EL PASO ELECTRIC CO /TX/
Form 8-K
December 06, 2012

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

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported):
December 6, 2012

El Paso Electric Company
(Exact name of registrant as specified in its charter)

Texas	001-14206	74-0607870
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

Stanton Tower, 100 North Stanton, El Paso, Texas	79901
(Address of principal executive offices)	(Zip Code)

(915) 543-5711
(Registrant’s telephone number, including area code)

N/A
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

¨ Written communication pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

¨ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

¨ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

¨ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 8.01 Other Events.
Issuance of $150 million of Senior Notes

On December 6, 2012, El Paso Electric Company (the “Company”) closed its issuance and sale of $150,000,000 aggregate principal amount of its 3.30% Senior Notes due 2022 (the “Senior Notes”) pursuant to an underwriting agreement dated December 3, 2012 (the “Underwriting Agreement”) between the Company and J.P. Morgan Securities LLC and Mitsubishi UFJ Securities (USA), Inc. The Senior Notes were issued pursuant to an Indenture dated as of May 1, 2005 between the Company and The Bank of New York Mellon Trust Company, N.A. (formerly known as The Bank of New York Trust Company, N.A.), as successor to JPMorgan Chase Bank, National Association, as trustee (the “Trustee”), and as amended by the First Supplemental Indenture dated as of May 19, 2008 between the Company and the Trustee, and as further supplemented by a Securities Resolution No. 3 approved by the Pricing Committee of the Board of Directors of the Company, dated December 3, 2012. The terms and conditions of the Senior Notes are contained in Securities Resolution No. 3, to which a form of the global note representing the Senior Notes is attached. The offering of the Senior Notes has been registered under the Securities Act of 1933 (the “Act”) pursuant to a Registration Statement on Form S-3 (Reg. No. 333- 178319) filed with the Securities and Exchange Commission under the Act, which became automatically effective upon filing on December 5, 2011. Copies of the Underwriting Agreement, Securities Resolution No. 3, the opinion of Duggins Wren Mann & Romero, LLP regarding the validity of the Senior Notes, and the opinion of Davis Polk & Wardwell LLP regarding the validity of the Senior Notes, are attached hereto as Exhibits 1.1, 4.1, 5.1 and 5.2, respectively.

Item 9.01 Financial Statements and Exhibits
(d) Exhibits.

Exhibit Number	Description
1.1	Underwriting Agreement, dated December 3, 2012, between the Company and J.P. Morgan Securities LLC and Mitsubishi UFJ Securities (USA), Inc.
4.1	Securities Resolution No. 3 approved by the Pricing Committee of the Board of Directors of the Company, dated December 3, 2012
5.1	Opinion of Duggins Wren Mann & Romero, LLP
5.2	Opinion of Davis Polk & Wardwell LLP
23.1	Consent of Duggins Wren Mann & Romero, LLP (contained in Exhibit 5.1)
23.2	Consent of Davis Polk & Wardwell LLP (contained in Exhibit 5.2)

SIGNATURE

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

EL PASO ELECTRIC COMPANY
(Registrant)

By: /s/ DAVID G. CARPENTER
Name: David G. Carpenter
Title: Senior Vice President - Chief Financial Officer

Dated: December 6, 2012

Index to Exhibits

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ter;color:#000000;font-family:Times New Roman,Times,serif;font-size: 8pt;"> Interest

Average

Interest

Average

Average

Income /

Yield /

Average

Income /

Yield /

Balance

Expense

Rate

Balance

Expense

Rate

(Dollars in thousands)

Assets:

Loans, gross (1)(2)

$

1,918,791

28,632

5.92

%

$

1,560,421

22,507

5.72

%

Securities — taxable

624,352

3,483

2.21

%

671,528

3,596

2.12

%

Securities — exempt from Federal tax (3)

87,410

702

3.19

%

89,426

866

3.84

%

Other investments, interest-bearing deposits in other financial institutions and Federal funds sold

335,373

1,940

2.29

%

335,706

1,289

1.52

%

Total interest earning assets (3)

2,965,926

34,757

4.65

%

2,657,081

28,258

4.22

%

Cash and due from banks

40,704

35,173

Premises and equipment, net

7,320

7,609

Goodwill and other intangible assets

96,436

51,715

Other assets

82,753

85,229

Total assets

$

3,193,139

$

2,836,807

Liabilities and shareholders' equity:

Deposits:

Demand, noninterest-bearing

$

1,071,638

$

980,554

Demand, interest-bearing

682,694

551

0.32

%

583,363

290

0.20

%

Savings and money market

823,762

761

0.37

%

686,511

429

0.25

%

Time deposits — under $100

23,699

23

0.39

%

19,770

14

0.28

%

Time deposits — $100 and over

131,262

237

0.72

%

181,167

317

0.69

%

CDARS — interest-bearing demand, money

market and time deposits

15,971

3

0.07

%

18,650

1

0.02

%

Total interest-bearing deposits

1,677,388

1,575

0.37

%

1,489,461

1,051

0.28

%

Total deposits

2,749,026

1,575

0.23

%

2,470,015

1,051

0.17

%

Subordinated debt, net of issuance costs

39,292

583

5.89

%

39,120

583

5.91

%

Short-term borrowings

133

1

2.98

%

84

—

0.00

%

Total interest-bearing liabilities

1,716,813

2,159

0.50

%

1,528,665

1,634

0.42

%

Total interest-bearing liabilities and demand, noninterest-bearing / cost of funds

2,788,451

2,159

0.31

%

2,509,219

1,634

0.26

%

Other liabilities

54,717

54,922

Total liabilities

2,843,168

2,564,141

Shareholders’ equity

349,971

272,666

Total liabilities and shareholders’ equity

$

3,193,139

$

2,836,807

Net interest income (3) / margin

32,598

4.36

%

26,624

3.98

%

Less tax equivalent adjustment (3)

(147)

(303)

Net interest income

$

32,451

$

26,321

(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 $73,000 for the third quarter of 2018, compared to $200,000 for the third quarter of 2017.

(3) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the third quarter of 2018, and a 35% tax rate for the third quarter of 2017.

52

Table of Contents

	Nine Months Ended September 30, 2018				Nine Months Ended September 30, 2017			
	Average Balance	Interest Income / Expense	Average Yield / Rate		Average Balance	Interest Income / Expense	Average Yield / Rate	
Assets:								
Loans, gross (1)(2)	$ 1,776,546	77,272	5.82	%	$ 1,521,447	$ 64,112	5.63	%
Securities — taxable	662,274	11,112	2.24	%	616,648	9,916	2.15	%
Securities — exempt from Federal tax (3)	87,990	2,120	3.22	%	89,991	2,606	3.87	%
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	271,757	4,408	2.17	%	291,222	3,037	1.39	%
Total interest earning assets (3)	2,798,567	94,912	4.53	%	2,519,308	79,671	4.23	%
Cash and due from banks	37,890				33,656			
Premises and equipment, net	7,330				7,581			
Goodwill and other intangible assets	77,777				52,103			
Other assets	82,666				85,901			
Total assets	$ 3,004,230				$ 2,698,549			
Liabilities and shareholders' equity:								
Deposits:								
Demand, noninterest-bearing	$ 1,003,590				$ 924,841			
Demand, interest-bearing	651,445	1,319	0.27	%	574,966	880	0.20	%
Savings and money market	769,448	1,823	0.32	%	632,907	1,081	0.23	%
Time deposits — under $100	21,235	58	0.37	%	20,141	44	0.29	%
Time deposits — $100 and over	131,436	564	0.57	%	191,301	859	0.60	%
CDARS — interest-bearing demand, money market and time deposits	16,086	8	0.07	%	13,061	3	0.03	%
Total interest-bearing deposits	1,589,650	3,772	0.32	%	1,432,376	2,867	0.27	%
Total deposits	2,593,240	3,772	0.19	%	2,357,217	2,867	0.16	%
Subordinated debt, net of issuance costs	39,246	1,731	5.90	%	17,912	811	6.05	%
Short-term borrowings	76	1	1.76	%	68	1	1.97	%
Total interest-bearing liabilities	1,628,972	5,504	0.45	%	1,450,356	3,679	0.34	%
Total interest-bearing liabilities and demand, noninterest-bearing / cost of funds	2,632,562	5,504	0.28	%	2,375,197	3,679	0.21	%
Other liabilities	54,204				57,377			
Total liabilities	2,686,766				2,432,574			

Shareholders’ equity	317,464				265,975			
Total liabilities and shareholders’ equity	$ 3,004,230				$ 2,698,549			
Net interest income (3) / margin		89,408	4.27	%		75,992	4.03	%
Less tax equivalent adjustment (3)		(445)				(912)		
Net interest income		$ 88,963				$ 75,080		

(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 $322,000 for the nine months ended September 30, 2018, compared to $370,000 for the nine months ended September 30, 2017.

(3) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for 2018, and a 35% tax rate for 2017.

53

Table of Contents

Volume and Rate Variances

The Volume and Rate Variances table below sets forth the dollar difference in interest earned and paid for each major category of interest earning assets and interest bearing liabilities for the noted periods, and the amount of such change attributable to changes in average balances (volume) or changes in average interest rates. Volume variances are equal to the increase or decrease in the average balance times the prior period rate, and rate variances are equal to the increase or decrease in the average rate times the prior period average balance. Variances attributable to both rate and volume changes are equal to the change in rate times the change in average balance and are included below in the average volume column.

	Three Months Ended September 30, 2018 vs. 2017 Increase (Decrease) Due to Change in:		
	Average Volume	Average Rate	Net Change
	(Dollars in thousands)		
Income from the interest earning assets:			
Loans, gross	$ 5,348	$ 777	$ 6,125
Securities — taxable	(258)	145	(113)
Securities — exempt from Federal tax (1)	(17)	(147)	(164)
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	2	649	651
Total interest income on interest earning assets (1)	5,075	1,424	6,499
Expense from the interest-bearing liabilities:			
Demand, interest-bearing	80	181	261
Savings and money market	121	211	332
Time deposits — under $100	4	5	9
Time deposits — $100 and over	(92)	12	(80)
CDARS — interest-bearing demand, money market and time deposits	—	2	2
Subordinated debt, net of issuance costs	2	(2)	—
Short-term borrowings	1	—	1
Total interest expense on interest-bearing liabilities	116	409	525
Net interest income (1)	$ 4,959	$ 1,015	5,974
Less tax equivalent adjustment (1)			156
Net interest income			$ 6,130

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for the third quarter of 2018, and a 35% tax rate for the third quarter of 2017.

