or otherwise contrary to public interest, (vi) required establishment of a company-wide policy regarding "excessive or luxury expenditures," and (vii) inclusion in a participant's proxy statements for annual shareholder meetings of a nonbinding "say on pay" shareholder vote on the compensation of executives. Such restrictions and any future restrictions on executive compensation, which may be adopted, could adversely affect our ability to hire and retain senior executive officers and other key employees.

Until we are able to repurchase the Series A Preferred Stock we are required to operate under the restrictions imposed by the U.S. Treasury under the Capital Purchase Program, and such restrictions may have unforeseen and unintended adverse effects on our business.

Until such time as we repurchase the Series A Preferred Stock, we will remain subject to the respective terms and conditions set forth in the agreements we entered into with the U.S. Treasury under the Capital Purchase Program. The continued existence of the Capital Purchase Program investment subjects us to increased regulatory and legislative oversight. Future legal requirements and implementing standards under the Capital Purchase Program may apply retroactively and may have unforeseen or unintended adverse effects on Capital Purchase Program participants and on the financial services industry as a whole. They may require us to expend significant time, effort and resources to ensure compliance, and the evolving regulations concerning executive compensation may impose limitations on us that affect our ability to compete successfully for executive and management talent.

We can make no assurance as to when or if we will be in a position to repurchase the Series A Preferred Stock and the warrant issued to the U.S. Treasury. Furthermore, the repurchase of the Series A Preferred Stock and warrant is subject to regulatory approval.

Federal and state law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Federal law prohibits a person or group of persons "acting in concert" from acquiring "control" of a bank holding company unless the Federal Reserve Board has been given 60 days prior written notice of such proposed acquisition and within that time period the Federal Reserve has not issued a notice disapproving the proposed acquisition or extending for up to another 30 days the period during which such a disapproval may be issued. An acquisition may be made prior to the expiration of the disapproval period if the Federal Reserve issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank or bank holding company with a class of securities registered under Section 12 of the Exchange Act would, under the circumstances set forth in the presumption, constitute the acquisition of control. In addition, any "company" would be required to obtain the approval of the Federal Reserve under the Bank Holding Company Act before acquiring 25% (5% in the case of an acquiror that is, or is deemed to be, a bank holding company) or more of any class of voting stock, or such lesser number of shares as may constitute control.

Under the California Financial Code, no person shall, directly or indirectly, acquire control of a California state bank or its holding company unless the DFI 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 (1) to vote 25% or more of the voting power of HBC, or (2) 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.

These provisions of federal and state law may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

Risks Related to Our Common Stock

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit, is not insured by the FDIC or any other deposit insurance fund, and is subject to investment risk, including the loss of some or all of your investment. Our common stock is subject to the same market forces that affect the price of common stock in any company.

We may raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.

We frequently evaluate opportunities to access the capital markets taking into account our regulatory capital ratios, financial condition and other relevant considerations, and subject to market conditions, we may take further capital actions. Such actions could include, among other things, the issuance of additional shares of common stock in public or private transactions in order to further increase our capital levels above the requirements for a well-capitalized institution established by the federal bank regulatory agencies as well as other regulatory targets.

In addition, we face significant regulatory and other governmental risk as a financial institution and a participant in the Capital Purchase Program, and it is possible that capital requirements and directives could in the future require us to change the amount or composition of our current capital, including common equity. In this regard, we were not one of the 19 institutions required to conduct a forward-looking capital assessment, or "stress test," in conjunction with the Federal Reserve and other federal bank supervisors, pursuant to the Supervisory Capital Assessment Program, a complement to the U.S. Treasury's Capital Assistance Program, which makes capital available to financial institutions as a bridge to private capital in the future. However, the stress assessment requirements under the Capital Assistance Program or similar requirement could be extended or otherwise impact financial institutions beyond the 19 participating institutions, including us. As a result, we could determine, or our regulators could require us, to raise additional capital. There could also be market perceptions regarding the need to raise additional capital, whether as a result of public disclosures that were made regarding the Capital Assistance Program stress test methodology or otherwise, and, regardless of the outcome of the stress tests or other stress case analysis, such perceptions could have an adverse effect on the price of our common stock.

The issuance of any additional shares of common stock as a result of the warrant issued to the U.S. Treasury or other securities convertible into or exchangeable for common stock or that represent the right to receive common stock, or the exercise of such securities (including the exercise of stock options or vesting of restricted stock issued under our Amended and Restated 2004 Equity Plan), could be substantially dilutive to shareholders of our common stock. Holders of our shares of common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to our shareholders. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our shareholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in us.

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. 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 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" and below. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;
- failure to meet analysts' revenue or earnings estimates;
- speculation in the press or investment community generally relating to our reputation, 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 our current shareholders, including sales of common stock by existing shareholders and/or directors and executive officers;
- trends in our nonperforming assets;

- the costs and effectiveness of our efforts to reduce our classified assets;
- 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;
- trading activities in our common stock, including short-selling;
- 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.

A significant decline in our stock price could result in substantial losses for individual shareholders and could lead to costly and disruptive securities litigation.

Our common stock is listed for trading on the NASDAQ Global Select Market under the symbol "HTBK"; the trading volume has historically been less than that of larger financial services companies. Stock price volatility may make it more difficult for you to sell your common stock when you want and at prices you find attractive.

A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

We are a holding company and depend on our subsidiaries for dividends, distributions and other payments.

We are a company separate and apart from HBC that must provide for our own liquidity. Substantially all of our revenues are obtained from dividends declared and paid by HBC. There are statutory and regulatory provisions that could limit the ability of HBC to pay dividends to us. Under applicable California law, HBC cannot make any distribution (including a cash dividend) to its shareholder, us, in an amount which exceeds the lesser of: (1) the retained earnings of HBC and (2) the net income of HBC for its last three fiscal years, less the amount of any distributions made by HBC to its shareholder during such period. Notwithstanding the foregoing, with the prior approval of the California Commissioner of Financial Institutions, HBC may make a distribution (including a cash dividend) to us in an amount not exceeding the greatest of: (1) its retained earnings; (2) its net income for its last fiscal year; and (3) its net income for its current fiscal year.

In addition, if in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice, such authority may require, after notice and an opportunity for a hearing, that such bank cease and desist from such practice. Depending on the financial condition of HBC, the applicable regulatory authority might deem us to be engaged in an unsafe or unsound practice if HBC were to pay dividends. The Federal Reserve has issued policy statements generally requiring insured banks and bank holding companies to pay dividends only out of current operating earnings.

In addition, if HBC becomes insolvent, the direct creditors of HBC will have a prior claim on its assets, as discussed further below. Our rights and the rights of our creditors will be subject to that prior claim, unless we are also a direct creditor of that subsidiary.

As discussed above, we have entered into a written agreement with the Federal Reserve and DFI that will require HBC to obtain the prior approval of the Federal Reserve and the DFI to make any dividend payment to the Company.

Our common stock is equity and therefore is subordinate to our and HBC's indebtedness and our Series A Preferred Stock, and our ability to declare dividends on our common stock may be limited.

Shares of the common stock are equity interests in us and do not constitute indebtedness. As such, shares of the common stock will rank junior to all current and future indebtedness and other non-equity claims on us with respect to assets available to satisfy claims on us, including in a liquidation of us.

We have supported our growth through the issuance of trust preferred securities from special purpose trusts and accompanying sales of junior subordinated debentures to these trusts. The accompanying subordinated debt had a principle amount totaling $23.7 million at December 31, 2009. Payments of the principal and interest on the trust preferred securities of these trusts are conditionally guaranteed by us. Further, the accompanying subordinated debt that we issued to the trusts is senior to our shares of common stock and Series A Preferred Stock. As a result, we must make payments on the subordinated debt before any dividends can be paid on our common stock and Series A Preferred Stock. Under the terms of the subordinated debt, we may defer interest payments for up to five years. In November 2009, we exercised our right to defer interest payments and we will continue to defer interest payments until further notice. Because we have deferred such interest payments, we may not declare or pay any cash dividends on any shares of our common stock or Series A Preferred Stock during the deferral period. In the event of our bankruptcy, dissolution or liquidation, the holders of the subordinated debt must be satisfied before any distributions can be made on our common stock or Series A Preferred Stock.

We may, and HBC may also, incur additional indebtedness from time to time and may increase our aggregate level of outstanding indebtedness.

Additionally, holders of our common stock are subject to the prior dividend and liquidation rights of any holders of our preferred stock then outstanding. Under the terms of the Series A Preferred Stock, our ability to declare or pay dividends on or repurchase our common stock or other equity or capital securities will be subject to restrictions in the event that we fail to declare and pay (or set aside for payment) full dividends on the Series A Preferred Stock. In November 2009, we announced that we have suspended the payment of dividends on the Series A Preferred Stock until further notice. In addition, prior to November 21, 2011, unless we have redeemed all of the Series A Preferred Stock or the U.S. Treasury has transferred all of the Series A Preferred Stock to third parties, the consent of the U.S. Treasury will be required for us to, among other things, increase our quarterly common stock dividend above $0.08 per share.

Our board of directors is authorized to cause us to issue additional classes or series of preferred stock without any action on the part of the shareholders. If we issue preferred shares in the future that have a preference over our common stock with respect to the payment of dividends or upon liquidation, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, then the rights of holders of our common stock or the market price of our common stock could be adversely affected.

Holders of our common stock are only entitled to receive such dividends as our board of directors may declare out of funds legally available for such payments.

We are also subject to various regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The Federal Reserve Board is authorized to determine, under certain circumstances relating to the financial condition of a bank holding company, such as us, that the payment of dividends would be an unsafe or unsound practice and prohibit payment (or require prior approval) of common stock dividends. As discussed above, we have entered into a written agreement with the Federal Reserve and DFI that will require us to obtain the prior approval of the Federal Reserve and DFI to make any interest payments on our outstanding trust preferred securities and the accompanying junior subordinated debentures, or to pay any dividends on our Series A Preferred Stock or common stock.

An entity holding as little as a 5% interest in our outstanding common stock could, under certain circumstances, be subject to regulation as a "bank holding company."

Any entity (including a "group" composed of natural persons) owning or controlling with the power to vote 25% or more of our outstanding common stock, or 5% or more if such holder otherwise exercises a "controlling influence" over us, may be subject to regulation as a "bank holding company" in accordance with the Bank Holding Company Act of 1956, as amended. In addition, (1) any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve under the Bank Holding Company Act to acquire or retain 5% or more of our outstanding common stock and (2) any person not otherwise defined as a company by the Bank Holding Company Act and its implementing regulations may be required to obtain the approval of the Federal Reserve under the Change in Bank Control Act to acquire or retain 10% or more of our outstanding common stock. Becoming a bank holding company imposes certain statutory and regulatory restrictions and obligations, such as providing managerial and financial strength for its bank subsidiaries. Regulation as a bank holding company could require the holder to divest all or a portion of the holder's investment in our common stock or such nonbanking investments that may be deemed impermissible or incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

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 387 Diablo Road in Danville, California 94526, at 3077 Stevenson Boulevard in Fremont, California 94538, at 300 Main Street in Pleasanton, California 94566, at 101 Ygnacio Valley Road in Walnut Creek, California 94596, at 18625 Sutter Boulevard in Morgan Hill, California 95037, at 7598 Monterey Street in Gilroy, California 95020, at 419 S. San Antonio Road in Los Altos, California 94022, and at 175 E. El Camino Real in Mountain View, California 94040.

Main Offices

The main offices of HBC are 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 May 31, 2015. The current monthly rent payment for the first two floors, consisting of approximately 22,723 square feet, is $56,808 and is subject to 3% annual increases until the lease expires. The current monthly rent payment for the third floor, which consists of approximately 12,824 square feet, is $53,861 until the lease expires. The Company has reserved the right to extend the term of the lease for two additional periods of five years each.

In January of 1997, the Company leased 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 current monthly rent payment is $5,271 until the lease expires on May 31, 2015. The Company has reserved the right to extend the term of the lease for two additional periods of five years each.

Branch Offices

In March of 1999, the Company leased approximately 7,260 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 $12,183 and is subject to adjustment every 36 months, based on the Consumer Price Index of the Labor of Statistics as defined in the lease agreement, until the lease expires on October 31, 2014.

In May of 2006, the Company leased 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 $4,785 and is subject to annual increases of 2% until the lease expires on September 30, 2016. The Company has reserved the right to extend the term of the lease for two additional periods of five years each.

In April of 2007, the Company leased approximately 3,850 square feet on the first floor in a four-story multi-tenant office building located at 101 Ygnacio Valley Road in Walnut Creek, California. The current monthly rent payment is $13,479 and is subject to annual increases of 3% until the lease expires on August 15, 2014. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In June of 2007, as part of the acquisition of Diablo Valley Bank the Company took ownership of an 8,300 square foot one-story commercial building, including the land, located at 387 Diablo Road in Danville, California. The Company also assumed a 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 $15,895 and is subject to annual increases of 3% until the lease expires on October 31, 2010. The Company has reserved the right to extend the term of the lease for one additional period of seven years.

In August of 2007, the Company extended its lease for approximately 6,590 square feet in a one-story stand-alone office building located at 3077 Stevenson Boulevard in Fremont, California. The current monthly rent payment is $13,983 and is subject to annual increases of 3% until the lease expires on February 28, 2013. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In February 2008, the Company extended its lease for approximately 4,840 square feet in a one-story multi-tenant shopping center located at 175 E. El Camino Real in Mountain View, California. The current monthly rent payment is $14,405 and is subject to annual increases, based on the Consumer Price Index of the Bureau of Labor Statistics as defined in the lease agreement. The lease expires on May 31, 2013; however, the Company has reserved the right to extend the term of the lease for one additional period of five years.

In June of 2008, the Company entered into a sublease agreement 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 $17,182 and is subject to annual increases of 3% until the sublease expires on April 30, 2012. After the sublease has expired, occupancy will continue under a direct lease, also entered into in June of 2008. The monthly rent payment beginning on May 1, 2012 will be $24,501 and is subject to annual increases of 3% until the lease expires on April 30, 2018. The Company has reserved the right to extend the term of the lease for two additional periods of five years each.

In December of 2008, 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 $5,438 and is subject to annual increases of 3% until the lease expires on November 30, 2013. The Company has reserved the right to extend the term of the lease for one additional period of five years.

Loan Production Offices

In November of 2008, the Company extended its lease on a month-to-month basis for approximately 243 square feet of office space located at 1440 Broadway in Oakland, California 94612. The current monthly rent payment is $535.

In January of 2009, the Company extended its lease on a month-to-month basis for approximately 225 square feet of office space located at 8788 Elk Grove Boulevard in Elk Grove, California. The current monthly rent payment is $675.

In October of 2009, the Company renewed its lease for approximately 250 square feet of office space located at 740 Fourth Street in Santa Rosa, California. The current monthly rent payment is $1,287 until the lease expires on October 8, 2010.

For additional information on operating leases and rent expense, refer to Footnote 10 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 — *RESERVED*

PART II

ITEM 5 — *MARKET FOR 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." Management is aware of the following securities dealers which make a market in the Company's common stock: Credit Suisse Securities, UBS Securities, Goldman Sachs & Company, Citadel Derivatives Group, Morgan Stanley & Company, Knight Equity Markets, Keefe, Bruyette & Woods, Barclays Capital Inc., Howes Barnes Investments, Timber Hill, Susquehanna Capital Group, Susquehanna Financial Group, Merrill Lynch, Cantor Fitzgerald & Company, Fig Partners, D.A. Davidson, Natixis Bleichroeder, Automated Trading Desk Financial Services, Bloomberg Tradebook, Domestic Securities Inc., E*Trade Capital Markets, Hudson Securities, Nasdaq Execution Services, Sandler, O'Neill & Partners, and Stifel, Nicolaus & Company. These market makers have committed to make a market for the Company's common stock, although they may discontinue making a market at any time. No assurance can be given that an active trading market will be sustained for the common stock at any time in the future.

The information in the following table for 2009 and 2008 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, 2009:			
Fourth quarter	$ 4.64	$ 2.50	$ —
Third quarter	$ 5.75	$ 2.99	$ —
Second quarter	$ 8.66	$ 3.61	$ —
First quarter	$11.75	$ 3.75	$0.02
Year ended December 31, 2008:			
Fourth quarter	$15.83	$ 9.61	$0.08
Third quarter	$16.43	$ 8.48	$0.08
Second quarter	$18.78	$ 9.90	$0.08
First quarter	$18.93	$15.23	$0.08

The closing price of our common stock on March 10, 2010 was $3.99 per share as reported by the NASDAQ Global Select Market.

As of March 10, 2010, there were approximately 700 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 should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also Federal Reserve policy that bank holding companies should not maintain dividend levels that undermine the bank 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 discussed above, we have entered into a written agreement with the Federal Reserve and the DFI that will require us to obtain the prior approval of the Federal Reserve and DFI to make any interest payments on our outstanding trust preferred debt, or to pay any dividends on our Series A Preferred Stock or common stock. Dividends from HBC constitute the principal source of income to HCC. HBC is subject to various statutory and regulatory restrictions on its ability to pay dividends to us, which determines our ability to pay dividends to our shareholders.

Under the terms of the Capital Purchase Program, for so long as any preferred stock issued under the Capital Purchase Program remains outstanding, we are prohibited from increasing quarterly dividends on our common stock in excess of $0.08 per share, and from making certain repurchases of equity securities, including our common stock, without the U.S. Treasury's consent until the third anniversary of the U.S. Treasury investment or until the U.S. Treasury has transferred all of the preferred stock it purchased under the Capital Purchase Program to third parties. As long as the preferred stock issued to the U.S. Treasury is outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including our common stock, are also prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. We have not paid or declared any dividends on our common stock since the first quarter of 2009. In November 2009, we suspended the payment of dividends on the Series A Preferred Stock until further notice.

We have supported our growth through the issuance of trust preferred securities from special purpose trusts and accompanying sales of subordinated debt to these trusts. The subordinated debt that we issued to the trusts is senior to our shares of common stock and Series A Preferred Stock. As a result, we must make payments on the subordinated debt before any dividends can be paid on our common stock and Series A Preferred Stock. Under the terms of the subordinated debt, we may defer interest payments for up to five years. In November 2009, we exercised our right to defer interest payments and we will continue to defer interest payments until further notice. Because we have deferred such interest payments, we may not declare or pay any cash dividends on any shares of our common stock or Series A Preferred Stock during the deferral period. In the event of our bankruptcy, dissolution or liquidation, the holders of the subordinated debt must be satisfied before any distributions can be made on our common stock or Series A Preferred Stock.

At such time as we become current with the dividends payable on the Series A Preferred Stock and interest payments on our junior subordinated debentures, 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 regulatory restrictions on payment of dividends by the Company, see *Item 1 — "BUSINESS — Supervision and Regulation — Heritage Commerce Corp — Limitations on Dividend Payments*."

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2009 regarding equity compensation plans under which equity securities of the Company were authorized for issuance:

Plan Category	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	1,110,056(1)	$16.93	778,508
Equity compensation plans not approved by security holders	25,500(2)	$18.15	N/A
Equity compensation plans not approved by security holders	462,963(3)	$12.96	N/A

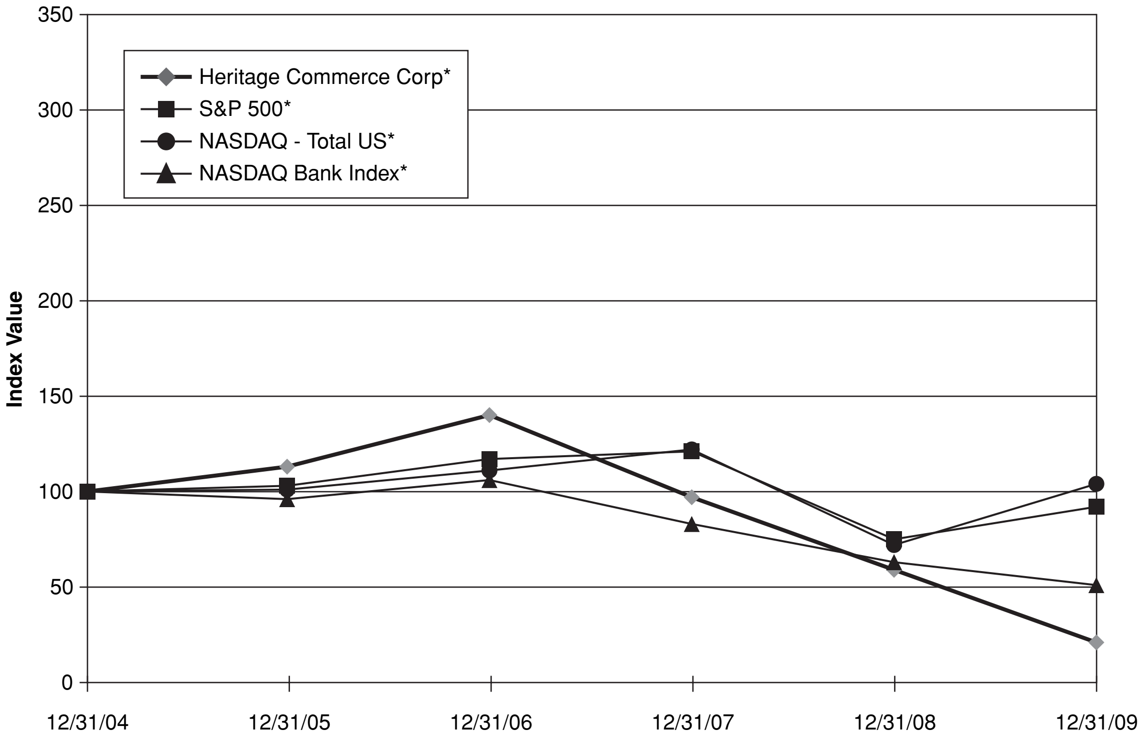
(1) Consists of 150,969 options to acquire shares of common stock issued under the Company's 1994 stock option plan, and 959,087 options to acquire shares under the Company's Amended and Restated 2004 Equity Plan.

(2) Consists of restricted stock issued to the Company's chief executive officer pursuant to a restricted stock agreement dated March 17, 2005.

(3) Consists of warrant issued to the U.S. Treasury to purchase 462,963 shares of the Company's common stock. The warrant is immediately exercisable and has a 10-year term with an initial exercise price of $12.96 pursuant to a Letter Agreement of Securities Purchase dated November 21, 2008.

