

A decorative graphic consisting of several vertical, slightly tapered bars of varying widths and colors (orange, brown, grey, blue) on the left side, set against a dark grey background.

2020 Annual Report

2020 Annual Report | On Form 10-K

2021 Notice of Annual Meeting of Shareholders

2021 Annual Meeting Proxy Statement

To Our Shareholders

April 15, 2021

Dear Fellow Shareholders:

The year of 2020 was an extraordinary year, creating both challenges and opportunities for Heritage Commerce Corp (the "Company"). As we faced unprecedented challenges caused by the economic impact of COVID-19, including a significant decline in interest rates, we generated net income of \$35.3 million for the year; just \$5.2 million shy of 2019, which was the most profitable year in the history of our Company. At the same time, opportunities presented themselves through the Small Business Administration Paycheck Protection Program ("PPP") allowing us to significantly help meet the financial needs of our customers who were impacted by the coronavirus pandemic.

As the premier business bank in the Greater San Francisco Bay Area, Heritage Bank of Commerce (the "Bank") funded 1,105 PPP loans, totaling \$333.4 million during the first half of 2020. Our employees were resilient and flexible throughout this process, as they came together to support our customers and communities facing many obstacles brought on by the pandemic.

During 2020, we successfully completed the integration of Presidio Bank after acquiring the bank in the fourth quarter of 2019. This was the largest bank acquisition in the history of our Company; and, although merger-related costs reduced pre-tax earnings by \$2.6 million during 2020, we gained traction in the new markets introduced to us through the Presidio Bank merger.

Additionally, by year-end, we had fully relocated our San Jose headquarters offices and Bay View Funding to new facilities at 224 Airport Parkway, San Jose, CA. This consolidated different operating areas of the Bank into a single location, which has allowed us to better serve our customers, community partners and the entire Heritage organization across the region.

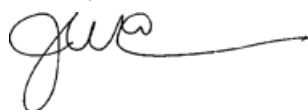
2020 Highlights:

- Net income for the full year of 2020 was \$35.3 million, or \$0.59 per average diluted common share, compared to record earnings of \$40.5 million, or \$0.84 per average diluted common share for 2019. Total assets increased 13% over 2019 to \$4.6 billion.
- Credit quality improved with nonperforming assets declining (20%) from 2019 to 0.17% of total assets, while the allowance for credit losses on loans to total loans ("ACLL") was 1.70%, and the ACLL to total loans, excluding PPP loans, was 1.91% at December 31, 2020.
- Capital levels remained strong with a total risk-based capital ratio and leverage for Heritage Commerce Corp at 16.5% and 9.1% respectively, and 15.8% and 9.5% respectively, for Heritage Bank of Commerce at December 31, 2020. All capital levels exceeded regulatory requirements for a "well-capitalized" financial institution under the Basel III regulatory requirements.
- In May of 2020, Heritage Commerce Corp was awarded the coveted Raymond James Community Bankers Cup, an award based on profitability, operational efficiencies, and balance sheet metrics.
- At the beginning of 2020, the Board of Directors raised our quarterly cash dividend for the seventh consecutive year by 8% to \$0.13 per share to holders of common stock.
- The Company continued to provide significant grants and sponsorships to support local community groups.

We would like to thank our employees across the Company for their ongoing hard work and dedication to our customers and communities. We also want to thank you, our shareholders, for the trust you have placed in Heritage Commerce Corp.

Please join us for our annual meeting on Thursday, May 27, 2021, at 1:00 p.m. You may access the meeting virtually by going to: <https://register.proxypush.com/HTBK>. As a shareholder, you will then be required to enter your control number in the upper right-hand corner of your proxy card. After registering, you will receive a confirmation email. You will receive another email approximately one hour prior to the start of the meeting to the email address you provided during registration with a unique link to the virtual meeting.

Sincerely,



Jack W. Conner
Chairman of the Board



Walter T. Kaczmarek
President and CEO

HERITAGE COMMERCE CORP

April 15, 2021

Dear Shareholder:

You are cordially invited to attend the 2021 Annual Meeting of Shareholders, which will be held at 1:00 p.m., Pacific Daylight Time (PDT) on Thursday, May 27, 2021. 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 2020 Annual Report on Form 10-K.

Due to the public health impact of the coronavirus (COVID-19) outbreak and to support the health and well being of our shareholders, this year's Annual Meeting will be a completely virtual meeting of shareholders, which will be conducted online via live webcast. You will be able to attend the Annual Meeting by registering at register.proxypush.com/HTBK. Upon completing your registration, you will receive further instructions via email, including a unique link that will allow you access to the Annual Meeting and to vote and submit questions during the Annual Meeting.

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

Sincerely,



Jack W. Conner
Chairman of the Board



Walter T. Kaczmarek
President and Chief Executive Officer

HERITAGE COMMERCE CORP

224 Airport Parkway
San Jose, California 95110

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

- Date and Time:** Thursday, May 27, 2021, at 1:00 p.m., Pacific Daylight Time (PDT).
- Items of Business:**
1. To elect 11 members of the Board of Directors, each for a term of one year;
 2. To approve an advisory proposal on the Company's 2020 executive compensation;
 3. To ratify the selection of Crowe LLP as the Company's independent registered public accounting firm for the year ending December 31, 2021; and
 4. To transact such other business as may properly come before the meeting, and any adjournment or postponement.
- Record Date:** You can vote if you are a shareholder of record on March 26, 2021.
- Mailing Date:** The proxy materials are being distributed to our shareholders on or about April 15, 2021, and include our Annual Report on Form 10-K, Notice of Annual Meeting, this proxy statement, and proxy or voting instruction card.
- Important Notice Regarding the Internet Availability of Proxy Materials:** The proxy statement and Annual Report on Form 10-K are available at www.heritagecommercecorp.com. **Your Vote is Important.** Please vote as promptly as possible by using the Internet or telephone or by signing, dating and returning the enclosed proxy card.

VIRTUAL ANNUAL MEETING

The Annual Meeting will be held in a virtual-only meeting format, via live video webcast that will provide shareholders with the ability to participate in the Annual Meeting, vote their shares and ask questions. We are implementing a virtual-only meeting format in order to leverage technology to enhance shareholder access to the Annual Meeting by enabling attendance and participation from any location around the world. We believe that the virtual-only meeting format will give shareholders the opportunity to exercise the same rights as if they had attended an in-person meeting and believe that these measures will enhance shareholder access and encourage participation and communication with our Board of Directors and management.

BENEFITS OF A VIRTUAL ANNUAL MEETING

We believe a virtual-only meeting format facilitates shareholder attendance and participation by enabling all shareholders to participate fully and equally, and without cost, using an Internet-connected device from any location around the world. In addition, the virtual-only meeting format increases our ability to engage with all shareholders, regardless of size, resources or physical location, and enables us to protect the health and safety of all attendees, particularly in light of the COVID-19 pandemic.

Shareholders of record and beneficial owners as of the close of the business day on March 26, 2021, the record date, will have the ability to submit questions and vote electronically at the Annual Meeting via the virtual-only meeting platform.

ATTENDANCE AT THE VIRTUAL ANNUAL MEETING

Only shareholders of record and beneficial owners of shares of our common stock as of the close of business on March 26, 2021, the record date, may attend and participate in the Annual Meeting, including voting and asking questions during the virtual Annual Meeting. You will not be able to attend the Annual Meeting physically in person.

In order to attend the Annual Meeting, you must register at register.proxypush.com/HTBK. Upon completing your registration, you will receive further instructions via email, including a unique link that will allow you access to the Annual Meeting and to vote and submit questions during the Annual Meeting.

As part of the registration process, you must enter the control number located on your proxy card or voting instruction form. If you are a beneficial owner of shares registered in the name of a broker, bank or other nominee, you will also need to provide the registered name on your account and the name of your broker, bank or other nominee as part of the registration process.

On the day of the Annual Meeting, May 27, 2021, shareholders may begin to log in to the virtual-only Annual Meeting 15 minutes prior to the Annual Meeting. The Annual Meeting will begin promptly at 1:00 p.m. Pacific Daylight Time.

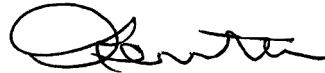
We will have technicians ready to assist you with any technical difficulties you may have accessing the Annual Meeting. If you encounter any difficulties accessing the virtual-only Annual Meeting platform, including any difficulties voting or submitting questions, you may call the technical support number that will be posted in your instructional email.

QUESTIONS AT THE VIRTUAL ANNUAL MEETING

Our virtual Annual Meeting will allow shareholders to submit questions before and during the Annual Meeting. During a designated question and answer period at the Annual Meeting, we will respond to appropriate questions submitted by shareholders.

We will answer as many shareholder-submitted questions as time permits, and any questions that we are unable to address during the Annual Meeting will be answered following the meeting, with the exception of any questions that are irrelevant to the purpose of the Annual Meeting or our business or that contain inappropriate or derogatory references which are not in good taste. If we receive substantially similar questions, we will group such questions together and provide a single response to avoid repetition.

By Order of the Board of Directors,



Deborah Reuter
Executive Vice President
and Corporate Secretary

April 15, 2021
San Jose, California

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**PROXY STATEMENT FOR HERITAGE COMMERCE CORP
2021 ANNUAL MEETING OF SHAREHOLDERS
INFORMATION ABOUT THE ANNUAL MEETING AND VOTING
QUESTIONS & ANSWERS**

Why did you send me this proxy statement?

We sent you this proxy statement and the enclosed proxy card because our Board of Directors (the “Board of Directors” or the “Board”) is soliciting your proxy to vote at the 2021 Annual Meeting (“Annual Meeting”) of Shareholders. This proxy statement summarizes the information you need to know to cast an informed vote at the Annual Meeting. Heritage Commerce Corp is referred to in this proxy statement as the “Company.” Along with this proxy statement, we are also sending you the Heritage Commerce Corp 2020 Annual Report on Form 10-K, which includes our consolidated financial statements.

How will our Annual Meeting be held?

The Annual Meeting will be held in a virtual-only meeting format, via live video webcast that will provide shareholders with the ability to participate in the Annual Meeting, vote their shares and ask questions. We are implementing a virtual-only meeting format in order to leverage technology to enhance shareholder access to the Annual Meeting by enabling attendance and participation from any location around the world. We believe that the virtual-only meeting format will give shareholders the opportunity to exercise the same rights as if they had attended an in-person meeting and believe that these measures will enhance shareholder access and encourage participation and communication with our Board of Directors and management.

We believe a virtual-only meeting format facilitates shareholder attendance and participation by enabling all shareholders to participate fully and equally, and without cost, using an Internet-connected device from any location around the world. In addition, the virtual-only meeting format increases our ability to engage with all shareholders, regardless of size, resources or physical location, and enables us to protect the health and safety of all attendees, particularly in light of the COVID-19 pandemic.

Shareholders of record and beneficial owners as of the close of business on March 26, 2021, the record date, will have the ability to submit questions and vote electronically at the Annual Meeting via the virtual-only meeting platform.

Only shareholders of record and beneficial owners of shares of our common stock as of the close of business on March 26, 2021, the record date, may attend and participate in the Annual Meeting, including voting and asking questions during the virtual Annual Meeting. You will not be able to attend the Annual Meeting physically in person.

In order to attend the Annual Meeting, you must register at register.proxypush.com/HTBK. Upon completing your registration, you will receive further instructions via email, including a unique link that will allow you access to the Annual Meeting and to vote and submit questions during the Annual Meeting.

As part of the registration process, you must enter the control number located on your proxy card or voting instruction form. If you are a beneficial owner of shares registered in the name of a broker, bank or other nominee, you will also need to provide the registered name on your account and the name of your broker, bank or other nominee as part of the registration process.

On the day of the Annual Meeting, May 27, 2021, shareholders may begin to log in to the virtual-only Annual Meeting 15 minutes prior to the Annual Meeting. The Annual Meeting will begin promptly at 1:00 p.m. Pacific Daylight Time.

We will have technicians ready to assist you with any technical difficulties you may have accessing the Annual Meeting. If you encounter any difficulties accessing the virtual-only Annual Meeting platform, including any difficulties voting or submitting questions, you may call the technical support number that will be posted in your instructional email.

Our virtual Annual Meeting will allow shareholders to submit questions before and during the Annual Meeting. During a designated question and answer period at the Annual Meeting, we will respond to appropriate questions submitted by shareholders.

We will answer as many shareholder-submitted questions as time permits, and any questions that we are unable to address during the Annual Meeting will be answered following the meeting, with the exception of any questions that are irrelevant to the purpose of the Annual Meeting or our business or that contain inappropriate or derogatory references which are not in good taste. If we receive substantially similar questions, we will group such questions together and provide a single response to avoid repetition.

Who is entitled to vote?

We will begin sending this proxy statement, the attached Notice of Annual Meeting and the enclosed proxy card on or about April 15, 2021, to all shareholders entitled to vote. Shareholders who were the record owners of the Company's common stock at the close of the business day on March 26, 2021, are entitled to vote. On this record date, there were 59,932,334 shares of common stock outstanding.

What constitutes a quorum?

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

How many votes do I have?

Each share of common stock entitles you to one vote in person or by proxy, for each share of common stock outstanding in your name on the books of the Company as of March 26, 2021, the record date for the Annual Meeting on any matter submitted to a vote of the shareholders, except that in connection with the election of directors (Proposal 1), you may cumulate your shares (*see "What is cumulative voting and how do I cumulate my shares?" on page 3*). The proxy card indicates the number of votes that you have as of the record date.

Is voting confidential?

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

How do I vote by proxy?

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

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

- **"FOR"** the election of all 11 nominees for director;
- **"FOR"** the approval of the advisory proposal on the Company's 2020 executive compensation; and
- **"FOR"** the ratification of the selection of Crowe LLP as our independent registered public accounting firm for 2021.

For the election of directors (Proposal 1), a shareholder may withhold authority for the proxy holders to vote for any one or more of the nominees by marking the enclosed proxy card in the manner instructed on the proxy card. Unless authority to vote for the nominees is withheld, the proxy holders will vote the proxies received by them for the election of the nominees listed on the proxy card as directors of the Company. Your

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

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

If your shares are held by your broker, sometimes called “street name” shares, you must vote your shares through your broker. You should receive a form from your broker asking how you want to vote your shares. Follow the instructions on that form to give voting instructions to your broker. Under the rules that govern brokers who are voting with respect to shares held in street name, brokers have the discretion to vote such shares on routine, but not on non-routine matters. A “broker non vote” occurs when your broker does not vote on a particular proposal because the broker does not receive instructions from the beneficial owner and does not have discretionary authority. Proposal 1 (election of directors) and Proposal 2 (advisory proposal on the 2020 executive compensation), are non-routine items on which a broker may vote only if the beneficial owner has provided voting instructions. Proposal 3 (ratification of independent registered public accounting firm) is a routine item.

How do I vote at the virtual meeting?

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

May I vote over the Internet or by telephone?

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

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

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

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

Certain affirmative steps must be taken by you in order to be entitled to vote your shares cumulatively for the election of directors. At the shareholders’ meeting at which directors are to be elected, no shareholder is entitled to cumulate votes (i.e., cast for any one or more candidates a number of votes greater than the number

of the shareholder's shares) unless the candidates' names have been placed in nomination at the meeting and prior to the commencement of the voting and at least one shareholder has given notice at the meeting and prior to commencement of the voting of the shareholder's intention to cumulate votes. If any shareholder has given such notice, then every shareholder entitled to vote may cumulate votes for candidates in nomination and give one candidate a number of votes equal to the number of directors to be elected multiplied by the number of votes to which that shareholder's shares are entitled, or distribute the shareholder's votes on the same principle among any or all of the candidates, as the shareholder thinks appropriate. The candidates receiving the highest number of votes, up to the number of directors to be elected, will be elected.

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

May I change my vote after I return my proxy?

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

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

What if I receive multiple proxy cards?

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

What vote is required to approve each proposal?

Approval of Proposal 1 (election of directors) requires a plurality of votes cast for each nominee. This means that the 11 nominees who receive the most votes will be elected. So, if you do not vote for a particular nominee, or you indicate "WITHHOLD AUTHORITY" to vote for a particular nominee on your proxy card, your vote will not count either "for" or "against" the nominee. Abstentions will not have any effect on the outcome of the vote. You may cumulate your votes in the election of directors as described under "*What is cumulative voting and how do I cumulate my shares?*" on page 3. Broker non-votes will not count as a vote on the proposal and will not affect the outcome of the vote.

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

firm for 2021 is a matter on which a broker or other nominee is generally empowered to vote and, therefore, no broker non-votes are expected to exist with respect to Proposal 3.

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 \$5,000 plus expenses.

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

A copy of our 2020 Annual Report on Form 10-K accompanies this proxy statement. If you would like another copy of this report, we will send you one without charge. The Annual Report on Form 10-K includes a list of exhibits filed with the Securities and Exchange Commission (“SEC”), but does not include the exhibits. If you wish to receive copies of the exhibits, we will send them to you. Please write to:

Heritage Commerce Corp
224 Airport Parkway
San Jose, California 95110
Attention: Executive Vice President and Corporate Secretary

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

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table sets forth information as of February 28, 2021, pertaining to beneficial ownership of the Company's common stock by persons known to the Company to own 5% or more of the Company's common stock, nominees to be elected to the Board of Directors, the executive officers named in the Summary Compensation Table presented in this proxy statement, and all directors and executive officers of the Company, as a group. This information has been obtained from the Company's records, or from information furnished directly by the individual or entity to the Company.

For purposes of the following table, shares issuable pursuant to stock options which may be exercised within 60 days of February 28, 2021, 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.

<u>Name of Beneficial Owner(1)</u>	<u>Position</u>	<u>Shares Beneficially Owner(2)(3)</u>	<u>Exercisable Options</u>	<u>Percent of Class(3)</u>
Michael E. Benito	Executive Vice President/ Business Banking Manager of Heritage Bank of Commerce	90,406(4)(24)	22,500	0.15%
Julianne Biagini-Komas	Director	32,233(5)	—	0.05%
Frank G. Bisceglia	Director	140,857(6)	18,000	0.23%
Margo G. Butsch	Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce	43,258(7)(24)	10,849	0.07%
Bruce H. Cabral	Director	110,285(8)	17,290	0.18%
Jack W. Conner	Director and Chairman of the Board	141,533(9)	—	0.24%
Jason DiNapoli	Director	326,162(10)	—	0.54%
Stephen G. Heitel	Director	293,089(11)	123,499	0.49%
Robertson Clay Jones	Executive Vice President and President of Community Business Bank Group of Heritage Bank of Commerce	260,123(12)(24)	160,549	0.43%
Walter T. Kaczmarek	Chief Executive Officer, President and Director(13)	107,605(14)	—	0.18%
Lawrence D. McGovern	Executive Vice President and Chief Financial Officer	138,080(15)(24)	30,000	0.23%
Robert T. Moles	Director	77,024(16)	18,000	0.13%
Laura Roden	Director	33,620(17)	10,700	0.06%
Marina Park Sutton	Director	104,152(18)	32,110	0.17%
Ranson W. Webster	Director	639,198(19)	18,000	1.07%
Keith A. Wilton	Former Chief Executive Officer, President and Director(20)	139,077(21)(24)	—	0.23%
All directors, and executive officers (16 individuals)		2,676,702	461,497	4.43%
BlackRock Inc.		4,829,721(22)	—	8.06%
T. Rowe Price Associates, Inc.		6,945,413(23)	—	11.59%

- (1) Except as otherwise noted, the address for all persons is c/o Heritage Commerce Corp, 224 Airport Parkway, San Jose, California, 95110.
- (2) Subject to applicable community property laws and shared voting and investment power with a spouse, the persons listed have sole voting and investment power with respect to such shares unless otherwise noted. Listed amounts reflect all previous stock splits and stock dividends.
- (3) Includes shares beneficially owned (including options exercisable within 60 days of February 28, 2021, as shown in the "Exercisable Options" column).

- (4) Includes 26,187 shares of restricted stock that have not vested and of which Mr. Benito has the right to vote.
- (5) Includes 3,086 shares of restricted stock that have not vested and of which Ms. Biagini-Komas has the right to vote.
- (6) Includes 93,237 shares as one of two trustees of the Bisceglia Family Trust, and 11,000 shares held by Mr. Bisceglia in a personal Individual Retirement Account. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. Bisceglia has the right to vote.
- (7) Includes 24,909 shares of restricted stock that have not vested and of which Ms. Butsch has the right to vote.
- (8) Includes 46,312 shares held indirectly by trust. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. Cabral has the right to vote.
- (9) Includes 29,344 shares held by Mr. Conner's spouse. Also includes 3,858 shares of restricted stock that have not vested and of which Mr. Conner has the right to vote.
- (10) Includes 300,815 shares held by a partnership. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. DiNapoli has the right to vote.
- (11) Includes 75,658 shares held by Individual Retirement Account. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. Heitel has the right to vote.
- (12) Includes 92,296 shares held directly. Also includes 7,278 shares of restricted stock that have not vested and of which Mr. Jones has the right to vote.
- (13) Mr. Kaczmarek became the Company's President and Chief Executive Officer on March 12, 2021.
- (14) Includes 42,906 shares held in a personal Individual Retirement Account. Includes 28,696 shares held indirectly by trust. Also includes 36,003 shares of restricted stock that have not vested and of which Mr. Kaczmarek has the right to vote.
- (15) Includes 4,980 shares held by Mr. McGovern in a personal Individual Retirement Account. Includes 62,970 shares held indirectly by trust. Also includes 34,436 shares of restricted stock that have not vested and of which Mr. McGovern has the right to vote.
- (16) Includes 18,295 shares held by Mr. Moles' spouse. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. Moles has the right to vote.
- (17) Includes 3,086 shares of restricted stock that have not vested and of which Ms. Roden has the right to vote.
- (18) Includes 33,345 shares held indirectly by trust. Also includes 3,086 shares of restricted stock that have not vested and of which Ms. Sutton has the right to vote.
- (19) Includes 8,493 shares held indirectly. Also includes 3,086 shares of restricted stock that have not vested and of which Mr. Webster has the right to vote.
- (20) Mr. Wilton retired from the Company on March 12, 2021.
- (21) Includes 59,370 shares of restricted stock that had not vested on February 28, 2021. On March 12, 2021, 25,012 shares vested and 34,358 shares were forfeited when Mr. Wilton retired.
- (22) BlackRock, Inc. is an investment management firm and may be deemed to beneficially own 4,829,721 shares of the Company, which are held of record by clients of BlackRock, Inc. The address for BlackRock, Inc. is 55 East 52nd Street, New York, NY 10055. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on January 29, 2021.
- (23) T. Rowe Price Associates, Inc. is an investment management firm and may be deemed to beneficially own 6,945,413 shares of the Company, which are held of record by clients of T. Rowe Price Associates, Inc. the address for T. Rowe Price Associates, Inc. is 100 East Pratt Street, Baltimore, MD 21202. All of the foregoing information has been obtained by Schedule 13G filed with the SEC on February 16, 2021.

(24) The Company's Employee Stock Ownership Plan owns 101,231 shares of our common stock, all of which have been allocated. These include shares held for the account of the following named executive officers and includes in the table for Mr. McGovern 5,694 shares, Mr. Benito 2,369 shares, and zero shares for Ms. Butsch, Mr. Jones, and Mr. Wilton. Mr. McGovern is one of the two trustees of the Employee Stock Ownership Plan. As trustees, they have the power to vote any unallocated shares of the Employee Stock Ownership Plan (currently no shares are unallocated) and allocated shares for which voting instructions are not otherwise provided.

CORPORATE GOVERNANCE AND BOARD MATTERS

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

Board of Directors

Board Independence

In 2020, 10 out of 12 members of the Board of Directors were independent directors, as defined by the applicable rules and regulations of the Nasdaq Stock Market, as follows:

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

Board and Committee Meeting Attendance

During the fiscal year ended December 31, 2020, our Board of Directors held a total of 10 meetings. For the meetings directors were qualified to attend in 2020, each incumbent director who was a director during 2020 attended at least 75% of the aggregate of (a) the total number of such meetings and (b) the total number of meetings held by the standing committees of the Board on which such director served.

Director Attendance at Annual Meetings of Shareholders

The Board believes it is important for all directors to attend the Annual Meeting of Shareholders in order to show their support for the Company and to provide an opportunity for shareholders to communicate any concerns to them. The Company's policy is to encourage, but not require, attendance by each director at the Company's Annual Meeting of Shareholders. All of the directors of the Company are encouraged to attend the Annual Meeting of Shareholders and at the 2020 Annual Meeting of Shareholders all of our directors were in attendance.

Communications with the Board

Shareholders may communicate with the Board of Directors, including a committee of the Board or individual directors, by writing to the Corporate Secretary, Heritage Commerce Corp, 224 Airport Parkway, San Jose, California 95110. Each communication from a shareholder should include the following information in order to permit shareholder status to be confirmed and to provide an address to forward a response if deemed appropriate:

- The name, mailing address and telephone number of the shareholder sending the communication; and

- If the shareholder is not a record holder of our common stock, the name of the record holder of our common stock beneficially owned must be identified along with the shareholder.

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

Nomination of Directors

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

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

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

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

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

shareholder must be delivered not earlier than the close of business 120 days prior to such annual meeting and not later than the close of business 90 days prior to such annual meeting or 10 days following the day on which public announcement of the date of such meeting is first made by the Company.

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

The notice must also set forth with respect to the shareholder submitting the nomination: (i) the name and address of the shareholder (and beneficial owner, if applicable), as it appears on the Company's books, (and of such beneficial owner, if applicable) and any other shareholders and beneficial owners known by such shareholder to be supporting the Nominee(s) for election; (ii) the class or series and number of shares of capital stock of the Company that are, directly or indirectly, owned beneficially and of record by such shareholder (and by such beneficial owner, if applicable); (iii) any derivative positions with respect to shares of capital stock of the Company held or beneficially held by or on behalf of such shareholder (and by or on behalf of such beneficial owner), the extent to which any hedging or other transaction or series of transactions has been entered into with respect to the shares of capital stock of the Company by or on behalf of such shareholder (and by or on behalf of such beneficial owner), and the extent to which any other agreement, arrangement or understanding has been made, the effect or intent of which is to increase or decrease the voting power of such shareholder (and such beneficial owner) with respect to shares of capital stock of the Company; (iv) a representation that the shareholder is a holder of record of stock of the Company entitled to vote at the meeting and intends to appear in person or by proxy at the meeting to propose the Nominee, and (v) a representation whether the shareholder (or the beneficial owner, if any), intends or is part of a group that intends to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding capital stock required to elect the nominee or otherwise to solicit proxies from shareholders in support of such nomination (and a copy of such documents must be provided with the notice). The information required of clauses (iii) and (iv) must be supplemented not later than ten days following the record date to disclose the information contained in clauses (iii) and (iv) above as of the record date.

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

Nominees for the Board must also meet certain qualifications set forth in Section 2.2(b) of our Bylaws, which prohibit the election as a director of any person who is a director, executive officer, branch manager or trustee for any unaffiliated commercial bank, savings bank, trust company, savings and loan association,

building and loan association, industrial bank or credit union that is engaged in business in: (i) any city, town or village in which the Company or any affiliate or subsidiary thereof has offices; or (ii) any city, town or village adjacent to a city, town or village in which the Company or any affiliate or subsidiary thereof has offices.

Diversity of the Board of Directors

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

Term of Office

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

Board Committees

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

Executive Sessions

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

Evaluation of Board Performance

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

Management Performance and Compensation

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

Director Stock Ownership Guidelines

The Board has adopted a policy that each member of the Board who is not an employee of the Company is expected to hold a minimum number of shares of the Company's common stock. In 2020, each such director

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

Code of Ethics

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

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

Reporting of Complaints/Concerns Regarding Accounting or Auditing Matters

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

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

INFORMATION ABOUT DIRECTORS AND EXECUTIVE OFFICERS

The Board of Directors

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

The Company's Bylaws currently permit the number of Board members to range from 9 to 15, leaving the Board authority to fix the exact number of directors within that range. On March 12, 2021, the Board fixed the number of directors at 11.

Board Leadership Structure

The Board is committed to maintaining an independent Board, and a majority of the Board has been comprised of independent directors. It has further been the practice for many years of the Company to separate the roles of Chief Executive Officer and Chairman of the Board in recognition of the differences between the two roles. The Chief Executive Officer is responsible for setting the strategic direction for the Company and the day-to-day leadership and performance of the Company. The Chairman of the Board provides guidance to the Chief Executive Officer, sets the agenda for Board meetings, presides over meetings of the full Board (including executive sessions), and facilitates communication among the independent directors and between the independent directors and the Chief Executive Officer. The Board further believes that the separation of the duties of the Chief Executive Officer and the Chairman of the Board eliminates any inherent conflict of interest that may arise when the roles are combined, and that an independent director who

has not served as an executive of the Company can best provide the necessary leadership and objectivity required as Chairman of the Board.

Board Authority for Risk Oversight

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

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

The Committees of the Board

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

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

The responsibilities of the Audit Committee include the following:

- oversee our financial, accounting and reporting process, our system of internal accounting and financial controls, and our compliance with related legal and regulatory requirements;
- oversee the appointment, compensation, retention and oversight of our independent auditors, including conducting a review of their independence, reviewing and approving the planned scope of our annual audit, overseeing the independent auditors' work, and reviewing and pre-approving any audit and non-audit services that may be performed by them;
- review with management and our independent auditors the effectiveness of our internal controls over financial reporting;
- approve the scope and engagement of external audit services and review significant accounting policies and adjustments recommended by the independent auditors and address any significant, unresolved disagreements between the independent auditors and management;
- review and discuss the annual audited financial statements with management and the independent auditors prior to publishing the annual report and filing the Annual Report on Form 10-K with the SEC;

- review and discuss with management and the independent auditors any significant changes, significant deficiencies and material weaknesses regarding internal controls over financial reporting required by the Sarbanes Oxley Act of 2002, and oversee the corrective action taken to mitigate any significant deficiencies and material weaknesses identified;
- review with management and the independent auditors the effect of significant regulatory and accounting initiatives, changes, and pronouncements as well as significant and unique transactions and financial relationships;
- review with the independent auditors the matters required to be discussed by Auditing Standards No. 1301, and receive and discuss with the independent auditors disclosures regarding the auditors' independence;
- oversee the internal audit function and the audits directed under its auspices;
- establish policies to ensure all non-audit services provided by the independent auditors are approved prior to work being performed; and
- oversee and report to the full Board on the effectiveness of the Company's risk management processes and overall risk assessment of the Company's activities.

Each member of the Audit Committee meets the independence criteria as defined by applicable rules and regulations of the SEC for audit committee membership and is independent and is "financially sophisticated" as defined by the applicable rules and regulations of the Nasdaq Stock Market. The members of the Audit Committee are Julianne M. Biagini-Komas (Committee Chair), Bruce H. Cabral, Laura Roden, and Marina Park Sutton. The Audit Committee met 10 times during 2020.

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

The Audit Committee Report for 2020 appears on page 53 of this Proxy Statement.

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

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

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

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

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

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

The members of the Corporate Governance and Nominating Committee are Jason DiNapoli, Robert T. Moles, Marina Park Sutton, and Ranson W. Webster (Committee Chair). The Committee met nine times during 2020.

Strategic Initiatives and Finance and Investment Committee. The Strategic Initiatives and Finance and Investment Committee provides oversight and guidance to senior management regarding the strategic direction of the Company. The Committee is also responsible for the development of policies and procedures related to liquidity, asset liability management, and supervision of the Company's investments. The Committee also oversees and reviews internal financial reports including annual forecasts and budgets, and stress test analysis prepared by management. The members of the Committee are Frank G. Bisceglia, Jack W. Conner, Jason DiNapoli, Stephen G. Heitel, Walter T. Kaczmarek, Laura Roden (Committee Chair), and Ranson Webster. The Committee met eight times during 2020.

Heritage Bank of Commerce Loan Committee. The Heritage Bank of Commerce Loan Committee is responsible for the approval and supervision of loans and the development of the Company's loan policies and procedures. The members of the Loan Committee are Bruce H. Cabral (Committee Chair), Jason DiNapoli, Stephen G. Heitel, and Walter T. Kaczmarek. The Loan Committee met 41 times during 2020.

Role of Compensation Consultant

The Compensation Committee of the Board retained McLagan, an Aon Hewitt Company ("McLagan") as its independent compensation consultant in 2019 and its report delivered in the first quarter of 2019 was used to make compensation decisions for 2019 and 2020. McLagan was also retained in the fourth quarter of 2020 and its report delivered in the first quarter of 2021 was used for compensation decisions in 2021.

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

- review existing compensation programs for executive officers;

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

Executive Officers of the Company

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

<u>Name</u>	<u>Position</u>
Walter T. Kaczmarek	President and Chief Executive Officer of Heritage Commerce Corp and Heritage Bank of Commerce
Michael E. Benito	Executive Vice President/Business Banking Manager of Heritage Bank of Commerce
Margo G. Butsch	Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce
Robertson Clay Jones	Executive Vice President/President of Community Business Banking Group for Heritage Bank of Commerce
Lawrence D. McGovern	Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce

Biographical information for Walter T. Kaczmarek is found under “Proposal 1—Election of Directors.” Mr. Kaczmarek assumed the position of President and Chief Executive Officer of the Company and the Bank on March 12, 2021.

Michael E. Benito, age 60, has served as Executive Vice President/Business Banking Manager of Heritage Bank of Commerce since January 2012. Mr. Benito joined Heritage Bank of Commerce in 2003 as Senior Vice President/Director of Sales & Business Development. From 1998 through 2003, Mr. Benito served as a Managing Director for Greater Bay Bank and from December 1986 through 1998, he served as Regional Vice President with Imperial Bancorp. Mr. Benito began his banking career more than 32 years ago at Union Bank of California (formerly Union Bank).

Margo G. Butsch, age 57, has served as Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce since July 2017. Ms. Butsch joined Heritage Bank of Commerce through Focus Business Bank which was acquired by Heritage Bank of Commerce in August 2015. After the acquisition, Ms. Butsch joined Heritage Bank of Commerce as Vice President/Credit Administration and was promoted to Senior Vice President/Credit Administration in November 2015. Since 1995 and prior to joining Heritage Bank of Commerce, Ms. Butsch held various Vice President and Senior Vice President relationship management and loan administration positions with Focus Business Bank, The Independent Bankers Bank, Greater Bay Bank, and Imperial Bank.

Robertson Clay Jones, age 50, has served as Executive Vice President/President Community Business Banking Group for Heritage Bank of Commerce since October 12, 2019. Mr. Jones was formally the President of Presidio Bank assuming the position in July 2018. Mr. Jones joined Presidio Bank in 2010 as Executive Vice President and Mid Peninsula Market President. Prior to joining Presidio Bank, Mr. Jones was the organizing and initial President and Chief Executive Officer of New Resource Bank. From October 1993 to May 2005 Mr. Jones served in ever increasing corporate capacities for subsidiaries of Greater Bay Bancorp and Comerica Bank, including his position as Executive Vice President & Chief Operating Officer at Cupertino National Bank and Executive Vice President and Manager of the Venture Banking Group.

Lawrence D. McGovern, age 66, has served as Executive Vice President and Chief Financial Officer of Heritage Commerce Corp and Heritage Bank of Commerce since July 1998.

Transactions with Management

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

Policies and Procedures for Approving Related Party Transactions

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

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

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

The Board has determined that the Audit Committee is best suited to review and approve related party transactions. The Committee considers all of the relevant facts and circumstances available to the Committee, including (if applicable) but not limited to: (i) the benefits to the Company; (ii) the impact on a director's independence in the event the related person is a director, an immediate family member of a director or an entity in which a director is a partner, shareholder or executive officer; (iii) the availability of other sources for

comparable products or services; (iv) the terms of the transaction; and (v) the terms available to unrelated third parties or to employees generally. No member of the Audit Committee may participate in any review, consideration or approval of any related person transaction with respect to which such member or any of his or her immediate family members is the related person. The Committee will approve only those related person transactions that are in, or are not inconsistent with, the best interests of the Company and its shareholders, as the Committee determines in good faith. The Audit Committee conveys its decision to the Chief Executive Officer, who conveys the decision to the appropriate persons within the Company.

Delinquent Section 16(a) Reports

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, except as disclosed below, 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, 2020. The Company inadvertently failed to file a timely Form 4 on behalf of Michael Benito following notice that he exercised stock options. A Form 4 was filed a few weeks later to report the transaction.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

This Compensation Discussion and Analysis identifies the Company's current compensation philosophy and objectives and describes the various methodologies, policies and practices for establishing and administering the compensation programs for our executives including the named executive officers. The strategies and policies of the Compensation Committee have been developed so that there is a direct correlation between executive compensation and the Company's overall performance and individual performance. The individuals who served as the Company's Chief Executive Officer and Chief Financial Officer during 2020, as well as, the other individuals included in the Summary Compensation Table, are referred to as the "named executive officers."

Overview of Compensation Philosophy

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

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

The first goal of our compensation program is to link a reasonable percentage of executive compensation to the financial performance of the Company. We achieve this goal by providing our named executive officers the opportunity to significantly increase their annual cash compensation through our variable performance based cash award incentive plan. The plan awards improvement in the Company's performance in key financial metrics on an annual basis. We also expect that as those improvements are maintained and built upon, they will be reflected in the Company's stock price.

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

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

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

Compensation Program Objectives and Rewards

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

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

Consequently, the guiding principles of our programs are to:

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

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

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

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

- *Base salary and benefits* are designed to:
 - Reward core competence in the executive role relative to position, performance, experience and responsibility;
 - Provide fixed cash compensation with merit increases competitive with the market place; and
 - Control fixed expenses.
 - *Annual incentive variable cash awards* are designed to:
 - Focus employees on annual financial objectives derived from the business plan that lead to long-term success;
 - Provide annual variable performance based cash awards to reward and motivate achievement of critical annual performance metrics selected by the Compensation Committee; and
 - Foster an equal pay for performance culture that aligns our compensation programs with our overall business strategy.
- *Equity based compensation awards* are designed to:
 - Align the interests of executives with those of our shareholders;
 - Promote teamwork by tying compensation significantly to the value of our common stock;
 - Attract the next generation of management by providing significant capital accumulation opportunities; and
 - Retain executives by providing a long-term-oriented program whose value could only be achieved by remaining with and performing for the Company.
- *Change of control and separation benefits*:
 - Individual employment contracts with certain executives provide for double-trigger change of control and separation benefits;
 - Separation benefits provide benefits to ease an employee's transition due to an unexpected employment termination by the Company due to ongoing changes in the Company's employment needs; and
 - Change in control benefits encourage key executives to remain focused on the Company's business in the event of rumored or actual fundamental corporate changes which will enhance shareholder value.
- *Manage excessive risk-taking* through plan design and oversight of incentive plans:
 - Incentive awards are capped;
 - Performance objectives are aligned with annual financial plan approval by the Board of Directors;
 - Multiple financial metrics are used taking into account performance and risk;
 - A "claw-back policy" is applied to performance based cash payments;
 - Payouts are modified through the use of risk-based capital ratio metrics;
 - Long-term incentive equity awards are deferred through vesting requirements; and
 - The Compensation Committee has discretion to reduce cash bonus payments.

Role of Shareholder Input

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

Committee's compensation consultant. The Compensation Committee will continue to consider our shareholders' views when making executive compensation decisions in the future.

Commencing in 2019 we included a say-on-pay non-binding advisory proposal every year with our annual meeting proxy statement. Last year our non-binding shareholder advisory vote on executive compensation was approved, with approximately 96% of voting shareholders casting their votes in favor of the say-on-pay resolution.

Role of Compensation Committee in Determining Compensation

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

The Compensation Committee regularly monitors performance against established goals and approves funding accruals, as well as focus on other aspects of the compensation program, including, among other things, peer group review and determination, compensation risk review, and monitoring of market and governance trends impacting compensation.

In carrying out its oversight responsibilities, the Compensation Committee regularly reports to the Board on the actions it has taken, as well as confers with the Board on compensation matters, as necessary. The Compensation Committee also makes recommendations for all other compensation-related matters that require full Board approval.

At least annually, the Compensation Committee reviews the executive compensation program overall, and establishes base salaries, target annual cash bonus opportunities and equity grants (if any) for the fiscal year. In setting these elements of compensation, the Compensation Committee reviews the total target compensation for our executives and also considers developments in compensation practices outside of the Company. Specifically, the Compensation Committee is provided with competitive positioning data for similarly situated executives at companies in our peer group, as well as summary consolidated information about our executives' total compensation and pay history to use in setting individual compensation elements and making decisions on total executive compensation levels. Peer data is a helpful reference for the Compensation Committee to assess the competitiveness and appropriateness of our executive compensation program within the banking industry and the broader business community. Ultimately, the Compensation Committee applies its own business judgment and experience to determine the individual compensation elements, the amount of each compensation element and total target compensation

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

The Compensation Committee periodically reviews the compensation levels of the Board. In its review, the Compensation Committee looks to ensure that the compensation is fair, reasonably competitive and commensurate to the responsibilities of both the individual directors as well as the Board in the aggregate.

Additionally, the Committee specifically takes into consideration the directors' adherence to the Company's director Stock Ownership Guidelines when reviewing compensation.

The Compensation Committee is comprised of five independent directors who satisfy The Nasdaq Stock Market listing requirements and relevant SEC regulations on independence. The Compensation Committee's Chair regularly reports to the Board on the Compensation Committee actions and recommendations. To evaluate and administer the compensation practices of the Chief Executive Officer and other executive officers, the Compensation Committee meets a minimum of four times a year. The Compensation Committee also holds special meetings and meets telephonically to discuss extraordinary items, such as the hiring or dismissal of executive officers. The Compensation Committee meets on a regular basis, and routinely meets in executive session without management present. During 2020, the committee held six meetings.

Role of the Chief Executive Officer

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

Role of Compensation Consultants

Generally, at least every two years the Compensation Committee retains the services of an independent executive compensation consultant to assess the competitiveness of our compensation programs, conduct other research as directed by the Compensation Committee, and support the Compensation Committee in the design and implementation of executive and Board of Director compensation. In 2019, the Compensation Committee retained McLagan, an Aon Hemitt Company ("McLagan") to: (i) review existing compensation programs; (ii) provide market benchmark information pertaining to both cash and noncash compensation for executives; (iii) provide recommendations and guidance to the Compensation Committee to support its oversight over such compensation programs; and (iv) provide other advice and consultation, including guidance relative to evolving compensation-related regulatory requirements and industry best practices. McLagan delivered its report in the first quarter of 2019 ("2019 Report"). The information from the 2019 Report was used in making compensation decisions for 2020.

Representatives of the compensation consultant attend meetings of the Compensation Committee as requested and also communicate with the Compensation Committee outside of meetings. The compensation consultant reports to the Compensation Committee rather than to management, although representatives of the firm may meet with members of management, including our Chief Executive Officer for purposes of gathering information on proposals that management may make to the Compensation Committee. The compensation consultant met with various executives to collect data and obtain management's perspective on the fiscal year 2020 compensation for our executives. The Compensation Committee may replace its compensation consultant or hire additional advisors at any time. After the Committee's review of applicable rules for independence, the Committee determined that there are no known conflicts of interest between McLagan and its affiliates and the Company and its affiliates. McLagan reports directly to the Committee and does not provide services to, or on behalf of, any other part of the Company's business.

Market Positioning and Pay Benchmarking

Many factors are taken into account in determining the actual positioning of each executive officer's compensation, including the executive's experience, responsibilities, management abilities and job performance, overall performance of the Company, current market conditions and competitive pay for similar

positions at comparable companies. In addition, the Compensation Committee reviews the relationship of various positions between departments, the affordability of desired pay levels and the importance of each position within the Company. These factors are considered by the Compensation Committee in a subjective manner without any specific formula or weighting.

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

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

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

* Acquired.

The Compensation Committee does not solely rely on comparative data from the Compensation Peer Group. Such comparative data provides helpful market information about our peer companies as a reference, but the Compensation Committee does not target any specific positioning or percentile, nor does it use a formulaic approach, in determining executive pay levels. All applicable information is reviewed and considered in aggregate, and the Compensation Committee does not place any particular weighting on any one factor.

Chief Executive Officer Compensation

The Compensation Committee meets with the other independent directors each year in an executive session, including the Corporate Governance committee, without management present to evaluate the performance of the Chief Executive Officer. The Chief Executive Officer does not participate in any deliberations regarding his own compensation. The Compensation Committee annually reviews and approves goals and objectives relevant to the Chief Executive Officer and evaluates the Chief Executive Officer’s performance against those objectives. The Compensation Committee typically considers corporate financial performance, the Company’s achievement of its short and long-term goals versus its strategic objectives and financial targets. With the assistance of the compensation consultant, the Compensation Committee also considers the compensation data related to the Compensation Peer Group for base pay, total cash compensation, and total direct compensation. When Keith A. Wilton assumed the position of Chief Executive Officer in August 2019, his salary was increased to \$500,000. In March 2020, his salary was increased to \$550,000. Mr. Wilton retired from the Company on March 12, 2021.

Base Salary Decisions for the Other Named Executive Officers

We pay base salaries in order to provide executives with a reasonable level of fixed short-term compensation. Executive base salary levels are typically reviewed at least annually by the Compensation

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

At its March 2020 meeting, the Compensation Committee approved the following salaries for 2020:

Named Executive	2020 Salary
Keith A. Wilton*	\$550,000
Michael E. Benito	\$304,880
Margo G. Butsch	\$298,700
Robertson Clay Jones	\$324,250
Lawrence D. McGovern	\$350,200

* Mr. Wilton retired from the Company on March 12, 2021.

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

Management Incentive Plan

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

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

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

Named Executive	As a percent of base salary		
	Threshold	Target	Max
Keith A. Wilton*	10%	60%	100%
Michael E. Benito	10%	40%	60%
Margo G. Butsch	10%	40%	60%
Robertson Clay Jones	10%	40%	60%
Lawrence D. McGovern	10%	45%	65%

* Mr. Wilton retired from the Company on March 12, 2021.

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

2020, the following financial metrics along with the relative weights of each financial metric were established by the Compensation Committee were approved in March 2020:

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

The Compensation Committee believes pre-tax income is a valid measurement in assessing how the Company is performing from a financial standpoint. Pre-tax income is an accepted accounting measure that drives earnings per share and shareholder returns over the long term. Noninterest income and noninterest expense are important components of net income that senior management and the Board of Directors sought to improve upon in 2020. In addition, the Compensation Committee, in consultation with the Chief Executive Officer, concluded that management should continue its focus on credit quality and loan and deposit growth. Financial metrics for noninterest income and noninterest expense are financial metrics that drive overall net income. The Compensation Committee believes that nonperforming assets are an effective measure to monitor the Company's progress in improving its credit quality.

The Compensation Committee did not realign the weighting of the mix of the financial metrics in 2020 from 2019. Because the Compensation Committee believed that the Incentive Plan should also balance risk-taking with performance, the Compensation Committee maintained a risk-based capital element to the Incentive Plan. If the total risk-based capital ratio was below 10% at year-end 2020, bonus payments would be reduced to zero. The Incentive Plan is also subject to a claw back policy if financial statements or other financial metric criteria are found to be materially inaccurate as determined by the Audit Committee.

Performance objectives were generally identified through our annual financial planning and budgeting process. Senior management developed a financial plan for 2020, and the financial plan was reviewed and approved by the Board. The Compensation Committee received recommendations from senior management for financial performance objective ranges. In setting the Threshold, Target and Maximum levels, the Compensation Committee considered specific circumstances anticipated to be encountered by the Company during the coming year and the level of improvement from year-to-year required to achieve the performance level. The Compensation Committee believed that the Threshold, Target and Maximum levels established for the Incentive Plan in 2020 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 2020, performance was assessed relative to performances for the year ended December 31, 2020, as shown below and compared to actual results:

<u>Financial Metrics (dollars in thousands)</u>	<u>Threshold (90% of Plan)</u>	<u>Target (Plan)</u>	<u>Maximum (110% of Plan)</u>	<u>2020 Actual</u>
Pre-Tax Income	\$ 74,490	\$ 82,767	\$ 91,044	\$ 49,068
Nonperforming Assets	\$ 3,300	\$ 3,000	\$ 2,700	\$ 7,869
Loans Outstanding(1)	\$2,720,993	\$2,864,203	\$3,007,413	\$2,619,261
Noninterest Income(2)	\$ 10,623	\$ 11,804	\$ 12,984	\$ 9,645
Noninterest Expense(3)	\$ 96,191	\$ 94,191	\$ 92,191	\$ 89,511
Deposits Outstanding(4)	\$3,619,533	\$3,810,035	\$4,000,537	\$3,890,575

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

(2) Securities gains or losses excluded from calculations.

- (3) 90% and 100% of plan not used. A \$2.0 million differential below and over Target was used for Threshold and Maximum.
- (4) Threshold and Maximum at 95% and 105% of plan (excludes brokered deposits, CDARS and State CDs).

During the first quarter of the following fiscal year-end, the Compensation Committee assesses the performance of the Company for each financial metric comparing the actual fiscal year-end 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. 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.

Impact of Covid-19. The Covid-19 pandemic has had an ongoing global impact on nearly every aspect of daily life in the U.S. since early 2020. As infection and death rates continued to accelerate throughout 2020, many businesses and schools were forced to close or alter their way of business to ensure public safety. Businesses shifted to work-from-home arrangements for their employees, and some had to juggle new childcare and home-schooling responsibilities due to shutdowns. Despite government intervention to facilitate financial assistance and small business loans, as well as the roll-out of a vaccine in mid-December 2020 to prevent Covid-19, many businesses suffered losses or closures. The pandemic has led to a weakening in gross domestic product and employment in the United States.

California where the Company primarily operates, implemented significant restrictions on the movement of its citizens and the operations of business beyond those enacted in many other states, with a resultant significant impact on economic activity in the state. The pandemic resulted in temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in California, including our primary market area. As a result, the Company's business was significantly impacted in 2020. In addition, certain other government actions such as loan deferrals, a reduction in the prime rate and the effect on yields from a decline in Fed funds impacted the securities portfolio and net interest income.

The Covid-19 pandemic adversely affected the Company's performance and impacted its forecast and budget for 2020. During 2020, the only Incentive Plan metrics achieved were Noninterest Expense (at maximum level) and Deposits Outstanding (target level). These results would provide a 15% of salary award for the named executive officers, other than the Chief Executive Officer and Chief Financial Officer, 16.5% for the Chief Financial Officer, and 24% for the Chief Executive Officer. Had the Company achieved target for each metric measure the awards would have been 40% of base salary for the named executive officers other than the Chief Executive Officer and Chief Financial Officer, 45% for the Chief Financial Officer and 60% for the Chief Executive Officer.

Committee Review of Incentive Plan Results. Mid-year the Compensation Committee reviewed the performance target metrics used for the Incentive Plan, and concluded that because the circumstances around the pandemic were expected to continue to evolve during 2020 the Compensation Committee did not have confidence that it would be possible to establish appropriate revised metrics for 2020. In its year-end review, the Compensation Committee analyzed the actual results for 2020 and then considered the use of its discretion to modify the pro forma award results. The Compensation Committee recognized that 2020 was unlike any year, and neither management nor the Board could have anticipated or forecasted the impact of Covid-19 when the Incentive Plan metrics were adopted. The Covid-19 pandemic and the uncertainty it created, along with various governmental shutdowns, rendered most of the metrics used for the Incentive Plan outside the control of management.

The Compensation Committee discussed qualitative factors in reviewing management's performance in 2020. The Compensation Committee focused on the number of major tactics that were accomplished by the management team including developing an operational strategy to deal with the effects of the pandemic, as follows:

- Completing the integration of Presidio Bank, including conversions systems and employees.

- Establishing a Covid-19 operating plan and for remote operations, converting branch servers to remote servers, adopting protocols at all branches, developing “pandemic team” meetings and Chief Executive Officer updates for all personnel.
- Completing the successful adoption and conversion in the first quarter of 2020 of Accounting Standards Update (“ASU”) No. 2016-13, “Measurement of Credit Losses on Financial Instruments”, commonly referred to as “CECL”.
- Remotely assimilating a new executive team from Presidio Bank, new head of IT and a new marketing director.
- Pivoting the Bank line organization for a greater focus on customer relationships and credit management.
- Instituting policies and procedures to implement the SBA Paycheck Protection Program (“PPP”) and completion of the first phase successfully for Bank clients, including processing the loan forgiveness feature of the PPP program.
- Processing \$189 million of loan deferments as encouraged by government authorities and regulators and then working and reducing the deferments to \$2.6 million by year-end.
- Completing the build out of the new Company principal executive offices under pandemic construction restrictions, and then completing the move of the entire corporate headquarters offices to the new facilities as well as relocating and moving Bay View Funding (a subsidiary of the Bank) into a new building.
- Consolidating the Bank’s San Mateo branch and administrative offices to new build out premises.
- Maintaining noninterest expense cost controls.
- Reducing the costs of deposits.

The Compensation Committee used its discretionary authority to modify target metrics for extra ordinary events that affect the Company that were not incorporated into the development of the 2020 Incentive Plan and to use discretion for awards for qualitative achievements during 2020. The Committee concluded that in view of the historic pandemic and its material impact on the economy, the Bank’s customers, employees and the response by management and its performance in 2020, and comparison of performance statistics with peer banks that cash awards for 2020 should be paid out at the “target” level based on the base salary paid in 2020 for each participant in the Plan. Therefore, the Committee approved the following incentive cash awards.

<u>Named Executive</u>	<u>Bonus Award</u>
Keith A. Wilton*	\$322,500
Michael E. Benito	\$121,064
Margo G. Butsch	\$118,610
Robertson Clay Jones	\$128,835
Lawrence D. McGovern	\$156,443

* Mr. Wilton retired from the Company on March 12, 2021.

Equity Based Compensation

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

The Compensation Committee believes that equity based compensation should be a significant component of total executive compensation to align executive compensation with the long-term performance of the Company and to encourage executives to make value enhancing decisions for the benefit of our

shareholders. Each of the named executive officers is eligible to receive equity compensation. The Compensation Committee is responsible for determining equity grants to all staff members, including named executive officers. The Compensation Committee may also grant equity-based awards to award performance, coincide with promotions and hirings, and for recruiting and retention purposes.

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

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

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

The Compensation Committee approves primarily nonstatutory stock options instead of incentive stock options because of the tax advantages available to the Company for nonstatutory options and because employees generally do not take full advantage of the tax benefits available to them from incentive stock options.

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

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

We do not backdate options or grant options or award restricted stock retroactively. In addition, we do not coordinate grants of options or awards of restricted stock so that they are made before announcement of favorable information, or after announcement of unfavorable information. The Company's options and restricted stock are granted at fair market value on a fixed date or event (the first day of service for new hires and the date of Compensation Committee approval for existing employees), with all required approvals obtained in advance of or on the actual grant date. All grants to executive officers require the approval of the Compensation Committee and the Board of Directors. Fair market value has been consistently determined as the closing price on The Nasdaq Global Select Market on the grant date. In order to ensure that an option

exercise price or restricted stock date of grant valuation fairly reflects all material information, without regard to whether the information seems positive or negative, every grant of options and restricted stock is contingent upon an assurance by management and legal counsel that the Company is not in possession of material undisclosed information. If the Company is in a “black-out” period for trading under its trading policy or otherwise in possession of inside information, the date of grant is suspended until the second business day after public dissemination of the information. We do not grant stock options with a so-called “reload” feature, nor do we loan funds to employees to enable them to exercise stock options. We have never re-priced stock options.

The Company’s general practice has been to grant options and restricted stock at the Compensation Committee and Board of Directors’ regular meeting held during the first quarter for the named executive officers as well as current staff, and at any other Compensation Committee meeting (whether a regular meeting or otherwise) held on the same date as a regularly scheduled Board of Directors meeting (which are held monthly) as required to attract new staff, retain staff or recognize key specific achievements. Commencing in 2021, restricted stock grants to directors will be made on the date of the annual meeting.

For 2020, the Compensation Committee determined to grant restricted stock awards to executives based on a percentage of the executive’s salary. The percentage applied was the same percentage used as “target” in the Incentive Plan.

For 2020, the Compensation Committee approved the following restricted stock awards:

Named Executive	Restricted Shares	Dollar Value on Date of Grant	Percent of Salary
Keith A. Wilton*	37,037	\$330,000	60%
Michael E. Benito	13,687	\$121,951	40%
Margo G. Butsch	13,409	\$119,474	40%
Robertson Clay Jones**	7,278	\$ 64,847	20%
Lawrence D. McGovern	17,686	\$157,582	45%

* Mr. Wilton retired from the Company on March 12, 2021.

** Mr. Jones joined the Company after the acquisition of Presidio Bank and was therefore allocated a pro rata portion of his “target” percentage.

Retirement Plans

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

Termination of Employment and Change in Control Provisions

We recognize that it is possible that we may be involved in a transaction involving a change of control of the Company, and that this possibility could result in the departure or distraction of our executives to the

detriment of our business. The Compensation Committee and the Board believe that the prospect of such a change of control transaction would likely result in our executives facing uncertainties about their future employment and distractions resulting from concern over how the potential transaction might affect them.

To allow our executives to focus solely on making decisions that are in the best interests of our shareholders in the event of a possible, threatened, or pending change of control transaction, and to encourage them to remain with us despite the possibility that a change of control might affect them adversely, each of our named executives and chief executive officer have change of control provisions in their respective employment agreements that provide them with certain payments and benefits in the event of the termination of their employment within 120 days prior to, or the 24 month period following, a change of control of the Company (referred to as the “change of control period”). The Compensation Committee and the Board believe that these “double-trigger” agreements serve as an important retention tool to ensure that personal uncertainties do not dilute our executives’ complete focus on building shareholder value.

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

The severance benefits provided for our named executive officers were determined by the Compensation Committee based on its judgment of prevailing market practices at the time each agreement was entered into. At present, we have employment agreements with the Chief Executive Officer and the other named executive officers, which detail their eligibility for payments under various termination scenarios. In addition, certain equity grants made to the named executive officers provide for vesting of stock options and restricted stock upon a change of control. We have disclosed the severance and/or change in control payouts that would be payable to each named executive officer if the triggering event occurred on December 31, 2020, in the “Change in Control Arrangements and Termination of Employment” section in this proxy statement.

Prohibition on Hedging

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

Prohibition on Pledging

Directors and executive officers are prohibited from purchasing Company securities on margin, borrowing against Company securities held in a margin account, or pledging Company securities as collateral for a loan.

Tax Considerations

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

In light of Section 162(m) of the Code, it is the policy of the Compensation Committee to examine our executive compensation program to maximize the tax deductibility of compensation paid to our executive officers when and if the \$1 million threshold becomes an issue. At the same time, the Compensation Committee also believes that the overall performance of our executives cannot in all cases be reduced to a fixed formula

and that the prudent use of discretion in determining pay levels is in our best interests and those of our shareholders. Under some circumstances, the Compensation Committee's use of discretion in determining appropriate amounts of compensation may be essential. In those situations where discretion is or can be used by the Compensation Committee, compensation may not be fully deductible.