Table of Contents

	Nine Months Ended September 30, 2018 vs. 2017 Increase (Decrease) Due to Change in:		
	Average Volume	Average Rate	Net Change
	(Dollars in thousands)		
Income from the interest earning assets:			
Loans, gross	$ 11,042	$ 2,117	$ 13,159
Securities — taxable	781	415	1,196
Securities — exempt from Federal tax (1)	(47)	(439)	(486)
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	(318)	1,690	1,372
Total interest income on interest-earning assets (1)	11,458	3,783	15,241
Expense from the interest-bearing liabilities:			
Demand, interest-bearing	158	281	439
Savings and money market	308	434	742
Time deposits — under $100	2	12	14
Time deposits — $100 and over	(252)	(43)	(295)
CDARS — interest-bearing demand, money market and time deposits	1	4	5
Subordinated debt, net of issuance costs	941	(21)	920
Short-term borrowings	—	—	—
Total interest expense on interest-bearing liabilities	1,158	667	1,825
Net interest income (1)	$ 10,300	$ 3,116	13,416
Less tax equivalent adjustment (1)			467
Net interest income			$ 13,883

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate for 2018, and a 35% tax rate for 2017.

The Company’s net interest margin (FTE), expressed as a percentage of average earning assets, increased 38 basis points to 4.36% for the third quarter of 2018, from 3.98% for the third quarter of 2017. The improvement was primarily due to a higher average balance of loans, an increase in the accretion of the loan purchase discount into loan interest income from the Tri-Valley Bank and the United American Bank acquisitions in the second quarter of 2018, the impact of increases in the prime rate, and the rate on overnight funds.

For the first nine months of 2018, the net interest margin increased 24 basis points to 4.27%, compared to 4.03% for the first nine months of 2017, primarily due to a higher average balance of loans and securities, an increase in the accretion of the loan purchase discount into loan interest income from the Tri-Valley and United American acquisitions in the second quarter of 2018, the impact of increases in the prime rate, and the rate on overnight funds.

The average yield on the loan portfolio increased to 5.92% for the third quarter of 2018, compared to 5.72% for the third quarter of 2017, primarily due to an increase in the accretion of the loan purchase discount into loan interest income from the acquisitions, and increases in the prime rate. The average yield on the Company's legacy loan portfolio (excluding the purchased residential loans, purchased CRE loans, factored receivables portfolio, and accretion of the loan purchase discount from the acquisitions) increased 10 basis points for the third quarter of 2018, compared to the third quarter of 2017. The average yield on the purchased residential loans was 2.68% for the third quarter of 2018, compared to 2.67% for the third quarter of 2017. The average yield on the purchased CRE loans was 3.24% for the third quarter of 2018, compared to 3.52% the third quarter of 2017.

The yield on the loan portfolio increased to 5.82% for the first nine months of 2018, compared to 5.63% for the first nine months of 2017, primarily due to to an increase in accretion of the loan purchase discount into loan interest income from the acquisitions and increases in the prime rate. The yield on the Company's legacy loan portfolio (excluding the purchased residential loans, purchased CRE loans, factored receivables portfolio, and accretion of the loan purchase discount from the acquisitions) increased 9 basis points for the first nine months of 2018, compared to the first nine months of 2017. The yield on the purchased residential loans was 2.71% for the first nine months of 2018, compared to 2.67% for the first nine months of 2017. The yield on the purchased CRE loans was 3.45% for the first nine months of 2018, compared to 3.51% for the first nine months of 2017.

Net interest income, before the provision for loan losses, increased 23% to $32.5 million for the third quarter of 2018, compared to $26.3 million for the third quarter of 2017. Net interest income increased 18% to $89.0 million for the nine months ended September 30, 2018, compared to $75.1 million for the nine months ended September 30, 2017. Net interest income increased for the third quarter of 2018 and the first nine months of 2018, compared to the respective periods in 2017, primarily due to the impact of the increase in loans and deposits from the Tri-Valley and United American acquisitions, in addition to organic loan growth and the positive impact of rising interest rates.

Provision for Loan Losses

Credit risk is inherent in the business of making loans. The Company establishes an allowance for loan losses through charges to earnings, which are presented in the statements of income as the provision for loan losses. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for loan losses is determined by conducting a quarterly evaluation of the adequacy of the Company's allowance for loan losses and charging the shortfall or excess, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to the Company's earnings. The provision for loan losses and level of allowance for each period are dependent upon many factors, including loan growth, net charge offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in the Company's market area.

There was a ($425,000) credit to the provision for loan losses for the third quarter of 2018, compared to a provision for loan losses of $115,000 for the third quarter of 2017. The credit to the provision for loan losses for the third quarter of 2018 was primarily due to net recoveries of $1.2 million. For the nine months ended September 30, 2018, there was a $7.3 million provision for loan losses compared to a $390,000 provision for loan losses for the nine months ended September 30, 2017. The increase in the provision for loan losses for the first nine months of 2018 compared to the first nine months of 2017 was primarily due to a single large lending relationship that was placed on nonaccrual during the second quarter of 2018. At September 30, 2018, the recorded investment of this lending relationship was $21.8 million, and the Company had a $7.0 million specific loan loss reserve allocated for this lending relationship. Additionally, subsequent to the end of the third quarter of 2018, the recorded investment of this lending relationship was reduced to $17.4 million. Provisions for loan losses are charged to operations to bring the allowance for loan losses to a level deemed appropriate by the Company based on the factors discussed under "Allowance for Loan Losses".

The allowance for loan losses totaled $27.4 million, or 1.44% of total loans at September 30, 2018, compared to $19.7 million, or 1.26% of total loans at September 30, 2017, and $19.7 million, or 1.24% of total loans at

December 31, 2017. Net recoveries totaled $1.2 million for the third quarter of 2018, compared to net recoveries of $236,000 for the third quarter of 2017, and net recoveries of $201,000 for the fourth quarter of 2017. The allowance for loan losses to total nonperforming loans decreased to110.97% at September 30, 2018, compared to 565.68% at September 30, 2017, and 791.07% at December 31, 2017, primarily due to the single lending relationship that was placed on nonaccrual during the second quarter of 2018. The loans acquired from Tri-Valley and United American are included in total loans; however, there was minimal allowance for loan losses attributed to these loans at September 30, 2018 because upon acquisition they were marked to fair value.

Table of Contents

Noninterest Income

	Three Months Ended September 30,		Increase (decrease) 2018 versus 2017	
	2018	2017	Amount	Percent
	(Dollars in thousands)			
Service charges and fees on deposit accounts	$ 1,107	$ 869	$ 238	27 %
Gain on sales of SBA loans	236	147	89	61 %
Increase in cash surrender value of life insurance	216	417	(201)	(48) %
Servicing income	163	246	(83)	(34) %
Other	484	781	(297)	(38) %
Total	$ 2,206	$ 2,460	$ (254)	(10) %

	Nine Months Ended September 30,		Increase (decrease) 2018 versus 2017	
	2018	2017	Amount	Percent
	(Dollars in thousands)			
Service charges and fees on deposit accounts	$ 2,981	$ 2,410	$ 571	24 %
Gain on sales of SBA loans	551	635	(84)	(13) %
Increase in cash surrender value of life insurance	816	1,259	(443)	(35) %
Servicing income	533	736	(203)	(28) %
Gain (loss) on sales of securities	266	(6)	272	4,533 %
Other	2,034	2,014	20	1 %
Total	$ 7,181	$ 7,048	$ 133	2 %

Total noninterest income decreased to $2.2 million for the third quarter of 2018, compared to $2.5 million for the third quarter of 2017. For the nine months ended September 30, 2018, noninterest income increased to $7.2 million, compared to $7.0 million for the nine months ended September 30, 2017, primarily due to proceeds from a legal settlement during the second quarter of 2018, higher service charges and fees on deposit accounts and gain on sales of securities for the first nine months of 2018, partially offset by a lower increase in cash surrender value of life insurance proceeds, servicing income, and gain on sale of SBA loans for the first nine months of 2018. The first nine months of 2017 also included a higher fee income from Bay View Funding which was included in other noninterest income. The Company received $1.3 million in proceeds from a legal settlement during the second quarter of 2018, of which $377,000 was recorded in other noninterest income, and $922,000 was credited to professional fees for recaptured legal fees previously paid by the Company.

Historically, a portion of the Company's noninterest income has been associated with its SBA lending activity, as gains on the sale of loans sold in the secondary market and servicing income from loans sold with servicing rights retained. For the three months ended September 30, 2018, SBA loan sales resulted in a $236,000 gain, compared to a $147,000 gain on sales of SBA loans for the three months ended September 30, 2017. For the nine months ended September 30, 2018, SBA loan sales resulted in a $551,000 gain, compared to a $635,000 gain on sale of SBA loans for the nine months ended September 30, 2017.

The servicing assets that result from the sales of SBA loans with servicing retained are amortized over the expected term of the loans using a method approximating the interest method. Servicing income generally declines as the respective loans are repaid.

57

Table of Contents

Noninterest Expense

	Three Months Ended September 30,			Increase (Decrease) 2018 versus 2017		
	2018	2017		Amount	Percent	
	(Dollars in thousands)					
Salaries and employee benefits (1)	$ 10,719	$ 9,071		$ 1,648	18	%
Occupancy and equipment	1,559	1,142		417	37	%
Professional fees	721	695		26	4	%
Amortization of intangible assets	631	296		335	113	%
Software subscriptions	555	475		80	17	%
Data processing	525	411		114	28	%
Insurance expense	430	401		29	7	%
Acquisition and integration related costs	16	—		16	N	/A
Other	2,572	2,343		229	10	%
Total	$ 17,728	$ 14,834		$ 2,894	20	%

(1) Salaries and employee benefits included severance and retention expense of $183,000 related to the Tri-Valley and United American acquisitions for the third quarter 2018.