Performance Graph

The following graph compares the stock performance of the Company from December 31, 2004 to December 31, 2009, 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, 2004 to December 31, 2009, 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 Ended					
Index	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**
Heritage Commerce Corp*	100	113	140	97	59	21
S&P 500*	100	103	117	121	75	92
NASDAQ — Total US*	100	101	111	122	72	104
NASDAQ Bank Index*	100	96	106	83	63	51

* Source: SNL Financial Bank Information Group — (434) 977-1600

Stock Repurchase Program

In July 2007, the Company's Board of Directors authorized the purchase of up to an additional $30 million of its common stock, which represented approximately 1.48 million shares, or 11%, of its outstanding shares at the current market price on the date of authorization. From August 2007 through May 2008, the Company repurchased 1,645,607 shares of common stock for a total of $29.8 million completing the repurchase program. The Company financed the repurchase of shares from its available cash.

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 included under Item 8 — *"FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA."*

SELECTED FINANCIAL DATA

	AT OR FOR YEAR ENDED DECEMBER 31,				
	2009	2008	2007	2006	2005
	(Dollars in thousands, except per share amounts and ratios)				
INCOME STATEMENT DATA:					
Interest income	$ 62,293	$ 75,957	$ 78,712	$ 72,957	$ 63,756
Interest expense	16,326	24,444	27,012	22,525	15,907
Net interest income before provision for loan losses	45,967	51,513	51,700	50,432	47,849
Provision for loan losses	33,928	15,537	(11)	(503)	313
Net interest income after provision for loan losses	12,039	35,976	51,711	50,935	47,536
Noninterest income	8,027	6,791	8,052	9,840	9,423
Noninterest expense	44,760	42,392	37,530	34,268	35,233
Income (loss) before income taxes	(24,694)	375	22,233	26,507	21,726
Income tax expense (benefit)	(12,709)	(1,387)	8,137	9,237	7,280
Net income (loss)	(11,985)	1,762	14,096	17,270	14,446
Dividends and discount accretion on preferred stock	(2,376)	(255)	—	—	—
Net income (loss) allocable to common shareholders	$ (14,361)	$ 1,507	$ 14,096	$ 17,270	$ 14,446
PER COMMON SHARE DATA:					
Basic net income (loss)(1)	$ (1.21)	$ 0.13	$ 1.13	$ 1.47	$ 1.22
Diluted net income (loss)(2)	$ (1.21)	$ 0.13	$ 1.12	$ 1.44	$ 1.19
Book value per common share(3)	$ 11.34	$ 12.38	$ 12.90	$ 10.54	$ 9.45
Tangible book value per common share(4)	$ 7.38	$ 8.37	$ 9.20	$ 10.54	$ 9.45
Weighted average number of shares outstanding — basic	11,820,509	12,002,910	12,449,270	11,776,671	11,795,635
Weighted average number of shares outstanding — diluted	11,820,509	12,039,776	12,566,801	11,966,397	12,107,230
Shares outstanding at period end	11,820,509	11,820,509	12,774,926	11,656,943	11,807,649
BALANCE SHEET DATA:					
Securities	$ 109,966	$ 104,475	$ 135,402	$ 172,298	$ 198,495
Net loans	$ 1,041,345	$ 1,223,624	$ 1,024,247	$ 699,957	$ 669,901
Allowance for loan losses	$ 28,768	$ 25,007	$ 12,218	$ 9,279	$ 10,224
Goodwill and other intangible assets	$ 46,770	$ 47,412	$ 48,153	$ —	$ —
Total assets	$ 1,363,870	$ 1,499,227	$ 1,347,472	$ 1,037,138	$ 1,130,509
Total deposits	$ 1,089,285	$ 1,154,050	$ 1,064,226	$ 846,593	$ 939,759
Securities sold under agreement to repurchase	$ 25,000	$ 35,000	$ 10,900	$ 21,800	$ 32,700
Subordinated debt	$ 23,702	$ 23,702	$ 23,702	$ 23,702	$ 23,702
Note payable	$ —	$ 15,000	$ —	$ —	$ —
Short-term borrowings	$ 20,000	$ 55,000	$ 60,000	$ —	$ —
Total shareholders' equity	$ 172,305	$ 184,267	$ 164,824	$ 122,820	$ 111,617
SELECTED PERFORMANCE RATIOS:(5)					
Return on average assets	−0.83%	0.12%	1.18%	1.57%	1.27%
Return on average tangible assets	−0.86%	0.13%	1.21%	1.57%	1.27%
Return on average equity	−6.68%	1.15%	9.47%	14.62%	13.73%
Return on average tangible equity	−9.06%	1.67%	11.43%	14.62%	13.73%
Net interest margin	3.53%	3.94%	4.86%	5.06%	4.58%
Efficiency ratio	82.90%	72.71%	62.81%	56.86%	61.52%
Average net loans (excludes loans held-for-sale) as a percentage of average deposits	98.98%	100.01%	84.06%	77.61%	73.55%
Average total shareholders' equity as a percentage of average total assets	12.46%	10.52%	12.47%	10.75%	9.25%
SELECTED ASSET QUALITY RATIOS:(6)					
Net loan charge-offs (recoveries) to average loans	2.59%	0.23%	(0.10)%	0.06%	0.28%
Allowance for loan losses to total loans	2.69%	2.00%	1.18%	1.31%	1.51%
Nonperforming loans to total loans	5.83%	3.24%	0.33%	0.61%	0.54%
CAPITAL RATIOS:					
Total risk-based	12.9%	13.4%	12.5%	18.4%	15.3%
Tier 1 risk-based	11.6%	12.1%	11.5%	17.3%	14.2%
Leverage	10.1%	11.3%	11.1%	13.6%	11.6%

Notes:

1) Represents net income (loss) allocable to common shareholders divided by the average number of shares of common stock outstanding for the respective period. For years prior to 2009, earnings per share ("EPS") and weighted average shares outstanding have been adjusted retrospectively to apply new accounting guidance that became effective in 2009. Except for reducing basic EPS from $1.14 to $1.13 in 2007, this change in computation did involve a sufficient number of shares to change basic or diluted EPS from amounts previously reported.

2) Represents net income (loss) allocable to common shareholders divided by the average number of shares of common stock and common stock-equivalents outstanding for the respective period.

3) Represents shareholders' equity minus preferred stock divided by the number of shares of common stock outstanding at the end of the period indicated.

4) Represents shareholders' equity minus preferred stock and minus goodwill and other intangible assets divided by the number of shares of common stock outstanding at the end of period indicated.

5) Average balances used in this table and throughout this Annual Report are based on daily averages.

6) 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 HCC and its wholly-owned subsidiary, HBC. 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.

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 southern and eastern regions of the general San Francisco Bay area of California in the counties of Santa Clara, Alameda and Contra Costa. The largest city in this area is San Jose and the Company's market includes 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

Comparison of 2009 operating results to 2008 and 2007 includes the effects of acquiring Diablo Valley Bank on June 20, 2007. In the Diablo Valley Bank transaction, the Company acquired $269.0 million of tangible assets, including $203.8 million of net loans, and assumed $249.0 million of deposits.

For the year ended December 31, 2009, the net loss was $12.0 million. Net loss allocable to common shareholders was $14.4 million, or $(1.21) per diluted common share for the year ended December 31, 2009, which included a $33.9 million provision for loan losses and $2.4 million for dividends and discount accretion on preferred stock. For the year ended December 31, 2008, net income allocable to common shareholders was $1.5 million, or $0.13 per diluted common share, including a provision for loan losses of $15.5 million and $255,000 for dividends or discount accretion on preferred stock. For the year ended December 31, 2007, net income allocable to common shareholders was $14.1 million, or $1.12 per diluted common share, including a credit provision for loan losses of $11,000 and no dividends or discount accretion on preferred stock.

The annualized returns on average assets and average equity for the year ended December 31, 2009 was −0.83% and −6.68%, respectively, compared to 0.12% and 1.15%, respectively, for 2008, and 1.18% and 9.47%, respectively, for 2007. The annualized returns on average tangible assets and average tangible equity for the year ended December 31, 2009 was −0.86% and −9.06%, respectively, compared to 0.13% and 1.67%, respectively, for 2008, and 1.21% and 11.43%, respectively, for 2007.

The following are major factors that impacted the Company's results of operations:

- Net interest income decreased 11% to $46.0 million for the year ended December 31, 2009 from $51.5 million for the year ended December 31, 2008, primarily due to compression of the net interest margin. Net interest income was relatively flat in 2008 compared to 2007, primarily due to a lower net interest margin, mostly offset by an increase in the volume of interest-earning assets as a result of the merger with Diablo Valley Bank and significant new loan production.
- The net interest margin decreased 41 basis points to 3.53% for the year ended December 31, 2009, compared with 3.94% for the year ended December 31, 2008. The decrease in the net interest margin for 2009 compared to 2008 was primarily due to the 325 basis points decline in short-term interest rates from January 22, 2008 through December 16, 2008, with the prime rate remaining at a historically low level of 3.25% for all of 2009. The net interest margin also declined in 2009 due to an increase in nonaccrual loans. The net interest margin for 2008 was 3.94%, a decrease of 92 basis points from 4.86% for 2007, primarily due to the decline in short-term interest rates.
- The provision for loan losses was $33.9 million for the year ended December 31, 2009, compared to $15.5 million for the year ended December 31, 2008, and a credit provision for loan losses of $11,000 in 2007. The significant increase in provision for loan losses in 2009 reflects a higher volume of classified and nonperforming loans and an increase in loan charge-offs caused by challenging conditions in commercial lending and the residential housing market, turmoil in the financial markets, and the prolonged downturn in the overall economy.
- Noninterest income increased 18% to $8.0 million for the year ended December 31, 2009 from $6.8 million for the year ended December 31, 2008. The increase in noninterest income in 2009 compared to 2008 was primarily due to $1.3 million in gains on the sale of SBA loans in 2009. Noninterest income decreased by 16% in 2008 to $6.8 million, compared to $8.1 million in 2007, primarily a result of no gains on the sale of SBA loans in 2008.
- Noninterest expense increased 6% to $44.8 million for the year ended December 31, 2009 from $42.4 million for the year ended December 31, 2008. The increase in noninterest expense was primarily due to higher FDIC deposit insurance costs. Operating expenses increased 13% in 2008 from $37.5 million in 2007 due to the full year impact of the acquisition of Diablo Valley Bank on June 20, 2007, including an increase in amortization of intangible assets, the new office in Walnut Creek, the addition of experienced banking professionals, the write-off of leasehold improvements due to the consolidation of our two offices in Los Altos, higher FDIC insurance costs, and an increase in legal fees and OREO expense.
- The efficiency ratio was 82.90% for the year ended December 31, 2009, compared to 72.71% for the year ended December 31, 2008, and 62.81% for the year ended December 31, 2007. The efficiency ratio increased in 2009 and 2008 primarily due to lower net interest income, higher professional fees and increased FDIC deposit insurance premiums.
- The income tax benefit for the year ended December 31, 2009 was $12.7 million, as compared to an income tax benefit of $1.4 million for the year ended December 31, 2008, and income tax expense of $8.1 million in 2007. The effective income tax rate for 2009 was 51.5%. The negative effective income tax rate of 369.9% for 2008 was due to reduced pre-tax earnings. The effective tax rate for 2007 was 36.6%. The difference in the effective tax rate compared to the combined Federal and state statutory tax rate of 42% 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, and interest income from tax-free loans and municipal securities.

The following are important factors in understanding our current financial condition and liquidity position:

- Total assets decreased by $135.4 million, or 9%, to $1.36 billion at December 31, 2009 from $1.50 billion at December 31, 2008.
- Total loans, excluding loans held-for-sale, decreased $178.5 million, or 14%, to $1.07 billion at December 31, 2009 compared to $1.25 billion at December 31, 2008. Land and construction loans decreased $73.7 million from $256.6 million at December 31, 2008 to $182.9 million at December 31, 2009.
- The allowance for loan losses increased to $28.8 million, or 2.69% of total loans at December 31, 2009, compared to $25.0 million, or 2.00% of total loans at December 31, 2008.
- Nonperforming assets increased $23.5 to $64.6 million, or 4.74% of total assets at December 31, 2009, from $41.1 million, or 2.74% of total assets at December 31, 2008.
- Net loan charge-offs increased to $30.2 million for the year ended December 31, 2009, compared to $2.7 million for the year ended December 31, 2008.
- Deposits decreased to $1.09 billion at December 31, 2009, compared to $1.15 billion at December 31, 2008.
- The ratio of noncore funding (which consists of time deposits $100,000 and over, CDARS deposits, brokered deposits, securities under agreement to repurchase, notes payable and short-term borrowings) to total assets was 29% at December 31, 2009, compared to 32% at December 31, 2008.
- The loan to deposit ratio was 98.24% at December 31, 2009, compared to 108.20% at December 31, 2008.
- As of December 31, 2009, HBC had a leverage ratio of 9.9%, a Tier 1 risk-based capital ratio of 11.4%, and a total risk-based capital ratio of 12.7%.
- As of December 31, 2009, HCC had a leverage ratio of 10.1%, a Tier 1 risk-based capital ratio of 11.6%, and a total risk-based capital ratio of 12.9%.

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. The Company had $178.0 million in brokered deposits at December 31, 2009, compared to $184.6 million at December 31, 2008. Deposits from title insurance companies, escrow accounts and real estate exchange facilitators decreased to $23.0 million at December 31, 2009, compared to $56.6 million at December 31, 2008. 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 deposit concentrations.

HBC is a member of the Certificate of Deposit Account Registry Service ("CDARS") program. The CDARS program allows customers with deposits in excess of 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. Deposits in the CDARS program totaled $38.2 million at December 31, 2009, and $11.7 million at December 31, 2008.

HBC is a participant in the FDIC's Transaction Account Guarantee Program ("TAGP"), which provides HBC's depositors with unlimited FDIC insurance coverage for certain noninterest-bearing transaction accounts. Unless extended by the FDIC, the TAGP will expire on June 30, 2010, at which time the amount of coverage for each depositor will be limited to $250,000. The impact of the TAGP expiration in June 2010 could have an adverse effect on HBC's deposit base.

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. We believe that our liquidity position is more than sufficient to meet our operating expenses, borrowing needs and other obligations for 2010. At December 31, 2009, we had $45.6 million in cash and cash equivalents and approximately $191.1 million in available borrowing capacity from various sources including the FHLB, the Federal Reserve, and Federal funds facilities with several financial institutions. The Company also had $53.3 million in unpledged securities available at December 31, 2009. Our loan to deposit ratio decreased to 98.24% at December 31, 2009 compared to 108.20% at December 31, 2008, primarily due to a $178.5 million reduction in the loan portfolio.

Lending

Our lending business originates primarily through our branch offices located in our primary market. The Company also has SBA loan production offices in Sacramento, Oakland and Santa Rosa, California. As a result of the weakened economy in our primary service area throughout 2008 and 2009 and loan payoffs, we have seen a contraction in our loan portfolio during 2009 and this trend may continue through 2010. In addition to managing the growth of our loan portfolio during 2009, we actively managed the mix of our loan portfolio. At December 31, 2009, commercial loans accounted for 40% of the total loan portfolio, and commercial real estate loans (of which 53% are owner occupied) accounted for 37% of the portfolio. We have actively lowered our exposure to land and construction loans and our overall credit risk on these portfolios has been reduced. Land and construction loans decreased $73.7 million for the year ended December 31, 2009, compared to December 31, 2008, and accounted for 17% of our loan portfolio. We expect the decreasing trend in land and construction loans to continue through 2010.

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).

Because of our focus on commercial lending to closely held businesses, the Company will continue to have a high percentage of floating rate loans and other assets. Given the current volume, mix and repricing characteristics of our interest-bearing liabilities and interest-earning assets, we believe our interest rate spread is expected to increase in a rising rate environment, and decrease in a declining interest rate environment.

The Company, through its asset and liability policies and practices, seeks to maximize net interest income without exposing the Company to an excessive level of interest rate risk. 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.

From January 22, 2008 through December 16, 2008, the Board of Governors of the Federal Reserve System reduced short-term interest rates by 325 basis points. This decrease in short-term rates immediately affected the rates applicable to the majority of the Company's loans. While the decrease in interest rates also lowered the cost of interest bearing deposits, which represents the Company's primary funding source, these deposits tend to price more slowly than floating rate loans. The rapid, substantial drop in short-term interest rates, including the prime rate, has significantly compressed the Company's net interest margin.

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 enable us to resolve credit issues with potentially less 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, at any time there are loans included in the portfolio that may result in losses, but that have not yet been identified as 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, there may be loans that deteriorate in an accelerated time frame. As a result, future additions to the allowance may be necessary. Because the loan portfolio contains a number of commercial real estate, 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."*

Noninterest Income

While net interest income remains the largest single component of total revenues, noninterest income is an important component. Prior to the third quarter of 2007, a significant percentage of the Company's noninterest income was associated with its 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. From the third quarter of 2007 through the second quarter of 2009, the Company retained its SBA production. In the third quarter of 2009, the Company began to again sell loans in the secondary market. During the third and fourth quarters of 2009, SBA loans were sold resulting in a net gain on sale of loans of $1.3 million for the year ended December 31, 2009. We expect to continue to sell loans in the secondary market in 2010 to enhance liquidity and improve noninterest income. Other sources of noninterest income include loan servicing fees, service charges and fees, and cash surrender value from company owned life insurance policies.

Noninterest Expense

Management considers the control of operating expenses to be a critical element of the Company's performance. During the last several quarters, the Company has undertaken several initiatives to reduce its noninterest expense and improve its efficiency. Nonetheless, noninterest expense increased for the year ended December 31, 2009 compared to the year ended December 31, 2008, due to a substantial increase in FDIC deposit insurance premiums, increased professional fees, and loan workout expense resulting from the current credit cycle. The Company's efficiency ratio was 82.90% for the year ended December 31, 2009, compared with 72.71% for the year ended December 31, 2008. The efficiency ratio increased year to year primarily due to compression of the Company's net interest margin, and higher professional fees and increased FDIC insurance premiums.

Capital Management

As part of its asset and liability process, the Company continually assesses its capital position to take into consideration growth, expected earnings, risk profile and potential corporate activities that it may choose to pursue.

At December 31, 2009, HBC's total risk-based capital ratio was 12.7%, compared to the 10% regulatory requirement for well-capitalized banks under the regulatory framework for prompt corrective actions. HBC's Tier 1 risk-based capital ratio of 11.4% and our leverage ratio of 9.9% at December 31, 2009 also exceeded regulatory guidelines for well-capitalized banks under the prompt corrective actions framework. On a consolidated basis, the Company has a leverage ratio of 10.1%, a Tier 1 risk-based capital ratio of 11.6%, and a total risk-based capital ratio of 12.9% at December 31, 2009.

On November 21, 2008, the Company issued to the U.S. Treasury under its Capital Purchase Program 40,000 shares of Series A Preferred Stock and a warrant to purchase 462,963 shares of common stock at an exercise price of $12.96 for $40 million. The terms of the U.S. Treasury Capital Purchase Program could reduce investment returns to our shareholders by restricting dividends to common shareholders, diluting existing shareholders' interests, and restricting capital management practices.

In April 2009, the Board of Directors suspended the quarterly dividend on our common stock, commencing with the second quarter of 2009, to build capital and further strengthen our balance sheet.

In November 2009, we exercised our right to defer interest payments on our outstanding trust preferred subordinated debt and our right to suspend payment of dividends on our Series A Preferred Stock. We do not expect to resume paying cash dividends on our common stock or Series A Preferred Stock or interest on our trust preferred subordinated debt for the near term, and future dividends and interest payments will depend on sufficient earnings to support them and prior approval of the Federal Reserve. We believe these actions will further enhance our capital levels during the current economic challenges.

Results of Operations

The Company earns income from two primary sources. The first is net 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 SBA 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. 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.

Distribution, Rate and Yield

	Year Ended December 31,								
	2009			2008			2007		
	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)	$1,171,537	$58,602	5.00%	$1,178,194	$70,488	5.98%	$ 844,928	$68,405	8.10%
Securities	106,806	3,628	3.40%	126,223	5,395	4.27%	165,884	7,636	4.60%
Interest bearing deposits in other financial institutions	22,827	63	0.28%	881	16	1.82%	3,132	141	4.50%
Federal funds sold	433	—	0.10%	3,060	58	1.90%	49,118	2,530	5.15%
Total interest earning assets	1,301,603	62,293	4.79%	1,308,358	75,957	5.81%	1,063,062	78,712	7.40%
Cash and due from banks	24,985			34,339			37,435		
Premises and equipment, net	9,311			9,273			6,218		
Goodwill and other intangible assets	47,105			47,788			25,331		
Other assets	56,940			56,603			61,844		
Total assets	$1,439,944			$1,456,361			$1,193,890		
Liabilities and shareholders' equity:									
Deposits:									
Demand, interest bearing	$ 136,734	$ 336	0.25%	$ 145,785	$ 1,513	1.04%	$ 143,801	$ 3,154	2.19%
Savings and money market	334,657	2,514	0.75%	433,839	7,679	1.77%	393,750	12,368	3.14%
Time deposits-under $100	43,946	983	2.24%	36,301	1,101	3.03%	32,196	1,243	3.86%
Time deposits-$100 and over	155,475	2,813	1.81%	162,298	4,853	2.99%	119,812	5,151	4.30%
Time deposits-CDARS	19,702	303	1.54%	3,488	81	2.32%	—	—	N/A
Time deposits-brokered	196,113	6,513	3.32%	120,591	4,808	3.99%	49,846	2,295	4.60%
Subordinated debt	23,702	1,933	8.15%	23,702	2,148	9.06%	23,702	2,329	9.83%
Securities sold under agreement to repurchase	28,822	787	2.73%	32,030	937	2.93%	14,504	387	2.67%
Note payable	2,507	82	3.27%	10,243	292	2.85%	—	—	N/A
Short-term borrowings	24,940	62	0.25%	48,238	1,032	2.14%	1,751	85	4.85%
Total interest bearing liabilities	966,598	16,326	1.69%	1,016,515	24,444	2.40%	779,362	27,012	3.47%
Demand, noninterest bearing	261,539			258,624			242,308		
Other liabilities	32,417			28,006			23,385		
Total liabilities	1,260,554			1,303,145			1,045,055		
Shareholders' equity	179,390			153,216			148,835		
Total liabilities and shareholders' equity	$1,439,944			$1,456,361			$1,193,890		
Net interest income / margin		$45,967	3.53%		$51,513	3.94%		$51,700	4.86%

(1) Yields and amounts earned on loans include loan fees and costs. Nonaccrual loans are included in the average balance calculations above.

