bank of commerce
Holdings

STRENGTH | SECURITY | LONGEVITY **2019 ANNUAL REPORT**

VISION

We will deliver strong and sustainable returns to our shareholders that maximize the long-term value of our company and earn our independence.

PURPOSE

To be a catalyst for successful growth in our people, our company, and our community.

CORE VALUES

INTEGRITY

OWNERSHIP

RESPECT

EXCELLENCE

TEAMWORK

bank of commerce HOLDINGS

TO THE SHAREHOLDERS OF BANK OF COMMERCE HOLDINGS,

We are surrounded by COVID-19 and news of this health crisis obscures most all else. The year 2019 and its successes have been discarded into the past by the intense focus on daily, if not hourly updates on the coronavirus. But this annual report is about that past year, a year of which we are quite proud.

For much of 2019, we focused on the consummation and integration of our acquisition of The Merchants National Bank of Sacramento. As we reported throughout the year, the transaction was a success by all metrics. We retained a high percentage of loan and deposit customers, realized all anticipated cost saves and the systems integration went smoothly without negative impact to customers. The acquisition, which allowed for expansion of our business footprint into downtown Sacramento, aligned perfectly with our strategic goal of emphasizing growth in the greater Sacramento region.

During the early months of last year, our subsidiary bank operated under three separate names. In May we announced that all three names would be replaced with one unified new name, **Merchants Bank of Commerce**. This name change was an unquestioned success and has been readily accepted by employees, customers and the marketplace.

Net income for 2019 totaled $15 million ($0.83 per share) which equated to a ROAA of 1.03% and a ROAE of 9.09%. While these results were a modest decline from our performance in 2018, they included acquisition related expenses of $2.2 million and costs related to our name change of $503 thousand. We believe that these one-time expenses are easily justified by the many benefits they will yield in future years.

Aided by our acquisition, average deposits during the year increased $146 million (13%), average loans increased $105 million (11%) and average earning assets increased $140 million (11%). Our net interest margin for 2019 improved four basis points to 3.94%, all capital ratios increased from levels a year previous, asset quality remained strong and high caliber additions were made to our sales teams. Investors saw improvement in our stock price, gains in our tangible book value per share and an increase in the cash dividend. It was a successful year.

Now, only a couple months later, everything has been upended by a pandemic that has induced significant declines in interest rates, pushed our economy into freefall and most of all, left the country with uncertainty. We will be tested and for some unknown period of time our financial performance will be negatively impacted. But, the core of our company is strong and we will prevail against these economic challenges. We remain committed to supporting our employees as they focus on meeting the needs of our customers and communities. Thank you for placing your trust in us.

RANDALL S. ESLICK
President & CEO

JAMES A. SUNDQUIST
Executive Vice President & CFO

LEADERSHIP

DIRECTORS

ORIN N. BENNETT
Founder and Senior Advisor
Bennett Engineering Services

GARY R. BURKS
General Manager
Blach Beverage LLC

RANDALL S. ESLICK
President & Chief Executive Officer
Bank of Commerce Holdings

JOSEPH Q. GIBSON
Insurance Agent
George Petersen Insurance

JON W. HALFHIDE
Vice Chairman of the Board
Retired President
Dignity Healthcare North State Service Area
and St. Elizabeth Community Hospital

DAVID J. INDERKUM
Owner, Coast Line Supply and Equipment,
for the wine and beverage industry

LINDA J. MILES
Retired Executive Vice President
Chief Operating Officer
Bank of Commerce Holdings

KARL L. SILBERSTEIN
Retired Senior Vice President
Financial Operations
Dignity Health

TERENCE J. STREET
Project Director
General Contracting Division
Clark Pacific

LYLE L. TULLIS
Chairman of the Board
President, Tullis, Inc.,
a general engineering
construction company

EXECUTIVE OFFICERS

RANDALL S. ESLICK
President &
Chief Executive Officer

JAMES A. SUNDQUIST
Executive Vice President
& Chief Financial Officer

ROBERT H. MUTTERA
Executive Vice President
& Chief Credit Officer

The bank's **SUCCESSFUL INTEGRATION OF THE MERCHANTS NATIONAL BANK OF SACRAMENTO** and our name change will lead to **GREATER EFFICIENCIES THROUGHOUT** the company.

— **Randall S. Eslick** | PRESIDENT & CEO,
BANK OF COMMERCE HOLDINGS

5-YEAR FINANCIAL SUMMARY

The selected consolidated financial data set forth below for the five years ended December 31, 2019, have been derived from the Company's audited Consolidated Financial Statements and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's audited Consolidated Financial Statements and notes thereto, included in our 2019 Form 10-K.

	2019	2018	2017	2016	2015
	Amounts in thousands (except ratios and per share data)				
STATEMENTS OF INCOME					
Interest income	$ 59,563	$ 52,701	$ 45,949	$ 41,009	$ 38,753
Net interest income	$ 53,535	$ 47,546	$ 41,362	$ 36,231	$ 33,770
Provision for loan and lease losses	$ —	$ —	$ 950	$ —	$ —
Noninterest income	$ 4,184	$ 4,019	$ 4,824	$ 3,486	$ 3,183
Noninterest expense	$ 37,255	$ 32,206	$ 30,964	$ 32,500	$ 24,905
Net income available to common shareholders	$ 14,961	$ 15,730	$ 7,344	$ 5,259	$ 8,295
BALANCE SHEETS					
Total assets	$ 1,479,616	$ 1,307,104	$ 1,269,421	$ 1,140,992	$ 1,015,441
Average total assets	$ 1,458,112	$ 1,288,841	$ 1,198,251	$ 1,079,750	$ 992,731
Total gross loans	$ 1,032,903	$ 946,251	$ 879,835	$ 804,211	$ 716,639
Allowance for loan and lease losses	$ 12,231	$ 12,292	$ 11,925	$ 11,544	$ 11,180
Total deposits	$ 1,267,171	$ 1,131,716	$ 1,102,732	$ 1,004,666	$ 803,735
Total shareholders' equity	$ 174,478	$ 138,321	$ 127,264	$ 94,106	$ 90,522
RATIOS[1]					
Return on average assets[2]	1.03 %	1.22 %	0.61 %	0.49 %	0.86 %
Return on average shareholders' equity[3]	9.09 %	12.08 %	6.34 %	5.68 %	8.10 %
Average equity to average assets	11.29 %	10.10 %	9.67 %	8.57 %	10.68 %
Common equity Tier 1 capital ratio[4]	13.19 %	12.79 %	12.26 %	9.43 %	10.06 %
Tier 1 capital ratio[4]	14.04 %	13.71 %	13.23 %	10.42 %	11.16 %
Total capital ratio[4]	15.97 %	15.82 %	15.44 %	12.68 %	13.52 %
Tier 1 leverage ratio[4]	11.30 %	11.21 %	10.86 %	9.13 %	10.03 %
Net interest margin[5]	3.94 %	3.90 %	3.68 %	3.60 %	3.64 %
Average earning assets to total average assets	93.29 %	94.67 %	93.85 %	93.34 %	93.43 %
Nonperforming assets to total assets[6]	0.38 %	0.32 %	0.46 %	1.06 %	1.53 %
Net charge-offs (recoveries) to average loans	0.01 %	(0.04)%	0.07 %	(0.05)%	(0.05)%
Allowance for loan and lease losses to gross loans	1.18 %	1.30 %	1.36 %	1.44 %	1.56 %
Nonperforming loans to allowance for loan and lease losses	45.92 %	33.73 %	48.63 %	98.64 %	126.09 %
Efficiency ratio[7]	64.5 %	62.5 %	67.0 %	81.8 %	67.4 %
SHARE DATA					
Average common shares outstanding — basic	17,956	16,248	15,207	13,367	13,331
Average common shares outstanding — diluted	18,024	16,332	15,310	13,425	13,365
Book value per common share	$ 9.62	$ 8.47	$ 7.82	$ 7.00	$ 6.76
Book value per common share — tangible[8]	$ 8.71	$ 8.36	$ 7.70	$ 6.83	$ 6.76
Basic earnings per share	$ 0.83	$ 0.97	$ 0.48	$ 0.39	$ 0.62
Diluted earnings per share	$ 0.83	$ 0.96	$ 0.48	$ 0.39	$ 0.62
Cash dividends per common share	$ 0.19	$ 0.15	$ 0.12	$ 0.12	$ 0.12