	Nine Months Ended September 30,			Increase (Decrease) 2018 versus 2017		
	2018	2017		Amount	Percent	
	(Dollars in thousands)					
Salaries and employee benefits (1)	$ 35,302	$ 27,766		$ 7,536	27	%
Occupancy and equipment	3,927	3,426		501	15	%
Professional fees	1,116	2,439		(1,323)	(54)	%
Amortization of intangible assets	1,336	1,083		253	23	%
Software subscriptions	1,747	1,333		414	31	%
Data processing	1,501	1,080		421	39	%
Insurance expense	1,236	1,123		113	10	%
Acquisition and integration related costs	5,452	—		5,452	N	/A
Other	6,963	7,166		(203)	(3)	%
Total	$ 58,580	$ 45,416		$ 13,164	29	%

(1)

Salaries and employee benefits included severance and retention expense of $3.6 million related to the Tri-Valley and United American acquisitions for the nine months of 2018.

Table of Contents

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

Noninterest Expense by Category

	Three Months Ended September 30,					
	2018	Percent of Total		2017	Percent of Total	
	(Dollars in thousands)					
Salaries and employee benefits (1)	$ 10,719	60	%	$ 9,071	61	%
Occupancy and equipment	1,559	9	%	1,142	8	%
Professional fees	721	4	%	695	4	%
Amortization of intangible assets	631	4	%	296	2	%
Software subscriptions	555	3	%	475	3	%
Data processing	525	3	%	411	3	%
Insurance expense	430	2	%	401	3	%
Acquisition and integration related costs	16	0	%	—	0	%
Other	2,572	15	%	2,343	16	%
Total	$ 17,728	100	%	$ 14,834	100	%

(1) Salaries and employee benefits included severance and retention expense of $183,000 related to the Tri-Valley and United American acquisitions for the third quarter of 2018.

	Nine Months Ended September 30,					
	2018			2017		
	Amount	Percent of Total		Amount	Percent of Total	
	(Dollars in thousands)					
Salaries and employee benefits (1)	$ 35,302	60	%	$ 27,766	61	%
Occupancy and equipment	3,927	7	%	3,426	8	%
Professional fees	1,116	2	%	2,439	5	%
Amortization of intangible assets	1,336	2	%	1,083	2	%
Software subscriptions	1,747	3	%	1,333	3	%
Data processing	1,501	3	%	1,080	2	%
Insurance expense	1,236	2	%	1,123	3	%
Acquisition and integration related costs	5,452	9	%	—	0	%
Other	6,963	12	%	7,166	16	%
Total	$ 58,580	100	%	$ 45,416	100	%

(1) Salaries and employee benefits included severance and retention expense of $3.6 million related to the Tri-Valley and United American acquisitions for the nine months of 2018.

Total noninterest expense for the third quarter of 2018 was $17.7 million, compared to $14.8 million for the third quarter of 2017. Noninterest expense for the nine months ended September 30, 2018 was $58.5 million, compared to $45.4 million for the nine months ended September 30, 2017. The increase in noninterest expense in the first nine months of 2018, compared to first nine months of 2017, was primarily due to costs related to the merger transactions and higher salaries and employee benefits as a result of annual salary increases, and additional operating costs of Tri-Valley and United American, partially offset by lower professional fees. Other noninterest expense included pre-tax acquisition and integration costs of $16,000 and $5.5 million for the third quarter of 2018, and the first nine months of 2018, respectively. In addition, salaries and employee benefits included severance and retention expense of $183,000, and $3.6 million for the third quarter of 2018, and the first nine months of 2018, respectively, related to the Tri-Valley and United American acquisitions. Total severance, retention, acquisition and integration costs were $199,000 and $9.0 million for the third quarter of 2018, and the first nine months of 2018, respectively. Professional fees totaled $1.1 million for the first nine months of 2018, compared to $2.4 million for the first nine months of 2017, primarily due to the recovery of $922,000 of professional fees from a legal settlement in the second quarter of 2018. Full time equivalent employees were 296, 282, and 278 at September 30, 2018, September 30, 2017, and December 31, 2017, respectively

Table of Contents

Income Tax Expense

The Company computes its provision for income taxes on a quarterly 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 Company's effective income tax rates for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Effective income tax rate	28.7 %	37.9 %	27.0 %	37.9 %

The Company's income tax expense for the third quarter of 2018 was $5.0 million, compared to income tax expense of $5.2 million for the third quarter of 2017. The effective tax rate for the third quarter of 2018 decreased compared to the third quarter of 2017, primarily due to lower federal corporate tax rate for the third quarter of 2018. On December 22, 2017, the Tax Act, was signed into law, which among other things reduced the federal corporate tax rate to 21% from 35%, effective January 1, 2018. Income tax expense for the nine months ended September 30, 2018 was $8.2 million, compared to $13.8 million for the nine months ended September 30, 2017.

The difference in the effective tax rate for the periods reported compared to the combined Federal and state statutory tax rate of 29.6% for the third quarter of 2018 and the first nine months of 2018, and 42% for the the third quarter of 2017 and first nine months of 2017, is primarily the result of the Company's investment in life insurance policies whose earnings are not subject to taxes, tax credits related to investments in low income housing limited partnerships (net of low income housing investment losses), and tax-exempt interest income earned on municipal bonds.

In March 2016, the FASB issued new guidance intended to simplify several areas of accounting for share-based compensation programs, including the income tax impact, classification on the statement of cash flows, and forfeitures. The Company adopted the new guidance on share-based compensation during the first quarter of 2017. All excess tax benefits and tax deficiencies (including tax benefits of dividends on share based payment awards) are recognized as income tax expense or benefit on the income statement. The tax effects of exercised or vested awards are treated as discrete items in the reporting period in which they occur. The adoption of this guidance resulted in a reduction to income tax expense of ($58,000) for the third quarter of 2018, compared to a reduction of ($106,000) for the third quarter of 2017, and a reduction to income tax expense of ($351,000) for the first nine months of 2018, compared to a reduction of ($158,000) for the first nine months of 2017.

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles leading to timing differences between the Company's actual tax liability, and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse.

Realization of the Company's deferred tax assets is primarily dependent upon the Company generating sufficient future taxable income to obtain benefit from the reversal of net deductible temporary differences and the utilization of tax credit carryforwards and the net operating loss carryforwards for Federal and state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles a valuation allowance is required to be recognized if it is "more likely than not" that the deferred tax assets will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

The Company had net deferred tax assets of $28.1 million at September 30, 2018, $22.4 million at September 30, 2017, and $16.2 million at December 31, 2017. After consideration of the matters in the preceding paragraph, the

Table of Contents

Company determined that it is more likely than not that the net deferred tax assets September 30, 2018, September 30, 2017, and December 31, 2017 will be fully realized in future years.

Business Segment Information

The following presents the Company's operating segments. Transactions between segments consist primarily of borrowed funds. Intersegment interest expense is allocated to the Factoring segment based on the Company's prime rate and funding costs. The provision for loan loss is allocated based on the segment's allowance for loan loss determination which considers the effects of charge offs. Noninterest income and expense directly attributable to a segment are assigned to it. Taxes are paid on a consolidated basis and allocated for segment purposes. The Factoring segment includes only factoring originated by Bay View Funding.

	Three Months Ended September 30, 2018		
	Banking(1)	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 30,425	$ 4,185	$ 34,610
Intersegment interest allocations	601	(601)	—
Total interest expense	2,159	—	2,159
Net interest income	28,867	3,584	32,451
Provision (credit) for loan losses	(671)	246	(425)
Net interest income after provision	29,538	3,338	32,876
Noninterest income	2,011	195	2,206
Noninterest expense (2)	16,045	1,683	17,728
Intersegment expense allocations	172	(172)	—
Income before income taxes	15,676	1,678	17,354
Income tax expense	4,483	496	4,979
Net income	$ 11,193	$ 1,182	$ 12,375
Total assets	$ 3,107,897	$ 85,013	$ 3,192,910
Loans, net of deferred fees	$ 1,828,379	$ 71,008	$ 1,899,387
Goodwill	$ 70,708	$ 13,044	$ 83,752

(1) Includes the holding company's results of operations
(2) The banking segment's noninterest expense includes acquisition costs of $199,000

	Three Months Ended September 30, 2017		
	Banking(1)	Factoring	Consolidated
	(Dollars in thousands)		

Interest income	$ 24,805	$ 3,150	$ 27,955
Intersegment interest allocations	284	(284)	—
Total interest expense	1,634	—	1,634
Net interest income	23,455	2,866	26,321
Provision for loan losses	107	8	115
Net interest income after provision	23,348	2,858	26,206
Noninterest income	2,101	359	2,460
Noninterest expense	13,149	1,685	14,834
Intersegment expense allocations	130	(130)	—
Income before income taxes	12,430	1,402	13,832
Income tax expense	4,660	589	5,249
Net income	$ 7,770	$ 813	$ 8,583
Total assets	$ 2,776,262	$ 67,686	$ 2,843,948
Loans, net of deferred fees	$ 1,517,186	$ 48,764	$ 1,565,950
Goodwill	$ 32,620	$ 13,044	$ 45,664

(1) Includes the holding company’s results of operations

61

Table of Contents

	Nine Months Ended September 30, 2018		
	Banking(1)	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 83,781	$ 10,686	$ 94,467
Intersegment interest allocations	1,304	(1,304)	—
Total interest expense	5,504	—	5,504
Net interest income	79,581	9,382	88,963
Provision for loan losses	6,958	321	7,279
Net interest income after provision	72,623	9,061	81,684
Noninterest income	6,628	553	7,181
Noninterest expense (2)	53,813	4,767	58,580
Intersegment expense allocations	574	(574)	—
Income before income taxes	26,012	4,273	30,285
Income tax expense	6,923	1,263	8,186
Net income	$ 19,089	$ 3,010	$ 22,099
Total assets	$ 3,107,897	$ 85,013	$ 3,192,910
Loans, net of deferred fees	$ 1,828,379	$ 71,008	$ 1,899,387
Goodwill	$ 70,708	$ 13,044	$ 83,752

(1)Includes the holding company's results of operations

(2)The banking segment's noninterest expense includes acquisition costs of $9.0 million

	Nine Months Ended September 30, 2017		
	Banking(1)	Factoring	Consolidated
	(Dollars in thousands)		
Interest income	$ 70,146	$ 8,613	$ 78,759
Intersegment interest allocations	786	(786)	—
Total interest expense	3,679	—	3,679
Net interest income	67,253	7,827	75,080
Provision for loan losses	372	18	390
Net interest income after provision	66,881	7,809	74,690
Noninterest income	6,153	895	7,048
Noninterest expense	40,152	5,264	45,416
Intersegment expense allocations	392	(392)	—
Income before income taxes	33,274	3,048	36,322
Income tax expense	12,472	1,280	13,752
Net income	$ 20,802	$ 1,768	$ 22,570
Total assets	$ 2,776,262	$ 67,686	$ 2,843,948
Loans, net of deferred fees	$ 1,517,186	$ 48,764	$ 1,565,950
Goodwill	$ 32,620	$ 13,044	$ 45,664