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

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

Accounting Considerations

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

Compensation Committee Interlocks and Insider Participation

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

Compensation Committee Report

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

Compensation Committee of the Board

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

Executive Compensation Tables

The following table provides for the periods shown, information as to compensation for services of the Company's principal executive officer, principal financial officer, and the three other executive officers of the Company who had the highest total compensation (as defined in accordance with applicable regulations) with respect to the year ended 2020 (collectively referred to as the "named executive officers"):

Summary Compensation Table

Name and Principal Position (a)	Year (b)	Salary (\$) (c)(1)	Bonus (\$) (d)	Stock Awards (\$) (e)(2)	Option Awards (\$) (f)(2)	Non-Equity Incentive Plan Compensation (\$) (g)(3)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) (h)(4)	All Other Compensation (\$) (i)(5)	Total (\$) (j)
Keith A. Wilton*	2020	\$537,500	\$ —	\$330,000	\$ —	\$322,500	\$ —	\$47,428	\$1,237,428
President and Chief Executive	2019	\$429,839	\$ —	\$243,200	\$ —	\$151,733	\$ —	\$30,834	\$ 855,606
Officer of Heritage Commerce Corp and President of Heritage Bank of Commerce	2018	\$358,440	\$ —	\$201,600	\$ —	\$ 89,610	\$ —	\$32,229	\$ 681,879
Michael E. Benito	2020	\$302,660	\$ —	\$121,951	\$ —	\$121,064	\$343,000	\$31,130	\$ 919,805
Executive Vice President/Business Banking	2019	\$292,517	\$ —	\$145,920	\$ —	\$ 90,172	\$374,600	\$30,220	\$ 933,429
Manager of Heritage Bank of Commerce	2018	\$280,013	\$ —	\$100,800	\$ —	\$ 70,003	\$ 24,000	\$28,053	\$ 502,869
Margo G. Butsch	2020	\$296,525	\$ —	\$119,474	\$ —	\$118,610	\$ —	\$26,199	\$ 560,808
Executive Vice President & Chief Credit Officer	2019	\$281,250	\$ —	\$145,920	\$ —	\$ 86,961	\$ —	\$19,332	\$ 533,463
of Heritage Bank of Commerce	2018	\$250,000	\$ —	\$117,600	\$ —	\$ 62,500	\$ —	\$14,431	\$ 444,531
Robertson Clay Jones (6)	2020	\$322,088	\$ —	\$ 64,847	\$ —	\$128,835	\$ 44,900	\$13,534	\$ 574,204
Executive Vice President and President of Community Business Bank Group of Heritage Bank of Commerce	2019	\$ 68,015	\$142,500	\$ —	\$ —	\$ —	\$ 38,315	\$ 4,585	\$ 253,415
Lawrence D. McGovern	2020	\$347,650	\$ —	\$157,582	\$ —	\$156,443	\$375,900	\$50,068	\$1,087,643
Executive Vice President & Chief Financial Officer	2019	\$332,109	\$ —	\$182,400	\$ —	\$101,456	\$352,100	\$32,820	\$1,000,885
of Heritage Commerce Corp and Heritage Bank of Commerce	2018	\$305,471	\$ —	\$151,200	\$ —	\$ 76,368	\$ —	\$30,030	\$ 563,069

* Mr. Wilton retired from the Company on March 12, 2021.

- (1) The amounts in column (c) include amounts voluntarily deferred by each of the named executive officers into their 401(k) plan accounts. For 2020, each executive officer deferred \$26,000.
- (2) The amounts shown in columns (e) and (f) reflect the applicable full grant date fair values for stock options and stock awards in accordance with ASC 718 (excluding the effect of forfeitures), and are reported for the fiscal year during which the stock options and stock awards were issued. The assumptions used in calculating the valuation for stock options and stock awards may be found in Note 13 to the Company's consolidated financial statements for the year ended December 31, 2020, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 5, 2021.
- (3) The amounts shown in column (g) for 2020 reflect payments made under the terms of the Management Incentive Plan for 2020 performance and paid in the first quarter of 2021.
- (4) The amounts shown in column (h) for 2020 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, 2019 to December 31, 2020. The amounts in column (h) were determined using interest rate and mortality rate assumptions consistent with those used in the Company's consolidated financial statements and include amounts which the named executive officer may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2020, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 5, 2021.

Mr. Jones has a Supplemental Executive Retirement Agreement, dated November 28, 2017 (amended November 9, 2018) that was entered into with Presidio Bank. The agreement was assumed by the Company when the Company acquired Presidio Bank. Under the agreement Mr. Jones is entitled to a present value accumulated benefit of \$106,100 as of December 31, 2020. The amount shown in column (h) for 2019 and 2020 represent only the aggregate change in the actuarial present value of the

accumulated benefit from December 31, 2018 to December 31, 2019 and from December 31, 2019 to December 31, 2020. He is fully vested.

- (5) The amounts shown in column (i) for 2020 include the following for each named executive:
- (6) Mr. Jones joined the Company on October 12, 2019. His bonus in 2019 in column (d) represents an amount accrued by Presidio Bank prior to the acquisition of Presidio Bank or the Company, pursuant to a Presidio Bank bonus plan.

Named Executive	Economic Value of Death Benefit of Life Insurance for Beneficiaries(1)	401(k) Plan Company Matching Contributions	Other Insurance Benefit	Vacation	Auto Compensation	Cash Dividend on Unvested Restricted Stock Award	Total
Keith A. Wilton*	\$ —	\$3,000	\$3,564	\$ —	\$12,000	\$28,864	\$47,428
Michael E. Benito	\$2,654	\$3,000	\$3,564	\$ —	\$ 8,400	\$13,512	\$31,130
Margo G. Butsch	\$ —	\$3,000	\$2,322	\$ —	\$ 8,400	\$12,477	\$26,199
Robertson Clay Jones	\$ 454	\$3,000	\$1,242	\$ —	\$ 6,000	\$ 2,838	\$13,534
Lawrence D. McGovern	\$2,410	\$3,000	\$7,430	\$13,469	\$ 6,000	\$17,759	\$50,068

* Mr. Wilton retired from the Company on March 12, 2021.

- (1) 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.”

CEO Pay Ratio

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

We identified the median employee for 2020 by examining the 2020 total W-2 compensation from our payroll and employment records, including 401(k) deferrals and 401(k) matching of up to \$3,000 per employee, for all individuals, excluding our CEO, who were employed by us on December 31, 2020. We included all employees, whether employed on a full time, part time, temporary or seasonal basis as of that payroll date. We did not make any assumptions, adjustments or estimates with respect to such total W-2 reported compensation except for the 401(k) matching as described above. We did not annualize the compensation for any full or part time employees that were not employed by us for all of 2020. We believe the use of total W-2 compensation, including 401(k) deferrals and 401(k) matching of up to \$3,000 per employee, for all employees is a consistently applied compensation measure.

After identifying the median employee based upon the methodology described above, we calculated annual total compensation for such employee using the same methodology we used for our CEO and other named executive officers as set forth in the 2020 Summary Compensation Table in this proxy statement. The annual total compensation in 2020 for our median employee using this methodology was \$101,217. The annual total compensation in 2020 for our CEO using this methodology is shown in the Summary Compensation Table and was \$1,237,428. The ratio of the annual total compensation of our CEO to the annual total compensation of our median employee in 2020 was 12.23 to 1.

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

Executive Contracts

Walter T. Kaczmarek—On April 5, 2021, the Company and Heritage Bank of Commerce entered into a new employment agreement with Walter T. Kaczmarek who was appointed by the board of Directors as President and Chief Executive Officer of Heritage Commerce Corp and Heritage Bank of Commerce. The employment agreement is for one year and is automatically renewed for one year terms. Under the agreement, Mr. Kaczmarek receives an annual salary of \$721,000 with annual increases, if any, as determined by the Board of Directors' annual review of executive salaries. He received a grant of \$540,000 of restricted common stock. He is eligible to participate in the Heritage Commerce Corp Management Incentive Plan. Mr. Kaczmarek may participate in the Company's 401(k) plan, under which he may receive matching contributions up to \$3,000. 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 \$700,000. The Company will reimburse Mr. Kaczmarek for up to \$1,200 for tax consultation and tax return preparation. He is also reimbursed for expenses that exceed insurance coverage for an annual physical examination, certain long-term care policy expenses, monthly dues for one country club membership and one business club membership. He receives an automobile allowance in the amount of \$1,000 per month, together with reimbursements for gasoline and maintenance expenditures.

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

Keith A. Wilton—On August 8, 2019, the Company and Heritage Bank of Commerce entered into an employment agreement with Keith A. Wilton. The employment agreement was for one year and was automatically renewed each year. Under the agreement, Mr. Wilton received an annual salary of \$550,000 (last increased in March 2020) with annual increases, if any, as determined by the Board of Directors' annual review of executive salaries. In addition to his salary, he was eligible to participate in the Heritage Commerce Corp Management Incentive Plan. Mr. Wilton participated in the Company's 401(k) plan, under which he received matching contributions up to \$3,000. The Company provided Mr. Wilton, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Wilton was provided with life insurance coverage in the amount of \$700,000. He was provided with long term care insurance, with a lifetime benefit of up to \$72,000. The Company reimbursed Mr. Wilton for up to \$1,200 for tax consultation and tax return preparation. He was also reimbursed for expenses that exceed insurance coverage for an annual physical examination, monthly dues for one country club membership and one business club membership. He received an automobile allowance in the amount of \$1,000 per month, together with reimbursements for gasoline and maintenance expenditures.

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

Mr. Wilton retired from the Company on March 12, 2021. The Company and Mr. Wilton entered into a separation agreement dated March 12, 2021. Pursuant to the agreement, Mr. Wilton received a severance payment of \$1,475,895, acceleration of vesting on 25,012 shares of restricted common stock and three years of monthly COBRA payments. 34,358 shares of restricted common stock were forfeited.

Michael E. Benito—On February 1, 2012, the Company entered into an employment agreement with Michael E. Benito when he was promoted to Executive Vice President/Business Banking Manager. The employment contract is for one year and is automatically renewed for one year terms. Under the Agreement, Mr. Benito receives an annual salary of \$320,124 with annual increases, if any (last increased in March 2021), as determined by the Company's Chief Executive Officer and Board of Directors' Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Benito participates in the Company's 401(k) plan, under which he may receive matching contributions up to \$3,000. Mr. Benito also participates in the Company's Employee Stock Ownership Plan. The Company provides to Mr. Benito, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Benito receives an automobile allowance in the amount of \$700 per month, together with reimbursements for gasoline expenditures. Mr. Benito is provided with life

insurance coverage in the amount of two times his salary not to exceed \$700,000. He is also provided with long term care insurance, with a lifetime benefit of up to \$72,000.

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

Margo G. Butsch—On July 8, 2017, the Company entered into an employment agreement with Margo G. Butsch when she was promoted by the Company to Executive Vice President and Chief Credit Officer of Heritage Bank of Commerce. The employment contract is for one year and is automatically renewed for one year terms. Under the agreement, Ms. Butsch receives an annual salary of \$313,635 with annual increases, if any (last increased in March 2021), as determined by the Company’s Chief Executive Officer and Board of Directors’ Compensation Committee annual review of executive salaries. In addition to her salary, she is eligible to participate in the Management Incentive Plan. Ms. Butsch participates in the Company’s 401(k) plan, under which she could receive matching contributions up to \$3,000. Ms. Butsch also participates in the Company’s Employee Stock Ownership Plan. The Company provides to Ms. Butsch, at no cost to her, group life, health, accident and disability insurance coverage for herself and her dependents. Ms. Butsch also receives an automobile allowance in the amount of \$700 per month. Ms. Butsch is provided with life insurance coverage in the amount of two times her salary not to exceed \$700,000. She is also provided with long term care insurance, with a lifetime benefit of up to \$72,000.

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

Robertson Clay Jones—On October 11, 2019, the Company entered into an employment agreement with Robertson Clay Jones. The employment agreement is for one year and is automatically renewed for one year terms. Under the Agreement, Mr. Jones receives an annual salary of \$360,140 (last increased in March 2021) with annual increases, if any, as determined by the Company’s Chief Executive Officer and Board of Directors’ Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. Jones participates in the Company’s 401(k) plan, under which he may receive matching contributions up to \$3,000. The Company provides to Mr. Jones, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. Jones receives an automobile allowance in the amount of \$500 per month. Mr. Jones is provided with life insurance coverage in the amount of two times his salary not to exceed \$700,000. He is also provided with long term care insurance, with a lifetime benefit of up to \$72,000.

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

Lawrence D. McGovern—On July 21, 2011, the Company entered into an Employment Agreement with Lawrence D. McGovern. The employment contract is for one year and is automatically renewed for one year terms. Under the agreement, Mr. McGovern receives an annual salary of \$367,710 with annual increases, if any (last increased in March 2021), as determined by the Company’s Chief Executive Officer and Board of Directors’ Compensation Committee annual review of executive salaries. In addition to his salary, he is eligible to participate in the Management Incentive Plan. Mr. McGovern participates in the Company’s 401(k) plan, under which he may receive matching contributions up to \$3,000. He also participates in the Company’s Employee Stock Ownership Plan. The Company provides to Mr. McGovern, at no cost to him, group life, health, accident and disability insurance coverage for himself and his dependents. Mr. McGovern receives an automobile allowance in the amount of \$500 per month, together with reimbursements for gasoline expenditures. Mr. McGovern is provided with life insurance coverage in the amount of two times his salary but not to exceed \$700,000. He is also provided with long term care insurance, with a lifetime benefit of up to \$72,000.

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

Plan Based Awards

Equity Based Plans. In 2004, the Board of Directors adopted the Heritage Commerce Corp 2004 Stock Option Plan (the “2004 Plan”), which was approved by the Company’s shareholders at the 2004 Annual Meeting. The 2004 Plan authorized the Company to grant stock options to officers, employees and directors of the Company and its affiliates. In 2009, the 2004 Plan was amended and restated as the 2004 Equity Plan to authorize the issuance of restricted stock in addition to stock options. The 2004 Equity Plan was approved by the Company’s shareholders at the 2009 Annual Meeting.

In 2013, the Board of Directors approved the 2013 Equity Incentive Plan (“2013 Equity Plan”) to replace the 2004 Equity Plan. The 2013 Equity Plan was approved by the Company’s shareholders at the 2013 Annual Meeting. The purpose of the Equity Plan is to promote the long term success of the Company and the creation of shareholder value. The Board of Directors believes that the availability of stock awards is a key factor in the ability of the Company to attract and retain qualified individuals to serve as directors, officers and employees. Under the 2013 Equity Plan incentives are provided through the grant of stock options and restricted stock awards. At the 2020 Annual Meeting, the shareholders approved an amendment to the 2013 Equity Plan to increase the number of share authorized under the 2013 Equity Plan from 3,000,000 to 5,000,000.

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

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

The following table provides information on the potential performance based awards available if defined performance objectives were achieved in 2020 for each of the Company’s named executive officers under the Company’s Management Incentive Plan, and stock options or other stock awards granted to the named executive officers for the year ended December 31, 2020:

Grants of Plan-Based Awards

Name (a)	Grant Date (b)	Estimated Future Payouts Under Non-Equity			Estimated Future Payouts Under Equity			All Other Stock Awards: Number of Shares of Stock or Units (#) (i)(2)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards (\$/Sh) (k)	Grant Date Fair Value of Stock And Options Awards (l)(3)
		Incentive Plan Awards(1)			Incentive Plan Awards			Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)	
		Threshold (\$) (c)	Target (\$) (d)	Maximum (\$) (e)	Threshold (\$) (f)	Target (\$) (g)	Maximum (\$) (h)				
Keith A. Wilton*	4/28/20	—	—	—	—	—	—	37,037	—	—	\$330,000
	1/23/20	\$55,000	\$330,000	\$550,000	—	—	—	—	—	—	\$ —
Lawrence D. McGovern	4/28/20	—	—	—	—	—	—	17,686	—	—	\$157,582
	1/23/20	\$35,020	\$157,590	\$227,630	—	—	—	—	—	—	\$ —
Michael E. Benito	4/28/20	—	—	—	—	—	—	13,687	—	—	\$121,951
	1/23/20	\$30,488	\$121,952	\$182,928	—	—	—	—	—	—	\$ —
Margo G. Butsch	4/28/20	—	—	—	—	—	—	13,409	—	—	\$119,474
	1/23/20	\$29,870	\$119,480	\$179,220	—	—	—	—	—	—	\$ —
Robertson Clay Jones	4/28/20	—	—	—	—	—	—	7,278	—	—	\$ 64,847
	1/23/20	\$32,425	\$129,700	\$194,550	—	—	—	—	—	—	\$ —

* Mr. Wilton retired from the Company on March 12, 2021.

(1) These potential performance based awards were established under the Management Incentive Plan if the indicated level of performance was achieved in 2020 as described further in the “Compensation and Discussion Analysis” and in the discussion under “Plan Based Awards—Management Incentive Plan.”

They do not represent the actual payments made to the named executive officers. The payments made for actual performance in 2020 are reflected in column (g) in the Summary Compensation Table.

- (2) This column reflects restricted stock award granted in 2020 pursuant to the 2013 Equity Incentive Plan.
- (3) The amounts shown in column (l) reflect the applicable full grant date fair values for restricted stock award in accordance with ASC 718 (excluding the effect of forfeitures), and are reported for the fiscal year during which the restricted stock awards were issued. The assumptions used in calculating the valuation for stock and options awards may be found in Note 13 to the Company's consolidated financial statements for the year ended December 31, 2020, included in the Company's Annual Report on Form 10-K, filed with the SEC on March 5, 2021.

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, 2020:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))(c)
Equity compensation plans approved by security holders	\$2,546,821(1)	\$9.30	2,409,062(2)
Equity compensation plans not approved by security holders	N/A	N/A	N/A

- (1) Consists of 266,818 options to acquire shares under the Company's 2004 Equity Incentive Plan, 1,602,919 options to acquired shares under the Company's 2013 Equity Incentive Plan, and the aggregate amount of 677,084 stock options assumed under the Presidio Plans.
- (2) Available under the Company's 2013 Equity Incentive Plan.

Outstanding Equity Awards

The following table shows the number of Company shares of common stock covered by exercisable and unexercisable stock options and the number of Company unvested shares of restricted common stock held by the Company's named executive officers as of December 31, 2020:

Outstanding Equity Awards at Year End

Name (a)	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable (b)	Number of Securities Underlying Unexercised Options (#) Unexercisable (c)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) (d)	Options Exercise Price (\$) (e)	Options Expiration Date (f)	Number of Shares or Units of Stock That Have Not Vested (#) (g)(1)	Market Value of Shares or Units of Stock That Have Not Vested (\$) (h)(2)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#) (i)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$) (j)
Keith A. Wilton*	—	—	—	\$ —	—	59,370	\$526,612	—	—
Lawrence D. McGovern	15,000	—	—	\$ 8.07	02/27/2024	34,436	\$305,447	—	—
	15,000	—	—	\$ 6.57	04/30/2023	—	—	—	—
Michael E. Benito	12,500	—	—	\$ 8.07	02/27/2024	26,187	\$232,279	—	—
	10,000	—	—	\$ 6.57	04/30/2023	—	—	—	—
Margo G. Butsch	7,181	819(3)	—	\$14.48	05/02/2027	24,909	\$220,943	—	—
	3,000	—	—	\$10.34	05/03/2026	—	—	—	—
Robertson Clay Jones	49,399(4)	—	—	\$10.74	07/01/2028	7,278	\$ 64,556	—	—
	37,050(4)	—	—	\$ 4.92	01/29/2025	—	—	—	—
	37,050(4)	—	—	\$ 3.98	01/30/2024	—	—	—	—
	37,050(4)	—	—	\$ 2.79	01/10/2022	—	—	—	—

* Mr. Wilton retired from the Company on March 12, 2021. When Mr. Wilton retired, he vested in 25,012 shares of restricted common stock and forfeited 34,358 shares of restricted common stock.

- (1) This column represents the unvested shares for restricted stock awards granted. Restricted stock awards vest 25% per year from the date of grants for the 2017 and 2018 grants. Restricted stock awards vest 33% per year from the date of grant for the 2019 and 2020 grants.
- (2) The market value of the shares of restricted stock that have not vested is calculated by multiplying the number of shares of stock that have not vested by the closing price of our common stock at December 31, 2020, as reported on The Nasdaq Global Select Market, which was \$8.87.
- (3) The options vest daily over 4 years beginning May 2, 2017, and have a term of 10 years.
- (4) Stock options granted by Presidio Bank under the Presidio Plans which the Company assumed at the effective time of the acquisition of Presidio Bank. The options were adjusted to reflect the acquisition exchange ratio. The options are fully vested.

Option Exercises and Vested Stock Awards

The following table sets forth information with regard to the exercise and vesting of stock options and vesting of shares of restricted stock for the year ended December 31, 2020, for each of the named executive officers:

Option Exercises and Stock Vested

Name (a)	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#) (b)	Value Realized upon Exercise (\$) (c)	Number of Shares Acquired on Vesting (#) (d)	Value Realized on Vesting (\$) (e)(1)
Keith A. Wilton*	—	—	14,917	\$120,775
Lawrence D. McGovern	—	—	11,550	\$ 93,672
Michael E. Benito	4,500	\$ 12,915	8,875	\$ 71,824
Margo G. Butsch	—	—	5,750	\$ 45,168
Robertson Clay Jones	61,750	\$413,108	—	—

* Mr. Wilton retired from the Company on March 12, 2021. When Mr. Wilton retired, he vested in 25,012 shares of restricted common stock and forfeited 34,358 shares of restricted common stock.

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

401(k) Plan

The Company has established a broad based employee benefit plan under Section 401(k) of the Internal Revenue Code of 1986 (“401(k) Plan”). The purpose of the 401(k) Plan is to encourage employees to save for retirement. Eligible employees may make contributions to the plan subject to the limitations of Section 401(k). The 401(k) Plan trustees administer the Plan. The Company matched up to \$3,000 of each employee’s contributions in 2020. The 401(k) Plan allows highly compensated employees to contribute up to a maximum percentage of their base salary, up to the limits imposed by the Internal Revenue Code, on a pre-tax basis. Participants choose to invest their account balances from an array of investment options as selected by plan fiduciaries. The 401(k) Plan is designed to provide for distributions in a lump sum after termination of service. However, loans and in service distributions under certain circumstances such as hardship, attainment of age 59½, or a disability are permitted. For named executive officers, these amounts are included in the Summary Compensation Table under “All Other Compensation.”

Employee Stock Ownership Plan

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

Supplemental Retirement Plan for Executive Officers

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

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

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

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

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

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

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

Change of Control. If a participant’s employment is terminated for any reason (except cause or after qualifying for normal retirement) within two years following a change of control, the participant will receive 100% of his or her supplemental retirement benefit commencing at the later of the first month following the age selected by the participant or the first month following the participant’s separation from service (except executive officers who receive their benefit six months from separation of service), and continuing until the death of the participant (unless the joint survivor option is selected). In the event payments commence prior to the participant’s normal retirement age, then the benefit due to the participant will be reduced by 5% for each year (or partial year) that the participant’s benefit is paid prior to the participant’s normal retirement age.

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

The following table shows the present value of the accumulated benefit payable to each of the named executive officers that participate in the SERP, including the number of service years credited to each named executive officer at December 31, 2020:

Name (a)	Plan Name (b)	Present Value of Accumulated Benefit(1)(2) (\$) (c)	Payments During Last Fiscal Year (\$) (d)
Lawrence D. McGovern	Heritage Commerce Corp SERP	\$1,872,300	—
Michael E. Benito(3)	Heritage Commerce Corp SERP	\$1,446,300	—
Robertson Clay Jones	Heritage Commerce Corp SERP	\$ 106,100	—

(1) The amounts in column (c) were determined using interest rate and mortality rate assumptions consistent with those used in the Company’s consolidated financial statements and include amounts which the named executive officer may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company’s consolidated financial statements for the fiscal year ended December 31, 2020, included in the Company’s Annual Report on Form 10-K, filed with the SEC on March 5, 2021.

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

End of the year prior to termination	Lawrence D. McGovern	Michael E. Benito(3)	Robertson Clay Jones
12/31/2020	100%	100% 90%	100%
12/31/2021	100%	100% 100%	100%
12/31/2022	100%	100% 100%	100%
12/31/2023	100%	100% 100%	100%
12/31/2024	100%	100% 100%	100%

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

Deferred Compensation Plan

In January 2004, the Company adopted the Heritage Commerce Corp Nonqualified Deferred Compensation Plan for certain executive officers. The purpose of the plan is to offer those employees an opportunity to elect to defer the receipt of compensation in order to provide termination of employment and related benefits taxable pursuant to Section 451 of the Internal Revenue Code of 1986, as amended. The plan is intended to be a “top hat” plan (i.e., an unfunded deferred compensation plan maintained for a select group of management or highly compensated employees) under Sections 201(2), 301(a)(3) and 401(a)(1) of the Employee Retirement Income Security Act of 1974. The executive may elect to defer up to 100% of any bonus and 50% of any regular salary into the Deferred Compensation Plan. Amounts deferred are invested in a portfolio of approved investment choices as directed by the executive. Under the Deferred Compensation Plan, the Company may make discretionary contributions for the executive, but has not done so. Amounts deferred by executives to the plan will be distributed at a future date they have selected or upon termination of employment. The executive can select a distribution schedule of up to fifteen years.

Change of Control Arrangements and Termination of Employment

Equity Plans. Each of the named executive officers holds options granted under the 2004 Equity Plan and the 2013 Equity Plan. Under these plans, option holders will be given 30 days advance notice of the consummation of a change of control transaction during which time the option holders will have the right to

exercise their options, and all outstanding options become immediately vested. The options terminate on the consummation of the change of control. In the event the option holder dies or becomes disabled, the option holder or his or her estate will have 12 months to exercise those options that have vested as of the date of termination of employment from a disability or death.

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

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

Mr. Kaczmarek's Employment Agreement. If Mr. Kaczmarek's employment is terminated without cause or he resigns for good reason (as defined in the agreement), he is entitled to a lump sum payment equal to two times his base salary and his average annual bonus in the last three years. The appointment of a new President and Chief Executive Officer within 24 months of the date of his employment agreement will not result in a severance payment under the termination without cause or good reason resignation provisions. If Mr. Kaczmarek's employment is terminated or he resigns for good reason 120 days before, or within two years after, a change of control (as defined in the agreement), he will be paid a lump sum of 2.75 times his base salary and average annual bonus in the last three years (or shorter period). His shares of restricted common stock granted to him under his contract vest over three years, but vesting will accelerate if a new President and Chief Executive Officer is appointed, a change of control, a termination without cause or a termination for good reason. Additionally, following the termination of his employment, Mr. Kaczmarek has agreed to refrain from using trade secrets or proprietary information in certain activities that would be competitive with the Company.

Mr. Wilton's Employment Agreement. Mr. Wilton retired from the Company on March 12, 2021. Under his employment contract, if Mr. Wilton's employment was terminated without cause or he resigned for good reason (as defined in the agreement), he was entitled to a lump sum payment equal to two times his base salary and his average annual bonus in the last three years. If Mr. Wilton's employment was terminated or he resigned for good reason 120 days before, or within two years after, a change of control (as defined in the agreement), he would have been paid a lump sum of 2.75 times his base salary and average annual bonus in the last three years. If his employment was terminated by the Company without cause, or he resigned for good reason, or as a result of a change of control the Company terminated his employment or he resigned for good reason, his participation in group insurance coverages would continue on at least the same level as at the time of termination for a period of 36 months from the date of termination. Additionally, following the termination of his employment, Mr. Wilton agreed to refrain from using trade secrets or proprietary information in certain activities that would be competitive with the Company.

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

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

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

Mr. McGovern's Employment Agreement. If Mr. McGovern's employment is terminated without cause, he will be entitled to a lump sum payment equal to one times his base salary, his highest annual bonus in the last three years and his annual automobile allowance. If Mr. McGovern's employment is terminated by the Company or he resigns for good reason 120 days before, or within two years after, a change in control, he will be entitled to a lump sum payment of two times his base salary, his highest annual bonus in the last three years and his annual automobile allowance. If the employment agreement is terminated by the Company without cause, his participation in group insurance coverage will continue on at least the same level as at the time of termination for a period of 12 months from the date of termination. If Mr. McGovern's employment is terminated as a result of a change in control during the change of control period, or he resigns for a good reason as a result of a change in control, these benefits will continue for an additional 24 months from the date of termination. In the event that the amounts payable to Mr. McGovern under the agreement constitute "excess parachute payments" under the Internal Revenue Code of 1986, as amended, that are subject to an

excise or similar tax, the amounts payable to Mr. McGovern will be increased so that he receives substantially the same economic benefit under the agreement had there been no such tax imposed. Additionally, following the termination of his employment, Mr. McGovern has agreed to refrain from certain activities that would be competitive with the Company within the counties in California in which the Company has located its headquarters or branch offices, including refraining for 12 months from the date of termination from soliciting Company employees or customers.

The following tables summarize the payments which would be payable to our named executive officers in the event of various termination scenarios as of December 31, 2020. 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.

	<u>Change in Control</u>	<u>Involuntary Termination Without Cause</u>	<u>Termination for Good Reason</u>	<u>Death</u>	<u>Disability</u>
Keith A. Wilton*					
Cash severance under employment agreement	\$1,838,677	\$1,337,219	\$1,337,219	\$ —	\$ —
Health insurance premiums	113,502	113,502	113,502	—	—
Life insurance benefits	—	—	—	700,000	180,000(3)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested restricted stock awards (accelerated)	526,612	—	—	526,612	526,612
Total:	<u>\$2,478,791</u>	<u>\$1,450,721</u>	<u>\$1,450,721</u>	<u>\$1,226,612</u>	<u>\$778,612</u>
Michael E. Benito					
Cash severance under employment agreement	\$ 777,257	\$ 388,628	\$ —	\$ —	\$ —
Health insurance premiums	91,865	45,933	—	—	—
Life insurance benefits	—	—	—	609,760	180,000(3)
Long-term care insurance benefits	—	—	—	—	72,000
Supplemental executive retirement plan(1)(2)	18,707	18,918	—	—	15,936
Unvested restricted stock awards (accelerated)	232,279	—	—	232,279	232,279
Split-dollar death benefits (upon death)	—	—	—	730,711	—
Total:	<u>\$1,120,108</u>	<u>\$ 453,479</u>	<u>\$ —</u>	<u>\$1,572,750</u>	<u>\$500,215</u>
Margo G. Butsch					
Cash severance under employment agreement	\$ 739,508	\$ 369,754	\$ —	\$ —	\$ —
Health insurance premiums	130,682	65,341	—	—	—
Life insurance benefits	—	—	—	597,400	180,000(3)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested restricted stock awards (accelerated)	220,943	—	—	220,943	220,943
Total:	<u>\$1,091,133</u>	<u>\$ 435,095</u>	<u>\$ —</u>	<u>\$ 818,343</u>	<u>\$472,943</u>

	<u>Change in Control</u>	<u>Involuntary Termination Without Cause</u>	<u>Termination for Good Reason</u>	<u>Death</u>	<u>Disability</u>
Robertson Clay Jones					
Cash severance under employment agreement	\$ 946,833	\$473,417	\$ —	\$ —	\$ —
Health insurance premiums	130,682	65,341		—	—
Life insurance benefits	—	—	—	648,500	180,000(3)
Long-term care insurance benefits	—	—	—	—	72,000
Split-dollar death benefits (upon death)	—	—	—	648,900	—
Unvested restricted stock awards (accelerated)	64,556	—	—	64,556	64,556
Total:	<u>\$1,142,071</u>	<u>\$538,758</u>	<u>\$ —</u>	<u>\$1,361,956</u>	<u>\$316,556</u>
Lawrence D. McGovern					
Cash severance under employment agreement	\$ 915,312	\$457,656	\$ —	\$ —	\$ —
Health insurance premiums	91,865	45,933	—	—	—
Life insurance benefits	—	—	—	700,000	180,000(3)
Long-term care insurance benefits	—	—	—	—	72,000
Unvested restricted stock awards (accelerated)	305,447	—	—	305,447	305,447
Split-dollar death benefits (upon death)	—	—	—	876,754	—
Total:	<u>\$1,312,624</u>	<u>\$503,589</u>	<u>\$ —</u>	<u>\$1,882,201</u>	<u>\$557,447</u>

* Mr. Wilton retired from the Company on March 12, 2021. The Company and Mr. Wilton entered into a separation agreement dated March 12, 2021. Pursuant to the agreement, Mr. Wilton received a severance payment of \$1,475,895, acceleration of vesting on 25,012 shares of restricted common stock and three years of monthly COBRA payments. 34,358 shares of restricted common stock were forfeited.

- (1) Assumes executive selected age 62 for commencement of the payment of this benefit.
- (2) 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.
- (3) This balance represents the annual payment of long-term disability for the named executive officers. This long-term payment would begin after an elimination period and a twenty-five week short term disability period. This long-term disability payment will increase by 3% (cost of living adjustment) over the first ten years of payments and cease at age 65.

Director Compensation

This section provides information regarding the compensation policies for non-employee directors and amounts paid to these directors in 2020.

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 2020, each director received an annual retainer fee of \$50,000. The chair of each standing committee of the Board received an additional \$6,000 per year, and the Chairman of the Board receives an additional \$17,500 per year. Board Members are not paid separate fees for attending Board or committee meetings.

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

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

In 2020, each of the directors received restricted stock in accordance with the above schedule.

The following table summarizes the compensation of non-employee directors for the year ended December 31, 2020:

Director Compensation Table

Name (a)	Fees Earned or Paid in Cash (\$) (b)	Stock Awards (\$) (c)(1)	Options Awards (\$) (d)	Non-Equity Incentive Plan Compensation (\$) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) (f)(2)	Cash Dividend on Unvested Restricted Stock Award (\$) (g)	All Other Compensation (\$) (h)(3)	Total (\$) (i)
Julianne Biagini-Komas	\$59,500	\$27,496	\$ —	\$ —	—	\$1,791	\$ —	\$ 88,787
Frank G. Bisceglia	\$50,000	\$27,496	\$ —	\$ —	\$19,300	\$1,791	\$ 871(3)	\$ 99,458
Bruce H. Cabral	\$56,000	\$27,496	\$ —	\$ —	—	\$1,204	\$ —	\$ 84,700
Jack W. Conner	\$72,000	\$34,375	\$ —	\$ —	\$13,400	\$2,239	\$1,376(3)	\$123,390
Jason DiNapoli	\$50,000	\$27,496	\$ —	\$ —	—	\$1,791	\$ —	\$ 79,287
Stephen G. Heitel	\$50,000	\$27,496	\$ —	\$ —	—	\$1,204	\$ —	\$ 78,700
Walter T. Kaczmarek(4)	\$51,500	\$27,496	\$ —	\$ —	—	\$1,791	\$ —	\$ 80,787
Robert T. Moles	\$50,000	\$27,496	\$ —	\$ —	\$36,800	\$1,791	\$ —	\$116,087
Laura Roden	\$56,000	\$27,496	\$ —	\$ —	—	\$1,791	\$ —	\$ 85,287
Marina Park Sutton	\$54,333	\$27,496	\$ —	\$ —	—	\$1,204	\$ —	\$ 83,033
Ranson W. Webster	\$56,000	\$27,496	\$ —	\$ —	\$14,000	\$1,791	\$ 902(3)	\$100,189

- (1) The amounts shown in column (c) reflect the applicable full grant date value for stock awards in accordance with ASC 718 (excluding the effect of forfeitures). See Note 13 to the Company's consolidated financial statements for the year ended December 31, 2020 included in the Company's Annual Report on Form 10-K, filed with the SEC on March 5, 2021.
- (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, 2019 to December 31, 2020, under the respective director compensation benefits agreements. The amounts in column (f) were determined using interest rate and mortality rate assumptions, consistent with those used in the Company's consolidated financial statements, and include amounts which the named director may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company's consolidated financial statements for the year ended December 31, 2020, included in the Company's Annual Report on Form 10-K filed with the SEC on March 5, 2021.
- (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. Kaczmarek became the Company's President and Chief Executive Officer on March 12, 2021.

Director Outstanding Stock Options and Stock Awards

Each of the non-employee directors owned the following stock options and stock awards as of December 31, 2020:

<u>Director</u>	<u>Stock Options</u>	<u>Stock Awards</u>
Julianne M. Biagini-Komas	—	3,086
Frank G. Bisceglia	18,000	3,086
Bruce H. Cabral(1)	17,290	3,086
Jack W. Conner	—	3,086
Jason DiNapoli	—	3,086
Stephen G. Heitel(1)	123,499	3,086
Walter T. Kaczmarek(2)	—	36,003
Robert T. Moles	18,000	3,086
Laura Roden	10,700	3,086
Marina Park Sutton(1)	32,110	3,086
Ranson W. Webster	18,000	3,086

- (1) The stock options were granted by Presidio Bank prior to the acquisition by the Company and were assumed by the Company in connection with the acquisition.
- (2) Mr. Kaczmarek became the Company’s President and Chief Executive Officer on March 12, 2021. Of the stock awards listed in the table, 32,917 stock awards were issued while Mr. Kaczmarek was President and Chief Executive Officer of the Company prior to his initial retirement in August 2019.

Director Compensation Benefits Agreement

Prior to 2007, the Company entered into individual director compensation benefits agreements with each of its then directors. These agreements were amended and restated in December, 2008 (“*Benefit Agreements*”). The Benefit Agreements provide an annual benefit equal to a designated applicable percentage of \$1,000 times each year served as a director, subject to a 2% increase each year from the date of the commencement of payments. The applicable percentage increases over time and equals 100% after nine years of service. In the event of a disability, or a resignation or termination pursuant to a change of control, the director’s applicable percentage will be accelerated to 100%. Payments of benefits will be made in equal monthly payments on the first day of each month, commencing on the later of the director’s attaining the age of 62 or the month following the month in which the director separates from service on the Board and continuing until the director’s death. If a director is removed from the Board for cause he or she will forfeit any benefits under the Benefit Agreement.

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

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

Name (a)	Plan Name (b)	Present Value of Accumulated Benefit(1)(2) (\$) (c)	Payments During Last Fiscal Year (\$) (d)
Frank G. Bisceglia	Heritage Commerce Corp SERP	\$338,300	—
Jack W. Conner	Heritage Commerce Corp SERP	\$153,100	—
Robert T. Moles	Heritage Commerce Corp SERP	\$330,500	—
Ranson W. Webster	Heritage Commerce Corp SERP	\$199,200	—

- (1) The amounts in column (c) were determined using interest rate and mortality rate assumptions consistent with those used in the Company’s consolidated financial statements and include amounts which the director may not currently be entitled to receive because such amounts are not vested. Assumptions used in the calculation of these amounts are included in Note 14 to the Company’s consolidated financial statements for the year ended December 31, 2020, included in the Company’s Annual Report on Form 10-K, filed with the SEC on March 5, 2021.
- (2) Each participant is fully vested.

PROPOSAL 1—ELECTION OF DIRECTORS

The Bylaws of the Company provide that the number of directors shall not be less than 9 nor more than 15. By resolution, the Board has fixed the number of directors at 11 effective on the date of and prior to the Annual Meeting. All of our directors serve one year terms that expire at the next following annual meeting. The Bylaws of the Company provide the procedure for nominations and election of the Board of Directors. For information on these procedures see “Corporate Governance and Board Matters—Nomination of Directors.” Nominations not made in accordance with the procedures may be disregarded by the Chairman of the Annual Meeting and upon his instructions, the inspector of election will disregard all votes cast for such nominees.

The Board, upon the recommendation of the Corporate Governance and Nominating Committee, has recommended the nomination of 11 of the current members of the Board of Directors for one year terms that will expire at the Annual Meeting to be held in 2022. If any nominee should become unable or unwilling to serve as a director, the proxies will be voted at the Annual Meeting for substitute nominees designated by the Board. The Board presently has no knowledge that any of the nominees will be unable or unwilling to serve.

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

JULIANNE M. BIAGINI-KOMAS, age 58, was formerly a member on the Focus Business Bank board of directors and joined the Board of Directors of the Company in August 2015. Ms. Biagini-Komas is currently the Vice President, Finance and Human Resources of CNEX Labs, Inc., San Jose, California. She was the Chief Financial Officer of Quantumscape Corporation, San Jose, California, from 2011 to 2014. Previously, she was the Chief Financial Officer of Endwave Corporation, a Nasdaq listed company, from 1994 to 2007. Ms. Biagini-Komas has a Bachelor of Science degree in Accounting from San Jose State University and a Masters in Business Administration degree from Santa Clara University. She is a Certified Public Accountant. With her experience as a chief financial officer and her accounting background, Ms. Biagini Komas provides valuable insight and perspective regarding accounting and tax issues and is particularly suited to serve as the Chair of the Board’s Audit Committee. With over 20 years of human resource administration experience, Ms. Biagini-Komas is a valuable member of the Compensation Committee.

FRANK G. BISCEGLIA, age 75, became a director of the Company in 1994. Mr. Bisceglia is a Senior Vice President—Investments, Advisory and Brokerage Services, Senior Portfolio Manager, Portfolio Management Program at UBS Financial Services, Inc., a full service securities firm. Mr. Bisceglia has a Bachelor of Science degree in Industrial Management from San Jose State University. Mr. Bisceglia contributes to the Board a substantial understanding of finance and investments from over 41 years of experience as a financial advisor to corporate and high wealth individuals. As a long term member of the Board, he has a broad based understanding of the Company’s business, and, as the former Chair of the Loan Committee, he has a general knowledge of the Company’s credit administration and loan underwriting process.

BRUCE H. CABRAL, age 66, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Mr. Cabral was a director of Presidio Bank. Mr. Cabral is the former Senior Executive Vice President and Chief Credit Officer of Union Bank, in San Francisco, California. Mr. Cabral retired from Union Bank in January, 2010 after a 32 year tenure which lasted from 1977 until his retirement. Mr. Cabral brings to the Board his previous experience and knowledge of the business of Presidio Bank and his vast experience in the banking industry. He serves as Chair of the Bank’s Loan Committee.

JACK W. CONNER, age 81, became a director of the Company in 2004. Mr. Conner was elected Chairman of the Board in July, 2006. Mr. Conner was Chairman and Chief Executive Officer of Comerica California from 1991 until his retirement in 1998, and remained a director until 2002. He was President and a director of Plaza Bank of Commerce from 1979 to 1991. Prior to joining Plaza Bank of Commerce, he held various positions with Union Bank of California (formerly Union Bank) where he began his banking career in 1964. Mr. Conner has a Bachelor of Arts degree from San Jose State University. Mr. Conner contributes to the Board over 20 years of executive leadership and substantial experience in the community banking industry. Having served as a Chief Executive Officer and President at several successful community banks in the Company’s primary market, he brings a wide ranging understanding of bank management, finance, operations and strategic planning. His demonstrated leadership ability, judgment and executive experience led the Board to elect him as Chairman of the Board.

JASON DINAPOLI, age 52, was one of the founders of 1st Century Bank, N.A., a wholly owned subsidiary of 1st Century Bancshares, Inc., headquartered in Los Angeles, California. In 2008, Mr. DiNapoli assumed the role of the President and Chief Executive Officer of 1st Century Bank and President of 1st Century Bancshares, Inc. He served in this role until July 1, 2016, when 1st Century Bancshares, Inc. was acquired by Midland Financial Co., a privately held bank holding company based in Oklahoma City, Oklahoma, as a division of MidFirst Bank, a subsidiary of Midland. Mr. DiNapoli presently serves as an Executive Vice President of MidFirst Bank and President and Chief Executive Officer of the 1st Century Bank division. Before joining 1st Century Bank, Mr. DiNapoli was vice president of finance for JP DiNapoli Companies Inc., a real estate investment, development and property management organization. Prior thereto, he served as a Vice President at Union Bank of California (formerly Union Bank). Mr. DiNapoli earned a bachelor's degree from the University of California, Berkeley. He is active in numerous community organizations. Mr. DiNapoli is the son of Philip DiNapoli, a former director of the Company who retired in 2018. Mr. DiNapoli brings to the Board his extensive experience and knowledge in banking and finance and management experience in the financial industry as well as experience as a board member of a publicly traded bank holding company.

STEPHEN G. HEITEL, age 62, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Mr. Heitel is the former Chief Executive Officer and director of Presidio Bank. Prior to joining Presidio Bank in October 2008, he served as President and Chief Executive Officer of Mid-Peninsula Bank based in Palo Alto, California. Mr. Heitel served in other senior positions at Greater Bay Bancorp, including President and Chief Executive Officer of San Jose National Bank from December 2003 to November 2005, and as Executive Vice President and Chief Operating Officer of Cupertino National Bank from August 2001 to December 2003. Mr. Heitel's additional experience also includes executive roles with Bank of America including serving as head of Commercial Banking activities for the Bay Area, focused on middle market businesses. Mr. Heitel brings to the Board his understanding and knowledge of the business and personnel of Presidio Bank as well as his previous executive experience and knowledge of the community banking industry.

WALTER T. KACZMAREK, age 69, has been a director since 2005. He was appointed as President and Chief Executive Officer of Heritage Commerce Corp and Heritage Bank of Commerce on March 12, 2021. He had previously served in those positions from 2005 until his initial retirement effective August 8, 2019. Prior to joining the Company in 2005, Mr. Kaczmarek was Executive Vice President of Comerica Bank and of Plaza Bank of Commerce from 1990. Prior to joining Plaza Bank of Commerce he served in various positions with Union Bank of California (formerly Union Bank) and also The Martin Group, a real estate investment development company. Mr. Kaczmarek has a Bachelor of Science in Commerce degree from Santa Clara University, and a Masters in Business Administration degree from San Jose State University. Mr. Kaczmarek's familiarity of the Company and its business as the former President and Chief Executive Officer and broad experience in the community banking industry brings a valuable perspective to the Board. He provides the Board with an overall perspective of all facets of the Company's business, financial condition and its strategic direction.

ROBERT T. MOLES, age 66, 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 Candant Corporation, the largest franchiser of residential and commercial real estate brokerage offices in the world. Prior to joining Candant, he served as President and Chief Executive Officer of Contempo Realty, Inc. in Santa Clara, California. Mr. Moles contributes to the Board a substantial expertise in the real estate industry in the Company's primary market. With over 33 years of experience in executive and managerial positions, he brings to the Board his skills in dealing with business and financial planning and personnel management. With his background, Mr. Moles is particularly suited to serve as a member of the Compensation Committee.

LAURA RODEN, age 62, is the founder and managing director of Capital Formation Consultants LLC, an advisor to alternative asset funds including venture capital, private equity, hedge and debt funds. Prior to founding Capital Formation Consultants LLC, Ms. Roden was the managing director for The Angels' Forum (Palo Alto, CA), an early stage angel and venture capital investing group for high net worth individuals. For most of Ms. Roden's prior career she was engaged as chief financial officer at both established and emerging corporations, including most notably Chronicle Broadcasting Company (San Francisco, CA) and PowerTV,

Inc. (acquired by Cisco Corporation, San Jose, CA). Ms. Roden has expertise in general management, finance, fundraising and marketing. Ms. Roden has taught courses on finance at San Jose State University, and is a frequent speaker for angel investment and venture capital groups and associations. Ms. Roden has a Bachelor of Arts degree from Harvard College and Masters in Business Administration degree from Harvard Business School. Ms. Roden has extensive management experience in a full range of business operations, strategic planning, marketing strategies and capital formation for entrepreneurial companies in the technology industry. In addition, with her prior experience as a chief financial officer, she is particularly suited to serve as Chair of the Board's Strategic Initiatives and Finance and Investment Committee, and serve as a member of the Audit Committee.

MARINA PARK SUTTON, age 64, became a director of the Company in October, 2019 when the Company acquired Presidio Bank. Ms. Park Sutton was a director of Presidio Bank. Ms. Park Sutton is Chief Executive Officer of Girl Scouts of Northern California, which serves 19 counties in Northern California with almost 40,000 girls and 28,000 adults taking part in programs each year. Prior to joining Girl Scouts of Northern California in 2007, Ms. Park Sutton held a variety of progressively more senior positions at Pillsbury Winthrop Shaw Pittman LLP, an international law firm. The Board benefits from Ms. Park Sutton's experience as a director and member of the audit, corporate governance and compensation committees at Presidio Bank, as well as her valuable general business insight and legal experience. With her background she is suited to serve as the Chair of the Compensation Committee, and as a member of the Audit Committee and Nominating and Corporate Governance Committee.

RANSON W. WEBSTER, age 76, became a director of the Company in 2004. Mr. Webster founded Computing Resources, Inc. ("CRI") in 1978, a privately held general purpose data processing service bureau specializing in payroll processing for small business nationwide. He served as CRI's Chief Executive Officer and Chief Financial Officer. In 1999, CRI merged with Intuit, Inc., the maker of QuickBooks and Quicken financial software. In 1998, Mr. Webster founded Evergreen Capital, LLC, an early stage investment company focused on Internet and biotech companies. In 2012, Mr. Webster became the Chief Executive Officer for Chargerback, Inc. a cloud based startup company dedicated to automating the lost and found process at hotels, airlines, rental car companies and other public spaces. Mr. Webster contributes to the Board substantial business acumen, executive strategic planning and financial experience developed through years of proven entrepreneurial success. Mr. Webster has a unique perspective of the Company from his long standing service on the Board. He has a general understanding of corporate governance principles as Chairman of the Board's Nominating and Corporate Governance Committee.

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 PROPOSAL ON EXECUTIVE COMPENSATION

The Dodd-Frank Act requires, among other things, that we permit a non-binding, advisory vote on the 2020 compensation of our named executive officers, as described in the Compensation Discussion and Analysis, compensation tables and accompanying narrative discussion contained in this proxy statement.

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

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

“RESOLVED, that the shareholders approve the 2020 compensation of our named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosures required by Item 402 of Regulation S-K contained in the proxy statement.”

As discussed in the Compensation Discussion and Analysis contained in this proxy statement, the Compensation Committee of the Board of Directors believes that the executive compensation for 2020 was reasonable and appropriate, and was the result of a carefully considered approach.

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

Recommendation of the Board of Directors

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

PROPOSAL 3—RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors, upon the recommendation of its Audit Committee, has ratified the selection of Crowe LLP to serve as our independent registered public accounting firm for 2021, subject to ratification by our shareholders. A representative of Crowe LLP will be present at the Annual Meeting to answer questions and will have the opportunity to make a statement if so desired.

We are asking our shareholders to ratify the selection of Crowe LLP as our independent registered public accounting firm. Although ratification is not required by our Bylaws, the SEC or the Nasdaq Stock Market, the Board is submitting the selection of Crowe LLP to our shareholders for ratification because we value our shareholders' views on the Company's independent registered public accounting firm and as a matter of good corporate practice. In the event that our shareholders fail to ratify the selection of Crowe LLP, however, we reserve the discretion to retain Crowe LLP as our independent registered public accounting firm for 2021. 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 2020, the Committee met 10 times. The Committee discussed the interim financial information contained in each quarterly earnings announcement with the Chief Financial Officer prior to public release. The Committee also discussed the interim financial statements with the Chief Financial Officer and the independent auditors prior, with and without management present, to the filing of each quarterly Form 10-Q and the annual report on Form 10-K.

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

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

The Committee reviewed the audited financial statements of the Company as of and for the year ended December 31, 2020, with management and the independent auditors. The Committee has also reviewed "Management's Assessment over Financial Reporting" and the independent registered public accounting firm's opinion on the effectiveness of the Company's internal control over financial reporting, and discussed these reports and opinions with management and the independent registered public accounting firm prior to the Company's filing of its Annual Report on Form 10-K for the year ended December 31, 2020.

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, 2020, for filing with the SEC.

Heritage Commerce Corp
Audit Committee

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

March 4, 2021

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:

<u>Category of Services</u>	<u>Fiscal Year 2020</u>	<u>Fiscal Year 2019</u>
Audit fees(1)	\$655,100	\$ 625,000
Audit related fees(2)	48,000	162,500
Tax fees(3)	205,450	128,250
All other fees(4)	10,000	97,500
Total accounting fees	<u>\$918,550</u>	<u>\$1,013,250</u>

- (1) Fees for audit services for 2020 and 2019 consisted of the audit of the Company’s annual financial statements, review of the consolidated financial statements included in the Company’s Quarterly Reports on Form 10-Q, and the audit of the Company’s internal control over financial reporting as required by Section 404 of the Sarbanes Oxley Act of 2002.
- (2) Fees for audit related services for 2020 and 2019 consisted of financial accounting and reporting consultations, consents and other services related to SEC matters, and audits of the consolidated financial statements of the Company’s employee benefit plans.
- (3) Fees for tax services for 2020 and 2019 consisted of tax compliance and tax planning and advice.
 - Fees for tax compliance services totaled \$145,450 and \$58,000 in 2020 and 2019, respectively. Tax compliance services are those rendered based upon facts already in existence or transactions that have already occurred to document, compute, and obtain government approval for amounts to be included in tax filings. Such services consisted primarily of preparation of the Company’s consolidated federal and state income tax returns, trust preferred returns and a limited liability company tax return for a subsidiary entity.
 - Tax planning and advice services are those rendered with respect to proposed transactions, assistance regarding the Internal Revenue Code Section 280(G) “excise tax gross up” disclosures in the proxy statement for hypothetical events, and consultation with management regarding various internal control and accounting matters. Tax planning and advice services totaled \$60,000 and \$70,250 in 2020 and 2019, respectively.
- (4) All other fees consisted primarily of consulting services for the Company’s strategic objectives merger and acquisitions, and other discussions.

The ratio of tax planning and advice fees and all other fees to audit fees, audit related fees and tax compliance fees was 8.25% for 2020 and 19.84% for 2019.

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

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

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

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

Recommendation of the Audit Committee and the Board of Directors

The Audit Committee of the Board of Directors and the Board of Directors recommends approval of the ratification of the appointment of Crowe LLP as the Company's independent registered public accounting firm for the year ending December 31, 2021. The proxy holders intend to vote all proxies they hold in favor of the proposal. If no instruction is given, the proxy holders intend to vote FOR approval of the proposal.

OTHER BUSINESS

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

SHAREHOLDER PROPOSALS

Any shareholder that intends to propose business to be considered at the 2022 Annual Meeting must comply with the Company's Bylaws including providing the required notice to the Company's Corporate Secretary not later than the close of business on February 27, 2022 nor earlier than January 28, 2022. If a shareholder gives notice of such a proposal before or after these deadlines, proxy holders will be allowed to use their discretionary voting authority to vote against the shareholder proposal without discussion when and if the proposal is raised at the 2022 Annual Meeting of Shareholders.

Proposals of shareholders intended to be presented for consideration at the 2022 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 15, 2021, in a form that complies with applicable regulations.

HERITAGE COMMERCE CORP



Deborah Reuter
Executive Vice President
and Corporate Secretary

April 15, 2021
San Jose, California

HERITAGE COMMERCE CORP

2020 Annual Report on Form 10-K

Annual Report

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

FORM 10-K

(MARK ONE)

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

or the fiscal year ended December 31, 2020

OR

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

FOR THE TRANSITION PERIOD FROM TO
Commission file number 000-23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

California
*(State or Other Jurisdiction of
Incorporation or Organization)*

77-0469558
*(I.R.S. Employer
Identification Number)*

**224 Airport Parkway
San Jose, California 95110**
(Address of Principal Executive Offices including Zip Code)

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

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

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

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

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C.7262(b)) by the registered public accounting firm that prepared or issued its audit report

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

The aggregate market value of the common stock held by non-affiliates of the Registrant as of June 30, 2020, based upon the closing price on that date of \$7.51 per share as reported on the NASDAQ Global Select Market, and 47,177,689 shares held, was approximately \$354.3 million.

As of February 10, 2021, there were 59,919,957 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 2021 Annual Meeting of Shareholders to be held on May 20, 2021 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, 2020.

HERITAGE COMMERCE CORP
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FOR YEAR ENDED DECEMBER 31, 2020

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Cautionary Note Regarding Forward-Looking Statements

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

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

- the effect of the COVID-19 pandemic, and other infectious illness outbreaks that may arise in the future, on our customers, employees, businesses, liquidity, financial results and overall condition and which has created significant uncertainties in U.S. and global markets, including our customers' ability to make timely payments on obligations, and operating expense due to alternative approaches to doing business;
- current and future economic and market conditions in the United States generally or in the communities we serve, including the effects of declines in property values and overall slowdowns in economic growth should these events occur;
- effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;
- our ability to anticipate interest rate changes and manage interest rate risk;
- changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources;
- volatility in credit and equity markets and its effect on the global economy;
- our ability to effectively compete with other banks and financial services companies and the effects of competition in the financial services industry on our business;
- our ability to achieve loan growth and attract deposits;
- risks associated with concentrations in real estate related loans;
- the relative strength or weakness of the commercial and real estate markets where our borrowers are located, including related asset and market prices;
- credit related impairment charges to our securities portfolio;
- changes in the level of nonperforming assets and charge offs and other credit quality measures, and their impact on the adequacy of our allowance for credit losses and our provision for credit losses;
- increased capital requirements for our continual growth or as imposed by banking regulators, which may require us to raise capital at a time when capital is not available on favorable terms or at all;

- regulatory limits on Heritage Bank of Commerce’s ability to pay dividends to the Company;
- changes in our capital management policies, including those regarding business combinations, dividends, and share repurchases;
- operational issues stemming from, and/or capital spending necessitated by, the potential need to adapt to industry changes in information technology systems, on which we are highly dependent;
- our inability to attract, recruit, and retain qualified officers and other personnel could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, results of operations and growth prospects;
- possible adjustment of the valuation of our deferred tax assets;
- our ability to keep pace with technological changes, including our ability to identify and address cyber-security risks such as data security breaches, “denial of service” attacks, “hacking” and identity theft;
- inability of our framework to manage risks associated with our business, including operational risk and credit risk;
- risks of loss of funding of Small Business Administration (“SBA”) or SBA loan programs, or changes in those programs;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Act and others relating to banking, consumer protection, securities, accounting and tax matters;
- significant changes in applicable laws and regulations, including those concerning taxes, banking and securities;
- effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- costs and effects of legal and regulatory developments, including resolution of regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;
- the expense and uncertain resolution of litigation matters whether occurring in the ordinary course of business or otherwise;
- availability of and competition for acquisition opportunities;
- risks resulting from domestic terrorism;
- risks resulting from social unrest and protests;
- risks of natural disasters (including earthquakes) and other events beyond our control;
- changes in governmental policy and regulation, including measures taken in response to economic, business, political and social conditions, such as the SBA Paycheck Protection Program (“PPP”), the Federal Reserve Board's efforts to provide liquidity to the financial system and provide credit to private commercial and municipal borrowers, and other programs designed to address the effects of the COVID-19 pandemic;
- our participation as a lender in the PPP and similar programs and its effect on our liquidity, financial results, businesses and customers, including the availability of program funds and the ability of customers to comply with requirements and otherwise perform with respect to loans obtained under such programs;
- our success in managing the risks involved in the foregoing factors.

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

PART I

ITEM 1 — BUSINESS

General

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

Heritage Bank of Commerce is a multi-community independent bank that offers a full range of commercial banking services to small and medium-sized businesses and their owners, managers and employees. We operate through 17 full service branch offices located entirely in the general San Francisco Bay Area of California in the counties of Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara. Our market includes the headquarters of a number of technology based companies in the region commonly known as “Silicon Valley.”