[1] With the exception of end of period ratios, all ratios are based on average daily balances during the indicated period.

[2] Return on average assets is net income (which included preferred stock costs in 2015) divided by average total assets.

[3] Return on average shareholders' equity is net income (which included preferred stock costs in 2015) divided by average shareholders' equity.

[4] See Item 7— Management's Discussion And Analysis Of Financial Condition And Results Of Operations and Note 17 Regulatory Capital in the Notes to Consolidated Financial Statements in our 2019 Form 10-K for a discussion of the regulatory capital guidelines.

[5] Net interest margin is net interest income expressed as a percentage of average interest-earning assets.

[6] Nonperforming assets include all nonperforming loans (nonaccrual loans, loans 90 days past due and still accruing interest and restructured loans that are nonperforming) and real estate acquired by foreclosure or transfer to OREO.

[7] The efficiency ratio is calculated by dividing noninterest expense by the sum of net interest income and noninterest income and presented based on results from continuing operations.

[8] Tangible book value per share is computed by dividing total shareholders' equity less goodwill and other intangible assets, net by shares outstanding. Management believes that tangible book value per share is meaningful because it is a measure that the Company and investors commonly use to assess capital adequacy.

FINANCIALS AT A GLANCE

IN THOUSANDS (EXCEPT RATIOS AND PER SHARE DATA)

AT DECEMBER 31

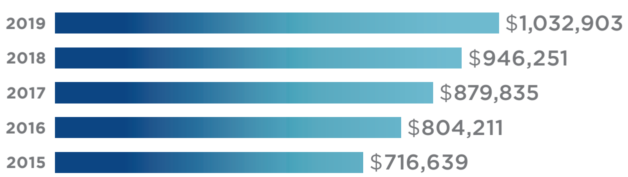
Total Deposits

FOR THE YEAR

Net Interest Margin

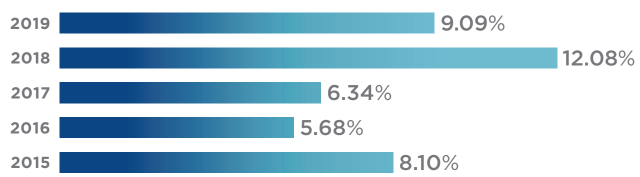
AT DECEMBER 31

Total Gross Loans



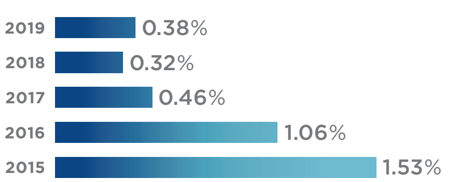
FOR THE YEAR

Return on Average Shareholders' Equity



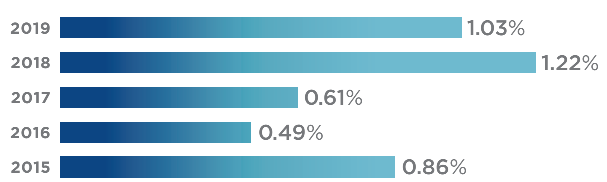
AT DECEMBER 31

Nonperforming Assets to Total Assets



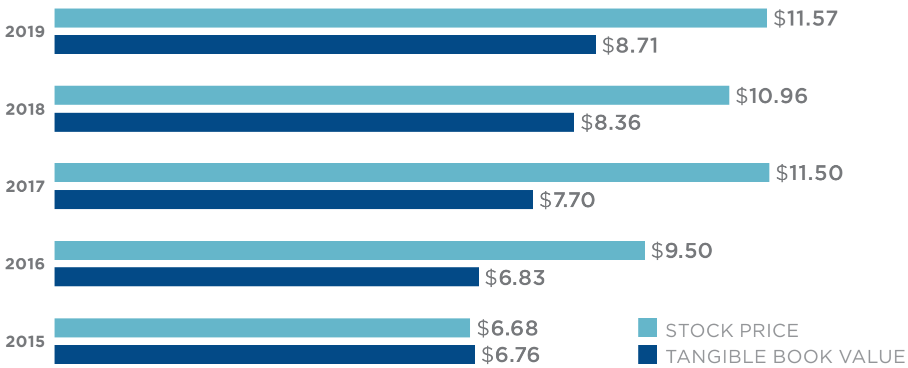
FOR THE YEAR

Return on Average Assets



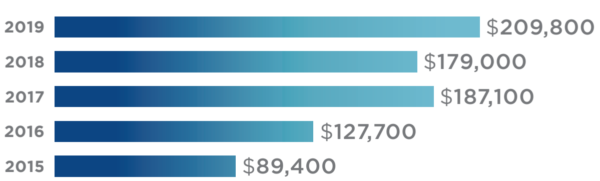
AT DECEMBER 31

Stock Price and Tangible Book Value Per Share



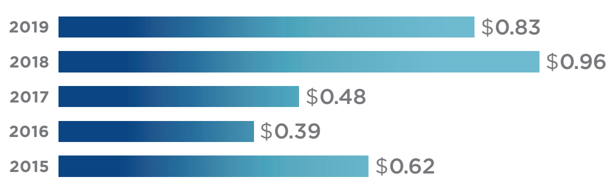
AT DECEMBER 31

Total Market Capitalization



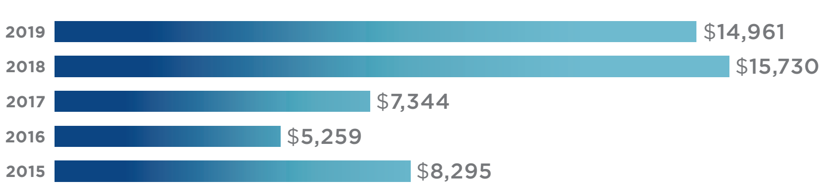
FOR THE YEAR

Diluted Earnings Per Share



FOR THE YEAR

Net Income



COMMUNITY REINVESTMENT

Taking action to improve the well being of others is a responsibility and commitment we have upheld since our Company's inception. In 2019, we contributed time, finances and emotional energy to a number of worthwhile organizations in the areas in which we live and do business. Our efforts are vital to the communities we serve to help ensure that housing is safe and affordable; essential services such as financial education, social services, and job skills development are available for those in need; and distressed neighborhoods are improved and revitalized. We are proud of the positive impact our efforts are making.