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 times the prior period rate and rate variances are equal to the increase or decrease in the average rate times the prior period average balance. Variances attributable to both rate and volume changes are equal to the change in rate times the change in average balance and are included below in the average volume column.

Volume and Rate Variances

	2009 vs. 2008			2008 vs. 2007		
	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	$ (308)	$(11,578)	$(11,886)	$19,961	$(17,878)	$ 2,083
Securities	(664)	(1,103)	(1,767)	(1,688)	(553)	(2,241)
Interest bearing deposits in other financial institutions	61	(14)	47	(41)	(84)	(125)
Federal funds sold	(3)	(55)	(58)	(875)	(1,597)	(2,472)
Total interest income on interest earning assets	$ (914)	$(12,750)	$(13,664)	$17,357	$(20,112)	$(2,755)
Expense from the interest bearing liabilities:						
Demand, interest bearing	$ (28)	$ (1,149)	$ (1,177)	$ 17	$ (1,658)	$(1,641)
Savings and money market	(740)	(4,425)	(5,165)	710	(5,399)	(4,689)
Time deposits-under $100	170	(288)	(118)	125	(267)	(142)
Time deposits-$100 and over	(125)	(1,915)	(2,040)	1,271	(1,569)	(298)
Time deposits-CDARS	249	(27)	222	2,845	(332)	2,513
Time deposits-brokered	2,509	(804)	1,705	81	—	81
Subordinated debt	—	(216)	(216)	—	(181)	(181)
Securities sold under agreement to repurchase	(87)	(63)	(150)	512	38	550
Notes payable	(253)	43	(210)	292	—	292
Short-term borrowings	(58)	(911)	(969)	995	(48)	947
Total interest expense on interest bearing liabilities	$ 1,637	$ (9,755)	$ (8,118)	$ 6,847	$ (9,415)	$(2,568)
Net interest income	$(2,551)	$ (2,995)	$ (5,546)	$10,510	$(10,697)	$ (187)

Net interest income for 2009 decreased $5.5 million from 2008, primarily due to compression of the net interest margin. The decrease in the net interest margin in 2009 compared to 2008 was primarily due to the 325 basis points decline in short-term interest rates from January 22, 2008 through December 16, 2008, with the prime rate remaining at a historically low level of 3.25% for all of 2009. The Company's net interest margin, expressed as a percentage of average earning assets, was 3.53% in 2009 compared to 3.94% in 2008, a decrease of 41 basis points. The net interest margin was also lower in 2009 due to an increase in nonaccrual loans.

A substantial portion of the Company's earning assets are variable-rate loans that re-price when the Company's prime lending rate is changed, in contrast to a large base of core deposits that are generally slower to re-price. This causes the Company's balance sheet to be asset-sensitive which means that, all else being equal, the Company's net interest margin will be lower during periods when short-term interest rates are falling and higher when rates are rising.

The net interest margin decreased 92 basis points to 3.94% in 2008 from 4.86% in 2007. Net interest income decreased $187,000 for 2008 to $51.5 million from $51.7 million for 2007, primarily due to the 500 basis points decline in short-term interest rates from September 18, 2007 through December 31, 2008, partially offset by a 23% increase in average interest-earning assets in 2008 from 2007.

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 losses are promptly charged off against the allowance. The loan loss provision is determined by conducting a quarterly evaluation of the adequacy of the Company's allowance for loan losses and charging the shortfall, 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 loan loss provision 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.

For 2009, the Company had a provision for loan losses of $33.9 million, compared to a provision for loan losses of $15.5 million for 2008 and a credit provision for loan losses of $11,000 for 2007. The significant increase in provision for loan losses in 2009 reflects a higher volume of classified and nonperforming loans and an increase in loan charge-offs caused by challenging conditions in commercial lending and the residential housing market, turmoil in the financial markets, and the prolonged downturn in the overall economy.

The allowance for loan losses represented 2.69%, 2.00% and 1.18% of total loans at December 31, 2009, 2008 and 2007, respectively. See "*Allowance for Loan Losses*" for additional information.

Noninterest Income

The following table sets forth the various components of the Company's noninterest income:

Noninterest Income

	Year Ended December 31,			Increase (decrease) 2009 versus 2008		Increase (decrease) 2008 versus 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Service charges and fees on deposit accounts	$2,221	$2,007	$1,284	$ 214	11%	$ 723	56%
Increase in cash surrender value of life insurance	1,664	1,645	1,443	19	1%	202	14%
Servicing income	1,587	1,790	2,181	(203)	(11)%	(391)	(18)%
Gain on sale of SBA loans	1,306	—	1,766	1,306	N/A	(1,766)	(100)%
Gain on sale of securities	231	—	—	231	N/A	—	N/A
Other	1,018	1,349	1,378	(331)	(25)%	(29)	(2)%
Total	$8,027	$6,791	$8,052	$1,236	18%	$(1,261)	(16)%

The increase in noninterest income in 2009 compared to 2008 was primarily attributable to a $1.3 million increase in gain on sale of SBA loans. There was no gain on sale of SBA loans in 2008, and a $1.8 million gain on sale of SBA loans in 2007. Other sources of noninterest income include loan servicing fees, service charges and fees, and the cash surrender value from company owned life insurance policies.

Historically, a significant percentage of the Company's noninterest income has been associated with its SBA lending activity, as gains on the sale of loans sold in the secondary market and servicing income from loans sold with servicing rights retained. From the third quarter of 2007 through the second quarter of 2009, the Company changed its strategy regarding its SBA loan business by retaining new SBA production in lieu of selling the loans. Reflecting the strategic shift to retain SBA loan production, there were no gains from sales of loans during 2008 and for the first six months of 2009. The Company transferred $20.5 million of SBA loans to loans held-for-sale in the second quarter of 2009 to enhance its liquidity position and improve noninterest income in future periods. During the third and fourth quarters of 2009, SBA loans were sold resulting in a net gain on sale of $1.3 million for the year ended December 31, 2009. We expect to continue to sell loans in the secondary market in 2010 to enhance liquidity and improve noninterest income.

The servicing assets that result from the sale 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.

Service charges and fees on deposit accounts were higher during 2009 compared to 2008, due to higher fees from accounts on analysis as a result of lower interest rates and fewer waived fees. Lower interest rates generally result in lower earnings credits and higher net fees for services provided to clients.

The increase in cash surrender value of life insurance approximates a 4.10% after tax yield on the policies. To realize this tax advantaged yield, the policies must be held until death of the insured individuals, who are current and former officers and directors of the Company.

The decrease in noninterest income in 2008 compared to 2007 was primarily attributable to a $1.8 million decrease in gain on sale of SBA loans.

Noninterest Expense

The following table sets forth the various components of the Company's noninterest expense:

Noninterest Expense

	Year Ended December 31,			Increase (decrease) 2009 versus 2008		Increase (decrease) 2008 versus 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Salaries and employee benefits	$22,927	$22,624	$21,160	$ 303	1%	$1,464	7%
Occupancy and equipment	3,937	4,623	4,195	(686)	(15)%	428	10%
Professional fees	3,851	2,954	2,342	897	30%	612	26%
Deposit insurance premiums and regulatory assessments	3,454	885	313	2,569	290%	572	183%
Low income housing investment losses	922	865	828	57	7%	37	4%
Data processing	912	1,021	867	(109)	(11)%	154	18%
Software subscription	865	940	831	(75)	(8)%	109	13%
Advertising and promotion	406	882	1,092	(476)	(54)%	(210)	(19)%
Other	7,486	7,598	5,902	(112)	(1)%	1,696	29%
Total	$44,760	$42,392	$37,530	$2,368	6%	$4,862	13%

The following table indicates the percentage of noninterest expense in each category:

Noninterest Expense by Category

	2009		2008		2007	
	Amount	Percent to Total	Amount	Percent of Total	Amount	Percent to Total
			(Dollars in thousands)			
Salaries and employee benefits	$22,927	51%	$22,624	53%	$21,160	56%
Occupancy and equipment	3,937	9%	4,623	11%	4,195	12%
Professional fees	3,851	9%	2,954	7%	2,342	6%
Deposit insurance premiums and regulatory assessments	3,454	8%	885	2%	313	1%
Low income housing investment losses	922	2%	865	2%	828	2%
Data processing	912	2%	1,021	3%	867	2%
Software subscription	865	2%	940	2%	831	2%
Advertising and promotion	406	1%	882	2%	1,092	3%
Other	7,486	16%	7,598	18%	5,902	16%
Total	$44,760	100%	$42,392	100%	$37,530	100%

Salaries and employee benefits is the single largest component of noninterest expenses. Salaries and employee benefits increased $303,000 for 2009, compared to 2008, primarily due to reduced capitalized loan origination costs, partially offset by lower bonuses and lower 401(k) plan contributions. The Company reduced bonuses for management and employees resulting in a bonus expense of $444,000 in 2009, compared to $1.2 million in 2008. There were no 401(k) plan contributions for employees in 2009, compared to $332,000 of contributions in 2008. Salaries and employee benefits increased $1.5 million for 2008, compared to 2007, primarily due to the full year impact from the acquisition of Diablo Valley Bank, opening a new branch in Walnut Creek, and the hiring of experienced bankers. There were 206 full-time equivalent employees at December 31, 2009, a reduction of 19 full-time equivalent employees from 225 at December 31, 2008 and December 31, 2007.

Occupancy, furniture and equipment decreased $686,000 in 2009 compared to 2008 primarily due to the consolidation of our two offices in Los Altos in the third quarter of 2008. The $428,000 increase in 2008 compared to 2007 was a result of the write-off of leasehold improvements in the third quarter of 2008 due to the consolidation of our two offices in Los Altos and the full year impact of the acquisition of Diablo Valley Bank and the opening of our Walnut Creek office in August 2007.

Professional fees increased $897,000 for 2009 from 2008. The increase in professional fees was primarily due to legal fees related to loan workouts and litigation, a branch acquisition transaction that was terminated in the second quarter of 2009 and increased expenses for bank regulatory compliance. More frequent testing for goodwill impairment, with the assistance of a valuation firm, also increased professional fees in 2009 compared to 2008. Professional fees increased $612,000 for 2008, compared to 2007, primarily due to the full year impact of the acquisition of Diablo Valley Bank, and legal services related to our recovery efforts on $5.1 million of defaulted loans from one borrower and his related entities.

Deposit insurance premiums and regulatory assessments increased 290%, or $2.6 million for 2009 from 2008. The increase in deposit insurance premiums and regulatory assessments is primarily due to the special assessment imposed on each depository institution to help maintain public confidence in the federal deposit insurance system. The special assessment was based on total assets minus Tier 1 capital as of June 30, 2009. This special assessment resulted in a $652,000 negative impact to our pre-tax earnings during the second quarter of 2009 and was paid on September 30, 2009. Additionally, increases in the

FDIC deposit assessment rate during the second quarter of 2009 contributed to the increase in deposit insurance premiums. FDIC insurance costs are expected to increase further in 2010.

Advertising and promotion decreased $476,000 in 2009 from 2008, and decreased $210,000 in 2008 from 2007, as a result of management's effort to control costs.

Income Tax Expense

The Company computes its provision for income taxes on a monthly basis. As indicated in Note 8 to the Consolidated Financial Statements, 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, tax-exempt interest income, increases in the cash surrender value of life insurance policies, California Enterprise Zone deductions, certain expenses that are not allowed as tax deductions, and tax credits.

The Company's Federal and state income tax benefit in 2009 was $12.7 million, as compared to $1.4 million in 2008, and income tax expense of $8.1 million in 2007. The effective income tax rate for 2009 was 51.5%. The negative effective income tax rate of 369.9% for 2008 was due to reduced pre-tax earnings. The effective income tax rate for the year ended December 31, 2007 was 36.6%. The difference in the effective tax rate compared to the combined federal and state statutory tax rate of 42% 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 and investments in tax-free municipal securities.

Tax-exempt interest income is generated primarily by the Company's investments in state, county and municipal loans and securities, which provided $325,000 in federal tax-exempt income in 2009 and $263,000 in 2008 and $181,000 in 2007. Although not included in the securities portfolio, the Company also has total investments of $5.5 million in low-income housing limited partnerships as of December 31, 2009. These investments have generated annual tax credits of approximately $1.1 million in 2009, 2008 and 2007. The investments are expected to generate an additional $4.1 million in aggregate tax credits from 2010 through 2016; however, the amount of the credits are dependent upon the occupancy level of the housing projects and income of the tenants and cannot be projected with certainty.

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. At the end of 2009, the Company had a net deferred tax asset of $22.4 million, compared to a deferred tax asset of $17.3 million at the end of 2008.

Financial Condition

As of December 31, 2009, total assets were $1.36 billion, a decrease of 9% from $1.50 billion at year-end 2008. Total securities available-for-sale (at fair value) were $110.0 million, an increase of 5% from $104.5 million at year-end 2008. The total loan portfolio, excluding loans held-for-sale, was $1.07 billion, a decrease of 14% from $1.25 billion at year-end 2008. Total deposits were $1.09 billion, a decrease of 6% from $1.15 billion at year-end 2008. Securities sold under agreement to repurchase decreased $10.0 million, or 29%, to $25.0 million at December 31, 2009, from $35.0 million at year-end 2008.

Securities Portfolio

The following table reflects the estimated fair value for each category of securities for the past three years:

Investment Portfolio

	December 31, 2009	2008	2007
	(Dollars in thousands)		
Securities available-for-sale (at fair value)			
U.S. Treasury	$ —	$ 19,496	$ 4,991
U.S. Government Sponsored Entities	1,973	8,696	35,803
Municipals — Tax Exempt	—	701	4,114
Mortgage-Backed Securities — Residential	102,546	69,036	83,046
Collateralized Mortgage Obligations — Residential	5,447	6,546	7,448
Total	$109,966	$104,475	$135,402

The following table summarizes the weighted average life and weighted average yields of securities as of December 31, 2009:

	December 31, 2009 Weighted Average Life: Within One Year		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):										
U.S. Government Sponsored Entities	$ —	—	$ 1,973	2.20%	$ —	—	$ —	—	$ 1,973	2.20%
Mortgage-Backed Securities — Residential	8	6.02%	35,555	4.40%	62,418	3.78%	4,565	4.58%	102,546	4.03%
Collateralized Mortgage Obligations — Residential	1,190	2.82%	4,257	5.79%	—	—	—	—	5,447	5.14%
Total	$1,198	2.84%	$41,785	4.44%	$62,418	3.78%	$4,565	4.58%	$109,966	4.05%

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 any analysis of the financial condition of the Company. The portfolio serves the following purposes: (i) it can be readily reduced in size to provide liquidity for loan balance increases or deposit decreases; (ii) 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; (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; (iv) it is an alternative interest-earning use of funds when loan demand is weak or when deposits grow more rapidly than loans; and (v) it can enhance the Company's tax position by providing partially tax exempt income.

The Company's securities are all currently classified under existing accounting rules as "available-for-sale" to allow flexibility for the management of the portfolio. Accounting guidance requires available-for-sale securities to be marked to fair value with an offset to accumulated other comprehensive income, 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 Company's portfolio is historically comprised primarily of: (i) U.S. Treasury securities and 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; and (iv) collateralized mortgage obligations, which generally enhance the yield of the portfolio.

The Company increased its holding of mortgage-back securities and decreased its U.S. Government sponsored securities from $8.7 million to $2.0 million to take advantage of higher yields during 2009. Except for U.S. Government sponsored entities, no securities of a single issuer exceeded 10% of shareholders' equity at December 31, 2009. The Company has no direct exposure to so-called subprime loans or securities, nor does it own any Fannie Mae or Freddie Mac equity securities. 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.

Compared to December 31, 2008, the securities portfolio increased by $5.5 million, or 5%, and increased to 8% of total assets at December 31, 2009, from 7% at December 31, 2008. U.S. Treasury securities and Government sponsored entities' debt securities decreased to 2% of the portfolio at December 31, 2009, from 27% at December 31, 2008. The Company's mortgage-backed securities and collateralized mortgage obligations are issued by U.S. Government sponsored entities. These securities were determined not to be "other than temporarily impaired" as of December 31, 2009. The Company invests in securities with the available cash based on market conditions and the Company's cash flow.

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 78% of total assets at December 31, 2009, as compared to 83% of at December 31, 2008. The ratio of loans to deposits decreased to 98.24% at the end of 2009 from 108.20% at the end of 2008.

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.

Loan Distribution

	December 31,									
	2009	% to Total	2008	% to Total	2007	% to Total	2006	% to Total	2005	% to Total
	(Dollars in thousands)									
Commercial	$ 427,177	40%	$ 525,080	42%	$ 411,251	40%	$284,093	40%	$248,060	37%
Real estate — mortgage	400,731	37%	405,530	33%	361,211	35%	239,041	34%	237,566	35%
Real estate — land and construction	182,871	17%	256,567	21%	215,597	21%	143,834	20%	149,851	22%
Home equity	51,368	5%	55,490	4%	44,187	4%	38,976	6%	41,772	6%
Consumer	7,181	1%	4,310	0%	3,044	0%	2,422	0%	1,721	0%
Loans	1,069,328	100%	1,246,977	100%	1,035,290	100%	708,366	100%	678,970	100%
Deferred loan costs, net	785	—	1,654	—	1,175	—	870	—	1,155	—
Total loans, including deferred costs	1,070,113	100%	1,248,631	100%	1,036,465	100%	709,236	100%	680,125	100%
Allowance for loan losses	(28,768)		(25,007)		(12,218)		(9,279)		(10,224)	
Loans, net	$1,041,345		$1,223,624		$1,024,247		$699,957		$669,901	

The Company's loan portfolio is concentrated in commercial, primarily manufacturing, wholesale, and services and commercial real estate, with a balance in land development and construction and home equity and consumer loans. The decrease in the Company's loan portfolio in 2009 is due to loans transferred to loans held-for-sale, diminished loan demand, and loan payoffs exceeding draw downs of loan commitments. Outstanding loan balances to total loan commitments were 77% at December 31, 2009, compared to 74% at December 31, 2008, which is partially due to decreases in unfunded commitments as lines of credit are reduced. The Company does not have any concentrations by industry or group of industries in its loan portfolio, however, 59% of its gross loans were secured by real property as of December 31, 2009, compared to 58% as of December 31, 2008. 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'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 guaranteed loans (collectively referred to as "SBA loans"). Prior to the third quarter of 2007, the guaranteed portion of these loans were sold in the secondary market depending on market conditions. When the guaranteed portion of an SBA loan was sold, the Company retained the servicing rights for the sold portion. From the third quarter of 2007 through the first quarter of 2009, the Company changed its strategy regarding its SBA loan business by retaining new SBA production in lieu of selling the loans. During the second quarter of 2009, the Company transferred $20.5 million of SBA loans to loans held-for-sale to enhance its liquidity and improve noninterest income in future periods. During the third and fourth quarters of 2009, SBA loans were sold resulting in a net gain on sale of $1.3 million. The Company presently expects to continue to sell SBA loans during 2010.

As of December 31, 2009, real estate mortgage loans of $401 million consist primarily of adjustable and fixed rate loans secured by deeds of trust on commercial property. The real estate mortgage loans at December 31, 2009 consist of $211 million, or 53%, of owner occupied properties, $184 million, or 46%, of investment properties, and $6 million, or 1%, in other properties. Properties securing the commercial real estate mortgage loans are primarily located in the Company's primary market, which is the Greater San Francisco Bay Area.

The Company's real estate mortgage loans consist primarily of loans based on the borrower's cash flow and are secured by deeds of trust on commercial and residential property to provide a secondary source of repayment. The Company generally restricts real estate term loans to no more than 80% of the property's appraised value or the purchase price of the property during the initial underwriting of the credit, depending on the type of property and its utilization. The Company offers both fixed and floating rate loans. Maturities on real estate mortgage 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 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.

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, in the instances of home equity loans or lines, real property.

Additionally, the Company makes home equity lines of credit available to its existing customers. Home equity lines of credit are underwritten with a maximum 70% loan to value ratio. Home equity lines are reviewed at least semiannually, with specific emphasis on loans with a loan to value ratio greater than 70% and loans that were underwritten from mid-2005 through 2008, when real estate values were at the peak in the cycle. The Company takes measures to work with customers to reduce line commitments and minimize potential losses. There have been no adverse classifications to date as a result of the review.

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 $32.7 million and $54.4 million at December 31, 2009, respectively.

Loan Maturities

The following table presents the maturity distribution of the Company's loans as of December 31, 2009. 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, 2009, approximately 69% of the Company's loan portfolio consisted of floating interest rate loans.

Loan Maturities

	Due in One Year or Less	Over One Year But Less than Five Years	Over Five Years	Total
		(Dollars in thousands)		
Commercial	$296,500	$ 41,405	$ 89,272	$ 427,177
Real estate — mortgage	129,939	220,766	50,026	400,731
Real estate — land and construction	162,076	20,795	—	182,871
Home equity	48,991	132	2,245	51,368
Consumer	6,902	279	—	7,181
Loans	$644,408	$283,377	$141,543	$1,069,328
Loans with variable interest rates	$567,067	$ 79,663	$ 90,686	$ 737,416
Loans with fixed interest rates	77,341	203,714	50,857	331,912
Loans	$644,408	$283,377	$141,543	$1,069,328

Nonperforming Assets

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 which have brought about declines in overall property values. 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.

To help minimize credit quality concerns, we have established a sound approach to credit that includes well-defined goals and objectives and well-documented credit policies and procedures. The 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; 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 other real estate owned ("OREO") from foreclosures. 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, reverses any uncollected interest that had been accrued as income, and begins recognizing interest income only as cash interest payments are received as long as 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. OREO consists of properties acquired by foreclosure or similar means that management is offering or will offer for sale. Total OREO was $2.2 million at December 31, 2009, compared to $660,000 at December 31, 2008.