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

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

Our principal executive office is located at 224 Airport Parkway, San Jose, California 95110, telephone number: (408) 947-6900.

At December 31, 2020, we had consolidated assets of \$4.63 billion, deposits of \$3.91 billion and shareholders’ equity of \$577.9 million.

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

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

Presidio Bank Merger

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

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

Tri-Valley Bank and United American Bank Mergers

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

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

Heritage Bank of Commerce

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

San Jose:	Administrative Office Main Branch 224 Airport Parkway Suite 100 San Jose, CA 95110	Los Altos:	Branch Office 419 South San Antonio Road Los Altos, CA 94022
Danville:.	Branch Office 387 Diablo Road Danville, CA 94526	Los Gatos:	Branch Office 15575 Los Gatos Boulevard Building B Los Gatos, CA 95032
Fremont:.	Branch Office 3137 Stevenson Boulevard Fremont, CA 94538	Morgan Hill: . . .	Branch Office 18625 Sutter Boulevard Suite 100 Morgan Hill, CA 95037
Gilroy:	Branch Office 7598 Monterey Street Suite 110 Gilroy, CA 95020	Palo Alto:.	Branch Office 325 Lytton Avenue Suite 100 Palo Alto, CA 94301
Hollister:	Branch Office 351 Tres Pinos Road Suite 102A Hollister, CA 95023	Pleasanton:.	Branch Office 300 Main Street Pleasanton, CA 94566
Livermore.	Branch Office 1987 First Street Livermore, CA 94550	Redwood City:. .	Branch Office 2400 Broadway Suite 100 Redwood City, CA 94063

San Francisco: . . .	Branch Office 120 Kearny Street Suite 2300 San Francisco, CA 94108	Walnut Creek: . . .	Branch Office 1990 N. California Boulevard Suite 100 Walnut Creek, CA 94596
San Mateo:	Branch Office 400 S. El Camino Real Suite 150 San Mateo, CA 94402	Walnut Creek: . . .	Loan Production Office 101 Ygnacio Valley Road Suite 108 Walnut Creek, CA 94596
San Rafael:	Branch Office 999 5th Avenue Suite 100 San Rafael, CA 94901	Bay View Funding:	Administrative Office 224 Airport Parkway Suite 200 San Jose, CA 95110
Sunnyvale:	Branch Office 333 W. El Camino Real Suite 150 Sunnyvale, CA 94087		

Lending Activities

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

As of December 31, 2020, the percentage of our total loans for each of the principal areas in which we directed our lending activities were as follows: (i) commercial and industrial loans 32% (including SBA loans, PPP loans, asset-based lending, and factored receivables); (ii) commercial real estate loans 48%; (iii) land and construction loans 6%; (iv) residential mortgage loans 3%; and (v) consumer and other loans (including home equity and multifamily loans) 11%. While no specific industry concentration is considered significant, our lending operations are located in market areas dependent on technology and real estate industries and their supporting companies.

Commercial and Industrial Loans. Our commercial loan portfolio is comprised of operating secured and unsecured loans advanced for working capital, equipment purchases and other business purposes. Generally short-term loans have maturities ranging from thirty days to one year, and “term loans” have maturities ranging from one to five years. Short-term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans generally provide for floating or fixed interest rates, with monthly payments of both principal and interest. Repayment of secured and unsecured commercial loans depends substantially on the borrower’s underlying business, financial condition and cash flows, as well as the sufficiency of the collateral. Compared to real estate, the collateral may be more difficult to monitor, evaluate and sell. It may also depreciate more rapidly than real estate. Such risks can be significantly affected by economic conditions. In addition, the Company had \$290.7 million of PPP loans at December 31, 2020.

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

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

Commercial Real Estate Loans. The commercial real estate (“CRE”) loan portfolio is comprised of loans secured by commercial real estate. Commercial real estate loans comprise two segments differentiated by owner occupied commercial real estate and non-owner commercial real estate. Owner occupied commercial real estate loans are secured by commercial properties that are at least 50% occupied by the borrower or borrower affiliate. Non-owner occupied commercial real estate loans are secured by commercial properties that are less than 50% occupied by the borrower or borrower affiliate. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. These loans are generally advanced based on the borrower’s cash flow, and the underlying collateral provides a secondary source of payment. HBC generally restricts real estate term loans to no more than 75% of the property’s appraised value or the purchase price of the property, depending on the type of property and its utilization. HBC offers both fixed and floating rate loans. Maturities on such loans are generally restricted to between five and ten years (with amortization ranging from fifteen to twenty-five years and a balloon payment due at maturity); however, SBA and certain real estate loans that can be sold in the secondary market may be advanced for longer maturities. CRE loans typically involve large balances to single borrowers or groups of related borrowers. Since payments on these loans are often dependent on the successful operation or management of the properties, as well as the business and financial condition of the borrower, repayment of such loans may be subject to adverse conditions in the real estate market, adverse economic conditions or changes in applicable government regulations. If the cash flow from the project decreases, or if leases are not obtained or renewed, the borrower’s ability to repay the loan may be impaired.

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

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

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

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

Multifamily Loans. Multifamily loans are loans on residential properties with five or more units. These loans rely primarily on the cash flows of the properties securing the loan for repayment and secondarily on the value of the properties securing the loan. The cash flows of these borrowers can fluctuate along with the values of the underlying property depending on general economic conditions.

Residential Mortgage Loans. From time to time the Company has purchased single family residential mortgage loans. There were no purchases of residential mortgage loans during the years ended December 31, 2020, 2019 and 2018. Residential mortgage loans outstanding at December 31, 2020 totaled \$85.1 million, which included \$33.4 million of purchased residential mortgage loans, and \$12.9 million of residential mortgage loans from United American. HBC does not originate first trust deed home mortgage loans or home improvement loans, other than HELOCS.

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

Deposit Products

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

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

Electronic Banking

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

HBC offers multiple electronic banking options to its customers. It does not allow the origination of deposit accounts through online banking. All of HBC's electronic banking services allow customers to review transactions and statements, review images of paid items, transfer funds between accounts at HBC, place stop orders, pay bills and export to various business and personal software applications. HBC online commercial banking also allows customers to initiate domestic wire transfers and ACH transactions, with the added security and functionality of assigning discrete access and levels of security to different employees of the client and division of functions to allow separation of duties, such as input and release.

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

Other Banking Services

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

Investments

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

Sources of Funds

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

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

On May 26, 2017, the Company completed an underwritten public offering of \$40,000,000 aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month London Inter-Bank Offered Rate ("LIBOR") plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium. It is anticipated that the LIBOR index for new contracts will cease by December 31, 2021. However the LIBOR index will continue to be published through June 30, 2023, and it is anticipated that the Subordinated Debt will remain under this LIBOR index until this time. The Federal Reserve Bank of New York has established the Secured Overnight Financing Rate ("SOFR") as its recommended alternative to LIBOR, but until the alternative rate is instituted, the SOFR fallback rate is not definitive. We have created a sub-committee of our Asset Liability Management Committee to address LIBOR transition and phase-out issues. We are currently reviewing loan documentation, technology systems and procedures we will need to implement for the transition.

Correspondent Banks

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

Competition

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

With respect to commercial bank competitors, the business is dominated by a relatively small number of major banks that operate a large number of offices within our geographic footprint. For the combined Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara county region, the seven counties within which the Company operates, the top three institutions are all multi-billion dollar entities with an aggregate of 424 offices that control a combined 59.93% of deposit market share based on June 30, 2020 FDIC market share data. HBC ranks sixteenth with 0.57% share of total deposits based on June 30, 2020 market share data. Larger institutions have, among other advantages, the ability to finance wide-ranging advertising campaigns and to allocate their resources to regions of highest yield and demand. Larger banks are seeking to expand lending to small businesses, which are traditionally community bank customers. They can also offer certain services that we do not offer directly, but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, these banks also have substantially higher lending limits than we do. For customers whose needs exceed our legal lending limit, we arrange for the sale, or "participation," of some of the balances to financial institutions that are not within our geographic footprint.

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

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

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

Human Capital

We strive to hire, develop and promote a workforce that shares our mission and values and cultivates a culture of team work, diversity and inclusion that will meet the expectations of our customers, markets and communities. To foster these goals and to attract and retain quality employees we aim to ensure an inclusive, safe and healthy workplace, and to provide our employees with competitive and comprehensive compensation, professional development opportunities and robust health and welfare programs.

Employee Profile

We seek employees from a wide range of backgrounds and experiences for positions through-out our Company with the skills and experience necessary for the success of our business banking model. We are committed to a diverse and inclusive workplace and we have developed a formalized Affirmative Action Plan to meet these objectives. We employed 318 full time and 17 part time employees as of December 31, 2020. We had 331 full time equivalent employees at December 31, 2020, and 357 at December 31, 2019, and 302 at December 31, 2018. The average tenure of all employees, including employees that joined through acquisitions, is eight years.

Compensation

Our compensation philosophy is driven by our objective to attract and retain the premier talent needed to lead our Company in an extremely competitive environment and to strongly align the interests of our employees with those of our shareholders for the long term. Our employee compensation is aligned with our overall business strategy, with a focus on driving growth, profitability and long-term value for our shareholders. Our compensation philosophy encompasses a broad program and includes competitive base salaries, annual bonus opportunities, and Company matched 401(k) Plan contributions. We also provide equity awards throughout our workforce.

Health and Safety

The health and safety of our employees is paramount and the Company's success is fundamentally connected with the well-being of our team members. All full time employees are offered partially subsidized health and medical insurance coverage, paid vacation time, paid sick leave, paid bereavement leave, standard maternity and medical leave policies and Company subsidized health club membership.

We are and have been taking proactive steps to protect employees during the current COVID-19 outbreak. We believe we have been able to operate effectively to service our customers and at the same time maintain the safety of all employees within the workplace. We have identified high risk groups, limited travel, implemented enhanced sanitary procedures at Bank locations, required masks, enforced social distancing, expanded remote working capabilities and access, and have implemented specific procedures for handling any instances of COVID-19 exposure in the workplace in accordance with local health department directives.

Employee Development and Opportunity

Employee development is a critical focus for the Bank to ensure team members have long term success within the organization. We have established standard review processes for all team members that include employee feedback, performance assessment and development goals for all positions. Additionally, we provide an education reimbursement program and we may assist employees on a case by case basis with associated education costs, additional education and development programs relevant to their contribution and success at the Bank. We have a hire from within first policy and the Company looks first to internal candidates to fill open positions.

Supervision and Regulation

General

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

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

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

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

Financial Regulatory Reform

Legislation and regulations enacted and implemented since 2008 in response to the U.S. economic downturn and financial industry instability continue to impact most institutions in the banking sector. Most of the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), which was enacted in 2010, are now effective and have been fully implemented, but a few are still subject to rulemaking. Many provisions of Dodd-Frank have affected our operations and expenses, including but not limited to changes in FDIC assessments, the permitted payment of interest on demand deposits, and enhanced compliance requirements. Some of the rules and regulations promulgated or yet to be promulgated under Dodd-Frank will apply directly only to institutions much larger than ours, but could indirectly impact smaller banks, either due to competitive influences or because certain required practices for

larger institutions may subsequently become expected “best practices” for smaller institutions. We could see continued attention and resources devoted by the Company to ensure compliance with the statutory and regulatory requirements engendered by Dodd-Frank.

Regulatory Capital Requirements

The Company and HBC are subject to the comprehensive capital framework adopted by the federal banking agencies for U.S. banking organizations known as the Basel III Capital Rules. The Basel III Capital Rules are risk-based, meaning that they provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization’s operations, both for transactions reported on the balance sheet as assets and for transactions, such as letters of credit and recourse arrangements, that are recorded as off-balance sheet items.

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

The Basel III Capital Rules also introduced a “capital conservation buffer,” composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer was phased in over a three-year period until it reached 2.5% on January 1, 2019. As of January 1, 2019, the Company and HBC must maintain the following fully phased-in minimum capital ratios:

- 4.0% Tier 1 leverage ratio;
- 4.5% CET1 to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%;
- 6.0% Tier 1 capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum Tier 1 capital ratio of at least 8.5%; and
- 8.0% total capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum total capital ratio of at least 10.5%.

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

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

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

As of December 31, 2020, the Company's and HBC's capital ratios exceeded the minimum capital adequacy guideline percentage requirements of the federal banking agencies for "well capitalized" institutions under the Basel III Capital Rules on a fully phased-in basis.

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

On September 17, 2019, the federal bank regulatory agencies adopted a final rule that provides certain community banking organizations the ability to opt into a new community bank leverage ratio ("CBLR") intended to simplify regulatory capital requirements. Starting on January 1, 2020, community banking organizations with less than \$10 billion in total consolidated assets may elect the new community banking leverage framework if they have a CBLR of greater than 8% in 2020, 8.5% in 2021, and 9% beginning on January 1, 2022, and hold 25 percent or less of assets in off-balance sheet exposures and 5 percent or less of assets in trading assets and liabilities. The CBLR is determined by dividing a banking organization's tangible equity capital by its average total consolidated assets. Upon the opt-in to the community banking leverage framework, a qualifying community banking organization would not be subject to other risk-based and capital leverage requirements (including the Basel III and Basel IV requirements) and would be considered to have met the well capitalized ratio requirements. The Company determined not to opt in to the community banking leverage framework as of January 1, 2020.

Prompt Corrective Action

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

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

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

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

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

The capital classification of a bank holding company and a bank affects the frequency of regulatory examinations, the bank holding company’s and the bank’s ability to engage in certain activities and the deposit insurance premium paid by the bank. As of December 31, 2020, we met the requirements to be “well-capitalized” based upon the aforementioned ratios for purposes of the PCA regulations, as currently in effect.

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

Heritage Commerce Corp

General. As a bank holding company, HCC is subject to regulation and supervision by the Federal Reserve under the Bank Holding Company Act of 1956, as amended, or the BHCA. Under the BHCA, HCC is subject to periodic examination by the Federal Reserve. HCC is required to file with the Federal Reserve periodic reports of its operations and such additional information as the Federal Reserve may require. In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, HCC is legally obligated to act as a source of financial strength to HBC and to commit resources to support HBC in circumstances where HCC might not otherwise do so.

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

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

principal shareholders regarding transactions in HCC's common stock and short swing profits rules promulgated by the SEC under Section 16 of the Exchange Act, and certain additional reporting requirements by principal shareholders of HCC promulgated by the SEC under Section 13 of the Exchange Act.

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

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

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

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

Source of Strength Doctrine. Federal Reserve policy historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement HCC is expected to commit resources to support HBC, including at times when HCC may not be in a financial position to do so. HCC must stand ready to use its available resources to provide adequate capital to the subsidiary bank during periods of financial stress or adversity. HCC must also maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting HBC. HCC's failure to meet its source of strength obligations may constitute an unsafe and unsound practice or a violation of the Federal Reserve's regulations or both. The source of strength doctrine most directly affects bank holding companies where a bank holding company's subsidiary bank fails to maintain adequate capital levels. In such a situation, the subsidiary bank will be required by the bank's federal regulator to take "prompt corrective action." Any capital loans by a bank holding company to HBC are subordinate in right of payment to deposits and to certain other indebtedness of HBC. The BHCA provides that in the event of HCC's bankruptcy any commitment by a bank holding company to a federal bank regulatory agency to maintain the capital of its subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Dividend Payments, Stock Redemptions and Repurchases. HCC's ability to pay dividends to its shareholders is affected by both general corporate law considerations and the policies of the Federal Reserve applicable to bank holding companies. As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to shareholders if: (i) the bank holding company's net income

available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the bank holding company's capital needs and overall current and prospective financial condition; or (iii) the bank holding company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. If HCC's fails to adhere to these policies, the Federal Reserve could find that HCC is operating in an unsafe and unsound manner. In addition, under the Basel III Rule, institutions that seek to pay dividends must maintain 2.5% in CET1 attributable to the capital conservation buffer. See "Supervision and Regulation—Regulatory Capital Requirements" above.

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

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

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

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

Federal law also prohibits any person or company from acquiring "control" of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. On January 30, 2020, the Federal Reserve finalized regulations revising the rules for determining control of a banking organization under the BHCA

and adopted a tiered framework of presumptions where the level of voting share ownership is assessed in combination with relationship-based factors to determine whether “control” exists. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company, but may arise under certain circumstances between 5% and 24.99% ownership.

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

Heritage Bank of Commerce

General. HBC is a California state-chartered commercial bank that is a member of the Federal Reserve System and whose deposits are insured by the FDIC. HBC is subject to regulation, supervision, and regular examination by the DFPI and the Federal Reserve Bank as HBC’s primary federal regulator. The regulations of these agencies govern most aspects of a bank’s business.

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

HBC is a member of the 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. As of December 31, 2020, HBC was in compliance with the FHLB’s stock ownership requirement. FHLB stock is carried at cost and classified as a restricted security. Both cash and stock dividends are reported as income.

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

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

Brokered Deposit Restrictions. Well capitalized institutions are not subject to limitations on brokered deposits, while an adequately capitalized institution is able to accept, renew or roll over brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are generally not permitted to accept, renew, or roll over brokered deposits. As of December 31, 2020, HBC was eligible to accept brokered deposits without limitations.

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

Tie in Arrangements. Federal law prohibits a bank holding company and any subsidiary banks from engaging in certain tie in arrangements in connection with the extension of credit. For example, HBC may not extend credit, lease or sell property, furnish any services, fix or vary the consideration for any of the foregoing on the condition that: (i) the

customer must obtain or provide some additional credit, property or services from or to HBC other than a loan, discount, deposit or trust services; (ii) the customer must obtain or provide some additional credit, property or service from or to HCC or HBC; or (iii) the customer must not obtain some other credit, property or services from competitors, except reasonable requirements to assure soundness of credit extended.

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

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

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

Supervisory Assessments. California-chartered banks are required to pay supervisory assessments to the DFPI to fund its operations. The amount of the assessment paid by a California bank to the DFPI is calculated on the basis of the institution’s total assets, including consolidated subsidiaries, as reported to the DFPI. During the year ended December 31, 2020, HBC paid supervisory assessments to the DFPI totaling \$261,000.

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

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

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. In addition, in order to pay a dividend, the Basel III Capitals generally require that a financial institution must maintain over a 2.5% in CET1 attributable to the Capital Conservation Buffer. See “—Regulatory Capital Requirements” above. As described above, HBC exceeded its minimum capital requirements under applicable regulatory guidelines as of December 31, 2020.

Transactions with Affiliates. Transactions between depository institutions and their affiliates, including transactions between HBC and HCC, are governed by Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve’s Regulation W promulgated thereunder. Generally, Section 23A limits the extent to which a depository institution and its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of the depository institution’s capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates of an amount equal to 20% of the depository institution’s capital stock and surplus. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, acceptances or letters of credit issued on behalf

of, an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or at least as favorable to the depository institution and its subsidiaries, as those for similar transactions with non-affiliates.

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

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

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

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

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

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

The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance based evaluation system. The current 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.

The federal banking agencies have expressed support for modernizing the CRA regulatory framework. In December 2019, the FDIC and the OCC issued a joint proposed rule clarifying what qualifies for credit under the CRA, updating the definition of a small business loan and creating an additional definition of "assessment area" tied to where deposits are located, partly to address changes that have occurred due to the rise in digital banking. While the OCC has finalized its amended regulations in May 2020, the FDIC has not yet done so, and it remains unclear whether and to what extent any changes will be made to the applicable CRA requirements.

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

Treasury's Office of Foreign Assets Control ("OFAC"), administers and enforces economic and trade sanctions against targeted foreign countries and regimes under authority of various laws, including designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. Financial institutions are responsible for, among other things, blocking accounts of and transactions with such targets and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked transactions after their occurrence. Banking regulators examine banks for compliance with the economic sanctions regulations administered by OFAC and failure of a financial institution to maintain and implement adequate OFAC programs, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Concentrations in Commercial Real Estate. Concentration risk exists when financial institutions deploy too many assets to any one industry or segment. Concentration stemming from commercial real estate is one area of regulatory concern. The Commercial Real Estate Concentration Guidance provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Concentration Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. As of December 31, 2020, using regulatory definitions in the CRE Concentration Guidance, our CRE loans represented 245% of HBC total risk-based capital, as compared to 282%

as of December 31, 2019. If the regulatory agencies become concerned about our CRE loan concentrations, it could limit our ability to grow by restricting its approvals for the establishment or acquisition of branches, or approvals of mergers or other acquisition opportunities.

Consumer Financial Services. We are subject to a number of federal and state consumer protection laws that extensively govern our relationship with our customers. These laws include, among others, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, the Military Lending Act, and these laws' respective state law counterparts, as well as state usury laws and laws regarding unfair, deceptive or abusive acts and practices ("UDAAP"). These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit UDAAP practices, restrict our ability to raise interest rates and subject us to substantial regulatory oversight. Many states and local jurisdictions have consumer protection laws analogous to those listed above.

Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys' fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, and civil money penalties. Failure to comply with consumer protection requirements may also result in our failure to obtain any required bank regulatory approval for merger or acquisition transactions we may wish to pursue or our prohibition from engaging in such transactions even if approval is not required.

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

Under the newly adopted California Consumer Financial Protection Law (the "CCFPL") that went into effect on January 1, 2021, the DFPI is given broad jurisdiction and sweeping new authorities that closely resemble those of the CFPB. The DFPI stated that it intends to exercise its powers to protect consumers from unlawful, unfair, deceptive, and abusive practices in connection with consumer financial products or services. The DFPI also as a matter of state law can now enforce the Dodd-Frank Act's UDAAP provisions against any person offering or providing consumer financial products in the state of California. While financial institutions licensed under federal or another state law, such as banks, are excluded from the scope of the CCFPL, financial institutions in California are likely to be faced with a powerful state financial services regulatory regime with expansive enforcement authority and it is unclear how the DFPI and its broad enforcement activities will affect us going forward.

Mortgage and Mortgage-Related Products. Because abuses in connection with home mortgages were a significant factor contributing to the financial crisis of 2008, many new rules issued by the CFPB and required by the Dodd-Frank Act address mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages."

Ability-to-Repay Requirement and Qualified Mortgage Rules. The CFPB administers regulations implementing the Dodd-Frank Act's ability-to-repay/qualified mortgage requirements ("ATR/QM Rule"), which require lenders to make a reasonable good faith determination of a consumer's ability to repay a mortgage loan based on verified borrower financial information and provide certain protections from liability for residential mortgage loans that meet the ATR/QM Rule's requirements for "qualified mortgages." On December 10, 2020, the CFPB issued two final rules amending the ATR/QM

Rule that are scheduled to have a mandatory compliance date of July 1, 2021. The principal purpose of these final rules is to avoid anticipated problems concerning mortgage credit availability following the scheduled expiration on July 1, 2021 of the temporary category of qualified mortgages (known as government sponsored enterprises qualified mortgages or “GSE QM”) that are eligible for purchase by Fannie Mae or Freddie Mac while they operate under federal conservatorship or receivership.

The first final rule is set to eliminate the GSE QM category and to replace the existing 43% debt-to-income ratio limit with price-based thresholds and remove the Appendix Q national underwriting standards as well as any requirement to use them. The price-based threshold provides that the loan’s annual percentage rate not exceed the average prime offer rate for a comparable transaction by 2.25 percentage points or more as of the date the interest rate is set (with higher thresholds provided for smaller loans and subordinate-lien loans). Under this final rule, instead of the debt-to-income ratio limit, the creditor must instead meet “consider and verify” loan underwriting requirements, by considering the consumer’s current or reasonably expected income or assets other than the value of the subject dwelling, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income in order to assess the consumer’s ability to repay the mortgage loan, and verify this information using third-party records that provide reasonably reliable evidence to support accuracy.

The second final rule creates a new category of qualified mortgages – “seasoned qualified mortgage.” It allows non-qualified mortgages and higher-priced qualified mortgages to acquire safe harbor protection from liability under the ATR/QM Rule following their origination based on specified performance and portfolio requirements.

Pandemic Protections. To alleviate economic hardships brought on by the COVID-19 pandemic, the CARES Act included certain components that impact consumer rights and obligations, such as a foreclosure moratorium, right to forbearance, and consumer credit protection. Specifically, the CARES Act prohibits foreclosures on all federally-backed mortgage loans for a period of time, provides forbearance of up to 180 days (which may be extended by up to another 180 days) for borrowers who suffer a financial hardship due to COVID-19, and requires that any accounts in forbearance be reported to the credit bureau reporting agencies as current or as the status reported prior to receiving forbearance. In addition, state governments have instituted additional protections for consumers and businesses affected by the pandemic, including by halting residential and commercial evictions and instituting a moratorium on residential and commercial foreclosures and related evictions.

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

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

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

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

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

The CFPB has recently announced its intention to embark on rulemaking about consumer control over their financial data. California is also actively enacting legislation relating to data privacy and data protection, such as the California Consumer Privacy Act (“CCPA”), which went into effect on January 1, 2020. The CCPA granted California consumers robust data privacy rights and control over their personal information, including the right to know, the right to delete, and the right to opt-out of the sale of their personal information. The CCPA was recently further expanded by the California Privacy Rights Act of 2020 (“CPRA”), which provides additional privacy rights to California residents and creates a new agency tasked with implementing regulations and conducting investigations and enforcement actions. The CPRA is set to become effective on January 1, 2023.

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

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

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

Impact of Monetary Policy. The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

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

Further Legislative and Regulatory Initiatives. Federal and state legislators as well as regulatory agencies may introduce or enact new laws or rules, or amend existing laws and rules, which may affect the regulation of financial institutions and their holding companies. In addition, some of the financial laws and regulations aiming to ease regulatory and compliance burden on financial institutions that were adopted during the last presidential administration could be repealed or eliminated going forward. The impact of any future legislative or regulatory changes cannot be predicted, but they could affect the Company and HBC's business and operations.

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.

Summary of Risk Factors

Risks Related to Our Business

- Unfavorable general business, economic and market conditions
- Adverse impact of the COVID-19 pandemic
- Participation in SBA Paycheck Protection Program
- Changes in U.S. trade policy, impositions of tariffs and retaliatory tariffs
- Fluctuations in interest rates
- Losses on our securities portfolio, particularly from increases in interest rates
- Liquidity risks
- Competition for customer deposits
- Failure to successfully manage credit risks
- Uncertainty relating to LIBOR calculation process

Risks Related to Our Loans

- Negative changes in the economy affecting real estate values and liquidity
- Risks involved with construction and land development loans
- Failure to follow supervisory guidance on concentration in commercial real estate lending
- Unreliability of loan appraisals used in real property loan decisions
- Commercial loans are more sensitive to the borrower's successful operations or property development
- Small and medium business loans are subject to greater risks from adverse business developments
- Underwriting criteria and practices may not prevent poor loan performance

Risks Related of our SBA Loan Program

- Dependence on U.S. federal government SBA loan program
- Recognition of gains on sale of loans and servicing asset valuations reflect certain assumptions we use
- Credit risks from non-guaranteed portion of SBA loans we retain and do not sell
- Credit risks from SBA loans we sell as a result of repurchase obligations

Risks Related to Credit Quality

- Non-performing assets require management time to resolve and can affect our financial results
- The allowance for loans losses may be insufficient to absorb potential losses in our loan portfolio
- Real estate market volatility may have an adverse effect on disposition of other real estate owned
- Exposure to environmental liabilities on foreclosed real estate collateral
- Adverse effect of new accounting standards for loan losses which may increase our allowance

Risks Related to our Growth Strategy

- General risks associated with acquisitions, including availability of suitable targets and integration risks
- Dilution affect resulting from the issuance of common stock consideration for acquisitions
- Impairment of the goodwill recorded for an acquisition
- Incorrect estimate of fair value for assets acquired in an acquisitions
- Managing our branch growth strategy
- Managing risks of adding newlines of business or new products

Risks Related to Our Capital

- Recent regulatory requirements
- Raising new capital in conditions beyond our control

Risks Related to Management

- Our success depends on the skills of our management and their retention
- Competition for skilled and experienced management level senior level employees

Risks Related to Our Reputation and Operations

- Failure to maintain a favorable reputation with our customers and communities
- Failure of our risk management framework
- Failure to implement new technology
- System failures or breaches of our network security
- Difficulties of our third-party providers, termination of their services, or their failure to comply with regulatory requirements
- Employee misconduct
- Breaches of customer information, computer viruses
- Inaccurate information provided to us by customers or counterparties

Risks from Competition

- Competition from financial service companies and other companies that offer commercial banking services
- Competitive need to implement new technology and related operational challenges

Other Business Risks

- Costs and effects of litigation, investigations or similar matters
- Company-owned life insurance is dependent on the financial strength of the underlying insurance company
- The soundness of other financial institutions
- Severe weather, natural disasters (including fire and earthquakes, pandemics, acts of war, terrorism, and social unrest)

Finance and Accounting Risks

- Reliance on estimates and risk management processes and analytical and forecasting models
- Changes in accounting standards
- Failure maintain effective internal controls over financial reporting
- Realization of our deferred assets

Legislative and Regulatory Risks

- Extensive government regulation that could limit or restrict our activities
- Legislative and regulatory actions now or in the future increase our costs, and impact our business

- Monetary policies and regulations of the Federal Reserve
- Federal and state regulatory exams
- Noncompliance with the Bank Secrecy Act and other anti-money laundering statutes and regulations
- Responsibility to financially support HBC
- Consumer protection laws and regulations
- Potential violation of predatory lending laws
- Failure to comply with privacy, data protection and information security legal requirements
- Potential regulatory limitations on incentive compensation affecting the hiring and retention of key employees

Risks Related to Our Common Stock

- Investment in common stock is not an insured deposit
- Volatile trading price of our common stock
- Limited trading volume trading volume
- Changes in dividend policy
- Limitations on director liability for monetary damages for failure to exercise their fiduciary duty
- Potential dilution from issuance of additional equity securities
- Issuance of preferred stock which may have rights and preferences over our common stock
- Failure to satisfy our obligations under our subordinated notes would preclude the payment of dividends
- Our charter documents and California law may have an anti-takeover effect limiting changes of control

Risks Relating to Our Business

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

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

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

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

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

Our profitability is dependent upon the geographic concentration of the markets in which we operate.

We operate primarily in in the general San Francisco Bay Area of California in the counties of Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara and, as a result, our business, financial condition and results of operations are subject the demand for our products in those areas and is also 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 demand for our products or our credit risks across multiple markets.

Risks relating to the impact of COVID-19 could have a material adverse effect on our business, financial condition and results of operations.

The COVID-19 pandemic has had, and continues to have, a material impact on businesses around the world and the economic environments in which they operate. In March 2020, the United States declared a federal state of emergency in response to the COVID-19 pandemic, which continues to spread throughout the United States. The outbreak of this virus has disrupted global financial markets and negatively affected supply and demand across a broad range of industries. There are a number of factors associated with the outbreak and its impact on global economies including the United States that have had and could continue to have a material adverse effect on (among other things) the profitability, capital and liquidity of financial institutions.

The COVID-19 pandemic has caused disruption to our customers, vendors and employees. California where we primarily operate, has implemented restrictions on the movement of its citizens, with a resultant significant impact on economic activity in the state. The pandemic has resulted in temporary closures of many businesses and the institution of

social distancing and sheltering in place requirements in California, including our primary market area. As a result, the demand for our products and services has been and may continue to be significantly impacted. The circumstances around this pandemic are evolving rapidly and will continue to impact our business in future periods. In the United States, the Federal Government has taken action to provide financial support to parts of the economy most impacted by the COVID-19 pandemic. The details of how these actions will impact our customers and therefore the impact on the Company remains uncertain at this stage. The actions taken by the U.S. Government and the Federal Reserve may indicate a view on the potential severity of a downturn and post recovery environment, which from a commercial, regulatory and risk perspective could be significantly different to past crises and persist for a prolonged period. The pandemic has led to a weakening in gross domestic product and employment in the United States.

As the result of the COVID-19 pandemic and the related adverse local and national economic consequences, we could be subject to any of the following risks, any of which could have a material, adverse effect on our business, financial condition, or results of operations:

- demand for our products and services may decline, making it difficult to grow assets and income;
- if the economy is unable to substantially reopen, and high levels of unemployment continue for an extended period of time, loan delinquencies, problem assets, and foreclosures may increase, resulting in increased charges and reduced income;
- collateral for loans, especially real estate, may decline in value, which could cause loan losses to increase;
- our allowance for credit losses on loans may have to be increased if borrowers experience financial difficulties beyond modeled projections, which will adversely affect our net income;
- the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us;
- as the result of the decline in the Federal Reserve Board's target federal funds rate, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread and reducing net income;
- a material decrease in net income or a net loss over several quarters could result in a decrease in the rate of our quarterly cash dividend;
- a prolonged weakness in economic conditions resulting in a reduction of future projected earnings could result in our recording a valuation allowance against our current outstanding deferred tax assets;
- the goodwill we recorded in connection with business acquisitions could become impaired and require charges to earnings;
- we rely on third party vendors for certain services and the unavailability of a critical service due to the COVID-19 outbreak could have an adverse effect on us; and
- Federal Deposit Insurance Corporation premiums may increase if the agency experiences additional resolution costs.

Our future success and profitability substantially depends on the management skills of our executive officers and directors, many of whom have held officer and director positions with us for many years. The unanticipated loss or unavailability of key employees due to the outbreak could harm our ability to operate our business or execute our business strategy. We may not be successful in finding and integrating suitable successors in the event of key employee loss or unavailability.

Furthermore, if the U.S. economy experiences a recession as a result of the pandemic, our business could be materially and adversely affected. To the extent the pandemic adversely affects our business, financial condition, or results of operations, it may also have the effect of heightening many of the other risks described in this report. The extent of such

impact will depend on the outcome of certain developments, including but not limited to, the duration and spread of the pandemic as well as its continuing impact on our customers, vendors and employees, all of which are uncertain.

As a participating lender in the U.S. Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”), we are subject to additional risks of litigation from our customers or other parties regarding our processing of loans for the PPP and risks that the SBA may not fund some or all PPP loan guaranties.

On March 27, 2020, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which included a loan program administered through the SBA referred to as the PPP. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to numerous limitations and eligibility criteria. We are participating as a lender in the PPP. The PPP opened on April 3, 2020; however, because of the short timeframe between the passing of the CARES Act and the opening of the PPP, there was some ambiguity in the laws, rules and guidance regarding the operation of the PPP, which exposes us to risks relating to noncompliance with the PPP.

Since the opening of the PPP, several other larger banks have been subject to litigation regarding the process and procedures that such banks used in processing applications for the PPP and claims related to agent fees. We may be exposed to the risk of similar litigation, from both customers and non-customers that approached the us regarding PPP loans, regarding its process and procedures used in processing applications for the PPP, or litigation from agents with respect to agent fees. If any such litigation is filed against us and is not resolved in a manner favorable to the Company or the Bank, it may result in significant financial liability or adversely affect the Company’s reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP related litigation could have a material adverse effect on our business, financial condition or results of operations.

We also have credit risk on PPP loans if a determination is made by the SBA that there is a deficiency in the manner in which the loan was originated, funded, or serviced by us, such as an issue with the eligibility of a borrower to receive a PPP loan, which may or may not be related to the ambiguity in the laws, rules and guidance regarding the operation of the PPP. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which the PPP loan was originated, funded, or serviced by us, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

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

There have been changes and discussions with respect to U.S. trade policies, legislation, treaties and tariffs, including trade policies and tariffs affecting other countries, including China, the European Union, Canada and Mexico and retaliatory tariffs by such countries. Tariffs and retaliatory tariffs have been imposed, and additional tariffs and retaliation tariffs have been proposed. Such tariffs, retaliatory tariffs or other trade restrictions on products and materials that our customers import or export, including among others, agricultural products, could cause the prices of our customers’ products to increase which could reduce demand for such products, or reduce our customer margins, and adversely impact their revenues, financial results and ability to service debt; which, in turn, could have a material adverse effect on our business financial condition and results of operations. In addition, to the extent changes in the political environment have a negative impact on us or on the markets in which we operate our business, results of operations and financial condition could be materially and adversely impacted in the future. It remains unclear what the U.S. Administration or foreign governments will or will not do with respect to tariffs already imposed, additional tariffs that may be imposed, or international trade agreements and policies. On October 1, 2018, the United States, Canada and Mexico agreed to a new trade deal to replace the North American Free Trade Agreement and it went into full force on July 1, 2020. The full impact of this agreement on us, our customers and on the economic conditions in our states is currently unknown. A trade war or other governmental action related to tariffs or international trade agreements or policies has the potential to negatively impact ours and/or our customers' costs, demand for our customers' products, and/or the U.S. economy or certain sectors thereof and, thus, have a material adverse effect on our business, financial condition and results of operations.

Fluctuations in interest rates may reduce net interest income and otherwise negatively affect our financial condition and results of operations.

Shifts in short-term interest rates may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. When interest rates rise, the rate of interest we earn on our assets, such as loans, typically rises more quickly than the rate of interest that we pay on our interest-bearing liabilities, such as deposits, which may cause our profits to increase. When interest rates decrease, the rate of interest we earn on our assets, such as loans, typically declines more quickly than the rate of interest that we pay on our interest-bearing liabilities, such as deposits, which may cause our profits to decrease. Interest rates are volatile and highly sensitive to many factors beyond our control, including governmental monetary policies, inflation, recession, changes in unemployment, the money supply and international disorder and instability in domestic and foreign financial markets.

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and financial condition. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets could have a material adverse effect on our net interest income.

Rising interest rates result in a decline in value of fixed-rate debt securities we hold in our investment securities portfolio. The unrealized losses resulting from holding these securities will be recognized in accumulated other comprehensive income (loss) and reduce total shareholders' equity. Unrealized losses do not negatively affect our regulatory capital ratios; however, tangible common equity and the associated ratios would be reduced. If unrealized loss debt securities are sold, such realized losses will reduce our regulatory capital ratios.

Changes in interest rates can also affect the level of loan refinancing activity, which impacts the amount of prepayment penalty income we receive on loans we hold. Because prepayment penalties are recorded as interest income when received, the extent to which they increase or decrease during any given period could have a significant impact on the level of net interest income and net income we generate during that time. A decrease in our prepayment penalty income resulting from any change in interest rates or as a result of regulatory limitations on our ability to charge prepayment penalties could therefore adversely affect our net interest income, net income or results of operations.

We could recognize losses on securities held in our securities portfolio, particularly if interest rates increase or economic and market conditions deteriorate.

As of December 31, 2020, the fair value of our securities portfolio was approximately \$540.7 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities or our own analysis of the value of the security, defaults by the issuer or individual mortgagors with respect to the underlying securities, and continued instability in the credit markets. Any of the foregoing factors could cause credit-related impairment in future periods and result in realized losses. The process for determining whether impairment is credit related usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have a material adverse effect on our business, financial condition and results of operations.

Liquidity risks could affect operations and jeopardize our business, financial condition, and results of operations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and/or investment securities and from other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of our customer deposits. Such deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out

of bank deposits and into other investments, we could lose a relatively low cost source of funds, thereby increasing our funding costs.

Additional liquidity is provided by our ability to borrow from the Federal Reserve Bank of San Francisco and the Federal Home Loan Bank of San Francisco. We also may borrow from third-party lenders from time to time. Our access to funding sources in amounts adequate to finance or capitalize our activities on terms that are acceptable to us could be impaired by factors that affect us directly or the financial services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

Any decline in available funding could adversely impact our ability to continue to implement our strategic plan, including our ability to originate loans, invest in securities, meet our expenses, or to fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse effect on our liquidity, business, financial condition and results of operations.

Competition among U.S. banks for customer deposits is intense, may increase the cost of retaining current deposits or procuring new deposits, and may otherwise negatively affect our ability to grow our deposit base.

Competition among U.S. banks for customer deposits is intense, may increase the cost of retaining current deposits or procuring new deposits, and may otherwise negatively affect our ability to grow our deposit base. Maintaining and attracting new deposits is integral to our business and a major decline in deposits or failure to attract deposits in the future, including any such decline or failure related to an increase in interest rates paid by our competitors on interest-bearing accounts, could have an adverse effect on our results of operations and financial condition. Interest-bearing accounts earn interest at rates established by management based on competitive market factors. The demand for the deposit products we offer may also be reduced due to a variety of factors, such as demographic patterns, changes in customer preferences, reductions in consumers' disposable income, regulatory actions that decrease customer access to particular products, or the availability of competing products.

Our business depends on our ability to successfully manage credit risk.

The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we significantly increase our allowance for credit losses on loans, each of which could adversely affect our net income. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition and results of operations.

An important feature of our credit risk management system is our use of an internal credit risk rating and control system through which we identify, measure, monitor and mitigate existing and emerging credit risk of our customers. As this process involves detailed analysis of the customer or credit risk, taking into account both quantitative and qualitative factors, it is subject to human error. In exercising their judgment, our employees may not always be able to assign an accurate credit rating to a customer or credit risk, which may result in our exposure to higher credit risks than indicated by our risk rating and control system. Although our management seeks to address possible credit risk proactively, it is possible that the credit risk rating and control system will not identify credit risk in our loan portfolio and that we may fail to manage credit risk effectively.

Uncertainty relating to LIBOR calculation process and potential phasing out of LIBOR may adversely affect us.

Reforms to and uncertainty regarding LIBOR may adversely affect our business. On July 27, 2017, the United Kingdom's Financial Conduct Authority ("FCA"), which regulates LIBOR, announced that it will no longer compel banks to submit rates for the calculation of LIBOR in the future. Until recently, it was generally expected that LIBOR would be

discontinued on December 31, 2021. However, in November 2020, the ICE Benchmark Administrator (“IBA”), which publishes the LIBOR rates and is regulated by the FCA, announced that it would initiate a consultation that would end 1-week and 2-month LIBOR by December 31, 2021 and continue to publish all other LIBOR rates through June 30, 2023. The consultation period ended on January 25, 2021 and the IBA and FCA are discussing the results now. While the 18-month extension of certain LIBOR rates is generally expected to be implemented, the FCA has not yet issued a final decision on the matter. As such, the U.S. Federal Reserve Bank's Alternative Reference Rates Committee (“ARRC”) continues to urge parties to implement the preferred alternative to LIBOR, which is SOFR, in all new contracts and use the potential 18-month extension to allow time for existing agreements that use LIBOR to either expire or be re-negotiated. ARRC selected SOFR in June 2017 as the preferred alternative rate to LIBOR. SOFR differs from LIBOR in two respects: SOFR is a single overnight rate, while LIBOR includes rates of several tenors; and SOFR is deemed a credit risk-free rate while LIBOR incorporates an evaluation of credit risk. The ARRC and other entities intend for the transition to be economically neutral. The Federal Reserve Bank of New York has proposed a methodology for generating SOFRs of three different tenors and an index is currently published with daily, 30, 90 and 180 day SOFR tenors. The ARRC has developed a methodology for adjusting SOFR to reflect the risk considerations that underlie LIBOR. On July 12, 2019, the SEC issued a statement on LIBOR transition, indicating the significant impact that the discontinuation of LIBOR could have on financial markets and market participants. Since some of our products are indexed to LIBOR, the transition, if not sufficiently planned for and managed by our cross-functional teams, could adversely affect the Company’s financial condition and results of operations. Although implementation of the SOFR benchmark is intended to have minimal economic effect on the parties to a LIBOR-based contract, the transition from LIBOR to a new benchmark rate could result in significant operational, systems, increased compliance, legal and operational costs. This transition may also result in our customers challenging the determination of their interest payments or entering into fewer transactions or postponing their financing needs, which could reduce the Company’s revenue and adversely impact our business. In addition, the uncertainty regarding the future of LIBOR as well as the transition from LIBOR to another benchmark rate or rates could have adverse impacts on floating-rate obligations, loans, deposits, derivatives, and other financial instruments that currently use LIBOR as a benchmark rate and, ultimately, adversely affect the Company’s financial condition and results of operations.

Risks Related to Our Loans

Because a significant portion of our loan portfolio is comprised of real estate loans, negative changes in the economy affecting real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.

Real estate lending (including commercial, land development and construction, home equity, multifamily, and residential mortgage loans) is a large portion of our loan portfolio. At December 31, 2020, approximately \$1.76 billion, or 67% of our loan portfolio, was comprised of loans with real estate as a primary or secondary component of collateral. Included in CRE loans were \$560.4 million or 21% of owner occupied loans. The real estate securing our loan portfolio is concentrated in California.

As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, the rate of unemployment, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature, such as earthquakes and natural disasters. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which would adversely affect profitability. Such declines and losses would have a material adverse effect on our business, financial condition, and results of operations. In addition, if hazardous or toxic substances are found on properties pledged as collateral, the value of the real estate could be impaired.

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, 2020, land and construction loans, (including land acquisition and development loans) totaled \$144.6 million or 6% of our portfolio. Of these loans, 12% were comprised of owner occupied and 88% non-owner occupied construction and land loans. These loans involve additional risks because funds are advanced upon the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of project construction. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it.

Supervisory guidance on commercial real estate concentrations could restrict our activities and impose financial requirements or limits on the conduct of our business.

As a part of their regulatory oversight, in 2006 federal bank regulators issued guidance titled, “Concentrations in Commercial Real Estate Lending, Sound Risk Management,” which we refer to as the CRE Concentration Guidance. Additional guidance which focused on CRE lending, including an Interagency Statement titled, “Statement on Prudent Risk Management for Commercial Real Estate Lending,” has been issued from time to time since 2006 and CRE lending continues to be a significant focus of federal and state bank regulators. These various guidelines and pronouncements were issued in response to the agencies’ concerns that rising CRE concentrations might expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the commercial real estate market. The CRE Concentration Guidance identifies certain concentration levels that, if exceeded, will expose the institution to additional supervisory analysis with regard to the institution’s CRE concentration risk. The CRE Concentration Guidance is designed to promote appropriate levels of capital and sound loan and risk management practices for institutions with a concentration of CRE loans. In general, the CRE Concentration Guidance establishes the following supervisory criteria as preliminary indications of possible CRE concentration risk: (i) the institution’s total construction, land development and other land loans represent 100% or more of total risk-based capital; or (ii) total CRE loans as defined in the regulatory guidelines represent 300% or more of total risk-based capital, and the institution’s CRE loan portfolio has increased by 50% or more during the prior 36-month period. Pursuant to the CRE Concentration Guidelines, loans secured by owner-occupied commercial real estate are not included for purposes of CRE Concentration calculation. As of December 31, 2020, using regulatory definitions in the CRE Concentration Guidance, our CRE loans decreased to 245% of HBC total risk-based capital, as compared to 282% as of December 31, 2019. If the FDIC became concerned about our CRE loan concentrations, they could inhibit our organic growth by restricting our ability to execute on our strategic plan.

Our use of appraisals in deciding whether to make a loan on or secured by real property does not ensure the value of the real property collateral.

In considering whether to make a loan secured by real property we generally require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is conducted, and an error in fact or judgment could adversely affect the reliability of an appraisal. In addition, events occurring after the initial appraisal may cause the value of the real estate to decrease. As a result of any of these factors the value of collateral securing a loan may be less than estimated, and if a default occurs we may not recover the outstanding balance of the loan.

Many of our loans are to commercial borrowers, which may have a higher degree of risk than other types of borrowers.

At December 31, 2020, commercial loans totaled \$846.4 million or 32% of our loan portfolio (including SBA loans and PPP loans), asset-based lending, and factored receivables). Commercial loans often involve risks that are different from other types of lending. Unlike residential property loans, which generally are made on the basis of the borrowers’ ability to make repayment from their employment and other income and which are secured by real property

whose value tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. Our commercial loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. Most often, this collateral consists of accounts receivable, inventory and equipment. Inventory and equipment may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. Due to the larger average size of each commercial loan, as well as collateral that is generally less readily-marketable, losses incurred on a small number of commercial loans could have a material adverse effect on our business, financial condition and results of operations.

The small and medium-sized businesses that we lend to may have fewer resources to weather adverse business developments, which may impair a borrower's ability to repay a loan, and such impairment could adversely affect our results of operations and financial condition.

We target our business development and marketing strategy primarily to serve the banking and financial services needs of small to medium-sized businesses. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small and medium-sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could have a material adverse impact on the business and its ability to repay its loan. Negative general economic conditions in markets were operate that adversely affect our medium-sized business borrowers may impair the borrower's ability to repay a loan and such impairment could have a material adverse effect on our business, financial condition and results of operation.

We may suffer losses in our loan portfolio despite our underwriting practices.

We mitigate the risks inherent in our loan portfolio by adhering to sound and proven underwriting practices, managed by experienced and knowledgeable credit professionals. These practices include analysis of a borrower's prior credit history, financial statements, tax returns, and cash flow projections, valuations of collateral based on reports of independent appraisers and verifications of liquid assets. Nonetheless, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan loss.

Risks Related to our SBA Loan Program

Small Business Administration lending is an important part of our business. Our SBA lending program is dependent upon the U.S. federal government, and we face specific risks associated with originating SBA loans.

At December 31, 2020, SBA loans totaled \$50.1 million, which are included in the commercial loan portfolio, and SBA loans held-for-sale totaled \$1.7 million. Our SBA lending program is dependent upon the U.S. federal government. As an approved participant in the SBA Preferred Lender's Program (an "SBA Preferred Lender"), we enable our clients to obtain SBA loans without being subject to the potentially lengthy SBA approval process necessary for lenders that are not SBA Preferred Lenders. The SBA periodically reviews the lending operations of participating lenders to assess, among other things, whether the lender exhibits prudent risk management. When weaknesses are identified, the SBA may request corrective actions or impose enforcement actions, including revocation of the lender's SBA Preferred Lender status. If we lose our status as an SBA Preferred Lender, we may lose some or all of our customers to lenders who are SBA Preferred Lenders, and as a result we could experience a material adverse effect to our financial results. Any changes to the SBA program, including but not limited to changes to the level of guarantee provided by the federal government on SBA loans, changes to program specific rules impacting volume eligibility under the guaranty program, as well as changes to the program amounts authorized by Congress may also have a material adverse effect on our business. In addition, any default by the U.S. government on its obligations or any prolonged government shutdown could, among other things, impede our ability to originate SBA loans or sell such loans in the secondary market, which could have a material adverse effect on our business, financial condition and results of operations.

The SBA's 7(a) Loan Program is the SBA's primary program for helping start-up and existing small businesses, with financing guaranteed for a variety of general business purposes. Generally, we sell the guaranteed portion of our SBA 7(a) loans in the secondary market. These sales result in premium income for us at the time of sale and create a stream of future servicing income, as we retain the servicing rights to these loans. For the reasons described above, we may not be

able to continue originating these loans or sell them in the secondary market. Furthermore, even if we are able to continue to originate and sell SBA 7(a) loans in the secondary market, we might not continue to realize premiums upon the sale of the guaranteed portion of these loans or the premiums may decline due to economic and competitive factors. When we originate SBA loans, we incur credit risk on the non-guaranteed portion of the loans, and if a customer defaults on a loan, we share any loss and recovery related to the loan pro-rata with the SBA. If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by us, the SBA may seek recovery of the principal loss related to the deficiency from us. Generally, we do not maintain reserves or loss allowances for such potential claims and any such claims could materially adversely affect our business, financial condition or results of operations.

The laws, regulations and standard operating procedures that are applicable to SBA loan products may change in the future. We cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies and especially our organization, changes in the laws, regulations and procedures applicable to SBA loans could adversely affect our ability to operate profitably.

The recognition of gains on the sale of loans and servicing asset valuations reflect certain assumptions.

We expect that gains on the sale of U.S. government guaranteed loans will contribute to noninterest income. The gains on such sales recognized for the year ended December 31, 2020 was \$839,000. The determination of these gains is based on assumptions regarding the value of unguaranteed loans retained, servicing rights retained and deferred fees and costs, and net premiums paid by purchasers of the guaranteed portions of U.S. government guaranteed loans. The value of retained unguaranteed loans and servicing rights are determined based on market derived factors such as prepayment rates, current market conditions and recent loan sales. Deferred fees and costs are determined using internal analysis of the cost to originate loans. Significant errors in assumptions used to compute gains on sale of loans or servicing asset valuations could result in material revenue misstatements, which may have a material adverse effect on our business, results of operations and profitability.

The non-guaranteed portion of SBA loans that we retain on our balance sheet as well as the guaranteed portion of SBA loans that we sell could expose us to various credit and default risks.

We originated \$29.3 million of SBA loans for the year ended December 31, 2020. We sold \$10.1 million of the guaranteed portion of our SBA loans for the year ended December 31, 2020. We generally retain the non-guaranteed portions of the SBA loans that we originate. Consequently, as of December 31, 2020, we held \$50.1 million of SBA loans on our balance sheet, \$31.3 million of which consisted of the non-guaranteed portion of SBA loans and \$1.7 million, or 3.4%, consisted of the guaranteed portion of SBA loans which we intend to sell in 2021. The non-guaranteed portion of SBA loans have a higher degree of credit risk and risk of loss as compared to the guaranteed portion of such loans and make up a substantial majority of our remaining SBA loans.

When we sell the guaranteed portion of SBA loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the SBA loans and the manner in which they were originated. Under these agreements, we may be required to repurchase the guaranteed portion of the SBA loan if we have breached any of these representations or warranties, in which case we may record a loss. In addition, if repurchase and indemnity demands increase on loans that we sell from our portfolios, our liquidity, results of operations and financial condition could be adversely affected. Further, we generally retain the non-guaranteed portions of the SBA loans that we originate and sell, and to the extent the borrowers of such loans experience financial difficulties, our financial condition and results of operations could be adversely impacted.

Risks Related to our Credit Quality

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

As of December 31, 2020, our nonperforming loans (which consist of nonaccrual loans, loans past due 90 days or more and still accruing interest and loans modified under troubled debt restructurings) totaled \$7.9 million, or 0.30% of our loan portfolio, and our nonperforming assets (which include nonperforming loans plus other real estate owned) totaled \$7.9 million, or 0.17% of total assets.

Our nonperforming assets adversely affect our net income in various ways. We do not record interest income on nonaccrual loans or other real estate owned, thereby adversely affecting our net interest income, net income and returns on assets and equity, and our loan administration costs increase, which together with reduced interest income adversely affects our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then-fair market value, which may result in a loss. These nonperforming loans and other real estate owned also increase our risk profile and the level of capital our regulators believe is appropriate for us to maintain in light of such risks. The resolution of nonperforming assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in nonperforming loans and nonperforming assets, our net interest income may be negatively impacted and our loan administration costs could increase, each of which could have a material adverse effect on our business, financial condition and results of operations.

Our allowance for credit losses on loans may prove to be insufficient to absorb potential losses in our loan portfolio.

A significant source of risk arises from the possibility that losses could be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The underwriting and credit monitoring policies and procedures that we have adopted to address this risk may not prevent unexpected losses and such losses could have a material adverse effect on our business, financial condition, results of operations and cash flows. These unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond our ability to predict, influence or control.

Like all financial institutions, we maintain an allowance for credit losses on loans to provide for loan defaults and non-performance. This allowance, expressed as a percentage of loans, was 1.70%, at December 31, 2020. Allowance for credit losses on loans is funded from a provision for credit losses on loans, which is a charge to our income statement. Our provision for credit losses on loans was \$13.2 million for the year ended December 31, 2020.

The allowance for credit losses on loans reflects our estimate of the current expected credit losses in our loan portfolio at the relevant balance sheet date. Our allowance for credit losses on loans is based on our prior experience, as well as an evaluation of the known risks in the current portfolio, composition and growth of the loan portfolio and economic forecasts for correlated economic factors. The determination of an appropriate level of credit allowance losses on loans is an inherently difficult and subjective process, requiring complex judgments, and is based on numerous analytical assumptions. The amount of future losses is susceptible to changes in economic and other conditions, including changes in interest rates, changes in economic forecasts, changes in the financial condition of borrowers, and deteriorating values of collateral that may be beyond our control, and these losses may exceed current estimates. If our allowance for credit losses on loans is inaccurate, for any of the reasons discussed above (or other reasons), and is inadequate to cover the loan losses that we actually experience, the resulting losses could have a material and adverse effect on our business, financial condition, and results of operations.

We individually evaluate all nonperforming loans and allocate a specific reserve based upon our estimation of the potential loss associated with those nonperforming loans. While we strive to carefully manage and monitor credit quality and to identify loans that may be deteriorating, at any time there are loans in our loan portfolio that may result in losses, but that have not yet been identified as nonperforming loans. Through established credit practices, we attempt to identify deteriorating loans and adjust the allowance for credit losses on loans accordingly. However, because future events are uncertain and because we may not successfully identify all deteriorating loans in a timely manner, there may be loans that deteriorate in an accelerated time frame. We cannot be certain that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that have been so identified.

Although management believes that the allowance for credit losses on loans is adequate to absorb losses on any existing loans that may become uncollectible, we may be required to take additional provisions for credit losses on loans in the future to further supplement the allowance for credit losses on loans, either due to management's decision to do so or because our banking regulators require us to do so. Our bank regulatory agencies will periodically review our allowance for credit losses on loans and the value attributed to nonaccrual loans or to real estate acquired through foreclosure and may require us to adjust our determination of the value for these items. These adjustments could have a material adverse effect on our business, financial condition and results of operations.

Real estate market volatility and future changes in our disposition strategies could result in net proceeds that differ significantly from our other real estate owned fair value appraisals.

As of December 31, 2020 we had no other real estate owned (“OREO”) on our financial statements, but in the ordinary course of our business we expect to hold some level of OREO from time to time. OREO typically consists of properties that we obtain through foreclosure or through an in-substance foreclosure in satisfaction of an outstanding loan. OREO properties are valued on our books at the lesser of the recorded investment in the loan for which the property previously served as collateral or the property’s “fair value,” which represents the estimated sales price of the property on the date acquired less estimated selling costs. Generally, in determining “fair value,” an orderly disposition of the property is assumed, unless a different disposition strategy is expected. Significant judgment is required in estimating the fair value of OREO property, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility.

In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our OREO disposition strategy, such as immediate liquidation sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from the appraisals, comparable sales and other estimates used to determine the fair value of our OREO properties.

We could be exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third-parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third-parties based on damages and costs resulting from environmental contamination emanating from the property. Significant environmental liabilities could have a material adverse effect on our business, financial condition, and results of operations.

Risks Related to Growth Strategy

There are risks related to acquisitions.

We plan to continue to grow our business organically. However, from time to time, we may consider opportunistic strategic acquisitions that we believe support our long-term business strategy. We face significant competition from numerous other financial services institutions, many of which will have greater financial resources than we do, when considering acquisition opportunities. Accordingly, attractive acquisition opportunities may not be available to us. We may not be successful in identifying or completing any future acquisitions. Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect our organization.

If we complete any future acquisitions, we may not be able to successfully integrate the operations, management, products and services of the entities that we acquire and eliminate redundancies. The integration process could result in the loss of key employees or disruption of the combined entity’s ongoing business or inconsistencies in standards, controls, procedures, and policies that adversely affect our ability to maintain relationships with customers and employees or achieve the anticipated benefits of the transaction. The integration process may also require significant time and attention from our management that they would otherwise direct at servicing existing business and developing new business. We may not be able to realize any projected cost savings, synergies or other benefits associated with any such acquisition we complete. We cannot determine all potential events, facts and circumstances that could result in loss and our investigation or mitigation efforts may be insufficient to protect against any such loss.