We are proud to serve the greater part of Northern California

COLUSA | CORNING | ORLAND | REDDING | ROSEVILLE | SACRAMENTO | WILLOWS | YREKA

Community Development Investment Portfolio $18,814,420

Donations, Sponsorships and Scholarships $347,048

Community Development Projects Financed $58,644,732

Volunteer Hours 3,576

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

Form 10-K

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

For the fiscal year ended December 31, 2019

Commission File Number 0-25135

Bank of Commerce Holdings

(Exact name of Registrant as specified in its charter)

California **(State or jurisdiction of incorporation or organization)**	**94-2823865** **(I.R.S. Employer Identification Number)**
555 Capitol Mall, Suite 1255 **Sacramento, California** **(Address of principal executive offices)**	**95814** **(Zip Code)**

Registrant's telephone number, including area code: (800) 421-2575

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	BOCH	NASDAQ

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

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

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

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

Large accelerated filer ☐	Accelerated filer ☒	Non-accelerated filer ☐	Smaller Reporting Company ☒	Emerging growth company ☐

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant’s most recently completed second fiscal quarter.

As of the last day of the second fiscal quarter of 2019, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $183,709,927 based on the closing sale price of $10.69 as reported on the NASDAQ Global Market as of June 30, 2019.

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the last practicable date.

The number of shares of the registrant’s no par value Common Stock outstanding as of February 25, 2020 was 17,756,658.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement of the registrant for its 2020 Annual Meeting of Shareholders, which will be subsequently filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates, are incorporated by reference into Part III of this Annual Report on Form 10-K.

Bank of Commerce Holdings Form 10-K

Part I

Special Note Regarding Forward-Looking Statements

This report includes forward-looking statements within the meaning of the Securities Exchange Act of 1934 (“Exchange Act”) and the Private Securities Litigation Reform Act of 1995. These statements are based on management’s current beliefs and assumptions, and on information available to management as of the date of this document. Forward-looking statements include the information concerning possible or assumed future results of operations of the Company set forth under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Forward-looking statements may also include statements in which words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates,” “considers” or similar expressions or conditional verbs such as “will,” “should,” “would” and “could” and other comparable words or phrases of a future- or forward-looking nature, are intended to identify such forward-looking statements. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions. The Company’s actual future results and shareholder values may differ materially from those anticipated and expressed in these forward-looking statements. Many of the factors that will determine these results and values are beyond the Company’s ability to control or predict. Except as specifically noted herein all references to the “Company” refer to Bank of Commerce Holdings, a California corporation, and its consolidated subsidiaries.

The following factors, among others, could cause our actual results to differ materially from those expressed in such forward-looking statements:

- The strength of the United States economy in general and the strength of the local economies in California in which we conduct operations;
- Our failure to realize all of the anticipated benefits of our acquisition of Merchants Holding Company;
- Our inability to successfully manage our growth or implement our growth strategy;
- The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, or the Federal Reserve Board;
- Volatility in the capital or credit markets;
- Changes in the financial performance and/or condition of our borrowers;
- Our concentration in real estate lending;
- Developments and changes in laws and increased regulation of the banking industry through legislative action and revised rules and standards applied by the Federal Reserve Board, the Federal Deposit Insurance Corporation and the California Department of Business Oversight;
- Changes in the cost and scope of insurance from the Federal Deposit Insurance Corporation and other third parties;
- Changes in consumer spending, borrowing and savings habits;
- Deterioration in the reputation of banks and the financial services industry could adversely affect the Company's ability to obtain and retain customers;
- Changes in the level of our nonperforming assets and loan charge-offs;
- Deterioration in values of real estate in California and the United States generally, both residential and commercial;
- Possible other-than-temporary impairment of securities held by us;
- The timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- The willingness of customers to substitute competitors’ products and services for our products and services;
- Technological changes could expose us to new risks, including potential systems failures or fraud;
- The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission (“SEC”), the Public Company Accounting Oversight Board, the Financial Accounting Standards Board (“FASB”) or other accounting standards setters;
- The risks presented by public stock market volatility, which could adversely affect the market price of the Company's common stock and the ability to raise additional capital;
- Inability to attract deposits and other sources of liquidity at acceptable costs;
- Changes in the competitive environment among financial and bank holding companies and other financial service providers;
- Consolidation in the financial services industry in the Company's markets resulting in the creation of larger financial institutions that may have greater resources could change the competitive landscape and the influx of fintech companies competing for business;
- The loss of critical personnel and the challenge of hiring qualified personnel at reasonable compensation levels;
- Natural disasters, such as earthquakes, volcanic eruptions, tsunami, wildfires, droughts, floods, mudslides, hurricanes, tornados and other geologic processes;
- A natural disaster outside California, could negatively impact our purchased loan portfolio or our third party loan servicers;
- The economic effects of the coronavirus disease 2019 or similar pandemic diseases could adversely affect our future results of operations or the market price of our stock;
- Unauthorized computer access, computer hacking, cyber-attacks, electronic fraudulent activity, attempted theft of financial assets, computer viruses, phishing schemes and other security problems;
- Geopolitical conditions, including acts or threats of war or terrorism, actions taken by the United States or other governments in response to acts or threats of war or terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;
- Our inability to manage the risks involved in the foregoing; and
- The effects of any reputational damage to the Company resulting from any of the foregoing.

Additional factors that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed in the sections entitled “RISK FACTORS,” BUSINESS” and in “MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS” in this Form 10-K.

If our assumptions regarding one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this document and in the information incorporated by reference in this document. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We do not undertake any obligation to publicly correct, revise, or update any forward-looking statement if we later become aware that actual results are likely to differ materially from those expressed in such forward-looking statement, except as required under federal securities laws.

Item 1 - Business

Bank of Commerce Holdings ("Company," "Holding Company," "we," or "us") is a corporation organized under the laws of California and a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended ("BHC Act") with its principal offices in Sacramento, California. The Holding Company's principal business is to serve as a holding company for Merchants Bank of Commerce (the "Bank" and together with the Holding Company, the "Company") and Bank of Commerce Mortgage (inactive). The Bank, which previously operated under three separate names, changed its name for all operations to Merchants Bank of Commerce effective May 20, 2019. We have an unconsolidated subsidiary in Bank of Commerce Holdings Trust II, which was organized in connection with our prior issuance of trust-preferred securities. Our common stock is traded on the NASDAQ Global Market under the symbol "BOCH."

We commenced banking operations in 1982 and grew organically to four branches before purchasing five Bank of America branches in 2016. With our recent acquisition of Merchants Holding Company, we now operate ten full service facilities and one limited service facility in northern California. We also operate a "cyber office" as identified in our summary of deposits reporting filed with the FDIC. We provide a wide range of financial services and products for business and retail customers which are competitive with those traditionally offered by banks of similar size in California. As of December 31, 2019, we operated under one primary business segment: Community Banking. Additional information regarding operating segments can be found in Note 2 *Summary of Significant Accounting Policies* in the *Notes to Consolidated Financial Statements* in this document.

We continuously seek expansion opportunities through internal growth, strategic alliances, acquisitions, establishing new offices or the delivery of new products and services. Periodically, we reevaluate the short and long-term profitability of all of our lines of business, and do not hesitate to reduce or eliminate unprofitable locations or lines of business. We remain a viable, independent bank committed to enhancing shareholder value. This commitment has been fostered by proactive management and dedication to staff, customers and the markets we serve.