The following table provides information with respect to components of the Company's nonperforming assets at the dates indicated:

Nonperforming Assets

	December 31,				
	2009	2008	2007	2006	2005
	(Dollars in thousands)				
Nonaccrual loans	$59,480	$39,981	$3,363	$3,866	$3,672
Loans 90 days past due and still accruing	2,895	460	101	451	—
Total nonperforming loans	62,375	40,441	3,464	4,317	3,672
Other real estate owned	2,241	660	1,062	—	—
Total nonperforming assets	$64,616	$41,101	$4,526	$4,317	$3,672
Nonperforming assets as a percentage of loans plus other real estate owned	6.03%	3.30%	0.44%	0.61%	0.54%

Primarily due to the general economic slowdown and a softening of the real estate market, nonperforming assets at December 31, 2009 increased $23.5 million, or 57%, from December 31, 2008. Both the general economic slowdown and soft real estate markets are expected to continue into 2010 in some geographic sub-markets and price points. Real estate assets within the revised federal mortgage guidelines have become available to refinance and investors are coming to the market to purchase commercial real estate assets, but at higher investor returns than have been in the market historically.

The following table provides nonperforming loans by loan type as of December 31, 2009:

Loan Type	Nonaccrual	Over 90 Days Past Due and Still Accruing	Total
		(Dollars in thousands)	
Commercial	$17,607	$1,067	$18,674
Real estate — mortgage	7,924	1,528	9,452
Real estate — land and construction	33,805	—	33,805
Home equity	—	300	300
Consumer	144	—	144
Total	$59,480	$2,895	$62,375

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. 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 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 portion of the allowance is calculated by applying estimated loss factors to pools of outstanding loans. At December 31, 2008, loss factors were based on the Company's historical loss experience, adjusted for significant factors that, in management's judgment, affected the collectibility of the portfolio as of the evaluation date. The adjustment factors for the formula allowance included existing general economic and business conditions affecting the key lending areas of the Company, in particular the real estate market, credit quality trends, collateral values, loan volumes and concentrations, the technology industry, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, and bank regulatory examination results. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty.

In 2009, 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 adjustment factors are similar to the factors considered under the previous methodology. 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.

Loans that demonstrate a weakness, for which there is a possibility of loss if the weakness is 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, net of SBA guarantees, was $164.1 million, $131.4 million, and $22.9 million, at December 31, 2009, 2008, and 2007, respectively. Management of the level of classified loans will continue to be a focus for executive management, the lending staff and the Company's Special Assets Department.

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 independently assess our methodology and perform independent credit reviews of our loan portfolio. The Federal Reserve and DFI also review the allowance for loan losses as an integral part of the 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 further 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:

Allowance for Loan Losses

	2009	2008	2007	2006	2005
	(Dollars in thousands)				
Balance, beginning of year	$ 25,007	$12,218	$ 9,279	$10,224	$12,497
Charge-offs:					
Commercial	(16,512)	(2,731)	(84)	(291)	(3,273)
Real estate — mortgage	(1,610)	—	—	—	—
Real estate — land and construction	(12,588)	(75)	—	—	—
Home equity	(764)	—	(20)	(540)	—
Consumer	(60)	—	—	—	—
Total charge-offs	(31,534)	(2,806)	(104)	(831)	(3,273)
Recoveries:					
Commercial	1,187	49	929	389	1,358
Real estate — mortgage	10	—	—	—	—
Real estate — land and construction	170	9	—	—	—
Home equity	—	—	—	—	—
Consumer	—	—	—	—	—
Total recoveries	1,367	58	929	389	1,358
Net recoveries (charge-offs)	(30,167)	(2,748)	825	(442)	(1,915)
Provision for loan losses	33,928	15,537	(11)	(503)	313
Reclassification of allowance for loan losses(1)	—	—	—	—	(671)
Allowance acquired in bank acquisition	—	—	2,125	—	—
Balance, end of year	$ 28,768	$25,007	$12,218	$ 9,279	$10,224
RATIOS:					
Net charge-offs (recoveries) to average loans*	2.59%	0.23%	(0.10)%	0.06%	0.28%
Allowance for loan losses to total loans*	2.69%	2.00%	1.18%	1.31%	1.51%
Allowance for loan losses to nonperforming loans	46%	62%	353%	215%	278%

* Average loans and total loans exclude loans held-for-sale

(1) The Company reclassified $0.7 million of the allowance allocated to $32 million of commercial asset based loans that were reclassified to loans held-for-sale as of December 31, 2005. Thus, the carrying value of these loans held-for-sale includes an allowance for loan losses of $0.7 million.

The Company's allowance for loan losses increased $3.8 million in 2009. The significant increase in the provision for loan losses in 2009 was primarily due to a higher volume of classified and nonperforming loans and an increase in loan charge-offs caused by challenging conditions in commercial lending and the residential housing market, turmoil in the financial markets, and the prolonged downturn in the overall economy. The Company had $31.5 million in charge-offs in 2009, which were nominally offset by loan by recoveries of $1.4 million.

Net loans charged-off reflects the realization of losses in the portfolio that were partially recognized previously through provisions for loan losses. Net charge-offs were $30.2 million in 2009, compared to net charge-offs of $2.7 million in 2008, and to net recoveries of $825,000 in 2007. Historical net loan charge-offs are not necessarily indicative of the amount of net charge-offs that the Company will realize in the future.

The following table provides a summary of the allocation of the allowance for loan losses for specific categories 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 categories.

Allocation of Loan Loss Allowance

	December 31,									
	2009		2008		2007		2006		2005	
	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	$12,687	40%	$13,913	42%	$ 6,067	40%	$4,872	40%	$ 4,199	37%
Real estate — mortgage	3,467	37%	4,261	33%	2,416	35%	1,507	34%	2,631	35%
Real estate — land and construction	11,492	17%	5,014	21%	1,923	21%	1,243	20%	1,914	22%
Home equity	993	5%	367	4%	335	4%	244	6%	300	6%
Consumer	129	1%	47	0%	88	0%	24	0%	33	0%
Unallocated	—	N/A	1,405	N/A	1,389	N/A	1,389	N/A	1,147	N/A
Total	$28,768	100%	$25,007	100%	$12,218	100%	$9,279	100%	$10,224	100%

In conjunction with the Company's revised methodology in estimating losses on loans that are not impaired, the unallocated portion of the allowance for loan losses was reallocated to the respective loan categories in 2009. Management believes that the revised methodology improves its ability to allocate probable credit loss to loan types. Prior to 2009, management considered the unallocated portion of the allowance for loan losses necessary because of inherent subjective risk in the loan portfolio; however, the prior methodology did not distinguish this subjective allocation by loan type. Management considers this matter to be a reallocation in its allowance for loan losses calculation, and believes that there would be no significant change in the balance of the allowance for loan losses if this approach was used in all of the years presented above. Therefore, amounts prior to 2009 have not been reallocated.

Goodwill

Goodwill resulted from the acquisition of Diablo Valley Bank and 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, as of November 30, for impairment with the assistance of an independent valuation firm. Goodwill impairment exists when a reporting unit's carrying value exceeds its fair value, which is determined through a two-step impairment test. 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.

The Company completed its annual impairment analysis as of November 30, 2009 with the assistance of an independent valuation firm. The Step 1 valuation of the Company was based on a weighted blend of the income approach and market approach. The income approach estimates the fair value of the Company based on the present value of discounted cash flows from future operations. The market approach considers key pricing multiples of similar companies. The Step 1 valuation indicated that the Step 2 analysis was necessary.

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 will be recognized in an amount equal to that excess. After performing Step 2, with the assistance of the same independent valuation firm, the Company determined that the implied fair value of goodwill was greater than the carrying value, resulting in no impairment charge in 2009.

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 herein. The Company's liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions in California, and the Company's market area in particular, continue to weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $100,000, 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:

Deposits

	Years Ended December 31,					
	2009		2008		2007	
	Balance	% to Total	Balance	% to Total	Balance	% to Total
	(Dollars in thousands)					
Demand Deposits — Noninterest Bearing	$ 260,840	24%	$ 261,337	22%	$ 268,005	25%
Demand Deposits — Interest Bearing	146,828	13%	134,814	12%	150,527	14%
Savings and Money Market	295,404	27%	344,767	30%	432,293	41%
Time Deposits — under $100	40,197	4%	45,615	4%	34,092	3%
Time Deposits — $100 and Over	129,831	12%	171,269	15%	139,562	13%
Time Deposits — CDARS	38,154	4%	11,666	1%	—	N/A
Time Deposits — brokered	178,031	16%	184,582	16%	39,747	4%
Total deposits	$1,089,285	100%	$1,154,050	100%	$1,064,226	100%

The Company obtains deposits from a cross-section of the communities it serves. The Company's business is not generally seasonal in nature. The Company is not dependent upon funds from sources outside the United States. At December 31, 2009 and 2008, less than 1% and 4% of deposits were from public sources, respectively.

The decrease in deposits was primarily due to decreases in savings and money market deposits as a result of lower balances in title insurance company, escrow, and real estate exchange facilitators' accounts and lower time deposits, $100,000 and over. At December 31, 2009, title insurance company, escrow, and real estate exchange facilitators' accounts decreased $33.6 million, or 59% compared to December 31, 2008. Time deposits $100,000 and over decreased $41.4 million, or 24% from December 31, 2008, primarily due to the withdrawal of public deposits.

The following table indicates the contractual maturity schedule of the Company's time deposits of $100,000 and over, including CDARS and brokered deposits of $100,000 and over, as of December 31, 2009:

Deposit Maturity Distribution

	Balance	% to Total
	(Dollars in thousands)	
Three months or less	$ 80,745	24%
Over three months through six months	65,957	19%
Over six months through twelve months	96,191	28%
Over twelve months	100,990	29%
Total	$343,883	100%

The Company focuses primarily on providing and servicing business deposit accounts that are frequently over $100,000 in average balance per account. As a result, certain types of business clients that the Company serves typically carry average deposits in excess of $100,000. 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, dividend payout, and average equity to average assets for 2009, 2008, and 2007:

	2009	2008	2007
Return on average assets	−0.83%	0.12%	1.18%
Return on average tangible assets	−0.86%	0.13%	1.21%
Return on average equity	−6.68%	1.15%	9.47%
Return on average tangible equity	−9.06%	1.67%	11.43%
Dividend payout ratio(1)	−1.64%	253.42%	23.06%
Average equity to average assets ratio	12.46%	10.52%	12.47%

(1) Percentage is calculated based on dividends declared on common stock divided by net income (loss) available to common shareholders.

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 $328.2 million at December 31, 2009, as compared to $436.6 million at December 31, 2008. Unused commitments represented 31% and 35% of outstanding gross loans at December 31, 2009 and 2008, 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 14 to the financial statements located elsewhere herein.

The following table presents the Company's commitments to extend credit for the periods indicated:

	December 31, 2009	December 31, 2008	December 31, 2007
	(Dollars in thousands)		
Unused lines of credit and commitments to make loans	$308,441	$414,312	$444,172
Standby letters of credit	19,774	22,260	21,143
	$328,215	$436,572	$465,315

Contractual Obligations

The contractual obligations of the Company, summarized by type of obligation and contractual maturity, at December 31, 2009, are as follows:

	Less Than One Year	One to Three Years	Three to Five Years	After Five Years	Total
	(Dollars in thousands)				
Securities sold under agreement to repurchase	$ 20,000	$ 5,000	$ —	$ —	$ 25,000
Subordinated debt	—	—	—	23,702	23,702
Short-term borrowings	20,000	—	—	—	20,000
Operating leases	2,386	4,570	3,964	1,732	12,652
Time deposits of $100 or more	242,893	100,990		—	343,883
Total debt and operating leases	$285,279	$110,560	$3,964	$25,434	$425,237

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 utilizes overnight Federal funds purchase arrangements and other borrowing arrangements with correspondent banks, solicits brokered deposits if cost effective deposits are not available from local sources and maintains 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.

During 2008, the Company experienced a tightening in its liquidity position as a result of significant loan growth and a decrease in real estate exchange facilitators' deposit balances, which was partially funded by an increase in brokered deposits. Since December 31, 2008, the Company had loan contraction of $167.8 million, including loans held-for-sale, and it has experienced a modest improvement in its liquidity position. One of the more important measures of liquidity is our loan to deposit ratio. Our loan to deposit ratio improved to 98.24% at December 31, 2009 compared to 108.20% at December 31, 2008.

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, including the FHLB. The Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. At December 31, 2009, the Company had $20.0 million of overnight borrowings from the FHLB, bearing interest at 0.04%. As of December 31, 2008, the Company had $55.0 million in FHLB advances at December 31, 2008, bearing interest at 0.05%. The Company had $271.2 million of loans pledged to the FHLB as collateral on an available line of credit of $136.4 million at December 31, 2009.

The Company can also borrow from FRB's discount window. The Company had $88.4 million of loans pledged to the FRB as collateral on an available line of credit of $39.7 million at December 31, 2009, none of which was outstanding.

At December 31, 2008, the Company had Federal funds purchase arrangements available of $35.0 million. There were no Federal funds purchased at December 31, 2009 or 2008.

At December 31, 2008, the Company also had a $15.0 million line of credit with a correspondent bank, all of which was outstanding. The Company repaid the line of credit in March 2009, thus terminating the line of credit.

The Company also utilizes securities sold under repurchase agreements to manage our liquidity position. Repurchase agreements are accounted for as collateralized financial transactions and are secured by mortgage-backed securities carried at an amortized cost of approximately $29.1 million at December 31, 2009, and approximately $40.0 million at December 31, 2008. Securities sold under agreements to repurchase totaled $25.0 million at December 31, 2009, compared to $35.0 million at December 31, 2008.

The following table summarizes the Company's borrowings under its Federal funds purchased, security repurchase arrangements and lines of credit for the periods indicated:

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Average balance during the year	$ 56,269	$ 90,511	$16,255
Average interest rate during the year	1.65%	2.50%	2.90%
Maximum month-end balance during the year	$122,000	$105,000	$70,900
Average rate at December 31,	1.32%	2.27%	2.83%

Capital Resources

At December 31, 2009, the Company had total shareholders' equity of $172.3 million, including $38.2 million in preferred stock, and $2.6 million of accumulated other comprehensive loss.

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 help ensure that such measurements are within established internal and external guidelines. The external guidelines, which are issued by the Federal Reserve Board and the FDIC, establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures. There are two categories of capital under the Federal Reserve Board and FDIC guidelines: Tier 1 and Tier 2 Capital. Our Tier 1 Capital consists of shareholders' equity (excluding accumulated other comprehensive income/loss) and the proceeds from the issuance of trust preferred securities, less goodwill and other intangible assets. Our Tier 2 Capital includes the allowances for loan losses and off balance sheet credit losses, subject to certain limits.

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of the Company:

	December 31, 2009	2008	2007	
	(Dollars in thousands)			
Capital components:				
Tier 1 Capital	$ 134,833	$ 163,328	$ 141,227	
Tier 2 Capital	14,720	16,989	12,461	
Total risk-based capital	$ 149,553	$ 180,317	$ 153,688	
Risk-weighted assets	$1,163,125	$1,350,823	$1,227,628	
Average assets (regulatory purposes)	$1,341,670	$1,449,380	$1,278,207	
				Minimum Regulatory Requirements
Capital ratios:				
Total risk-based capital	12.9%	13.4%	12.5%	8.00%
Tier 1 risk-based capital	11.6%	12.1%	11.5%	4.00%
Leverage(1)	10.1%	11.3%	11.1%	4.00%

(1) Tier 1 capital divided by quarterly average assets (excluding goodwill, other intangible assets and disallowed deferred tax assets).

The table above presents the capital ratios of the Company computed in accordance with applicable regulatory guidelines and compared to the standards for minimum capital adequacy requirements. The risk-based and leverage capital ratios are also discussed in Item 1 — "*Business — Supervision and Regulation — Heritage Bank of Commerce*."

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of HBC:

	December 31, 2009	December 31, 2008	December 31, 2007	Well-Capitalized Regulatory Requirements	Minimum Regulatory Requirements
	(Dollars in thousands)				
Capital components:					
Tier 1 Capital	$ 133,216	$ 152,675	$ 131,693		
Tier 2 Capital	14,743	16,973	12,461		
Total risk-based capital	$ 147,959	$ 169,648	$ 144,154		
Risk-weighted assets	$1,165,014	$1,349,471	$1,226,202		
Average assets for capital purposes	$1,344,407	$1,449,158	$1,270,224		
Capital ratios					
Total risk-based capital	12.7%	12.6%	11.8%	10.00%	8.00%
Tier 1 risk-based capital	11.4%	11.3%	10.7%	6.00%	4.00%
Leverage(1)	9.9%	10.5%	10.4%	5.00%	4.00%

(1) Tier 1 capital divided by quarterly average assets (excluding goodwill other intangible assets and disallowed deferred tax assets).

The table above presents the capital ratios of HBC computed in accordance with applicable regulatory guidelines and compared to the standards for minimum capital adequacy requirements under the FDIC's prompt corrective action authority. In February 2010, we agreed with our regulators to submit a written plan for sufficient capitalization of both HBC and HCC (on a consolidated basis), based on their respective risk profiles.

The Company paid cash dividends totaling $236,000 or $0.02 per common share in 2009. On January 29, 2009, the Company announced it would pay a $0.02 per share quarterly cash dividend. The dividend was paid on March 10, 2009, to shareholders of record on February 27, 2009. The Company announced in April 2009 that although it remains "well-capitalized," the Board of Directors approved the suspension of cash dividends in view of its desire to preserve the capital of the Company to support its banking activities in the markets it serves during this challenging economy.

Mandatory Redeemable Cumulative Trust Preferred Securities.

To enhance regulatory capital and to provide liquidity, the Company, through unconsolidated subsidiary grantor trusts, issued the following mandatory redeemable cumulative trust preferred securities of subsidiary grantor trusts: In the first quarter of 2000, the Company issued $7.2 million aggregate principal amount of 10.875% subordinated debt due on March 8, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2000, the Company issued $7.2 million aggregate principal amount of 10.60% subordinated debt due on September 7, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2001, the Company issued $5.2 million aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on July 31, 2031 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2002, the Company issued $4.1 million of aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on September 26, 2032 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. Under applicable regulatory guidelines, the trust preferred securities currently qualify as Tier I capital. The subsidiary trusts are not consolidated in the Company's consolidated financial statements. The subordinated debt is recorded as a component of long-term debt and includes the value of the common stock issued by the trusts to the Company. The common stock is recorded as other assets for the amount issued.

In November 2009, the Company announced that it was exercising its right to defer interest payments on its outstanding trust preferred subordinated debt securities. The Company will continue to accrue the cost and recognize the expense of the interest at the normal rate on a compounded basis until such time as the deferred arrearage has been paid current. See Note 7 to the Consolidated Financial Statements.

U.S. Treasury Capital Purchase Program

The Company received $40 million in November 2008 through the issuance of its Series A Preferred Stock and a warrant to purchase 462,963 shares of its common stock to the Treasury through the U.S. Treasury Capital Purchase Program. The Series A Preferred qualifies as a component of Tier 1 capital. In November 2009, the Company announced that it was exercising its right to suspend payment of dividends on its Series A Preferred Stock. The Company accrues the cumulative unpaid dividends at the compounded dividend rate. See Note 15 to the Consolidated Financial Statements.

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 Company applies a market value ("MV") methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, MV is the discounted present value of the difference between incoming cash flows on interest-earning assets and other investments and outgoing cash flows on interest-bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the MV which would result from a theoretical 200 basis point (1 basis point equals 0.01%) change in market interest rates. Both a 200 basis point increase and a 200 basis point decrease in market rates are considered.

At December 31, 2009, it was estimated that the Company's MV would increase 11.96% in the event of a 200 basis point increase in market interest rates. The Company's MV at the same date would decrease 19.93% in the event of a 200 basis point decrease in applicable interest rates.

Presented below, as of December 31, 2009 and 2008, is an analysis of the Company's interest rate risk as measured by changes in MV for instantaneous and sustained parallel shifts of 200 basis points in applicable interest rates:

	2009				2008			
			Market Value as a % of Present Value of Assets				Market Value as a % of Present Value of Assets	
	$ Change in Market Value	% Change in Market Value	MV Ratio	Change (bp)	$ Change in Market Value	% Change in Market Value	MV Ratio	Change (bp)
	(Dollars in thousands)							
Change in rates								
+200 bp	$ 24,837	11.96%	15.5%	166	$ 42,272	20.39%	16.7%	282
+100 bp	$ 13,600	6.55%	14.8%	91	$ 23,095	11.14%	15.4%	154
0 bp	$ —	0.00%	13.9%	—	$ —	0.00%	13.8%	—
−100 bp	$(20,150)	−9.71%	12.5%	(134)	$(35,314)	−17.03%	11.5%	(236)
−200 bp	$(41,364)	−19.93%	11.1%	(276)	$(70,361)	−33.94%	9.1%	(469)

Management believes that the MV methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the MV method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institution's interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the MV methodology. 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 MV methodology 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 clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

CRITICAL ACCOUNTING POLICIES

General

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our consolidated financial statements is, to a significant extent, based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. In certain instances, we use a discount factor and prepayment assumptions to determine the present value of assets and liabilities. A change in the discount factor or prepayment speeds could increase or decrease the values of those assets and liabilities which would result in either a beneficial or adverse impact to our financial results. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. Other estimates that we use are related to the realization of our deferred tax assets and the expected useful lives of our depreciable assets. In addition, GAAP itself may change from one previously acceptable method to another method, although the economics of our transactions would be the same.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses in our loan portfolio. Our accounting for estimated loan losses was previously discussed under the heading "Allowance for Loan Losses."

Loan Sales and Servicing

The amounts of gains recorded on sales of loans and the initial recording of servicing assets and I/O strips are based on the estimated fair values of the respective components. In recording the initial value of the servicing assets and the fair value of the I/O strips receivable, the Company uses estimates which are made on management's expectations of future prepayment and discount rates as discussed in Notes 1 and 3 to the consolidated financial statements.

Stock Based Compensation

We grant stock options to purchase our common stock to our employees and directors under the 2004 Plan. We also granted our chief executive officer restricted stock when he joined the Company.

Additionally, we have outstanding options that were granted under an option plan from which we no longer make grants. The benefits provided under all of these plans are subject to the provisions of accounting guidance related to share-based payments. Our results of operations for fiscal years 2009, 2008, and 2007 were impacted by the recognition of non-cash expense related to the fair value of our share-based compensation awards.