In addition, we must generally satisfy a number of meaningful conditions prior to completing any acquisition, including, in certain cases, federal and state bank regulatory approval. Bank regulators consider a number of factors when determining whether to approve a proposed transaction, including the effect of the transaction on financial stability and the ratings and compliance history of all institutions involved, including the CRA, examination results and anti-money laundering and Bank Secrecy Act compliance records of all institutions involved. The process for obtaining required

regulatory approvals has become substantially more difficult, which could affect our future business. We may fail to pursue, evaluate or complete strategic and competitively significant business opportunities as a result of our inability, or our perceived inability, to obtain any required regulatory approvals in a timely manner or at all.

Issuing additional shares of our common stock to acquire other banks and bank holding companies may result in dilution for existing shareholders and may adversely affect the market price of our stock.

In connection with our growth strategy, we have issued, and may issue in the future, shares of our common stock to acquire additional banks or bank holding companies that may complement our organizational structure. Resales of substantial amounts of common stock in the public market and the potential of such sales could adversely affect the prevailing market price of our common stock and impair our ability to raise additional capital through the sale of equity securities. We sometimes must pay an acquisition premium above the fair market value of acquired assets for the acquisition of banks or bank holding companies. Paying this acquisition premium, in addition to the dilutive effect of issuing additional shares, may also adversely affect the prevailing market price of our common stock.

If the goodwill that we recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on our financial condition and results of operations.

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in connection with the purchase. We review goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that the carrying value of the asset might be impaired. We determine impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. Estimates of fair value are determined based on a complex model using cash flows, the fair value of our Company as determined by our stock price, and company comparisons. If management's estimates of future cash flows are inaccurate, fair value determined could be inaccurate and impairment may not be recognized in a timely manner. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. There can be no assurance that our future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on our financial condition and results of operations.

Our decisions regarding the fair value of assets acquired could be different than initially estimated, which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

In business combinations, we acquire significant portfolios of loans that are marked to their estimated fair value. There is no assurance that the acquired loans will not suffer deterioration in value. The fluctuations in national, regional and local economic conditions, including those related to local residential, commercial real estate and construction markets, may increase the level of charge offs in the loan portfolio that we acquire and correspondingly reduce our net income. These fluctuations are not predictable, cannot be controlled and may have a material adverse effect on our business, financial condition, and results of operations.

We must effectively manage our branch growth strategy.

We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of our business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without increasing interest rate risk or compressing our net interest margin, maintaining sufficient capital, maintaining proper system and controls, and recruiting, training and retaining qualified professionals. We also may experience a lag in profitability associated with new branch openings. As part of our general growth strategy we may expand into additional communities or attempt to strengthen our position in our current markets by opening new offices, subject to any regulatory constraints on our ability to open new offices. To the extent that we are able to open additional offices, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations for a period of time which could have a material adverse effect on our business, financial condition and results of operations.

New lines of business or new products and services may subject us to additional risks.

From time to time, we may implement or may acquire new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in

instances where the markets are not fully developed. In developing and marketing new lines of business and new products and services we may invest significant time and resources. We may not achieve target timetables for the introduction and development of new lines of business and new products or services and price and profitability targets may not prove feasible. External factors, such as regulatory compliance obligations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Our Capital

As a result of the Dodd-Frank Act and rulemaking, we are subject to more stringent capital requirements.

In July 2013, the U.S. federal banking authorities approved the implementation of the Basel III regulatory capital reforms, or Basel III, and issued rules affecting certain changes required by the Dodd-Frank Act. Basel III is applicable to all U.S. banks that are subject to minimum capital requirements as well as to bank and saving and loan holding companies, other than “small bank holding companies” (generally bank holding companies with consolidated assets of less than \$3.0 billion). Basel III not only increases most of the required minimum regulatory capital ratios, it introduces a new common equity Tier 1 capital ratio and the concept of a capital conservation buffer. Basel III also expands the current definition of capital by establishing additional criteria that capital instruments must meet to be considered additional Tier 1 and Tier 2 capital. In order to be a “well-capitalized” depository institution under the new regime, an institution must maintain a common equity Tier 1 capital ratio of 6.5% or more; a Tier 1 capital ratio of 8% or more; a total capital ratio of 10% or more; and a Tier 1 leverage ratio of 5% or more. The Basel III capital rules became effective as applied to the Company and HBC on January 1, 2015 with a phase-in period that extended through January 1, 2019 for many of the changes.

The failure to meet applicable regulatory capital requirements could result in one or more of our regulators placing limitations or conditions on our activities, including our growth initiatives, or restricting the commencement of new activities, and could affect customer and investor confidence, our costs of funds and FDIC insurance costs, our ability to pay dividends on our common stock, our ability to make acquisitions, and our business, results of operations and financial condition, generally.

We may need to raise additional capital in the future, and if we fail to maintain sufficient capital, whether due to losses, an inability to raise additional capital or otherwise, our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance, would be adversely affected.

We face significant capital and other regulatory requirements as a financial institution. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, which could include the possibility of financing acquisitions. In addition, the Company, on a consolidated basis, and HBC, on a stand-alone basis, must meet certain regulatory capital requirements and maintain sufficient liquidity. Regulatory capital requirements could increase from current levels, which could require us to raise additional capital or contract our operations. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Any occurrence that may limit our access to the capital markets may adversely affect our capital costs and our ability to raise capital. Moreover, if we need to raise capital in the future, we may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. Accordingly, we cannot assure you that we will be able to raise additional capital if needed or on terms acceptable to us. Failure to meet regulatory requirements, could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to our Management

We are highly dependent on our management team, and the loss of our senior executive officers or other key employees could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, financial condition and results of operations.

Our success depends, in large degree, on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. Our senior management team has significant industry experience, and their knowledge and relationships would be difficult to replace. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the financial services and banking industry is intense, which means the cost of hiring, paying incentives and retaining skilled personnel may continue to increase. We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. In addition, as a provider of relationship-based commercial banking services, we must attract and retain qualified banking personnel to continue to grow our business, and competition for such personnel can be intense. Our ability to effectively compete for senior executives and other qualified personnel by offering competitive compensation and benefit arrangements may be restricted by applicable banking laws and regulations as discussed in “*Supervision and Regulation—Incentive Compensation Guidance and Proposed Restrictions.*” The loss of the services of any senior executive or other key personnel, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on our business, financial condition or results of operations. In addition, to attract and retain personnel with appropriate skills and knowledge to support our business, we may offer a variety of benefits, which could reduce our earnings or could have a material adverse effect on our business, financial condition and results of operations.

Risks Related to Our Reputation and Operations

Our ability to maintain our reputation is critical to the success of our business, and the failure to do so may materially adversely affect our business and the value of our common stock.

We are a community bank, and our reputation is one of the most valuable components of our business. Threats to our reputation can come from many sources, including adverse sentiment about financial institutions generally, unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased governmental regulation. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our common stock may be materially adversely affected.

Our risk management framework may not be effective in mitigating risks and/or losses to us.

Our risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate and compliance. Our risk management framework may not be effective under all circumstances and may not adequately mitigate any risk or loss to us. If our risk management framework is not effective, we could suffer unexpected losses and our business, financial condition and results of operations could be materially and adversely affected. We may also be subject to potentially adverse regulatory consequences.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to hardware and cyber-security issues. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. We could also experience a breach by intentional or negligent conduct on the part of employees or other internal or external sources, including our third-party vendors. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our business, financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us, including our internet banking activities, against damage from

physical break-ins, cyber-security breaches and other disruptive problems caused by the internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability, damage our reputation and inhibit the use of our internet banking services by current and potential customers.

We rely heavily on communications, information systems (both internal and provided by third-parties) and the internet to conduct our business. Our business is dependent on our ability to process and monitor large numbers of daily transactions in compliance with legal, regulatory and internal standards and specifications. In addition, a significant portion of our operations relies heavily on the secure processing, storage and transmission of personal and confidential information, such as the personal information of our customers and clients. In recent periods, several governmental agencies and large corporations, including financial service organizations and retail companies, have suffered major data breaches, in some cases exposing not only their confidential and proprietary corporate information, but also sensitive financial and other personal information of their clients or clients and their employees or other third-parties, and subjecting those agencies and corporations to potential fraudulent activity and their clients, clients and other third-parties to identity theft and fraudulent activity in their credit card and banking accounts. Therefore, security breaches and cyber-attacks can cause significant increases in operating costs, including the costs of compensating clients and customers for any resulting losses they may incur and the costs and capital expenditures required to correct the deficiencies in and strengthen the security of data processing and storage systems. These risks may increase in the future as we continue to increase mobile payments and other internet-based product offerings and expand our internal usage of web-based products and applications.

In addition to well-known risks related to fraudulent activity, which take many forms, such as check “kiting” or fraud, wire fraud, and other dishonest acts, information security breaches and cyber-security related incidents have become a material risk in the financial services industry. Potential attacks have attempted to obtain unauthorized access to confidential information, steal money, or manipulate or destroy data, often through the introduction of computer viruses or malware, cyber-attacks and other means. Other threats of this type may include fraudulent or unauthorized access to data processing or data storage systems used by us or by our clients, electronic identity theft, “phishing,” account takeover, and malware or other cyber-attacks. To date, none of these type of attacks have had a material effect on our business or operations. Such security attacks can originate from a wide variety of sources, including persons who are involved with organized crime or who may be linked to terrorist organizations or hostile foreign governments. Those same parties may also attempt to fraudulently induce employees, customers or other users of our systems to disclose sensitive information in order to gain access to our data or that of our customers or clients.

We are also subject to the risk that our employees may intercept and transmit unauthorized confidential or proprietary information. An interception, misuse or mishandling of personal, confidential or proprietary information being sent to or received from a customer or third-party could result in legal liabilities, remediation costs, regulatory actions and reputational harm.

Unfortunately, it is not always possible to anticipate, detect, or recognize these threats to our systems, or to implement effective preventative measures against all breaches, whether those breaches are malicious or accidental. Cyber-security risks for banking organizations have significantly increased in recent years and have been difficult to detect before they occur because of the following, among other reasons:

- the proliferation of new technologies, and the use of the Internet and telecommunications technologies to conduct financial transactions;
- threats arise from numerous sources, not all of which are in our control, including among others human error, fraud or malice on the part of employees or third-parties, accidental technological failure, electrical or telecommunication outages, failures of computer servers or other damage to our property or assets, natural disasters or severe weather conditions, health emergencies or pandemics, or outbreaks of hostilities or terrorist acts;
- the techniques used in cyber-attacks change frequently and may not be recognized until launched or until well after the breach has occurred;

- the increased sophistication and activities of organized crime groups, hackers, terrorist organizations, hostile foreign governments, disgruntled employees or vendors, activists and other external parties, including those involved in corporate espionage;
- the vulnerability of systems to third-parties seeking to gain access to such systems either directly or using equipment or security passwords belonging to employees, customers, third-party service providers or other users of our systems; and
- our frequent transmission of sensitive information to, and storage of such information by, third-parties, including our vendors and regulators, and possible weaknesses that go undetected in our data systems notwithstanding the testing we conduct of those systems.

Our investments in systems and processes that are designed to detect and prevent security breaches and cyber-attacks and our conduct of periodic tests of our security systems and processes, may not succeed in anticipating or adequately protecting against or preventing all security breaches and cyber-attacks from occurring. Even the most advanced internal control environment may be vulnerable to compromise. Targeted social engineering attacks are becoming more sophisticated and are extremely difficult to prevent. Additionally, the existence of cyber-attacks or security breaches at third-parties with access to our data, such as vendors, may not be disclosed to us in a timely manner. As cyber-threats continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any information security vulnerabilities or incidents. We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. If our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

As is the case with non-electronic fraudulent activity, cyber-attacks or other information or security breaches, whether directed at us or third-parties, may result in a material loss or have material consequences. Furthermore, the public perception that a cyber-attack on our systems has been successful, whether or not this perception is correct, may damage our reputation with customers and third-parties with whom we do business. A successful penetration or circumvention of system security could cause us negative consequences, including loss of customers and business opportunities, disruption to our operations and business, misappropriation or destruction of our confidential information and/or that of our customers, or damage to our customers' and/or third-parties' computers or systems, and could expose us to additional regulatory scrutiny and result in a violation of applicable privacy laws and other laws, litigation exposure, regulatory fines, penalties or intervention, loss of confidence in our security measures, reputational damage, reimbursement or other compensatory costs, additional compliance costs, and could have a material adverse effect on our business, financial condition and results from operations.

Our operations could be interrupted by our third-party service providers experiencing difficulty in providing their services, terminating their services or failing to comply with banking regulations.

We depend to a significant extent on relationships with third party service providers. Specifically, we utilize third party core banking services and receive credit card and debit card services, branch capture services, Internet banking services and services complementary to our banking products from various third party service providers. These types of third party relationships are subject to increasingly demanding regulatory requirements and attention by our federal bank regulators. Recent regulation requires us to enhance our due diligence, ongoing monitoring and control over our third party vendors and other ongoing third party business relationships. In certain cases, we may be required to renegotiate our agreements with these vendors to meet these enhanced requirements, which could increase our costs. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships, which could result in enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect on our business, financial condition and results of operations. In addition, if these third party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted. It may be difficult for us to replace some of our third party vendors, particularly vendors providing our core banking, credit card and debit card services, in a timely manner if they were unwilling or unable to provide us with these services in the future for any reason. If an interruption were to continue for a significant period of time, it could have a material adverse effect on our business, financial condition or results of operations. Even if we are able to replace them, it may be at higher cost to us, which could have a material

adverse effect on our business, financial condition or results of operations. In addition, if a third party provider fails to provide the services we require, fails to meet contractual requirements, such as compliance with applicable laws and regulations, or suffers a cyber-attack or other security breach, our business could suffer economic and reputational harm that could have a material adverse effect on our business, financial condition and results of operations.

Employee misconduct could expose us to significant legal liability and reputational harm.

We are vulnerable to reputational harm because we operate in an industry in which integrity and the confidence of our customers are of critical importance. Our employees could engage in fraudulent, illegal, wrongful or suspicious activities, and/or activities resulting in consumer harm that adversely affects our customers and/or our business. The precautions we take to detect and prevent such misconduct may not always be effective and regulatory sanctions and/or penalties, serious harm to our reputation, financial condition, customer relationships and ability to attract new customers. In addition, improper use or disclosure of confidential information by our employees, even if inadvertent, could result in serious harm to our reputation, financial condition and current and future business relationships. If our internal controls against operational risks fail to prevent or detect an occurrence of such employee error or misconduct, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

We depend on the accuracy and completeness of information provided by customers and counterparties and any misrepresented information could adversely affect our business, financial condition and results of operations.

In deciding whether to extend credit or to enter into other transactions with customers and counterparties, we may rely on information furnished to us by or on behalf of customers and counterparties, including financial statements and other financial information. Some of the information regarding customers provided to us is also used in our proprietary credit decisioning and scoring models, which we use to determine whether to do business with customers and the risk profiles of such customers which are subsequently utilized by counterparties who lend us capital to fund our operations. We may also rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, we may rely upon our customers' representations that their financial statements conform to GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. We also may rely on customer representations and certifications, or other audit or accountants' reports, with respect to the business and financial condition of our customers. Our financial condition, results of operations, financial reporting and reputation could be negatively affected if those representations are misleading, false, inaccurate or fraudulent and we rely on that materially misleading, false, inaccurate or fraudulent information.

Risks from Competition

We face strong competition from financial services companies and other companies that offer commercial banking services, which could harm our business.

We face substantial competition in all phases of our operations from a variety of different competitors. Our competitors, including larger commercial banks, community banks, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, insurance companies, securities dealers, brokers, mortgage bankers, investment advisors, money market mutual funds and other financial institutions, compete with lending and deposit gathering services offered by us. Many of these competing institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale and may offer a broader range of products and services than we can. If we are unable to offer competitive products and services, our business may be negatively affected. Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions or are not subject to increased supervisory oversight arising from regulatory examinations. As a result, these non-bank competitors have certain advantages over us in accessing funding and in providing various services.

We anticipate intense competition will continue for the coming year due to the recent consolidation of many financial institutions and more changes in legislature, regulation and technology. Further, we expect loan demand to continue to be challenging due to the uncertain economic climate and the intensifying competition for creditworthy borrowers, both of which could lead to loan rate concession pressure and could impact our ability to generate profitable loans. We expect we may see tighter competition in the industry as banks seek to take market share in the most profitable customer segments, particularly the small business segment and the mass affluent segment, which offers a rich source of

deposits as well as more profitable and less risky customer relationships. Further, with the rebound of the equity markets our deposit customers may perceive alternative investment opportunities as providing superior expected returns. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. The current low interest rate environment could increase such transfers of deposits to higher yielding deposits or other investments. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When our customers move money into higher yielding deposits or in favor of alternative investments, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

New technology and other changes are allowing parties to effectuate financial transactions that previously required the involvement of banks. For example, consumers can maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and access to lower cost deposits as a source of funds could have a material adverse effect on our business, financial condition and results of operations.

Increased competition in our markets may result in reduced loans, deposits and commissions and brokers’ fees, as well as reduced net interest margin and profitability. Ultimately, we may not be able to compete successfully against current and future competitors. If we are unable to attract and retain banking customers and expand our sales market for such loans, then we may be unable to continue to grow our business which could have a material adverse effect on our business, financial condition and results of operations.

We have a continuing competitive need for technological change, and we may not have the resources to effectively implement new technology or we may experience operational challenges when implementing new technology.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new, technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements than we do. We may not be able to effectively implement new, technology-driven products and services or be successful in marketing these products and services to our customers. In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. Failure to successfully keep pace with technological change affecting the financial services industry and avoid interruptions, errors and delays could have a material adverse effect on our business, financial condition or results of operations.

We expect that new technologies and business processes applicable to the consumer credit industry will continue to emerge, and these new technologies and business processes may be better than those we currently use. Because the pace of technological change is high and our industry is intensely competitive, we may not be able to sustain our investment in new technology as critical systems and applications become obsolete or as better ones become available. A failure to maintain current technology and business processes could cause disruptions in our operations or cause our products and services to be less competitive, all of which could have a material adverse effect on our business, financial condition or results of operations.

Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, a risk exists that we will not be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

Other Risks Related to Our Business

The costs and effects of litigation, investigations or similar matters, or adverse facts and developments related thereto, could materially affect our business, financial condition and results of operations.

We are and will continue to be involved from time to time in a variety of litigation, investigations or similar matters arising out of our business. It is inherently difficult to assess the outcome of these matters, and we may not prevail in any proceedings or litigation. Any claims and lawsuits, and the disposition of such claims and lawsuits, whether through settlement, or litigation, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, lead to attempts on the part of other parties to pursue similar claims. Any claims asserted against us, regardless of merit or eventual outcome may harm our reputation. Any adverse determination related to pending or other litigation could have a material adverse effect on our business, financial condition and results of operations.

We currently hold a significant amount of company-owned life insurance.

At December 31, 2020, we held company-owned life insurance (“COLI”) on current and former senior employees and executives, with a cash surrender value of \$77.5 million, as compared with a cash surrender value of \$76.0 million at December 31, 2019. The eventual repayment of the cash surrender value is subject to the ability of the various insurance companies to pay death benefits or to return the cash surrender value to us if needed for liquidity purposes. We continually monitor the financial strength of the various companies with whom we carry these policies. However, any one of these companies could experience a decline in financial strength, which could impair its ability to pay benefits or return our cash surrender value. If we need to liquidate these policies for liquidity purposes, we would be subject to taxation on the increase in cash surrender value and penalties for early termination, both of which could have a material adverse effect on our business, financial condition and results of operations.

Our ability to access markets for funding and acquire and retain customers could be adversely affected by the deterioration of other financial institutions or the financial service industry’s reputation.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. These losses or defaults could have a material adverse effect on our business, financial condition and results of operations. Additionally, if our competitors were extending credit on terms we found to pose excessive risks, or at interest rates which we believed did not warrant the credit exposure, we may not be able to maintain our business volume and could experience deteriorating financial performances.

Severe weather, natural disasters, pandemics, acts of war or terrorism, social unrest and other external events could significantly impact our business.

Severe weather, natural disasters (including fires and earthquakes), wide spread disease or pandemics (such as COVID-19), acts of war or terrorism, social unrest and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. The majority of our branches are located in the San Jose and San Francisco, California areas, which in the past have experienced both severe earthquakes and wildfires. We do not carry earthquake insurance on our properties. Earthquakes, wildfires or other natural disasters could severely disrupt our operations, and could have a material adverse effect on our business, financial condition and results of operations. In addition, our customers and loan collateral may be severely impacted by such events, resulting in losses. Operations in our market could be disrupted by both the evacuation of large portions of the population as well as damage to and/or lack of access to our banking and operation facilities. Although management has established disaster recovery policies and procedures, the occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.

Finance and Accounting Risks

Accounting estimates and risk management processes rely on analytical models that may prove inaccurate resulting in a material adverse effect on our business, financial condition and results of operations.

The processes we use to estimate probable incurred loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models using those assumptions may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for credit losses on loans may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical models could result in losses that could have a material adverse effect on our business, financial condition and results of operations.

Changes in accounting standards could materially impact our financial statements.

From time to time, the FASB or the SEC, may change the financial accounting and reporting standards that govern the preparation of our financial statements. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting standards (such as banking regulators or outside auditors) may change their interpretations or positions on how these standards should be applied. These changes may be beyond our control, can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, in each case resulting in our needing to revise or restate prior period financial statements. Restating or revising our financial statements may result in reputational harm or may have other adverse effects on us.

Failure to maintain effective internal controls over financial reporting could have a material adverse effect on our business and stock price.

We are required to comply with the SEC's rules implementing Sections 302 and 404 of the Sarbanes-Oxley Act, which will require management to certify financial and other information in our quarterly and annual reports and provide an annual management report on the effectiveness of controls over financial reporting. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act, which requires us to furnish annually a report by management on the effectiveness of our internal control over financial reporting and our independent registered public accounting firm is required to report on the effectiveness of our internal control over financial reporting.

If we identify any material weaknesses in our internal control over financial reporting or are unable to comply with the requirements of Section 404 in a timely manner or assert that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors, counterparties and customers may lose confidence in the accuracy and completeness of our financial statements and reports; our liquidity, access to capital markets and perceptions of our creditworthiness could be adversely affected; and the market price of our common stock could decline. In addition, we could become subject to investigations by the stock exchange on which our securities are listed, the SEC, the Federal Reserve, the FDIC, the DBO or other regulatory authorities, which could require additional financial and management resources. These events could have an adverse effect on our business, financial condition and results of operations.

We have significant deferred tax assets and cannot assure that it will be fully realized.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax basis of assets and liabilities computed using enacted tax rates. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax assets will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because

it requires estimates that cannot be made with certainty. At December 31, 2020, we had a net deferred tax assets of \$28.2 million. If we were to determine at some point in the future that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we would be required, under generally accepted accounting principles, to establish a full or partial valuation allowance which would require us to incur a charge to operations for the period in which the determination was made.

Risks Related to Legislative and Regulatory Developments

We are subject to extensive government regulation that could limit or restrict our activities, which in turn may adversely impact our ability to increase our assets and earnings.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Federal Reserve, the Department of Financial Protection and Innovation (“DFPI”) and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels, and other aspects of our operations. These bank regulators possess broad authority to prevent or remedy unsafe or unsound practices or violations of law. The laws and regulations applicable to the banking industry could change at any time and we cannot predict the effects of these changes on our business, profitability or growth strategy. Increased regulation could increase our cost of compliance and adversely affect profitability. Moreover, certain of these regulations contain significant punitive sanctions for violations, including monetary penalties and limitations on a bank’s ability to implement components of its business plan, such as expansion through mergers and acquisitions or the opening of new branch offices. In addition, changes in regulatory requirements can significantly affect the services that we provide as well as the costs associated with compliance efforts. Furthermore, government policy and regulation, particularly as implemented through the Federal Reserve System, significantly affect credit conditions. Negative developments in the financial industry and the impact of new legislation and regulation in response to those developments could negatively impact our business operations and adversely impact our financial performance. In addition, adverse publicity and damage to our reputation arising from the failure or perceived failure to comply with legal, regulatory or contractual requirements could affect our ability to attract and retain customers.

Legislative and regulatory actions taken now or in the future may impact our business, governance structure, financial condition or results of operations. Proposed legislative and regulatory actions, including changes to financial regulation and the corporate tax law, may not occur on the timeframe that is expected, or at all, which could result in additional uncertainty for our business.

Current and recent-past economic conditions, particularly in the financial markets, have resulted in government regulatory agencies and political bodies placing increased focus and scrutiny on the financial services industry. The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act and the regulations thereunder affect large and small financial institutions, including several provisions that will affect how community banks, thrifts and small bank and thrift holding companies will be regulated in the future. Although the applicability of certain elements of the Dodd-Frank Act is limited to institutions with more than \$10 billion in assets, there can be no guarantee that such applicability will not be extended in the future or that regulators or other third parties will not seek to impose such requirements on institutions with less than \$10 billion in assets, such as HBC. Compliance with the Dodd-Frank Act and its implementing regulations has and will continue to result in additional operating and compliance costs that could have a material adverse effect on our business, financial condition and results of operations.

New proposals for legislation continue to be introduced in the U.S. Congress that could substantially increase regulation of the financial services industry, impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices, including in the areas of compensation, interest rates, financial product offerings and disclosures, and have an effect on bankruptcy proceedings with respect to consumer residential real estate mortgages, among other things. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied.

Certain aspects of current or proposed regulatory or legislative changes, including to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads, and could expose us to additional costs, including increased

compliance costs. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations to comply and could have a material adverse effect on our business, financial condition and results of operations. In addition, any proposed legislative or regulatory changes, including those that could benefit our business, financial condition and results of operations, may not occur on the timeframe that is proposed, or at all, which could result in additional uncertainty for our business.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

Federal and state regulators periodically examine our business, and we may be required to remediate adverse examination findings.

The Federal Reserve, the FDIC, and the DFPI periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the USA Patriot Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. The federal banking agencies and Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have recently engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

The Federal Reserve may require us to commit capital resources to support HBC.

As a matter of policy, the Federal Reserve expects a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. The Dodd-Frank Act codified the Federal Reserve's policy on serving as a source of financial strength. Under the "source of strength" doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the bank holding company may not have the resources

to provide it and therefore may be required to borrow the funds or raise capital. Any loans by a bank holding company to its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be incurred by us to make a required capital injection to HBC becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose non-discriminatory lending and other requirements on financial institutions. The U.S. Department of Justice and other federal agencies, including the FDIC and CFPB, are responsible for enforcing these laws and regulations. A successful challenge to an institution's performance under the Community Reinvestment Act, fair lending and other compliance laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. The costs of defending, and any adverse outcome from, any such challenge could damage our reputation or could have a material adverse effect on our business, financial condition and results of operations.

We may be subject to liability for potential violations of predatory lending laws, which could adversely impact our business, financial condition and results of operations.

Various U.S. federal, state and local laws have been enacted that are designed to discourage predatory lending practices. The U.S. Home Ownership and Equity Protection Act of 1994 ("HOEPA") prohibits inclusion of certain provisions in mortgages that have interest rates or origination costs in excess of prescribed levels and requires that borrowers be given certain disclosures prior to origination. These laws also prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. Some states have enacted, or may enact, similar laws or regulations, which in some cases impose restrictions and requirements greater than those in HOEPA. In addition, under the anti-predatory lending laws of some states, the origination of certain mortgages, including loans that are not classified as "high-cost" loans under applicable law, must satisfy a net tangible benefit test with respect to the related borrower. Such tests may be highly subjective and open to interpretation. As a result, a court may determine that a home mortgage, for example, does not meet the test even if the related originator reasonably believed that the test was satisfied. It is our policy not to make predatory loans, but these laws create the potential for liability with respect to our lending and loan investment activities. They increase our cost of doing business and, ultimately, may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make. If any of our mortgages are found to have been originated in violation of predatory or abusive lending laws, we could incur losses, which could adversely impact our business, financial condition and results of operations.

Regulations relating to privacy, information security and data protection could increase our costs, affect or limit how we collect and use personal information.

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively impacted by these laws. For example, our business is subject to the Gramm-Leach-Bliley Act of 1999 which, among other things: (i) imposes certain limitations on our ability to share nonpublic personal information about our customers with nonaffiliated third parties; (ii) requires that we provide certain disclosures to customers about our information collection, sharing and security practices and afford customers the right to "opt out" of any information sharing by us with nonaffiliated third parties (with certain exceptions); and (iii) requires we develop, implement and maintain a written comprehensive information security program containing safeguards appropriate based on our size and complexity, the nature and scope of our activities, and the sensitivity of customer information we process, as well as plans for responding to data security breaches. Various state and federal banking regulators and states have also enacted data security breach notification requirements with varying levels of

individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the United States are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information.

Compliance with current or future privacy, data protection and information security laws (including those regarding security breach notification) affecting customer or employee data to which we are subject could result in higher compliance and technology costs and could restrict our ability to provide certain products and services, which could have a material adverse effect on our business, financial condition and results of operations. Our failure to comply with privacy, data protection and information security laws could result in potentially significant regulatory or governmental investigations or actions, litigation, fines, sanctions and damage to our reputation, which could have a material adverse effect on our business, financial condition and results of operations.

Potential limitations on incentive compensation contained in proposed federal agency rulemaking may adversely affect our ability to attract and retain our highest performing employees.

During the second quarter of 2016, the Federal Reserve and the FDIC, along with other U.S. regulatory agencies, jointly published proposed rules designed to implement provisions of the Dodd-Frank Act prohibiting incentive compensation arrangements that would encourage inappropriate risk taking at covered financial institutions, which includes a bank or bank holding company with \$1 billion or more in assets. It cannot be determined at this time whether or when a final rule will be adopted and whether compliance with such a final rule will substantially affect the manner in which we structure compensation for our executives and other employees. Depending on the nature and application of the final rules, we may not be able to compete successfully with certain financial institutions and other companies that are not subject to some or all of the rules to retain and attract executives and other high performing employees. If this were to occur, relationships that we have established with our customers may be impaired and our business, financial condition and results of operations could be materially adversely affected.

Risks Related to Our Common Stock

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

An investment in our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described herein, and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you could lose some or all of your investment.

The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above under "Cautionary Note Regarding Forward Looking Statements" and "Risk Factors" contained in this report. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock some of which are out of our control. Among the factors that could affect our stock price are:

- changes in business and economic condition;
- actual or anticipated quarterly fluctuations in our operating results and financial condition;
- actual occurrence of one or more of the risk factors outlined above;

- recommendations by securities analysts or failure to meet, securities analysts' estimates of our financial and operating performance, or lack of research reports by industry analysts or ceasing of coverage;
- speculation in the press or investment community generally or relating to our reputation, our operations, our market area, our competitors or the financial services industry in general;
- strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;
- actions by institutional investors;
- fluctuations in the stock price and operating results of our competitors;
- future sales of our equity, equity related or debt securities;
- proposed or adopted regulatory changes or developments;
- anticipated or pending investigations, proceedings, or litigation that involve or affect us;
- the level and extent to which we do or are allowed to pay dividends;
- trading activities in our common stock, including short selling;
- deletion from well-known index or indices;
- domestic and international economic factors unrelated to our performance; and
- general market conditions and, in particular, developments related to market conditions for the financial services industry.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the Nasdaq, its trading volume is generally less than that of other, larger financial services companies, and investors are not assured that a liquid market will exist at any given time for our common stock. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace at any given time of willing buyers and sellers of our common stock. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

Our dividend policy may change without notice, and our future ability to pay dividends is subject to restrictions.

Historically, our board of directors has declared quarterly dividends on our common stock. However, we have no obligation to continue doing so and may change our dividend policy at any time without notice to holders of our common stock. Holders of our common stock are only entitled to receive such cash dividends as our board of directors, in its discretion, may declare out of funds legally available for such payments. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs, and other factors, we have made, and will continue to make, capital management decisions and policies that could adversely impact the amount of dividends paid to holders of our common stock.

HCC is a separate and distinct legal entity from HBC. We receive substantially all of our revenue from dividends paid to us by HBC, which we use as the principal source of funds to pay our expenses and to pay dividends to our shareholders, if any. Various federal and/or state laws and regulations limit the amount of dividends that HBC may pay us. If the HBC does not receive regulatory approval or does not maintain a level of capital sufficient to permit it to make dividend payments to us while maintaining adequate capital levels, our ability to pay our expenses and our business, financial condition and results of operations could be materially adversely impacted.

As a bank holding company, we are subject to regulation by the Federal Reserve. The Federal Reserve has indicated that bank holding companies should carefully review their dividend policy in relation to the organization's overall asset quality, current and prospective earnings and level, composition and quality of capital. The guidance provides that we inform and consult with the Federal Reserve prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to our capital structure, including interest on our debt obligations. If required payments on our debt obligations are not made or are deferred, or dividends on any preferred stock we may issue are not paid, we will be prohibited from paying dividends on our common stock.

The Basel III capital rules also introduced a new capital conservation buffer on top of the minimum risk-based capital ratios. Failure to maintain a capital conservation buffer above certain levels will result in restrictions on HCC's ability to make dividend payments, redemptions or other capital distributions. These requirements, and any other new regulations or capital distribution constraints, could adversely affect the ability of HBC to pay dividends to HCC and, in turn, affect our ability to pay dividends on our common stock.

We have limited the circumstances in which our directors will be liable for monetary damages.

We have included in our articles of incorporation a provision to eliminate the liability of directors for monetary damages to the maximum extent permitted by California law. The effect of this provision will be to reduce the situations in which we or our shareholders will be able to seek monetary damages from our directors.

Our bylaws also have a provision providing for indemnification of our directors and executive officers and advancement of litigation expenses to the fullest extent permitted or required by California law, including circumstances in which indemnification is otherwise discretionary. Also, we have entered into agreements with our officers and directors in which we similarly agreed to provide indemnification that is otherwise discretionary. Such indemnification may be available for liabilities arising in connection with future offerings.

Future equity issuances could result in dilution, which could cause our common stock price to decline.

We are generally not restricted from issuing additional shares of our common stock, up to the 100 million shares of voting common stock and 10 million shares of preferred stock authorized in our articles of incorporation (subject to Nasdaq shareholder approval rules), which in each case could be increased by a vote of a majority of our shares. We may issue additional shares of our common stock in the future pursuant to current or future equity compensation plans, upon conversions of preferred stock or debt, upon exercise of warrants or in connection with future acquisitions or financings. If we choose to raise capital by selling shares of our common stock for any reason, the issuance would have a dilutive effect on the holders of our common stock and could have a material negative effect on the market price of our common stock.

We may issue shares of preferred stock in the future, which could make it difficult for another company to acquire us or could otherwise adversely affect holders of our common stock, which could depress the price of our common stock.

Although there are currently no shares of our preferred stock issued and outstanding, our articles of incorporation authorize us to issue up to 10 million shares of one or more series of preferred stock. The board also has the power, without shareholder approval (subject to Nasdaq shareholder approval rules), to set the terms of any series of preferred stock that may be issued, including voting rights, dividend rights, preferences over our common stock with respect to dividends or in the event of a dissolution, liquidation or winding up and other terms. In the event that we issue preferred stock in the future that has preference over our common stock with respect to payment of dividends or upon our liquidation, dissolution or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of the holders of our common stock or the market price of our common stock could be adversely affected. In addition, the ability of our board of directors to issue shares of preferred stock without any action on the part of our shareholders may impede a takeover of us and prevent a transaction perceived to be favorable to our shareholders.

The holders of our debt obligations and preferred stock, if any, will have priority over our common stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of interest and dividends.

The holders of our debt obligations and preferred stock, if any, will have priority over our common stock with respect to payment in the event of liquidation, dissolution or winding up and with respect to the payment of interest and dividends.

In any liquidation, dissolution or winding up of the Company, our common stock would rank below all claims of the holders of outstanding debt issued by the Company. As of December 31, 2020, we had \$40.0 million principal amount of subordinated notes outstanding due June 1, 2027. In such event, holders of our common stock would not be entitled to receive any payment or other distribution of assets upon the liquidation, dissolution or winding up of the Company until after all of the Company's obligations to the debt holders were satisfied and holders of the subordinated debt had received any payment or distribution due to them. In addition, we are required to pay interest on the subordinated notes and if we are in default in the payment of interest we would not be able to pay any dividends on our common stock.

Provisions in our charter documents and California law may have an anti-takeover effect, and there are substantial regulatory limitations on changes of control of bank holding companies.

Our articles of incorporation and bylaws contain a number of provisions relating to corporate governance and rights of shareholders that might discourage future takeover attempts. As a result, shareholders who might desire to participate in such transactions may not have an opportunity to do so. In addition, these provisions will also render the removal of our board of directors or management more difficult. Such provisions include a requirement that shareholder approval for any action proposed by the Company must be obtained at a shareholders meeting and may not be obtained by written consent. Our bylaws provide that shareholders seeking to make nominations of candidates for election as directors, or to bring other business before an annual meeting of the shareholders, must provide timely notice of their intent in writing and follow specific procedural steps in order for nominees or shareholder proposals to be brought before an annual meeting.

Provisions of our charter documents and the California General Corporation Law, or the CGCL, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial by our shareholders. Furthermore, with certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be "acting in concert" from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve. Under the California Financial Code, no person may, directly or indirectly, acquire control of a California state bank or its holding company unless the DBO has approved such acquisition of control. A person would be deemed to have acquired control of HBC if such person, directly or indirectly, has the power (i) to vote 25% or more of the voting power of HBC or (ii) to direct or cause the direction of the management and policies of HBC. For purposes of this law, a person who directly or indirectly owns or controls 10% or more of our outstanding common stock would be presumed to control HBC. Accordingly, prospective investors need to be aware of and comply with these requirements, if applicable, in connection with any purchase of shares of our common stock. Moreover, the combination of these provisions effectively inhibits certain mergers or other business combinations, which, in turn, could adversely affect the market price of our common stock.

ITEM 1B — UNRESOLVED STAFF COMMENTS

None.

ITEM 2 — PROPERTIES

The main and executive offices of Heritage Commerce Corp and Heritage Bank of Commerce are located at 224 Airport Parkway in San Jose, California 95110, with branch offices located at 15575 Los Gatos Boulevard in Los Gatos, California 95032, at 3137 Stevenson Boulevard in Fremont, California 94538, at 387 Diablo Road in Danville, California 94526, at 300 Main Street in Pleasanton, California 94566, at 1990 N. California Boulevard in Walnut Creek, California 94596, at 1987 First Street in Livermore, California 94550, at 18625 Sutter Boulevard in Morgan Hill, California 95037, at 7598 Monterey Street in Gilroy, California 95020, at 351 Tres Pinos Road in Hollister, California 95023, at 419 S. San Antonio Road in Los Altos, California 94022, at 333 W. El Camino Real in Sunnyvale,

California 94087, at 400 S. El Camino Real in San Mateo, California, 94402, at 325 Lytton Avenue in Palo Alto, California 94301, at 120 Kearny Street in San Francisco, California 94108, at 999 5th Avenue in San Rafael, California 94901 and at 2400 Broadway in Redwood City, California 94063. The Company has a loan production office at 101 Ygnacio Valley Road in Walnut Creek, California 94596. Bay View Funding's administrative offices are located at 224 Airport Parkway, San Jose, California 95110.

Main Offices

The main office of HBC, the San Jose branch office of HBC and the Bay View Funding administrative office are located at 224 Airport Parkway in San Jose, in a six-story Class-A type office building consisting of approximately 54,910 square feet, which are subject to a direct lease dated June 27, 2019, which expires on July 31, 2030. The current monthly rent is \$197,676 subject to 3% annual increases.

Branch Offices

In June of 2007, as part of the acquisition of Diablo Valley Bank, the Company took ownership of an 8,285 square foot one-story commercial office building, including the land, located at 387 Diablo Road in Danville, California.

In February 2020, the Company renewed its lease for approximately 3,172 square feet in a one-story multi-tenant multi-use building located at 3137 Stevenson Boulevard in Fremont, California. The monthly rent payment is \$10,128, subject to annual increases of 3% until the lease expires on February 29, 2024.

In August of 2014, the Company amended and extended its lease for approximately 4,716 square feet in a one-story multi-tenant office building located at 18625 Sutter Boulevard in Morgan Hill, California. The current monthly rent payment is \$6,639, subject to annual increases of 2% until the lease expires on October 31, 2021. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In July of 2017, the Company extended its lease for approximately 5,213 square feet on the first floor in a two-story multi-tenant office building located at 419 S. San Antonio Road in Los Altos, California. The current monthly rent payment is \$30,133, subject to annual increases of 3% until the lease expires on April 30, 2023. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In March of 2018, the Company extended its lease for approximately 3,022 square feet on the first floor of a three-story multi-tenant office building located at 333 West El Camino Real in Sunnyvale, California. The current monthly rent payment is \$17,725, subject to annual increases of 3% until the lease expires on May 31, 2023.

In May of 2018, as part of the acquisition of United American Bank, the Company assumed a lease for approximately 2,369 square feet on the first floor of a two-story multi-tenant multi-use building located at 2400 Broadway in Redwood City, California. The current monthly rent payment is \$13,712, subject to annual increases of 5% until the lease expires on October 31, 2022. The Company has reserved the right to extend the lease for one additional period of two years.

In November of 2018, the Company extended its lease for approximately 1,920 square feet in a one-story stand-alone building located in an office complex at 15575 Los Gatos Boulevard in Los Gatos, California. The current monthly rent payment is \$7,129, subject to annual increases of 3% until the lease expires on November 30, 2023. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In May of 2019, the Company amended its lease for approximately 4,096 square feet in a one-story stand-alone office building located at 300 Main Street in Pleasanton, California. The current monthly rent payment is \$21,089, subject to 3% annual increases until the lease expires on April 30, 2026. The Company has reserved the right to extend the term of the lease for two additional periods of five years.

In June of 2019, the Company exercised its right to extend the lease term for an additional five years for approximately 3,391 square feet in a two-story multi-tenant commercial center located at 351 Tres Pinos in Hollister, California. The current monthly rent payment is \$4,914 subject to 3% annual increases until the lease expires on June 30, 2024.

In August of 2019, the Company extended its lease for approximately 2,505 square feet on the first floor in a three-story multi-tenant multi-use building located at 7598 Monterey Street in Gilroy, California. The current monthly rent payment is \$5,926 until the lease expires on September 30, 2021.

In August of 2019, the Company renewed a lease for approximately 3,772 square feet on the first and second floors in a two-story multi-tenant multi-use building located at 1987 First Street in Livermore, California. The current monthly rent payment is \$9,045, until the lease expires on September 30, 2024. The Company has reserved the right to extend the term of the lease for one additional period of five years.

In October of 2019, as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 8,565 square feet on the twenty third floor in a multi-tenant office building located at 120 Kearny Street in San Francisco, California. The current monthly rent payment is \$60,255 until the lease expires on March 31, 2021. In January 2021 the Company renewed the lease for this office for approximately 6,233 square feet. The monthly rent beginning April 2021 will be \$44,150, subject to annual increases of 3% until the lease expires in March 31, 2026.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 4,188 square feet on the first floor in a multi-tenant office building located at 999 5th Avenue in San Rafael, California. The current monthly rent payment is \$19,099, subject to annual increases of 3% until the lease expires on November 30, 2022. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 4,154 square feet on the first floor in a multi-tenant office building located at 325 Lytton Avenue in Palo Alto, California. The current monthly rent payment is \$38,615 subject to annual increases of 3% until the lease expires January 31, 2025. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 7,029 square feet on the first floor in a multi-tenant office building located at 1990 N. California Boulevard in Walnut Creek, California. The current monthly rent payment is \$28,046, subject to annual increases of 3% until the lease expires December 31, 2027. The Company has reserved the right to extend the lease for one additional period of five years.

In October of 2019, also as part of the acquisition of Presidio Bank, the Company assumed a lease for approximately 3,063 square feet on the first floor in a multi-tenant office building located at 400 S. Camino Real in San Mateo, California expiring on October 31, 2024. In January 2020, The Company amended this lease expiration date to October 31, 2030 and executed a new lease for an additional suite on the tenth floor of comprised of 5,023 square feet. The current monthly rent payment for the combined space of approximately 8,086 square feet is \$54,704, subject to annual increases of 3% until the lease expires October 31, 2030. The Company has reserved the right to extend the lease for one additional period of five years.

Loan Production Office

As a result of the merger with Presidio Bank and the closing of its Walnut Creek Branch at 101 S. Ygnacio Valley Road in Walnut Creek California, the Company retained approximately 1,461 square feet of office space at 101 S. Ygnacio Valley Road to use as a loan production office. The current monthly rent payment is \$4,967 until the lease expires on August 15, 2021.

Bay View Funding Office

The Bay View Funding administrative office is located at 224 Airport Parkway in San Jose, California, consisting of approximately 7,849 square feet and is subject to a sublease with Heritage Bank of Commerce dated March 6, 2020. The current monthly rent payment is \$29,095, which is included in the main office of HBC's total rent of \$197,676, subject to 3% annual increases until the sublease expires July 31, 2030.

For additional information on operating leases and rent expense, refer to Note 7 to the Consolidated Financial Statements following "Item 15 — Exhibits and Financial Statement Schedules."

ITEM 3 — LEGAL PROCEEDINGS

We evaluate all claims and lawsuits with respect to their potential merits, our potential defenses and counterclaims, settlement or litigation potential and the expected effect on us. The outcome of any claims or litigation, regardless of the merits, is inherently uncertain. Any claims and other lawsuits, and the disposition of such claims and lawsuits, whether through settlement or litigation, could be time-consuming and expensive to resolve, divert our attention from executing our business plan, result in efforts to enjoin our activities, and lead to attempts by third parties to seek similar claims.

For more information regarding legal proceedings, see Note 16 “Commitments and Contingencies” to the consolidated financial statements.

ITEM 4 — MINE SAFETY DISCLOSURES

Not Applicable.

PART II

ITEM 5 — MARKET FOR THE REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The Company’s common stock is listed on the NASDAQ Global Select Market under the symbol “HTBK.”

The information in the following table for 2020 and 2019 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		Dividend Per Share
	High	Low	
Year ended December 31, 2020:			
Fourth quarter	\$ 9.33	\$ 6.67	\$ 0.13
Third quarter	\$ 7.69	6.20	\$ 0.13
Second quarter	\$ 9.36	6.74	\$ 0.13
First quarter	\$ 12.80	6.45	\$ 0.13
Year ended December 31, 2019:			
Fourth quarter	\$ 13.05	\$ 11.14	\$ 0.12
Third quarter	\$ 12.43	11.16	\$ 0.12
Second quarter	\$ 12.84	11.80	\$ 0.12
First quarter	\$ 14.43	11.57	\$ 0.12

The closing price of our common stock on February 10, 2021 was \$9.42 per share as reported by the NASDAQ Global Select Market.

As of February 10, 2021, there were approximately 839 holders of record of common stock. There are no other classes of common equity outstanding.

Dividend Policy

The amount of future dividends will depend upon our earnings, financial condition, capital requirements and other factors, and will be determined by our board of directors on a quarterly basis. It is Federal Reserve policy that bank holding companies generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. It is also Federal Reserve policy that bank holding companies not maintain dividend levels that undermine the holding company’s

ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. Under the federal Prompt Corrective Action regulations, the Federal Reserve or the FDIC may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as undercapitalized.

As a holding company, our ability to pay cash dividends is affected by the ability of our bank subsidiary, HBC, to pay cash dividends. The ability of HBC (and our ability) to pay cash dividends in the future and the amount of any such cash dividends is and could be in the future further influenced by bank regulatory requirements and approvals and capital guidelines.

The decision whether to pay dividends will be made by our board of directors in light of conditions then existing, including factors such as our results of operations, financial condition, business conditions, regulatory capital requirements and covenants under any applicable contractual arrangements, including agreements with regulatory authorities.

For information on the statutory and regulatory limitations on the ability of the Company to pay dividends and on HBC to pay dividends to HCC see “*Item 1 — Business — Supervision and Regulation — Heritage Commerce Corp — Dividend Payments, Stock Redemptions, and Repurchases and — Heritage Bank of Commerce — Dividend Payments.*”

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information as of December 31, 2020 regarding equity compensation plans under which equity securities of the Company were authorized for issuance:

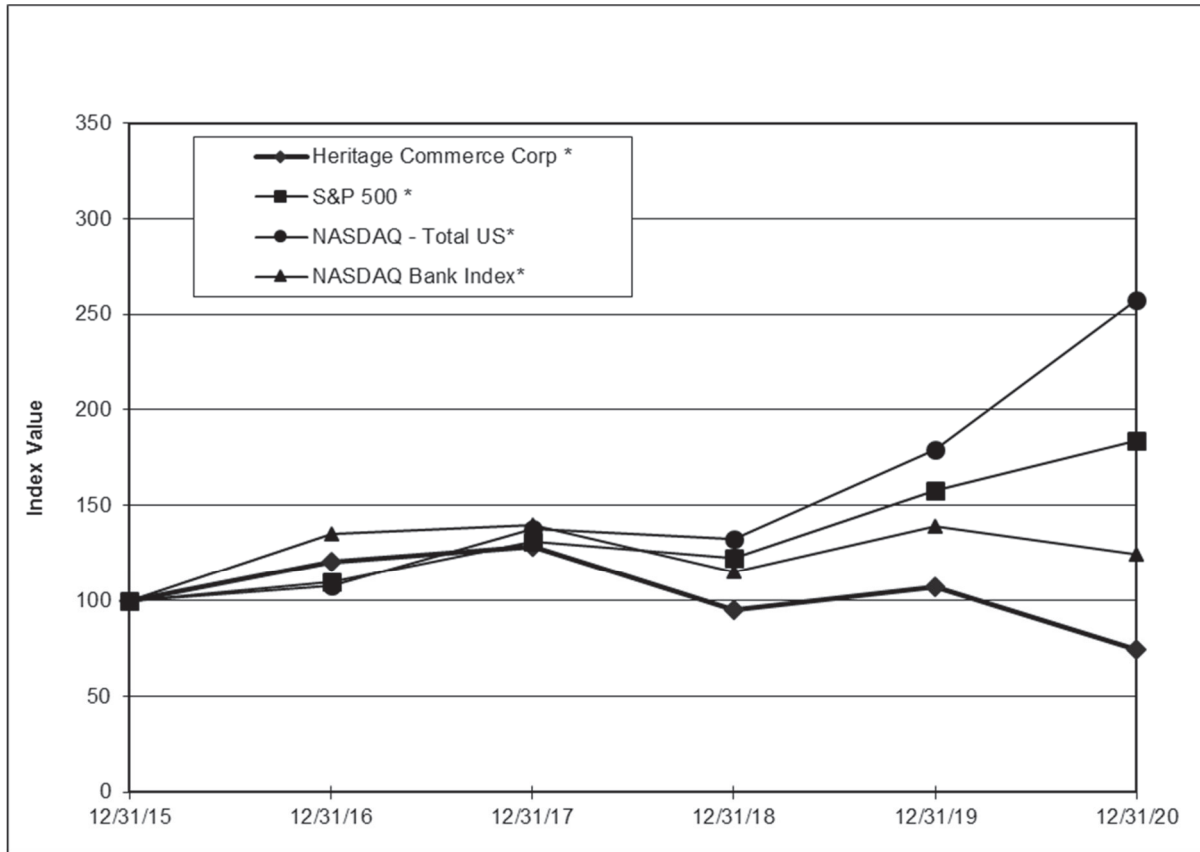
	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,546,821 ⁽¹⁾	\$ 9.30	2,409,062 ⁽²⁾
Equity compensation plans not approved by security holders	N/A	N/A	N/A

(1) Consists of 266,818 options to acquire shares under the Company's Amended and Restated 2004 Equity Plan, 1,602,919 options to acquire shares under the Company's 2013 Equity Incentive Plan, and the aggregate amount of 677,084 stock options assumed from the Presidio stock option and equity incentive plans.

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

Performance Graph

The following graph compares the stock performance of the Company from December 31, 2015 to December 31, 2020, 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, 2015 to December 31, 2020, 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.

Index	Period Ending					
	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19	12/31/20
Heritage Commerce Corp *	100	121	128	95	107	74
S&P 500 *	100	110	131	123	158	184
NASDAQ - Total US*	100	108	138	133	179	257
NASDAQ Bank Index*	100	135	140	115	139	124

* Source: S&P Global — (434) 977-1600

ITEM 6 — SELECTED FINANCIAL DATA

The following table presents a summary of selected financial information that should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto following Item 15 — *Exhibits and Financial Statement Schedules*.

SELECTED FINANCIAL DATA

	AT OR FOR YEAR ENDED DECEMBER 31,				
	2020	2019	2018	2017	2016
(Dollars in thousands, except per share data)					
INCOME STATEMENT DATA:					
Interest income	\$ 150,471	\$ 142,659	\$ 129,845	\$ 106,911	\$ 94,431
Interest expense	8,581	10,847	7,822	5,387	3,211
Net interest income before provision for credit losses on loans(1)	141,890	131,812	122,023	101,524	91,220
Provision for credit losses on loans(1)	13,233	846	7,421	99	1,237
Net interest income after provision for credit losses on loans(1)	128,657	130,966	114,602	101,425	89,983
Noninterest income	9,922	10,244	9,574	9,612	11,625
Noninterest expense	89,511	84,898	75,521	60,738	57,639
Income before income taxes	49,068	56,312	48,655	50,299	43,969
Income tax expense	13,769	15,851	13,324	26,471	16,588
Net income	35,299	40,461	35,331	23,828	27,381
Dividends and discount accretion on preferred stock	—	—	—	—	(1,512)
Net income available to common shareholders	35,299	40,461	35,331	23,828	25,869
Less: undistributed earnings allocated to Series C Preferred Stock	—	—	—	—	(1,278)
Distributed and undistributed earnings allocated to common shareholders	\$ 35,299	\$ 40,461	\$ 35,331	\$ 23,828	\$ 24,591
PER COMMON SHARE DATA:					
Basic net income(2)	\$ 0.59	\$ 0.87	\$ 0.85	\$ 0.63	\$ 0.72
Diluted net income(3)	\$ 0.59	\$ 0.84	\$ 0.84	\$ 0.62	\$ 0.72
Book value per common share	\$ 9.64	\$ 9.71	\$ 8.49	\$ 7.10	\$ 6.85
Tangible book value per common share	\$ 6.57	\$ 6.55	\$ 6.28	\$ 5.76	\$ 5.46
Dividend payout ratio(4)	88.04 %	56.16 %	52.26 %	63.95 %	49.77 %
Weighted average number of shares outstanding — basic	59,478,343	46,684,384	41,469,211	38,095,250	33,933,806
Weighted average number of shares outstanding — diluted	60,169,139	47,906,229	42,182,939	38,610,815	34,219,121
Common shares outstanding at period end	59,917,457	59,368,156	43,288,750	38,200,883	37,941,007
BALANCE SHEET DATA:					
Securities (available-for sale and held-to-maturity)	\$ 533,163	\$ 771,385	\$ 836,241	\$ 790,193	\$ 630,599
Net loans	\$ 2,574,861	\$ 2,510,559	\$ 1,858,557	\$ 1,563,009	\$ 1,483,518
Allowance for credit losses on loans(5)	\$ 44,400	\$ 23,285	\$ 27,848	\$ 19,658	\$ 19,089
Goodwill and other intangible assets	\$ 184,295	\$ 187,835	\$ 95,760	\$ 51,253	\$ 52,614
Total assets	\$ 4,634,114	\$ 4,109,463	\$ 3,096,562	\$ 2,843,452	\$ 2,570,880
Total deposits	\$ 3,914,486	\$ 3,414,768	\$ 2,637,532	\$ 2,482,989	\$ 2,262,140
Subordinated debt, net of issuance costs	\$ 39,740	\$ 39,554	\$ 39,369	\$ 39,183	\$ —
Short-term borrowings	\$ —	\$ 328	\$ —	\$ —	\$ —
Total shareholders' equity	\$ 577,889	\$ 576,708	\$ 367,466	\$ 353,566	\$ 259,850
SELECTED PERFORMANCE RATIOS:(6)					
Return on average assets	0.80 %	1.21 %	1.16 %	0.86 %	1.13 %
Return on average tangible assets	0.83 %	1.25 %	1.19 %	0.88 %	1.15 %
Return on average equity	6.12 %	9.51 %	10.79 %	8.86 %	10.71 %
Return on average tangible equity	9.04 %	13.09 %	14.41 %	10.98 %	13.55 %
Net interest margin (fully tax equivalent)	3.50 %	4.28 %	4.31 %	3.99 %	4.12 %
Efficiency ratio (7)	58.96 %	59.76 %	57.39 %	54.65 %	56.04 %
Average net loans (excludes loans held-for-sale) as a percentage of average deposits	69.58 %	69.65 %	67.35 %	62.65 %	66.25 %
Average total shareholders' equity as a percentage of average total assets	13.00 %	12.69 %	10.72 %	9.76 %	10.54 %
SELECTED ASSET QUALITY DATA:(8)					
Net charge-offs (recoveries) to average loans	0.03 %	0.27 %	(0.04)%	(0.03)%	0.08 %
Allowance for credit losses on loans to total loans (5)	1.70 %	0.92 %	1.48 %	1.24 %	1.27 %
Nonperforming loans to total loans	0.30 %	0.39 %	0.79 %	0.16 %	0.20 %
Nonperforming assets	\$ 7,869	\$ 9,828	\$ 14,887	\$ 2,485	\$ 3,288
HERITAGE COMMERCE CORP CAPITAL RATIOS:					
Total risk-based	16.5 %	14.6 %	15.0 %	14.4 %	12.5 %
Tier 1 risk-based	14.0 %	12.5 %	12.0 %	11.4 %	11.5 %
Common equity Tier 1 risk-based capital	14.0 %	12.5 %	12.0 %	11.4 %	11.5 %
Leverage	9.1 %	9.7 %	8.9 %	8.0 %	8.5 %

Notes:

- (1) Provision for credit losses on loans for the year ended December 31, 2020. Provision for loan losses for previous years.
 - (2) Represents distributed and undistributed earnings allocated to common shareholders, divided by the average number of shares of common stock outstanding for the respective period. See Note 17 to the consolidated financial statements.
 - (3) Represents distributed and undistributed earnings allocated to common shareholders, divided by the average number of shares of common stock and common stock-equivalents outstanding for the respective period. See Note 17 to the consolidated financial statements.
 - (4) Percentage is calculated based on dividends paid on common stock and Series C Preferred Stock for the year ended December 31, 2016 (on an as converted basis) divided by net income.
 - (5) Allowance for credit losses on loans at December 31, 2020. Allowance for loan losses for previous years.
 - (6) Average balances used in this table and throughout this Annual Report are based on daily averages.
 - (7) The efficiency ratio is calculated by dividing noninterest expenses by the sum of net interest income before provision for credit losses on loans and noninterest income.
 - (8) Average loans and total loans exclude loans held-for-sale.
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ITEM 7 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of Heritage Commerce Corp (the "Company" or "HCC"), its wholly-owned subsidiary, Heritage Bank of Commerce (the "Bank" or "HBC"), and HBC's wholly-owned subsidiary, CSNK Working Capital Finance Corp, a California Corporation, dba Bay View Funding. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our consolidated financial statements and the accompanying notes presented elsewhere in this report. Unless we state otherwise or the context indicates otherwise, references to the "Company," "Heritage," "we," "us," and "our," in this Report on Form 10-K refer to Heritage Commerce Corp and its subsidiaries.