(1) Includes the holding company's results of operations

Banking. Our banking segment's net income was $11.2 million for the three months ended September 30, 2018, compared to net income of $7.8 million for the three months ended September 30, 2017. The banking segment's earnings for the first nine months of 2018 was $19.1 million, compared to $20.8 million for the first nine months of 2017. Net interest income increased to $28.9 million for the three months ended September 30, 2018, compared to $23.5 million for the three months ended September 30, 2017. For the nine months ended September 30, 2018, net interest income increased to $79.6 million, compared to $67.3 million for the nine months ended September 30, 2017. The increase in net interest income for the three and nine months ended September 30, 2018, compared to the comparable periods in 2017, was primarily due to the impact of the increase in loans and deposits from the Tri-Valley and United American acquisitions, in addition to organic loan growth and the positive impact of rising interest rates. The credit to the provision for loan losses was ($671,000) for the three months ended September 30, 2018, compared to a provision for loan losses of $107,000 for the three months ended September 30, 2017. The credit to the provision for loan losses for the third quarter

62

of 2018 was primarily due to net recoveries of $1.2 million. For the nine months ended September 30, 2018, the provision for loan losses was $7.0 million, compared to a provision for loan losses of $372,000 for the nine months ended September 30, 2017. The increase in the provision for loan losses for the first nine months of 2018 compared to the first nine months of 2017 was primarily due to a single large lending relationship that was placed on nonaccrual during the second quarter of 2018. Noninterest income was $2.0 million for the three months ended September 30, 2018, compared to $2.1 million for the three months ended September 30, 2017. Noninterest income increased to $6.6 million for the nine months ended September 30, 2018, compared to $6.2 million for the nine months ended September 30, 2017, primarily due to proceeds from a legal settlement during the second quarter of 2018, higher service charges and fees on deposit accounts and gain on sales of securities for the first nine months of 2018. Noninterest expense increased to $16.0 million for the three months ended September 30, 2018, compared to $13.1 million for the three months ended September 30, 2017. For the nine months ended September 30, 2018, noninterest expense was $53.8 million, compared to $40.2 million for the nine months ended September 30, 2017. The increase in noninterest expense in the first nine months of 2018, compared to first nine months of 2017, was primarily due to costs related to the merger transactions and higher salaries and employee benefits as a result of annual salary increases, and additional operating costs of Tri-Valley and United American, partially offset by lower professional fees.

Factoring. Bay View Funding's primary business operation is purchasing and collecting factored receivables. Factored receivables are receivables that have been transferred by the originating organization and typically have not been subject to previous collection efforts. In a factoring transaction Bay View Funding directly purchases the receivables generated by its clients at a discount to their face value. The transactions are structured to provide the clients with immediate working capital when there is a mismatch between payments to the client for a good and service and the payment of operating costs incurred to provide such good or service. The average life of the factored receivables was 35 days for the nine months ended September 30, 2018, compared to 36 days for the nine months ended September 30, 2017. Net interest income for the three months and nine months ended September 30, 2018, increased compared to the three months and nine months ended September 30, 2017, primarily due to an increase in the average balance of factored receivables outstanding, partially offset by a decrease in the average yield on the factored receivables portfolio.

FINANCIAL CONDITION

As of September 30, 2018, total assets increased to $3.19 billion, compared to $2.84 billion at September 30, 2017, and December 31, 2017. The increase in total assets at September 30, 2018 was primarily due to the Tri-Valley and United American acquisitions. Tri-Valley added $115.2 million in loans, at fair value, and $91.4 million in deposits, at fair value at September 30, 2018. United American added $208.8 million in loans, at fair value, and $266.6 million in deposits, at fair value, at September 30, 2018.

Securities available for sale, at fair value, were $319.1 million at September 30, 2018, a decrease of (18%) from $390.1 million at September 30, 2017, and a decrease of (19%) from $391.9 million at December 31, 2017. Securities held to maturity, at amortized cost, were $375.7 million at September 30, 2018, a decrease of (1%) from $379.5 million at September 30, 2017, and a decrease of (6%)from $398.3 million at December 31, 2017. Total loans, excluding loans held for sale, increased $333.4 million, or 21%, to $1.90 billion at September 30, 2018, compared to $1.57 billion at September 30, 2017, which included $208.8 million in loans from United American, $115.2 million in loans from Tri-Valley, and an increase of $20.3 million, or 1% in the Company's legacy portfolio, partially offset by a decrease of $7.5 million in purchased residential mortgage loans and a decrease of $3.4 million in purchased CRE loans. Loans increased 20% at September 30, 2018, compared to $1.58 billion at December 31, 2017, which included $208.8 million in loans from United American, $115.2 million in loans from Tri-Valley, and an increase of $1.4 million in the Company's legacy portfolio, partially offset by a decrease of $5.6 million in purchased residential mortgages, and a decrease of $3.1 million in purchased CRE loans.

Total deposits increased $264.7 million, or 11%, to $2.75 billion at September 30, 2018, compared to $2.48 billion at September 30, 2017, which included $266.6 million in deposits from United American, $91.4 million in deposits from Tri-Valley, a decrease of $65.1 million in State of California certificates of deposits due to maturity, and a decrease of $28.2 million, or (1%), in the Company's legacy deposits. Total deposits increased $262.3 million, or 11%, at September 30, 2018 from $2.48 billion at December 31, 2017, which included $266.6 million in deposits from United American, $91.4 million in deposits from Tri-Valley, the maturity of $65.1 million in State of California certificates of deposits, and a decrease of $30.6 million in the Company's legacy deposits.

Table of Contents

Deposits, excluding all time deposits and CDARS deposits, increased $318.1 million, or 14%, to $2.58 billion at September 30, 2018, compared to $2.26 billion at September 30, 2017, which included $231.9 million of deposits added from United American, $83.0 million of deposits added from Tri-Valley, and an increase of $3.1 million in the Company's legacy deposits. Deposits, excluding all time deposits and CDARS deposits, increased $305.0 million, or 13%, compared to $2.28 billion at December 31, 2017, which included $231.9 million of deposits added from United American, $83.0 million of deposits added from Tri-Valley, partially offset by a decrease of $10.0 million in the Company's legacy deposits.

Securities Portfolio

The following table reflects the balances for each category of securities at the dates indicated:

	September 30, 2018	2017	December 31, 2017
	(Dollars in thousands)		
Securities available-for-sale (at fair value):			
Agency mortgage-backed securities	$ 311,665	$ 373,167	$ 374,733
U.S. Government sponsored entities	7,406	—	—
Trust preferred securities	—	16,940	17,119
Total	$ 319,071	$ 390,107	$ 391,852
Securities held-to-maturity (at amortized cost):			
Agency mortgage-backed securities	$ 288,594	$ 290,418	$ 309,616
Municipals — exempt from Federal tax	87,138	89,132	88,725
	$ 375,732	$ 379,550	$ 398,341

The following table summarizes the weighted average life and weighted average yields of securities at September 30, 2018:

	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	Amoun
	(Dollars in thousands)								
able-for-sale (at fair value):									
ge-backed securities	$ —	—	$ 238,391	2.22 %	$ 73,274	2.52 %	$ —	—	$ 311,6
nt sponsored entities	—	—	7,406	2.65 %	—	—	—	—	7,406
	$ —	—	$ 245,797	2.24 %	$ 73,274	2.52 %	$ —	—	$ 319,0

o-maturity (at amortized cost):																
ge-backed securities	$	—	—		$	204,487	2.04	%	$	43,486	2.43	%	$	40,621	3.17	%	$ 288,5
xempt from Federal tax (1)		4,297	3.22	%		21,107	3.38	%		12,289	3.04	%		49,445	3.20	%	87,13
	$	4,297	3.22	%	$	225,594	2.16	%	$	55,775	2.56	%	$	90,066	3.19	%	$ 375,7

(1) Reflects tax equivalent adjustment for Federal tax exempt income based on a 21% tax rate.

The securities portfolio is the second largest component of the Company’s interest earning assets, and the structure and composition of this portfolio is important to an analysis of the financial condition of the Company. The portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it provides liquidity to even out cash flows from the loan and deposit activities of customers; (iii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Company; and (iv) it is an alternative interest earning use of funds when loan demand is weak or when deposits grow more rapidly than loans.

The Company’s portfolio may include: (i) U.S. Treasury securities and U.S. Government sponsored entities’ debt securities for liquidity and pledging; (ii) mortgage backed securities, which in many instances can also be used for pledging, and which generally enhance the yield of the portfolio; (iii) municipal obligations, which provide tax free

64

income and limited pledging potential; (iv) single entity issue trust preferred securities, which generally enhance the yield on the portfolio; (v) corporate bonds, which also enhance the yield on the portfolio; (vi) money market mutual funds; (vii) certificates of deposit; (viii) commercial paper; (ix) bankers acceptances; (x) repurchase agreements; (xi) collateralized mortgage obligations; and (xii) asset-backed securities.

The Company classifies its securities as either available for sale or held to maturity at the time of purchase. Accounting guidance requires available for sale securities to be marked to fair value with an offset to accumulated other comprehensive income (loss), a component of shareholders' equity. Monthly adjustments are made to reflect changes in the fair value of the Company's available for sale securities.

The investment securities available for sale portfolio, at fair value, totaled $319.1 million at September 30, 2018, a decrease of (18%) from $390.1 million at September 30, 2017, and a decrease of (19%) from $391.9 million at December 31, 2017. At September 30, 2018, the Company's securities available-for-sale portfolio was comprised of $311.7 million agency mortgage-backed securities (all issued by U.S. Government sponsored entities) and $7.4 million U.S. Government sponsored entities debt securities. The pre-tax unrealized loss on securities available-for-sale at September 30, 2018 was ($12.7) million, compared to a pre-tax unrealized gain on securities available-for-sale of $1.0 million at September 30, 2017, and a pre-tax unrealized loss on securities available-for-sale of ($1.5) million at December 31, 2017. All other factors remaining the same, when market interest rates are rising, the Company will experience a lower unrealized gain (or a higher unrealized loss) on the securities portfolio. Investment securities available-for-sale acquired from United American totaled $63.7 million, at fair value, on May 4, 2018. Subsequent to closing, the Company sold $55.4 million of these securities, for a gain on sale of securities of $179,000 in the second quarter of 2018.