On January 31, 2019, we completed the acquisition of Merchants Holding Company ("Merchants"), to extend our presence in the Sacramento marketplace. Merchants, headquartered in Sacramento, California, was the parent company of The Merchants National Bank of Sacramento ("Merchants Bank"), a 97-year-old bank with approximately $211.7 million in assets as of January 31, 2019. See Note 21 *Acquisition* in the *Notes to Consolidated Financial Statements* for more information on this acquisition.

Our governance structure enables us to manage all major aspects of our business effectively through an integrated process that includes financial, strategic, risk and leadership planning. Our management processes, structures and policies and procedures help to ensure compliance with laws and regulations and provide clear lines of authority for decision-making and accountability. Results are important, but we are equally concerned with how we achieve those results. Our core values and our commitment to high ethical standards are material to sustaining public trust and confidence in our Company.

Our primary business strategy is to provide comprehensive banking and related services to businesses, not-for-profit organizations, professional service providers and consumers in northern California. We continue to emphasize the diversity of our product lines and high levels of personal service. Through our technology, we offer convenient access typically associated with larger financial institutions, while maintaining the local decision-making authority and market knowledge, typical of a local community bank. Management intends to continue to pursue our business strategy through the following initiatives:

Utilize the Strength of Our Management Team. We believe the experience, depth and knowledge of our management team represent one of our greatest strengths and competitive advantages.

Leverage Our Existing Foundation for Additional Growth. Based on certain infrastructure investments, we believe that we will be able to take advantage of certain economies of scale typically enjoyed by larger organizations to expand our operations both organically and through strategic cost-effective avenues. We believe that the investments we have made in data processing, our staff, our risk and compliance function, and our branch network will support a much larger asset base. We are committed, however, to control any additional growth within acceptable risk limits and to maintain appropriate capital ratios.

Maintain Local Decision-Making and Accountability. We believe we have a competitive advantage over larger national and regional financial institutions by providing superior customer service with experienced, knowledgeable management, localized decision-making capabilities and prompt credit decisions. We believe that our customers want to deal directly with the people who make the ultimate credit decisions and have provided our Bank officers and relationship managers with authority commensurate with their experience and responsibilities, which we believe strikes the right balance between local decision-making and sound banking practice.

Focus on Asset Quality and Strong Underwriting. We consider asset quality to be of primary importance and have taken measures to ensure that credit risks are managed effectively to safeguard shareholder value. As part of our efforts, we utilize a third party loan review service to evaluate our loan portfolio on a quarterly basis and recommend action on certain loans if deemed appropriate.

Build a Stable Core Deposit Base. We continue to focus on increasing a stable core deposit base of business and retail customers. Our Branch Acquisition in 2016 allowed us to reduce our historic reliance on Federal Home Loan Bank of San Francisco borrowings and our former reliance on nonlocal time deposits. Our recently completed acquisition of Merchants Bank further enhanced our core deposit base by adding $152.2 million in demand and savings accounts. We intend to continue our practice of developing full deposit relationships with each of our loan customers, their business partners, and key employees.

Principal Market

We operate under the name Merchants Bank of Commerce in northern California from Sacramento to Yreka along the Interstate 5 corridor.

Principal Products and Services

Most of our current customers are small to medium-sized businesses and retail consumers. No single person or group of persons provides a material portion of the Bank's deposits or loans, the loss of any one or more of which would have a materially adverse effect on the business of the Bank.

We provide a wide range of financial services and products for businesses and consumers. The services we offer include those traditionally offered by banks of similar size and character in California. Our principal deposit products include the following types of accounts; checking, interest-bearing checking, money market, savings and certificates of deposit. We also offer sweep arrangements, commercial loans, construction loans, term loans, consumer loans, safe deposit boxes, and electronic banking services. We currently do not offer trust services or international banking services.

The majority of the loans we originate are direct loans made to small businesses and individuals in our principal market. We accept as collateral for loans, real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery and equipment and other general business assets such as accounts receivable and inventory. In addition to direct lending, our loan portfolio includes loans that were purchased as pools of loans, or participations where a portion of a loan was originated by another lending institution.

Regulatory Capital

Our regulators measure our capital adequacy and compliance with minimum leverage ratio guidelines. As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's risk category. See Item 7 - *Management's Discussion And Analysis Of Financial Condition And Results Of Operations* and Note 17 *Regulatory Capital* in the *Notes to Consolidated Financial Statements* in this document for a discussion of the regulatory capital guidelines.

Competition

We engage in the highly competitive financial services industry. Generally, our market and our lines of activity involve competition with other banks, thrifts, credit unions and other non-bank financial institutions, such as investment banking firms, investment advisory firms, brokerage firms, investment companies and insurance entities which offer financial services, located both domestically and through alternative delivery channels such as the Internet. Many of these competitors enjoy fewer regulatory constraints and some may have lower cost structures. Our ability to compete is focused on various factors such as customer service, interest rates on loans and deposits, lending limits, customer convenience and technological advances.

Securities firms, insurance companies and brokerage houses that elect to become financial holding companies may acquire banks and other financial institutions. Combinations of this type will significantly change the competitive environment in which we conduct business.

In order to compete with major banks and other competitors in our primary service areas, we rely upon;

- The experience of our executive and senior officers;
- Our specialized services and local promotional activities;
- The personal contacts made by our officers, directors and employees;
- Third party referral sources.

Employees

As of December 31, 2019, we employed 214 full-time equivalent employees. None of the employees are subject to a collective bargaining agreement and management believes its relations with employees to be good. Information regarding employment agreements with our executive officers is contained in Item 11 – *Executive Compensation* below, which is incorporated by reference to our proxy statement for the 2020 annual meeting of shareholders.

Government Supervision and Regulation

Supervision and Regulation

The Holding Company and the Bank are subject to extensive regulation under federal and state law. In general, this regulatory framework is designed to protect depositors, the federal deposit insurance fund (the "DIF") and the federal and state banking system as a whole; it does not exist for the protection of shareholders. As the breadth and scope of regulatory requirements increase, our costs to identify, monitor and comply with these requirements increase, as well.

This section provides a general overview of the federal and state regulatory framework applicable to the Holding Company and the Bank. It is not intended to summarize all applicable laws and regulations. To the extent this section describes statutory and regulatory provisions, it is qualified by reference to those provisions. These statutes and regulations, as well as related policies, continue to be subject to change (or interpretation) by Congress, state legislatures and federal and state regulators. Numerous changes to the statutes, regulations and regulatory policies applicable to us (including their interpretation or implementation) have been proposed but cannot be predicted and could have a material effect on our business or operations.

The Holding Company is subject to regulation and supervision by the Federal Reserve (as a bank holding company) and regulation by the State of California (as a California corporation). The Holding Company is also subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both of which are administered by the SEC. As a listed company on the NASDAQ Global Market, the Holding Company is subject to the rules of the NASDAQ for listed companies. The Bank is subject to regulation and examination by the Federal Deposit Insurance Corporation ("FDIC") and by the California Department of Business Oversight ("CDBO").