The Company completed its acquisition of Bay View Funding on November 1, 2014. The Company completed its merger with Focus Business Bank ("Focus") on August 20, 2015. The Company completed its merger with Tri-Valley Bank ("Tri-Valley") on April 6, 2018, and the Company completed its merger with United American Bank ("United American") on May 4, 2018. The Company completed its merger with Presidio Bank ("Presidio") on October 11, 2019 (the "Presidio merger date"). These mergers are discussed in more detail below, and in Notes 1, 8, and 9 to the consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States ("U.S. GAAP") requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expense in the financial statements. Various elements of our accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those we applied, which might have produced different results that could have had a material effect on the financial statements.

We have identified the following accounting policies and estimates that, due to the inherent judgments and assumptions and the potential sensitivity of the financial statements to those judgments and assumptions, are critical to an understanding of our financial statements. We believe that the judgments, estimates and assumptions used in the preparation of the Company's financial statements are appropriate. For a further description of our accounting policies, see Note 1 — *Summary of Significant Accounting Policies* in the financial statements included in this Form 10-K.

Allowance for Credit Losses on Loans ("ACLL")

As a result of our January 1, 2020, adoption of Accounting Standards Update ("ASU") No. 2016-13, Measurement of Credit Losses on Financial Instruments, and its related amendments, our methodology for estimating the allowance for credit losses changed significantly from December 31, 2019. The standard replaced the "incurred loss" method with an "expected loss" method known as current expected credit loss ("CECL"). The CECL approach requires an estimate of the credit losses expected over the life of a loan (or pool of loans). It removes the incurred loss approach's threshold that delayed the recognition of a credit loss until it was "probable" a loss event was "incurred."

The estimate of expected credit losses under the CECL approach is based on relevant information about past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amounts. Historical loss experience is generally the starting point for estimating expected credit losses. We then consider whether the historical loss experience should be adjusted for asset-specific risk characteristics or current conditions at the reporting date that did not exist over the period from which historical experience was used. Finally, we consider forecasts about future economic conditions that are reasonable and supportable.

Management's evaluation of the appropriateness of the allowance for credit losses is often the most critical of accounting estimates for a financial institution. Our determination of the amount of the ACLL is a critical accounting estimate as it requires significant reliance on the use of estimates and significant judgment as to the amount and timing of expected future cash flows on criticized loans, significant reliance on historical loss rates, consideration of our quantitative and qualitative evaluation of economic factors, and the reliance on reasonable and supportable forecasts.

The allowance for credit losses attributable to each portfolio segment considers relevant available information from internal and external sources, relating to past events and current conditions. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics and environmental conditions such as concentrations of credit risk (geographic, large borrower, and industry), economic conditions, changes in underwriting standards, experience and depth of lending staff, trends in delinquencies, and the level of criticized loans. Going forward, the impact of utilizing the CECL approach to calculate the reserve for credit losses will be significantly influenced by the composition, characteristics and quality of our loan portfolio, and the prevailing economic conditions and forecasts utilized. Material changes to these and other relevant factors may result in greater volatility to the reserve for credit losses, and therefore, greater volatility to our reported earnings. See Note 4 to the Consolidated Financial Statements and the “*Credit Quality and Performance*” and “*Allowance for Credit Losses on Loans*” sections for more information on the Allowance.

Executive Summary

This summary is intended to identify the most important matters on which management focuses when it evaluates the financial condition and performance of the Company. When evaluating financial condition and performance management looks at certain key metrics and measures. The Company’s evaluation includes comparisons with peer group financial institutions and its own performance objectives established in the internal planning process.

The primary activity of the Company is commercial banking. The Company’s operations are located in the general San Francisco Bay Area of California in the counties of Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara. The Company’s market includes the cities of Oakland, San Francisco and San Jose and the headquarters of a number of technology based companies in the region known commonly as Silicon Valley. The Company’s customers are primarily closely held businesses and professionals.

Performance Overview

For the year ended December 31, 2020, net income was \$35.3 million, or \$0.59 per average diluted common share, compared to \$40.5 million, or \$0.84 per average diluted common share, for the year ended December 31, 2019, and \$35.3 million, or \$0.84 per average diluted common share for the year ended December 31, 2018. The Company’s annualized return on average tangible assets was 0.83% and annualized return on average tangible equity was 9.04% for the year ended December 31, 2020, compared to 1.25% and 13.09%, respectively, for the year ended December 31, 2019, and 1.19% and 14.41%, respectively, for the year ended December 31, 2018.

Earnings for the year ended December 31, 2020 were impacted by the effect of our \$13.3 million pre-tax CECL related provision for credit losses on loans for the first quarter of 2020, driven by forecasted effects on economic activity from the COVID-19 pandemic, and \$2.6 million of pre-tax merger-related costs resulting from the merger with Presidio. Earnings for the year ended December 31, 2019 were reduced by pre-tax merger-related costs of \$11.1 million, related to the merger with Presidio. Pre-tax earnings for the year ended December 31, 2019 were further reduced by an additional \$2.0 million of provision for loan losses for certain non-impaired loans acquired at a premium from Presidio. Earnings for the years ended December 31, 2018 were reduced by pre-tax merger-related costs of \$9.2 million, for the mergers with Tri-Valley and United American.

Coronavirus (COVID-19)

In response to two economic stimulus laws passed by Congress in the first half of the 2020, the Bank funded 1,105 U.S. Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”) loans, with total principal balances of \$333.4 million. Through 2020, PPP loan payoffs totaled \$9.1 million while SBA loan forgiveness totaled \$33.7 million and the Bank ended the fourth quarter of 2020 with \$290.7 million in outstanding PPP loan balances. These loans generated \$2.2 million in interest income and \$3.9 million in net deferred fee revenue during 2020. At December 31, 2020, total loans included remaining deferred fees on PPP loans of (\$6.8) million and deferred costs of \$783,000.

On April 7, 2020, the U.S. banking agencies issued an Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus. The statement describes accounting for COVID-19-related loan modifications, including clarifying the interaction between current accounting rules and the temporary relief provided by the Coronavirus Aid, Relief, and Economic Security (“CARES Act”). The Bank made accommodations for initial payment deferrals for a number of customers of up to 90 days, generally, with the

potential, upon application, of an additional 90 days of payment deferral (180 days maximum). The Bank also waived all normal applicable fees. Most of the deferrals we originally granted have returned to regular payments. The following table shows the deferrals at December 31, 2020 by category:

	Underlying Collateral		Total
	Business Assets	Real Estate	
	(Dollar in thousands)		
Initial Deferrals ⁽¹⁾	\$ -	\$ 1,573	\$ 1,573
2nd Deferrals ⁽²⁾	295	684	979
Total	\$ 295	\$ 2,257	\$ 2,552

⁽¹⁾ Initial deferrals were generally for 3 months

⁽²⁾ 2nd deferrals were for an additional 3 months

In addition to its portfolio of SBA PPP loans, the Bank also has a portfolio of SBA 7(a) loans totaling \$50.3 million as of February 28, 2021 (the most recent available data). As part of the SBA's Coronavirus debt relief efforts, beginning in April of 2020, the SBA commenced a program to cover payments of principal, interest and any associated fees for these borrowers. The following table reflects the status of these SBA 7(a) loans as of February 28, 2021:

	Dollars	Number of Loans
	(Dollars in thousands)	
SBA 7(a) loans (monthly payments are made through the Economic Aid Act)	\$ 46,245	239
Payments Not Made / NSF / Returned	604	7
New loans / No payment due	752	6
CARES	2,483	10
Request for Deferral or on Deferment	234	2
Total Portfolio	\$ 50,318	264

The CARES Act was recently amended to include \$3.5 billion of extended debt relief payments for SBA borrowers. The program will initially provide for 3 payments of principal and interest to a maximum of \$9,000 per month under various criteria and then an additional 5 payments for borrowers considered "underserved" as defined in the amended legislation.

Credit Quality and Performance

At December 31, 2020, nonperforming assets ("NPAs") declined by (\$1.9) million, or (20%), to \$7.9 million, compared to \$9.8 million at December 31, 2019. Classified assets increased to \$34.0 million, or 0.73% of total assets, at December 31, 2020, compared to \$32.6 million, or 0.79% of total assets, at December 31, 2019.

There was a \$13.2 million provision for credit losses on loans for the year ended December 31, 2020, compared to an \$846,000 provision for loan losses for the year ended December 31, 2019. The increase in the provision for credit losses on loans for the year ended December 31, 2020, compared to the year ended December 31, 2019, was driven primarily by a deteriorated economic outlook resulting from the COVID-19 pandemic. The three loan classes where the largest increases in reserves were recorded under the CECL loss rate methodology were investor-owned CRE, land and construction, and commercial and industrial ("C&I"). Ongoing impacts of the CECL methodology will be dependent upon changes in economic conditions and forecasts, originated and acquired loan portfolio composition, portfolio duration, and other factors.

The Company continues to monitor portfolio loans made to commercial customers with businesses in higher risk sectors due to the COVID-19 pandemic. The following table provides a breakdown of such loans as a percentage of total loans at December 31, 2020, September 30, 2020, June 30, 2020, and March 31, 2020:

HIGHER RISK SECTORS	% of Total Loans at December 31, 2020	% of Total Loans at September 30, 2020	% of Total Loans at June 30, 2020	% of Total Loans at March 31, 2020
Health care and social assistance:				
Offices of dentists	2.01 %	1.86 %	1.79 %	1.63 %
Offices of physicians (except mental health specialists)	0.81 %	0.74 %	0.76 %	0.70 %
Other community housing services	0.28 %	0.27 %	0.27 %	0.11 %
All others	2.15 %	2.15 %	2.21 %	1.84 %
Total health care and social assistance	5.25 %	5.02 %	5.03 %	4.28 %
Retail trade:				
Gasoline stations with convenience stores	2.16 %	1.97 %	1.90 %	1.98 %
All others	2.34 %	2.44 %	2.44 %	2.18 %
Total retail trade	4.50 %	4.41 %	4.34 %	4.16 %
Accommodation and food services:				
Full-service restaurants	1.30 %	1.40 %	1.38 %	0.86 %
Limited-service restaurants	0.57 %	0.74 %	0.79 %	0.63 %
Hotels (except casino hotels) and motels	0.95 %	0.92 %	0.89 %	0.94 %
All others	0.68 %	0.68 %	0.70 %	0.52 %
Total accommodation and food services	3.50 %	3.74 %	3.76 %	2.95 %
Educational services:				
Elementary and secondary schools	0.58 %	0.57 %	0.65 %	0.15 %
Education support services	0.45 %	0.43 %	0.40 %	0.15 %
All others	0.19 %	0.17 %	0.24 %	0.17 %
Total educational services	1.22 %	1.17 %	1.29 %	0.47 %
Arts, entertainment, and recreation	1.34 %	1.27 %	1.26 %	1.09 %
Purchased participations in micro loan portfolio	0.60 %	0.68 %	0.80 %	0.95 %
Total higher risk sectors	16.41 %	16.29 %	16.48 %	13.90 %

Presidio Merger

The Company completed its merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with Presidio effective October 11, 2019 (the “merger date”). Presidio’s results of operations were included in the Company’s results of operations beginning October 12, 2019. The Presidio systems and integration conversion was successfully completed in the first quarter of 2020. Merger-related costs reduced pre-tax earnings by \$2.6 million for the year ended December 31, 2020, compared to \$11.1 million for year ended December 31, 2019.

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

Tri-Valley and United American Mergers

The Company completed the merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with Tri-Valley effective as of April 6, 2018. Tri-Valley’s results of operations have been included in the Company’s results of operations beginning April 7, 2018. Tri-Valley was a full-service California state-chartered commercial bank with branches in San Ramon and Livermore, California and served businesses and individuals primarily in Contra Costa and Alameda counties in Northern California. The Company closed the San Ramon office on July 13, 2018.

The Company completed the merger of its wholly-owned bank subsidiary Heritage Bank of Commerce with United American effective as of May 4, 2018. United American’s results of operations have been included in the Company’s results of operations beginning May 5, 2018. United American was a full-service commercial bank located in San Mateo County with full-service branches located in San Mateo, Redwood City and Half Moon Bay, California and serviced businesses, professionals and individuals. The Company closed the Half Moon Bay office on August 10, 2018.

Factoring Activities - Bay View Funding

	December 31, 2020	December 31, 2019
	(Dollars in thousands)	
Total factored receivables.	\$ 47,201	\$ 45,980
Average factored receivables		
For the year ended	\$ 45,765	\$ 46,710
Total full time equivalent employees.	31	34

2020 Highlights

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

- Net interest income increased 8% to \$141.9 million for the year ended December 31, 2020, compared to \$131.8 million for the year ended December 31, 2019, primarily due to an increase in the average balance of loans resulting from the Presidio merger, additional interest and fee income from PPP loans, and an increase in the accretion of the loan discount into loan interest income from our merger with Presidio, partially offset by decreases in the prime rate, and decreases in the yield on investment securities and overnight funds.
- The fully tax equivalent ("FTE") net interest margin contracted 78 basis points to 3.50% for the year ended December 31, 2020, compared to 4.28% for the year ended December 31, 2019, primarily due to a decline in the average yield on loans, investment securities, and overnight funds, partially offset by a decline in the cost of interest-bearing liabilities.
- The average yield on the total loan portfolio decreased to 5.06% for the year ended December 31, 2020 compared to 5.86% for the year ended December 31, 2019, primarily due to decreases in the prime rate on loans and new average balances of lower yielding PPP loans, partially offset by higher PPP loan fees and an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions.
- In aggregate, the original total net purchase discount on loans from the Focus, Tri-Valley, United American, and Presidio loan portfolio was \$25.2 million. In aggregate, the remaining net purchase discount on total loans acquired was \$12.1 million at December 31, 2020.
- The average cost of deposits was 0.17% for the year ended December 31, 2020, compared to 0.29% for the year ended December 31, 2019.
- There was a \$13.2 million provision for credit losses on loans for the year ended December 31, 2020, compared to an \$846,000 provision for loan losses for the year ended December 31, 2019. The increase in the provision for credit losses on loans for the year ended December 31, 2020, compared to the year ended December 31, 2019, was driven primarily by a significantly deteriorated economic outlook resulting from the Coronavirus pandemic.
- Noninterest income was \$9.9 million for the year ended December 31, 2020, compared to \$10.2 million for the year ended December 31, 2019, primarily due to lower service charges and fees on deposit accounts, partially offset by an increase in the cash surrender value of life insurance, a gain realized on a warrant exercised, and a gain on the disposition of foreclosed assets during the first quarter of 2020.
- Noninterest expense for the year ended December 31, 2020 increased to \$89.5 million, compared to \$84.9 million for the year ended December 31, 2019, primarily due to higher salaries and employee benefits as a result of annual salary increases, and additional employees and operating costs added as a result of the Presidio merger, partially offset by lower merger-related costs.
 - The following table reflects pre-tax merger-related costs resulting from the mergers for the periods indicated:

	For the Year Ended		
	December 31, 2020	December 31, 2019	December 31, 2018
	(Dollars in thousands)		
Salaries and employee benefits	\$ 356	\$ 6,580	\$ 3,569
Other	2,245	4,500	5,598
Total merger-related costs	<u>\$ 2,601</u>	<u>\$ 11,080</u>	<u>\$ 9,167</u>

- The efficiency ratio for the year ended December 31, 2020 decreased to 58.96%, compared to 59.76% for the year ended December 31, 2019.
- Income tax expense for the year ended December 31, 2020 was \$13.8 million, compared to \$15.9 million for the year ended December 31, 2019. The effective tax rate was 28.1% for the years ended December 31, 2020 and December 31, 2019.

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

- Cash, interest bearing deposits in other financial institutions and securities available-for-sale increased 59% to \$1.37 billion at December 31, 2020, from \$862.2 million at December 31, 2019.
- Securities held-to-maturity, at amortized cost, totaled \$297.4 million, at December 31, 2020, compared to \$366.6 million at December 31, 2019.
- Loans, excluding loans held-for-sale, increased \$85.4 million, or 3%, to \$2.62 billion at December 31, 2020, compared to \$2.53 billion at December 31, 2019. Total loans at December 31, 2020, included \$290.7 million in PPP loans.
- NPAs were \$7.9 million, or 0.17% of total assets at December 31, 2020, compared to \$9.8 million, or 0.24% of total assets at December 31, 2019.
- Classified assets were \$34.0 million at December 31, 2020, compared to \$32.6 million at December 31, 2019. There were no foreclosed assets at December 31, 2020 and December 31, 2019.
- Net charge-offs totaled \$688,000 for the year ended December 31, 2020, compared to \$5.4 million for the year ended December 31, 2019. Net charge-offs of \$5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling \$5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling \$5.5 million in net charge-offs had a total of \$4.7 million in specific reserves.
- The ACLL at December 31, 2020, was \$44.4 million, or 1.70% of total loans, representing 564.24% of nonperforming loans. The allowance for loan losses (“ALLL”) at December 31, 2019, was \$23.3 million, or 0.92% of total loans, representing 236.93% of nonperforming loans.
- Total deposits increased \$499.7 million, or 15%, to \$3.91 billion at December 31, 2020, compared to \$3.41 billion at December 31, 2019.
- Deposits, excluding all time deposits and CDARS deposits, increased \$510.1 million, or 16%, to \$3.74 billion at December 31, 2020, compared to \$3.23 billion at December 31, 2019.
- The ratio of noncore funding (which consists of time deposits of \$250,000 and over, CDARS deposits, brokered deposits, securities under agreement to repurchase, subordinated debt and short-term borrowings) to total assets was 3.61% at December 31, 2020, compared to 4.10% at December 31, 2019.
- The loan to deposit ratio was 66.91% at December 31, 2020, compared to 74.20% at December 31, 2019.

- The Company's consolidated capital ratios exceeded regulatory guidelines and the Bank's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2020.

Capital Ratios	Heritage Commerce Corp	Heritage Bank of Commerce	Well-capitalized Financial Institution Basel III PCA Regulatory Guidelines	Basel III Minimum Regulatory Requirement(1)
Total Risk-Based	16.5 %	15.8 %	10.0 %	10.5 %
Tier 1 Risk-Based	14.0 %	14.6 %	8.0 %	8.5 %
Common Equity Tier 1 Risk-based .	14.0 %	14.6 %	6.5 %	7.0 %
Leverage	9.1 %	9.5 %	5.0 %	4.0 %

(1) Basel III minimum regulatory requirements for both HCC and HBC include a 2.5% capital conservation buffer, except the leverage ratio.

RESULTS OF OPERATIONS

The Company earns income from two primary sources. The first is interest income, which is interest income generated by earning assets less interest expense on interest-bearing liabilities. The second is noninterest income, which primarily consists of gains on the sale of loans, loan servicing fees, customer service charges and fees, the increase in cash surrender value of life insurance, and gains on the sale of securities. The majority of the Company's noninterest expenses are operating costs that relate to providing a full range of banking services to our customers.

Net Interest Income and Net Interest Margin

The level of net interest income depends on several factors in combination, including growth in earning assets, yields on earning assets, the cost of interest-bearing liabilities, the relative volumes of earning assets and interest-bearing liabilities, and the mix of products that comprise the Company's earning assets, deposits, and other interest-bearing liabilities. Net interest income can also be impacted by the reversal of interest on loans placed on nonaccrual status, and recovery of interest on loans that have been on nonaccrual and are either sold or returned to accrual status. To maintain its net interest margin, the Company must manage the relationship between interest earned and paid.

The following Distribution, Rate and Yield table presents for each of the past three years, the average amounts outstanding for the major categories of the Company's balance sheet, the average interest rates earned or paid thereon, and the resulting net interest margin on average interest earning assets for the periods indicated. Average balances are based on daily averages.

	Year Ended December 31,								
	2020			2019			2018		
	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate	Average Balance	Interest Income / Expense	Average Yield / Rate
(Dollars in thousands)									
Assets:									
Loans, gross ⁽¹⁾⁽²⁾	\$ 2,631,495	\$ 133,169	5.06 %	\$ 1,994,917	\$ 116,808	5.86 %	\$ 1,801,015	\$ 105,635	5.87 %
Securities — taxable	578,506	11,637	2.01 %	682,602	15,836	2.32 %	669,994	15,211	2.27 %
Securities — exempt from Federal tax ⁽³⁾	74,849	2,415	3.23 %	84,165	2,720	3.23 %	87,639	2,817	3.21 %
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	786,955	3,757	0.48 %	332,905	7,867	2.36 %	285,702	6,774	2.37 %
Total interest earning assets ⁽³⁾	4,071,805	150,978	3.71 %	3,094,589	143,231	4.63 %	2,844,350	130,437	4.59 %
Cash and due from banks.	40,401			40,070			38,665		
Premises and equipment, net	9,497			7,395			7,298		
Goodwill and other intangible assets.	186,239			116,481			82,398		
Other assets	126,387			95,235			82,925		
Total assets	<u>\$ 4,434,329</u>			<u>\$ 3,353,770</u>			<u>\$ 3,055,636</u>		
Liabilities and shareholders' equity:									
Deposits:									
Demand, noninterest-bearing	\$ 1,638,055			\$ 1,131,098			\$ 1,029,860		
Demand, interest-bearing	891,513	2,035	0.23 %	712,186	2,401	0.34 %	658,386	1,885	0.29 %
Savings and money market	1,026,319	3,144	0.31 %	811,266	4,298	0.53 %	777,749	2,701	0.35 %
Time deposits — under \$100	17,659	67	0.38 %	19,448	94	0.48 %	21,375	80	0.37 %
Time deposits — \$100 and over	128,461	1,009	0.79 %	130,856	1,359	1.04 %	130,548	830	0.64 %
CDARS — interest-bearing demand, money market and time deposits	17,889	5	0.03 %	15,078	7	0.05 %	15,369	10	0.07 %
Total interest-bearing deposits	2,081,841	6,260	0.30 %	1,688,834	8,159	0.48 %	1,603,427	5,506	0.34 %
Total deposits	3,719,896	6,260	0.17 %	2,819,932	8,159	0.29 %	2,633,287	5,506	0.21 %
Subordinated debt, net of issuance costs	39,641	2,320	5.85 %	41,278	2,686	6.51 %	39,270	2,314	5.89 %
Short-term borrowings	139	1	0.72 %	208	2	0.96 %	106	2	1.89 %
Total interest-bearing liabilities.	2,121,621	8,581	0.40 %	1,730,320	10,847	0.63 %	1,642,803	7,822	0.48 %
Total interest-bearing liabilities and demand, noninterest-bearing / cost of funds.	3,759,676	8,581	0.23 %	2,861,418	10,847	0.38 %	2,672,663	7,822	0.29 %
Other liabilities	97,978			66,678			55,416		
Total liabilities	3,857,654			2,928,096			2,728,079		
Shareholders' equity.	576,675			425,674			327,557		
Total liabilities and shareholders' equity	<u>\$ 4,434,329</u>			<u>\$ 3,353,770</u>			<u>\$ 3,055,636</u>		
Net interest income ⁽³⁾ / margin		142,397	3.50 %		132,384	4.28 %		122,615	4.31 %
Less tax equivalent adjustment ⁽³⁾		(507)			(572)			(592)	
Net interest income		<u>\$ 141,890</u>			<u>\$ 131,812</u>			<u>\$ 122,023</u>	

- (1) Includes loans held-for-sale. Nonaccrual loans are included in average balance.
- (2) Yield amounts earned on loans include fees and costs. The accretion (amortization) of deferred loan fees (costs) into loan interest income was \$4.5 million for the year ended December 31, 2020 (of which \$3.9 million was from PPP loans), compared to \$580,000 for the year ended December 31, 2019, and \$375,000 for the year ended December 31, 2018.
- (3) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the years ended December 31, 2020, 2019 and 2018.

The Volume and Rate Variances table below sets forth the dollar difference in interest earned and paid for each major category of interest-earning assets and interest-bearing liabilities for the noted periods, and the amount of such change attributable to changes in average balances (volume) or changes in average interest rates. Volume variances are equal to the increase or decrease in the average balance multiplied by prior period rates and rate variances are equal to the increase or decrease in the average rate multiplied by the prior period average balance. Variances attributable to both rate and volume changes are equal to the change in rate multiplied by the change in average balance and are included below in the average volume column.

	Year Ended December 31, 2020 vs. 2019			Year Ended December 31, 2019 vs. 2018		
	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	\$ 32,226	\$ (15,865)	\$ 16,361	\$ 11,269	\$ (96)	\$ 11,173
Securities — taxable	(2,083)	(2,116)	(4,199)	292	333	625
Securities — exempt from Federal tax ⁽¹⁾	(304)	(1)	(305)	(111)	14	(97)
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	2,159	(6,269)	(4,110)	1,124	(31)	1,093
Total interest income on interest-earning assets . .	<u>31,998</u>	<u>(24,251)</u>	<u>7,747</u>	<u>12,574</u>	<u>220</u>	<u>12,794</u>
Expense from the interest-bearing liabilities:						
Demand, interest-bearing	397	(763)	(366)	162	354	516
Savings and money market	629	(1,783)	(1,154)	176	1,421	1,597
Time deposits — under \$100	(7)	(20)	(27)	(9)	23	14
Time deposits — \$100 and over	(25)	(325)	(350)	1	528	529
CDARS — interest-bearing demand, money market and time deposits	—	(2)	(2)	(1)	(2)	(3)
Subordinated debt, net of issuance costs	(95)	(271)	(366)	130	242	372
Short-term borrowings	—	(1)	(1)	1	(1)	—
Total interest expense on interest-bearing liabilities . .	<u>899</u>	<u>(3,165)</u>	<u>(2,266)</u>	<u>460</u>	<u>2,565</u>	<u>3,025</u>
Net interest income	<u>\$ 31,099</u>	<u>\$ (21,086)</u>	<u>10,013</u>	<u>\$ 12,114</u>	<u>\$ (2,345)</u>	<u>9,769</u>
Less tax equivalent adjustment			65			20
Net interest income			<u>\$ 10,078</u>			<u>\$ 9,789</u>

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the years ended December 31, 2020, 2019 and 2018.

The Company's net interest margin (FTE), expressed as a percentage of average earning assets, contracted 78 basis points to 3.50% for the year ended December 31, 2020, compared to 4.28% for the year ended December 31, 2019, primarily due to a decline in the average yield on loans, investment securities, and overnight funds, and an increase in the average balance of lower yielding overnight funds, partially offset by a decline in the cost of interest-bearing liabilities.

The Company's net interest margin (FTE), expressed as a percentage of average earning assets, contracted three basis points to 4.28% for the year ended December 31, 2019, compared to 4.31% for the year ended December 31, 2018, primarily due to a higher cost of deposits, and a decrease in the average balance of Bay View Funding's factored receivables, partially offset by an increase in the average balance of loans and securities and an increase in the accretion of the loan purchase discount into loan interest income from a merger during the year ended December 31, 2019.

The following tables present the average balance of loans outstanding, interest income, and the average yield for the periods indicated:

	Year Ended December 31,								
	2020			2019			2018		
	Average Balance	Interest Income	Average Yield	Average Balance	Interest Income	Average Yield	Average Balance	Interest Income	Average Yield
	(Dollars in thousands)								
Loans, core bank and asset-based lending	\$ 2,327,624	\$ 110,652	4.75 %	\$ 1,890,079	\$ 100,380	5.31 %	\$ 1,670,065	\$ 86,610	5.19 %
SBA PPP loans	218,391	2,185	1.00 %	—	—	N/A	—	—	N/A
PPP fees, net.	—	3,877	1.78 %	—	—	N/A	—	—	N/A
Bay View Funding factored receivables	45,765	10,727	23.44 %	46,710	11,688	25.02 %	59,220	14,698	24.82 %
Purchased residential mortgages	29,648	725	2.45 %	35,343	951	2.69 %	40,998	1,118	2.73 %
Purchased CRE loans	24,072	831	3.45 %	30,936	1,107	3.58 %	36,080	1,257	3.48 %
Loan credit mark / accretion	(14,005)	4,172	0.18 %	(8,151)	2,682	0.14 %	(5,348)	1,952	0.12 %
Total loans (includes loans held-for-sale)	<u>\$ 2,631,495</u>	<u>\$ 133,169</u>	5.06 %	<u>\$ 1,994,917</u>	<u>\$ 116,808</u>	5.86 %	<u>\$ 1,801,015</u>	<u>\$ 105,635</u>	5.87 %

The average yield on the total loan portfolio decreased to 5.06% for the year ended December 31, 2020, compared to 5.86% for the year ended December 31, 2019, primarily due to decreases in the prime rate on loans and new average balances of lower yielding PPP loans, partially offset by higher PPP loan fees and an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions. The average yield on the total loan portfolio decreased to 5.86% for the year ended December 31, 2019, compared to 5.87% for the year ended December 31, 2018, primarily due to a decrease in the average balance of Bay View Funding's factored receivables, partially offset by the impact of the increasing prime rate on loans over the course of 2018 (prior to the prime rate decreasing in the latter part of 2019), and an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions.

In aggregate, the original total net purchase discount on loans from the Focus, Tri-Valley, United American, and Presidio loan portfolio was \$25.2 million. In aggregate, the remaining net purchase discount on total loans acquired was \$12.1 million at December 31, 2020.

The average cost of deposits was 0.17% for the year ended December 31, 2020, compared to 0.29% for the year ended December 31, 2019, and 0.21% for the year ended December 31, 2018.

Net interest income, before provision for credit losses on loans, for the year ended December 31, 2020 increased 8% to \$141.9 million, compared to \$131.8 million for the year ended December 31, 2019, primarily due to an increase in the average balance of loans resulting from the Presidio merger, additional interest and fee income from PPP loans, and an increase in the accretion of the loan discount into loan interest income from our merger with Presidio, partially offset by decreases in the prime rate, and decreases in the yield on investment securities and overnight funds. Net interest income, before provision for loan losses, for the year ended December 31, 2019 increased 8% to \$131.8 million, compared to \$122.0 million for the year ended December 31, 2018, primarily due to the impact of the increase in loans and deposits from the Presidio merger, in addition to the full year impact of the Tri-Valley and United American mergers.

Provision for Credit Losses on Loans

Credit risk is inherent in the business of making loans. The Company establishes an allowance for credit losses on loans through charges to earnings, which are presented in the statements of income as the provision for credit losses on loans. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for credit losses on loans is determined by conducting a quarterly evaluation of the adequacy of the Company's allowance for credit losses on loans and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to the Company's earnings. The provision for credit losses on loans 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. The provision for credit losses on loans and level of allowance for each period are also dependent on forecast data for the state of California including GDP and unemployment projections provided by the CEF, (www.CaliforniaForecast.com).

There was a \$13.2 million provision for credit losses on loans for the year ended December 31, 2020, compared to an \$846,000 provision for loan losses for the year ended December 31, 2019, and a \$7.4 million provision for loan losses for the year ended December 31, 2018. The increase in the provision for credit losses on loans for the year ended December 31, 2020, compared to the year ended December 31, 2019, was driven primarily by a significantly deteriorated

economic outlook resulting from the Coronavirus pandemic. The three loan classes where the largest increases in reserves were recorded under the CECL loss rate methodology were investor-owned CRE, land and construction, and C&I. Ongoing impacts of the CECL methodology will be dependent upon changes in economic conditions and forecasts, originated and acquired loan portfolio composition, portfolio duration, and other factors. Provisions for credit losses on loans are charged to operations to bring the allowance for credit losses on loans to a level deemed appropriate by the Company based on the factors discussed under “*Credit Quality and Performance*” and “*Allowance for Credit Losses on Loans*.”

The ACLL totaled \$44.4 million, or 1.70% of total loans at December 31, 2020. Total loans at December 31, 2020, included \$290.7 million of PPP loans which are guaranteed by the SBA, for which no ACLL was allocated. The ALLL was \$23.3 million, or 0.92% of total loans at December 31, 2019, and \$27.8 million, or 1.48% of total loans at December 31, 2018. The ACLL to total nonperforming loans was 564.24% at December 31, 2020. The ALLL to total nonperforming loans was 236.93% at December 31, 2019, and 187.06% at December 31, 2018. The loans acquired from Presidio are included in total loans. Due to the addition of the Presidio loans at fair value with no allowance, the ALLL to total loans decreased at December 31, 2019, compared to December 31, 2018. However, the Company provided an additional \$2.0 million in provision for loan losses to increase the ALLL at December 31, 2019 for certain non-impaired loans acquired at a premium from Presidio. This premium was due to higher interest rates on the loans versus market interest rates at the time of the merger. Due to the net premium on these loans, a provision for loan losses was required and it was not due to credit deterioration since the merger date.

Net charge-offs totaled \$688,000 for the year ended December 31, 2020, compared to net charge-offs of \$5.4 million for the year ended December 31, 2019, and net recoveries of \$769,000 for the year ended December 31, 2018. Net charge-offs of \$5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling \$5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling \$5.5 million in net charge-offs had a total of \$4.7 million in specific reserves.

Noninterest Income

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

	Year Ended December 31,			Increase (decrease) 2020 versus 2019		Increase (Decrease) 2019 versus 2018	
	2020	2019	2018	Amount	Percent	Amount	Percent
	(Dollars in thousands)						
Service charges and fees on deposit accounts	\$ 2,859	\$ 4,510	\$ 4,113	\$ (1,651)	(37)%	\$ 397	10 %
Increase in cash surrender value of life insurance	1,845	1,404	1,045	441	31 %	359	34 %
Gain on sales of SBA loans	839	689	698	150	22 %	(9)	(1)%
Gain on the disposition of foreclosed assets	791	—	—	791	N/A %	(73)	(10)%
Servicing income	673	636	709	37	6 %	395	148 %
Gain on sales of securities	277	661	266	(384)	(58)%	—	N/A
Other	2,638	2,344	2,743	294	13 %	(399)	(15)%
Total	<u>\$ 9,922</u>	<u>\$ 10,244</u>	<u>\$ 9,574</u>	<u>\$ (322)</u>	(3)%	<u>\$ 670</u>	7 %

For the year ended December 31, 2020, noninterest income was \$9.9 million, compared to \$10.2 million for the year ended December 31, 2019, primarily due to lower service charges and fees on deposit accounts, and a decrease in the gain on sale of securities, partially offset by an increase in the cash surrender value of life insurance, a gain realized on a warrant exercised, and a gain on the disposition of foreclosed assets during the first quarter of 2020.

For the year ended December 31, 2019, noninterest income was \$10.2 million, compared to \$9.6 million for the year ended December 31, 2018. The increase in noninterest income for the year ended December 31, 2019, was primarily due to higher service charges and fees on deposit accounts, an increase in the cash surrender value of life insurance, and an increase in the gain on sale of securities, partially offset by proceeds from a legal settlement in the year ended December 31, 2018.

Historically, a portion of the Company’s noninterest income is associated with its SBA lending activity, as gain

on sales of loans sold in the secondary market and servicing income from loans sold with servicing rights retained. During 2020, SBA loan sales resulted in an \$839,000 gain, compared to a \$689,000 gain on sales of SBA loans in 2019, and a \$698,000 gain on sales of SBA loans in 2018.

The servicing assets that result from the sales of SBA loans with servicing retained are amortized over the expected term of the loans using a method approximating the interest method. Servicing income generally declines as the respective loans are repaid.

Noninterest Expense

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

	Year Ended December 31,			Increase (Decrease) 2020 versus 2019		Increase (Decrease) 2019 versus 2018	
	2020	2019	2018	Amount	Percent	Amount	Percent
(Dollars in thousands)							
Salaries and employee benefits	\$ 50,571	\$ 44,174	\$ 40,193	\$ 6,397	14 %	\$ 3,981	10 %
Occupancy and equipment	8,018	6,647	5,411	1,371	21 %	1,236	23 %
Professional fees	5,338	3,259	2,891	2,079	64 %	368	13 %
Amortization of intangible assets	3,751	2,739	1,943	1,012	37 %	796	41 %
Software subscriptions	3,102	2,397	2,343	705	29 %	54	2 %
Data processing	2,770	2,890	1,978	(120)	(4)%	912	46 %
Insurance expense	2,286	1,864	1,685	422	23 %	179	11 %
Supplemental retirement plan cost	1,724	1,240	202	484	39 %	1,038	514 %
Recovery of legal fees (1)	—	—	(922)	—	N/A	922	(100)%
Other, excluding merger-related costs	9,350	8,608	10,630	742	9 %	(2,022)	(19)%
Total noninterest expense, excluding merger-related costs	86,910	73,818	66,354	13,092	18 %	7,464	11 %
Salaries and employee benefits merger-related costs (2)	356	6,580	3,569	(6,224)	(95)%	3,011	84 %
Other merger-related costs (3)	2,245	4,500	5,598	(2,255)	(50)%	(1,098)	(20)%
Total noninterest expense, including merger-related costs	\$ 89,511	\$ 84,898	\$ 75,521	\$ 4,613	5 %	\$ 9,377	12 %

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

	Year Ended December 31,					
	2020	Percent of Total	2019	Percent of Total	2018	Percent of Total
(Dollars in thousands)						
Salaries and employee benefits	\$ 50,571	57 %	\$ 44,174	52 %	\$ 40,193	53 %
Occupancy and equipment	8,018	9 %	6,647	8 %	5,411	7 %
Professional fees	5,338	6 %	3,259	4 %	2,891	4 %
Amortization of intangible assets	3,751	4 %	2,739	3 %	1,943	3 %
Software subscriptions	3,102	3 %	2,397	3 %	2,343	3 %
Data processing	2,770	3 %	2,890	3 %	1,978	3 %
Insurance expense	2,286	3 %	1,864	2 %	1,685	2 %
Supplemental retirement plan cost	1,724	2 %	1,240	2 %	202	0 %
Recovery of legal fees (1)	—	— %	—	— %	(922)	(1)%
Other, excluding merger-related costs	9,350	10 %	8,608	10 %	10,630	14 %
Total noninterest expense, excluding merger-related costs	86,910	97 %	73,818	87 %	66,354	88 %
Salaries and employee benefits merger-related costs (2)	356	0 %	6,580	8 %	3,569	5 %
Other merger-related costs (3)	2,245	3 %	4,500	5 %	5,598	7 %
Total noninterest expense, including merger-related costs	\$ 89,511	100 %	\$ 84,898	100 %	75,521	100 %

(3) Included in the "Professional fees" category in the Consolidated Statements of Income.

(4) Included in "Salaries and employee benefits" category in the Consolidated Statements of Income.

(5) Included in the "Other noninterest expense" category in the Consolidated Statements of Income.

Noninterest expense for the year ended December 31, 2020 increased 5% to \$89.5 million, compared to \$84.9 million for the year ended December 31, 2019, primarily due to higher salaries and employee benefits as a result of annual salary increases, and additional employees and operating costs added as a result of the Presidio merger, partially offset by lower merger-related costs. Full-time equivalent employees were 331 at December 31, 2020, and 357 at December 31, 2019, and 302 at December 31, 2018. Average full-time equivalent employees were 341 during 2020, and 320 during 2019, and 292 during 2018.

Noninterest expense for the year ended December 31, 2019 increased 12% to \$84.9 million, compared to \$75.5 million for the year ended December 31, 2018, primarily due to higher merger-related costs, a full year of additional operating costs of Tri-Valley and United American, and the operating costs of Presidio for most of the fourth quarter of 2019. Total noninterest expense for the year ended December 31, 2019 included total merger-related costs of \$11.1 million for the Presidio acquisition of which \$6.6 million was included in salaries and employee benefits, and \$4.5 million was included in other noninterest expense. Total merger-related costs were \$9.2 million for the year ended December 31, 2018 for the Tri-Valley and United American acquisitions, of which \$3.6 million was included in salaries and employee benefits and \$5.6 million was included in other noninterest expense. Professional fees for the year ended December 31, 2018 included a recovery of \$922,000 from a legal settlement.

Income Tax Expense

The Company computes its provision for income taxes on a monthly basis. The effective tax rate is determined by applying the Company’s statutory income tax rates to pre-tax book income as adjusted for permanent differences between pre-tax book income and actual taxable income. These permanent differences include, but are not limited to increases in the cash surrender value of life insurance policies, interest on tax-exempt securities, certain expenses that are not allowed as tax deductions, and tax credits.

The following table shows the effective income tax rates for the dates indicated:

	<u>Year Ended December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
Effective income tax rate	28.1%	28.1%	27.4%

The Company’s Federal and state income tax expense in 2020 was \$13.8 million, compared to \$15.9 million in 2019, and \$13.3 million in 2018.

The difference in the effective tax rate for the periods reported compared to the combined Federal and state statutory tax rate of 29.6% is primarily the result of the Company’s investment in life insurance policies whose earnings are not subject to taxes, tax credits related to investments in low income housing limited partnerships (net of low income housing investment losses), and tax-exempt interest income earned on municipal bonds.

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles leading to timing differences between the Company’s actual tax liability, and the amount accrued for this liability based on book income. These temporary differences comprise the “deferred” portion of the Company’s tax expense or benefit, which is accumulated on the Company’s books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company’s deferred tax assets is primarily dependent upon the Company generating sufficient future taxable income to obtain benefit from the reversal of net deductible temporary differences and the utilization of tax credit carryforwards and the net operating loss carryforwards for Federal and state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles a valuation allowance is required to be recognized if it is “more likely than not” that the deferred tax assets will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management’s evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

The Company had the net deferred tax assets of \$28.2 million and \$24.3 million at December 31, 2020, and December 31, 2019, respectively. After consideration of the matters in the preceding paragraph, the Company determined

that it is more likely than not that the net deferred tax assets at December 31, 2020 and December 31, 2019 will be fully realized in future years.

FINANCIAL CONDITION

As of December 31, 2020, total assets increased 13% to \$4.63 billion, compared to \$4.11 billion at December 31, 2019. Securities available-for-sale, at fair value, were \$235.8 million at December 31, 2020, a decrease of (42%) from \$404.8 million at December 31, 2019. Securities held-to-maturity, at amortized cost, were \$297.4 million at December 31, 2020, a decrease of (19%) from \$366.6 million at December 31, 2019. Total loans, excluding loans held-for-sale, increased \$85.4 million, or 3%, to \$2.62 billion at December 31, 2020, compared to \$2.53 billion at December 31, 2019.

Total deposits increased \$499.7 million, or 15%, to \$3.91 billion at December 31, 2020, compared to \$3.41 billion at December 31, 2019. Deposits, excluding all time deposits and CDARS deposits, increased \$510.1 million, or 16%, to \$3.74 billion at December 31, 2020, from \$3.23 billion at December 31, 2019.

Securities Portfolio

The following table reflects the balances for each category of securities at year-end:

	December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Securities available-for-sale (at fair value):			
Agency mortgage-backed securities	\$ 175,326	\$ 284,361	\$ 302,854
U.S. Treasury	60,448	120,464	148,753
U.S. Government sponsored entities	—	—	7,436
Total	<u>\$ 235,774</u>	<u>\$ 404,825</u>	<u>\$ 459,043</u>
Securities held-to-maturity (at amortized cost):			
Agency mortgage-backed securities	\$ 228,652	\$ 285,344	\$ 291,241
Municipals — exempt from Federal tax	68,791	81,216	85,957
Total	<u>\$ 297,443</u>	<u>\$ 366,560</u>	<u>\$ 377,198</u>

The table below summarizes the weighted average life and weighted average yields of securities as of December 31, 2020:

	Weighted Average Life									
	Within One Year or Less		After One and Within Five Years		After Five and Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(Dollars in thousands)									
Securities available-for-sale (at fair value):										
Agency mortgage-backed securities	\$ 5,540	0.62 %	\$ 169,786	1.66 %	\$ —	N/A	\$ —	N/A	\$ 175,326	1.62 %
U.S. Treasury	60,448	2.83 %	—	N/A	—	N/A	—	N/A	60,448	2.83 %
Total	<u>\$ 65,988</u>	2.65 %	<u>\$ 169,786</u>	1.66 %	<u>\$ —</u>	N/A	<u>\$ —</u>	N/A	<u>\$ 235,774</u>	1.93 %
Securities held-to-maturity (at amortized cost):										
Agency mortgage-backed securities	\$ 8,674	0.84 %	\$ 175,898	1.79 %	\$ 2,173	2.87 %	\$ 41,907	1.82 %	\$ 228,652	1.77 %
Municipals — exempt from Federal tax (1)	28,201	3.18 %	40,590	3.31 %	—	N/A	—	N/A	68,791	3.26 %
Total	<u>\$ 36,875</u>	2.63 %	<u>\$ 216,488</u>	2.08 %	<u>\$ 2,173</u>	2.87 %	<u>\$ 41,907</u>	1.82 %	<u>\$ 297,443</u>	2.11 %

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate.

The portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Company; and (iv) it is an alternative interest-earning use of funds when loan demand is weak or when deposits grow more

rapidly than loans.

The Company's portfolio may include: (i) U.S. Treasury securities and U.S. Government sponsored entities' debt securities for liquidity and pledging; (ii) mortgage-backed securities, which in many instances can also be used for pledging, and which generally enhance the yield of the portfolio; (iii) municipal obligations, which provide tax free income and limited pledging potential; (iv) single entity issue trust preferred securities, which generally enhance the yield on the portfolio; (v) corporate bonds, which also enhance the yield on the portfolio; (vi) money market mutual funds; (vii) certificates of deposit; (viii) commercial paper; (ix) bankers acceptances; (x) repurchase agreements; (xi) collateralized mortgage obligations; and (xii) asset-backed securities.

The Company classifies its securities as either available-for-sale or held-to-maturity at the time of purchase. Accounting guidance requires available-for-sale securities to be marked to fair value with an offset to accumulated other comprehensive income (loss), a component of shareholders' equity. Monthly adjustments are made to reflect changes in the fair value of the Company's available-for-sale securities.

During the year ended December 31, 2020, the Company sold \$56.6 million of investment securities available-for-sale for a net gain of \$259,000 and a net gain of \$18,000 for held-to-maturity bonds that were called.

During the year ended December 31, 2020, the Company purchased \$30.9 million of investment securities held-to-maturity, which were all agency mortgage-backed securities, with an average book yield of 1.15%.

The Company has not used interest rate swaps or other derivative instruments to hedge fixed rate loans or securities to otherwise mitigate interest rate risk.

Loans

The Company's loans represent the largest portion of earning assets, substantially greater than the securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when reviewing the Company's financial condition. Gross loans, excluding loans held-for-sale, represented 57% of total assets at December 31, 2020 and 62% at December 31, 2019. The ratio of loans to deposits decreased to 66.91% at December 31, 2020 from 74.20% at December 31, 2019.

Loan Distribution

The Loan Distribution table that follows sets forth the Company's gross loans outstanding, excluding loans held-for-sale, and the percentage distribution in each category at the dates indicated.

	December 31,									
	2020	% to Total	2019	% to Total	2018	% to Total	2017	% to Total	2016	% to Total
	(Dollars in thousands)									
Commercial	\$ 555,707	21 %	\$ 603,345	24 %	\$ 549,998	29 %	\$ 516,952	33 %	\$ 542,638	36 %
SBA PPP loans	290,679	11 %	—	0 %	—	— %	—	0 %	—	— %
Real estate:										
CRE - owner occupied	560,362	21 %	548,907	22 %	430,813	23 %	389,289	25 %	401,362	27 %
CRE - non-owner occupied	693,103	27 %	767,821	30 %	477,928	25 %	357,141	23 %	263,079	17 %
Land and construction	144,594	6 %	147,189	6 %	122,403	7 %	103,619	6 %	83,480	6 %
Home equity	111,885	4 %	151,775	6 %	95,478	5 %	77,175	5 %	82,410	5 %
Multifamily	166,425	6 %	180,623	7 %	88,614	5 %	56,058	3 %	37,812	3 %
Residential mortgages	85,116	3 %	100,759	4 %	100,586	5 %	62,579	4 %	67,162	4 %
Consumer and other	18,116	1 %	33,744	1 %	20,912	1 %	20,364	1 %	25,424	2 %
Total Loans	2,625,987	100 %	2,534,163	100 %	1,886,732	100 %	1,583,177	100 %	1,503,367	100 %
Deferred loan fees, net	(6,726)	—	(319)	—	(327)	—	(510)	—	(760)	—
Loans, net of deferred fees	2,619,261	100 %	2,533,844	100 %	1,886,405	100 %	1,582,667	100 %	1,502,607	100 %
Allowance for credit losses on loans	(44,400)		(23,285)		(27,848)		(19,658)		(19,089)	
Loans, net	<u>\$ 2,574,861</u>		<u>\$ 2,510,559</u>		<u>\$ 1,858,557</u>		<u>\$ 1,563,009</u>		<u>\$ 1,483,518</u>	

The Company's loan portfolio is concentrated in commercial (primarily manufacturing, wholesale, and services oriented entities) and commercial real estate, with the remaining balance in land development and construction and home equity, purchased residential mortgages, and consumer loans. The Company does not have any concentrations by industry or group of industries in its loan portfolio, however, 67% of its gross loans were secured by real property as of December 31, 2020, compared to 75% as of December 31, 2019. While no specific industry concentration is considered significant, the

Company's lending operations are located in areas that are dependent on the technology and real estate industries and their supporting companies.

The Company has established concentration limits in its loan portfolio for commercial real estate loans, commercial loans, construction loans and unsecured lending, among others. All loan types are within established limits. The Company uses underwriting guidelines to assess the borrowers' historical cash flow to determine debt service, and we further stress test the debt service under higher interest rate scenarios. Financial and performance covenants are used in commercial lending to allow the Company to react to a borrower's deteriorating financial condition, should that occur.

The Company's commercial loans are made for working capital, financing the purchase of equipment or for other business purposes. Commercial loans include loans with maturities ranging from thirty days to one year and "term loans" with maturities normally ranging from one to five years. Short-term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest.

The Company is an active participant in the SBA and U.S. Department of Agriculture guaranteed lending programs, and has been approved by the SBA as a lender under the Preferred Lender Program. The Company regularly makes such loans conditionally guaranteed by the SBA (collectively referred to as "SBA loans"). The guaranteed portion of these loans is typically sold in the secondary market depending on market conditions. When the guaranteed portion of an SBA loan is sold the Company retains the servicing rights for the sold portion. During 2020, loans were sold resulting in a gain on sales of SBA loans of \$839,000, compared to a gain on sales of SBA loans of \$689,000 for 2019, and \$698,000 for 2018.

The Company's factoring receivables are from the operations of Bay View Funding whose primary business is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. These receivables are acquired from a variety of companies, including, but not limited to, service providers, transportation companies, manufacturers, distributors, wholesalers, apparel companies, advertisers, and temporary staffing companies. The portfolio of factored receivables is included in the Company's commercial loan portfolio. The average life of the factored receivables was 37 days for the years ended December 31, 2020 and December 31, 2019 and 36 days for December 31, 2018. The balance of the purchased receivables as of December 31, 2020 and December 31, 2019 was \$47.2 million and \$46.0 million, respectively.

The commercial loan portfolio decreased \$47.6 million, or (8%), to \$555.7 million at December 31, 2020, from \$603.3 million at December 31, 2019. The commercial loan line usage was 28% at December 31, 2020, compared to 35% at December 31, 2019. In addition, the Company had \$290.7 million in PPP loans at December 31, 2020.

The Company's CRE loans consist primarily of loans based on the borrower's cash flow and are secured by deeds of trust on commercial property to provide a secondary source of repayment. The Company generally restricts real estate term loans to no more than 75% of the property's appraised value or the purchase price of the property depending on the type of property and its utilization. The Company offers both fixed and floating rate loans. Maturities on CRE loans are generally between five and ten years (with amortization ranging from fifteen to twenty-five years and a balloon payment due at maturity), however, SBA, and certain other real estate loans that can be sold in the secondary market, may be granted for longer maturities.

The CRE owner-occupied loan portfolio increased \$11.5 million, or 2% to \$560.4 million at December 31, 2020, from \$548.9 million at December 31, 2019. CRE non-owner occupied loans decreased \$74.7 million, or (10%) to \$693.1 million at December 31, 2020. At December 31, 2020, 45% of the CRE loan portfolio was secured by owner-occupied real estate.

The Company's land and construction loans are primarily to finance the development/construction of commercial and single family residential properties. The Company utilizes underwriting guidelines to assess the likelihood of repayment from sources such as sale of the property or availability of permanent mortgage financing prior to making the construction loan. Construction loans are provided primarily in our market area, and we have extensive controls for the disbursement process. Land and construction loans decreased \$2.6 million, or (2%), to \$144.6 million at December 31, 2020, from \$147.2 million at December 31, 2019.

The Company makes home equity lines of credit available to its existing customers. Home equity lines of credit are underwritten initially with a maximum 75% loan to value ratio. Home equity lines of credit decreased \$39.9 million, or (26%), to \$111.9 million at December 31, 2020, from \$151.8 million at December 31, 2019.

Multifamily loans decreased \$14.2 million, or (8%) to \$166.4 million, at December 31, 2020, compared to \$180.6 million at December 31, 2019

Residential mortgage loans decreased \$15.7 million, or (16%) to \$85.1 million, at December 31, 2020, compared to \$100.8 million at December 31, 2019.

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

With certain exceptions, state chartered banks are permitted to make extensions of credit to any one borrowing entity up to 15% of the bank's capital and reserves for unsecured loans and up to 25% of the bank's capital and reserves for secured loans. For HBC, these lending limits were \$96.0 million and \$160.0 million at December 31, 2020, respectively.

Loan Maturities

The following table presents the maturity distribution of the Company's loans (excluding loans held-for-sale), as of December 31, 2020. 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, 2020, approximately 42% of the Company's loan portfolio consisted of floating interest rate loans.

	<u>Due in One Year or Less</u>	<u>Over One Year But Less than Five Years</u>	<u>Over Five Years</u>	<u>Total</u>
	(Dollars in thousands)			
Commercial	\$ 421,369	\$ 369,877	\$ 55,140	\$ 846,386
Real estate:				
CRE - owner occupied	122,418	149,738	288,206	560,362
CRE - non-owner occupied	238,373	165,141	289,589	693,103
Land and construction	124,587	10,218	9,789	144,594
Home equity	111,768	—	117	111,885
Multifamily	1,779	50,008	114,638	166,425
Residential mortgages	1,545	23,075	60,496	85,116
Consumer and other	12,723	3,668	1,725	18,116
Loans	<u>\$ 1,034,562</u>	<u>\$ 771,725</u>	<u>\$ 819,700</u>	<u>\$ 2,625,987</u>
Loans with variable interest rates	\$ 989,755	\$ 27,583	\$ 89,444	\$ 1,106,782
Loans with fixed interest rates	44,807	744,142	730,256	1,519,205
Loans	<u>\$ 1,034,562</u>	<u>\$ 771,725</u>	<u>\$ 819,700</u>	<u>\$ 2,625,987</u>

Loan Servicing

As of December 31, 2020, 2019, and 2018 there were \$78.0 million, \$87.8 million, and \$104.0 million, respectively, of SBA loans that were serviced by the Company for others. Activity for loan servicing rights was as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Beginning of period balance	\$ 583	\$ 871	\$ 1,373
Additions	213	157	200
Amortization	<u>(265)</u>	<u>(445)</u>	<u>(702)</u>
End of period balance	<u>\$ 531</u>	<u>\$ 583</u>	<u>\$ 871</u>

Loan servicing rights are included in accrued interest receivable and other assets on the consolidated balance sheets and reported net of amortization. There was no valuation allowance as of December 31, 2020 and 2019, as the fair market value of the assets was greater than the carrying value.

Activity for the I/O strip receivable was as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Beginning of period balance	\$ 503	\$ 568	\$ 968
Unrealized holding (loss) gain	<u>(198)</u>	<u>(65)</u>	<u>(400)</u>
End of period balance	<u>\$ 305</u>	<u>\$ 503</u>	<u>\$ 568</u>

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, 2020, key economic assumptions and the sensitivity of the fair value of the I/O strip receivables to immediate changes to the CPR assumption of 10% and 20%, and changes to the discount rate assumption of 1% and 2%, are as follows:

	<u>(Dollars in thousands)</u>
Carrying amount/fair value of Interest-Only (I/O) strip	\$ 305
Prepayment speed assumption (annual rate)	14.6%
Impact on fair value of 10% adverse change in prepayment speed (CPR 16.1%)	\$ (3)
Impact on fair value of 20% adverse change in prepayment speed (CPR 17.6%)	\$ (6)
Residual cash flow discount rate assumption (annual)	12.9%
Impact on fair value of 1% adverse change in discount rate (14.2% discount rate) ..	\$ (8)
Impact on fair value of 2% adverse change in discount rate (15.5% discount rate) ..	\$ (15)

Credit Quality and Allowance for Credit Losses on Loans

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company's management of credit quality risk is focused primarily on loan quality. Banks have generally suffered their most severe earnings declines as a result of customers' inability to generate sufficient cash flow to service their debts and/or downturns in national and regional economies and declines in overall asset values including real estate. In addition, certain debt securities that the Company may purchase have the potential of declining in value if the obligor's financial capacity to repay deteriorates.

The Company's policies and procedures identify market segments, set goals for portfolio growth or contraction, and establish limits on industry and geographic credit concentrations. In addition, these policies establish the Company's underwriting standards and the methods of monitoring ongoing credit quality. The Company's internal credit risk controls are centered in underwriting practices, credit granting procedures, training, risk management techniques, and familiarity

with loan customers as well as the relative diversity and geographic concentration of our loan portfolio.

The Company's credit risk may also be affected by external factors such as the level of interest rates, employment, general economic conditions, real estate values, and trends in particular industries or geographic markets. As an independent community bank serving a specific geographic area, the Company must contend with the unpredictable changes in the general California market and, particularly, primary local markets. The Company's asset quality has suffered in the past from the impact of national and regional economic recessions, consumer bankruptcies, and depressed real estate values.

Nonperforming assets are comprised of the following: loans for which the Company is no longer accruing interest; restructured loans which have been current under six months; loans 90 days or more past due and still accruing interest (although they are generally placed on nonaccrual when they become 90 days past due, unless they are both well-secured and in the process of collection); and foreclosed assets. Past due loans 30 days or greater totaled \$6.2 million and \$15.3 million at December 31, 2020 and December 31, 2019, respectively, of which \$1.9 million and \$7.4 million were on nonaccrual. There were also \$5.9 million and \$1.3 million loans less than 30 days past due included in nonaccrual loans held-for-investment, at December 31, 2020 and December 31, 2019, respectively.

Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt. The loans may or may not be collateralized, and collection efforts are pursued. Loans may be restructured by management when a borrower has experienced some change in financial status causing an inability to meet the original repayment terms and where the Company believes the borrower will eventually overcome those circumstances and make full restitution. Foreclosed assets consist of properties and other assets acquired by foreclosure or similar means that management is offering or will offer for sale.