At September 30, 2018, investment securities held to maturity, at amortized cost, totaled $375.7 million, a decrease of (1%) from $379.5 million at September 30, 2017, and a decrease of (6%) from $398.3 million at December 31, 2017. At September 30, 2018, the Company's securities held-to-maturity portfolio was comprised of $288.6 million agency mortgage-backed securities, and $87.1 million tax-exempt municipal bonds.

The Company has not used interest rate swaps or other derivative instruments to hedge fixed rate loans or securities.

Loans

The Company's loans represent the largest portion of invested 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 59% of total assets at September 30, 2018, represented 55% at September 30, 2017, and represented 56% at December 31, 2017. The ratio of loans to deposits was 69.19% at September 30, 2018, compared to 63.13% at September 30, 2017, and 63.74% at

December 31, 2017.

Loan Distribution

The Loan Distribution table that follows sets forth the Company's gross loans, excluding loans held for sale, outstanding and the percentage distribution in each category at the dates indicated:

	September 30, 2018			September 30, 2017			December 31, 2017		
	Balance	% to Total		Balance	% to Total		Balance	% to Total	
	(Dollars in thousands)								
Commercial	$ 600,594	31	%	$ 587,276	38	%	$ 573,296	36	%
Real estate:									
CRE	988,491	52	%	754,856	48	%	772,867	49	%
Land and construction	131,548	7	%	92,310	6	%	100,882	6	%
Home equity	116,657	6	%	74,171	4	%	79,176	5	%
Residential mortgages	52,441	3	%	46,489	3	%	44,561	3	%
Consumer	9,932	1	%	11,749	1	%	12,395	1	%
Total Loans	1,899,663	100	%	1,566,851	100	%	1,583,177	100	%
Deferred loan fees, net	(276)	—		(901)	—		(510)	—	
Loans, net of deferred fees	1,899,387	100	%	1,565,950	100	%	1,582,667	100	%
Allowance for loan losses	(27,426)			(19,748)			(19,658)		
Loans, net	$ 1,871,961			$ 1,546,202			$ 1,563,009		

65

Table of Contents

The Company's loan portfolio is concentrated in commercial loans, (primarily manufacturing, wholesale, and services oriented entities), and commercial real estate, with the remaining balance in land development and construction, 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, 68% of its gross loans were secured by real property at September 30, 2018, compared to 60% at September 30, 2017 and 63% at December 31, 2017. While no specific industry concentration is considered significant, the Company's bank lending operations are substantially 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 guaranteed loans (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 the third quarter and nine months ended September 30, 2018, loans were sold resulting in a gain on sales of SBA loans of $236,000, and $551,000, respectively.

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 35 days for the first nine months of 2018, compared to 36 days for the first nine months of 2017. The average life of the factored receivables was 36 days for the year ended December 31, 2017. The balance of the purchased receivables was $71.0 million at September 30, 2018, compared to $48.8 million at both September 30, 2017 and at December 31, 2017.

The commercial loan portfolio increased $13.3 million to $600.6 million at September 30, 2018, from $587.3 million at September 30, 2017, which included $21.7 million of loans added from United American, and $10.2 million of loans added from Tri-Valley, partially offset by a decrease of $18.6 million, or (3%), the Company's legacy portfolio. The commercial loan portfolio increased $27.3 million from $573.3 million at December 31, 2017, which included $21.7 million of loans added from United American, $10.2 million of loans added from Tri-Valley, partially offset by a decrease of $4.6 million, or (1%), in the Company's legacy portfolio. C&I usage was 36% at September 30, 2018, compared to 37% at September 30, 2017 and December 31, 2017.

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 CRE loans are generally between five and ten years (with amortization ranging from fifteen to twenty five years and a balloon payment due at maturity), however, SBA and certain other real estate loans that can be sold in the secondary market may be granted for longer maturities.

The CRE loan portfolio increased $233.6 million, or 31%, to $988.5 million at September 30, 2018, compared to $754.9 million at September 30, 2017, which included $135.9 million of loans added from United American, $93.7 million of loans added from Tri-Valley, and an increase of $7.3 million, or 1%, in the Company's legacy portfolio, partially offset by a decrease of $3.3 million in purchased CRE loans. The CRE loan portfolio increased $215.6, or 28%, from $772.9 million at December 31, 2017, which included $135.9 million of loans added from United American, $93.7 million of loans added from Tri-Valley, partially offset by a decrease of $11.0 million, or (1%) in the Company's legacy portfolio, and $3.1 million in purchased CRE loans.

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 only in our market area, and the Company has extensive controls for the disbursement process. Land and construction loans increased $39.2 million, or 43%, to $131.5 million at September 30, 2018, compared to $92.3 million at September 30, 2017, and increased $30.7 million, or 30%, from $100.9 million at December 31, 2017, primarily due to organic growth of $26.6 million and $4.1 million of loans added from United American.

The Company makes home equity lines of credit available to its existing customers. Home equity lines of credit are underwritten initially with a maximum 75% loan to value ratio. Home equity lines of credit increased $42.5 million, or 57%, to $116.7 million at September 30, 2018, compared to $74.2 million at September 30, 2017, which included $32.9 million of loans added from United American, and $11.4 million of loans added from Tri-Valley, partially offset by a decrease of $1.8 million in the Company's legacy portfolio. Home equity lines of credit increased $37.5 million, or 47%, compared to $79.2 million at December 31, 2017, which included $32.9 million of loans added from United American, and $11.4 million of loans added from Tri-Valley, partially offset by a decrease of $6.8 million in the Company's legacy portfolio.

Residential mortgage loans increased $5.9 million, 13%, to $52.4 million at September 30, 2018, compared to $46.5 million at September 30, 2017, primarily due to $13.4 million of loans added from United American, partially offset by a $7.5 million decrease in purchased residential mortgage loans. Residential mortgage loans increased $7.8 million, from $44.6 million at December 31, 2017 primarily due to $13.4 million of loans added from United American, partially offset by a $5.6 million decrease in purchased residential mortgage loans.

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

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 $59.5 million and $99.2 million at September 30, 2018, respectively.

67

Table of Contents

Loan Maturities

The following table presents the maturity distribution of the Company's loans (excluding loans held for sale) as of September 30, 2018. 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 September 30, 2018, approximately 52% of the Company's loan portfolio consisted of floating interest rate loans.

	Due in One Year or Less	Over One Year But Less than Five Years	Over Five Years	Total
	(Dollars in thousands)			
Commercial	$ 478,040	100,660	21,894	$ 600,594
Real estate:				
CRE	115,730	443,557	429,204	988,491
Land and construction	128,571	1,705	1,272	131,548
Home equity	107,716	4,361	4,580	116,657
Residential mortgages	1,460	5,764	45,217	52,441
Consumer	9,729	199	4	9,932
Loans	$ 841,246	$ 556,246	$ 502,171	$ 1,899,663
Loans with variable interest rates	$ 749,126	169,428	77,556	$ 996,110
Loans with fixed interest rates	92,120	386,819	424,614	903,553
Loans	$ 841,246	$ 556,247	$ 502,170	$ 1,899,663

Loan Servicing

As of September 30, 2018 and 2017, $113.1 million and $141.9 million, respectively, in SBA loans were serviced by the Company for others. Activity for loan servicing rights was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Beginning of period balance	$ 1,065	$ 1,554	$ 1,373	$ 1,854
Additions	84	40	160	158
Amortization	(170)	(175)	(554)	(593)

End of period balance	$ 979	$ 1,419	$ 979	$ 1,419

Loan servicing rights are included in accrued interest receivable and other assets on the unaudited consolidated balance sheets and reported net of amortization. There was no valuation allowance as of September 30, 2018 and 2017, as the fair value of the assets was greater than the carrying value.

Activity for the I/O strip receivable was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Beginning of period balance	$ 919	$ 1,028	$ 968	$ 1,067
Unrealized holding loss	(56)	(39)	(105)	(78)
End of period balance	$ 863	$ 989	$ 863	$ 989

Credit Quality

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Company and generate the largest portion of its revenues, the Company’s management

68

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 $10.9 million and $6.9 million at September 30, 2018 and December 31, 2017, respectively, of which $617,000 and $1.4 million were on nonaccrual. At September 30, 2018, there were also $22.7 million loans less than 30 days past due included in nonaccrual loans held for investment. At December 31, 2017, there were also $840,000 loans less than 30 days past due included in nonaccrual loans held for investment.

Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt. The loans may or may not be collateralized, and collection efforts are pursued. 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 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:

	September 30, 2018	2017	December 31, 2017
	(Dollars in thousands)		
Nonaccrual loans — held-for-investment	$ 23,342	$ 2,560	$ 2,250
Restructured and loans 90 days past due and still accruing	1,373	931	235
Total nonperforming loans	24,715	3,491	2,485
Foreclosed assets	—	—	—
Total nonperforming assets	$ 24,715	$ 3,491	$ 2,485
Nonperforming assets as a percentage of loans plus foreclosed assets	1.30 %	0.22 %	0.16 %
Nonperforming assets as a percentage of total assets	0.77 %	0.12 %	0.09 %

Nonperforming assets were $24.7 million, or 0.77% of total assets, at September 30, 2018, compared to $3.5 million, or 0.12% of total assets, at September 30, 2017, and $2.5 million, or 0.09% of total assets, at December 31, 2017. The increase in nonperforming assets at September 30, 2018, compared to September 30, 2017 and December 31, 2017, was primarily due to a single large lending relationship that was place on nonaccrual during the second quarter of

Table of Contents

2018. At September 30, 2018, the recorded investment of this lending relationship was $21.8 million, and the Company had a $7.0 million specific loan loss reserve allocated for this lending relationship. Additionally, subsequent to the end of the third quarter of 2018, the recorded investment of this lending relationship was reduced to $17.4 million.