Bank Holding Company Regulation

General

As a bank holding company, the Holding Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and to inspection, examination and supervision by its primary regulator, the Board of Governors of the Federal Reserve System ("Federal Reserve" or "FRB"). In general, the BHC Act limits the business of bank holding companies to owning or controlling banks and engaging in other activities closely related to the business of banking. In addition, the Holding Company must file reports with the Federal Reserve and provide the agency with such additional information as it may require.

Holding Company Bank Ownership

The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

Holding Company Control of Nonbanks

With some exceptions, the BHC Act also prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities that, by federal statute, agency regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks.

Transactions with Affiliates

Subsidiary banks of a bank holding company are subject to restrictions imposed by the Federal Reserve Act on extensions of credit to the holding company or its subsidiaries, on investments in their securities and on the use of their securities as collateral for loans to any borrower. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") further expanded the definition of an "affiliate" and treats credit exposure arising from derivative transactions, securities lending, and borrowing transactions as a covered transaction under the regulations. It also expands the scope of covered transactions required to be collateralized, requires collateral to be maintained at all times for covered transactions required to be collateralized, and places limits on acceptable collateral. These regulations and restrictions may limit the Holding Company's ability to obtain funds from the Bank for its cash needs, including funds for payment of dividends, interest and operational expenses.

Tying Arrangements

We are also prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, neither the Holding Company nor its subsidiaries may condition an extension of credit to a customer on either (i) a requirement that the customer obtain additional services provided by us; or (ii) an agreement by the customer to refrain from obtaining other services from a competitor.

Support of Subsidiary Banks

Under Federal Reserve policy and the Dodd-Frank Act, the Holding Company is required to act as a source of financial and managerial strength to the Bank. This means that the Holding Company is required to commit, as necessary, capital and resources to support the Bank, including at times when the Holding Company may not be in a financial position to provide such resources, or when it may not be in the Holding Company's or its shareholders' best interests to do so. Any capital loans a bank holding company makes to its subsidiary banks are subordinate to deposits and to certain other indebtedness of those subsidiary banks.

State Law Restrictions

As a California corporation, the Holding Company is subject to certain limitations and restrictions under applicable California corporate law. For example, state law restrictions in California include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records and minutes and observance of certain corporate formalities.

Federal and State Regulation of the Bank

General

Deposits in the Bank, a California chartered commercial bank, are insured by the FDIC. As a result, the Bank is subject to primary supervision, periodic examination and regulation by the CDBO and the FDIC. These agencies have the authority to prohibit banks from engaging in what they believe constitute unsafe or unsound banking practices. The federal laws that apply to the Bank regulate, among other things, the scope of its business, its investments, its reserves against deposits, the timing of the availability of deposited funds, and the nature, amount of, and collateral for loans. Federal laws also regulate community reinvestment and insider credit transactions and impose safety and soundness standards. In addition to these federal laws, the Bank is also subject to the laws of the State of California.

Consumer Protection

Although the Bank is not supervised directly by the Consumer Financial Protection Bureau ("CFPB"), our consumer banking activities are subject to regulation by the CFPB. The Bank is subject to a variety of federal and state consumer protection laws and regulations that govern its relationships and interactions with consumers including laws and regulations that impose certain disclosure requirements and regulate the manner in which we take deposits, make and collect loans, and provide other services. In recent years, examination and enforcement by state and federal banking agencies for non-compliance with consumer protection laws and their implementing regulations have increased and become more intense. Failure to comply with these laws and regulations may subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil monetary penalties, criminal penalties, punitive damages, and the loss of certain contractual rights. The Bank has established a compliance system to ensure consumer protection.

Community Reinvestment

The Community Reinvestment Act of 1977 (the "CRA") requires that, in connection with examinations of financial institutions within their jurisdictions, federal bank regulators evaluate the record of financial institutions in meeting the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A bank's community reinvestment record is also considered by the applicable banking agencies in evaluating mergers, acquisitions and applications to open a branch or facility. In some cases, a bank's failure to comply with the CRA or CRA protests filed by interested parties during applicable comment periods, can result in the denial or delay of such transactions. The Bank received a "satisfactory" rating in its most recent CRA examination.

Insider Credit Transactions

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interests of such persons. These extensions of credit (i) must be made on substantially the same terms (including interest rates and collateral) and follow credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with persons not related to the lending bank; and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to insiders. A violation of these restrictions may result in the assessment of substantial civil monetary penalties, regulatory enforcement actions, and other regulatory sanctions. The Dodd-Frank Act and federal regulations place additional restrictions on loans to insiders and generally prohibit loans to senior officers other than for certain specified purposes.

Regulation of Management

Federal law (i) sets forth circumstances under which officers or directors of a bank may be removed by the institution's federal supervisory agency; (ii) as discussed above, places restraints on lending by a bank to its executive officers, directors, principal shareholders, and their related interests; and (iii) generally prohibits management personnel of a bank from serving as directors or in other management positions of another financial institution whose assets exceed a specified amount or which has an office within a specified geographic area.

Safety and Soundness Standards

Certain non-capital safety and soundness standards are also imposed upon banks. These standards cover, among other things, internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, such other operational and managerial standards as the agency determines to be appropriate, and standards for asset quality, earnings and stock valuation. In addition, each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program must be designed to ensure the security and confidentiality of customer information, protect against unauthorized access to or use of such information and ensure the proper disposal of customer and consumer information. An institution that fails to meet these standards may be required to submit a compliance plan, or be subject to regulatory sanctions, including restrictions on growth. The Bank has established policies and risk management procedures to ensure the safety and soundness of the Bank.

State Law Restrictions

California state-chartered banks are subject to various requirements relating to operations and administration (including the maintenance of branch offices and automated teller machines), capital and reserve requirements, declaration of dividends, deposit taking, shareholder rights and duties, borrowing limits, and investment and lending activities.

Under California law, the amount a bank generally may borrow may not exceed its shareholders' equity without the consent of the CDBO, except for borrowings from the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank. The Bank is required to invest its funds as limited by California law and in investments that are legal investments for banks, subject to any other limitations under general law. The Commissioner of the CDBO may take possession of the Bank if certain conditions exist, such as insufficient shareholders' equity, unsafe or unauthorized operations, or violations of law.

Interstate Banking and Branching

The Dodd-Frank Act eliminated interstate branching restrictions that were implemented as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Interstate Act"), and removed many restrictions on de novo interstate branching by state and federally chartered banks. Federal regulators now have authority to approve applications by such banks to establish de novo branches in states other than the bank's home state if the host state's banks could establish a branch at the same location. The Interstate Act requires regulators to consult with community organizations before permitting an interstate institution to close a branch in a low-income area. Federal banking agency regulations prohibit banks from using their interstate branches primarily for deposit production, and the federal banking agencies have implemented a loan-to-deposit ratio screen to ensure compliance with this prohibition.

Cash Dividends

Our ability to pay cash dividends is dependent on having sufficient cash and satisfying various regulatory and contractual requirements and restrictions. Our principal source of cash is dividends received from the Bank. Regulatory authorities may prohibit banks and bank holding companies from paying dividends in a manner that would constitute an unsafe or unsound banking practice or would reduce capital below an amount necessary to meet minimum applicable regulatory capital requirements. Basel III (discussed below) introduces additional restrictions on dividends.