The following table summarizes the Company's nonperforming assets at the dates indicated:

	December 31,				
	2020	2019	2018	2017	2016
	(Dollars in thousands)				
Nonaccrual loans — held-for-investment	\$ 7,788	\$ 8,675	\$ 13,699	\$ 2,250	\$ 3,059
Restructured and loans 90 days past due and still accruing	<u>81</u>	<u>1,153</u>	<u>1,188</u>	<u>235</u>	<u>—</u>
Total nonperforming loans	7,869	9,828	14,887	2,485	3,059
Foreclosed assets	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>229</u>
Total nonperforming assets	<u>\$ 7,869</u>	<u>\$ 9,828</u>	<u>\$ 14,887</u>	<u>\$ 2,485</u>	<u>\$ 3,288</u>
Nonperforming assets as a percentage of loans plus foreclosed assets	0.30 %	0.39 %	0.79 %	0.16 %	0.22 %
Nonperforming assets as a percentage of total assets . . .	0.17 %	0.24 %	0.48 %	0.09 %	0.13 %

Nonperforming assets were \$7.9 million, or 0.17% of total assets, at December 31, 2020, compared to \$9.8 million, or 0.24% of total assets, at December 31, 2019. The following table presents the amortized cost basis of nonperforming loans and loans past due over 90 days and still accruing at December 31, 2020:

	Nonaccrual with no Special Allowance for Credit Losses	Nonaccrual with Special Allowance for Credit Losses	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)			
Commercial	\$ 752	\$ 1,974	\$ 81	\$ 2,807
Real estate:	—	—	—	—
CRE - Owner Occupied	3,706	—	—	3,706
CRE - Non-Owner Occupied	—	—	—	—
Land and construction	—	—	—	—
Home equity	949	—	—	949
Multifamily	—	—	—	—
Residential mortgages	—	—	—	—
Consumer and other	407	—	—	407
Total	<u>\$ 5,814</u>	<u>\$ 1,974</u>	<u>\$ 81</u>	<u>\$ 7,869</u>

The following table presents nonperforming loans by class at December 31, 2019:

	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)		
Commercial	\$ 3,444	\$ 1,153	\$ 4,597
Real estate:			
CRE	5,094	—	5,094
Home equity	137	—	137
Total	<u>\$ 8,675</u>	<u>\$ 1,153</u>	<u>\$ 9,828</u>

When management determines that foreclosures are probable, expected credit losses for collateral-dependent loans are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate. For loans which foreclosure is not probable, but for which repayment is expected to be provided substantially through the operation or sale of the collateral and the borrower is experiencing financial difficulty, management has elected the practical expedient under ASC 326 to estimate expected credit losses based on the fair value of collateral, adjusted for selling costs as appropriate. The class of loan represents the primary collateral type associated with the loan. Significant quarter over quarter changes are reflective of changes in nonaccrual status and not necessarily associated with credit quality indicators like appraisal value.

The following table presents the amortized cost basis of collateral-dependent loans by loan classification December 31, 2020:

	Collateral Type			Total
	Real Estate Property	Business Assets	Unsecured	
	(Dollars in thousands)			
Commercial	\$ 29	\$ 1,815	\$ 130	\$ 1,974
Total	<u>\$ 29</u>	<u>\$ 1,815</u>	<u>\$ 130</u>	<u>\$ 1,974</u>

Loans with a well defined weakness, which are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected, are categorized as “classified.” Classified loans include all loans considered as substandard, substandard nonaccrual, and doubtful and may result from problems specific to a borrower’s business or from economic downturns that affect the borrower’s ability to repay or that cause a decline in the value of the

underlying collateral (particularly real estate). Loans held for sale are carried at the lower of cost or estimated fair value, and are not allocated an allowance for loan losses.

Classified loans increased to \$34.0 million, or 0.73% of total assets, at December 30, 2020, compared to \$32.6 million, or 0.79% of total assets at December 31, 2019. Deferrals included in classified assets total \$939,000 at December 31, 2020.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed in accordance with the Company's underwriting policy.

Beginning January 1, 2020, we calculated allowance for ACLL using CECL methodology. As of January 1, 2020, the Company increased the ACLL by \$8.6 million since the Topic 326 covers credit losses over the expected life of a loan as well as considering future changes in macroeconomic conditions.

The allowance for credit loss estimation process involves procedures to appropriately consider the unique characteristics of its loan portfolio segments. These segments are further disaggregated into loan classes, the level at which credit risk is monitored. When computing the level of expected credit losses, credit loss assumptions are estimated using a model that categorizes loan pools based on loss history, delinquency status, and other credit trends and risk characteristics, including current conditions and reasonable and supportable forecasts about the future. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. In future periods evaluations of the overall loan portfolio, in light of the factors and forecasts then prevailing, may result in significant changes in the allowance and credit loss expense in those future periods.

The allowance level is influenced by loan volumes, loan risk rating migration or delinquency status, changes in historical loss experience, and other conditions influencing loss expectations, such as reasonable and supportable forecasts of economic conditions. The methodology for estimating the amount of expected credit losses reported in the allowance for credit losses has two basic components: first, an asset-specific component involving individual loans that do not share risk characteristics with other loans and the measurement of expected credit losses for such individual loans; and second, a pooled component for estimated expected credit losses for pools of loans that share similar risk characteristics.

Prior to January 1, 2020, we calculated ALLL using incurred losses methodology.

Loans are charged-off against the allowance when management determines that a loan balance has been uncollectible. Subsequent recoveries, if any, are credited to the allowance for credit losses on loans.

The following provides a summary of the risks associated with various segments of the Company's loan portfolio, which are factors management regularly considers when evaluating the adequacy of the allowance:

Commercial

Commercial loans primarily rely on the identified cash flows of the borrower for repayment and secondarily on the underlying collateral provided by the borrower. However, the cash flows of the borrowers may not be as expected and the collateral securing these loans may vary in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable, inventory or equipment and may incorporate a personal guarantee; however, some loans may be unsecured. Included in commercial loans are \$290.7 million of PPP loans at December 31, 2020.

Commercial Real Estate

Commercial real estate loans rely primarily on the cash flows of the properties securing the loan and secondarily on the value of the property that is securing the loan. Commercial real estate loans comprise two segments differentiated by owner occupied commercial real estate and non-owner commercial real estate. Owner occupied commercial real estate loans are secured by commercial properties that are at least 50% occupied by the borrower or borrower affiliate. Non-owner occupied commercial real estate loans are secured by commercial properties that are less than 50% occupied by the borrower or borrower affiliate. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy.

Land and Construction

Land and construction loans are generally based on estimates of costs and value associated with the complete project. Construction loans usually involve the disbursement of funds with repayment substantially dependent on the success of the completion of the project. Sources of repayment for these loans may be permanent loans from HBC or other lenders, or proceeds from the sales of the completed project. These loans are monitored by on-site inspections and are considered to have higher risk than other real estate loans due to the final repayment dependent on numerous factors including general economic conditions.

Home Equity

Home equity loans are secured by 1-4 family residences that are generally owner occupied. Repayment of these loans depends primarily on the personal income of the borrower and secondarily by the value of the property securing the loan which can be impacted by changes in economic conditions such as the unemployment rate and property values.

Multifamily

Multifamily loans are loans on residential properties with five or more units. These loans rely primarily on the cash flows of the properties securing the loan for repayment and secondarily on the value of the properties securing the loan. The cash flows of these borrowers can fluctuate along with the values of the underlying property depending on general economic conditions.

Residential Mortgages

Residential mortgage loans are secured by 1-4 family residences which are generally owner-occupied. Repayment of these loans depends primarily on the personal income of the borrower and secondarily by the value of the property securing the loan which can be impacted by changes in economic conditions such as the unemployment rate and property values.

Consumer and Other

Consumer and other loans are secured by personal property or are unsecured and rely primarily on the income of the borrower for repayment and secondarily on the collateral value for secured loans. Borrower income and collateral value can vary dependent on economic conditions.

As a result of the matters mentioned above, changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for credit losses on loans and the associated provision for credit losses on loans.

On an ongoing basis, we have engaged an outside firm to perform independent credit reviews of our loan portfolio. The Federal Reserve Board and the California Department of Financial Protection and Innovation (“DFPI”) also review the allowance for credit losses as an integral part of the examination process. Based on information currently available, management believes that the allowance for credit losses on loans is adequate. However, the loan portfolio could be adversely affected if California economic conditions and the real estate market in the Company’s market area were to weaken. Also, any weakness of a prolonged nature in the technology industry would have a negative impact on the local market. The effect of such events, although uncertain at this time, could result in an increase in the level of nonperforming loans and increased loan losses, which could adversely affect the Company’s future growth and profitability. No assurance of the ultimate level of credit losses can be given with any certainty.

Changes in the allowance for credit losses on loans were as follows:

	Year Ended December 31, 2020								Total
	Commercial	CRE Owner Occupied	CRE Non-owner Occupied	Land & Construction	Home Equity	Multi- Family	Residential Mortgages	Consumer and Other	
	(Dollars in thousands)								
Beginning of period balance	\$ 10,453	\$ 3,825	\$ 3,760	\$ 2,621	\$ 2,244	\$ 57	\$ 243	\$ 82	\$ 23,285
Adoption of Topic 326	(3,663)	3,169	7,912	(1,163)	(923)	1,196	435	1,607	8,570
Balance at adoption on January 1, 2020	6,790	6,994	11,672	1,458	1,321	1,253	678	1,689	31,855
Charge-offs	(1,776)	-	-	-	-	-	-	(104)	(1,880)
Recoveries	998	1	-	70	93	-	-	30	1,192
Net (charge-offs) recoveries	(778)	1	-	70	93	-	-	(74)	(688)
Provision for credit losses on loans	5,575	1,565	4,744	981	(117)	1,551	265	(1,331)	13,233
End of period balance	<u>\$ 11,587</u>	<u>\$ 8,560</u>	<u>\$ 16,416</u>	<u>\$ 2,509</u>	<u>\$ 1,297</u>	<u>\$ 2,804</u>	<u>\$ 943</u>	<u>\$ 284</u>	<u>\$ 44,400</u>

	Year Ended December 31, 2019			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	\$ 17,061	\$ 10,671	\$ 116	\$ 27,848
Charge-offs	(6,609)	-	(14)	(6,623)
Recoveries	1,045	169	-	1,214
Net (charge-offs) recoveries	(5,564)	169	(14)	(5,409)
Provision (credit) for loan losses	(1,044)	1,910	(20)	846
End of period balance	<u>\$ 10,453</u>	<u>\$ 12,750</u>	<u>\$ 82</u>	<u>\$ 23,285</u>

	Year Ended December 31, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	\$ 10,608	\$ 8,950	\$ 100	\$ 19,658
Charge-offs	(2,002)	-	(24)	(2,026)
Recoveries	2,645	150	-	2,795
Net (charge-offs) recoveries	643	150	(24)	769
Provision for loan losses	5,810	1,571	40	7,421
End of period balance	<u>\$ 17,061</u>	<u>\$ 10,671</u>	<u>\$ 116</u>	<u>\$ 27,848</u>

Allocation of Allowance for Credit Losses on Loans

The following table summarizes the Company's loan loss experience, as well as provisions and charges to the allowance for credit losses on loans and certain pertinent ratios for the periods indicated:

	2020	2019	2018	2017	2016
	(Dollars in thousands)				
Beginning of year balance	\$ 23,285	\$ 27,848	\$ 19,658	\$ 19,089	\$ 18,926
Charge-offs:					
Commercial	(1,776)	(6,609)	(2,002)	(2,239)	(1,961)
Real estate:					
CRE - non-owner occupied	—	—	—	—	(5)
Consumer and other	(104)	(14)	(24)	—	(41)
Total charge-offs	<u>(1,880)</u>	<u>(6,623)</u>	<u>(2,026)</u>	<u>(2,239)</u>	<u>(2,007)</u>
Recoveries:					
Commercial	998	1,045	2,645	1,585	365
Real estate:					
CRE - owner occupied	1	—	—	859	—
Land and construction	70	76	114	244	568
Home equity	93	93	36	21	—
Consumer and other	30	—	—	—	—
Total recoveries	<u>1,192</u>	<u>1,214</u>	<u>2,795</u>	<u>2,709</u>	<u>933</u>
Net (charge-offs) recoveries	<u>(688)</u>	<u>(5,409)</u>	<u>769</u>	<u>470</u>	<u>(1,074)</u>
Impact of adopting Topic 326	8,570	—	—	—	—
Provision for credit losses on loans ⁽¹⁾	<u>13,233</u>	<u>846</u>	<u>7,421</u>	<u>99</u>	<u>1,237</u>
End of year balance	<u>\$ 44,400</u>	<u>\$ 23,285</u>	<u>\$ 27,848</u>	<u>\$ 19,658</u>	<u>\$ 19,089</u>

(1) Provision for credit losses on loans for the year ended December 31, 2020, Provision for loan losses for the previous years

The following table provides a summary of the allocation of the allowance for credit losses on loans by class at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for credit losses on loans will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each category represents the total amount available for charge-offs that may occur within these classes.

	December 31,									
	2020		2019		2018		2017		2016	
	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
Commercial	\$ 11,587	32 %	\$ 10,453	24 %	\$ 17,061	29 %	\$ 10,608	33 %	\$ 10,656	36 %
Real estate:										
CRE - owner occupied	8,560	21 %	3,825	22 %	2,907	23 %	2,873	25 %	2,968	27 %
CRE - non-owner occupied	16,416	27 %	3,760	30 %	3,456	25 %	2,724	23 %	1,935	17 %
Land and construction	2,509	6 %	2,621	6 %	2,008	7 %	1,441	6 %	1,221	6 %
Home equity	1,297	4 %	2,244	6 %	1,609	5 %	1,390	5 %	1,639	5 %
Multifamily	2,804	6 %	57	7 %	374	5 %	312	3 %	278	3 %
Residential mortgages	943	3 %	243	4 %	317	5 %	210	4 %	286	4 %
Consumer and other	284	1 %	82	1 %	116	1 %	100	1 %	106	2 %
Total	<u>\$ 44,400</u>	<u>100 %</u>	<u>\$ 23,285</u>	<u>100 %</u>	<u>\$ 27,848</u>	<u>100 %</u>	<u>\$ 19,658</u>	<u>99 %</u>	<u>\$ 19,089</u>	<u>100 %</u>

The allowance for credit losses on loan totaled \$44.4 million, or 1.70% of total loans at December 31, 2020. The allowance for loan losses totaled \$23.3 million, or 0.92% of total loans at December 31, 2019. The allowance for credit losses on loan to total nonperforming loans increased to 564.24% at December 31, 2020, compared to 236.93% at December 31, 2019. The Company had net charge-offs of \$688,000 or 0.03% of average loans, for the year ended

December 31, 2020, compared to net charge-offs of \$5.4 million, or 0.27% of average loans, for the year ended December 31, 2019. Net charge-offs of \$5.4 million for the year ended December 31, 2019 primarily consisted of three lending relationships totaling \$5.5 million in net charge-offs during the fourth quarter of 2019, including one large relationship which was previously disclosed and specifically reserved for during the second and third quarters of 2018. The three lending relationships totaling \$5.5 million in net charge-offs had a total of \$4.7 million in specific reserves.

The following table shows the results of adopting CECL for the year ended December 31, 2020:

DRIVERS OF CHANGE IN ACLL UNDER CECL

(in \$000's, unaudited)

ALLL at December 31, 2019	\$ 23,285
Day 1 adjustment impact of adopting Topic 326	8,570
ACLL at January 1, 2020	31,855
Net (charge-offs) during the first quarter of 2020	(422)
Portfolio changes during the first quarter of 2020	1,216
Economic factors during the first quarter of 2020	12,054
ACLL at March 31, 2020	44,703
Net (charge-offs) during the second quarter of 2020	(373)
Portfolio changes during the second quarter of 2020	(4,282)
Qualitative and quantitative changes during the second quarter of 2020 including changes in economic forecasts	5,396
ACLL at June 30, 2020	45,444
Net (charge-offs) during the third quarter of 2020	(219)
Portfolio changes during the third quarter of 2020	488
Qualitative and quantitative changes during the third quarter of 2020 including changes in economic forecasts	(291)
ACLL at September 30, 2020	\$ 45,422
Net (charge-offs) during the fourth quarter of 2020	326
Portfolio changes during the fourth quarter of 2020	(1,622)
Qualitative and quantitative changes during the fourth quarter of 2020 including changes in economic forecasts	274
ACLL at December 31, 2020	\$ 44,400

Leases

On January 1, 2019, the Company adopted Accounting Standards Update (“ASU”) No. 2016-02, Leases (Topic 842). Under the new guidance, the Company recognizes the following for all leases, at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use (“ROU”) asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. While the new standard impacts lessors and lessees, the Company is impacted as a lessee of the offices and real estate used for operations. Some of the Company's lease agreements include options to renew at the Company's discretion. The extensions are not reasonably certain to be exercised, therefore it was not considered in the calculation of the ROU asset and lease liability. Total assets and liabilities included \$35.9 million of right-of-use assets, included in other assets, and lease liabilities, included in other liabilities, related to non-cancelable operating lease agreements for office space. See Note 7 to the consolidated financial statements.

In June of 2019, the Company entered into a lease agreement for 54,910 square feet of office space in San Jose, California, which commenced on February 1, 2020. The Company moved its Bay View Funding office during the first quarter of 2020, and moved the main office of HBC during the second and third quarters of 2020, to this new location.

The merger with Presidio resulted in the Company operating overlapping branch locations in the cities of Walnut Creek and San Mateo, California. These branches were consolidated in 2020 by vacating the HBC leased locations prior to the lease termination date, and moving the operations to the Presidio branch locations. The consolidation of these two branches into the Presidio locations resulted in the impairment of both leases at December 31, 2019. The lease impairment and write-off of fixed assets and tenant improvements totaled \$434,000 for the Walnut Creek location, and \$625,000 for the San Mateo location during the fourth quarter of 2019.

Deposits

The composition and cost of the Company’s deposit base are important components in analyzing the Company’s net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections in this report. The Company’s liquidity is impacted by the volatility of deposits from the propensity of that money to leave the institution for rate-related or other reasons. Deposits can be adversely affected if economic conditions weaken in

California, and the Company's market area in particular. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed \$250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following table summarizes the distribution of deposits and the percentage of distribution in each category of deposits for the periods indicated:

	December 31, 2020		December 31, 2019		December 31, 2018	
	Balance	% to Total	Balance	% to Total	Balance	% to Total
(Dollars in thousands)						
Demand, noninterest-bearing	\$ 1,661,655	42 %	\$ 1,450,873	42 %	\$ 1,021,582	39 %
Demand, interest-bearing	960,179	25 %	798,375	23 %	702,000	27 %
Savings and money market	1,119,968	29 %	982,430	29 %	754,277	28 %
Time deposits — under \$250	45,027	1 %	54,361	2 %	58,661	2 %
Time deposits — \$250 and over	103,746	3 %	99,882	3 %	86,114	3 %
CDARS — interest-bearing demand, money market and time deposits	23,911	1 %	28,847	1 %	14,898	1 %
Total deposits	<u>\$ 3,914,486</u>	<u>100 %</u>	<u>\$ 3,414,768</u>	<u>100 %</u>	<u>\$ 2,637,532</u>	<u>100 %</u>

The Company obtains deposits from a cross-section of the communities it serves. The Company's business is not generally seasonal in nature. Public funds were less than 1% of deposits at December 31, 2020 and December 31, 2019.

Total deposits increased \$499.7 million, or 15%, to \$3.91 billion at December 31, 2020, compared to \$3.41 billion at December 31, 2019. Deposits, excluding all time deposits and CDARS deposits, increased \$510.1 million, or 16%, to \$3.74 billion at December 31, 2020, compared to \$3.23 billion at December 31, 2019.

At December 31, 2020, the \$23.9 million CDARS deposits were comprised of \$18.6 million of interest-bearing demand deposits, \$663,000 of money market accounts and \$4.6 million of time deposits. At December 31, 2019, the \$28.8 million CDARS deposits were comprised of \$12.9 million of interest-bearing demand deposits, \$2.1 million of money market accounts and \$13.8 million of time deposits.

The following table indicates the contractual maturity schedule of the Company's time deposits of \$250,000 and over, and all CDARS time deposits as of December 31, 2020:

	Balance	% of Total
(Dollars in thousands)		
Three months or less	\$ 34,194	32 %
Over three months through six months	22,913	21 %
Over six months through twelve months	39,004	36 %
Over twelve months	12,270	11 %
Total	<u>\$ 108,381</u>	<u>100 %</u>

The Company focuses primarily on providing and servicing business deposit accounts that are frequently over \$250,000 in average balance per account. As a result, certain types of business clients that the Company serves typically carry average deposits in excess of \$250,000. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Company to ensure its ability to fund deposit withdrawals.

Return on Equity and Assets

The following table indicates the ratios for return on average assets and average equity, and average equity to average assets for the periods indicated:

	2020	2019	2018
Return on average assets	0.80 %	1.21 %	1.16 %
Return on average tangible assets	0.83 %	1.25 %	1.19 %
Return on average equity	6.12 %	9.51 %	10.79 %
Return on average tangible equity	9.04 %	13.09 %	14.41 %
Average equity to average assets ratio	13.00 %	12.69 %	10.72 %

Off-Balance Sheet Arrangements

In the normal course of business, the Company makes commitments to extend credit to its customers as long as there are no violations of any conditions established in contractual arrangements. These commitments are obligations that represent a potential credit risk to the Company, yet are not reflected in any form within the Company's consolidated balance sheets. Total unused commitments to extend credit were \$1.1 billion at December 31, 2020 and December 31, 2019. Unused commitments represented 42% and 44% of outstanding gross loans at December 31, 2020 and December 31, 2019, respectively.

The effect on the Company's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted, because there is no certainty that the lines of credit will ever be fully utilized. For more information regarding the Company's off-balance sheet arrangements, see Note 16 to the consolidated financial statements located elsewhere herein.

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

	December 31,					
	2020		Total	2019		Total
Fixed Rate	Variable Rate	Fixed Rate		Variable Rate		
	(Dollars in thousands)					
Unused lines of credit and commitments to make loans	\$ 121,560	\$ 970,614	\$ 1,092,174	\$ 147,372	\$ 951,206	\$ 1,098,578
Standby letters of credit	3,049	18,970	22,019	11,445	10,615	22,060
	<u>\$ 124,609</u>	<u>\$ 989,584</u>	<u>\$ 1,114,193</u>	<u>\$ 158,817</u>	<u>\$ 961,821</u>	<u>\$ 1,120,638</u>

Contractual Obligations

The contractual obligations of the Company, summarized by type of obligation and contractual maturity, at December 31, 2020, are as follows:

	Less Than One Year	One to Three Years	Three to Five Years	After Five Years	Total
	(Dollars in thousands)				
Deposits(1).	\$ 3,899,179	\$ 14,381	\$ 926	\$ —	\$ 3,914,486
Subordinated debt	—	—	—	40,000	40,000
Operating leases	5,242	10,707	8,954	18,798	43,700
Other long-term liabilities(2)	2,123	3,732	3,980	48,615	58,450
Total contractual obligations	<u>\$ 3,906,544</u>	<u>\$ 28,820</u>	<u>\$ 13,860</u>	<u>\$ 107,413</u>	<u>\$ 4,056,637</u>

(1) Deposits with indeterminate maturities, such as demand, savings and money market accounts, are reflected as obligations due in less than one year.

(2) Includes maximum payments related to employee benefit plans, assuming all future vesting conditions are met. Additional information is provided in Note 14 to the consolidated financial statements.

In addition to those obligations listed above, in the normal course of business, the Company will make cash distributions for the payment of interest on interest-bearing deposit accounts and debt obligations, payments for quarterly income tax estimates and contributions to certain employee benefit plans.

Liquidity and Asset/Liability Management

Liquidity refers to the Company's ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely and cost effective fashion. At various times the Company requires funds to meet short-term cash requirements brought about by loan growth or deposit outflows, the purchase of assets, or liability repayments. An integral part of the Company's ability to manage its liquidity position appropriately is the Company's large base of core deposits, which are generated by offering traditional banking services in its service area and which have historically been a stable source of funds. To manage liquidity needs properly, cash inflows must be timed to coincide with anticipated outflows or sufficient liquidity resources must be available to meet varying demands. The Company manages liquidity to be able to meet unexpected sudden changes in levels of its assets or deposit liabilities without maintaining excessive amounts of balance sheet liquidity. Excess balance sheet liquidity can negatively impact the Company's interest margin. In order to meet short-term liquidity needs the Company may utilize overnight Federal funds purchase arrangements and other borrowing arrangements with correspondent banks, solicit brokered deposits if cost effective deposits are not available from local sources, and maintain collateralized lines of credit with the FHLB and FRB. In addition, the Company can raise cash for temporary needs by selling securities under agreements to repurchase and selling securities available-for-sale.

One of the measures of liquidity is our loan to deposit ratio. Our loan to deposit ratio was 66.91% at December 31, 2020, compared to 74.20% at December 31, 2019.

FHLB and FRB Borrowings and Available Lines of Credit

The Company has off-balance sheet liquidity in the form of Federal funds purchase arrangements with correspondent banks, and lines of credit from the FHLB and FRB. The Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. As of December 31, 2020, and December 31, 2019, the Company had no overnight borrowings from the FHLB. The Company had \$232.6 million of loans and pledged to the FHLB as collateral on a line of credit of \$160.5 million at December 31, 2020. The Company also had \$3.2 million of securities pledged to the FHLB as collateral on an available line of credit of \$3.0 million at December 31, 2020, none of which was outstanding.

The Company can also borrow from the FRB's discount window. The Company had approximately \$921.4 million of loans pledged to the FRB as collateral on an available line of credit of approximately \$528.1 million at December 31, 2020, none of which was outstanding.

At December 31, 2020 and 2019, the Company had Federal funds purchase arrangements available of \$80.0 million. There were no Federal funds purchased outstanding at December 31, 2020 and 2019.

The Company has a \$10.0 million line of credit with a correspondent bank, of which none was outstanding at December 31, 2020. The Company had a \$5,000,000 line of credit with a correspondent bank, of which none was outstanding at December 31, 2019.

The Company may also utilize securities sold under repurchase agreements to manage our liquidity position. There were no securities sold under agreements to repurchase at December 31, 2020, and 2019.

Capital Resources

The Company uses a variety of measures to evaluate capital adequacy. Management reviews various capital measurements on a regular basis and takes appropriate action to ensure that such measurements are within established internal and external guidelines. The external guidelines, which are issued by the Federal Reserve and the FDIC, establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures.

On May 26, 2017, the Company completed an underwritten public offering of \$40.0 million aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt

initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium.

It is anticipated that the LIBOR index will be phased-out by the end of 2021 and the Federal Reserve Bank of New York has established the Secured Overnight Financing Rate (“SOFR”) as its recommended alternative to LIBOR. We have created a sub-committee of our Asset Liability Management Committee to address LIBOR transition and phase-out issues. We are currently reviewing loan documentation, technology systems and procedures we will need to implement for the transition.

The Company acquired \$10.0 million of subordinated debt from the Presidio transaction, which was redeemed on December 19, 2019. As a result of the redemption of the Presidio subordinated debt, the Company paid a pre-payment penalty of \$300,000 during the fourth quarter of 2019.

The following table summarizes risk based capital, risk weighted assets, and risk based capital ratios of the consolidated Company under the Basel III requirements for the periods indicated:

	December 31,		
	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Capital components:			
Common equity Tier 1 capital	\$ 410,307	\$ 393,432	\$ 276,675
Additional Tier 1 capital	—	—	—
Tier 1 Capital	<u>410,307</u>	<u>393,432</u>	<u>276,675</u>
Tier 2 Capital	<u>73,563</u>	<u>63,726</u>	<u>67,922</u>
Total risk-based capital	<u>\$ 483,870</u>	<u>\$ 457,158</u>	<u>\$ 344,597</u>
Risk-weighted assets	\$ 2,924,448	\$ 3,136,252	\$ 2,303,941
Average assets for capital purposes	\$ 4,507,032	\$ 4,041,927	\$ 3,118,150
Capital ratios:			
Total risk-based capital	16.5 %	14.6 %	15.0 %
Tier 1 risk-based capital	14.0 %	12.5 %	12.0 %
Common equity Tier 1 risk-based capital	14.0 %	12.5 %	12.0 %
Leverage(1)	9.1 %	9.7 %	8.9 %

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

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of HBC under the Basel III requirements for the periods indicated:

	December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Capital components:			
Common equity Tier 1 capital	\$ 428,109	\$ 411,585	\$ 293,730
Additional Tier 1 capital	—	—	—
Tier 1 Capital	<u>428,109</u>	<u>411,585</u>	<u>293,730</u>
Tier 2 Capital	<u>33,824</u>	<u>24,172</u>	<u>28,553</u>
Total risk-based capital	<u>\$ 461,933</u>	<u>\$ 435,757</u>	<u>\$ 322,283</u>
Risk-weighted assets	\$ 2,922,577	\$ 3,134,848	\$ 2,302,751
Average assets for capital purposes	\$ 4,505,265	\$ 4,040,265	\$ 3,116,645
Capital ratios:			
Total risk-based capital	15.8 %	13.9 %	14.0 %
Tier 1 risk-based capital	14.6 %	13.1 %	12.8 %
Common equity Tier 1 risk-based capital	14.6 %	13.1 %	12.8 %
Leverage(1)	9.5 %	10.2 %	9.4 %

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

The following table presents the applicable well-capitalized regulatory guidelines and the standards for minimum capital adequacy requirements under Basel III:

	Minimum Regulatory Requirement(1)	Well-capitalized Financial Institution PCA Regulatory Guidelines
Capital ratios:		
Total risk-based capital	10.5 %	10.0 %
Tier 1 risk-based capital	8.5 %	8.0 %
Common equity Tier 1 risk-based capital	7.0 %	6.5 %
Leverage	4.0 %	5.0 %

(1) Includes 2.5% capital conservation buffer, except the leverage ratio.

The Basel III capital rules introduce a new “capital conservation buffer,” for banking organizations to maintain a common equity Tier 1 ratio more than 2.5% above these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of common equity Tier 1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

At December 31, 2020, the Company’s consolidated capital ratio exceeded regulatory guidelines and HBC’s capital ratios exceed the highest regulatory capital requirement of “well-capitalized” under Basel III prompt corrective action provisions. Quantitative measures established by regulation to help ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios of total risk-based capital, Tier 1 capital, and common equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2020, December 31, 2019, and December 31, 2018, the Company and HBC met all capital adequacy guidelines to which they were subject. There are no conditions or events since of December 31, 2020, that management believes have changed the categorization of the Company or HBC as well-capitalized.

At December 31, 2020, the Company had total shareholders' equity of \$577.9 million, compared to \$576.7 million at December 31, 2019. At December 31, 2020, total shareholders' equity included \$493.7 million in common stock, \$94.9 million in retained earnings, and (\$10.7) million of accumulated other comprehensive loss. The book value per common share was \$9.64 at December 31, 2020, compared to \$9.71 at December 31, 2019. The tangible book value per common share was \$6.57 at December 31, 2020, compared to \$6.55 at December 31, 2019.

The following table reflects the components of accumulated other comprehensive loss, net of taxes, for the periods indicated:

ACCUMULATED OTHER COMPREHENSIVE LOSS (in \$000's, unaudited)	December 31, 2020	December 31, 2019
Unrealized gain on securities available-for-sale	\$ 3,709	\$ 1,242
Remaining unamortized unrealized gain on securities available-for-sale transferred to held-to-maturity	261	298
Split dollar insurance contracts liability.	(6,140)	(4,835)
Supplemental executive retirement plan liability.	(8,767)	(6,843)
Unrealized gain on interest-only strip from SBA loans	220	360
Total accumulated other comprehensive loss	<u>\$ (10,717)</u>	<u>\$ (9,778)</u>

Market Risk

Market risk is the risk of loss of future earnings, fair values, or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as the Company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

Interest Rate Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Company's market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Company does not engage in the trading of financial instruments, nor does the Company have exposure to currency exchange rates.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Company in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage the risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or securities or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a

significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity GAP report may not provide a complete assessment of the exposure to changes in interest rates.

The Company uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on the Company's net interest margin, and to calculate the estimated fair values of the Company's financial instruments under different interest rate scenarios. The program imports current balances, interest rates, maturity dates and repricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for new volumes to project the effects of a given interest rate change on the Company's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Company's investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (an incremental increase or decrease in rates over a specified time period), based on current trends and econometric models or stable economic conditions (unchanged from current actual levels).

The following table sets forth the estimated changes in the Company's annual net interest income that would result from the designated instantaneous parallel shift in interest rates noted, as of December 31, 2020. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Increase/(Decrease) in Estimated Net Interest Income	
	Amount	Percent
	(Dollars in thousands)	
+400.....	\$ 59,450	50.0 %
+300.....	\$ 44,796	37.7 %
+200.....	\$ 30,037	25.3 %
+100.....	\$ 15,231	12.8 %
0.....	—	—
-100.....	\$ (11,927)	(10.0)%
-200.....	\$ (22,135)	(18.6)%

This data does not reflect any actions that we may undertake in response to changes in interest rates such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on net interest income, if any.

As with any method of gauging interest rate risk, there are certain shortcomings inherent to the methodology noted above. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. Additionally, the methodology noted above does not reflect the full impact of annual and lifetime restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan borrowers' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities and the market value of all interest-earning assets, other than those which have a short term to maturity. Based upon the nature of the Company's operations, the Company is not subject to foreign exchange or commodity price

risk. The Company has no market risk sensitive instruments held for trading purposes. As of December 31, 2020, 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 104 through 162.

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, 2020. 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, 2020, the period covered by this report.

Management's Annual Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Rule 13a-15(f) under the Exchange Act, internal control over financial reporting is a process designed by, or under the supervision of, a company's principal executive and principal financial officers and effected by a company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. It includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of a company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of a company are being made only in accordance with authorizations of management and the board of directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on its financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management has used the criteria established in the 2013 *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to evaluate the effectiveness of the Company's internal control over financial reporting. Management has selected the COSO framework for its evaluation as it is a control framework recognized by the SEC and the Public Company Accounting Oversight Board, that is free from bias, permits reasonably consistent qualitative and quantitative measurement of the Company's internal controls, is sufficiently complete so that relevant controls are not omitted and is relevant to an evaluation of internal controls over financial reporting.

Based on our assessment, management has concluded that our internal control over financial reporting, based on criteria established in the 2013 *Internal Control — Integrated Framework* issued by COSO was effective as of December 31, 2020.

The independent registered public accounting firm of Crowe LLP, as auditors of our consolidated financial statements, has issued an audit report on the effectiveness of the Company's internal control over financial reporting based on criteria established in the 2013 "*Internal Control — Integrated Framework*," issued by COSO.

Inherent Limitations on Effectiveness of Controls

The Company's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the year ended December 31, 2020 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 9B OTHER INFORMATION

None.

PART III

ITEM 10 DIRECTORS AND EXECUTIVE OFFICERS OF REGISTRANT

Information required by this item will be contained in our Definitive Proxy Statement for our 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2020. 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 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2020. 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 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2020. 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 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2020. 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 2021 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2020. Such information is incorporated herein by reference.

PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(1) FINANCIAL STATEMENTS

The Financial Statements of the Company and the Report of Independent Registered Public Accounting Firm are set forth on pages 104 through 162.

(2) FINANCIAL STATEMENT SCHEDULES

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(3) EXHIBITS

The exhibits listed below are filed or incorporated by reference as part of this Annual Report on Form 10-K.

Exhibit Number	Description
2.1	Agreement and Plan of Merger and Reorganization, dated April 23, 2015, by and among Heritage Commerce Corp, Heritage Bank of Commerce and Focus Business Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on April 23, 2015)
2.2	Agreement and Plan of Merger and Reorganization, dated December 20, 2017, by and among Heritage Commerce Corp, Heritage Bank of Commerce and Tri-Valley Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on December 20, 2017)
2.3	Agreement and Plan of Merger and Reorganization, dated January 10, 2018, by and among Heritage Commerce Corp, Heritage Bank of Commerce, AT Bancorp and United American Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on January 10, 2018)
2.4	Agreement and Plan of Merger, dated May 16, 2019, by and among Heritage Commerce Corp, Heritage Bank of Commerce, and Presidio Bank (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 17, 2019)

Exhibit Number	Description
3.1	Restated Articles of Incorporation of Heritage Commerce Corp (incorporated by reference from the Registrant's Annual Report on Form 10-K filed on March 16, 2009)
3.2	Certificate of Amendment of Articles of Incorporation of Heritage Commerce Corp, as filed with the California Secretary of State on June 1, 2010 (incorporated by reference from the Registration Statement on Form S-1 filed July 23, 2010)
3.3	Bylaws, as amended, of Heritage Commerce Corp (incorporated by reference from the Registrant's Current Report Form 8-K filed June 28, 2013)
3.4	Certificate of Amendment of Articles of Incorporation of Heritage Commerce Corp, as filed with the Secretary of State on August 29, 2019 (incorporated by reference from Registrant's Quarterly Report on Form 10-Q filed November 11, 2019)
3.5	Certificate of Determination of the Articles of Incorporation (Revocation of Series A Preferred), as filed with the Secretary of State on April 5, 2019 (incorporated by reference from the Registrant's Annual Report on Form 10-K filed on March 11, 2020)
3.6	Certificate of Determination of the Articles of Incorporation (Revocation of Series B Preferred), as filed with the Secretary of State on April 5, 2019 (incorporated by reference from the Registrant's Annual Report on Form 10-K filed on March 11, 2020)
3.7	Certificate of Determination of the Articles of Incorporation (Revocation of Series C Preferred), as filed with the Secretary of State on April 5, 2019 (incorporated by reference from the Registrant's Annual Report on Form 10-K filed on March 11, 2020)
4.1	Subordinated Indenture, dated as of May 26, 2017, by and between Heritage Commerce Corp and Wilmington Trust, National Association, as Trustee (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.2	First Supplemental Indenture, dated as of May 26, 2017, by and between Heritage Commerce Corp and Wilmington Trust, National Association, as Trustee (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.3	Form of 5.25% Fixed-to-Floating Rate Subordinated Notes due 2027 (included in Exhibit 4.2) (incorporated by reference from the Registrant's Current Report on Form 8-K filed on May 26, 2017)
4.4	Description of Securities Registered under Section 12 of the Securities Exchange Act of 1934 (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed on March 11, 2020)
*10.1	Heritage Commerce Corp Management Incentive Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed May 3, 2005)
*10.2	Amended and Restated 2004 Equity Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed June 2, 2009)
*10.3	Non-qualified Deferred Compensation Plan (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 31, 2005)
*10.4	Amended and Restated Employment Agreement with Lawrence McGovern, dated July 21, 2011 (incorporated herein by reference from the Registrant's Current Report on Form 8 K filed July 21, 2011)
*10.5	Employment Agreement with Michael E. Benito, dated February 1, 2012 (incorporated by reference from the Registrant's Current Report on Form 8-K filed February 1, 2012)
*10.6	Employment Agreement with Margo Butsch, dated June 26, 2017 (incorporated by reference from the Registrant's Current Report on Form 8-K filed June 26, 2017)
*10.7	Employment Agreement with Keith Wilton, dated August 8, 2019 (incorporated by reference from the Registrant's Current Report on Form 8-K filed August 12, 2019)
*10.8	Employment Agreement with Robertson Clay Jones, effective October 11, 2019 (incorporated by reference from the Registrant's Annual Report on Form 10-K filed March 11, 2020)
*10.9	Form of Stock Option Agreement For Amended and Restated 2004 Equity Plan (incorporated by reference from the Registrant's Annual Report on Form 10-K filed March 9, 2012)
*10.10	Form of Restricted Stock Agreement For Amended and Restated 2004 Equity Plan (incorporated by reference from the Registrant's Annual Report on Form 10-K filed March 9, 2012)
*10.11	2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)
*10.12	Form of Restricted Stock Agreement For 2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)
*10.13	Form of Stock Option Agreement for 2013 Equity Incentive Plan (incorporated by reference from the Registrant's Registration Statement on Form S-8 filed July 15, 2013)

Exhibit Number	Description
*10.14	2005 Amended and Restated Heritage Commerce Corp Supplemental Retirement Plan (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed September 30, 2008)
*10.15	Form of Endorsement Method Split Dollar Plan Agreement for Executive Officers (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 17, 2008)
*10.16	Form of Endorsement Method Split Dollar Plan Agreement for Directors (incorporated herein by reference from the Registrant's Annual Report on Form 10-K filed March 17, 2008)
*10.17	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Jack Conner and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.18	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Frank Bisceglia and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.19	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Robert Moles and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
*10.20	First Amended and Restated Director Compensation Benefits Agreement dated December 29, 2008 between Ranson Webster and the Company (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed January 2, 2009)
10.21	Form of Indemnification Agreement between the Registrant and its directors and executive officers (incorporated herein by reference from the Registrant's Current Report on Form 8-K filed December 23, 2009)
10.22	Stock Purchase Agreement, between Heritage Bank of Commerce, BVF Acquisition Corp and the stockholders named therein dated October 8, 2014 (incorporated herein from the Registrant's Current Report on Form 8-K, as filed October 9, 2014)
10.23	Presidio Bank Amended and Restated 2006 Stock Options Plan (incorporated herein by reference from the Registrant's Statement on Form S-8 filed October 15, 2019)
10.24	Presidio Bank 2016 Equity Incentive Plan (incorporated herein by reference from the Registrant's Statement on Form S-8 filed October 15, 2019)
21.1	Subsidiaries of the Registrant (incorporated herein from the Registrant's 2016 Annual Report on Form 10-K, as filed March 3, 2017)
23.1	Consent of Crowe LLP
31.1	Certification of Registrant's Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Registrant's Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Registrant's Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Registrant's Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document, filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document, filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document, filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document, filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document, filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document, filed herewith
104	Cover Page Interactive Data (formatted as inline XBRL)

* Management contract or compensatory plan or arrangement.

ITEM 16 *FORM 10-K SUMMARY*

Not applicable.

HERITAGE COMMERCE CORP
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DECEMBER 31, 2020

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
Heritage Commerce Corp
San Jose, California

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Heritage Commerce Corp (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2020, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2020 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company changed its method for accounting for credit losses effective January 1, 2020, due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, Financial Instruments - Credit Losses (ASC 326). The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles. The adoption of the new credit loss standard and its subsequent application is also communicated as a critical audit matter below.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Credit Losses on Loans – Model Techniques and Qualitative Factors

The Company adopted ASC 326, Financial Instruments – Credit Losses, on January 1, 2020, using a modified retrospective approach. Under ASC 326 the Company developed their allowance for credit losses on loans (“ACL”) utilizing the current expected credit loss (“CECL”) methodology which requires, among other things, that the Company recognize expected credit losses over the contractual life of financial assets within the scope of the standard. The Company recorded an ACL of \$31,855,000 at adoption and recorded a reduction to retained earnings net of tax of \$6,170,000 as a cumulative-effect adjustment. See change in accounting principle explanatory paragraph above. As of December 31, 2020, the Company's ACL was \$44,400,000 and the provision for credit losses was \$13,233,000 for the year then ended. Refer to Notes 1 and 4 of the consolidated financial statements for information on the ACL under CECL.

To estimate the ACL, the Company implemented a discounted cash flow methodology that includes loan level cash flow estimates for each loan segment based on peer and bank historic loss correlations with certain economic factors. The Company used forecast data for the state of California including gross state product, unemployment rate, home price index and a national commercial real estate value index in their forecasting models. Management used a four quarter forecast of each economic factor that is used for each loan segment and the economic factors are assumed to revert to the historic mean over an eight quarter period after the four quarter forecast period. The Company also developed a qualitative analysis framework to address increased risk due to loan quality trends, collateral risk, or other risks management determines are not adequately captured in the discounted cash flow loss estimation. Significant management judgment was required in determining whether, and to what extent, qualitative adjustments were required.

The audit procedures over the modeling techniques used to determine loss estimates and the selection and application of the macroeconomic variables involved a high degree of auditor judgment and required significant audit effort including the use of more experienced audit personnel and use of our credit and valuation specialists due to its complexity. Additionally, the audit procedures over the qualitative adjustments utilized in management's methodology involved especially challenging and subjective auditor judgment. Therefore, we identified auditing the CECL modeling techniques and qualitative risk factors as a critical audit matter.

The primary audit procedures we performed to address this critical audit matter included the following:

- Tested the design and operating effectiveness of the Company's controls over:

- Significant assumptions and judgments utilized in the modeling techniques employed and qualitative adjustments applied.
 - Completeness and accuracy of internal data utilized in the loss estimation models and in the qualitative analysis framework.
 - Evaluation of the relevance and reliability of external data utilized in the loss estimation models and in the qualitative analysis framework.
 - The reasonableness of the qualitative adjustments determined by management.
 - The accuracy of forecasted macroeconomic variables applied as inputs into the model.
 - Third-party model validation and testing of model performance including the conceptual soundness of the modeling techniques employed and the qualitative analysis framework applied.
- Evaluated the reasonableness and appropriateness of the methodologies employed including, but not limited to, evaluating their conceptual soundness and testing significant assumptions and judgments in estimating expected credit losses.
 - Tested the internal data utilized in the loss estimation models for completeness and accuracy.
 - Evaluated the relevancy and reliability of external data utilized in the loss estimation models.
 - Specific to the qualitative adjustments made to loss estimates we performed the following procedures:
 - Assessed the appropriateness and reasonableness of the framework developed for the qualitative adjustments including evaluating management’s judgments as to which factors impacted the qualitative adjustments for each portfolio segment.
 - Evaluated the reasonableness and the relevance of data used in the qualitative adjustment methodology.
 - Performed testing over the accuracy of inputs utilized in the calculation of qualitative adjustments for each portfolio segment.
 - Tested the mathematical accuracy of the calculation of qualitative factor adjustments.

/s/ CROWE LLP

 Crowe LLP

We have served as the Company's auditor since 2005.

Sacramento, California
 March 5, 2021

HERITAGE COMMERCE CORP
CONSOLIDATED BALANCE SHEETS

	December 31, 2020	December 31, 2019
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 30,598	\$ 49,447
Other investments and interest-bearing deposits in other financial institutions	<u>1,100,475</u>	<u>407,923</u>
Total cash and cash equivalents	1,131,073	457,370
Securities available-for-sale, at fair value	235,774	404,825
Securities held-to-maturity, at amortized cost, net of allowance for credit losses of \$54 at December 31, 2020 (fair value of \$304,927 at December 31, 2020 and \$368,107 at December 31, 2019)	297,389	366,560
Loans held-for-sale - SBA, at lower of cost or fair value, including deferred costs	1,699	1,052
Loans, net of deferred fees	2,619,261	2,533,844
Allowance for credit losses on loans ⁽¹⁾	<u>(44,400)</u>	<u>(23,285)</u>
Loans, net.	2,574,861	2,510,559
Federal Home Loan Bank, Federal Reserve Bank stock and other investments, at cost	33,522	29,842
Company-owned life insurance	77,523	76,027
Premises and equipment, net	10,459	8,250
Goodwill	167,631	167,420
Other intangible assets	16,664	20,415
Accrued interest receivable and other assets	87,519	67,143
Total assets.	<u><u>\$ 4,634,114</u></u>	<u><u>\$ 4,109,463</u></u>
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	\$ 1,661,655	\$ 1,450,873
Demand, interest-bearing	960,179	798,375
Savings and money market	1,119,968	982,430
Time deposits - under \$250	45,027	54,361
Time deposits - \$250 and over	103,746	99,882
CDARS - interest-bearing demand, money market and time deposits	<u>23,911</u>	<u>28,847</u>
Total deposits	3,914,486	3,414,768
Subordinated debt, net of issuance costs	39,740	39,554
Other short-term borrowings	—	328
Accrued interest payable and other liabilities	<u>101,999</u>	<u>78,105</u>
Total liabilities.	4,056,225	3,532,755
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; none issued and outstanding at December 31, 2020 and December 31, 2019	—	—
Common stock, no par value; 100,000,000 shares authorized; 59,917,457 shares issued and outstanding at December 31, 2020 and 59,368,156 shares issued and outstanding at December 31, 2019	493,707	489,745
Retained earnings	94,899	96,741
Accumulated other comprehensive loss	<u>(10,717)</u>	<u>(9,778)</u>
Total shareholders' equity	577,889	576,708
Total liabilities and shareholders' equity.	<u><u>\$ 4,634,114</u></u>	<u><u>\$ 4,109,463</u></u>

⁽¹⁾Allowance for credit losses on loans at December 31, 2020, Allowance for loan losses at December 31, 2019

See notes to consolidated financial statements

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2020	2019	2018
(Dollars in thousands, except per share data)			
Interest income:			
Loans, including fees	\$ 133,169	\$ 116,808	\$ 105,635
Securities, taxable	11,637	15,836	15,211
Securities, exempt from Federal tax	1,908	2,148	2,225
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	<u>3,757</u>	<u>7,867</u>	<u>6,774</u>
Total interest income	<u>150,471</u>	<u>142,659</u>	<u>129,845</u>
Interest expense:			
Deposits	6,260	8,159	5,506
Subordinated debt	2,320	2,686	2,314
Short-term borrowings	<u>1</u>	<u>2</u>	<u>2</u>
Total interest expense	<u>8,581</u>	<u>10,847</u>	<u>7,822</u>
Net interest income before provision for credit losses on loans ⁽¹⁾	141,890	131,812	122,023
Provision for credit losses on loans ⁽¹⁾	<u>13,233</u>	<u>846</u>	<u>7,421</u>
Net interest income after provision for credit losses on loans ⁽¹⁾	<u>128,657</u>	<u>130,966</u>	<u>114,602</u>
Noninterest income:			
Service charges and fees on deposit accounts	2,859	4,510	4,113
Increase in cash surrender value of life insurance	1,845	1,404	1,045
Gain on sales of SBA loans	839	689	698
Gain on the disposition of foreclosed assets	791	—	—
Servicing income	673	636	709
Gain on sales of securities	277	661	266
Other	<u>2,638</u>	<u>2,344</u>	<u>2,743</u>
Total noninterest income	<u>9,922</u>	<u>10,244</u>	<u>9,574</u>
Noninterest expense:			
Salaries and employee benefits	50,927	50,754	43,762
Occupancy and equipment	8,018	6,647	5,411
Professional fees	5,338	3,259	1,969
Other	<u>25,228</u>	<u>24,238</u>	<u>24,379</u>
Total noninterest expense	<u>89,511</u>	<u>84,898</u>	<u>75,521</u>
Income before income taxes	49,068	56,312	48,655
Income tax expense	<u>13,769</u>	<u>15,851</u>	<u>13,324</u>
Net income	<u>\$ 35,299</u>	<u>\$ 40,461</u>	<u>\$ 35,331</u>
Earnings per common share:			
Basic	\$ 0.59	\$ 0.87	\$ 0.85
Diluted	0.59	0.84	0.84

⁽¹⁾Provision for credit losses on loans for the year ended December 31, 2020, Provision for loan losses for the years ended December 31, 2019 and 2018

See notes to consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Net income.....	\$ 35,299	\$ 40,461	\$ 35,331
Other comprehensive income (loss):			
Change in net unrealized holding (losses) gains on available-for-sale securities and I/O strips	3,553	10,620	(6,383)
Deferred income taxes	(1,031)	(3,545)	1,925
Change in net unamortized unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	(52)	(65)	(44)
Deferred income taxes	15	19	13
Reclassification adjustment for gains realized in income	(277)	(661)	(266)
Deferred income taxes	82	195	79
Change in unrealized (losses) gains on securities and I/O strips, net of deferred income taxes	2,290	6,563	(4,676)
Change in net pension and other benefit plan liability adjustment	(4,036)	(5,622)	2,196
Deferred income taxes	807	1,662	(649)
Change in pension and other benefit plan liability, net of deferred income taxes	(3,229)	(3,960)	1,547
Other comprehensive (loss) income	(939)	2,603	(3,129)
Total comprehensive income.....	\$ 34,360	\$ 43,064	\$ 32,202

See notes to consolidated financial statements

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Years Ended December 31, 2020, 2019 and 2018				
	Common Stock		Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Amount			
	(Dollars in thousands, except per share data)				
Balance, January 1, 2018	38,200,883	\$ 218,355	\$ 62,136	\$ (9,252)	\$ 271,239
Net income	—	—	35,331	—	35,331
Other comprehensive loss	—	—	—	(3,129)	(3,129)
Issuance of common shares to acquire					
Tri-Valley Bank	1,889,613	30,725	—	—	30,725
Issuance of common shares to acquire					
United American Bank	2,826,032	47,280	—	—	47,280
Issuance of restricted stock awards, net	95,378	—	—	—	—
Amortization of restricted stock awards, net of forfeitures	—	1,109	—	—	1,109
Cash dividend declared \$0.44 per share	—	—	(18,464)	—	(18,464)
Stock option expense, net of forfeitures	—	708	—	—	708
Stock options exercised	276,844	2,667	—	—	2,667
Balance, December 31, 2018	<u>43,288,750</u>	<u>300,844</u>	<u>79,003</u>	<u>(12,381)</u>	<u>367,466</u>
Net income	—	—	40,461	—	40,461
Other comprehensive income	—	—	—	2,603	2,603
Issuance of common shares to acquire					
Presidio Bank, net of offering costs of \$246	15,684,064	177,926	—	—	177,926
Consideration for Presidio stock options exchanged for Heritage Commerce Corp stock options	—	7,426	—	—	7,426
Issuance of restricted stock awards, net	128,653	—	—	—	—
Amortization of restricted stock awards, net of forfeitures	—	1,283	—	—	1,283
Cash dividend declared \$0.48 per share	—	—	(22,723)	—	(22,723)
Stock option expense, net of forfeitures	—	640	—	—	640
Stock options exercised	266,689	1,626	—	—	1,626
Balance, December 31, 2019	<u>59,368,156</u>	<u>489,745</u>	<u>96,741</u>	<u>(9,778)</u>	<u>576,708</u>
Net income	—	—	35,299	—	35,299
Cumulative effect of change in accounting principles (Note 1)	—	—	(6,062)	—	(6,062)
Other comprehensive loss	—	—	—	(939)	(939)
Issuance of restricted stock awards, net	168,117	—	—	—	—
Amortization of restricted stock awards, net of forfeitures and taxes	—	1,689	—	—	1,689
Cash dividend declared \$0.52 per share	—	—	(31,079)	—	(31,079)
Stock option expense, net of forfeitures and taxes ..	—	559	—	—	559
Stock options exercised	381,184	1,714	—	—	1,714
Balance, December 31, 2020	<u>59,917,457</u>	<u>\$ 493,707</u>	<u>\$ 94,899</u>	<u>\$ (10,717)</u>	<u>\$ 577,889</u>

See notes to consolidated financial statements

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 35,299	\$ 40,461	\$ 35,331
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of discounts and premiums on securities	3,747	2,590	3,788
Gain on sale of securities available-for-sale	(277)	(661)	(266)
Gain on sale of SBA loans	(839)	(689)	(698)
Proceeds from sale of SBA loans originated for sale	11,154	10,096	11,765
SBA loans originated for sale	(10,962)	(8,504)	(15,214)
Provision (credit) for credit losses on loans ⁽¹⁾	13,233	846	7,421
Increase in cash surrender value of life insurance	(1,845)	(1,404)	(1,045)
Depreciation and amortization	951	846	753
Amortization of other intangible assets	3,751	2,739	1,943
Stock option expense, net	559	640	708
Amortization of restricted stock awards, net	1,689	1,283	1,109
Amortization of subordinated debt issuance costs	186	185	186
Gain on proceeds from company-owned life insurance	(20)	—	—
Effect of changes in:			
Accrued interest receivable and other assets	8,101	8,407	1,572
Accrued interest payable and other liabilities	(6,641)	(6,492)	1,219
Net cash provided by operating activities	<u>58,086</u>	<u>50,343</u>	<u>48,572</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of securities available-for-sale	—	(111,954)	(162,806)
Purchase of securities held-to-maturity	(30,916)	(50,041)	(31,496)
Maturities/paydowns/calls of securities available-for-sale	114,662	53,566	57,142
Maturities/paydowns/calls of securities held-to-maturity	97,365	59,361	50,773
Proceeds from sales of securities available-for-sale	56,598	167,551	94,291
Net change in loans	(85,646)	33,810	38,394
Changes in Federal Home Loan Bank stock and other investments	(3,680)	1,161	(4,483)
Purchase of premises and equipment	(3,160)	(203)	(187)
Proceeds from redemption of company-owned life insurance	369	—	—
Cash received in bank acquisition, net of cash paid	—	117,988	36,028
Net cash provided by investing activities	<u>145,592</u>	<u>271,239</u>	<u>77,656</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	499,718	2,977	(262,085)
Redemption of subordinated debt	—	(10,000)	—
Payment for early debt extinguishment penalty	—	(300)	—
Net change in short-term borrowings	(328)	(114)	—
Exercise of stock options	1,714	1,626	2,667
Common stock offering costs	—	(246)	—
Payment of cash dividends	(31,079)	(22,723)	(18,464)
Net cash provided by (used in) financing activities	<u>470,025</u>	<u>(28,780)</u>	<u>(277,882)</u>
Net increase in cash and cash equivalents	673,703	292,802	(151,654)
Cash and cash equivalents, beginning of period	457,370	164,568	316,222
Cash and cash equivalents, end of period	<u>\$ 1,131,073</u>	<u>\$ 457,370</u>	<u>\$ 164,568</u>
Supplemental disclosures of cash flow information:			
Interest paid	\$ 8,558	\$ 9,935	\$ 7,528
Income taxes paid, net	10,640	17,730	12,838
Supplemental schedule of non-cash activity:			
Recording of right to use assets in exchange for lease obligations	26,654	9,566	—
Transfer of loans held-for-sale to loan portfolio	—	694	4,917
Summary of assets acquired and liabilities assumed through acquisitions:			
Cash and cash equivalents, net of cash paid	—	117,988	36,028
Securities available-for-sale	—	45,069	63,723
Securities held-to-maturity	—	463	—
Net loans	—	685,964	336,446
Premises and equipment	—	1,756	350
Goodwill	—	83,878	38,039
Other intangible assets	—	11,147	8,361
Company owned life insurance	—	12,764	—
Other assets, net	—	29,397	14,736
Deposits	—	(774,259)	(416,628)
Subordinated debt	—	(10,000)	—
Other borrowings	—	(442)	(62)
Other liabilities	—	(18,127)	(3,038)
Common stock issued and stock options exchanged to acquire Presidio Bank, net of offering costs	—	185,598	—
Common stock issued to acquire Tri-Valley Bank and United American Bank	—	—	78,005

⁽¹⁾Provision for credit losses on loans for the year ended December 31, 2020, Provision for loan losses for the years ended December 31, 2019 and 2018

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 was incorporated on November 23, 1993 and commenced operations on June 8, 1994. HBC is a California state chartered bank which offers a full range of commercial and personal banking services to residents and the business/professional community in Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara counties of California.

CSNK Working Capital Finance Corp. a California corporation, dba Bay View Funding (“Bay View Funding”) is a wholly owned subsidiary of HBC. Bay View Funding’s primary business operation is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. In a factoring transaction Bay View Funding directly purchases the receivables generated by its clients at a discount to their face value. The transactions are structured to provide the clients with immediate working capital when there is a mismatch between payments to the client for a good and service and the payment of operating costs incurred to provide such good or service.