The following table presents nonperforming loans by class at the dates indicated:

	September 30, 2018			December 31, 2017		
	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total	Nonaccrual	Restructured and Loans over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)					
Commercial	$ 17,361	$ 1,148	$ 18,509	$ 1,250	$ 235	$ 1,485
Real estate:						
CRE	5,639	—	5,639	501	—	501
Land and construction	—	—	—	119	—	119
Home equity	342	225	567	379	—	379
Consumer	—	—	—	1	—	1
Total	$ 23,342	$ 1,373	$ 24,715	$ 2,250	$ 235	$ 2,485

Loans with a well defined weakness, which are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected, are categorized as “classified.” Classified loans include all loans considered as substandard, substandard nonaccrual, and doubtful and may result from problems specific to a borrower’s business or from economic downturns that affect the borrower’s ability to repay or that cause a decline in the value of the underlying collateral (particularly real estate). The principal balance of classified loans, was $30.5 million at September 30, 2018, $10.9 million at September 30, 2017, and $25.1 million at December 31, 2017. The increase in classified loans at September 30, 2018 was primarily due to loans associated with the lending relationship discussed above that was moved to classified loans, which totaled $21.8 million at September 30, 2018, compared to $12.5 million at December 31, 2017. Loans held for sale are carried at the lower of cost or estimated fair value, and are not allocated an allowance for loan losses.

The following table provides a summary of the loan portfolio by loan type and credit quality classification at the dates indicated:

September 30, 2018	September 30, 2017	December 31, 2017

	Nonclassified	Classified	Total	Nonclassified	Classified	Total	Nonclassified	Classified	Tot
	(Dollars in thousands)								
ial	$ 577,325	$ 23,269	$ 600,594	$ 578,867	$ 8,409	$ 587,276	$ 554,913	$ 18,383	$ 5
e:									
	982,852	5,639	988,491	754,152	704	754,856	766,988	5,879	7
on	131,548	—	131,548	91,217	1,093	92,310	100,763	119	1
uity	115,019	1,638	116,657	73,469	702	74,171	78,486	690	7
al									
s	52,441	—	52,441	46,489	—	46,489	44,561	—	4
r	9,932	—	9,932	11,748	1	11,749	12,394	1	1
	$ 1,869,117	$ 30,546	$ 1,899,663	$ 1,555,942	$ 10,909	$ 1,566,851	$ 1,558,105	$ 25,072	$ 1

Classified assets were $30.5 million, or 0.95% of total assets, at September 30, 2018, compared to $10.9 million, or 0.38% of total assets, at September 30, 2017 and $25.1 million, or 0.88% of total assests at December 31, 2017. The increase in classified assets at September 30, 2018 was primarily due to seasonal advances on lines of credit associated with a single large lending relationship that was moved to classified loans in the fourth quarter of 2017, which totaled $21.8 million at September 30, 2018, compared to $12.5 million at December 31, 2017. 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.

Table of Contents

The following provides a rollforward of troubled debt restructurings ("TDRs"):

	Nine Months Ended September 30, 2018		
	Performing TDRs	Nonperforming TDRs	Total
	(Dollars in thousands)		
Balance at January 1, 2018	$ 309	$ 16	$ 325
Additions	384	—	384
Principal repayments	(17)	(16)	(33)
Balance at September 30, 2018	$ 676	$ —	$ 676

	Nine Months Ended September 30, 2017		
	Performing TDRs	Nonperforming TDRs	Total
	(Dollars in thousands)		
Balance at January 1, 2017	$ 131	$ 2	$ 133
Additions	228	90	318
Principal repayments	(16)	(1)	(17)
Balance at September 30, 2017	$ 343	$ 91	$ 434

Allowance for Loan Losses

The allowance for loan losses is an estimate of probable incurred losses in the loan portfolio. Loans are charged off against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses. Management's methodology for estimating the allowance balance consists of several key elements, which include specific allowances on individual impaired loans and the formula driven allowances on pools of loans with similar risk characteristics. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

Specific allowances are established for impaired loans. Management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the loan agreement, including scheduled interest payments. Loans for which the terms have been modified with a concession granted, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. When a loan is considered to be impaired, the amount of impairment is measured based on the fair value of the collateral less costs to sell if the loan is collateral dependent, or on the present value of expected future cash flows or values that are observable in the secondary market. If the measure of the impaired loans is less than the investment in the loan, the deficiency will be charged off against the allowance for loan losses if the amount is a confirmed loss, or, alternatively, a specific allocation within the allowance will be established. Loans that are considered impaired are specifically excluded from the formula portion of the allowance for loan losses analysis.

The estimated loss factors for pools of loans that are not impaired are based on determining the probability of default and loss given default for loans within each segment of the portfolio, adjusted for significant factors that, in management's judgment, affect collectability as of the evaluation date. The Company's historical delinquency experience and loss experience are utilized to determine the probability of default and loss given default for segments of the portfolio where the Company has experienced losses in the past. For segments of the portfolio where the Company has no significant prior loss experience, the Company uses quantifiable observable industry data to determine the probability of default and loss given default.

The following provides a summary of the risks associated with various segments of the Company's loan portfolio, which are factors management regularly considers when evaluating the adequacy of the allowance:

· Commercial loans consist primarily of commercial and industrial loans (business lines of credit), and other commercial purpose loans. Repayment of commercial and industrial loans is generally provided from the cash flows of the related business to which the loan was made. Adverse changes in economic conditions may result in a decline in business activity, which may impact a borrower's ability to continue to make scheduled payments. The factored receivables at Bay View Funding are included in the Company's commercial loan portfolio; however, they are evaluated for risk primarily based on the agings of the receivables. Faster turning receivables imply less risk and therefore warrant a lower associated allowance.

Should the overall aging for the portfolio increase, this structure will by formula increase the allowance to reflect the increasing risk. Should the portfolio turn more quickly, it would reduce the associated allowance to reflect the reducing risk.

- Real estate loans consist primarily of loans secured by commercial and residential real estate. Also included in this segment are land and construction loans and home equity lines of credit secured by real estate. As the majority of this segment is comprised of commercial real estate loans, risks associated with this segment lay primarily within these loan types. Adverse economic conditions may result in a decline in business activity and increased vacancy rates for commercial properties. These factors, in conjunction with a decline in real estate prices, may expose the Company to the potential for losses if a borrower cannot continue to service the loan with operating revenues, and the value of the property has declined to a level such that it no longer fully covers the Company's recorded investment in the loan.

- Consumer loans consist primarily of a large number of small loans and lines of credit. The majority of installment loans are made for consumer and business purchases. Weakened economic conditions may result in an increased level of delinquencies within this segment, as economic pressures may impact the capacity of such borrowers to repay their obligations.

As a result of the matters mentioned above, changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the condition of the various markets in which collateral may be sold may all affect the required level of the allowance for loan losses and the associated provision for loan losses.

It is the policy of management to maintain the allowance for loan losses at a level adequate for risks inherent in the loan portfolio. On an ongoing basis, we have engaged an outside firm to perform independent credit reviews of our loan portfolio. The Federal Reserve Board and the California Department of Business Oversight—Division of Financial Institutions also review the allowance for loan losses as an integral part of the examination process. Based on information currently available, management believes that the allowance for loan losses is adequate. However, the loan portfolio can be adversely affected if California economic conditions and the real estate market in the Company's market area were to weaken. Also, any weakness of a prolonged nature in the technology industry would have a negative impact on the local market. The effect of such events, although uncertain at this time, could result in an increase in the level of nonperforming loans and increased loan losses, which could adversely affect the Company's future growth and profitability. No assurance of the ultimate level of credit losses can be given with any certainty.

The following tables summarize the Company's loan loss experience, as well as provisions and charges to the allowance for loan losses and certain pertinent ratios for the periods indicated:

	Three Months Ended September 30, 2018			
	Commercial	Real Estate	Consumer	Total

	(Dollars in thousands)			
Beginning of period balance	$ 17,522	$ 9,020	$ 122	$ 26,664
Charge-offs	(719)	—	(25)	(744)
Recoveries	1,897	34	—	1,931
Net (charge-offs) recoveries	1,178	34	(25)	1,187
Provision (credit) for loan losses	(1,427)	1,022	(20)	(425)
End of period balance	$ 17,273	$ 10,076	$ 77	$ 27,426
RATIOS:				
Annualized net charge-offs (recoveries) to average loans (1)	(0.24) %	(0.01) %	0.01 %	(0.24) %
Allowance for loan losses to total loans (1)	0.91 %	0.53 %	0.00 %	1.44 %
Allowance for loan losses to nonperforming loans	69.89 %	40.77 %	0.31 %	110.97 %

(1) Average loans and total loans exclude loans held for sale.

72

Table of Contents

	Three Months Ended September 30, 2017			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 11,259	$ 7,982	$ 156	$ 19,397
Charge-offs	(111)	—	—	(111)
Recoveries	281	66	—	347
Net recoveries	170	66	—	236
Provision (credit) for loan losses	(441)	592	(36)	115
End of period balance	$ 10,988	$ 8,640	$ 120	$ 19,748
RATIOS:				
Annualized net charge-offs (recoveries) to average loans (1)	(0.04) %	(0.02) %	0.00 %	(0.06) %
Allowance for loan losses to total loans (1)	0.70 %	0.55 %	0.01 %	1.26 %
Allowance for loan losses to nonperforming loans	314.75 %	247.49 %	3.44 %	565.68 %

	Nine Months Ended September 30, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 10,608	$ 8,950	$ 100	$ 19,658
Charge-offs	(1,835)	—	(25)	(1,860)
Recoveries	2,229	120	—	2,349
Net (charge-offs) recoveries	394	120	(25)	489
Provision for loan losses	6,271	1,006	2	7,279
End of period balance	$ 17,273	$ 10,076	$ 77	$ 27,426
RATIOS:				
Annualized net charge-offs (recoveries) to average loans (1)	(0.03) %	(0.01) %	0.00 %	(0.04) %
Allowance for loan losses to total loans (1)	0.91 %	0.53 %	0.00 %	1.44 %
Allowance for loan losses to nonperforming loans	69.89 %	40.77 %	0.31 %	110.97 %

	Nine Months Ended September 30, 2017			
	Commercial	Real Estate	Consumer	Total

	(Dollars in thousands)			
Beginning of period balance	$ 10,656	$ 8,327	$ 106	$ 19,089
Charge-offs	(2,179)	—	—	(2,179)
Recoveries	1,453	995	—	2,448
Net (charge-offs) recoveries	(726)	995	—	269
Provision (credit) for loan losses	1,058	(682)	14	390
End of period balance	$ 10,988	$ 8,640	$ 120	$ 19,748
RATIOS:				
Annualized net charge-offs (recoveries) to average loans (1)	0.07 %	(0.09) %	0.00 %	(0.02) %
Allowance for loan losses to total loans (1)	0.70 %	0.55 %	0.01 %	1.26 %
Allowance for loan losses to nonperforming loans	314.75 %	247.49 %	3.44 %	565.68 %

(1) Average loans and total loans exclude loans held for sale.