The determination of fair value of stock-based payment awards on the date of grant using the Black-Scholes model is affected by our stock price, as well as the input of other subjective assumptions. These assumptions include, but are not limited to, the expected term of stock options and our stock price volatility. Our stock options have characteristics significantly different from those of traded options, and changes in the assumptions can materially affect the fair value estimates.

Accounting guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If actual forfeitures vary from our estimates, we will recognize the difference in compensation expense in the period the actual forfeitures occur.

Our accounting for stock options is disclosed primarily in Notes 1 and 9 to the consolidated financial statements.

Accounting for Goodwill and Other Intangible Assets

The Company accounts for acquisitions of businesses using the purchase method of accounting. Under the purchase 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 intangible assets are evaluated at least annually for impairment or more frequently if events or circumstances, such as changes in economic or market conditions, indicate that impairment may exist. Goodwill is tested for impairment at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment for which discrete financial information is available and regularly reviewed by management. If the fair value of the reporting unit including goodwill is determined to be less than the carrying amount of the reporting unit, a further test is required to measure the amount of impairment. If an impairment loss exists, the carrying amount of the goodwill is adjusted to a new cost basis. For purposes of the goodwill impairment test, the valuation of the Company is based on a weighted blend of the income approach and market approach. The income approach estimates the fair value of the Company based on the present value of discounted cash flows from operations. The market approach considers key pricing multiples of similar companies. Management believes the assumptions used in these calculations are consistent with current industry practice for valuing similar types of companies. Goodwill was tested for impairment as of November 30, 2009 and 2008 and the end of each quarter in 2009 with the assistance of a valuation firm.

Intangible assets consist of core deposit and customer relationship intangible assets arising from the acquisition of Diablo Valley Bank in June 2007. These assets are amortized over their estimated useful lives. Impairment testing of these 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.

Our accounting policy for goodwill and other intangible assets is disclosed primarily in Notes 1 and 5 to the consolidated financial statements.

Deferred Tax Assets

Our net deferred income tax asset arises from temporary differences between the carrying amount of assets and liabilities reported in the financial statements and the amounts used for income tax return purposes. Deferred tax assets and liabilities are established for these items as they arise. For financial reporting purposes, deferred tax assets are reviewed to determine if a valuation allowance is required based on both positive and negative evidence currently available. Evidence includes the historical levels of our taxable income, estimates of our future taxable income including tax planning strategies, the reversals of temporary differences, and potentially refundable taxes paid in carry-back years.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient taxable income to obtain benefits from the reversal of net deductible temporary differences. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. In assessing the realization of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. We estimate that we have sufficient forecasted future taxable income, as well as various tax planning strategies which could be implemented to generate taxable income in future taxable periods, to support the balance of deferred tax assets. Based on these factors, we believe it is more likely than not that the Company will realize the benefits of these deductible differences and, therefore, no valuation allowance for deferred tax assets was recorded at December 31, 2009, and 2008.

Our deferred tax accounting is disclosed primarily in Notes 1 and 8 to the consolidated financial statements.

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, 2009, 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 82 through 127.

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, 2009. 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, 2009, 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 *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.

Based on our assessment, management has concluded that our internal control over financial reporting, based on criteria established in *Internal Control — Integrated Framework* issued by COSO was effective as of December 31, 2009.

The independent registered public accounting firm of Crowe Horwath LLP, as auditors of our consolidated financial statements, has issued an attestation report on the effectiveness of management's internal control over financial reporting based on criteria established in "*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 quarter ended December 31, 2009 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, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

Information required by this item will be contained in our Definitive Proxy Statement for our 2010 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2009. 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 2010 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2009. 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 2010 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2009. 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 2010 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2009. 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 2010 Annual Meeting of Shareholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2009. Such information is incorporated herein by reference.

PART IV

ITEM 15 — *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a)(1) FINANCIAL STATEMENTS

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages 82 through 127.

(a)(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.

(a)(3) EXHIBITS

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report.

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/ WALTER T. KACZMAREK

Walter T. Kaczmarek
Chief Executive Officer

DATE: March 16, 2010

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/ FRANK G. BISCEGLIA Frank G. Bisceglia	Director	March 16, 2010
/s/ JACK W. CONNER Jack W. Conner	Director and Chairman of the Board	March 16, 2010
/s/ CELESTE V. FORD Celeste V. Ford	Director	March 16, 2010
/s/ JOHN J. HOUNSLOW John J. Hounslow	Director	March 16, 2010
/s/ WALTER T. KACZMAREK Walter T. Kaczmarek	Director and Chief Executive Officer and President (Principle Executive Officer)	March 16, 2010
/s/ MARK E. LEFANOWICZ Mark E. Lefanowicz	Director	March 16, 2010
/s/ LAWRENCE D. MCGOVERN Lawrence D. McGovern	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 16, 2010
/s/ ROBERT T. MOLES Robert T. Moles	Director	March 16, 2010
/s/ HUMPHREY P. POLANEN Humphrey P. Polanen	Director	March 16, 2010
/s/ CHARLES T. TOENISKOETTER Charles T. Toeniskoetter	Director	March 16, 2010
/s/ RANSON W. WEBSTER Ranson W. Webster	Director	March 16, 2010

HERITAGE COMMERCE CORP

INDEX TO FINANCIAL STATEMENTS
DECEMBER 31, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Heritage Commerce Corp
San Jose, California

We have audited the accompanying consolidated balance sheets of Heritage Commerce Corp (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, statements of changes in shareholders' equity and statements of cash flows for each of the years in the three-year period ended December 31, 2009. We also have audited Heritage Commerce Corp's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Heritage Commerce Corp'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 in the accompanying Management's Annual Report on Internal Control over Financial Reporting included in Item 9A in Form 10-K. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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. 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.

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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Commerce Corp as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Heritage Commerce Corp maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Crowe Horwath LLP

Oak Brook, Illinois
March 16, 2010

HERITAGE COMMERCE CORP

CONSOLIDATED BALANCE SHEETS

	December 31, 2009	December 31, 2008
	(Dollars in thousands, except per share data)	
ASSETS		
Cash and due from banks	$ 45,372	$ 29,996
Federal funds sold	100	100
Interest-bearing deposits in other financial institutions	90	—
Total cash and cash equivalents	45,562	30,096
Securities available-for-sale, at fair value	109,966	104,475
Loans held-for-sale, at lower of cost or market, including deferred costs	10,742	—
Loans, including deferred costs	1,070,113	1,248,631
Allowance for loan losses	(28,768)	(25,007)
Loans, net	1,041,345	1,223,624
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	8,454	7,816
Company owned life insurance	42,313	40,649
Premises and equipment, net	9,006	9,517
Goodwill	43,181	43,181
Intangible assets	3,589	4,231
Accrued interest receivable and other assets	49,712	35,638
Total assets	$1,363,870	$1,499,227
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Demand, noninterest bearing	$ 260,840	$ 261,337
Demand, interest bearing	146,828	134,814
Savings and money market	295,404	344,767
Time deposits — under $100	40,197	45,615
Time deposits — $100 and over	129,831	171,269
Time deposits — CDARS	38,154	11,666
Time deposits — brokered	178,031	184,582
Total deposits	1,089,285	1,154,050
Securities sold under agreement to repurchase	25,000	35,000
Subordinated debt	23,702	23,702
Note payable	—	15,000
Short-term borrowings	20,000	55,000
Accrued interest payable and other liabilities	33,578	32,208
Total liabilities	1,191,565	1,314,960
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; 40,000 shares outstanding (liquidation preference of $1,000 per share plus accrued dividends)	39,846	39,846
Discount on preferred stock	(1,598)	(1,946)
Common stock, no par value; 30,000,000 shares authorized; 11,820,509 shares outstanding	80,222	78,854
Retained earnings	56,389	70,986
Accumulated other comprehensive loss	(2,554)	(3,473)
Total shareholders' equity	172,305	184,267
Total liabilities and shareholders' equity	$1,363,870	$1,499,227

See notes to consolidated financial statements

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2009	2008	2007
	(Dollars in thousands, except per share data)		
Interest income:			
Loans, including fees	$ 58,602	$70,488	$68,405
Securities, taxable	3,619	5,321	7,481
Securities, non-taxable	9	74	155
Interest-bearing deposits in other financial institutions	63	16	141
Federal funds sold	—	58	2,530
Total interest income	62,293	75,957	78,712
Interest expense:			
Deposits	13,462	20,035	24,211
Subordinated debt	1,933	2,148	2,329
Note payable	82	292	—
Repurchase agreements	787	937	387
Short-term borrowings	62	1,032	85
Total interest expense	16,326	24,444	27,012
Net interest income before provision for loan losses	45,967	51,513	51,700
Provision for loan losses	33,928	15,537	(11)
Net interest income after provision for loan losses	12,039	35,976	51,711
Noninterest income:			
Service charges and fees on deposit accounts	2,221	2,007	1,284
Increase in cash surrender value of life insurance	1,664	1,645	1,443
Servicing income	1,587	1,790	2,181
Gains on sales of SBA loans	1,306	—	1,766
Net gains on sales of securities	231	—	—
Other	1,018	1,349	1,378
Total noninterest income	8,027	6,791	8,052
Noninterest expense:			
Salaries and employee benefits	22,927	22,624	21,160
Occupancy and equipment	3,937	4,623	4,195
Professional fees	3,851	2,954	2,342
Deposit insurance premiums and regulatory assessments	3,454	885	313
Low income housing investment losses	922	865	828
Data processing	912	1,021	867
Software subscription	865	940	831
Advertising and promotion	406	882	1,092
Other	7,486	7,598	5,902
Total noninterest expense	44,760	42,392	37,530
Income (loss) before income taxes	(24,694)	375	22,233
Income tax expense (benefit)	(12,709)	(1,387)	8,137
Net income (loss)	$(11,985)	$ 1,762	$14,096
Dividends and discount accretion on preferred stock	(2,376)	(255)	—
Net (loss) income allocable to common shareholders	$(14,361)	$ 1,507	$14,096
Earnings (loss) per common share:			
Basic	$ (1.21)	$ 0.13	$ 1.13
Diluted	$ (1.21)	$ 0.13	$ 1.12

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Years Ended December 31, 2009, 2008, and 2007							
	Preferred Stock		Common Stock			Accumulated Other	Total	
	Amount	Discount	Shares	Amount	Retained Earnings	Comprehensive Loss	Shareholders' Equity	Comprehensive Income (Loss)
	(Dollars in thousands, except share data)							
Balance, January 1, 2007	$ —	$ —	11,656,943	$ 62,363	$ 62,452	$(1,995)	$122,820	
Net Income	—	—	—	—	14,096	—	14,096	$ 14,096
Net change in unrealized gain/loss on securities available-for-sale and interest-only strips, net of reclassification adjustment and deferred income taxes	—	—	—	—	—	1,028	1,028	1,028
Net change in pension liability, net of deferred income taxes	—	—	—	—	—	79	79	79
Total comprehensive income								$ 15,203
Issuance of 1,732,298 common shares to acquire Diablo Valley Bank, net of offering costs of $214	—	—	1,732,298	41,183	—	—	41,183	
Amortization of restricted stock award	—	—	—	154	—	—	154	
Cash dividend declared on common stock, $0.26 per share	—	—			(3,250)		(3,250)	
Common stock repurchased	—	—	(698,190)	(13,653)	—	—	(13,653)	
Stock option expense	—	—	—	1,159	—	—	1,159	
Stock options exercised, including related tax benefits	—	—	83,875	1,208	—	—	1,208	
Balance, December 31, 2007	—	—	12,774,926	92,414	73,298	(888)	164,824	
Cumulative effect adjustment upon adoption of split dollar life insurance accounting guidance, net of deferred income taxes	—	—	—	—	—	(3,182)	(3,182)	
Net Income	—	—	—	—	1,762	—	1,762	$ 1,762
Net change in unrealized gain/loss on securities available-for-sale and interest-only strips, net of reclassification adjustment and deferred income taxes	—	—	—	—	—	1,532	1,532	1,532
Net change in pension and other postretirement obligations, net of deferred income taxes	—	—	—	—	—	(935)	(935)	(935)
Total comprehensive income								$ 2,359
Amortization of restricted stock award	—	—	—	155	—	—	155	
Issuance of 40,000 preferred shares and a warrant to purchase 462,963 common shares, net of issuance costs of $154	39,846	(1,979)	—	1,979	—	—	39,846	
Cash dividends accrued on preferred stock	—	—	—	—	(222)	—	(222)	
Accretion of discount on preferred stock	—	33	—	—	(33)	—	—	
Cash dividend declared on common stock, $0.32 per share	—	—	—	—	(3,819)	—	(3,819)	
Common stock repurchased	—	—	(1,007,749)	(17,655)	—	—	(17,655)	
Stock option expense	—	—	—	1,381	—	—	1,381	
Stock options exercised, including related tax benefits	—	—	53,332	580	—	—	580	
Balance, December 31, 2008	39,846	(1,946)	11,820,509	78,854	70,986	(3,473)	184,267	
Net Loss	—		—	—	(11,985)		(11,985)	$(11,985)
Net change in unrealized gain/loss on securities available-for-sale and interest-only strips, net of reclassification adjustment and deferred income taxes	—	—	—	—	—	159	159	159
Net change in pension and other postretirement obligations, net of deferred income taxes						760	760	760
Total comprehensive loss								$(11,066)
Amortization of restricted stock award	—	—	—	154	—	—	154	
Cash dividends accrued on preferred stock	—	—	—	—	(2,028)	—	(2,028)	
Accretion of discount on preferred stock	—	348	—	—	(348)	—	—	
Cash dividend declared on common stock, $0.02 per share	—	—	—	—	(236)	—	(236)	
Stock option expense	—	—	—	1,284	—	—	1,284	
Income tax effect of restricted stock award vesting	—	—	—	(70)	—	—	(70)	
Balance, December 31, 2009	$39,846	$(1,598)	11,820,509	$ 80,222	$ 56,389	$(2,554)	$172,305	

See notes to consolidated financial statements

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,		
	2009	2008	2007
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ (11,985)	$ 1,762	$ 14,096
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	807	1,022	776
Gain on sale of securities available for sale	(231)	—	—
Provision for loan losses	33,928	15,537	(11)
Deferred income tax benefit	(6,519)	(6,006)	(225)
Stock option expense	1,284	1,381	1,159
Amortization of other intangible assets	642	741	352
Amortization of restricted stock award	154	155	154
Amortization (accretion) of discounts and premiums on securities	(259)	245	95
Writedowns and losses on sale of foreclosed assets	79	92	—
Gain on sale of SBA loans	(1,306)	—	(1,766)
Proceeds from sale of SBA loans	12,023	—	35,529
Net change in SBA loans originated held-for-sale	(20,630)	—	(17,469)
Increase in cash surrender value of life insurance	(1,664)	(1,645)	(1,443)
Federal Home Loan bank and Federal Reserve Bank stock dividends	(10)	(211)	(230)
Effect of changes in:			
Accrued interest receivable and other assets	(6,347)	8,266	3,162
Accrued interest payable and other liabilities	(1,944)	(855)	352
Net cash provided by (used in) operating activities	(1,978)	20,484	34,531
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net change in loans	121,989	(216,012)	(104,078)
Proceeds from sales of SBA loans previously transferred to held-for-sale	20,795	—	—
Net change in SBA loans previously transferred to held-for-sale	(1,118)	—	—
Purchase of securities available-for-sale	(147,590)	(25,415)	(9,322)
Maturities/paydowns/calls of securities available-for-sale	131,362	57,936	61,344
Proceeds from sales of securities available-for-sale	15,272	—	—
Purchase of company owned life insurance	—	(361)	—
Purchase of premises and equipment	(296)	(1,231)	(704)
Redemption (purchase) of restricted stock and other investments	(628)	(603)	58
Proceeds from sale of forcelosed assets	4,196	1,409	—
Cash received in bank acquisition, net of cash paid	—	—	16,407
Net cash provided by (used in) investing activities	143,982	(184,277)	(36,295)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	(64,765)	89,824	(31,390)
Exercise of stock options	—	580	1,208
Common stock offering costs	—	—	(214)
Common stock repurchased	—	(17,655)	(13,653)
Issuance of preferred stock, net of offering costs	—	39,846	—
Income tax effect of restricted stock award vesting	(70)	—	—
Payment of cash dividends — common stock	(236)	(3,819)	(3,250)
Payment of cash dividends — preferred stock	(1,467)	—	—
Net change in short-term borrowings	(35,000)	(5,000)	60,000
Net change in note payable	(15,000)	15,000	—
Net change in securities sold under agreement to repurchase	(10,000)	24,100	(10,900)
Other financing activities	—	1,920	(329)
Net cash provided by (used in) financing activities	(126,538)	144,796	1,472
Net increase (decrease) in cash and cash equivalents	15,466	(18,997)	(292)
Cash and cash equivalents, beginning of year	30,096	49,093	49,385
Cash and cash equivalents, end of year	$ 45,562	$ 30,096	$ 49,093
Supplemental disclosures of cash flow information:			
Interest paid	$ 19,030	$ 24,778	$ 27,216
Income taxes paid	605	1,199	6,319
Supplemental schedule of non-cash investing activity:			
Transfer of portfolio loans to loans held-for-sale	$ 20,506	$ —	$ 972
Transfer of loans held for sale to loan portfolio	—	—	18,430
Loans transferred to foreclosed assets	5,856	1,098	1,062
Due to broker for securities purchased, settling after year-end	4,065	—	—
Summary of assets acquired and liabilities assumed through acquisition:			
Cash and cash equivalents	—	—	41,807
Securities available-for-sale	—	—	12,214
Net loans	—	—	203,805
Goodwill and other intangible assets	—	—	48,506
Premises and equipment	—	—	6,841
Company owned life insurance	—	—	1,026
Federal Home Loan Bank stock	—	—	717
Other assets, net	—	—	2,615
Deposits	—	—	(249,023)
Other liabilities	—	—	(1,711)
Common stock issued to acquire Diablo Valley Bank	—	—	41,397

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

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 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, California. The Company acquired Diablo Valley Bank on June 20, 2007 and merged Diablo Valley Bank into HBC. HBC was incorporated on November 23, 1993 and commenced operations on June 8, 1994.

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.

The Company also has four wholly-owned Delaware business trusts that were formed to issue trust preferred and related common securities: Heritage Capital Trust I and Heritage Statutory Trust I, formed in 2000, Heritage Statutory Trust II, formed in 2001, and Heritage Statutory Trust III, formed in 2002 ("Trusts").

All of the common securities of the Trusts totaling $702,000 are owned by the Company and included in other assets on the consolidated balance sheets. The Trusts issued their preferred securities to investors, and used the proceeds to purchase subordinated debt issued by the Company. The subordinated debt payable to the Trusts is recorded as debt of the Company. The Company has fully and unconditionally guaranteed the trust preferred securities along with all obligations of the Trusts under the trust agreements. Interest income from the subordinated debt is the source of revenues for these Trusts. In accordance with generally accepted accounting standards, the Trusts are not consolidated in the Company's financial statements.

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. The allowance for loan losses, carrying value of the other real estate owned, goodwill and other intangible assets, loan servicing rights, interest-only strip receivables, defined benefit pension and other post-retirement obligations, purchase accounting adjustments, and the fair values of financial instruments are particularly subject to change.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, and Federal funds sold. Federal funds are generally sold and purchased for one-day periods.

Cash Flows

Net cash flows are reported for customer loan and deposit transactions, Federal funds purchased, 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. Securities available-for-sale are recorded at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of deferred income taxes, as a net amount within accumulated other comprehensive income (loss), which is a separate component of shareholders' equity. Securities held-to-maturity are recorded at amortized cost, based on the Company's positive intent and ability to hold the securities to maturity. As of December 31, 2009 and 2008, all of the Company's securities were classified as available-for-sale.

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 discount. 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.

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, classified as a restricted security, and periodically evaluated for impairment. Both cash and stock dividends 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 are reported as income.

Loan Sales and Servicing

The Company holds for sale the 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 net sales proceeds and the relative fair value of the guaranteed portion of the loan sold compared to the relative fair value of the unguaranteed portion.

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 did not sell any SBA loans in the fourth quarter of 2007, the year ended December 31, 2008, or the first two quarters of 2009.

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.

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 and an allowance for loan losses. The majority of the Company's loans have variable interest rates. Interest on loans is accrued on the unpaid principal balance and is credited to income using the effective yield interest method.

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. 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. 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.

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. 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 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 portion of the allowance is calculated by applying estimated loss factors to pools of outstanding loans. At December 31, 2008, loss factors were based on the Company's historical loss experience, adjusted for significant factors that, in management's judgment, affected the collectibility of the portfolio as of the evaluation date. The adjustment factors for the formula allowance included existing general economic and business conditions affecting the key lending areas of the Company, in particular the real estate market, credit quality trends, collateral values, loan volumes and concentrations, the technology industry, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, and bank regulatory examination results. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty.

In 2009, 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 adjustment factors are similar to the factors considered under the previous methodology. 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.

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.

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. Management does not believe that the ultimate loss from such matters, if any, will have a material effect on the financial statements.

Other Real Estate Owned

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 expense. Operating costs after acquisition are expensed. Gains and losses on disposition are included in noninterest income.

The carrying value of other real estate owned was $2,241,000 and $660,000 at December 31, 2009 and 2008, respectively, and is included in other assets on the consolidated balance sheet.

Company Owned Life Insurance and Other Postretirement 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 other 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.

In September 2006, final accounting guidance was established for deferred compensation and postretirement benefit aspects of endorsement split-dollar life insurance arrangements. The guidance requires that a liability be recorded over the average life expectancy 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. The Company adopted this guidance on January 1, 2008. The adoption of this guidance in 2008 resulted in a cumulative effect adjustment to retained earnings of $3,182,000 million, net of deferred income taxes, at January 1, 2008. In 2009, the Company determined that this adjustment should have been made to accumulated other comprehensive income and, as allowed by SEC Staff Accounting Bulletin No. 108, the Company reclassified the cumulative effect adjustment of $3,182,000 from retained earnings to accumulated other comprehensive income as of January 1, 2008. Total shareholders' equity remains unchanged due to this reclassification. The reclassification does not affect assets, liabilities, net income or loss, or cash flows for any period.