The Company acquired Tri-Valley Bank (“Tri-Valley”) on April 6, 2018. Tri-Valley was merged with HBC, with HBC as the surviving bank. Tri-Valley’s results of operations have been included in the Company’s results of operations beginning April 7, 2018.

The Company acquired United American Bank (“United American”) on May 4, 2018. United American was merged with HBC, with HBC as the surviving bank. United American’s results of operations have been included in the Company’s results of operations beginning May 5, 2018.

The Company acquired Presidio Bank (“Presidio”) on October 11, 2019. Presidio was merged with HBC, with HBC as the surviving bank. Presidio’s results of operations have been included in the Company’s results of operations beginning October 12, 2019.

The consolidated financial statements are prepared in accordance with accounting policies generally accepted in the United States of America and general practices in the banking industry. The financial statements include the accounts of the Company. All inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, amounts held at the Federal Reserve Bank, and Federal funds sold. The Company is required to maintain reserves against certain of the deposit accounts with the Federal Reserve Bank. Federal funds are generally sold and purchased for one-day periods.

Cash Flows

Net cash flows are reported for customer loan and deposit transactions, notes payable, repurchase agreements and other short-term borrowings.

Securities

The Company classifies its securities as either available-for-sale or held-to-maturity at the time of purchase. Debt securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of taxes.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts are amortized, or accreted, over the life of the related security, or the earliest call date for callable securities, 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.

Allowance for Credit Losses – Available-for-sale Securities

For available-for-sale debt securities in an unrealized loss position, the Company assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding the intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by rating agency, and adverse conditions specifically related to the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Allowance for Credit Losses – Held-to-Maturity Securities

Management measures expected credit losses on held-to-maturity debt securities on a collective basis by major security type and bond rating. The estimate of expected credit losses considers historical loss information that is adjusted for current conditions and reasonable and supportable forecasts.

Management classifies the held-to-maturity portfolio in the following major security types: Agency mortgage-backed and Municipals.

All the mortgage backed securities held by the Company are issued by U.S. government entities and agencies. These securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies, and have a long history of no credit losses.

Other securities are comprised primarily of tax exempt municipal securities. At December 31, 2020, these securities are primarily rated A-Aaa (defined as investment grade), with a small portion of the portfolio rated Baa2 (defined as medium grade). The issuers in these securities are primarily municipal entities and school districts.

Changes in the allowance for credit losses are recorded as a provision (or reversal of) credit loss expense. Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Loan Sales and Servicing

The Company holds for sale the conditionally guaranteed portion of certain loans guaranteed by the Small Business Administration or the U.S. Department of Agriculture (collectively referred to as "SBA loans"). These loans are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Gains or losses on SBA loans held-for-sale are recognized upon completion of the sale, based on the difference between the selling price and the carrying value of the related loan sold.

SBA loans are sold with servicing retained. Servicing assets recognized separately upon the sale of SBA loans consist of servicing rights and, for loans sold prior to 2009, interest-only strip receivables (“I/O strips”). The Company accounts for the sale and servicing of SBA loans based on the financial and servicing assets it controls and liabilities it has incurred, reversing recognition of financial assets when control has been surrendered, and reversing recognition of liabilities when extinguished. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sale of loans. Servicing rights are amortized in proportion to and over the period of net servicing income and are assessed for impairment on an ongoing basis. Impairment is determined by stratifying the servicing rights based on interest rates and terms. Any servicing assets in excess of the contractually specified servicing fees are reclassified at fair value as an I/O strip receivable and treated like an available for sale security. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance. The servicing rights, net of any required valuation allowance, and I/O strip receivable are included in other assets on the consolidated balance sheets.

Servicing income, net of amortization of servicing rights, is recognized as noninterest income. The initial fair value of I/O strip receivables is amortized against interest income on loans.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the principal amount outstanding, net of deferred loan origination fees and costs on originated loans, or unamortized premiums or discounts on purchased or acquired loans, and an allowance for credit losses on loans. Accrued interest receivable is excluded from the estimate of credit losses. Interest on loans is accrued on the unpaid principal balance and is credited to income using the effective yield interest method. Interest on purchased or acquired loans and the accretion (amortization) of the related purchase discount (premium) is also credited to income using the effective yield interest method.

A loan portfolio segment is defined as the level at which the Company uses a systematic methodology to determine the allowance for credit losses on loans. A loan portfolio class is defined as a group of loans having similar risk characteristics and methods for monitoring and assessing risk.

For all loan classes, when a loan is classified as nonaccrual, the accrual of interest is discontinued, any accrued and unpaid interest is reversed, and the amortization of deferred loan fees and costs is discontinued. For all loan classes, loans are classified as nonaccrual when the payment of principal or interest is 90 days past due, unless the loan is well secured and in the process of collection. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for credit loss and individually evaluated loans. In certain circumstances, loans that are under 90 days past due may also be classified as nonaccrual. Any interest or principal payments received on nonaccrual loans are applied toward reduction of principal. Nonaccrual loans generally are not returned to performing status until the obligation is brought current, the loan has performed in accordance with the contract terms for a reasonable period of time, and the ultimate collectability of the contractual principal and interest is no longer in doubt.

Non-refundable loan fees and direct origination costs are deferred and recognized over the expected lives of the related loans using the effective yield interest method.

Allowance for Credit Losses on Loans

The allowance for credit losses on loans is an estimate of the current expected credit losses in the loan portfolio. Loans are charged-off against the allowance when management determines that a loan balance has become uncollectible. Subsequent recoveries, if any, are credited to the allowance for credit losses on loans. Management’s methodology for estimating the allowance balance consists of several key elements, which include pooling loans with similar characteristics into segments and using a discounted cash flow calculation to estimate losses. The discounted cash flow model inputs include loan level cash flow estimates for each loan segment based on peer and bank historic loss correlations with certain economic factors. Management uses a four quarter forecast of each economic factor that is used for each loan segment and the economic factors are assumed to revert to the historic mean over an eight quarter period after the four quarter forecast period. The economic factors management has selected include the California unemployment rate, California gross state product, California home price index, and a national CRE value index. These factors are evaluated and updated occasionally and as economic conditions change. Additionally, management uses qualitative adjustments to the discounted

cash flow quantitative loss estimates in certain cases when management has assessed an adjustment is necessary. These qualitative adjustments are applied by pooled loan segment and have been made for increased risk due to loan quality trends, collateral risk, or other risks management determines are not adequately captured in the discounted cash flow loss estimation. Specific allowances on individually analyzed loans are added to the allowance on pools of collectively evaluated loans to derive the total allowance for credit losses on loans.

Loans that do not share risk characteristics with pooled segments are evaluated on an individual basis. 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. When foreclosure is probable or when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of collateral expected credit losses are based on the fair value of the collateral adjusted for selling costs as appropriate. When the discounted cash flow method is utilized the amount of credit loss is measured using the net present value of expected future cash flows adjusted for the effective interest rate used to discount expected cash flows to incorporate expected prepayments. The amount of any impairment will be charged off against the allowance for credit losses on loans if the amount is a confirmed loss or, alternatively, a specific allocation within the allowance will be established. Loans evaluated individually are specifically excluded from the collective evaluation in the allowance for credit losses.

The allowance for credit losses on loans was calculated by pooling loans of similar credit risk characteristics and credit monitoring procedures. The loan portfolio is classified into eight segments of loans - commercial, commercial real estate – owner occupied, commercial real estate – non-owner occupied, land and construction, home equity, multifamily, residential mortgage and consumer and other.

The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans primarily rely on the identified cash flows of the borrower for repayment and secondarily on the underlying collateral provided by the borrower. However, the cash flows of the borrowers may not be as expected and the collateral securing these loans may vary in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable, inventory or equipment and may incorporate a personal guarantee; however, some loans may be unsecured. Included in commercial loans are \$290,679,000 of PPP loans at December 31, 2020.

Commercial Real Estate

Commercial real estate loans rely primarily on the cash flows of the properties securing the loan and secondarily on the value of the property that is securing the loan. Commercial real estate loans comprise two segments differentiated by owner occupied commercial real estate and non-owner commercial real estate. Owner occupied commercial real estate loans are secured by commercial properties that are at least 50% occupied by the borrower or borrower affiliate. Non-owner occupied commercial real estate loans are secured by commercial properties that are less than 50% occupied by the borrower or borrower affiliate. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy.

Land and Construction

Land and construction loans are generally based on estimates of costs and value associated with the complete project. Construction loans usually involve the disbursement of funds with repayment substantially dependent on the success of the completion of the project. Sources of repayment for these loans may be permanent loans from HBC or other lenders, or proceeds from the sales of the completed project. These loans are monitored by on-site inspections and are considered to have higher risk than other real estate loans due to the final repayment dependent on numerous factors including general economic conditions.

Home Equity

Home equity loans are secured by 1-4 family residences that are generally owner occupied. Repayment of these loans depends primarily on the personal income of the borrower and secondarily by the value of the property securing the loan which can be impacted by changes in economic conditions such as the unemployment rate and property values.

Multifamily

Multifamily loans are loans on 5+ residential properties. These loans rely primarily on the cash flows of the properties securing the loan for repayment and secondarily on the value of the properties securing the loan. The cash flows of these borrowers can fluctuate along with the values of the underlying property depending on general economic conditions.

Residential Mortgages

Residential mortgage loans are secured by 1-4 family residences which are generally owner-occupied. Repayment of these loans depends primarily on the personal income of the borrower and secondarily by the value of the property securing the loan which can be impacted by changes in economic conditions such as the unemployment rate and property values.

Consumer and Other

Consumer and other loans are secured by personal property or are unsecured and rely primarily on the income of the borrower for repayment and secondarily on the collateral value for secured loans. Borrower income and collateral value can vary dependent on economic conditions.

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. The notional amount of these commitments is not reflected in the consolidated financial statement until they are funded. The Company maintains an allowance for credit losses on unfunded commercial lending commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The allowance is computed using a methodology similar to that used to determine the allowance for credit losses for loans, modified to take into account the probability of a drawdown on the commitment. The allowance for credit losses on unfunded loan commitments is classified as a liability account on the balance sheet and is adjusted as a provision for credit loss expense included in other noninterest expense.

Federal Home Loan Bank and Federal Reserve Bank Stock

As a member of the Federal Home Loan Bank (“FHLB”) system, the Bank is required to own common stock in the FHLB based on the Bank’s level of borrowings and outstanding FHLB advances. FHLB stock is carried at cost and classified as a restricted security. Both cash and stock dividends from the FHLB are reported as income.

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

Company-Owned Life Insurance and Split-Dollar Life Insurance Benefit Plan

The Company has purchased life insurance policies on certain directors and officers. Company-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for charges or other amounts due that are probable at settlement. The purchased insurance is subject to split-dollar insurance agreements with the insured participants, which continues after the participant’s employment and retirement.

Accounting guidance requires that a liability be recorded primarily over the participant’s service period when a split-dollar life insurance agreement continues after a participant’s employment or retirement. The required accrued liability is based on either the post-employment benefit cost for the continuing life insurance or the future death benefit depending on the contractual terms of the underlying agreement.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation and amortization are computed on the straight-line basis over the lesser of the respective lease terms or estimated useful lives. The Company owns one building which is being depreciated over 40 years. Furniture, equipment, and leasehold improvements are depreciated over estimated useful lives generally ranging from five to fifteen years. The Company evaluates the recoverability of long-lived assets on an ongoing basis.

Business Combinations

The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques including discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified.

Other intangible assets consist of a core deposit intangible, a below market lease, an above market lease liability, a customer relationship and brokered relationship intangible assets. They are initially measured at fair value and then are amortized over their estimated useful lives. The core deposits intangible assets from the acquisitions are being amortized on an accelerated method over ten years. The below market value lease intangible assets are being amortized on the straight line method over three years. The above market lease adjustment is being amortized on the straight line method over 60 months. The customer relationship and brokered relationship intangible assets are being amortized over ten years.

Foreclosed Assets

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through operations. Operating costs after acquisition are expensed. Gains and losses on disposition are included in noninterest expense. There were no foreclosed assets at December 31, 2020 and 2019.

Retirement Plans

Expenses for the Company's non-qualified, unfunded defined benefits plan consists of service and interest cost and amortization of gains and losses not immediately recognized. Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. The Company's accounting policy for legal costs related to loss contingencies is to accrue for the probable fees that can be reasonably estimated. The Company's accounting policy for uncertain recoveries is to recognize the anticipated recovery when realization is deemed probable.

Income Taxes

The Company files consolidated Federal and combined and separate state income tax returns. Income tax expense is the total of the current year income tax payable or refunded, the change in deferred tax assets and liabilities, and low income housing investment losses, net of tax benefits received. Some items of income and expense are recognized in different years for tax purposes when applying generally accepted accounting principles, leading to timing differences

between the Company's actual tax liability and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient taxable income to obtain benefit from the reversal of net deductible temporary differences and utilization of tax credit carryforwards for Federal and California state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company recognizes interest and penalties related to uncertain tax positions as income tax expense.

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. Compensation cost recognized reflects estimated forfeitures, adjusted as necessary for actual forfeitures.

Comprehensive Income (Loss)

Total comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) refers to gains and losses that are included in comprehensive income (loss) but are excluded from net income (loss) because they have been recorded directly in equity, net of tax, under the provisions of certain accounting guidance. The Company's sources of other comprehensive income (loss) are unrealized gains and losses on securities available-for-sale, and I/O strips, which are treated like available-for-sale securities, and the liabilities related to the Company's defined benefit pension plan and the split-dollar life insurance benefit plan. Reclassification adjustments result from gains or losses that were realized and included in net income (loss) of the current period that also had been included in other comprehensive income as unrealized holding gains and losses.

Segment Reporting

HBC is a commercial bank serving customers located in Alameda, Contra Costa, Marin, San Benito, San Francisco, San Mateo, and Santa Clara counties of California. Bay View Funding provides business essential working capital factoring financing to various industries throughout the United States. No customer accounts for more than 10 percent of revenue for HBC or the Company. With the previous acquisition of Bay View Funding, the Company has two reportable segments consisting of Banking and Factoring.

Reclassifications

Certain items in the consolidated financial statements for the years ended December 31, 2019 and 2018 were reclassified to conform to the 2020 presentation. These reclassifications did not affect previously reported net income or shareholders' equity.

London Inter-Bank Offered Rate (“LIBOR”) Transition and Phase-Out

We have loans and borrowings that are tied to LIBOR benchmark interest rates. It is anticipated that the LIBOR index will be phased-out by the end of 2021 and the Federal Reserve Bank of New York has established the Secured Overnight Financing Rate (“SOFR”) as its recommended alternative to LIBOR. We have created a sub-committee of our Asset Liability Management Committee to address LIBOR transition and phase-out issues. We are currently reviewing loan documentation, technology systems and procedures we will need to implement for the transition.

COVID-19

Capital and Liquidity

While the Company believes that it has sufficient capital to withstand an extended economic recession brought about by COVID-19, its reported and regulatory capital ratios could be adversely impacted by credit losses. The Company relies on cash on hand as well as dividends from its subsidiary bank to service its debt. If the Company’s capital deteriorates such that its subsidiary bank is unable to pay dividends to it for an extended period of time, the Company may not be able to service its debt.

The Company maintains access to multiple sources of liquidity. Wholesale funding markets have remained open to us, but rates for short term funding have recently been volatile. If funding costs are elevated for an extended period of time, it could have an adverse effect on the Company’s net interest margin. If an extended recession caused large numbers of the Company’s deposit customers to withdraw their funds, the Company might become more reliant on volatile or more expensive sources of funding.

Asset Valuation

The extent to which the COVID-19 pandemic will impact our business, results of operations and financial condition will depend on future developments, which are highly uncertain and difficult to predict. Those developments and factors include the duration and spread of the pandemic, its severity, the actions to contain the pandemic or address its impact, and how quickly and to what extent normal economic and operating conditions can resume. We do not yet know the full extent of the impact. However, the effects could have a material adverse impact on our business, asset valuations, financial condition and results of operations. Material adverse impacts may include all or a combination of valuation impairments on our intangible assets, investments, loans, or deferred tax assets.

Adoption of New Accounting Standards

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments in this update replace the incurred loss impairment methodology in prior GAAP with a methodology that reflects expected life-of-instrument credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization’s reasonable and supportable estimate of expected credit losses extends to held-to-maturity debt securities. The Company adopted CECL on January 1, 2020, using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures. Results for the reporting periods after January 1, 2020, are presented under Topic 326, while prior period amounts continue to be reported in accordance with previously applicable GAAP.

The following table shows the impact of adopting CECL on January 1, 2020:

	As Reported Under Topic 326	Pre- Topic 326 Adoption	Impact of Topic 326 Adoption
	(Dollars in thousands)		
Assets:			
Allowance for credit losses on debt securities			
Held-to-maturity municipal securities	\$ 58	\$ -	\$ 58
Loans			
Commercial	6,790	10,453	(3,663)
CRE - owner occupied	6,994	3,825	3,169
CRE - non-owner occupied	11,672	3,760	7,912
Land and construction	1,458	2,621	(1,163)
Home equity	1,321	2,244	(923)
Multifamily	1,253	57	1,196
Residential mortgage	678	243	435
Consumer and other	1,689	82	1,607
Allowance for credit losses on loans	<u>\$ 31,855</u>	<u>\$ 23,285</u>	<u>\$ 8,570</u>
Liabilities:			
Allowance for credit losses on off-balance sheet			
credit exposures	\$ 679	\$ 886	\$ (207)

As of the implementation date of January 1, 2020, the Company recognized an increase of \$8,570,000 to its allowance for credit losses for loans. The majority of this increase is related to loan portfolios acquired in our recent acquisitions that under the previous methodology had no recognized allowance for loan losses until the estimated allowance exceeded the unaccreted discount.

As of the implementation date, there was a \$58,000 allowance for losses recorded on the Company's held-to-maturity municipal investment securities portfolio. The allowance for losses on held-to-maturity securities is based on historic loss rates of municipal securities by bond ratings and change in bond ratings of the municipal securities held by the Company will impact the reserve. Any significant ratings downgrades on these securities will impact the allowance for losses on these securities.

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. As of the implementation date, there was a reduction of \$207,000 to the allowance for losses recorded for the Company's off-balance sheet credit exposures. The reduction in reserves for off-balance sheet credit exposures at implementation was primarily driven by applying a lower estimated CECL loss factor for unfunded commercial loan and construction loan commitments.

The cumulative-effect adjustment as a result of the adoption of this guidance was recorded, net of tax of \$2,359,000, as a \$6,062,000 reduction to retained earnings effective January 1, 2020.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The provisions of the update eliminated the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net remaining amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update provided that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. The Company adopted the new guidance on January 1, 2020 and there was no material impact to the financial statements and no cumulative adjustments were made.

In March 2020, the FASB issued ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting, which provides temporary, optional guidance to ease the potential

burden in accounting for, or recognizing the effects of, the transition away from the LIBOR or other interbank offered rate on financial reporting. To help with the transition to new reference rates, the ASU provides optional expedients and exceptions for applying GAAP to affected contract modifications and hedge accounting relationships. The main provisions include:

- A change in a contract's reference interest rate would be accounted for as a continuation of that contract rather than as the creation of a new one for contracts, including loans, debt, leases, and other arrangements, that meet specific criteria.
- When updating its hedging strategies in response to reference rate reform, an entity would be allowed to preserve its hedge accounting.

The guidance is applicable only to contracts or hedge accounting relationships that reference LIBOR or another reference rate expected to be discontinued. Because the guidance is meant to help entities through the transition period, it will be in effect for a limited time and will not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, except for hedging relationships existing as of December 31, 2022, for which an entity has elected certain optional expedients that are retained through the end of the hedging relationship. The amendments in this ASU are effective March 12, 2020 through December 31, 2022.

ASU 2020-04 permits relief solely for reference rate reform actions and permits different elections over the effective date for legacy and new activity. Accordingly, the Company is evaluating and reassessing the elections on a quarterly basis. For current elections in effect regarding the assertion of the probability of forecasted transactions, the Company elects the expedient to assert the probability of the hedged interest payments and receipts regardless of any expected modification in terms related to reference rate reform.

The Company believes the adoption of this guidance on activities subsequent to December 31, 2020 through December 31, 2022 will not have a material impact on the consolidated financial statements.

2) Accumulated Other Comprehensive Income (“AOCI”)

The following table reflects the changes in AOCI by component for the periods indicated:

	Year Ended December 31, 2020 and 2019			
	Unrealized Gains (Losses) on Available- for-Sale Securities and I/O Strips	Unamortized Unrealized Gain on Available- for-Sale Securities Reclassified to Held-to- Maturity	Defined Benefit Pension Plan Items(1)	Total
	(Dollars in thousands)			
Beginning balance January 1, 2020, net of taxes	\$ 1,602	\$ 298	\$ (11,678)	\$ (9,778)
Other comprehensive income (loss) before reclassification, net of taxes	2,522	—	(3,459)	(937)
Amounts reclassified from other comprehensive income (loss), net of taxes	(195)	(37)	230	(2)
Net current period other comprehensive income (loss), net of taxes	2,327	(37)	(3,229)	(939)
Ending balance December 31, 2020, net of taxes	<u>\$ 3,929</u>	<u>\$ 261</u>	<u>\$ (14,907)</u>	<u>\$ (10,717)</u>
Beginning balance January 1, 2019, net of taxes	\$ (5,007)	\$ 344	\$ (7,718)	\$ (12,381)
Other comprehensive income (loss) before reclassification, net of taxes	7,075	—	(4,022)	3,053
Amounts reclassified from other comprehensive income (loss), net of taxes	(466)	(46)	62	(450)
Net current period other comprehensive income (loss), net of taxes	6,609	(46)	(3,960)	2,603
Ending balance December 31, 2019, net of taxes	<u>\$ 1,602</u>	<u>\$ 298</u>	<u>\$ (11,678)</u>	<u>\$ (9,778)</u>

(1) This AOCI component is included in the computation of net periodic benefit cost (see Note 14—Benefit Plans) and includes split-dollar life insurance benefit plan.

Details About AOCI Components	Amounts Reclassified from AOCI(1) Year Ended December 31,			Affected Line Item Where Net Income is Presented
	2020	2019	2018	
	(Dollars in thousands)			
Unrealized gains on available-for-sale securities and I/O strips	\$ 277	\$ 661	\$ 266	Gain on sales of securities
	(82)	(195)	(79)	Income tax expense
	<u>195</u>	<u>466</u>	<u>187</u>	Net of tax
Amortization of unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	52	65	44	Interest income on taxable securities
	(15)	(19)	(13)	Income tax expense
	<u>37</u>	<u>46</u>	<u>31</u>	Net of tax
Amortization of defined benefit pension plan items ⁽¹⁾				
Prior transition obligation and actuarial losses ⁽²⁾ . . .	60	96	65	
Actuarial losses ⁽³⁾	(387)	(184)	(292)	
	(327)	(88)	(227)	Other noninterest expense
	97	26	67	Income tax benefit
	<u>(230)</u>	<u>(62)</u>	<u>(160)</u>	Net of tax
Total reclassification from AOCI for the period	<u>\$ 2</u>	<u>\$ 450</u>	<u>\$ 58</u>	

(1) This AOCI component is included in the computation of net periodic benefit cost (see Note 14 — *Benefit Plans*).

(2) This is related to the split dollar life insurance benefit plan.

(3) This is related to the supplemental executive retirement plan.

3) Securities

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

December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Allowance for Credit Losses	Estimated Fair Value
	(Dollars in thousands)				
Securities available-for-sale:					
Agency mortgage-backed securities	\$ 170,215	\$ 5,111	\$ —	\$ —	\$ 175,326
U.S. Treasury	59,797	651	—	—	60,448
Total	<u>\$ 230,012</u>	<u>\$ 5,762</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 235,774</u>
December 31, 2020	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized (Losses)	Estimated Fair Value	Allowance for Credit Losses
	(Dollars in thousands)				
Securities held-to-maturity:					
Agency mortgage-backed securities	\$ 228,652	\$ 6,075	\$ (230)	\$ 234,497	\$ —
Municipals - exempt from Federal tax	68,791	1,639	—	70,430	(54)
Total	<u>\$ 297,443</u>	<u>\$ 7,714</u>	<u>\$ (230)</u>	<u>\$ 304,927</u>	<u>\$ (54)</u>

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Estimated Fair Value</u>
(Dollars in thousands)				
Securities available-for-sale:				
Agency mortgage-backed securities	\$ 283,598	\$ 934	\$ (171)	\$ 284,361
U.S. Treasury	118,939	1,525	—	120,464
Total	<u>\$ 402,537</u>	<u>\$ 2,459</u>	<u>\$ (171)</u>	<u>\$ 404,825</u>

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Gross Unrecognized Gains</u>	<u>Gross Unrecognized (Losses)</u>	<u>Estimated Fair Value</u>
(Dollars in thousands)				
Securities held-to-maturity:				
Agency mortgage-backed securities	\$ 285,344	\$ 1,206	\$ (968)	\$ 285,582
Municipals - exempt from Federal tax	81,216	1,313	(4)	82,525
Total	<u>\$ 366,560</u>	<u>\$ 2,519</u>	<u>\$ (972)</u>	<u>\$ 368,107</u>

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

<u>December 31, 2020</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>
(Dollars in thousands)						
Securities held-to-maturity:						
Agency mortgage-backed securities	\$ 30,930	(230)	\$ —	\$ —	\$ 30,930	\$ (230)
Total	<u>\$ 30,930</u>	<u>\$ (230)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 30,930</u>	<u>\$ (230)</u>

<u>December 31, 2019</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>
(Dollars in thousands)						
Securities available-for-sale:						
Agency mortgage-backed securities	\$ 100,816	\$ (105)	\$ 27,534	\$ (66)	\$ 128,350	\$ (171)
Total	<u>\$ 100,816</u>	<u>\$ (105)</u>	<u>\$ 27,534</u>	<u>\$ (66)</u>	<u>\$ 128,350</u>	<u>\$ (171)</u>
Securities held-to-maturity:						
Agency mortgage-backed securities	\$ 50,060	\$ (178)	\$ 88,128	\$ (790)	\$ 138,188	\$ (968)
Municipals - exempt from Federal tax	1,556	(4)	—	—	1,556	(4)
Total	<u>\$ 51,616</u>	<u>\$ (182)</u>	<u>\$ 88,128</u>	<u>\$ (790)</u>	<u>\$ 139,744</u>	<u>\$ (972)</u>

There were no holdings of securities of any one issuer, other than the U.S. Government and its sponsored entities, in an amount greater than 10% of shareholders' equity. At December 31, 2020, the Company held 407 securities (116 available-for-sale and 291 held-to-maturity), of which five had fair values below amortized cost. At December 31, 2020, there were \$30,930,000 of agency mortgage-backed securities held-to-maturity, carried with an unrealized loss for less than 12 months. The total unrealized loss for securities less than 12 months was (\$230,000) at December 31, 2020. The unrealized losses were due to higher interest rates at period end compared to when the securities were purchased. The issuers are of high credit quality and all principal amounts are expected to be paid when securities mature. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline. The Company does not believe that it is more likely than not that the Company will be required to sell a security in an unrealized loss position prior to recovery in value. The Company does not consider these securities to have credit-related losses at December 31, 2020.

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
		(Dollars in thousands)	
Proceeds	\$ 56,598	\$ 167,551	\$ 94,291
Gross gains	277	1,094	1,243
Gross losses	—	(433)	(977)

The amortized cost and fair value of debt securities as of December 31, 2020, by contractual maturity, are shown below. The expected maturities will differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	<u>Available-for-sale</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
	(Dollars in thousands)	
Due 3 months or less	\$ 14,988	\$ 15,039
Due after 3 months through one year	44,809	45,409
Agency mortgage-backed securities	170,215	175,326
Total	<u>\$ 230,012</u>	<u>\$ 235,774</u>

	<u>Held-to-maturity</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
	(Dollars in thousands)	
Due after 3 months through one year	\$ 493	\$ 499
Due after one through five years	10,390	10,757
Due after five through ten years	31,509	32,149
Due after ten years	26,399	27,025
Agency mortgage-backed securities	228,652	234,497
Total	<u>\$ 297,443</u>	<u>\$ 304,927</u>

Securities with amortized cost of \$40,238,000 and \$32,773,000 as of December 31, 2020 and 2019 were pledged to secure public deposits and for other purposes as required or permitted by law or contract.

The table below presents a roll-forward by major security type for the year ended December 31, 2020 of the allowance for credit losses on debt securities held-to-maturity held at period end:

	<u>Municipals</u>	
	(Dollars in thousands)	
Beginning balance January 1, 2020	\$	-
Impact of adopting Topic 326		58
Provision (credit) for credit loss		(4)
Ending balance December 31, 2020	<u>\$</u>	<u>54</u>

For the year ended December 31, 2020, there was a reduction of \$4,000 to the allowance for credit losses on the Company's held-to-maturity municipal investment securities portfolio. This reduction was the result of a reduction in municipal securities amortized balances resulting from regular payments. The bond ratings for the Company's municipal investment securities at December 31, 2020 were consistent with the ratings at January 1, 2020.

4) Loans and Allowance for Credit Losses on Loans

The allowance for credit losses on loans was calculated by pooling loans of similar credit risk characteristics and credit monitoring procedures. The loan portfolio is classified into eight segments of loans - commercial, commercial real estate – owner occupied, commercial real estate – non-owner occupied, land and construction, home equity, multifamily, residential mortgage and consumer and other. See *Note 1 – Summary of Significant Accounting Policies - Allowance for Credit Losses on Loans* for the summary of risk characteristics of each loan segment.

Loans by portfolio segment and the allowance for credit losses on loans were as follows for the periods indicated:

	December 31, 2020	December 31, 2019
	(Dollars in thousands)	
Loans held-for-investment:		
Commercial.....	\$ 846,386	\$ 603,345
Real estate:		
CRE - owner occupied.....	560,362	548,907
CRE - non-owner occupied.....	693,103	767,821
Land and construction.....	144,594	147,189
Home equity.....	111,885	151,775
Multifamily.....	166,425	180,623
Residential mortgages.....	85,116	100,759
Consumer and other.....	18,116	33,744
Loans.....	<u>2,625,987</u>	<u>2,534,163</u>
Deferred loan fees, net.....	<u>(6,726)</u>	<u>(319)</u>
Loans, net of deferred fees.....	2,619,261	2,533,844
Allowance for credit losses on loans ⁽¹⁾	<u>(44,400)</u>	<u>(23,285)</u>
Loans, net.....	<u>\$ 2,574,861</u>	<u>\$ 2,510,559</u>

⁽¹⁾Allowance for credit losses on loans at December 31, 2020, Allowance for loan losses at December 31, 2019.

Changes in the allowance for credit losses on loans were as follows:

	Year Ended December 31, 2020								Total
	Commercial	Owner Occupied	Non-owner Occupied	Land & Construction	Home Equity	Multi-Family	Residential Mortgage	Consumer and Other	
	(Dollars in thousands)								
Beginning of period balance.....	\$ 10,453	\$ 3,825	\$ 3,760	\$ 2,621	\$ 2,244	\$ 57	\$ 243	\$ 82	\$ 23,285
Adoption of Topic 326.....	(3,663)	3,169	7,912	(1,163)	(923)	1,196	435	1,607	8,570
Balance at adoption on January 1, 2020.....	6,790	6,994	11,672	1,458	1,321	1,253	678	1,689	31,855
Charge-offs.....	(1,776)	—	—	—	—	—	—	(104)	(1,880)
Recoveries.....	998	1	—	70	93	—	—	30	1,192
Net (charge-offs) recoveries.....	(778)	1	—	70	93	—	—	(74)	(688)
Provision (credit) for credit losses on loans..	5,575	1,565	4,744	981	(117)	1,551	265	(1,331)	13,233
End of period balance.....	<u>\$ 11,587</u>	<u>\$ 8,560</u>	<u>\$ 16,416</u>	<u>\$ 2,509</u>	<u>\$ 1,297</u>	<u>\$ 2,804</u>	<u>\$ 943</u>	<u>\$ 284</u>	<u>\$ 44,400</u>

Management’s methodology for estimating the allowance balance consists of several key elements, which include pooling loans with similar characteristics into segments and using a discounted cash flow calculation to estimate losses. The discounted cash flow model inputs include loan level cash flow estimates for each loan segment based on peer and bank historic loss correlations with certain economic factors. Management uses a four quarter forecast of each economic factor that is used for each loan segment and the economic factors are assumed to revert to the historic mean over an eight quarter period after the four quarter forecast period. The economic factors management has selected include the California unemployment rate, California gross state product, California home price index, and a national CRE value index. These factors are evaluated and updated occasionally and as economic conditions change. Additionally, management uses qualitative adjustments to the discounted cash flow quantitative loss estimates in certain cases when management has assessed an adjustment is necessary. These qualitative adjustments are applied by pooled loan segment and have been made for increased risk due to loan quality trends, collateral risk, or other risks management determines are not adequately captured in the discounted cash flow loss estimation. Specific allowances on individually

evaluated loans are combined to the allowance on pools of loans with similar risk characteristics to derive to total allowance for credit losses on loans.

The increase in the allowance for credit loss and related provision during the year ended December 31, 2020 is primarily attributable to the change in projected economic conditions resulting from the COVID-19 pandemic, with elevated levels of unemployment being the most significant factor. Management has also considered other qualitative risks such as collateral values, concentrations of credit risk (geographic, large borrower, and industry), economic conditions, changes in underwriting standards, experience and depth of lending staff, trends in delinquencies, and the level of criticized loans to address asset-specific risks and current conditions that were not fully considered by the macroeconomic variables driving the quantitative estimate.

Changes in the allowance for loan losses were as follows:

	Year Ended December 31, 2019			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	\$ 17,061	\$ 10,671	\$ 116	\$ 27,848
Charge-offs	(6,609)	—	(14)	(6,623)
Recoveries	1,045	169	—	1,214
Net recoveries	(5,564)	169	(14)	(5,409)
Provision (credit) for loan losses.	(1,044)	1,910	(20)	846
End of period balance	<u>\$ 10,453</u>	<u>\$ 12,750</u>	<u>\$ 82</u>	<u>\$ 23,285</u>

	Year Ended December 31, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	\$ 10,608	\$ 8,950	\$ 100	\$ 19,658
Charge-offs	(2,002)	—	(24)	(2,026)
Recoveries	2,645	150	—	2,795
Net recoveries	643	150	(24)	769
Provision for loan losses.	5,810	1,571	40	7,421
End of period balance	<u>\$ 17,061</u>	<u>\$ 10,671</u>	<u>\$ 116</u>	<u>\$ 27,848</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment, based on the impairment method as follows at year-end:

	December 31, 2019			
	Commercial	Real Estate	Consumer and other	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	\$ 1,835	\$ —	\$ —	\$ 1,835
Collectively evaluated for impairment	8,618	12,750	82	21,450
Total allowance balance	<u>\$ 10,453</u>	<u>\$ 12,750</u>	<u>\$ 82</u>	<u>\$ 23,285</u>
Loans:				
Individually evaluated for impairment	\$ 4,810	\$ 5,454	\$ —	\$ 10,264
Collectively evaluated for impairment	598,535	1,891,620	33,744	2,523,899
Total loan balance	<u>\$ 603,345</u>	<u>\$ 1,897,074</u>	<u>\$ 33,744</u>	<u>\$ 2,534,163</u>

The following table presents the amortized cost basis of nonaccrual loans and loans past due over 90 days and still accruing at December 31, 2020:

	Nonaccrual with no Specific Allowance for Credit Losses	Nonaccrual with Specific Allowance for Credit Losses	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)			
Commercial	\$ 752	\$ 1,974	\$ 81	\$ 2,807
Real estate:				
CRE - Owner Occupied	3,706	—	—	3,706
Home equity	949	—	—	949
Consumer and other	407	—	—	407
Total	<u>\$ 5,814</u>	<u>\$ 1,974</u>	<u>\$ 81</u>	<u>\$ 7,869</u>

The following table presents nonperforming loans by class at December 31, 2019:

	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)		
Commercial	\$ 3,444	\$ 1,153	\$ 4,597
Real estate:			
CRE	5,094	—	5,094
Home equity	137	—	137
Total	<u>\$ 8,675</u>	<u>\$ 1,153</u>	<u>\$ 9,828</u>

The following tables presents the aging of past due loans by class for the periods indicated:

	December 31, 2020					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total
	(Dollars in thousands)					
Commercial	\$ 3,524	\$ 259	\$ 392	\$ 4,175	\$ 842,211	\$ 846,386
Real estate:						
CRE - Owner Occupied	1,133	—	29	1,162	559,200	560,362
CRE - Non-Owner Occupied	—	485	—	485	692,618	693,103
Land and construction	—	—	—	—	144,594	144,594
Home equity	—	—	—	—	111,885	111,885
Multifamily	—	—	—	—	166,425	166,425
Residential mortgages	—	—	—	—	85,116	85,116
Consumer and other	—	—	407	407	17,709	18,116
Total	<u>\$ 4,657</u>	<u>\$ 744</u>	<u>\$ 828</u>	<u>\$ 6,229</u>	<u>\$ 2,619,758</u>	<u>\$ 2,625,987</u>

	December 31, 2019					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total
	(Dollars in thousands)					
Commercial	\$ 4,770	\$ 2,097	\$ 3,217	\$ 10,084	\$ 593,261	\$ 603,345
Real estate:						
CRE - Owner Occupied	—	—	5,094	5,094	543,813	548,907
CRE - Non-Owner Occupied	—	—	—	—	767,821	767,821
Land and construction	—	—	—	—	147,189	147,189
Home equity	—	137	—	137	151,638	151,775
Multifamily	—	—	—	—	180,623	180,623
Residential mortgages	—	—	—	—	100,759	100,759
Consumer and other	—	—	—	—	33,744	33,744
Total	<u>\$ 4,770</u>	<u>\$ 2,234</u>	<u>\$ 8,311</u>	<u>\$ 15,315</u>	<u>\$ 2,518,848</u>	<u>\$ 2,534,163</u>

Past due loans 30 days or greater totaled \$6,229,000 and \$15,315,000 at December 31, 2020 and December 31, 2019, respectively, of which \$1,918,000 and \$7,413,000 were on nonaccrual. At December 31, 2020, there were also \$5,870,000 loans less than 30 days past due included in nonaccrual loans held-for-investment. At December 31, 2019, there were also \$1,262,000 loans less than 30 days past due included in nonaccrual loans held-for-investment. Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt.

Credit Quality Indicators

Concentrations of credit risk arise when a number of customers 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 remaining 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 downturn in these sectors of the economy which could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans.

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, and other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. Pass loans generally include those loans that are expected to be repaid in accordance with contractual loans terms. Loans not categorized as pass are assigned a rating using the following definitions:

Special Mention. A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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

Substandard-Nonaccrual. Loans classified as substandard-nonaccrual are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any, and it is probable that the Company will not receive payment of the full contractual principal and interest. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. In addition, the Company no longer accrues interest on the loan

because of the underlying weaknesses.

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

Loss. Loans classified as loss are considered uncollectable or of so little value that their continuance as assets is not warranted. This classification does not necessarily mean that a loan has no recovery or salvage value; but rather, there is much doubt about whether, how much, or when the recovery would occur. Loans classified as loss are immediately charged off against the allowance for credit losses on loans. Therefore, there is no balance to report as of December 31, 2020 and December 31, 2019.

Loans may be reviewed at any time throughout a loan's duration. If new information is provided, a new risk assessment may be performed if warranted.

The following table presents term loans amortized cost by vintage and loan grade classification, and revolving loans amortized cost by loan grade classification. The loan grade classifications are based on the Bank's internal loan grading methodology. Loan grade categories for doubtful and loss rated loans are not included on the table below as there are no loans with those grades at December 31, 2020. The vintage year represents the period the loan was originated or in the case of renewed loans, the period last renewed. The amortized balance is the loan balance less any purchase discounts, and plus any loan purchase premiums. The loan categories are based on the loan segmentation in the Company's CECL reserve methodology based on loan purpose and type.

	Term Loans Amortized Cost Basis by Originated Period						Revolving Loans Amortized	Total
	2020	2019	2018	2017	2016	2015 and Prior	Cost Basis	
	(Dollars in thousands)							
Commercial:								
Pass	\$ 431,369	\$ 33,350	\$ 21,154	\$ 13,840	\$ 7,341	\$ 8,292	\$ 296,286	\$ 811,632
Special Mention	15,720	716	1,301	953	713	170	1,937	21,510
Substandard	4,036	-	19	758	2,396	73	3,236	10,518
Substandard-Nonaccrual	2,106	56	36	-	115	26	387	2,726
Total	<u>453,231</u>	<u>34,122</u>	<u>22,510</u>	<u>15,551</u>	<u>10,565</u>	<u>8,561</u>	<u>301,846</u>	<u>846,386</u>
CRE - Owner Occupied:								
Pass	168,224	73,064	68,068	51,705	50,716	109,350	15,964	537,091
Special Mention	3,151	2,568	4,128	783	-	2,569	-	13,199
Substandard	2,561	-	400	2,954	-	451	-	6,366
Substandard-Nonaccrual	3,678	-	-	-	-	28	-	3,706
Total	<u>177,614</u>	<u>75,632</u>	<u>72,596</u>	<u>55,442</u>	<u>50,716</u>	<u>112,398</u>	<u>15,964</u>	<u>560,362</u>
CRE - Non-Owner Occupied:								
Pass	166,550	128,361	68,796	99,816	57,422	150,683	1,926	673,554
Special Mention	11,930	-	2,557	-	-	-	-	14,487
Substandard	3,166	-	1,411	-	485	-	-	5,062
Substandard-Nonaccrual	-	-	-	-	-	-	-	-
Total	<u>181,646</u>	<u>128,361</u>	<u>72,764</u>	<u>99,816</u>	<u>57,907</u>	<u>150,683</u>	<u>1,926</u>	<u>693,103</u>
Land and construction:								
Pass	114,932	22,054	-	-	-	1,343	4,906	143,235
Special Mention	-	-	-	-	-	-	-	-
Substandard	1,359	-	-	-	-	-	-	1,359
Substandard-Nonaccrual	-	-	-	-	-	-	-	-
Total	<u>116,291</u>	<u>22,054</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,343</u>	<u>4,906</u>	<u>144,594</u>
Home equity:								
Pass	266	-	74	-	-	-	109,848	110,188
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	143	605	748
Substandard-Nonaccrual	117	-	-	-	-	-	832	949
Total	<u>383</u>	<u>-</u>	<u>74</u>	<u>-</u>	<u>-</u>	<u>143</u>	<u>111,285</u>	<u>111,885</u>
Multifamily:								
Pass	31,481	39,183	17,248	24,572	16,235	30,751	880	160,350
Special Mention	-	-	-	-	-	5,186	-	5,186
Substandard	889	-	-	-	-	-	-	889
Substandard-Nonaccrual	-	-	-	-	-	-	-	-
Total	<u>32,370</u>	<u>39,183</u>	<u>17,248</u>	<u>24,572</u>	<u>16,235</u>	<u>35,937</u>	<u>880</u>	<u>166,425</u>
Residential mortgage:								
Pass	12,798	10,048	3,246	7,324	28,115	15,568	-	77,099
Special Mention	5,089	-	1,630	-	-	-	-	6,719
Substandard	-	-	-	-	-	1,298	-	1,298
Substandard-Nonaccrual	-	-	-	-	-	-	-	-
Total	<u>17,887</u>	<u>10,048</u>	<u>4,876</u>	<u>7,324</u>	<u>28,115</u>	<u>16,866</u>	<u>-</u>	<u>85,116</u>
Consumer and other:								
Pass	10	522	1,486	20	116	987	14,568	17,709
Special Mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Substandard-Nonaccrual	-	-	407	-	-	-	-	407
Total	<u>10</u>	<u>522</u>	<u>1,893</u>	<u>20</u>	<u>116</u>	<u>987</u>	<u>14,568</u>	<u>18,116</u>
Total loans	<u>\$ 979,432</u>	<u>\$ 309,922</u>	<u>\$ 191,961</u>	<u>\$ 202,725</u>	<u>\$ 163,654</u>	<u>\$ 326,918</u>	<u>\$ 451,375</u>	<u>\$ 2,625,987</u>
Risk Grades:								
Pass	\$ 925,630	\$ 306,582	\$ 180,072	\$ 197,277	\$ 159,945	\$ 316,974	\$ 444,378	\$ 2,530,858
Special Mention	35,890	3,284	9,616	1,736	713	7,925	1,937	61,101
Substandard	12,011	-	1,830	3,712	2,881	1,965	3,841	26,240
Substandard-Nonaccrual	5,901	56	443	-	115	54	1,219	7,788
Grand Total	<u>\$ 979,432</u>	<u>\$ 309,922</u>	<u>\$ 191,961</u>	<u>\$ 202,725</u>	<u>\$ 163,654</u>	<u>\$ 326,918</u>	<u>\$ 451,375</u>	<u>\$ 2,625,987</u>

The following table provides a summary of the loan portfolio by loan type and credit quality classification at December 31, 2019:

	December 31, 2019		
	Nonclassified	Classified	Total
Commercial	\$ 599,143	4,202	\$ 603,345
Real estate:			
CRE - Owner Occupied	538,229	10,678	548,907
CRE - Non-Owner Occupied	761,801	6,020	767,821
Land and construction	144,108	3,081	147,189
Home equity	149,131	2,644	151,775
Multifamily	180,623	—	180,623
Residential mortgages	100,262	497	100,759
Consumer and other	28,287	5,457	33,744
Total	<u>\$ 2,501,584</u>	<u>\$ 32,579</u>	<u>\$ 2,534,163</u>

Nonclassified loans include those rated as Pass or Special Mention using the definitions listed above. Classified loans are those rated Substandard, Substandard-Nonaccrual, Doubtful and Loss, using those definitions.

The following table presents the amortized cost basis of collateral-dependent loans by loan classification at December 31, 2020:

	Collateral Type			Total
	Real Estate Property	Business Assets	Unsecured	
	(Dollars in thousands)			
Commercial	\$ 29	\$ 1,815	\$ 130	\$ 1,974
Total	<u>\$ 29</u>	<u>\$ 1,815</u>	<u>\$ 130</u>	<u>\$ 1,974</u>

When management determines that foreclosures are probable, expected credit losses for collateral-dependent loans are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate. For loans which foreclosure is not probable, but for which repayment is expected to be provided substantially through the operation or sale of the collateral and the borrower is experiencing financial difficulty, management has elected the practical expedient under ASC 326 to estimate expected credit losses based on the fair value of collateral, adjusted for selling costs as appropriate. The class of loan represents the primary collateral type associated with the loan. Significant quarter over quarter changes are reflective of changes in nonaccrual status and not necessarily associated with credit quality indicators like appraisal value.

The following table details the allowance for loan losses and recorded investment in loans individually evaluated for impairment by loan classification as of December 31, 2019, as determined in accordance with ASC 310 prior to adoption of Topic 326:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial	\$ 2,113	\$ 2,113	\$ —
Real estate:			
CRE	5,094	5,094	—
Home Equity	360	360	—
Total with no related allowance recorded	<u>7,567</u>	<u>7,567</u>	<u>—</u>
With an allowance recorded:			
Commercial	2,697	2,697	1,835
Total with an allowance recorded	<u>2,697</u>	<u>2,697</u>	<u>1,835</u>
Total	<u>\$ 10,264</u>	<u>\$ 10,264</u>	<u>\$ 1,835</u>

The book balance of troubled debt restructurings at December 31, 2020 was \$674,000, which included \$468,000 of nonaccrual loans and \$206,000 of accruing loans. The book balance of troubled debt restructurings at December 31, 2019 was \$1,039,000, which included \$590,000 of nonaccrual loans and \$449,000 of accruing loans. Approximately \$352,000 and \$20,000 in specific reserves were established with respect to these loans as of December 31, 2020 and December 31, 2019. As of December 31, 2020 and December 31, 2019, the Company had no additional amounts committed on any loan classified as a troubled debt restructuring.

The following table presents loans by class modified as troubled debt restructurings for the periods indicated:

	During the Year Ended December 31, 2020		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
		(Dollars in thousands)	
Troubled Debt Restructurings:			
Commercial	15	\$ 630	\$ 630
Total	<u>15</u>	<u>\$ 630</u>	<u>\$ 630</u>
	During the Year Ended December 31, 2019		
	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
		(Dollars in thousands)	
Troubled Debt Restructurings:			
Commercial	3	\$ 591	\$ 591
Total	<u>3</u>	<u>\$ 591</u>	<u>\$ 591</u>

There were 15 new loans with total recorded investment of \$630,000 that were modified as troubled debt restructurings during the year ended December 31, 2020.

During the twelve months ended December 31, 2020, there were debt restructurings in which the amount of principal or accrued interest owed from the borrower was forgiven or which resulted in a charge-off or change to the allowance for credit losses on loans.

A loan is considered to be in payment default when it is 30 days contractually past due under the modified terms. There were no defaults on troubled debt restructurings, within twelve months following the modification, during the years ended December 31, 2020 and 2019.

A loan that is a troubled debt restructuring on nonaccrual status may return to accruing status after a period of at least six months of consecutive payments in accordance with the modified terms.

On March 22, 2020, the Interagency Statement was issued by our banking regulators that encourages financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations due to the effects of COVID-19. Additionally, Section 4013 of the CARES Act further provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak declared by the President of the United States under the National Emergencies Act terminates. The Interagency Statement was subsequently revised in April 2020 to clarify the interaction of the original guidance with Section 4013 of the CARES Act, as well as setting forth the banking regulators' views on consumer protection considerations. Section 541 of the Consolidated Appropriations Act extends this relief to the earlier of January 1, 2022 or 60 days after the national emergency termination date.

In accordance with such guidance, we are offering short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. These include short-term (180 days or less) modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. The table below presents these loan deferrals by loan category:

	<u>Underlying Collateral</u>		<u>Total</u>
	<u>Business Assets</u>	<u>Real Estate</u>	
(in \$000's, unaudited)			
Initial Deferments ⁽¹⁾	\$ -	\$ 1,573	\$ 1,573
2nd Deferments ⁽²⁾	295	684	979
Total	<u>\$ 295</u>	<u>\$ 2,257</u>	<u>\$ 2,552</u>

⁽¹⁾ Initial deferments were generally for 3 months

⁽²⁾ 2nd deferments were for an additional 3 months

5) Loan Servicing

At December 31, 2020, 2019, and 2018, the Company serviced SBA loans sold to the secondary market of approximately \$77,973,000, \$87,835,000, and \$104,016,000, respectively.

Servicing assets represent the servicing spread generated from the sold guaranteed portions of SBA loans. The weighted average servicing rate for all loans serviced was 1.12%, 1.16%, and 1.12% at December 31, 2020, 2019, and 2018, respectively.

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Beginning of year balance	\$ 583	\$ 871	\$ 1,373
Additions	213	157	200
Amortization	(265)	(445)	(702)
End of year balance	<u>\$ 531</u>	<u>\$ 583</u>	<u>\$ 871</u>

There was no valuation allowance for servicing rights at December 31, 2020, 2019, and 2018, because the estimated fair value of the servicing rights was greater than the carrying value. The estimated fair value of loan servicing rights was \$1,172,000, \$1,295,000, and \$1,651,000, at December 31, 2020, 2019, and 2018, respectively. The fair value

of servicing rights at December 31, 2020, was estimated using a weighted average constant prepayment rate (“CPR”) assumption of 14.65%, and a weighted average discount rate assumption of 12.91%. The fair value of servicing rights at December 31, 2019, was estimated using a weighted average CPR assumption of 13.50%, and a weighted average discount rate assumption of 15.90%. The fair value of servicing rights at December 31, 2018, was estimated using a weighted average CPR assumption of 10.89%, and a weighted average discount rate assumption of 16.40%.

The weighted average discount rate and CPR assumptions used to estimate the fair value of the I/O strip receivables are the same as for the servicing rights. Management reviews the key economic assumptions used to estimate the fair value of I/O strip receivables on a quarterly basis. The fair value of the I/O strip can be adversely impacted by a significant increase in either the prepayment speed of the portfolio or the discount rate.

I/O strip receivables are included in “accrued interest receivable and other assets” on the consolidated balance sheets. Activity for I/O strip receivables follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Beginning of year balance	\$ 503	\$ 568	\$ 968
Unrealized loss	(198)	(65)	(400)
End of year balance.	<u>\$ 305</u>	<u>\$ 503</u>	<u>\$ 568</u>

6) Premises and Equipment

Premises and equipment at year-end were as follows:

	<u>2020</u>	<u>2019</u>
	(Dollars in thousands)	
Building	\$ 3,508	\$ 3,508
Land	2,900	2,900
Furniture and equipment.	12,721	10,067
Leasehold improvements	<u>6,726</u>	<u>7,372</u>
	25,855	23,847
Accumulated depreciation and amortization.	<u>(15,396)</u>	<u>(15,597)</u>
Premises and equipment, net.	<u>\$ 10,459</u>	<u>\$ 8,250</u>

Depreciation and amortization expense was \$951,000, \$846,000, and \$753,000 in 2020, 2019, and 2018, respectively.

7) Leases

On January 1, 2019, the Company adopted ASU No. 2016-02, Leases (Topic 842). Under the new guidance, the Company recognizes the following for all leases, at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use (“ROU”) asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. The Company is impacted as a lessee of the offices and real estate used for operations. Some of the Company’s lease agreements include options to renew at the Company’s option. No lease extensions are reasonably certain to be exercised, therefore it was not considered in the calculation of the ROU asset and lease liability. As of December 31, 2020, operating lease ROU assets, included in other assets and lease liabilities, included in other liabilities, totaled \$35,873,000.

The following table presents the quantitative information for the Company's leases:

	December 31,	
	2020	2019
	(Dollars in thousands)	
Operating Lease Cost (Cost resulting from lease payments)	\$ 6,837	\$ 1,490
Operating Lease - Operating Cash Flows (Fixed Payments)	\$ 5,572	\$ 1,519
Operating Lease - ROU assets	\$ 35,873	\$ 12,173
Operating Lease – Liabilities	\$ 35,873	\$ 13,032
Weighted Average Lease Term - Operating Leases	8.30 yrs	4.79 yrs
Weighted Average Discount Rate - Operating Leases	4.55%	3.86%

The following maturity analysis shows the undiscounted cash flows due on the Company's operating lease liabilities:

	(Dollars in thousands)
2021	\$ 5,242
2022	5,668
2023	5,039
2024	4,692
2025	4,262
Thereafter.	18,798
Total undiscounted cash flows	43,701
Discount on cash flows.	(7,828)
Total lease liability.	<u>\$ 35,873</u>

The merger with Presidio resulted in the Company operating overlapping branch locations in the cities of Walnut Creek and San Mateo, California. These branches were consolidated in 2020 by vacating the HBC leased locations prior to the lease termination date, and moving the operations to the Presidio branch locations. The consolidation of these two branches into the Presidio locations resulted in the impairment of both Heritage leases at December 31, 2019. The lease impairment and write-off of fixed assets and tenant improvements totaled \$434,000 for the Walnut Creek location, and \$625,000 for the San Mateo location during the fourth quarter of 2019.

In June of 2019, the Company entered into a lease agreement for 54,910 square feet of office space in San Jose, California, commencing on February 1, 2020. The Company completed the relocation of its corporate headquarters, San Jose Branch and factoring subsidiary, Bay View Funding to 224 Airport Parkway, San Jose, California in the third quarter of 2020.

8) Business Combinations

On April 6, 2018, the Company completed its acquisition of Tri-Valley for a transaction value of \$32,320,000. At closing the Company issued 1,889,613 shares of the Company's common stock with an aggregate market value of \$30,725,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 0.0489 of a share of the Company's common stock for each outstanding share of Tri-Valley common stock. In addition, at closing the Company paid cash to the holder of a stock warrant and holders of outstanding stock options and related fees and fractional shares totaling \$1,595,000. Tri-Valley's results of operations were included in the Company's results of operations beginning April 7, 2018.

On May 4, 2018, the Company completed its acquisition of United American for a transaction value of \$56,417,000. At closing the Company issued 2,826,032 shares of the Company's common stock with an aggregate market value of \$47,280,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 2.1644 of a share of the Company's common stock for each outstanding share of United American common stock and each common stock equivalent underlying the United American Series D Preferred Stock and Series E Preferred Stock. The shareholders of the United American Series A Preferred Stock and Series B Preferred Stock received \$1,000 cash for each share totaling \$8,700,000 and \$435,000, respectively. In addition, the Company paid \$2,000 in cash for fractional shares, for total cash consideration of \$9,137,000. United American's results of operations were included in the Company's results of operations beginning May 5, 2018.

On October 11, 2019, the Company completed its merger with Presidio for an aggregate transaction value of \$185,598,000. Shareholders of Presidio received a fixed exchange ratio at closing of 2.47 shares of the Company's common stock for each share of Presidio common stock. Upon closing of the transaction, the Company issued 15,684,064 shares of the Company's common stock to Presidio shareholders and holders of restricted stock units for a total value of \$178,171,000 based on the Company's closing stock price of \$11.36 on the closing date of October 11, 2019. In addition, the consideration for Presidio stock options exchanged for the Company's stock options totaled \$7,426,000 and cash-in-lieu of fractional shares totaled \$1,000 on October 11, 2019. The following table summarizes the consideration paid for Presidio:

		(Dollars in thousands)
Issuance of 15,684,064 shares of common stock to Presidio shareholders and holders of restricted stock (stock price = \$11.36 on October 11, 2019)	\$	178,171
Consideration for Presidio stock options exchanged for Heritage Commerce Corp stock options		7,426
Cash paid for fractional shares		1
Total consideration	\$	<u>185,598</u>

The following table summarizes the estimated fair values of the Presidio assets acquired and liabilities assumed at the date of the merger.

	<u>As Recorded by Presidio</u>	<u>Fair Value Adjustments</u>		<u>As Recorded at Acquisition</u>
		(Dollars in thousands)		
Assets acquired:				
Cash and cash equivalents	\$ 117,989	\$ (1)	(a)	\$ 117,988
Securities available-for-sale	44,647	422	(b)	45,069
Securities held-to-maturity	463	—		463
Loans	698,493	(12,529)	(c)	685,964
Allowance for loan losses	(7,463)	7,463	(d)	—
Premises and equipment, net	1,756	—		1,756
Other intangible assets	—	11,147	(e)	11,147
Other assets, net	43,539	(1,378)	(f)	42,161
Total assets acquired	<u>\$ 899,424</u>	<u>\$ 5,124</u>		<u>904,548</u>
Liabilities assumed:				
Deposits	\$ 774,260	\$ (1)	(g)	774,259
Subordinated Debt	10,000	—	(h)	10,000
Other borrowings	442	—		442
Other liabilities	17,916	211	(i)	18,127
Total liabilities assumed	<u>\$ 802,618</u>	<u>\$ 210</u>		<u>802,828</u>
Net assets acquired				101,720
Purchase price				185,598
Goodwill recorded in the merger				<u>\$ 83,878</u>

Explanation of certain fair value related adjustments for the Presidio merger:

- (a) Represents cash paid for fractional shares in the transaction.
- (b) Represents the fair value adjustment on investment securities available-for-sale.
- (c) Represents the fair value adjustment to the net book value of loans includes an interest rate mark and credit mark adjustment.
- (d) Represents the elimination of Presidio's allowance for loan losses.
- (e) Represents intangible assets recorded to reflect the fair value of core deposits and an above market lease. The core deposit asset was recorded as an identifiable intangible asset and is amortized on an accelerated basis over the estimated average life of the deposit base. The above market lease liability will be accreted

- on the straight line method over 60 months.
- (f) Represents an adjustment to net deferred tax assets resulting from the fair value adjustments related to the acquired assets, liabilities assumed and identifiable intangible assets recorded.
- (g) Represents the fair value adjustment on time deposits, which was amortized as interest expense.
- (h) The Company acquired \$10,000,000 of subordinated debt from the Presidio transaction. The Presidio subordinated debt was redeemed on December 19, 2019.
- (i) Represents adjustments to accrued accounts payable.