Our ability to pay dividends from the Bank to the Holding Company is also subject to certain requirements under California law. Banks chartered under California law generally may only pay a cash dividend to the extent such payment does not exceed the lesser of (i) retained earnings of the bank or (ii) the bank's net income for its last three fiscal years less any distributions to shareholders during such period. As a result, future dividends from the Bank to the Holding Company will generally depend on the level of earnings at the Bank.

The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies which expresses the view that although no specific regulations restrict dividend payments by bank holding companies other than state corporate laws, a bank holding company should not pay cash dividends unless the company's net income for the past year is sufficient to cover both the cash dividends and a prospective rate of earnings retention that is consistent with the bank holding company's capital needs, asset quality and overall financial condition.

On December 10, 2015, we issued and sold $10.0 million in aggregate principal amount of fixed to floating rate Subordinated Notes pursuant to a private placement with certain institutional investors. The Subordinated Notes limit the payment of cash dividends to our common shareholders if the Company is not well capitalized, or if there is an event of default as described by the agreement.

Capital Adequacy and Prompt Corrective Action

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal regulatory agencies, which involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting, and other factors. The capital requirements are intended to ensure that institutions have adequate capital given the risk levels of assets and off-balance sheet financial instruments and are applied separately to the Holding Company and the Bank.

Federal regulations require insured depository institutions and bank holding companies to meet several minimum capital standards, including: (i) a common equity Tier 1 capital to risk-based assets ratio of 4.5%; (ii) a Tier 1 capital to risk-based assets ratio of 6%; (iii) a total capital to risk-based assets ratio of 8%; and (iv) a 4% Tier 1 capital to total assets leverage ratio. These minimum capital requirements became effective in January 2015 and were the result of final rules implementing certain regulatory amendments based on the recommendation of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Act (the "Final

Rules"). The Final Rules also require a new capital conservation buffer designed to absorb losses during periods of economic stress, change the risk-weights of certain assets for purposes of the risk-based capital ratios and phase out certain instruments as qualifying capital.

The Final Rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on an insured depository institution if its capital levels begin to show signs of weakness. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions will be required to meet the following increased capital level requirements to qualify as "well capitalized": (i) a Tier 1 common equity capital ratio of at least 6.5%; (ii) a Tier 1 capital ratio of at least 8%; (iii) a total capital ratio of at least 10%; (iv) a Tier 1 leverage ratio of at least 5%; and (v) not be subject to any order or written directive requiring a specific capital level. The FDIC's rules (as amended by the Final Rules) contain other capital classification categories, such as "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized," each of which are based on certain capital ratios. An institution may be downgraded to a category lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition, or if the institution receives an unsatisfactory examination rating. As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as "well capitalized".

The application of the Final Rules may result in lower returns on invested capital, require the raising of additional capital or require regulatory action if the Bank were unable to comply with such requirements. In addition, management may be required to modify its business strategy due to the changes to the asset risk-weights for risk-based capital calculations and the requirement to meet the capital conservation buffers. The imposition of liquidity requirements in connection with these rules could also cause the Bank to increase its holdings of liquid assets, change its business strategy, and make other changes to the terms of its funding.

The so-called "Crapo Bill" (*i.e.*, the Economic Growth, Regulatory Relief, and Consumer Protection Act) was signed into law by President Trump in May 2018. The Crapo Bill simplified the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than $10 billion and instructed the federal banking regulators to establish a single Community Bank Leverage Ratio ("CBLR") of between 8% and 10%. On September 17, 2019, the FDIC issued its final rule relating to the CBLR framework. To qualify for the framework, a community banking organization must have a tier 1 leverage ratio of greater than 9%, less than $10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework (and meets all requirements under the framework) will be considered to have met the well-capitalized ratio requirements under the prompt corrective action rules discussed above and will not be required to report or calculate risk-based capital. The CBLR framework will be available for banks to use in their March 31, 2020 call reports.

Regulatory Oversight and Examination

Inspections

The Federal Reserve conducts periodic inspections of bank holding companies, which are performed both onsite and offsite. The supervisory objectives of the Federal Reserve's inspection program are to ascertain whether the financial strength of the bank holding company is being maintained on an ongoing basis and to determine the effects or consequences of transactions between a bank holding company or its non-banking subsidiaries and its subsidiary banks. For holding companies under $10 billion in assets, the inspection type and frequency typically varies depending on asset size, complexity of the organization, and the bank holding company's rating at its last inspection.

Examinations

Banks are subject to periodic examinations by their primary regulators. The Bank's primary regulator is the FDIC. In assessing a bank's condition, bank examinations have evolved from reliance on transaction testing in assessing a bank's condition to a risk-focused approach. These examinations are extensive and cover the entire breadth of operations of the bank. Generally, safety and soundness examinations occur on a 12-month cycle. Examinations alternate between the federal and state bank regulatory agencies, and in some cases they may occur on a combined schedule. The frequency of consumer compliance and CRA examinations is linked to the size of the institution and its compliance and CRA ratings at its most recent examinations. However, the examination authority of the Federal Reserve and the FDIC allows them to examine supervised institutions as frequently as deemed necessary based on the condition of the bank or as a result of certain triggering events.

Commercial Real Estate Ratios

The federal banking regulators issued guidance reminding financial institutions to re-examine existing regulations regarding concentrations in commercial real estate lending. The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The banking agencies are directed to examine each bank's exposure to commercial real estate loans that are dependent on cash flow from the real estate held as collateral and to focus their supervisory resources on institutions that may have significant commercial real estate loan concentration risk. The guidance provides that the strength of an institution's lending and risk management practices with respect to such concentrations will be taken into account in evaluating capital adequacy and does not specifically limit a bank's commercial real estate lending to a specified concentration level.

Corporate Governance and Accounting

The Sarbanes-Oxley Act of 2002 (the "SOX Act") addresses, among other things, corporate governance, auditing and accounting, enhanced and timely disclosure of corporate information, and penalties for non-compliance. Generally the SOX Act (i) requires chief executive officers and chief financial officers to certify to the accuracy of periodic reports filed with the SEC; (ii) imposes specific and enhanced corporate disclosure requirements; (iii) accelerates the time frame for reporting of insider transactions and periodic disclosures by public companies; (iv) requires companies to adopt and disclose information about corporate governance practices, including whether or not they have adopted a code of ethics for senior financial officers and whether the audit committee includes at least one "audit committee financial expert", and (v) requires the SEC, based on certain enumerated factors, to regularly and systematically review corporate filings.

As a publicly reporting company, the Holding Company is subject to the requirements of the SOX Act and related rules and regulations issued by the SEC and NASDAQ. After enactment of the SOX Act, we updated our policies and procedures to comply with the SOX Act's requirements and have found that such compliance, including compliance with Section 404 relating to the Holding Company's internal controls over financial reporting, has resulted in additional expenses. We will continue to incur additional expenses in connection with our ongoing compliance with these requirements.

Anti-Money Laundering and Anti-Terrorism

The Bank Secrecy Act and the USA Patriot Act of 2001

The Bank Secrecy Act (the "BSA") requires all financial institutions to (among other requirements) establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. The BSA also sets forth various recordkeeping and reporting requirements (such as reporting suspicious activities that may signal criminal activity), and certain due diligence and "know your customer" documentation requirements. These requirements were recently expanded, and banks are now required to establish and maintain written procedures that are reasonably designed to identify and verify beneficial owners of legal entity customers, as well (and to include such procedures in their anti-money laundering compliance programs).