Goodwill and Intangible Assets

Goodwill results from the acquisition of Diablo Valley Bank and 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 core deposit and customer relationship intangible assets arising from the Diablo Valley Bank acquisition. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives. The core deposits and customer relationship intangible assets are being amortized over ten and seven years, respectively.

Retirement Plans

Expenses for the Company 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.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost. 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.

Income Taxes

The Company files consolidated Federal and combined state income tax returns. Income tax expense is the total of the current year income tax payable or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. For purposes of a valuation allowance, the Company evaluates all evidence currently available, both positive and negative, including existence of taxes paid in available carry-back years, forecasts of future income, cumulative losses, applicable tax planning strategies and assessments of the current and future economic and business conditions.

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 related to income tax matters as interest expense and penalties related to income tax matters as other noninterest expense.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees, 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.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of other comprehensive income and net income (loss). Other comprehensive income 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 under the provisions of other accounting guidance. The Company's sources of other comprehensive income 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 supplemental retirement plan and the split-dollar life insurance benefit plan. Reclassification adjustments result from gains or losses on securities 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.

The following is a summary of the components of other comprehensive income:

	Year ended December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Net unrealized holding gains on available-for-sale of securities and I/O strips during the year,	$ 505	$ 2,641	$1,766
Reclassification adjustment for (gains) realized in income	(231)	—	—
Less: Deferred income tax	(115)	(1,109)	(738)
Change in unrealized gains on available-for-sale securities and I/O strips, net of deferred income tax	159	1,532	1,028
Net pension and other post retirement plan liability adjustment	1,312	(1,615)	137
Less: Deferred income tax	(552)	680	(58)
Change in pension and other post retirement plan liability, net of deferred income tax	760	(935)	79
Other comprehensive income	$ 919	$ 597	$1,107

Accumulated other comprehensive income consisted of the following items, net of deferred income tax, at year-end.

	2009	2008
	(Dollars in thousands)	
Net unrealized gains on securities available-for-sale and I/O strips	$ 1,827	$ 1,668
Net pension and other post retirement plan liability	(4,381)	(5,141)
Accumulated other comprehensive loss	$(2,554)	$(3,473)

Segment Reporting

HBC is an independent community business bank with ten branch offices that offer similar products to customers. No customer accounts for more than 10 percent of revenues for HBC or the Company. While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company wide basis. Management evaluates the Company's performance as a whole and does not allocate resources based on the performance of different lending or transaction activities. Accordingly, the Company and its subsidiary bank all operate as one business segment.

Reclassifications

Certain items in the consolidated financial statements for the years ended December 31, 2008 and 2007 were reclassified to conform to the 2009 presentation. These reclassifications did not affect previously reported net income.

Adoption of Other New Accounting Standards

In September 2006, the FASB issued guidance that defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance also establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The guidance was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued guidance that delayed the effective date of this fair value guidance for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Except for additional disclosures in the notes to the financial statements, adoption of this guidance did not impact the Company.

In June 2008, the FASB issued guidance which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, included in the earnings allocation in computing earnings per share ("EPS") under the two-class method. Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented were adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform to the provisions of this guidance. Upon adoption of this guidance, the Company began including non-vested restricted stock award shares in the computation of basic EPS. Previously, non vested restricted stock awards were excluded from the basic EPS computation and included in the diluted EPS computation. The 2008 and 2007 EPS data presented has been adjusted retrospectively to conform with the provisions of this guidance. Except for reducing basic EPS in 2007 from \$1.14 to \$1.13, this change in computation did not involve a sufficient number of shares to change basic and diluted EPS from the amounts previously reported.

In April 2009, the FASB amended existing guidance for determining whether impairment is other-than-temporary for debt securities. The guidance requires an entity to assess whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment ("OTTI") related to other factors, which is recognized in other comprehensive income and 2) OTTI related to credit loss, which must be recognized in the income statement. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. Additionally, disclosures about other-than-temporary impairments for debt and equity securities were expanded. This guidance is effective for interim and annual reporting periods ending after June 15, 2009. The effect of adopting this new guidance did not have a material impact on the Company's financial statements.

In April 2009, the FASB issued guidance that emphasizes that the objective of a fair value measurement does not change even when market activity for the asset or liability has decreased significantly. Fair value is the price that would be received for an asset sold or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. When observable transactions or quoted prices are not considered orderly, then little, if any, weight should be assigned to the indication of the asset or liability's fair value. Adjustments to those transactions or prices should be applied to determine the appropriate fair value. The guidance, which was applied prospectively, is effective for interim and annual reporting periods ending after June 15, 2009. The effect of adopting this new guidance did not have a material impact on the Company's financial statements.

In June 2009, the FASB replaced *The Hierarchy of Generally Accepted Accounting Principles*, with the *FASB Accounting Standards Codification*™ ("the Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the Securities and Exchange Commission under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification is effective for financial statements issued for periods ending after September 15, 2009.

In August 2009, the FASB amended existing guidance for the fair value measurement of liabilities by clarifying that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using a valuation technique that uses the quoted price of the identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities when traded as assets, or that is consistent with existing fair value guidance. The amendments in this guidance also clarify that both a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The guidance was effective for the first reporting period beginning after issuance. The effect of adopting this new guidance did not have a material impact on the Company's financial statements.

Newly Issued, but not yet Effective Accounting Standards

In June 2009, the FASB amended previous guidance relating to transfers of financial assets and eliminates the concept of a qualifying special purpose entity. This guidance must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. The disclosure provisions were also amended and apply to transfers that occurred both before and after the effective date of this guidance. The Company does not expect adoption of this guidance to have a material impact on the Company's financial statements.

In June 2009, the FASB amended guidance for consolidation of variable interest entity guidance by replacing the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. Additional disclosures about an enterprise's involvement in variable interest entities are also required. This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Early adoption is prohibited. The Company does not expect adoption of this guidance to have a material impact on the Company's financial statements.

(2) Securities

The amortized cost and estimated fair value of securities at year-end were as follows:

2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
U.S. Government Sponsored Entities	$ 2,000	$ —	$ (27)	$ 1,973
Mortgage-Backed Securities — Residential	101,356	1,653	(463)	102,546
Collateralized Mortgage Obligations — Residential	5,227	220	—	5,447
Total securities available-for-sale	$108,583	$1,873	$(490)	$109,966

2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
U.S. Treasury	$ 19,370	$ 126	$ —	$ 19,496
U.S. Government Sponsored Entities	8,457	239	—	8,696
Municipals — Tax Exempt	696	5	—	701
Mortgage-Backed Securities — Residential	68,180	1,241	(385)	69,036
Collateralized Mortgage Obligations — Residential	6,370	198	(22)	6,546
Total securities available-for-sale	$103,073	$1,809	$(407)	$104,475

Securities classified as U.S. Government Sponsored Entities as of December 31, 2009 and 2008 were issued by the Federal National Mortgage Association ("Fannie Mae"), Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Federal Home Loan Bank. At December 31, 2009 and 2008, all mortgage-backed securities and collateralized mortgage obligations were issued by Fannie Mae, Freddie Mac, or the Government National Mortgage Association ("Ginnie Mae").

At year end 2009 and 2008, 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.

The proceeds from sales of securities and the resulting gains and losses are listed below:

	2009	2008	2007
	(Dollars in thousands)		
Proceeds	$15,272	$—	$—
Gross gains	238	—	—
Gross losses	(7)	—	—

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

2009	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
	(Dollars in thousands)					
U.S. Government Sponsored Entities	$ 1,973	$ (27)	$—	$—	$ 1,973	$ (27)
Mortgage-Backed Securities — Residential	43,600	(463)	—	—	43,600	(463)
Total	$45,573	$(490)	$—	$—	$45,573	$(490)

2008	Less Than 12 Months Fair Value	Less Than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
	(Dollars in thousands)					
Mortgage-Backed Securities — Residential	$4,727	$(27)	$14,327	$(358)	$19,054	$(385)
Collateralized Mortgage Obligations — Residential	—	—	1,872	(22)	1,872	(22)
Total	$4,727	$(27)	$16,199	$(380)	$20,926	$(407)

At December 31, 2009, the Company held 75 securities, of which 23 had fair values below amortized cost. No securities have been carried with an unrealized loss for over 12 months. Unrealized losses were primarily 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 intend to sell any securities with an unrealized loss and 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, 2009.

At December 31, 2008, the Company held 65 securities, of which six had fair values below amortized cost. Four securities have been carried with an unrealized loss for over 12 months. The Company did not consider these securities to be other-than-temporarily impaired at December 31, 2008.

The amortized cost and estimated fair values of securities as of December 31, 2009, by weighted average life, are shown below. The weighted average life will differ from contractual maturities because borrowers may have the right to call or pre-pay obligations with or without call or pre-payment penalties.

	Available-for-sale	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due within one year	$ 1,189	$ 1,198
Due after one through five years	40,367	41,785
Due after five through ten years	62,560	62,418
Due after ten years	4,467	4,565
Total	$108,583	$109,966

Securities with amortized cost of $55,263,000 and $99,486,000 as of December 31, 2009 and 2008 were pledged to secure repurchase agreements, public deposits and for other purposes as required or permitted by law or contract.

(3) Loans and Loan Servicing

Loans at year-end were as follows:

	2009	2008
	(Dollars in thousands)	
Loans held for investment		
Commercial	$ 427,177	$ 525,080
Real estate — mortgage	400,731	405,530
Real estate — land and construction	182,871	256,567
Home equity	51,368	55,490
Consumer	7,181	4,310
Loans	1,069,328	1,246,977
Deferred loan origination costs and fees, net	785	1,654
Loans, including deferred costs	1,070,113	1,248,631
Allowance for loan losses	(28,768)	(25,007)
Loans, net	$1,041,345	$1,223,624

Real estate mortgage loans are primarily secured by mortgages on commercial property.

Changes in the allowance for loan losses were as follows:

	Year ended December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Balance, beginning of year	$ 25,007	$12,218	$ 9,279
Loans charged-off	(31,534)	(2,806)	(104)
Recoveries	1,367	58	929
Net recoveries (charge-offs)	(30,167)	(2,748)	825
Provision for loan losses	33,928	15,537	(11)
Allowance acquired in bank acquisition	—	—	2,125
Balance, end of year	$ 28,768	$25,007	$12,218

Impaired loans were as follows:

	2009	2008
	(Dollars in thousands)	
Year-end loans with no allocated allowance for loan losses	$13,202	$10,745
Year-end loans with allocated allowance for loan losses	49,173	50,805
Total	$62,375	$61,550

	2009	2008	2007
	(Dollars in thousands)		
Amount of the allowance for loan losses allocated at year-end	$ 9,103	$10,581	$1,478
Average of impaired loans during the year	$59,539	$34,295	$8,329
Cash basis interest income recognized during impairment	$ 48	$ 246	$ 103
Interest income during impairment	$ 67	$ 554	$1,031

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:

	2009	2008
	(Dollars in thousands)	
Loans past due over 90 days still on accrual	$ 2,895	$ 460
Nonaccrual loans	$59,480	$39,981

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.

HBC makes loans to executive officers, directors, and their affiliates. The following table presents the loans outstanding to these related parties:

	2009	2008
	(Dollars in thousands)	
Balance, beginning of year	$ 2	$ 502
Advances on loans during the year	50	3,217
Repayment on loans during the year	(52)	(3,717)
Balance, end of year	$ —	$ 2

At December 31, 2009 and 2008, the Company serviced SBA loans sold to the secondary market of approximately $162,759,000 and $150,172,000.

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 1.42% and 1.56% at December 31, 2009 and 2008, respectively.

Servicing rights are included in "accrued interest receivable and other assets" on the consolidated balance sheets. Activity for loan servicing rights follows:

	2009	2008	2007
	(Dollars in thousands)		
Beginning of year balance	$1,013	$1,754	$2,154
Additions	572	—	575
Amortization	(518)	(741)	(975)
End of year balance	$1,067	$1,013	$1,754

There was no valuation allowance for servicing rights as of December 31, 2009 and 2008, because the fair value of the servicing rights was greater than the carrying value. The estimated fair value of loan servicing rights was $2,856,000 and $2,093,000 at December 31, 2009 and 2008. The fair value of servicing rights at December 31, 2009 was estimated using a weighted average constant prepayment rate ("CPR") assumption of 15.8%, and a weighted average discount rate assumption of 10.7%. The fair value of servicing rights at December 31, 2008 was estimated using a weighted average constant prepayment rate ("CPR") assumption of 22.6%, and a weighted average discount rate assumption of 14.0%.

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. At December 31, 2009, key economic assumptions and the sensitivity of the fair value of the I/O strip receivables to immediate 10% and 20% changes to the CPR assumption, and 1% and 2% changes to the discount rate assumption, are as follows:

	(Dollars in thousands)
Carrying amount/fair value of Interest-Only (I/O) strip	$2,116
Prepayment speed assumption (annual rate)	15.8%
Impact on fair value of 10% adverse change in prepayment speed (CPR 17.4%)	$ (141)
Impact on fair value of 20% adverse change in prepayment speed (CPR 18.9%)	$ (245)
Residual cash flow discount rate assumption (annual)	10.7%
Impact on fair value of 1% adverse change in discount rate (11.7% discount rate)	$ (89)
Impact on fair value of 2% adverse change in discount rate (12.8% discount rate)	$ (148)

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:

	2009	2008	2007
	(Dollars in thousands)		
Beginning of year balance	$2,248	$2,332	$ 4,537
Additions	—	—	27
Amortization	(425)	(886)	(991)
Unrealized gain (loss)	293	802	(1,241)
End of year balance	$2,116	$2,248	$ 2,332

(4) Premises and Equipment

Premises and equipment at year-end were as follows:

	2009	2008
	(Dollars in thousands)	
Building	$ 3,256	$ 3,256
Land	2,900	2,900
Furniture and equipment	6,494	6,299
Leasehold improvements	4,615	4,579
	17,265	17,034
Accumulated depreciation and amortization	(8,259)	(7,517)
Premises and equipment, net	$ 9,006	$ 9,517

Depreciation expense was $807,000, $1,022,000, and $776,000 in 2009, 2008, and 2007, respectively.

(5) Goodwill and Intangible Assets

Goodwill

The Company recognized $43,181,000 of goodwill upon its acquisition of Diablo Valley Bank on June 20, 2007. Goodwill remains at $43,181,000 as of December 31, 2009 and 2008.

Goodwill impairment exists when a reporting unit's carrying value exceeds its fair value, which is determined through a two-step impairment test. 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.

The Company completed its annual impairment analysis as of November 30, 2009 with the assistance of an independent valuation firm. The Step 1 valuation of the Company was based on a weighted blend of the income approach and market approach. The income approach estimates the fair value of the Company based on the present value of discounted cash flows from future operations. The market approach considers key pricing multiples of similar companies. The Step 1 valuation indicated that the Step 2 analysis was necessary.

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. After performing Step 2, with the assistance of the same independent valuation firm, it was determined that the implied fair value of goodwill was greater than the carrying value, resulting in no impairment charge in 2009.

Acquired Intangible Assets

Core deposit and customer relationship intangible assets acquired in the 2007 acquisition of Diablo Valley Bank were $5,049,000 and $276,000, respectively. Accumulated amortization of these intangible assets was $1,736,000 and $1,093,000 at December 31, 2009 and 2008, respectively.

Estimated amortization expense for each of the next five years follows:

	(Dollars in thousands)
2010	$575
2011	523
2012	492
2013	470
2014	460

(6) Deposits

Time deposits of $100,000 and over, including CDARS and brokered deposits of $100,000 and over, were $343,883,000 and $358,576,000 at December 31, 2009 and 2008, respectively. The following table presents the scheduled maturities of time deposits, including brokered deposits for the next five years:

	December 31, 2009 (Dollars in thousands)
2010	$280,657
2011	104,235
2012	1,294
2013	13
2014 and after	14
Total	$386,213

As of December 31, 2009, time deposits within the Certificate of Deposit Account Registry Service ("CDARS") program increased to $38,154,000 compared to $11,666,000 at December 31, 2008. 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 considered brokered deposits under current regulatory reporting guidelines.

Deposits from executive officers, directors, and their affiliates were $2,142,000 and $11,858,000 at December 31, 2009 and 2008, respectively.

(7) Borrowing Arrangements

Federal Home Loan Bank and Federal Reserve Bank Borrowings, Available Lines of Credit and Other Borrowings

The Company 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, 2009, the Company had $20,000,000 of overnight borrowings from the FHLB, bearing interest at 0.04%. As of December 31, 2008, the Company had $55,000,000 of overnight borrowings from the FHLB, bearing interest at 0.05%. The Company has $271,207,000 of loans and no securities pledged to the FHLB as collateral on a line of credit of $136,389,000 at December 31, 2009.

The Company can also borrow from the FRB's discount window. The Company had approximately $88,400,000 of loans pledged to the FRB as collateral on an available line of credit of approximately $39,700,000 at December 31, 2009, none of which was outstanding.

At December 31, 2009, the Company has Federal funds purchase arrangements and lines of credit available of $35,000,000. There were no Federal funds purchased at December 31, 2009 and 2008.

As of December 31, 2008, the Company also had a $15,000,000 line of credit with a correspondent bank, all of which was outstanding. The line of credit had a variable rate of interest and was unsecured. The Company repaid all of the obligations under the line of credit on March 3, 2009, thus terminating the line of credit facility.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are secured by mortgage-backed securities carried at approximately $29,100,000 and $40,000,000, respectively, at December 31, 2009 and 2008.

Securities sold under agreements to repurchase are financing arrangements that mature within two and a half years. At maturity, the securities underlying the agreements are returned to the Company. Information concerning securities sold under agreements to repurchase is summarized as follows:

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Average balance during the year	$28,822	$32,030	$14,504
Average interest rate during the year	2.73%	2.93%	2.67%
Maximum month-end balance during the year	$35,000	$35,000	$10,900
Average rate at December 31	2.35%	2.95%	2.73%

Subordinated Debt

Interest payments on the subordinated notes payable to the Company's subsidiary grantor Trusts are deductible for tax purposes. The subordinated debt is not registered with the Securities and Exchange Commission. For regulatory reporting purposes, the subordinated debt qualifies for Tier 1 capital treatment.

The table below summarizes subordinated debt as of December 31:

	2009	2008
	(Dollars in thousands)	
Subordinated debentures due to Heritage Capital Trust I with interest payable semi-annually at 10.875%, redeemable with a premium beginning March 8, 2010 and with no premium beginning March 8, 2020, due March 8, 2030	$ 7,217	$ 7,217
Subordinated debentures due to Heritage Statutory Trust I with interest payable semi-annually at 10.6%, redeemable with a premium beginning September 7, 2010 and with no premium beginning September 7, 2020, due September 7, 2030	7,206	7,206
Subordinated debentures due to Heritage Statutory Trust II with interest payable quarterly based on 3-month Libor plus 3.58% (3.86% at December 31, 2009), redeemable with a premium beginning July 31, 2006 and with no premium beginning July 31, 2011, due July 31, 2031	5,155	5,155
Subordinated debentures due to Heritage Statutory Trust III with interest payable quarterly based on 3-month Libor plus 3.40% (3.65% at December 31, 2009), redeemable with no premium beginning September 26, 2007 and due September 26, 2032	4,124	4,124
Total	$23,702	$23,702

The Company has deferred regularly scheduled interest payments on all of the subordinated debt. The terms of the subordinated debt and related indentures allow the Company to defer payments of interest for up to five consecutive years without default or penalty, although the Company will continue to accrue the cost and recognize the expense of the interest at the normal rate on a compounded basis until such time as the deferred arrearage has been paid current. As of December 31, 2009, interest totaling $575,000, which is included in accrued interest payable on the Consolidated Balance Sheets, was deferred and in arrears. During the deferral period, the respective Trusts will likewise suspend the declaration and payment of dividends on the trust preferred securities. The deferral began with respect to regularly scheduled quarterly interest payments that would otherwise have been made in December of 2009.

During the deferral period, the Company may not, among other things and with limited exceptions, pay cash dividends on or repurchase its common stock or preferred stock nor make any payment on outstanding debt obligations that rank equally with or junior to the subordinated debt.

(8) Income Taxes

Income tax expense consisted of the following:

	December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Currently (refundable) payable tax:			
Federal	$ (6,192)	$ 3,307	$ 6,013
State	2	1,312	2,349
Total currently payable (refundable)	(6,190)	4,619	8,362
Deferred tax (benefit)			
Federal	(3,108)	(4,426)	(223)
State	(3,411)	(1,580)	(2)
Total deferred tax (benefit)	(6,519)	(6,006)	(225)
Income tax expense (benefit)	$(12,709)	$(1,387)	$ 8,137

The effective tax rate differs from the federal statutory rate for the years ended December 31, as follows:

	2009	2008	2007
Statutory Federal income tax rate	−35.0%	35.0%	35.0%
State income taxes, net of federal tax benefit	−9.0%	−46.3%	7.2%
Low income housing credits	−4.3%	−283.1%	−4.9%
Non-taxable interest income	−0.4%	−20.3%	−0.2%
Increase in cash surrender value of life insurance	−2.4%	−153.4%	−2.3%
Stock based compensation	0.6%	55.9%	1.1%
Other	−1.0%	42.3%	0.7%
Effective tax rate	−51.5%	−369.9%	36.6%

In 2008, other items in the table above consist primarily of various nondeductible expenses that are not significantly different in dollar amount from the prior year.

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:

	2009	2008
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for loan losses	$12,062	$10,455
Defined postretirement benefit obligation	6,135	5,597
Other postretirement obligation	2,752	3,128
Tax credit carryforwards	1,882	—
California net operating loss carryforwards	1,615	172
Stock compensation	1,107	780
Nonaccrual loan interest	448	326
Accrued expenses	441	610
Fixed assets	439	516
Loans	88	211
Deferred compensation	53	272
State income taxes	1	453
Other	254	35
Total deferred tax assets	27,277	22,555
Deferred tax liabilities:		
FHLB stock	(304)	(304)
Prepaid expenses	(401)	(277)
Loan fees	(1,157)	(1,219)
Securities available-for-sale and I/O strips	(1,321)	(1,204)
Intangible assets	(1,509)	(1,779)
Other	(184)	(432)
Total deferred tax liabilities	(4,876)	(5,215)
Net deferred tax assets	$22,401	$17,340

Tax credit carryforwards as of December 31, 2009 consist of the following:

	2009	
	(Dollars in thousands)	
Low income housing credits	$1,296	(expiring in 2028 and 2029)
Alternative Minimum Tax credits	470	(no expiration date)
State tax credits, net of federal tax effects	116	(no expiration date)
Total tax credit carryforwards	$1,882	

After the carryback of the 2009 net operating loss and low income housing credits, the Company has approximately $2,100,000 of recoverable federal income taxes, which were paid for the 2008 tax year. In general, under current law, to recover 2008 federal income tax, the Company would need to have a sufficient net operating loss in 2010 which could then be carried back to 2008. Under California law, the Company cannot recover state income taxes paid in prior years.