The following table provides a summary of the allocation of the allowance for loan losses by class at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for loan losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each category represents the total amount available for charge offs that may occur within these classes.

73

Table of Contents

Allocation of Allowance for Loan Losses

	September 30, 2018			2017			December 31, 2017		
	Allowance	Percent of Loans in each category to total loans		Allowance	Percent of Loans in each category to total loans		Allowance	Percent of Loans in each category to total loans	
	(Dollars in thousands)								
Commercial	$ 17,273	31	%	$ 10,988	38	%	$ 10,608	36	%
Real estate:									
CRE	6,053	52	%	5,598	48	%	5,909	49	%
Land and construction	1,987	7	%	1,381	6	%	1,441	6	%
Home equity	1,826	6	%	1,435	4	%	1,390	5	%
Residential mortgages	210	3	%	226	3	%	210	3	%
Consumer	77	1	%	120	1	%	100	1	%
Total	$ 27,426	100	%	$ 19,748	100	%	$ 19,658	100	%

The allowance for loan losses totaled $27.4 million, or 1.44% of total loans at September 30, 2018, compared to $19.7 million, or 1.26% of total loans at at September 30, 2017, and $19.7 million, or 1.24% of total loans at December 31, 2017. The Company had net recoveries of $1.2 million, or (0.24%) of average loans, for the third quarter of 2018, compared to net recoveries of ($236,000), or (0.06%) of average loans, for the third quarter of 2017, and net recoveries of ($201,000), or (0.05)% of average loans, for the fourth quarter of 2017.

The allowance for loan losses related to the commercial portfolio increased $6.7 million, at September 30, 2018 from December 31, 2017, primarily due to a provision for loan losses of $6.3 million resulting from the $7.0 million specific loan loss reserve allocated for the single large lending relationship discussed above, and net recoveries of $394,000. The allowance for loan losses related to the real estate portfolio increased $1.1 million at September 30, 2018 from December 31, 2017, primarily due to increasing market risk associated with risk factors for real estate loans, resulting in a $1.0 million provision for loan losses and net recoveries of $120,000.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. The fair values of assets acquired and liabilities assumed are subject to adjustment during the first twelve months after the acquisition date if additional information becomes available to indicate a more accurate or appropriate value for an asset or liability. Total goodwill was $83.7 million at September 30, 2018, which consisted of, $13.0 million related to the Bay View Funding acquisition, $32.6 million related to the Focus acquisition, $13.8 million related to the Tri-Valley acquisition, and $24.3 million related to the United American acquisition. Total goodwill was $45.6 million at December 31, 2017, which consisted of $13.0 million related to the Bay View Funding acquisition, and $32.6 million related to the Focus acquisition.

On April 6, 2018, the Company completed its acquisition of Tri-Valley for a transaction value of $32.3 million. At closing the Company issued 1,889,613 shares of the Company’s common stock with an aggregate market value of $30.7 million on the date of closing. The number of shares issued was based on a fixed exchange ratio of 0.0489 of a share of the Company’s common stock for each outstanding share of Tri-Valley common stock. In addition, at closing the Company paid cash to the holder of a stock warrant and holders of outstanding stock options and related fees and fractional shares totaling $1.6 million. The Company recorded goodwill of $13.8 million for the Tri-Valley acquisition.

On May 4, 2018, the Company completed its acquisition of United American for a transaction value of $56.4 million. At closing the Company issued 2,826,032 shares of the Company’s common stock with an aggregate market value of $47.3 million on the date of closing. The number of shares issued was based on a fixed exchange ratio of 2.1644 of a share of the Company’s common stock for each outstanding share of United American common stock and each common stock equivalent underlying the United American Series D Preferred Stock and Series E Preferred Stock. The shareholders of the United American Series A Preferred Stock and the Series B Preferred Stock received $1,000 cash for each share totaling $8.7 million and $435,000, respectively. In addition, the Company paid $2,000 in cash for fractional

Table of Contents

shares, for total cash consideration of $9.1 million. The Company recorded goodwill of $24.3 million for the United American acquisition.

The Company completed its annual goodwill impairment analysis as of November 30, 2017 with the assistance of an independent valuation firm. No events or circumstances since the November 30, 2017 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists.

Other intangible assets were $12.6 million at September 30, 2018, compared to $5.6 million at December 31, 2017. A customer relationship and brokered relationship, and intangible assets arising from the acquisition of Bay View Funding were $1.2 million at September 30, 2018 and $1.3 million at December 31, 2017, net of accumulated amortization. The below market lease and non-compete intangible assets were fully amortized at December 31, 2017. The core deposit intangible assets arising from the acquisition of Focus was $3.7 million at September 30, 2018 and $4.3 million at December 31, 2017, net of accumulated amortization. The core deposit intangible and below market lease intangible assets arising from the Tri-Valley acquisition were $1.8 million at September 30, 2018, net of accumulated amortization. The core deposit intangible and below market lease intangible assets arising from the United American acquisition were $5.9 million at September 30, 2018, net of accumulated amortization.

Deposits

The composition and cost of the Company's deposit base are important components in analyzing the Company's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections herein. 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:

	September 30, 2018		September 30, 2017		December 31, 2017	
	Balance	% to Total	Balance	% to Total	Balance	% to Total
	(Dollars in thousands)					
Demand, noninterest-bearing	$ 1,081,846	39 %	$ 943,723	38 %	$ 989,753	40 %
Demand, interest-bearing	670,624	24 %	605,301	24 %	601,929	24 %
Savings and money market	828,297	30 %	713,693	29 %	684,131	27 %
	68,194	3 %	53,479	2 %	51,710	2 %

Time deposits — under $250									
Time deposits — $250 and over	84,763	3	%	147,422	6	%	138,634	6	%
CDARS — interest-bearing demand, money market and time deposits	11,575	1	%	16,986	1	%	16,832	1	%
Total deposits	$ 2,745,299	100	%	$ 2,480,604	100	%	$ 2,482,989	100	%

The Company obtains deposits from a cross section of the communities it serves. The Company's business is not generally seasonal in nature. Public funds were less than 1% of deposits at September 30, 2018, and 3% at September 30, 2017, and December 31, 2017.

Total deposits increased $264.7 million, or 11%, to $2.75 billion at September 30, 2018, compared to $2.48 billion at September 30, 2017, which included $266.6 million, at fair value, in deposits from United American, $91.4 million, at fair value, in deposits from Tri-Valley, partially offset by decrease of $28.2 million, or (1%), in the Company's legacy deposits. Total deposits increased $262.3 million or 11% from $2.48 billion at December 31, 2017, which included $266.6 million in deposits from United American, $91.4 million in deposits from Tri-Valley, partially offset by the maturity of $65.1 million State of California certificates of deposits, and a decrease of $30.6 million, or (1%), in the Company's legacy deposits.

Deposits, excluding all time deposits and CDARS deposits, increased $318.1 million, or 14%, to $2.58 billion at September 30, 2018, compared to $2.26 billion at September 30, 2017, which included $231.9 million of deposits added from United American, $83.0 million of deposits added from Tri-Valley, and an increase of $3.1 million in the Company's legacy deposits. Deposits, excluding all time deposits and CDARS deposits, increased $305.0 million, or

Table of Contents

13%, compared to $2.28 billion at December 31, 2017, which included $231.9 million of deposits added from United American, $83.0 million of deposits added from Tri-Valley, partially offset by a decrease of $10.0 million in the Company's legacy deposits.

Time deposits of $250,000 and over decreased $62.7 million, or (43%), to $84.8 million at September 30, 2018, compared to $147.4 million at September 30, 2017, which included the maturity of $65.1 million State of California certificates of deposits, and a decrease of $17.6 million, or (21%), in the Company's legacy deposits, partially offset by $16.2 million of deposits added from United American, and $3.8 million of deposits added from Tri-Valley. Time deposits of $250,000 and over decreased $53.9 million, or (39%), compared to $138.6 million at December 31, 2017, which included the maturity of $65.1 million State of California certificates of deposits, and a decrease of $8.8 million, or (12%), in the Company's legacy deposits, partially offset by $16.2 million of deposits added from United American, and $3.8 million of deposits added from Tri-Valley.

At September 30, 2018, the Company had no certificates of deposits from the State of California. At September 30, 2017, the Company had $71.5 million, at fair value, of securities pledged for $65.1 million in certificates of deposits from the State of California. At December 31, 2017, the Company had $72.5 million, at fair value, of securities pledged for $65.1 million in certificates of deposits from the State of California.

At September 30, 2018, the $11.6 million CDARS deposits were comprised of $7.3 million of interest-bearing demand deposits, $1.4 million of money market accounts and $2.9 million of time deposits. At September 30, 2017, the $17.0 million CDARS deposits were comprised of $11.8 million of interest-bearing demand deposits, $1.8 million of money market accounts and $3.4 million of time deposits. At December 31, 2017, the $16.8 million CDARS deposits were comprised of $10.9 million of interest-bearing demand deposits, $1.7 million of money market accounts and $4.2 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 September 30, 2018:

	Balance	% of Total
	(Dollars in thousands)	
Three months or less	$ 35,717	41 %
Over three months through six months	11,413	13 %
Over six months through twelve months	32,457	37 %
Over twelve months	8,098	9 %
Total	$ 87,685	100 %

The Company focuses primarily on providing and servicing business deposit accounts that are frequently over $250,000 in average balance per account. As a result, certain types of business clients that the Company serves typically carry average deposits in excess of $250,000. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Company to help 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Return on average assets	1.54 %	1.20 %	0.98 %	1.12 %
Return on average tangible assets	1.59 %	1.22 %	1.01 %	1.14 %
Return on average equity	14.03 %	12.49 %	9.31 %	11.35 %
Return on average tangible equity	19.36 %	15.41 %	12.33 %	14.11 %
Average equity to average assets ratio	10.96 %	9.61 %	10.57 %	9.86 %

Table of Contents

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 $721.0 million at September 30, 2018, compared to $684.0 million at September 30, 2017, and $687.4 million at December 31, 2017. Unused commitments represented 38% outstanding gross loans at September 30, 2018, 44% at September 30, 2017, and 43% at December 31, 2017.