Further, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, intended to combat terrorism, was renewed with certain amendments in 2006 (the "Patriot Act"). The Patriot Act, in relevant part, (i) prohibits banks from providing correspondent accounts directly to foreign shell banks; (ii) imposes due diligence requirements on banks opening or holding accounts for foreign financial institutions or wealthy foreign individuals; (iii) requires financial institutions to establish an anti-money-laundering compliance program; and (iv) eliminates civil liability for persons who file suspicious activity reports. The Patriot Act also includes provisions providing the government with power to investigate terrorism, including expanded government access to bank account records. Regulators are directed to consider a bank holding company's and a bank's effectiveness in combating money laundering when reviewing and ruling on applications under the BHC Act and the Bank Merger Act. The Holding Company and the Bank have established compliance programs designed to comply with the requirements of the BSA and Patriot Act.

Financial Services Modernization

Gramm-Leach-Bliley Act of 1999

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the "GLBA") brought about significant changes to the laws affecting banks and bank holding companies. Generally, the GLBA (i) repeals historical restrictions on preventing banks from affiliating with securities firms; (ii) provides a uniform framework for the activities of banks, savings institutions and their holding companies; (iii) broadens the activities that may be conducted by national banks and banking subsidiaries of bank holding companies; (iv) provides an enhanced framework for protecting the privacy of consumer information and requires notification to consumers of bank privacy policies; and (v) addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions. The Bank is subject to FDIC regulations implementing the privacy protection provisions of the GLBA. These regulations require a bank to disclose its privacy policy, including informing consumers of the bank's information sharing practices and their right to opt out of certain practices.

Deposit Insurance

FDIC Insured Deposits

The Bank's deposits are insured under the Federal Deposit Insurance Act, up to the maximum applicable limits and are subject to deposit insurance assessments by the FDIC, which are designed to tie what banks pay for deposit insurance to the risks they pose. The Dodd-Frank Act redefined the assessment base used for calculating deposit insurance assessments by requiring the FDIC to determine assessments based on assets instead of deposits. Assessments are now based on the average consolidated total assets less average tangible equity capital of a financial institution. In addition, the Dodd-Frank Act (i) raised the minimum designated reserve ratio (the FDIC is required to set the reserve ratio each year) of the Deposit Insurance Fund ("DIF") from 1.15% to 1.35%; (ii) required that the DIF reserve ratio meet 1.35% by 2020; and (iii) eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The FDIC has established a higher reserve ratio of 2.00% as a long-term goal beyond what is required by statute. The Dodd-Frank Act made banks with $10 billion or more in total assets responsible for the increase from 1.15% to 1.35% by imposing a surcharge on those institutions. The surcharge continued through September 2018, when the DIF reached 1.36%, which was ahead of Dodd Frank's 2020 deadline to meet the 1.35% reserve ratio. No institution may pay a dividend if it is in default on its federal deposit insurance assessment. The FDIC may also prohibit any insured institution from engaging in any activity determined by regulation or order to pose a serious risk to the DIF.

Safety and Soundness

The FDIC may terminate the deposit insurance of any insured depository institution if the FDIC determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. Management is not aware of any existing circumstances that would result in termination of the Bank's deposit insurance.

Insurance of Deposit Accounts

The Dodd-Frank Act permanently increased FDIC deposit insurance from $100,000 to $250,000 per depositor. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

Brokered Deposits

On December 12, 2019, the FDIC issued a proposed rule to modernize its brokered deposit regulations that apply to less than well capitalized insured depository institutions. This proposal would establish a new framework for analyzing whether deposits placed through deposit placement arrangements qualify as brokered deposits. Further, under FDIC deposit insurance rules, banks may be assessed higher premiums if they have a high level of brokered deposits. For calendar quarters prior to April 1, 2018, CDARS and ICS reciprocal deposits were considered to be brokered deposits by regulatory authorities and were reported as such on quarterly Call Reports. However, with the passage of the Crapo Bill, those CDARS and ICS reciprocal deposits are no longer classified as brokered deposits. At December 31, 2019, we had $64.0 million in deposits which are part of the CDARS and ICS programs.

The Dodd-Frank Act

General

The Dodd-Frank Act was signed into law in July of 2010. The Dodd-Frank Act significantly changed the bank regulatory structure and is affecting the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including the Holding Company and the Bank. Some of the provisions of the Dodd-Frank Act that may impact the business and operations of the Holding Company and the Bank are summarized below.

Corporate Governance

The Dodd-Frank Act requires publicly traded companies to provide their shareholders with (i) a non-binding shareholder vote on executive compensation, (ii) a non-binding shareholder vote on the frequency of such vote, (iii) disclosure of “golden parachute” arrangements in connection with specified change in control transactions, and (iv) a non-binding shareholder vote on golden parachute arrangements in connection with these change in control transactions. In 2015, the SEC adopted a rule mandated by the Dodd-Frank Act that requires a public company to disclose the ratio of the compensation of its Chief Executive Officer ("CEO") to the median compensation of its employees. This rule is intended to provide shareholders with information that they can use to evaluate a CEO's compensation.

Prohibition Against Charter Conversions of Troubled Institutions

The Dodd-Frank Act generally prohibits a depository institution from converting from a state to federal charter, or vice versa, while it is the subject to an enforcement action unless the depository institution seeks prior approval from its primary regulator and complies with specified procedures to ensure compliance with the enforcement action.

Consumer Financial Protection Bureau

The Dodd-Frank Act established the CFPB and empowered it to exercise broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws. The Bank is subject to consumer protection regulations issued by the CFPB, but as a financial institution with assets of less than $10 billion, the Bank is generally not subject to supervision and examination by the CFPB. The CFPB has issued and continues to propose and issue numerous regulations that may increase the compliance burden of the Bank. Significant recent CFPB developments that may affect the Bank’s operations and compliance costs include:

- Positions taken by the CFPB on fair lending, including applying the disparate impact theory which could make it more difficult for lenders to charge different rates or to apply different terms to loans to different customers.
- The CFPB’s final rule amending Regulation C, which implements the Home Mortgage Disclosure Act, requiring most lenders to report expanded information in order for the CFPB to more effectively monitor fair lending concerns and other information shortcomings identified by the CFPB.
- Positions taken by the CFPB regarding the Electronic Fund Transfer Act and Regulation E, which require companies to obtain consumer authorizations before automatically debiting a consumer’s account for pre-authorized electronic funds transfers.
- Focused efforts on enforcing certain compliance obligations the CFPB deems a priority, such as automobile loan servicing, debt collection, mortgage origination and servicing, remittances, and fair lending, among others.

Repeal of Demand Deposit Interest Prohibition

The Dodd-Frank Act repealed federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Board Composition

In 2018, the California “Women on Boards” bill was signed into law to advance equitable gender representation on certain California corporate boards. California is the first state in the nation to require all publicly-held domestic or foreign corporations whose principal executive offices are located in California to have at least one female director on their boards by December 31, 2019 (either by filling an open seat or by adding a seat). One or two more women directors may be required, depending upon the size of the public company’s board by December 31, 2021. We had one female serving on our board as of December 31, 2019, and we will continue to advance equitable gender representation by adding females to our board in accordance with California’s Women on Boards bill.