At year-end 2009, the Company has a California net operating loss carryforward of approximately $22,900,000 that will begin to expire in 2019 if not utilized to reduce future taxable income.

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 and the net operating loss carryforwards for 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. In assessing the realization of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income, including tax planning strategies, during the periods in which those temporary differences become deductible. The Company estimates that it has sufficient forecasted future taxable income, as well as various tax planning strategies which could be implemented to generate taxable income in future taxable periods, to support the balance of deferred tax assets. Based on these factors, the Company believes it is more likely than not that the Company will realize the benefits of these deductible differences and, therefore, no valuation allowance for deferred tax assets was recorded at December 31, 2009 and 2008.

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 taxing authorities for years before 2006.

(9) Equity Plan

The Company has an Amended and Restated 2004 Equity Plan (the "Equity Plan") for directors, officers, and key employees. The Equity Plan provides for the grant of incentive and non-qualified stock options and restricted stock. The Equity Plan provides that the option price for both incentive and non-qualified 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. The Equity Plan also authorized the issuance of restricted common stock on terms established by the Board of Directors. As of December 31, 2009, there are 778,508 shares available for future grants under the Equity Plan.

Stock option activity under the Equity Plan 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, 2009	1,044,737	$18.89		
Granted	200,000	$ 6.65		
Exercised	—	$ —		
Forfeited or expired	(134,681)	$16.87		
Outstanding at December 31, 2009	1,110,056	$16.93	6.8	$26,000
Vested or expected to vest	1,054,553	$16.93	6.8	$25,000
Exercisable at December 31, 2009	760,579	$18.33	6.1	$ 3,000

Information related to the Equity Plan for each of the last three years:

	2009	2008	2007
Intrinsic value of options exercised	$ —	$272,000	$1,105,000
Cash received from option exercise	$ —	$509,000	$ 802,000
Tax benefit realized from option exercises	$ —	$ 71,000	$ 406,000
Weighted average fair value of options granted	$2.92	$ 3.54	$ 6.10

As of December 31, 2009, there was $1,900,000 of total unrecognized compensation cost related to nonvested stock options granted under the Equity Plan. That cost is expected to be recognized over a weighted-average period of approximately 2.0 years. The total fair value of options vested during 2009 is approximately $1,284,000.

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.

	2009	2008	2007
Expected life in months(1)	72	72	72
Volatility(1)	45%	25%	22%
Weighted average risk-free interest rate(2)	2.48%	3.22%	4.49%
Expected dividends(3)	0.33%	2.15%	1.18%

(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, and has concluded that forfeitures have no significant effect on stock option expense. The Company issues authorized shares of common stock to satisfy stock option exercises.

The Company granted 51,000 restricted shares of its common stock to an executive officer pursuant to the terms of a restricted stock agreement, dated March 17, 2005. The grant price was $18.15. Under the terms of the agreement, the restricted shares will vest 25% per year at the end of years three, four, five and six, provided the executive officer is still with the Company, subject to accelerated vesting upon a change of control, termination without cause, termination by the executive officer for good reason (as defined by the executive employment agreement), death or disability. The fair value of stock award at the grant date was $926,000, which is being amortized over the six-year vesting period on the straight-line method. Amortization expense was $154,000, $155,000, and $154,000 in 2009, 2008 and 2007, respectively. In 2009 and 2008, 12,750 shares vested in each year and 25, 500 shares are nonvested at December 31, 2009.

(10) Leases

Operating Leases

The Company owns one of its offices and leases the others under non-cancelable operating leases with terms, including renewal options, ranging from five to fifteen years. Future minimum payments under the agreements are as follows:

Year ending December 31,	(Dollars in thousands)
2010	$ 2,386
2011	2,250
2012	2,320
2013	2,107
2014	1,857
Thereafter	1,732
Total	$12,652

Rent expense under operating leases was $2,558,000, $2,715,000, and $2,644,000 respectively, in 2009, 2008, and 2007.

(11) 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 $1,500 for each employee's contributions in 2008 and 2007. The Company suspended the discretionary matching contribution in 2009. Contribution expense was $0, $332,000, and $315,000 in 2009, 2008 and 2007, 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 suspended contributions to the ESOP in 2009 and 2008. Contribution expense was $0, $0, and $247,000 in 2009, 2008 and 2007, respectively. At December 31, 2009, the ESOP owned 154,413 shares of the Company's common stock.

Deferred Compensation Plan

The Company has a nonqualified deferred compensation plan for its directors ("Deferral Agreements"). Under the Deferral Agreements, a participating director may defer up to 100% of his or her board fees into a deferred account. The director may elect a distribution schedule of up to ten years. Amounts deferred earn interest. The Company's deferred compensation obligation of $472,000 and $645,000 as of December 31, 2009 and 2008 is included in "Accrued interest payable and other liabilities."

The Company has purchased life insurance policies on the lives of directors who have Deferral Agreements. It is expected that the earnings on these policies will offset the cost of the program. In addition, the Company will receive death benefit payments upon the death of the director. The proceeds will permit the Company to "complete" the deferral program as the director originally intended if he dies prior to the completion of the deferral program. The disbursement of deferred fees is accelerated at death and commences one month after the director dies.

In the event of the director's disability prior to attainment of his benefit eligibility date, the director may request that the Board permit him to receive an immediate disability benefit equal to the annualized value of the director's deferral account.

Defined Benefit Pension Plan

The Company has a supplemental retirement plan covering key executives and directors ("SERP"). The SERP is an unfunded, nonqualified defined benefit plan. The combined number of active and retired/terminated participants in the SERP was 53 at December 31, 2009. 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. Since the SERP has no assets, the entire 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:

	2009	2008
	(Dollars in thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	$13,301	$11,499
Service cost	965	811
Interest cost	762	727
Actuarial (gain)/loss	78	1,203
Benefits paid	(515)	(939)
Projected benefit obligation at end of year	$14,591	$13,301
Amounts recognized in accumulated other comprehensive loss		
Net actuarial loss	$ 2,625	$ 2,739
Prior service cost	99	135
Accumulated other comprehensive loss	$ 2,724	$ 2,874
Weighted-average assumptions used to determine the benefit obligation at year-end:		
Discount rate	5.85%	5.85%
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)
2010	$ 650
2011	772
2012	843
2013	865
2014	1,071
2015 to 2019	6,762

The components of pension cost for the SERP follow:

	2009	2008
	(Dollars in thousands)	
Components of net periodic benefit cost		
Service cost	$ 965	$ 811
Interest cost	762	727
Amortization of prior service cost	36	36
Amortization of net actuarial loss	192	58
Net periodic benefit cost	$1,955	$1,632

Net periodic benefit cost was determined using the following assumptions:

	2009	2008
Discount rate	5.85%	6.45%
Rate of compensation increase	N/A	N/A

Split-Dollar Life Insurance Postretirement Benefit Plan

The Company has purchased insurance on the lives of the directors and executive officers participating in the SERP. The purchased insurance is subject to split-dollar life insurance agreements with the insured participants, which continues after the participant's employment and retirement. 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.

	2009	2008
	(Dollars in thousands)	
Change in projected benefit obligation		
Projected benefit obligation at beginning of year	$7,447	$6,901
Service cost	—	—
Interest cost	443	196
Actuarial loss (gain)	(80)	506
Benefits paid	—	(156)
Amendments to split dollar agreements	(853)	—
Projected benefit obligation at end of year	$6,957	$7,447

Amounts recognized in accumulated other comprehensive income at December 31 consist of:

	2009	2008
	(Dollars in thousands)	
Net actuarial loss	$ 426	$ 506
Prior transition obligation	4,404	5,486
Accumulated other comprehensive loss	$4,830	$5,992

Components of net periodic benefit cost are:

	2009	2008
	(Dollars in thousands)	
Amortization of prior transition obligation	$229	$ —
Interest cost	443	196
Net periodic benefit cost	$672	$196

Weighted-average assumptions used to determine the benefit obligation at year-end follow:

	2009	2008
Discount rate	6.16%	6.05%

Weighted-average assumption used to determine the net periodic benefit cost:

	2009	2008
Discount rate	6.05%	6.45%

(12) Regulatory Matters

On February 17, 2010, HCC and HBC entered into a written agreement with the Federal Reserve Bank of San Francisco and the California Department of Financial Institutions (“DFI”). Under the terms of the written agreement, the Company must obtain the prior written approval of the Federal Reserve and DFI before it may (i) declare or pay any dividends, (ii) make any distributions of principal or interest on the Company’s outstanding trust preferred securities and related subordinated debt, (iii) incur, increase or guarantee any debt, (iv) redeem any outstanding stock, or (v) take dividends or any other form of payment that represents a reduction in capital from HBC. The written agreement also requires the Company to (i) submit a written plan to strengthen credit risk management practices, (ii) submit a written capital plan for sufficient capitalization of both HCC and HBC , (iii) submit a written business plan for 2010 to improve the Company’s earnings and overall financial condition, (iv) comply with notice and approval requirements related to the appointment of directors and senior executive officers or change in the responsibility of any current senior executive officer, (v) comply with restrictions on paying or agreeing to pay certain indemnification and severance payments without prior written approval, (vi) submit a written plan to improve management of the Company’s liquidity position and funds management practices, (vii) notify the Federal Reserve and DFI no more than 30 days after the end of any quarter in which the capital ratios of HCC or HBC fall below approved capital plan’s minimum ratios, together with an acceptable written plan to increase capital ratios to or above the approved capital plan’s minimum levels (viii) comply with specified procedures for board (or a committee of the board) approval for the extension, renewal or restructure of any “criticized loan”, (ix) submit plans to improve the Company’s position on outstanding past due and other problem loans in excess of $2 million, (x) maintain policies and procedures and submit a plan for the maintenance of an adequate allocation for loan losses, and (xi) provide quarterly progress reports to the Federal Reserve and DFI.

Prior to entering into the written agreement in February 2010, the Company had already ceased paying dividends on its common stock (in the second quarter of 2009), suspended interest payments on its trust preferred securities and related subordinated debt (in the fourth quarter of 2009), and suspended dividend payments on its preferred stock (also in the fourth quarter of 2009).

The Company is addressing the requirements of the written agreement, including efforts and plans to improve asset quality and credit risk management, improve profitability and liquidity management, and maintain capital at a level sufficient for the respective risk profiles of HCC (on a consolidated basis) and HBC. A committee of outside directors has been formed to monitor and coordinate compliance with the written agreement.

Failure to comply with the written agreement may subject HCC and HBC to additional supervisory actions and orders.

(13) 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 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).

Assets and Liabilities Measured on a Recurring Basis

		Fair Value Measurements at December 31, 2009 Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obeservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets/Liabilities at December 31, 2009:				
Available-for-sale securities				
U.S. Government Sponsored Entities	$ 1,973	$ —	$ 1,973	$—
Mortgage-Backed Securities — Residential	102,546	—	102,546	—
Collateralized Mortgage Obligations — Residential	5,447	—	5,447	—
I/O strip receivables	2,116	—	2,116	—

Assets and Liabilities Measured on a Recurring Basis

		Fair Value Measurements at December 31, 2008 Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obeservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets/Liabilities at December 31, 2008:				
Available-for-sale securities				
U.S. Treasury	$19,496	$19,496	$ —	$—
U.S. Government Sponsored Entities	8,696	—	8,696	—
Municipals — Tax Exempt	701	—	701	—
Mortgage-Backed Securities — Residential	69,036	—	69,036	—
Collateralized Mortgage Obligations — Residential	6,546	—	6,546	—
I/O strip receivables	2,248	—	2,248	—

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.

Nonrecurring adjustments to certain commercial and residential estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets and Liabilities Measured on a Non-recurring Basis

		Fair Value Measurements Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obeservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets at December 31, 2009:				
Impaired loans	$48,410	$—	$—	$48,410
Other real estate owned	812	—	—	812
Assets at December 31, 2008:				
Impaired loans	40,224	—	—	40,224

Impaired loans which are measured primarily for impairment using the fair value of the collateral were $62,375,000 at December 31, 2009, after partial charge-offs of $14,027,000 in 2009. In addition, these loans had a specific valuation allowance of $9,103,000 at December 31, 2009. Impaired loans totaling $57,513,000 at December 31, 2009 were carried at fair value as a result of the aforementioned partial charge-offs and specific valuation allowances at year-end. The remaining $4,862,000 of impaired loans were carried at cost at December 31, 2009, 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 2009 on impaired loans carried at fair value at December 31, 2009 resulted in an additional provision for loan losses of $16,574,000.

At December 31, 2008, impaired loans totaled $61,550,000. These loans had a specific valuation allowance of $10,581,000 at December 31, 2008. Impaired loans totaling $50,805,000, including $4,000,000 of unsecured loans with a $4,000,000 valuation allowance, were carried at fair value as a result of the aforementioned specific valuation allowances. The remaining $10,745,000 of impaired loans were carried at cost at December 31, 2008, as the fair value of the collateral exceeded the cost basis of each respective loan. Changes in specific valuation allowances during 2008 on impaired loans carried at the fair value of collateral at December 31, 2008 resulted in an additional provision for loan losses of $5,750,000.

Total other real estate owned, consisting of two properties, had a carrying value of $2,241,000 at December 31, 2009. One property is carried at fair value, less costs to sell, of $812,000 at December 31, 2009, with a valuation allowance of $0. The other property is carried at cost as of December 31, 2009. There were no impairment write-downs subsequent to acquisition in 2009.

The carrying amounts and estimated fair values of the Company's financial instruments, at year-end were as follows:

	2009		2008	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
	(Dollars in thousands)			
Assets				
Cash and cash equivalents	$ 45,562	$ 45,562	$ 30,096	$ 30,096
Securities available-for-sale	109,966	109,966	104,475	104,475
Loans (including loans held-for-sale), net	1,052,087	955,242	1,223,624	1,222,761
FHLB and FRB stock	8,454	N/A	7,816	N/A
Accrued interest receivable	3,472	3,472	4,116	4,116
Loan servicing rights and I/O strips receivables	3,183	4,972	3,261	4,341
Liabilities				
Time deposits	$ 386,213	$389,027	$ 413,132	$ 417,163
Other deposits	703,072	703,072	740,918	740,918
Securities sold under agreement to repurchase	25,000	25,341	35,000	35,788
Note payable	—	—	15,000	15,000
Short-term borrowings	20,000	20,000	55,000	55,000
Subordinated debt	23,702	14,938	23,702	18,600
Accrued interest payable	1,194	1,194	1,510	1,510

The methods and assumptions, not previously discussed, used to estimate the fair value are described as follows:

Cash and Cash Equivalents and Accrued Interest Receivable and Payable

The carrying amount approximates fair value because of the short maturities of these instruments.

Loans

Loans with similar financial characteristics are grouped together for purposes of estimating their fair value. Loans are segregated by type such as commercial, term real estate, construction and land development, and consumer. Each loan category is further segmented into fixed and adjustable rate interest terms.

The fair value of performing, fixed rate loans is calculated by discounting scheduled future cash flows using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The fair value of variable rate loans approximates the carrying amount as these loans generally reprice within 90 days.

The fair value of loans held-for-sale is based on estimated market values from third party investors.

FHLB and FRB Stock

It was not practical to determine the fair value of FHLB and FRB stock due to the restrictions placed on transferability.

Deposits

The fair value of deposits with no stated maturity, such as demand deposits, savings, and money market accounts, approximates the amount payable on demand. The carrying amount approximates the fair value of time deposits with a remaining maturity of less than 90 days. The fair value of all other time deposits is calculated based on discounting the future cash flows using rates currently offered for time deposits with similar remaining maturities.

Subordinated debt and Securities Sold Under Agreement to Purchase

The fair values of subordinated debt and securities sold under agreement to repurchase were determined based on the current market value for like kind instruments of a similar maturity and structure.

Short-term Borrowings and Note Payable

The carrying amount approximates the fair value of short-term borrowings and the note payable that reprice frequently and fully.

Off-Balance Sheet Items

The fair value of off-balance sheet items, such as commitments to extend credit, is not considered material and therefore is not included in the table above.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(14) 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,			
	2009		2008	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)			
Unused lines of credit and commitments to make loans	$10,540	$297,900	$19,310	$395,002
Standby letters of credit	557	19,218	3,690	18,570
	$11,097	$317,118	$23,000	$413,572

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 noninterest bearing reserves. Reserve requirements are based on a percentage of certain deposits. As of December 31, 2009, the Company maintained reserves of $7,593,000 in the form of vault cash and balances at the Federal Reserve Bank of San Francisco, which satisfied the regulatory requirements.

Claims

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.

(15) Stockholders' Equity and Earnings Per Share

Series A Preferred Stock Offering — On November 21, 2008, the Company issued 40,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A preferred stock"), with a liquidation preference of $1,000 per share. The Company received $40,000,000 of additional Tier 1 qualifying capital from the U.S. Treasury by participating in the U.S.Treasury's Capital Purchase Program ("Capital Purchase Program"). The Series A preferred stock has a cumulative dividend rate of 5% per annum until the fifth anniversary, and a rate of 9% per annum thereafter. The Series A preferred stock is transferable by the U.S. Treasury at any time. Subject to the approval of the FRB, the shares of Series A preferred stock are redeemable at the option of the Company at 100% of the liquidation preference plus any accrued and unpaid dividends. In connection with the Series A preferred stock offering, the Company issued a warrant to purchase 462,963 shares of the Company's common stock at an initial price of $12.96 per share of common stock (subject to antidilution adjustments). The U.S. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the warrant. Under the terms of the Capital Purchase Program, as long as any shares of Series A preferred stock remains outstanding, the Company is prohibited from increasing dividends on common stock, and from making certain repurchases of equity securities, including common stock, without the U.S. Treasury's consent until the third anniversary of the U.S. Treasury's investment or until the U.S. Treasury has transferred all of the Series A preferred shares it purchased to third parties. In November 2009, the Company suspended payment of dividends on the Series A preferred stock until further notice. As long as the shares of Series A preferred stock are outstanding, dividend payments and repurchases or redemptions relating to certain equity securities, including common stock, are prohibited until all accrued and unpaid dividends are paid on the

Series A preferred stock, subject to certain limited exceptions. The Company accrues the cumulative unpaid dividends at the compounded dividend rate. As of December 31, 2009, $783,000 has been accrued for cumulative unpaid dividends on the Series A preferred stock.

Warrants — During 2008, in conjunction with the Series A preferred stock offering, the Company issued a warrant with an initial exercise price of $12.96 per share of common stock, with an allocated fair value of $1,979,000. The estimated fair value of the warrant was recorded as a discount on the Series A preferred stock, with an offsetting credit to paid-in-capital. The discount on the preferred stock is being accreted on the effective yield method over five years as a charge to retained earnings, thus reducing net income available to common shareholders. The warrant may be exercised at any time on or before November 21, 2018. The warrant, and all rights under the warrant, are otherwise transferable. As of December 31, 2009, there were 462,963 shares issuable upon exercise of the warrant.

Stock Repurchase Program — In July, 2007, the Board of Directors authorized the repurchase of up to $30,000,000 of common stock through July 2009. From August 13, 2007 through May 27, 2008, the Company repurchased 1,645,607 shares for a total of $29,811,000 to complete the repurchase plan.

Earnings Per Share — Basic earnings per 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 and common stock warrants, using the treasury stock method. Due to the Company's net loss in 2009, all stock options and warrants were excluded from the computation of diluted earnings (loss) per share. There were 815,865 and 447,526 stock options in 2008 and 2007, respectively, that were considered to be antidilutive and excluded from the computation of diluted earnings per share. For each of the years presented, net income (loss) available to common shareholders is the same for basic and diluted earnings per share. Reconciliation of weighted average shares used in computing basic and diluted earnings (loss) per common share is as follows:

	Year ended December 31,		
	2009	2008	2007
Weighted average common shares outstanding — used in computing basic earnings (loss) per common share	11,820,509	12,002,910	12,449,270
Dilutive effect of stock options and warrants outstanding, using the treasury stock method	N/A	36,866	117,531
Shares used in computing diluted earnings (loss) per common share	11,820,509	12,039,776	12,566,801

(16) Capital Requirements

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory — and possibly additional discretionary — actions by regulators that, if undertaken, could have a 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.

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 table below) of total and 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, 2009 and 2008, the Company and HBC met all capital adequacy guidelines to which they were subject. However, as discussed under "Note 12 — Regulatory Matters", the written agreement signed in February 2010 requires the Company to submit a written plan to the FRB and DFI for sufficient capitalization of both HCC (on a consolidated basis) and HBC, based on their respective risk profiles.

As of December 31, 2009 HBC was categorized as "well-capitalized" under the regulatory framework for prompt corrective action. Except for the terms of the written agreement with the FRB and DFI, there are no conditions or events since December 31, 2009 that management believes has changed HBC's category.

The Company's consolidated capital amounts and ratios are presented in the following table, together with capital adequacy requirements without regard to the written agreement.

	Actual		Required For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
As of December 31, 2009				
Total Capital (to risk-weighted assets)	$149,553	12.9%	$ 93,035	8.0%
Tier 1 Capital (to risk-weighted assets)	$134,833	11.6%	$ 46,534	4.0%
Tier 1 Capital (to average assets)	$134,833	10.1%	$ 53,665	4.0%
As of December 31, 2008				
Total Capital (to risk-weighted assets)	$180,317	13.4%	$108,092	8.0%
Tier 1 Capital (to risk-weighted assets)	$163,328	12.1%	$ 55,085	4.0%
Tier 1 Capital (to average assets)	$163,328	11.3%	$ 59,177	4.0%

HBC's actual capital and required amounts and ratios are presented in the following table.