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:

	September 30, 2018		2017		December 31, 2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(Dollars in thousands)					
Unused lines of credit and commitments to make loans	$ 120,286	$ 584,141	$ 17,024	$ 652,105	$ 102,505	$ 570,190
Standby letters of credit	4,125	12,468	4,400	10,492	3,972	10,715
	$ 124,411	$ 596,609	$ 21,424	$ 662,597	$ 106,477	$ 580,905

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 cash inflows must be properly timed to coincide with anticipated outflows or sufficient liquidity resources must be available to meet varying demands. The Company manages liquidity to be able to meet unexpected sudden changes in levels of its assets or deposit liabilities without maintaining excessive amounts of balance sheet liquidity. Excess balance sheet liquidity can negatively impact the Company's interest margin. In order to meet short term liquidity needs the Company utilizes overnight Federal funds purchase arrangements and other borrowing arrangements with correspondent banks, solicits brokered deposits if cost effective deposits are not available from local sources, and maintains collateralized lines of credit with the FHLB and FRB. In addition, the Company can raise cash for temporary needs by selling securities under agreements to repurchase and selling securities available for sale.

One of the measures of liquidity is our loan to deposit ratio. Our loan to deposit ratio was 69.19% at September 30, 2018, compared to 63.13% at September 30, 2017, and 63.74% at December 31, 2017.

FHLB and FRB Borrowings and Available Lines of Credit

HBC has off balance sheet liquidity in the form of Federal funds purchase arrangements with correspondent banks, including the FHLB and FRB. HBC can borrow from the FHLB on a short term (typically overnight) or long term (over one year) basis. HBC had no overnight borrowings from the FHLB at September 30, 2018, September 30, 2017, and December 31, 2017. HBC had $233.0 million of loans pledged to the FHLB as collateral on an available line of credit of $183.2 million at September 30, 2018, none of which was outstanding.

HBC can also borrow from the FRB's discount window. HBC had $660.4 million of loans pledged to the FRB as collateral on an available line of credit of $392.7 million at September 30, 2018, none of which was outstanding.

At September 30, 2018, HBC had Federal funds purchase arrangements available of $55.0 million. There were no Federal funds purchased outstanding at September 30, 2018, September 30, 2017, and December 31, 2017.

Table of Contents

The Company has a $5.0 million line of credit with a correspondent bank, of which none was outstanding at September 30, 2018.

HBC may also utilize securities sold under repurchase agreements to manage our liquidity position. There were no securities sold under agreements to repurchase at September 30, 2018, September 30, 2017, and December 31, 2017.

Subordinated Debt

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. 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. The Subordinated Debt, net of unamortized costs totaled $39.3 million at September 30, 2018 and $39.2 million at December 31, 2017, and qualifies as Tier 2 capital for the Company under the guidelines established by the Federal Reserve Bank. The Company down streamed $20.0 million of the proceeds to HBC during the second quarter of 2017.

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.

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:

	September 30, 2018	September 30, 2017	December 31, 2017
	(Dollars in thousands)		
Capital components:			
Common equity Tier 1 capital	$ 266,654	$ 229,656	$ 229,258
Additional Tier 1 capital	—	—	—
Tier 1 Capital	266,654	229,656	229,258
Tier 2 Capital	67,498	59,575	59,496

Total risk-based capital	$ 334,152	$ 289,231	$ 288,754
Risk-weighted assets	$ 2,318,713	$ 1,986,488	$ 2,003,652
Average assets for capital purposes	$ 3,100,135	$ 2,783,219	$ 2,873,978
Capital ratios:			
Total risk-based capital	14.4 %	14.6 %	14.4 %
Tier 1 risk-based capital	11.5 %	11.6 %	11.4 %
Common equity Tier 1 risk-based capital	11.5 %	11.6 %	11.4 %
Leverage(1)	8.6 %	8.3 %	8.0 %

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

78

Table of Contents

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:

	September 30, 2018		September 30, 2017		December 31, 2017	
	(Dollars in thousands)					
Capital components:						
Common equity Tier 1 capital	$ 282,460		$ 244,831		$ 244,790	
Additional Tier 1 capital	—		—		—	
Tier 1 Capital	282,460		244,831		244,790	
Tier 2 Capital	28,176		20,438		20,312	
Total risk-based capital	$ 310,636		$ 265,269		$ 265,102	
Risk-weighted assets	$ 2,316,959		$ 1,985,132		$ 2,002,736	
Average assets for capital purposes	$ 3,098,391		$ 2,782,021		$ 2,873,102	
Capital ratios:						
Total risk-based capital	13.4	%	13.4	%	13.2	%
Tier 1 risk-based capital	12.2	%	12.3	%	12.2	%
Common equity Tier 1 risk-based capital	12.2	%	12.3	%	12.2	%
Leverage(1)	9.1	%	8.8	%	8.5	%

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

The following table presents the applicable well capitalized regulatory guidelines and the standards for minimum capital adequacy requirements under Basel III:

	Transitional Minimum Regulatory Requirement(1) Effective January 1, 2018		Fully Phased-in Minimum Regulatory Requirement(2) Effective January 1, 2019		Well-capitalized Financial Institution Regulatory Guidelines	
Capital ratios:						
Total risk-based capital	9.875	%	10.5	%	10.0	%
Tier 1 risk-based capital	7.875	%	8.5	%	8.0	%
Common equity Tier 1 risk-based capital	6.375	%	7.0	%	6.5	%
Leverage	4.000	%	4.0	%	5.0	%

(1) Includes 1.875% capital conservation buffer, except the leverage capital ratio.

(2) Includes 2.5% capital conservation buffer, except the leverage capital 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. The implementation of the capital conservation buffer was phased in beginning on January 1, 2016 at 0.625% and will be phased in over a four year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The capital conservation buffer increased to 1.875% beginning on January 1, 2018.

At September 30, 2018, 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

Table of Contents

(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 September 30, 2018, September 30, 2017, and December 31, 2017, the Company and HBC met all capital adequacy guidelines to which they were subject. There are no conditions or events since September 30, 2018, that management believes have changed the categorization of the Company or HBC as well capitalized.

At September 30, 2018, the Company had total shareholders' equity of $353.5 million, compared to $275.4 million at September 30, 2017, and $271.2 million at December 31, 2017. At September 30, 2018, total shareholders' equity included $300.2 million in common stock, $70.5 million in retained earnings, and ($17.2) million of accumulated other comprehensive loss.

The accumulated other comprehensive loss was ($17.2) million at September 30, 2018, compared to ($6.1) million at September 30, 2017, and ($9.3) million at December 31, 2017. The unrealized gain loss on securities available for sale, net of taxes, included in accumulated other comprehensive loss was an unrealized loss of ($9.0) million at September 30, 2018, compared to an unrealized gain of $614,000 at September 30, 2017, and an unrealized loss ($1.1) million at December 31, 2017. The components of accumulated other comprehensive loss, net of taxes, at September 30, 2018 include the following: an unrealized loss on available for sale securities of ($9.0) million; the remaining unamortized unrealized gain on securities available for sale transferred to held to maturity of $351,000; a split dollar insurance contracts liability of ($3.7) million; a supplemental executive retirement plan liability of ($5.4) million; and an unrealized gain on interest only strip from SBA loans of $613,000.

The book value per share was $8.17 at September 30, 2018, compared to $7.21 at September 30, 2017, and $7.10 at December 31, 2017. The tangible book value per share was $5.94 at September 30, 2018, compared to $5.86 at September 30, 2017, and $5.76 at December 31, 2017.

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 Managemnent's Asset/Liability Committee and the Director's Finance and Investment 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

Table of Contents

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 September 30, 2018. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

	Increase/(Decrease) in Estimated Net Interest Income		
	Amount	Percent	
	(Dollars in thousands)		
Change in Interest Rates (basis points)			
+400	$ 29,678	22.8	%
+300	$ 22,441	17.3	%
+200	$ 15,244	11.7	%
+100	$ 7,836	6.0	%
0	$ —	—	%
−100	$ (12,013)	(9.2)	%
−200	$ (25,463)	(19.6)	%

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.

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 clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

Table of Contents

ITEM 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET 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 2 above.

ITEM 4—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 September 30, 2018. 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 the Company's disclosure controls were effective at September 30, 2018, the period covered by this report on Form 10 Q.

During the three and nine months ended September 30, 2018, there were no changes in our internal controls over financial reporting that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II—OTHER INFORMATION

ITEM 1—LEGAL PROCEEDINGS

The Company is involved in certain legal actions arising from normal business activities. Management, based upon the advice of legal counsel, believes the ultimate resolution of all pending legal actions will not have a material effect on the financial statements of the Company.

ITEM 1A—RISK FACTORS

In addition to the other information set forth in this Report, you should carefully consider the other factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10 K for the year ended December 31, 2017, which could materially affect our business, financial condition and/or operating results. There were no material changes from risk factors previously disclosed in our 2017 Annual Report on Form 10 K. The risk factors identified are in addition to those contained in any other cautionary statements, written or oral, which may be or otherwise addressed in connection with a forward looking statement or contained in any of our subsequent filings with the Securities and Exchange Commission.

ITEM 2—UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3—DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4—MINE SAFETY DISCLOSURES

None

ITEM 5—OTHER INFORMATION

None

Table of Contents

ITEM 6—EXHIBITS

Exhibit	Description
3.1	Heritage Commerce Corp Restated Articles of Incorporation, (incorporated by reference to Exhibit 3.1 to 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 to Exhibit 3.2 to the Registrant's Registration Statement on Form S 1 filed July 23, 2010).
3.3	Heritage Commerce Corp Bylaws, as amended (incorporated by reference to the Registrant's Current Report on Form 8 K filed on June 28, 2013)
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

Table of Contents

SIGNATURES

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

	Heritage Commerce Corp (Registrant)
Date: November 6, 2018	/s/ WALTER T. KACZMAREK Waletr T. Kaczmarek Chief Executive Officer
Date: November 6, 2018	/s/ Lawrence D. McGovern Lawrence D. McGovern Chief Financial Officer