Presidio's results of operations were included in the Company's results of operations beginning October 12, 2019.

The following table presents pro forma financial information as if the merger had occurred on January 1, 2018, which includes the pre-acquisition period for Presidio. The historical unaudited pro forma financial information has been adjusted to reflect supportable items that are directly attributable to the acquisition and expected to have a continuing impact on consolidated results of operations, as such, one-time acquisition costs are not included. The unaudited pro forma financial information is provided for informational purposes only. The unaudited pro forma financial information is not necessarily, and should not be assumed to be, an indication of the results that would have been achieved had the acquisition been completed as of the dates indicated or that may be achieved in the future. The preparation of the unaudited pro forma combined consolidated financial statements and related adjustments required management to make certain assumptions and estimates.

	For the Year Ended	
	December 31, 2019	December 31, 2018
(Unaudited)	(Dollars in thousands, except per share amounts)	
Net interest income	\$ 163,555	\$ 160,044
Provision for loan losses	870	7,694
Noninterest income	11,291	10,795
Noninterest expense	92,708	97,563
Income before income taxes	81,268	65,582
Income tax expense	23,730	17,549
Net income	<u>\$ 57,538</u>	<u>\$ 48,033</u>
Net income per share - basic	\$ 0.98	\$ 0.84
Net income per share - diluted	\$ 0.96	\$ 0.83

The Company believes the mergers provide the opportunity to combine independent business banking franchises with similar philosophies and cultures into a combined over \$4,000,000,000 business bank based in San Jose, California. The pooling of the four banks' resources and knowledge enhance the Company's capabilities, operational efficiencies, and community outreach. The Company also believes the combined bank will be much better positioned to meet the needs of the Company's customers, shareholders and the community. The following table summarizes the pre-tax merger-related costs for the year ended December 31, 2020 for the Presidio merger, and the pre-tax merger-related costs for the years ended December 31, 2019 and 2018 for the Tri-Valley and United American acquisitions:

	For the Year Ended		
	December 31, 2020	December 31, 2019	December 31, 2018
	(Dollars in thousands)		
Salaries and employee benefits	\$ 356	\$ 6,580	\$ 3,569
Other	2,245	4,500	5,598
Total merger-related costs	<u>\$ 2,601</u>	<u>\$ 11,080</u>	<u>\$ 9,167</u>

Goodwill of \$13,819,000 arising from the Tri-Valley acquisition, \$24,271,000 from the United American acquisition and \$83,878,000 from the Presidio merger is largely attributable to synergies and cost savings resulting from combining the operations of the companies. As these transactions were structured as tax-free exchanges, the goodwill will not be deductible for tax purposes. As of April 6, 2019, May 4, 2019, and October 11, 2020, the Company finalized its valuation of all assets acquired and liabilities assumed in its acquisition of Tri-Valley, United American, and Presidio respectively, resulting in no material changes to acquisition accounting adjustments.

9) Goodwill and Other Intangible Assets

Goodwill

At December 31, 2020, the carrying value of goodwill was \$167,631,000, which included \$13,044,000 of goodwill related to its acquisition of Bay View Funding, \$32,619,000 from its acquisition of Focus Business Bank (“Bank”), \$13,819,000 from its acquisition of Tri-Valley, \$24,271,000 from its acquisition of United American and \$83,878,000 from Presidio.

Goodwill impairment exists when a reporting unit’s carrying value exceeds its fair value, which is determined through a qualitative assessment whether it is more likely than not that the fair value of equity of the reporting unit exceeds the carrying value (“Step Zero”). If the qualitative assessment indicates it is more likely than not that the fair value of equity of a reporting unit is less than book value, then a quantitative two-step impairment test is required. Step 1 includes the determination of the carrying value of the Company’s reporting units, including the existing goodwill and intangible assets, and estimating the fair value of each reporting unit.

The Company completed its annual goodwill impairment analysis as of November 30, 2020 with the assistance of an independent valuation firm. The goodwill related to the acquisition of Bay View Funding was tested separately for impairment under this analysis. No events or circumstances since the November 30, 2020 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists, for either the Company’s banking or factoring reporting units.

The following table summarizes the carrying amount of goodwill by segment at December 31, 2020 and 2019:

	December 31,	
	2020	2019
	(Dollars in thousands)	
Banking	\$ 154,587	\$ 154,376
Factoring	13,044	13,044
Total Goodwill	<u>\$ 167,631</u>	<u>\$ 167,420</u>

Other Intangible Assets

The Company's intangible assets are summarized as follows for the periods indicated:

	December 31, 2020		
	Gross Carrying Amount	Accumulated Amortization	Total
	(Dollars in thousands)		
Core deposit intangibles	\$ 25,023	\$ (9,153)	\$ 15,870
Customer relationship and brokered relationship intangibles	1,900	(1,171)	729
Below market leases	770	(705)	65
Total	<u>\$ 27,693</u>	<u>\$ (11,029)</u>	<u>\$ 16,664</u>

	December 31, 2019		
	Gross Carrying Amount	Accumulated Amortization	Total
	(Dollars in thousands)		
Core deposit intangibles	\$ 25,023	\$ (5,846)	\$ 19,177
Customer relationship and brokered relationship intangibles	1,900	(981)	919
Below market leases	770	(451)	319
Total	<u>\$ 27,693</u>	<u>\$ (7,278)</u>	<u>\$ 20,415</u>

Estimated amortization expense for each of the next five years and thereafter is as follows:

Year	Presidio Core Deposit Intangible	Presidio Above Market Lease	United		Tri-Valley Core Deposit Intangible	Tri-Valley Below Market Lease	Bay View Funding		Total Amortization Expense
			American Core Deposit Intangible	American Below Market Lease			Focus Core Deposit Intangible	Customer & Brokered Relationship Intangible	
2021	\$ 1,447	\$ (20)	\$ 602	\$ (21)	\$ 184	\$ 18	\$ 596	\$ 190	\$ 2,996
2022	1,225	(20)	553	—	167	18	502	190	2,635
2023	1,118	(20)	521	—	158	18	420	190	2,405
2024	1,026	(13)	499	—	152	18	346	159	2,187
2025	970	—	478	—	145	18	202	—	1,813
Thereafter..	3,211	—	1,042	—	306	69	—	—	4,628
	<u>\$ 8,997</u>	<u>\$ (73)</u>	<u>\$ 3,695</u>	<u>\$ (21)</u>	<u>\$ 1,112</u>	<u>\$ 159</u>	<u>\$ 2,066</u>	<u>\$ 729</u>	<u>\$ 16,664</u>

Impairment testing of the intangible assets is performed at the individual asset level. Impairment exists if the carrying amount of the asset is not recoverable and exceeds its fair value at the date of the impairment test. For intangible assets, estimates of expected future cash flows (cash inflows less cash outflows) that are directly associated with an intangible asset are used to determine the fair value of that asset. Management makes certain estimates and assumptions in determining the expected future cash flows from core deposit and customer relationship intangibles including account attrition, expected lives, discount rates, interest rates, servicing costs and other factors. Significant changes in these estimates and assumptions could adversely impact the valuation of these intangible assets. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is then amortized over the remaining useful life of the asset. Based on its assessment, management concluded that there was no impairment of intangible assets at December 31, 2020 and December 31, 2019.

10) Deposits

The following table presents the scheduled maturities of all time deposits for the next five years:

	<u>(Dollars in thousands)</u>
2021.....	\$ 138,100
2022.....	10,255
2023.....	4,126
2024.....	435
2025.....	491
Total	<u>\$ 153,407</u>

Time deposits of \$250,000 and over were \$103,746,000 and \$99,882,000 at December 31, 2020 and 2019, respectively. At December 31, 2020, Certificate of Deposit Account Registry Service (“CDARS”) deposits totaled \$23,911,000 which were comprised of money market deposits of \$663,000, and interest-bearing demand deposits of \$18,614,000, (which have no scheduled maturity date, and therefore, are excluded from the table above), and time deposits of \$4,634,000, (which are included in the table above). At December 31, 2019, CDARS deposits totaled \$28,847,000, which were comprised of money market deposits of \$2,171,000, and interest-bearing demand deposits of \$12,885,000, (which have no scheduled maturity date, and therefore, are excluded from the table above), and time deposits of \$13,791,000, (which are included in the table above). The CDARS program allows customers with deposits in excess of FDIC-insured limits to obtain full coverage on time deposits through a network of banks within the CDARS program. Deposits gathered through these programs are not considered brokered deposits under current regulatory reporting guidelines.

Deposits from executive officers, directors, and their affiliates were \$4,491,000 and \$12,636,000 at December 31, 2020 and 2019, respectively.

11) Borrowing Arrangements

Federal Home Loan Bank Borrowings, Federal Reserve Bank Borrowings, and Available Lines of Credit

HBC maintains a collateralized line of credit with the FHLB of San Francisco. Under this line, the Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. As of December 31, 2020, and December 31, 2019, HBC had no overnight borrowings from the FHLB. HBC had \$232,632,000 of loans and pledged to the FHLB as collateral on a line of credit of \$160,523,000 at December 31, 2020. HBC also had \$3,202,000 of securities pledged to the FHLB as collateral on an available line of credit of \$3,041,000 at December 31, 2020, none of which was outstanding. HBC had \$272,879,000 of loans and no securities pledged to the FHLB as collateral on a line of credit of \$228,103,000 at December 31, 2019.

HBC can also borrow from the FRB’s discount window. HBC had approximately \$921,373,000 of loans pledged to the FRB as collateral on an available line of credit of approximately \$528,064,000 at December 31, 2020, none of which was outstanding. HBC had approximately \$726,709,000 of loans pledged to the FRB as collateral on an available line of credit of approximately \$408,401,000 at December 31, 2019, none of which was outstanding

At December 31, 2020, HBC had Federal funds purchase arrangements available of \$80,000,000. There were no Federal funds purchased outstanding at December 31, 2020 and 2019.

HCC has a \$10,000,000 line of credit with a correspondent bank, of which none was outstanding at December 31, 2020. HCC had a \$5,000,000 line of credit with a correspondent bank, of which none was outstanding at December 31, 2019.

HBC may also utilize securities sold under repurchase agreements to manage our liquidity position. There were no securities sold under agreements to repurchase at December 31, 2020, and 2019.

Subordinated Debt

On May 26, 2017, the Company completed an underwritten public offering of \$40,000,000 aggregate principal amount of its fixed-to-floating rate subordinated notes (“Subordinated Debt”) due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company, at its option, may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium. Unamortized debt issuance cost totaled \$260,000 at December 31, 2020. See “LIBOR Transition and Phase-Out” above.

The Company acquired \$10,000,000 of subordinated debt from the Presidio transaction with an interest rate of 8%, which was redeemed on December 19, 2019. As a result of the redemption of the Presidio subordinated debt, the Company paid a pre-payment penalty of \$300,000 during the fourth quarter of 2019.

12) Income Taxes

Income tax expense (benefit) consisted of the following for the year ended December 31, as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)		
Currently payable tax:			
Federal	\$ 9,630	\$ 7,631	\$ 9,187
State	<u>5,828</u>	<u>4,689</u>	<u>5,416</u>
Total currently payable	15,458	12,320	14,603
Deferred tax expense (benefit):			
Federal	(932)	2,200	(1,133)
State	<u>(757)</u>	<u>1,331</u>	<u>(146)</u>
Total deferred tax	<u>(1,689)</u>	<u>3,531</u>	<u>(1,279)</u>
Income tax expense	<u>\$ 13,769</u>	<u>\$ 15,851</u>	<u>\$ 13,324</u>

The effective tax rate differs from the Federal statutory rate for the years ended December 31, as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Statutory Federal income tax rate	21.0 %	21.0 %	21.0 %
State income taxes, net of federal tax benefit	8.2 %	8.5 %	8.5 %
Low income housing credits, net of investment losses	(0.5)%	(0.5)%	(0.8)%
Increase in cash surrender value of life insurance	(0.8)%	(0.5)%	(0.5)%
Stock option/restricted stock windfall tax benefit	0.6 %	(0.3)%	(0.9)%
Non-taxable interest income	(0.8)%	(0.8)%	(0.9)%
Split-dollar term insurance	0.1 %	0.1 %	0.1 %
Merger cost	0.0 %	0.5 %	0.5 %
Other, net	<u>0.3 %</u>	<u>0.1 %</u>	<u>0.4 %</u>
Effective tax rate	<u>28.1 %</u>	<u>28.1 %</u>	<u>27.4 %</u>

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:

	<u>2020</u>	<u>2019</u>
	(Dollars in thousands)	
Deferred tax assets:		
Allowance for credit losses on loans	\$ 12,827	\$ 7,231
Lease accounting	10,537	1,647
Defined postretirement benefit obligation	10,419	9,901
Accrued expenses	2,896	2,562
Federal net operating loss carryforwards	2,846	3,662
Stock compensation	1,894	1,636
State income taxes	1,142	954
California net operating loss carryforwards	1,106	1,489
Premises and equipment	459	695
Nonaccrual interest	101	61
Split-dollar life insurance benefit plan	80	75
Tax credit carryforwards	57	57
Other	469	654
Total deferred tax assets	<u>44,833</u>	<u>30,624</u>
Deferred tax liabilities:		
Lease accounting	(10,537)	(1,647)
Loan fees	(1,820)	(1,842)
Securities available-for-sale	(1,764)	(772)
Intangible liabilities	(1,388)	(1,321)
Prepaid expenses	(689)	(289)
FHLB stock	(166)	(177)
I/O strips	(87)	(144)
Other	(161)	(130)
Total deferred tax liabilities	<u>(16,612)</u>	<u>(6,322)</u>
Net deferred tax assets	<u>\$ 28,221</u>	<u>\$ 24,302</u>

At December 31, 2020, the Company's federal net operating loss ("NOL") carryforwards were \$13,553,000 and the Company's California net operating loss carryforwards were \$12,903,000. These amounts are attributable to the merger transactions. The realization of these NOL carryforwards for Federal and State tax purposes are limited on the amount of net operating losses that can be utilized annually under the current tax law. The Company does not believe that its annual limitation on each acquisition will impact the ultimate deductibility of the NOL carryforwards. The State tax credit carryforwards, net of Federal tax effects, were \$72,567 as of December 31, 2020 which will begin to expire in 2022. Since the Company will be able to fully utilize the net operating loss carryforwards before they begin to expire in 2029, no valuation allowance is required against the deferred tax assets.

Under generally accepted accounting principles, a valuation allowance is required if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions. As of December 31, 2020 and 2019 the Company's recorded amount of uncertain tax positions was not considered significant for financial reporting and the Company does not expect this amount to significantly increase or decrease in the next twelve months.

At December 31, 2020, and December 31, 2019, the Company had net deferred tax assets of \$28,221,000 and \$24,302,000, respectively. At December 31, 2020, the Company determined that a valuation allowance for deferred tax assets was not necessary.

The Company and its subsidiaries are subject to U.S. Federal income tax as well as income tax of the State of California. The Company is no longer subject to examination by Federal and state taxing authorities for years before 2017, and by the State of California taxing authority for years before 2016.

The following table reflects the carrying amounts of the low income housing investments included in accrued interest receivable and other assets, and the future commitments included in accrued interest payable and other liabilities for the periods indicated:

	<u>December 31,</u> <u>2020</u>	<u>December 31,</u> <u>2019</u>
	(Dollars in thousands)	
Low income housing investments	\$ 5,246	\$ 6,126
Future commitments	\$ 596	\$ 625

The Company expects \$46,000 of the future commitments to be paid in 2021, and \$550,000 in 2022 through 2025.

For tax purposes, the Company recognized low income housing tax credits of \$839,000 and \$511,000 for the years ended December 31, 2020 and December 2019, respectively, and low income housing investment expense of \$850,000 and \$520,000, respectively. The Company recognizes low income housing investment expenses as a component of income tax expense.

13) Equity Plan

The Company maintained an Amended and Restated 2004 Equity Plan (the “2004 Plan”) for directors, officers, and key employees. The 2004 Plan was terminated on May 23, 2013. The Company’s shareholders approved the 2013 Equity Incentive Plan (the “2013 Plan”). The equity plans provide for the grant of incentive and nonqualified stock options and restricted stock. The equity plans provide that the option price for both incentive and nonqualified stock options will be determined by the Board of Directors at no less than the fair value at the date of grant. Options granted vest on a schedule determined by the Board of Directors at the time of grant. Generally options vest over four years. All options expire no later than ten years from the date of grant. Restricted stock is subject to time vesting. In 2020, the Company granted 329,500 shares of nonqualified stock options and 168,117 shares of restricted stock subject to time vesting requirements. There were 2,409,062 shares available for the issuance of equity awards under the 2013 Plan as of December 31, 2020.

The Presidio equity plans were assumed by the Company and the outstanding options issued under the Presidio equity plans were converted into the right to receive the Company’s shares at the exercise price pursuant to the formula defined in the merger agreement. Consideration for the assumed Presidio stock options exchanged for 1,176,757 shares of the Company’s stock options totaled \$7,426,000.

Stock option activity under the equity plans is as follows:

Total Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2020	2,712,846	\$ 8.80		
Granted	329,500	\$ 9.11		
Exercised	(381,184)	\$ 4.50		
Forfeited or expired	(114,341)	\$ 12.93		
Outstanding at December 31, 2020	2,546,821	\$ 9.30	5.43	\$ 3,473,312
Vested or expected to vest	2,394,012		5.43	\$ 3,264,913
Exercisable at December 31, 2020	2,017,899		4.60	\$ 3,473,312

Information related to the equity plans for each of the last three years:

	December 31,		
	2020	2019	2018
Intrinsic value of options exercised	\$ 2,258,245	\$ 1,618,615	\$ 1,844,909
Cash received from option exercise	\$ 1,713,737	\$ 1,626,113	\$ 2,667,305
Tax benefit realized from option exercises	\$ 63,124	\$ 258,037	\$ 534,638
Weighted average fair value of options granted	\$ 1.15	\$ 1.91	\$ 3.03

As of December 31, 2020, there was \$894,000 of total unrecognized compensation cost related to nonvested stock options granted under the equity plans. That cost is expected to be recognized over a weighted-average period of approximately 2.63 years.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table, including the weighted average assumptions for the option grants in each year.

	December 31,		
	2020	2019	2018
Expected life in months(1)	72	72	72
Volatility(1)	29 %	24 %	21 %
Weighted average risk-free interest rate(2)	0.53 %	2.23 %	2.88 %
Expected dividends(3)	5.71 %	3.95 %	2.64 %

-
- (1) The expected life of employee stock options represents the weighted average period the stock options are expected to remain outstanding based on historical experience. Volatility is based on the historical volatility of the stock price over the same period of the expected life of the option.
- (2) Based on the U.S. Treasury constant maturity interest rate with a term consistent with the expected life of the option granted.
- (3) Each grant's dividend yield is calculated by annualizing the most recent quarterly cash dividend and dividing that amount by the market price of the Company's common stock as of the grant date
-

The Company estimates the impact of forfeitures based on historical experience. Should the Company's current estimate change, additional expense could be recognized or reversed in future periods. The Company issues authorized shares of common stock to satisfy stock option exercises.

Restricted stock activity under the equity plans is as follows:

Total Restricted Stock Award	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares at January 1, 2020.....	239,453	\$ 11.23
Granted	168,117	\$ 9.20
Vested	(108,870)	\$ 13.19
Forfeited or expired.	—	\$ —
Nonvested shares at December 31, 2020	298,700	\$ 10.83

As of December 31, 2020, there was \$2,198,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted under the 2013 Plan. The cost is expected to be recognized over a weighted-average period of approximately 1.76 years.

The Company has two share based compensation plans. Total compensation cost has been charged against income for those plans was \$2,248,000, \$1,924,000, \$1,817,000, for 2020, 2019, and 2018, respectively. The total income tax expense was \$301,000 for the year ended December 31, 2020. The total income tax benefit was (\$146,000), and (\$424,000) for the years ended December 31, 2019, and 2018, respectively.

14) Benefit Plans

401(k) Savings Plan

The Company offers a 401(k) savings plan that allows employees to contribute up to a maximum percentage of their compensation, as established by the Internal Revenue Code. The Company made a discretionary matching contribution of up to \$3,000 for each employee’s contributions in 2020 and 2019. Contribution expense was \$942,000, \$934,000, and \$749,000 in 2020, 2019 and 2018, respectively.

Employee Stock Ownership Plan

The Company sponsors a non-contributory employee stock ownership plan (“ESOP”). To participate in this plan, an employee must have worked at least 1,000 hours during the year and must be employed by the Company at year-end. Employer contributions to the ESOP are discretionary. The Company has suspended contributions to the ESOP since 2010. The Plan was “frozen” as of January 1, 2019. At December 31, 2020, the ESOP owned 101,231 shares of the Company’s common stock.

Deferred Compensation Plan

The Company has a nonqualified deferred compensation plan for some of its employees. Under the deferred compensation plan, an employee may defer up to 100% of their bonus and 50% of their regular salary into a deferred account. Amounts deferred are invested in a portfolio of approved investment choices as directed by the employee. Amounts deferred by employees to the deferred compensation plan will be distributed at a future date they have selected or upon termination of employment. There were eight and five employees who elected to participate in the deferred compensation plan during 2020 and 2019, respectively.

Nonqualified Defined Benefit Pension Plan

The Company has a supplemental retirement plan (“SERP”) covering some current and some former key executives and directors. The SERP is an unfunded, nonqualified defined benefit plan. The combined number of active and retired/terminated participants in the SERP was 53 at December 31, 2020. The defined benefit represents a stated amount for key executives and directors that generally vests over nine years and is reduced for early retirement. The projected benefit obligation is included in “Accrued interest payable and other liabilities” on the consolidated balance sheets. The SERP has no assets and the projected benefit obligation is unfunded. The measurement date of the SERP is December 31.

The following table sets forth the SERP's status at December 31:

	<u>2020</u>	<u>2019</u>
	(Dollars in thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 33,689	\$ 26,781
Projected benefit obligation of SERP agreements acquired from Presidio	—	2,541
Service cost	492	263
Actuarial loss (gain)	3,008	4,182
Interest cost	935	1,059
Benefits paid	(3,118)	(1,137)
Plan amendment	398	—
Projected benefit obligation at end of year	<u>\$ 35,404</u>	<u>\$ 33,689</u>
Amounts recognized in accumulated other comprehensive loss:		
Net actuarial loss	\$ 12,445	\$ 9,714

Weighted-average assumptions used to determine the benefit obligation at year-end:

	<u>2020</u>	<u>2019</u>
Discount rate	2.26 %	3.01 %
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:

<u>Year</u>	<u>Estimated Benefit Payments</u>
	(Dollars in thousands)
2021	\$ 2,123
2022	1,814
2023	1,918
2024	1,954
2025	2,026
2026 to 2030	11,465

The components of pension cost for the SERP follow:

	<u>2020</u>	<u>2019</u>
	(Dollars in thousands)	
Components of net periodic benefit cost:		
Service cost	\$ 492	\$ 263
Interest cost	935	1,059
Amortization of prior transition obligation	299	—
Amortization of net actuarial loss	387	184
Accelerated benefits for Presidio SERP agreements due to change in control	—	1,465
Net periodic benefit cost	<u>\$ 2,113</u>	<u>\$ 2,971</u>
Amount recognized in other comprehensive income	<u>\$ 1,924</u>	<u>\$ 2,847</u>

The components of net periodic benefit cost other than the service cost component are included in the line item "other noninterest expense" in the Consolidated Statements of Income. The estimated net actuarial loss and prior service cost for the SERP that will be amortized from Accumulated Other Comprehensive Loss into net periodic benefit cost over the next fiscal year are \$643,000 as of December 31, 2020.

Net periodic benefit cost for the years ended December 31, 2020 and 2019 were determined using the following assumption:

	<u>2020</u>	<u>2019</u>
Discount rate	3.01 %	4.03 %
Rate of compensation increase	N/A	N/A

Split-Dollar Life Insurance Benefit Plan

The Company maintains life insurance policies for some current and some former directors and officers that are subject to split-dollar life insurance agreements, some of which continues after the participant’s employment and retirement. The policies acquired from Focus and Presidio do not include a post retirement benefit. All participants are fully vested in their split-dollar life insurance benefits. The accrued benefit liability for the split-dollar insurance agreements represents either the present value of the future death benefits payable to the participants’ beneficiaries or the present value of the estimated cost to maintain life insurance, depending on the contractual terms of the participant’s underlying agreement.

The split-dollar life insurance projected benefit obligation is included in “Accrued interest payable and other liabilities” on the consolidated balance sheets. The measurement date of the split-dollar life insurance benefit plan is December 31.

The following sets forth the funded status of the split dollar life insurance benefits:

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
	(Dollars in thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 8,198	\$ 6,903
Interest cost	246	278
Actuarial loss (gain)	1,245	1,017
Projected benefit obligation at end of period	<u>\$ 9,689</u>	<u>\$ 8,198</u>

Amounts recognized in accumulated other comprehensive loss at December 31 consist of:

	<u>December 31, 2020</u>	<u>December 31, 2019</u>
	(Dollars in thousands)	
Net actuarial loss	\$ 5,170	\$ 3,776
Prior transition obligation	970	1,059
Accumulated other comprehensive loss	<u>\$ 6,140</u>	<u>\$ 4,835</u>

Weighted-average assumption used to determine the benefit obligation at year-end follow:

	<u>2020</u>	<u>2019</u>
Discount rate	2.26 %	3.01 %

Components of net periodic benefit cost during the year are:

	<u>2020</u>	<u>2019</u>
	(Dollars in thousands)	
Amortization of prior transition obligation and actuarial losses	\$ (60)	\$ (96)
Interest cost	246	278
Net periodic benefit cost	<u>\$ 186</u>	<u>\$ 182</u>
Amount recognized in other comprehensive income	<u>\$ 1,305</u>	<u>\$ 1,113</u>

The estimated net actuarial loss and prior transition obligation for the split-dollar life insurance benefit plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year are \$90,000 as of December 31, 2020 and 2019.

Weighted-average assumption used to determine the net periodic benefit cost:

	<u>2020</u>	<u>2019</u>
Discount rate	3.01 %	4.03 %

15) Fair Value

Accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data (for example, interest rates and yield curves observable at commonly quoted intervals, prepayment speeds, credit risks, and default rates).

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Financial Assets and Liabilities Measured on a Recurring Basis

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

The fair value of interest-only (“I/O”) strip receivable assets is based on a valuation model used by a third party. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

	<u>Balance</u>	<u>Fair Value Measurements Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
(Dollars in thousands)				
Assets at December 31, 2020				
Available-for-sale securities:				
Agency mortgage-backed securities	\$ 175,326	—	\$ 175,326	—
U.S. Treasury	60,448	60,448	—	—
I/O strip receivables	305	—	305	—
Assets at December 31, 2019				
Available-for-sale securities:				
Agency mortgage-backed securities	\$ 284,361	—	\$ 284,361	—
U.S. Treasury	120,464	120,464	—	—
I/O strip receivables	503	—	503	—

Assets and Liabilities Measured on a Non-Recurring Basis

The fair value of collateral dependent loans individually evaluated with specific allocations of the allowance for credit losses on loans 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. Assets carried at fair value on a non-recurring basis are immaterial.

Foreclosed assets are valued at the time the loan is foreclosed upon and the asset is transferred to foreclosed assets. The fair value is based primarily on third party appraisals, less costs to sell. The appraisals may utilize a single valuation approach or a combination of approaches including the comparable sales and 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 typically significant and result in a Level 3 classification of the inputs for determining fair value. At December 31, 2020 and December 31, 2019, there were no foreclosed assets on the balance sheet.

The carrying amounts and estimated fair values of financial instruments at December 31, 2020 are as follows:

	Carrying Amounts	Estimated Fair Value			Total
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(Dollars in thousands)					
Assets:					
Cash and cash equivalents	\$ 1,131,073	\$ 1,131,073	\$ —	\$ —	\$ 1,131,073
Securities available-for-sale	235,774	60,448	175,326	—	235,774
Securities held-to-maturity	297,389	—	304,927	—	304,927
Loans (including loans held-for-sale), net . . .	2,576,560	—	1,699	2,572,993	2,574,692
FHLB stock, FRB stock, and other investments	33,522	—	—	—	N/A
Accrued interest receivable	10,546	309	1,512	8,725	10,546
I/O strips receivables	305	—	305	—	305
Liabilities:					
Time deposits	\$ 153,407	\$ —	\$ 153,740	\$ —	\$ 153,740
Other deposits	3,761,079	—	3,761,079	—	3,761,079
Subordinated debt	39,740	—	40,340	—	40,340
Accrued interest payable	545	—	545	—	545

The carrying amounts and estimated fair values of financial instruments at December 31, 2019 are as follows:

	Carrying Amounts	Estimated Fair Value			Total
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(Dollars in thousands)					
Assets:					
Cash and cash equivalents	\$ 457,370	\$ 457,370	\$ —	\$ —	\$ 457,370
Securities available-for-sale	404,825	120,464	284,361	—	404,825
Securities held-to-maturity	366,560	—	368,107	—	368,107
Loans (including loans held-for-sale), net . . .	2,511,611	—	1,052	2,512,277	2,513,329
FHLB stock, FRB stock, and other investments	29,842	—	—	—	N/A
Accrued interest receivable	10,915	446	2,218	8,251	10,915
I/O strips receivables	503	—	503	—	503
Liabilities:					
Time deposits	\$ 168,034	\$ —	\$ 158,704	\$ —	\$ 158,704
Other deposits	3,246,734	—	3,246,734	—	3,246,734
Subordinated debt	39,554	—	40,404	—	40,404
Accrued interest payable	707	—	707	—	707

16) Commitments and Contingencies

Loss Contingencies

Within the ordinary course of our business, we are subject to private lawsuits, government audits, administrative proceedings and other claims. A number of these claims may exist at any given time, and some of the claims may be pled as class actions. We could be affected by adverse publicity and litigation costs resulting from such allegations, regardless of whether they are valid or whether we are legally determined to be liable.

The Company had the following outstanding matters as of February 25, 2021.

- In December 2020, *Solar Eclipse Investment Fund III, et al v. Heritage Bank of Commerce, et al.*, was filed against Heritage, and others, in the Solano County Superior Court for the State of California (“Solar Eclipse”). Also in December 2020, *Solarmore Management Services, Inc. v. Jeff Carpoﬀ et al.*, (“Solarmore”) filed an amended complaint in the United States District Court for the Eastern District of California against Heritage and others. Both of these cases relate to our former deposit relationships with D.C. Solar and their affiliates (collectively “D.C. Solar”) and its sponsored investment funds. D.C. Solar is a former customer that allegedly perpetrated a Ponzi scheme and declared bankruptcy. These actions seek unspecified damages and are in an early phase. We intend to vigorously defend these actions.
- *In re Double Jump, Inc.* is pending in the United States Bankruptcy Court of Nevada and was filed by D.C. Solar and some of its affiliated entities. One of the chapter 7 trustees has indicated that it may bring an adversary action against Heritage related to our former deposit relationships with D.C. Solar and its sponsored investment funds. The parties have agreed to attend a pre-filing mediation.
- In November 2020, a present and a former bank employee purporting to represent a class of Bank employees, have alleged in a lawsuit that the Bank violated the California Labor Code and California Business and Professions Code, by failing to permit required meal and rest breaks, and failing to provide accurate wage statements, among other claims. The lawsuit seeks unspecified penalties under the California Private Attorneys General Act (“PAGA”) in addition to other monetary payments. The case is in the early phase. In February 2021,

the Bank was notified of another set of PAGA and potential class claims alleged by letter to the California Labor and Workforce Development Agency transmitted on behalf of another former Bank employee. The notice to the California Labor and Workforce Development Agency, which is a prerequisite to a PAGA filing, alleged the same claims, class, and relief requested that are the subject of the lawsuit filed in November 2020, and disclosed no new claims. We intend to vigorously defend the filed class and PAGA complaint and any subsequent related class action and PAGA filing.

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. The outcomes of legal proceedings and other contingencies are, however, inherently unpredictable and subject to significant uncertainties. As a result, the Company is not able to reasonably estimate the amount or range of possible losses, including losses that could arise as a result of application of non-monetary remedies, with respect to the contingencies it faces, and the Company's estimates may not prove to be accurate.

At this time, we believe that the amount of reasonably possible losses resulting from final disposition of any pending lawsuits, audits, proceedings and claims will not have a material adverse effect individually or in the aggregate on our financial position, results of operations or liquidity. It is possible, however, that our future results of operations for a particular quarter or fiscal year could be impacted by changes in circumstances relating to lawsuits, audits, proceedings or claims. Legal costs related to such claims are expensed as incurred.

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 the contractual arrangements. These commitments are obligations that represent a potential credit risk to the Company, but are not reflected on the Company's consolidated balance sheets. Total unused commitments to extend credit were \$1,114,193,000 at December 31, 2020, compared to \$1,120,638,000 at December 31, 2019. Unused commitments represented 42% outstanding gross loans at December 31, 2020, and 44% at December 31, 2019.

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 lines of credit and letters of credit will ever be fully utilized. The following table presents the Company's commitments to extend credit for the periods indicated:

	December 31,					
	2020			2019		
	Fixed Rate	Variable Rate	Total	Fixed Rate	Variable Rate	Total
	(Dollars in thousands)					
Unused lines of credit and commitments to make loans	\$ 121,560	\$ 970,614	\$ 1,092,174	\$ 147,372	\$ 951,206	\$ 1,098,578
Standby letters of credit	3,049	18,970	22,019	11,445	10,615	22,060
	<u>\$ 124,609</u>	<u>\$ 989,584</u>	<u>\$ 1,114,193</u>	<u>\$ 158,817</u>	<u>\$ 961,821</u>	<u>\$ 1,120,638</u>

For the year ended December 31, 2020, there was an increase of \$192,000 to the allowance for credit losses on loans for the Company's off-balance sheet credit exposures, compared to the year ended December 31, 2019. The allowance for losses for the Company's off-balance sheet credit exposures was \$1,078,000 at December 31, 2020. As of the implementation date, there was a reduction of \$207,000 to allowance for credit losses on loans recorded for the Company's off-balance sheet credit exposures. The offsetting increase of \$399,000 in 2020 in the allowance for credit losses on loans for off-balance sheet credit exposures was driven by increased loss factors in the CECL model for all loan segments with off-balance sheet exposures which resulted from deterioration in the economic forecast assumptions used in the CECL model.

17) Shareholders' Equity and Earnings Per Share

Authorized Shares of Common Stock — At a Special Meeting of Shareholders on August 27, 2019, the Company's shareholders approved an amendment to the Company's articles of incorporation to increase the number of authorized shares of common stock from 60,000,000 to 100,000,000 shares of common stock.

Earnings Per Share — Basic earnings per common share is computed by dividing net income, less dividends and discount accretion on preferred stock, by the weighted average common shares outstanding. Diluted earnings per share reflect potential dilution from outstanding stock options using the treasury stock method. There were 1,524,757 stock options for the year ended December 31, 2020, considered to be antidilutive and excluded from the computation of diluted earnings per share. There were 789,065 stock options for the year ended December 31, 2019, considered to be antidilutive and excluded from the computation of diluted earnings per share. There were 534,106 stock options for the year ended December 31, 2018, considered to be antidilutive and excluded from the computation of diluted earnings per share. A reconciliation of these factors used in computing basic and diluted earnings per common share is as follows:

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands, except per share amounts)		
Net income	\$ 35,299	\$ 40,461	\$ 35,331
Weighted average common shares outstanding for basic earnings per common share	59,478,343	46,684,384	41,469,211
Dilutive potential common shares	<u>690,796</u>	<u>1,221,845</u>	<u>713,728</u>
Shares used in computing diluted earnings per common share	<u>60,169,139</u>	<u>47,906,229</u>	<u>42,182,939</u>
Basic earnings per share	\$ 0.59	\$ 0.87	\$ 0.85
Diluted earnings per share	\$ 0.59	\$ 0.84	\$ 0.84

18) Capital Requirements

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and HBC must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. There are no conditions or events since December 31, 2020, that management believes have changed the categorization of the Company or HBC as “well-capitalized.”

The Company's consolidated capital ratios and the HBC's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at December 31, 2020.

As permitted by the interim final rule issued on March 27, 2020 by our federal regulatory agency, we elected the option to delay the estimated impact of the adoption of the CECL Standard in our regulatory capital for two years. This two-year delay is in addition to the three-year transition period the agency had already made available. The adoption will delay the effects of CECL on our regulatory capital for the next two years, after which the effects will be phased-in over a three-year period from January 1, 2022 through December 31, 2024. Under the interim final rule, the amount of adjustments to regulatory capital deferred until the phase-in period include both the initial impact of adoption of the CECL Standard at January 1, 2020 and 25% of subsequent changes in our allowance for credit losses during each quarter of the two-year period ending December 31, 2021.

Quantitative measures established by regulation to help ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios (set forth in the tables below) of total, Tier 1 capital, and common equity Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2020 and December 31, 2019, the Company and HBC met all

capital adequacy guidelines to which they were subject.

The Company's consolidated capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of December 31, 2020, and December 31, 2019.

	Actual		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio ⁽¹⁾
(Dollars in thousands)				
<u>As of December 31, 2020</u>				
Total Capital (to risk-weighted assets)	\$ 483,870	16.5 %	\$ 307,067	10.5 %
Tier 1 Capital (to risk-weighted assets)	\$ 410,307	14.0 %	\$ 248,578	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 410,307	14.0 %	\$ 204,711	7.0 %
Tier 1 Capital (to average assets)	\$ 410,307	9.1 %	\$ 180,281	4.0 %

(1) Includes 2.5% capital conservation buffer, except the Tier 1 Capital to average assets ratio.

	Actual		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio ⁽¹⁾
(Dollars in thousands)				
<u>As of December 31, 2019</u>				
Total Capital (to risk-weighted assets)	\$ 457,158	14.6 %	\$ 329,306	10.5 %
Tier 1 Capital (to risk-weighted assets)	\$ 393,432	12.5 %	\$ 266,581	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 393,432	12.5 %	\$ 219,538	7.0 %
Tier 1 Capital (to average assets)	\$ 393,432	9.7 %	\$ 161,677	4.0 %

(1) Includes 2.5% capital conservation buffer, except the Tier 1 Capital to average assets ratio.

HBC's actual capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of December 31, 2020, and December 31, 2019.

	Actual		To Be Well-Capitalized Under Basel III PCA Regulatory Requirements		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio	Amount	Ratio ⁽¹⁾
	(Dollars in thousands)					
<u>As of December 31, 2020</u>						
Total Capital (to risk-weighted assets)	\$ 461,933	15.8 %	\$ 292,258	10.0 %	\$ 306,871	10.5 %
Tier 1 Capital (to risk-weighted assets)	\$ 428,109	14.6 %	\$ 233,806	8.0 %	\$ 248,419	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 428,109	14.6 %	\$ 189,968	6.5 %	\$ 204,580	7.0 %
Tier 1 Capital (to average assets)	\$ 428,109	9.5 %	\$ 225,263	5.0 %	\$ 180,211	4.0 %

(1) Includes 2.5% capital conservation buffer, except the Tier 1 Capital to average assets ratio.

	Actual		To Be Well-Capitalized Under Basel III PCA Regulatory Requirements		Required For Capital Adequacy Purposes Under Basel III	
	Amount	Ratio	Amount	Ratio	Amount	Ratio ⁽¹⁾
	(Dollars in thousands)					
<u>As of December 31, 2019</u>						
Total Capital (to risk-weighted assets)	\$ 435,757	13.9 %	\$ 313,485	10.0 %	\$ 329,159	10.5 %
Tier 1 Capital (to risk-weighted assets)	\$ 411,585	13.1 %	\$ 250,788	8.0 %	\$ 266,462	8.5 %
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 411,585	13.1 %	\$ 203,765	6.5 %	\$ 219,439	7.0 %
Tier 1 Capital (to average assets)	\$ 411,585	10.2 %	\$ 202,013	5.0 %	\$ 161,611	4.0 %

(1) Includes 2.5% capital conservation buffer, except the Tier 1 Capital to average assets.

The Subordinated Debt, net of unamortized issuance costs, totaled \$39,740,000 at December 31, 2020, and qualifies as Tier 2 capital for the Company under the guidelines established by the Federal Reserve Bank.

Under California General Corporation Law, the holders of common stock are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available. The California Financial Code provides that a state licensed bank may not make a cash distribution to its shareholders in excess of the lesser of the following: (i) the bank's retained earnings; or (ii) the bank's net income for its last three fiscal years, less the amount of any distributions made by the bank to its shareholders during such period. However, a bank, with the prior approval of the Commissioner of the California Department of Business Oversight—Division of Financial Institutions (“DBO”) may make a distribution to its shareholders of an amount not to exceed the greater of (i) a bank's retained earnings; (ii) its net income for its last fiscal year; or (iii) its net income for the current fiscal year. Also with the prior approval of the Commissioner of the DBO and the shareholders of the bank, the bank may make a distribution to its shareholders, as a reduction in capital of the bank. In the event that the Commissioner determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by a bank would be unsafe or unsound, the Commissioner may order a bank to refrain from making such a proposed distribution. As of December 31, 2020, HBC would not be required to obtain regulatory approval, and the amount available for cash dividends is \$21,996,000. Similar restrictions applied to the amount and sum of loan advances and other transfers of funds from HBC to the parent company. HBC distributed to HCC dividends of \$32,000,000 and \$22,500,000 for the years ended December 31, 2020 and 2019, respectively.

19) Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09 (*Topic 606*) and all subsequent ASUs that modified Topic 606. Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, gain on sale of securities, bank-owned life insurance, gain on sales of SBA loans, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. The following noninterest income revenue streams are in-scope of Topic 606:

Service charges and fees on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. We sometimes charge customers fees that are not specifically related to the customer accessing its funds, such as account maintenance or dormancy fees. The amount of deposit fees assessed varies based on a number of factors, such as the type of customer and account, the quantity of transactions, and the size of the deposit balance. We charge, and in some circumstances do not charge, fees to earn additional revenue and influence certain customer behavior. An example would be where we do not charge a monthly service fee, or do not charge for certain transactions, for customers that have a high deposit balance. Deposit fees are considered either transactional in nature (such as wire transfers, nonsufficient fund fees, and stop payment orders) or non-transactional (such as account maintenance and dormancy fees). These fees are recognized as earned or as transactions occur and services are provided. Check orders and other deposit account related fees are largely transactional based and, therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

The Company currently accounts for sales of foreclosed assets in accordance with Topic 360-20. In most cases the Company will seek to engage a real estate agent for the sale of foreclosed assets immediately upon foreclosure. However, in some cases, where there is clear demand for the property in question, the Company may elect to allow for a marketing period on no more than six months to attempt a direct sale of the property. We generally recognize the sale, and any associated gain or loss, of a real estate property when control of the property transfers. Any gains or losses from the sale are recorded to noninterest income/expense.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the periods indicated:

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Noninterest Income In-scope of Topic 606:			
Service charges and fees on deposit accounts	\$ 2,859	\$ 4,510	\$ 4,113
Gain on the disposition of foreclosed assets	791	—	—
Total noninterest income in-scope of Topic 606.	<u>3,650</u>	<u>4,510</u>	<u>4,113</u>
Noninterest Income Out-of-scope of Topic 606	<u>6,272</u>	<u>5,734</u>	<u>5,461</u>
Total noninterest income	<u>\$ 9,922</u>	<u>\$ 10,244</u>	<u>\$ 9,574</u>

20) Noninterest Expense

The following table indicates the various components of the Company's noninterest expense in each category for the periods indicated:

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Salaries and employee benefits	\$ 50,927	\$ 50,754	\$ 43,762
Occupancy and equipment	8,018	6,647	5,411
Professional fees	5,338	3,259	1,969
Amortization of intangible assets	3,751	2,739	1,943
Software subscriptions	3,102	2,397	2,343
Data processing	2,770	2,890	1,978
Insurance expense	2,286	1,864	1,685
Supplemental retirement plan cost	1,724	1,240	202
Other	11,595	13,108	16,228
Total noninterest expense	<u>\$ 89,511</u>	<u>\$ 84,898</u>	<u>\$ 75,521</u>

The following table presents the merger-related costs by category for the periods indicated:

	For the Year Ended		
	December 31, 2020	December 31, 2019	December 31, 2018
	(Dollars in thousands)		
Salaries and employee benefits	\$ 356	\$ 6,580	\$ 3,569
Other	2,245	4,500	5,598
Total merger-related costs	<u>\$ 2,601</u>	<u>\$ 11,080</u>	<u>\$ 9,167</u>

21) Business Segment Information

The following presents the Company's operating segments. The Company operates through two business segments: Banking segment and Factoring segment. Transactions between segments consist primarily of borrowed funds. Intersegment interest expense is allocated to the Factoring segment based on the Company's prime rate and funding costs. The provision for loan loss is allocated based on the segment's allowance for loan loss determination which considers the effects of charge-offs. Noninterest income and expense directly attributable to a segment are assigned to it. Taxes are paid on a consolidated basis and allocated for segment purposes. The Factoring segment includes only factoring originated by Bay View Funding.

	Year Ended December 31, 2020		
	Banking ⁽¹⁾	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	\$ 139,744	\$ 10,727	\$ 150,471
Intersegment interest allocations	923	(923)	—
Total interest expense	8,581	—	8,581
Net interest income	132,086	9,804	141,890
Provision for credit losses on loans	12,928	305	13,233
Net interest income after provision	119,158	9,499	128,657
Noninterest income	9,277	645	9,922
Noninterest expense (2)	83,149	6,362	89,511
Intersegment expense allocations	404	(404)	—
Income before income taxes	45,690	3,378	49,068
Income tax expense	12,770	999	13,769
Net income	<u>\$ 32,920</u>	<u>\$ 2,379</u>	<u>\$ 35,299</u>
Total assets	\$ 4,567,239	\$ 66,875	\$ 4,634,114
Loans, net of deferred fees	\$ 2,572,060	\$ 47,201	\$ 2,619,261
Goodwill	\$ 154,587	\$ 13,044	\$ 167,631

(1) Includes the holding company's results of operations.

(2) The banking segment's noninterest expense includes merger-related costs of \$2,601,000.

	Year Ended December 31, 2019		
	Banking ⁽¹⁾	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	\$ 130,971	\$ 11,688	\$ 142,659
Intersegment interest allocations	1,182	(1,182)	—
Total interest expense	10,847	—	10,847
Net interest income	121,306	10,506	131,812
Provision for loan losses	517	329	846
Net interest income after provision	120,789	10,177	130,966
Noninterest income	9,643	601	10,244
Noninterest expense (2)	78,159	6,739	84,898
Intersegment expense allocations	547	(547)	—
Income before income taxes	52,820	3,492	56,312
Income tax expense	14,819	1,032	15,851
Net income	<u>\$ 38,001</u>	<u>\$ 2,460</u>	<u>\$ 40,461</u>
Total assets	\$ 4,045,801	\$ 63,662	\$ 4,109,463
Loans, net of deferred fees	\$ 2,487,864	\$ 45,980	\$ 2,533,844
Goodwill	\$ 154,376	\$ 13,044	\$ 167,420

(1) Includes the holding company's results of operations.

(2) The banking segment's noninterest expense includes merger-related costs of \$11,080,000.

	Year Ended December 31, 2018		
	Banking ⁽¹⁾	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	\$ 115,147	\$ 14,698	\$ 129,845
Intersegment interest allocations	1,856	(1,856)	—
Total interest expense	7,822	—	7,822
Net interest income	109,181	12,842	122,023
Provision for loan losses	7,224	197	7,421
Net interest income after provision	101,957	12,645	114,602
Noninterest income	8,662	912	9,574
Noninterest expense (2)	69,164	6,357	75,521
Intersegment expense allocations	753	(753)	—
Income before income taxes	42,208	6,447	48,655
Income tax expense	11,418	1,906	13,324
Net income	<u>\$ 30,790</u>	<u>\$ 4,541</u>	<u>\$ 35,331</u>
Total assets	\$ 3,028,721	\$ 67,841	\$ 3,096,562
Loans, net of deferred fees	\$ 1,832,815	\$ 53,590	\$ 1,886,405
Goodwill	\$ 70,709	\$ 13,044	\$ 83,753

(1) Includes the holding company's results of operations.

(2) The banking segment's noninterest expense includes merger-related costs of \$9,167,000.

22) Parent Company only Condensed Financial Information

The condensed financial statements of Heritage Commerce Corp (parent company only) are as follows:

Condensed Balance Sheets

	December 31,	
	2020	2019
	(Dollars in thousands)	
Assets		
Cash and cash equivalents	\$ 20,378	\$ 20,260
Investment in subsidiary bank	595,681	594,868
Other assets	1,881	1,761
Total assets	<u>\$ 617,940</u>	<u>\$ 616,889</u>
Liabilities and Shareholders' Equity		
Subordinated debt, net of issuance costs	\$ 39,740	\$ 39,554
Other liabilities	311	627
Shareholders' equity	577,889	576,708
Total liabilities and shareholders' equity	<u>\$ 617,940</u>	<u>\$ 616,889</u>

Condensed Statements of Operations

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Dividend from subsidiary bank	\$ 32,000	\$ 22,500	\$ 17,000
Other income	—	121	—
Interest expense	(2,321)	(2,314)	(2,315)
Other expenses	(3,263)	(3,084)	(3,030)
Income before income taxes and equity in net income of subsidiary bank	26,416	17,223	11,655
Equity in undistributed net income of subsidiary bank	7,255	21,757	22,161
Income tax benefit	1,628	1,481	1,515
Net income	<u>\$ 35,299</u>	<u>\$ 40,461</u>	<u>\$ 35,331</u>

Condensed Statements of Cash Flows

	Year Ended December 31,		
	2020	2019	2018
	(Dollars in thousands)		
Cash flows from operating activities:			
Net Income	\$ 35,299	\$ 40,461	\$ 35,331
Adjustments to reconcile net income to net cash provided by operations:			
Amortization of restricted stock awards, net	1,689	1,283	1,109
Equity in undistributed net income of subsidiary bank	(7,255)	(21,757)	(22,161)
Net change in other assets and liabilities	(250)	12	(64)
Net cash provided by operating activities	29,483	19,999	14,215
Cash flows from financing activities:			
Payment of cash dividends	(31,079)	(22,723)	(18,464)
Proceeds from exercise of stock options	1,714	1,626	2,667
Net cash provided by (used in) financing activities	(29,365)	(21,097)	(15,797)
Net increase (decrease) in cash and cash equivalents	118	(1,098)	(1,582)
Cash and cash equivalents, beginning of year	20,260	21,358	22,940
Cash and cash equivalents, end of year	<u>\$ 20,378</u>	<u>\$ 20,260</u>	<u>\$ 21,358</u>

23) Quarterly Financial Data (Unaudited)

The following table discloses the Company's selected unaudited quarterly financial data:

	Quarter Ended			
	12/31/2020	9/30/2020	6/30/2020	3/31/2020
	(Dollars in thousands, except per share amounts)			
Interest income	\$ 36,145	\$ 36,252	\$ 37,132	\$ 40,942
Interest expense	1,940	2,087	2,192	2,362
Net interest income	34,205	34,165	34,940	38,580
Provision (recapture) for credit losses on loans	(1,348)	197	1,114	13,270
Net interest income after provision for credit losses on loans	35,553	33,968	33,826	25,310
Noninterest income	2,056	2,595	2,078	3,193
Noninterest expense (1)	21,557	21,168	21,012	25,774
Income before income taxes	16,052	15,395	14,892	2,729
Income tax expense	4,429	4,198	4,274	868
Net income	<u>\$ 11,623</u>	<u>\$ 11,197</u>	<u>\$ 10,618</u>	<u>\$ 1,861</u>
Earnings per common share				
Basic	\$ 0.19	\$ 0.19	\$ 0.18	\$ 0.03
Diluted	\$ 0.19	\$ 0.19	\$ 0.18	\$ 0.03

(1) Includes \$101,000, \$17,000, \$59,000, and \$2,424,000 pre-tax acquisition costs in the fourth, third, second and first quarters of 2020, respectively, related to the Presidio merger.

	Quarter Ended			
	12/31/2019	9/30/2019	6/30/2019	3/31/2019
	(Dollars in thousands, except per share amounts)			
Interest income	\$ 42,471	\$ 33,250	\$ 33,489	\$ 33,449
Interest expense	3,242	2,625	2,573	2,407
Net interest income	39,229	30,625	30,916	31,042
Provision (credit) for loan losses	3,223	(576)	(740)	(1,061)
Net interest income after provision for loan losses	36,006	31,201	31,656	32,103
Noninterest income	2,393	2,618	2,765	2,468
Noninterest expense (1)	30,626	17,909	18,445	17,918
Income before income taxes	7,773	15,910	15,976	16,653
Income tax expense	2,088	4,633	4,623	4,507
Net income	<u>\$ 5,685</u>	<u>\$ 11,277</u>	<u>\$ 11,353</u>	<u>\$ 12,146</u>
Earnings per common share				
Basic	\$ 0.10	\$ 0.26	\$ 0.26	\$ 0.28
Diluted	\$ 0.10	\$ 0.26	\$ 0.26	\$ 0.28

(1) Includes \$9,879,000, \$661,000, and \$540,000 pre-tax acquisition costs in the fourth, third, and second quarters of 2019, respectively, related to the Presidio merger.

24) Subsequent Events

On January 28, 2021, the Company announced that its Board of Directors declared a \$0.13 per share quarterly cash dividend to holders of common stock. The dividend will be paid on February 26, 2021 to shareholders of record on February 12, 2021.

**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, 2020**

I, Keith A. Wilton, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2020 of Heritage Commerce Corp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ KEITH A. WILTON

Keith A. Wilton
President and Chief Executive Officer
Heritage Commerce Corp

Date: March 5, 2021

**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, 2020**

I, Lawrence D. McGovern, certify that:

1. I have reviewed this Annual Report on Form 10-K for the Year Ended December 31, 2020 of Heritage Commerce Corp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ LAWRENCE D. MCGOVERN

Lawrence D. McGovern

Executive Vice President and Chief Financial Officer
Heritage Commerce Corp

Date: March 5, 2021

**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, 2020**

In connection with the Annual Report of Heritage Commerce Corp (the “Company”) on Form 10-K for the year ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Keith A. Wilton, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ KEITH A. WILTON

Keith A. Wilton
President and Chief Executive Officer
Heritage Commerce Corp

March 5, 2021

**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, 2020**

In connection with the Annual Report of Heritage Commerce Corp (the “Company”) on Form 10-K for the year ended December 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Lawrence D. McGovern, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ LAWRENCE D. MCGOVERN

Lawrence D. McGovern
Executive Vice President and Chief Financial Officer
Heritage Commerce Corp

March 5, 2021

Corporate Information

Board of Directors

Jack W. Conner, Chair
Ranson W. Webster, Vice Chair
Julianne M. Biagini-Komas
Frank G. Bisceglia
Bruce H. Cabral
Jason DiNapoli
Stephen G. Heitel
Walter T. Kaczmarek
Robert T. Moles
Marina H. Park Sutton
Laura Roden

Executive Management

Walter T. Kaczmarek
President and Chief Executive Officer

Michael E. Benito
Executive Vice President
Business Banking Manager

Margo G. Butsch
Executive Vice President
Chief Credit Officer

Jeffrey L. Javits
Executive Vice President
Chief Information Officer

Robertson Clay Jones
Executive Vice President
President of Community Business
Banking

Lawrence D. McGovern
Executive Vice President
Chief Financial Officer

Teresa L. Powell
Executive Vice President
HOA & Deposit Services

Deborah K. Reuter
Executive Vice President
Chief Risk Officer &
Corporate Secretary

Glen E. Shu
Executive Vice President
President of Specialty Finance Group

May K. Y. Wong
Executive Vice President
Controller

Subsidiary Bank Offices Heritage Bank of Commerce

San Jose Main
224 Airport Parkway
San Jose, CA 95110
408.947.6900

Danville
387 Diablo Road
Danville, CA 94526
925.314.2851

Fremont
3137 Stevenson Boulevard
Fremont, CA 94538
510.445.0400

Gilroy
7598 Monterey Street, Suite 110
Gilroy, CA 95020
408.842.8310

Hollister
351 Tres Pinos Road, Suite 102A
Hollister, CA 95023
831.637.2152

Livermore
1987 First Street
Livermore, CA 94550
925.791.4360

Los Altos
419 S. San Antonio Road
Los Altos, CA 94022
650.941.9300

Los Gatos
15575 Los Gatos Boulevard,
Suite B
Los Gatos, CA 95032
408.356.6190

Morgan Hill
18625 Sutter Boulevard, Suite 100
Morgan Hill, CA 95037
408.778.2320

Palo Alto
325 Lytton Avenue, Suite 100
Palo Alto, CA 94301
650.321.0500

Pleasanton
300 Main Street
Pleasanton, CA 94566
925.314.2876

Redwood City
2400 Broadway, Suite 100
Redwood City, CA 94063
650.298.7000

San Francisco
120 Kearny St., Suite 2300
San Francisco, CA 94108
415.229.8400

San Mateo
400 S. EL Camino, Suite 150
San Mateo, CA 94402
650.645.6480

San Rafael
999 Fifth Ave., Suite 100
San Rafael, CA 94901
415.456.6000

Sunnyvale
333 W. El Camino Real, Suite 150
Sunnyvale, CA 94087
650.919.2159

Walnut Creek
1990 N. California Boulevard,
Suite 100
Walnut Creek, CA 94596
925.287.4818

Walnut Creek
Loan Production Office
101 Ygnacio Valley Road, Suite 108
Walnut Creek, CA 94596
925.930.9287

Bay View Funding

Administrative Office
224 Airport Parkway Suite 200
San Jose, CA 95110
650.294.6600

Heritage Commerce Corp Investor Relations Contact

Deborah K. Reuter
Executive Vice President
Chief Risk Officer &
Corporate Secretary
408.947.6900

Transfer Agent

Equiniti Trust Company
EQ Shareowner Services
1110 Centre Pointe Curve,
Suite 101
Mendota Heights, MN 55120
800.468.9716

Independent Auditors

Crowe LLP
400 Capitol Mall, Suite 1400
Sacramento, CA 95814
916.441.1000

Corporate Counsel

Buchalter
A Professional Corporation
1000 Wilshire Boulevard,
Suite 1500
Los Angeles, CA 90017
213.891.0700



To get further information on
Heritage Commerce Corp, or to
receive regular financial updates,
please visit our website at
HeritageCommerceCorp.com
and click on "Information Request."



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