	Actual		Required For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
As of December 31, 2009						
Total Capital (to risk-weighted assets)	$147,959	12.7%	$ 93,203	8.0%	$116,503	10.0%
Tier 1 Capital (to risk-weighted assets)	$133,216	11.4%	$ 46,620	4.0%	$ 69,930	6.0%
Tier 1 Capital (to average assets)	$133,216	9.9%	$ 53,770	4.0%	$ 67,213	5.0%
As of December 31, 2008						
Total Capital (to risk-weighted assets)	$169,648	12.6%	$107,920	8.0%	$134,900	10.0%
Tier 1 Capital (to risk-weighted assets)	$152,676	11.3%	$ 53,969	4.0%	$ 80,953	6.0%
Tier 1 Capital (to average assets)	$152,676	10.5%	$ 57,943	4.0%	$ 72,429	5.0%

Under California 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 therefore. The California Banking Law 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, 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. 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 discussed in Note 12, at December 31, 2009, the amount available for such dividends without prior regulatory approval was $0 for HBC. Similar restrictions apply to the amounts and sum of loan advances and other transfers of funds from HBC to the parent Company.

(17) 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, 2009	December 31, 2008
	(Dollars in thousands)	
Assets		
Cash and cash equivalents	$ 5,593	$ 25,809
Investment in subsidiary bank	188,904	196,614
Investment in subsidiary trusts	702	702
Other assets	2,216	633
Total assets	$197,415	$223,758
Liabilities and Shareholder's Equity		
Subordinated debt	$ 23,702	$ 23,702
Note payable	—	15,000
Other liabilities	1,408	789
Shareholder's equity	172,305	184,267
Total liabilities and shareholder's equity	$197,415	$223,758

Condensed Statements of Operations

	For the Year Ended December 31, 2009	2008	2007
	(Dollars in thousands)		
Interest income	$ 49	$ 50	$ 24
Dividend from subsidiary bank	5,000	—	25,699
Interest expense	(2,014)	(2,440)	(2,331)
Other expenses	(2,287)	(2,109)	(2,156)
Income (loss) before income taxes and undistributed income of subsidiary bank	748	(4,499)	21,236
Equity in undistributed net income (loss) of subsidiary bank	(14,843)	4,456	(8,739)
Income tax benefit	2,110	1,805	1,599
Net income (loss)	$(11,985)	$ 1,762	$14,096
Dividends and discount accretion on preferred stock	(2,376)	(255)	—
Net income (loss) allocable to common shareholders	$(14,361)	$ 1,507	$14,096

Condensed Statements of Cash Flows

	For the Year Ended December 31,		
	2009	2008	2007
	(Dollars in thousands)		
Cash flows from operating activities:			
Net Income (loss)	$(11,985)	$ 1,762	$ 14,096
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations:			
Amortization of restricted stock award	154	155	154
Equity in undistributed loss/net income of subsidiary bank	14,843	(4,456)	8,739
Net change in other assets and liabilities	(1,525)	76	399
Net cash provided by (used in) operating activities	1,487	(2,463)	23,388
Cash flows from investing activities:			
Equity investment in subsidiary bank	(5,000)	(15,000)	—
Cash flows from financing activities:			
Net change in note payable	(15,000)	15,000	—
Exercise of stock options	—	509	802
Common stock repurchased	—	(17,655)	(13,653)
Payment of cash dividends — common stock	(236)	(3,819)	(3,250)
Payment of cash dividends — preferred stock	(1,467)	—	—
Issuance of preferred stock, net of issuance costs of $154	—	39,846	—
Net cash provided by (used in) financing activities	(16,703)	33,881	(16,101)
Net increase (decrease) in cash and cash equivalents	(20,216)	16,418	7,287
Cash and cash equivalents, beginning of year	25,809	9,391	2,104
Cash and cash equivalents, end of year	$ 5,593	$ 25,809	$ 9,391

(18) Quarterly Financial Data (Unaudited)

The following table discloses the Company's selected unaudited quarterly financial data:

	For the Quarters Ended			
	12/31/09	09/30/09	06/30/09	03/31/09
	(Dollars in thousands, except per share amounts)			
Interest income	$14,942	$15,495	$15,824	$16,033
Interest expense	3,438	3,872	4,135	4,881
Net interest income	11,504	11,623	11,689	11,152
Provision for loan losses	5,676	7,129	10,704	10,420
Net interest income after provision for loan losses	5,828	4,494	985	732
Noninterest income(1)	2,453	2,350	1,601	1,623
Noninterest expense	10,575	10,744	12,080	11,362
Income (loss) before income taxes	(2,294)	(3,900)	(9,494)	(9,007)
Income tax expense (benefit)	(1,720)	(1,824)	(4,113)	(5,052)
Net income (loss)	(574)	(2,076)	(5,381)	(3,955)
Dividends and discount accretion on preferred stock	(600)	(599)	(591)	(585)
Net income (loss) allocable to common shareholders	$(1,174)	$(2,675)	$(5,972)	$(4,540)
Earnings (loss) per common share				
Basic	$ (0.10)	$ (0.23)	$ (0.51)	$ (0.38)
Diluted	$ (0.10)	$ (0.23)	$ (0.51)	$ (0.38)

(1) Noninterest income increased in the third and fourth quarters due to a decision to sell SBA loans.

	For the Quarters Ended			
	12/31/08	09/30/08	06/30/08	03/31/08
	(Dollars in thousands, except per share amounts)			
Interest income	$18,166	$19,197	$18,699	$19,895
Interest expense	5,771	6,151	5,731	6,791
Net interest income	12,395	13,046	12,968	13,104
Provision for loan losses(1)	4,500	1,587	7,800	1,650
Net interest income after provision for loan losses	7,895	11,459	5,168	11,454
Noninterest income	1,797	1,688	1,792	1,514
Noninterest expense	10,417	10,397	10,998	10,580
Income (loss) before income taxes	(725)	2,750	(4,038)	2,388
Income tax expense (benefit)	(1,425)	309	(955)	684
Net income (loss)	700	2,441	(3,083)	1,704
Dividends and discount accretion on preferred stock	(255)	—	—	—
Net income (loss) allocable to common shareholders	$ 445	$ 2,441	$ (3,083)	$ 1,704
Earnings (loss) per common share				
Basic	$ 0.04	$ 0.21	$ (0.26)	$ 0.14
Diluted	$ 0.04	$ 0.21	$ (0.26)	$ 0.14

(1) The provision for loan losses in the second quarter of 2008 includes $5.1 million of estimated losses to one borrower and his related entities.

EXHIBIT INDEX

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
2.1	Agreement and Plan of Merger, dated February 8, 2007, by and between Heritage Commerce Corp, Heritage Bank of Commerce and Diablo Valley Bank					3/16/07	2.1
3.1	Heritage Commerce Corp Restated Articles of Incorporation, as amended					3/16/09	3.1
3.2	Heritage Commerce Corp Bylaws, as amended	X					
3.3	Certificate of Determination for Fixed Rate Cumulative Perpetual Preferred Stock, Series A			11/26/08			3.1
4.1	Indenture, dated as of March 23, 2000, between Heritage Commerce Corp, as Issuer, and the Bank of New York, as Trustee					4/6/01	4.1
4.2	Amended and restated Declaration of Trust, Heritage Capital Trust I, dated as of March 23, 2000					4/6/01	4.2
4.3	Indenture, dated as of September 7, 2000, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company of Connecticut, National Association, as Trustee					4/6/01	4.3
4.4	Amended and restated Declaration of Trust by and among State Street Bank and Trust Company of Connecticut, National Association, as Institutional Trustee, and Heritage Commerce Corp, as Sponsor					4/6/01	4.4

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
4.5	Indenture, dated as of July 31, 2001, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company of Connecticut, National Association, as Trustee					3/29/02	4.6
4.6	Amended and restated Declaration of Trust by and among State Street Bank and Trust Company of Connecticut, National Association as Institutional Trustee, and Heritage Commerce Corp, as Sponsor, dated as of July 31, 2001					3/29/02	4.7
4.7	Indenture, dated as of September 26, 2002, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company of Connecticut, National Association, as Trustee					3/29/03	4.8
4.8	Amended and restated Declaration of Trust by and among State Street Bank and Trust Company of Connecticut, National Association, as Institutional Trustee and Heritage Commerce Corp, as Sponsor, dated as of September 26, 2002					3/29/03	4.9
4.9	Warrant to Purchase Common Stock dated November 21, 2008			11/26/08			4.2
10.1	Real Property Leases for Registrant's Principal Office			3/5/98			10.1
10.2	Third Amendment to Lease for Registrant's Principal Office			8/17/05			10.1
10.3	Fourth Amendment to Lease for Registrant's Principle Office			8/17/05			99.1

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
10.4	Fourth Amendment to Sublease for Registrant's Principle Office			6/22/05			99.1
10.5	Heritage Commerce Corp Management Incentive Plan*			5/3/05			99.1
10.6	1994 Stock Option Plan and Form of Agreement*		07/17/98				4.2
10.7	Amended and Restated 2004 Equity Plan*			6/2/09			99.1
10.8	Modification to Employment Agreement of James Mayer dated December 11, 2008*			12/17/08			
10.9	Restricted stock agreement with Walter Kaczmarek dated March 17, 2005*			03/22/05			10.2
10.10	2004 stock option agreement with Walter Kaczmarek dated March 17, 2005*			03/22/05			10.3
10.11	Non-qualified Deferred Compensation Plan*					03/31/05	10.11
10.12	Amended and Restated Employment Agreement with Walter Kaczmarek, dated October 17, 2007*			10/22/07			10.1
10.13	Amended and Restated Employment Agreement with Lawrence McGovern, dated October 17, 2007*			10/22/07			10.2
10.14	Amended and Restated Employment Agreement with Raymond Parker, dated October 17, 2007*			10/22/07			10.3
10.15	Employment Agreement with Michael R. Ong, dated August 12, 2008*			8/13/08			10.1
10.16	Employment Agreement with Dan Kawamoto, dated June 11, 2009*			6/16/09			10.1
10.17	Employment Agreement with Margaret Incandela, dated September 1, 2009*	X					

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
10.18	Consulting Agreement dated of February 8, 2007 between Heritage Bank of Commerce and John J. Hounslow*			6/22/07			10.1
10.19	Non-Compete, Non-Solicitation and Confidentiality Agreement dated as of February 8, 2007 by and among Heritage Commerce Corp, Heritage Bank of Commerce and John J. Hounslow			6/22/07			10.2
10.20	Letter Agreement between John J. Hounslow and Heritage Commerce Corp dated June 20, 2007*			6/22/07			10.3
10.21	Non-Compete, Non-Solicitation and Confidentiality Agreement dated as of February 8, 2007 by and among James Mayer, Heritage Commerce Corp and Heritage Bank of Commerce			6/22/07			10.5
10.22	2005 Amended and Restated Heritage Commerce Corp Supplemental Retirement Plan*			9/30/08			99.1
10.23	Form of Endorsement Method Split Dollar Plan Agreement for Executive Officers*					3/17/08	10.20
10.24	Form of Endorsement Method Split Dollar Plan Agreement for Directors*					3/17/08	10.21
10.25	Amendment No. 1 to Employment dated December 29, 2008 between the Company and Walter T. Kaczmarek*			1/2/09			10.1
10.26	Amendment No. 1 to Employment dated December 29, 2008 between the Company and Lawrence D. McGovern*			1/2/09			10.2

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
10.27	Amendment No. 1 to Employment dated December 29, 2008 between the Company and Raymond Parker*			1/2/09			10.3
10.28	Amendment No. 1 to Employment dated December 29, 2008 between the Company and Michael Ong*			1/2/09			10.4
10.29	Amendment No. 1 to Employment dated December 29, 2008 between the Company and James Mayer*			1/2/09			10.5
10.30	First Amended and Restated Deferred Agreement dated December 29, 2008 between James Blair and the Company*			1/2/09			10.7
10.31	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Jack Conner and the Company*			1/2/09			10.8
10.32	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Frank Bisceglia and the Company*			1/2/09			10.9
10.33	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between James Blair and the Company*			1/2/09			10.10
10.34	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Robert Moles and the Company*			1/2/09			10.11

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
10.35	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Humphrey Polanen and the Company*			1/2/09			10.14
10.36	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Charles Toeniskoetter and the Company*			1/2/09			10.15
10.37	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Ranson Webster and the Company*			1/2/09			10.16
10.38	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between William Del Biaggio, Jr. and the Company*			1/2/09			10.17
10.39	Letter Agreement dated November 21, 2008 between the Company and United States Treasury for Fixed Rate Cumulative Perpetual Preferred Stock, Series A and Warrant for Common Stock			11/26/08			10.1
12.1	Calculation of Ratio of Earnings to Fixed Charges and Ratio of Earnings to Fixed Charges and Preferred Stock Dividends	X					
21.1	Subsidiaries of the registrant					3/16/07	21.1
23.1	Consent of Crowe Horwath LLP	X					
31.1	Certification of Registrant's Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X					

			Incorporated by Reference to Form				
		Filed Herewith	Form S-8	8-K Filed	10-Q Filed	10-K Filed	Exhibit No.
31.2	Certification of Registrant's Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X					
32.1	Certification of Registrant's Chief Executive Officer Pursuant to 18 U.S.C. Section 1350	X					
32.2	Certification of Registrant's Chief Financial Officer Pursuant to 18 U.S.C. Section 1350	X					
99.1	Certification of Registrant's Chief Executive Officer Pursuant to the Section 111(6)(4) of the Emergency Economic Stabilization Act of 2008, as amended	X					
99.2	Certification of Registrant's Chief Financial Officer Pursuant to the Section 111(6)(4) of the Emergency Economic Stabilization Act of 2008, as amended	X					

* Management contract or compensatory plan or arrangement.

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, 2009

I, Walter T. Kaczmarek, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2009 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/ WALTER T. KACZMAREK

Walter T. Kaczmarek
Chief Executive Officer

Date: March 16, 2010

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, 2009**

I, Lawrence D. McGovern, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2009 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
Chief Financial Officer

Date: March 16, 2010

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, 2009**

In connection with the Annual Report of Heritage Commerce Corp (the "Company") on Form 10-K for the year ending December 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Walter T. Kaczmarek, 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:

(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/ WALTER T. KACZMAREK

Walter T. Kaczmarek
Chief Executive Officer

March 16, 2010

**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, 2009**

In connection with the Annual Report of Heritage Commerce Corp (the "Company") on Form 10-K for the year ending December 31, 2009 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:

(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
Chief Financial Officer

March 16, 2010

Exhibit 99.1

CERTIFICATION PURSUANT TO SECTION 111(b)(4) OF THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008, AS AMENDED

(PRINCIPAL EXECUTIVE OFFICER)

CERTIFICATION

I, Walter T. Kaczmarek, certify, based on my knowledge, that:

(i) The compensation committee of Heritage Commerce Corp ("the Company") has discussed, reviewed, and evaluated with senior risk officers at least every six months during the period beginning on September 14, 2009, or ninety days after the closing date of the agreement between the Company and Treasury and ending with the last day of the Company's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and the employee compensation plans and the risks these plans pose to the Company;

(ii) The compensation committee of the Company has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company, and during the same applicable period has identified any features in the employee compensation plans that pose risks to the Company and has limited those features to ensure that the Company is not unnecessarily exposed to risks;

(iii) The compensation committee has reviewed at least every six months during the applicable period the terms of each employee compensation plan and identified the features in the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee, and has limited these features;

(iv) The compensation committee of the Company will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

(v) The compensation committee of the Company will provide a narrative description of how it limited during any part of the most recently completed fiscal year that was a TARP period the features in

(A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company;

(B) Employee compensation plans that unnecessarily expose the Company to risks; and

(C) Employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;

(vi) The Company has required that bonus payments to SEOs or any of the next twenty most highly compensated employees, as defined in the regulations and guidance established under section 111 of EESA, be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(vii) The Company has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to a SEO or any of the next five most highly compensated employees during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(viii) The Company has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(ix) The board of directors of the Company has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by the later of September 14, 2009, or ninety days after the closing of the agreement between the Company and Treasury. This policy has been provided to Treasury and the Company's primary regulatory agency. The Company and its employees have complied with this policy during the applicable period; and any expenses that pursuant to this policy, required approval of the board of directors, a director, an SEO, or an executive officer with a similar level or responsibility were properly approved;

(x) The Company will permit a non-binding shareholder resolution in compliance with any applicable Federal securities rules and regulations on the disclosures provided under the Federal securities laws related to SEO compensation paid or accrued during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(xi) The Company will disclose the amount, nature, and justification for the offering during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds $25,000 for each employee subject to the bonus payment limitations identified in paragraph (viii);

(xii) The Company will disclose whether the Company, the board of directors of the Company, or the compensation committee of the Company has engaged during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date, a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

(xiii) The Company has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(xiv) The Company has substantially complied with all other requirements related to employee compensation that are provided in the agreement between the Company and Treasury, including any amendments;

(xv) The Company has submitted the to Treasury a complete and accurate list of the SEOs and the next twenty most highly compensated employees for the current fiscal year and the most recently completed fiscal year, with the non-SEOs ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

(xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both.

Dated: March 16, 2010

/s/ WALTER T. KACZMAREK

Walter T. Kaczmarek
President and Chief Executive Officer
Heritage Commerce Corp

Exhibit 99.2

**CERTIFICATION PURSUANT TO SECTION 111(b)(4)
OF THE EMERGENCY ECONOMIC STABILIZATION
ACT OF 2008, AS AMENDED**

(PRINCIPAL FINANCIAL OFFICER)

CERTIFICATION

I, Lawrence D. McGovern, certify, based on my knowledge, that:

(i) The compensation committee of Heritage Commerce Corp ("the Company") has discussed, reviewed, and evaluated with senior risk officers at least every six months during the period beginning on September 14, 2009, or ninety days after the closing date of the agreement between the Company and Treasury and ending with the last day of the Company's fiscal year containing that date (the applicable period), the senior executive officer (SEO) compensation plans and the employee compensation plans and the risks these plans pose to the Company;

(ii) The compensation committee of the Company has identified and limited during the applicable period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company, and during the same applicable period has identified any features in the employee compensation plans that pose risks to the Company and has limited those features to ensure that the Company is not unnecessarily exposed to risks;

(iii) The compensation committee has reviewed at least every six months during the applicable period the terms of each employee compensation plan and identified the features in the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee, and has limited these features;

(iv) The compensation committee of the Company will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

(v) The compensation committee of the Company will provide a narrative description of how it limited during any part of the most recently completed fiscal year that was a TARP period the features in

(A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the Company;

(B) Employee compensation plans that unnecessarily expose the Company to risks; and

(C) Employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;

(vi) The Company has required that bonus payments to SEOs or any of the next twenty most highly compensated employees, as defined in the regulations and guidance established under section 111 of EESA, be subject to a recovery or "clawback" provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(vii) The Company has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to a SEO or any of the next five most highly compensated employees during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(viii) The Company has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(ix) The board of directors of the Company has established an excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA, by the later of September 14, 2009, or ninety days after the closing of the agreement between the Company and Treasury. This policy has been provided to Treasury and the Company's primary regulatory agency. The Company and its employees have complied with this policy during the applicable period; and any expenses that pursuant to this policy, required approval of the board of directors, a director, an SEO, or an executive officer with a similar level or responsibility were properly approved;

(x) The Company will permit a non-binding shareholder resolution in compliance with any applicable Federal securities rules and regulations on the disclosures provided under the Federal securities laws related to SEO compensation paid or accrued during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(xi) The Company will disclose the amount, nature, and justification for the offering during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds $25,000 for each employee subject to the bonus payment limitations identified in paragraph (viii);

(xii) The Company will disclose whether the Company, the board of directors of the Company, or the compensation committee of the Company has engaged during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date, a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

(xiii) The Company has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during the period beginning on the later of the closing date of the agreement between the Company and Treasury or June 15, 2009 and ending with the last day of the Company's fiscal year containing that date;

(xiv) The Company has substantially complied with all other requirements related to employee compensation that are provided in the agreement between the Company and Treasury, including any amendments;

(xv) The Company has submitted the to Treasury a complete and accurate list of the SEOs and the next twenty most highly compensated employees for the current fiscal year and the most recently completed fiscal year, with the non-SEOs ranked in descending order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

(xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both.

Dated: March 16, 2010

/s/ LAWRENCE D. MCGOVERN

Lawrence D. McGovern
Executive Vice-President and
Chief Financial Officer
Heritage Commerce Corp

Corporate Information

Board of Directors

Jack W. Conner, Chairman
Frank G. Bisceglia
Celeste V. Ford
John J. Hounslow
Walter T. Kaczmarek
Mark E. Lefanowicz
Robert T. Moles
Humphrey P. Polanen
Charles J. Toeniskoetter
Ranson W. Webster

Executive Management

Walter T. Kaczmarek
President
Chief Executive Officer

William J. Del Biaggio, Jr.
Executive Vice President
Marketing & Community Relations

Margaret A. Incandela
Executive Vice President
Credit Risk Management

Dan T. Kawamoto
Executive Vice President
Chief Administrative Officer

Lawrence D. McGovern
Executive Vice President
Chief Financial Officer

Michael R. Ong
Executive Vice President
Chief Credit Officer

Raymond Parker
Executive Vice President
Banking Division

Subsidiary Bank Offices
Heritage Bank of Commerce

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San Jose, CA 95113
408.947.6900

Danville
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Danville, CA 94526
925.314.2851

Fremont
3077 Stevenson Boulevard
Fremont, CA 94538
510.445.0400

Gilroy
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Suite 110
Gilroy, CA 95020
408.842.8310

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
Cochrane Business Ranch
18625 Sutter Boulevard
Morgan Hill, CA 95037
408.778.2320

Mountain View
175 East El Camino Real
Mountain View, CA 94040
650.941.9300

Pleasanton
300 Main Street
Pleasanton, CA 94566
925.314.2876

Walnut Creek
101 Ygnacio Valley Road
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Walnut Creek, CA 94596
925.930.9287

Heritage Commerce Corp
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Debbie K. Reuter
Senior Vice President
Corporate Secretary

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Corporate Counsel

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To get further information on Heritage Commerce Corp, or to receive regular financial updates, please visit our web site HeritageCommerceCorp.com and click on "Information Request."

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