Recent and Proposed Legislation

The economic and political environment of the past several years has led to a number of proposed legislative, governmental and regulatory initiatives that may significantly impact the banking industry. Other regulatory initiatives by federal and state agencies may also significantly impact our business. We cannot predict whether these or any other proposals will be enacted or the ultimate impact of any such initiatives on our operations, competitive situation, financial conditions, or results of operations. While recent history has demonstrated that new legislation or changes to existing laws or regulations typically result in a greater compliance burden (and therefore increase the general costs of doing business), the current Administration has expressed a desire to reduce regulatory burden.

In 2018, President Trump signed into law the Crapo Bill discussed above, which modified and removed certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act in an effort to provide regulatory relief to certain financial institutions. While the Crapo Bill maintains most of the regulatory structure established by the Dodd-Frank Act, it amended certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion. Many of these changes could result in meaningful regulatory changes for community banks.

For example, the Crapo Bill simplified the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than $10 billion, and the FDIC issued its final rule relating to the CBLR framework on September 17, 2019. The Crapo Bill also included regulatory relief for community banks regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures and risk weights for certain high-risk commercial real estate. However, it is difficult at this time to predict when or how the new standards under the Crapo Bill will ultimately be applied to us or what specific impact the Crapo Bill (and any further implementing rules and regulations) will have on community banks.

Effects of Federal Government Monetary Policy

Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates. Through its open market operations in U.S. government securities, control of the discount rate applicable to borrowings, establishment of reserve requirements against certain deposits, and control of the interest rate applicable to excess reserve balances and reverse repurchase agreements, the Federal Reserve influences the availability and cost of money and credit and, ultimately, a range of economic variables including employment, output, and the prices of goods and services. The nature and impact of future changes in monetary policies and their impact on the Holding Company and the Bank cannot be predicted with certainty.

Available Information

The Company files annual, quarterly and current reports, proxy statements and other business and financial information with the SEC. The SEC maintains an Internet site that contains the Company's SEC filings, as well as reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, located at http://www.sec.gov. These filings are also accessible free of charge at the Company's website at www.bankofcommerceholdings.com as soon as reasonably practicable after filing with the SEC. By making this reference to the Company's website, the Company does not intend to incorporate into this report any information contained in the website. The website should not be considered part of this report.

Our principal executive office is located at 555 Capitol Mall, Suite 1255, Sacramento, California 95814 and the telephone number is (800) 421-2575.

Annual Disclosure Statement

This Annual Report on Form 10-K also serves as the annual disclosure statement of the Bank pursuant to Part 350 of the FDIC's rules and regulations. This statement has not been reviewed or confirmed for accuracy or relevance by the FDIC.

Item 1a - Risk Factors

Company

The following is a discussion of what the Company believes are the most significant risks and uncertainties that may affect the Company's business, financial condition and future results.

National and global economic and geopolitical conditions could adversely affect our future results of operations or market price of our stock.

Our business is impacted by factors such as economic, political and market conditions, broad trends in industry and finance, changes in government monetary and fiscal policies, inflation, and market volatility, all of which are beyond our control. National and global economies are constantly in flux, as evidenced by recent market volatility resulting from, among other things, a relatively new presidential administration and new tax and economic policies associated therewith, the uncertain future relationship between the European Union and United Kingdom, and the ever-changing landscape of the energy industry. Future economic conditions cannot be predicted, and any renewed deterioration in the economies of the nation as a whole or in our market could have an adverse effect, which could be material, on our business, financial condition, results, operations and prospects, and could cause the market price of our stock to decline.

Our business is subject to geographic risks that could adversely impact our results of operations and financial condition.

We conduct banking operations principally in northern California. As a result, our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in northern California. Any future deterioration in economic conditions, particularly within our geographic region, could result in the following consequences, any of which could have a material adverse effect on our business, prospects, financial condition and results of operations:

- Loan delinquencies may increase causing increases in our provision for loan and lease losses and in our Allowance for Loan and Lease Losses ("ALLL");
- Financial sector regulators may adopt more restrictive practices or interpretations of existing regulations, or adopt new regulations;
- Collateral for loans made by the Bank, especially real estate related, may decline in value, which in turn could reduce a client's borrowing power, and reduce the value of assets and collateral associated with our loans held for investment;
- Consumer confidence levels may decline and cause adverse changes in payment patterns, resulting in increased delinquencies and default rates on loans and other credit facilities and decreased demand for our products and services;
- Demand for loans and other products and services may decrease;
- Low cost or non-interest-bearing deposits may decrease; and
- Performance of the underlying loans in the private label mortgage backed securities we hold may deteriorate, potentially causing other-than-temporary impairment markdowns to our investment portfolio.

Our inability to successfully manage our growth or implement our growth strategy could affect our results of operations and financial condition.

We may not be able to successfully implement our growth strategy if we are unable to expand market share in our existing market or identify attractive new markets, locations or opportunities to expand in the future. In addition, our ability to manage growth successfully will depend on whether we can maintain adequate capital levels, maintain cost controls, effectively manage asset quality and successfully integrate any expanded business divisions or acquired businesses into our operations.

As we continue to implement our growth strategy by opening new branches or acquiring branches or banks, we expect to incur increased personnel, occupancy, and other operating expenses. In the case of new branches, we must absorb higher expenses while we begin to generate new deposits. In the case of acquired branches, we must absorb higher expenses while we begin deploying the newly assumed deposit liabilities. With either new branches opened or branches acquired, there could be a lag time involved in deploying new deposits into attractively priced loans and other higher yielding earning assets. Thus, expansion could depress earnings in the short-term, even if an efficiently executed branching strategy leads to long-term financial benefits.

The value of goodwill and other intangible assets may decline in the future

We have goodwill and core deposit intangible assets from business acquisitions. A significant decline in the expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock could necessitate taking charges in the future related to the impairment of goodwill or other intangible assets. If we were to conclude that a write-down of goodwill or other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations.

The loan portfolio includes a significant amount of purchased loans and a significant amount of loans serviced by other companies.

Purchased loans included in the loan portfolio totaled $93.6 million or 9% of gross portfolio loans as of December 31, 2019. The loans were purchased as a pool of loans, individual loans or as purchased participations from other institutions. The majority of the loans are located outside our principal market. The loans were purchased under several different contracts and, $61.0 million or 6% of our gross portfolio loans are serviced by two unrelated third party servicing companies. A disruption to the operations of either of the loan servicing companies could reduce the value of the assets that we own. In addition, if we were forced to service these loans ourselves, we would incur additional monitoring and servicing costs due to the geographic disbursement of the portfolio, which would adversely affect our noninterest expense.

We have a concentration risk in real estate related loans.

A substantial portion of our lending is tied to real estate. As of December 31, 2019, approximately 83% of our loan portfolio was secured by real estate as follows:

- 69% was commercial real estate (non-owner occupied and owner-occupied),
- 6% was residential 1-4 family mortgage,
- 3% was residential ITIN,
- 2% was residential equity lines and
- 3% was construction and land development.

A large percentage of our loan portfolio is comprised of commercial real estate loans which generally carry larger loan balances and historically have involved a greater degree of financial and credit risks than residential first mortgage loans. These loans are primarily made based on and repaid from the cash flow of the borrower (which may be unpredictable) and secondarily on the underlying collateral provided by the borrower. Any decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in our principal market areas in particular, could have an adverse impact on the repayment of these loans. Further, our ability to recover on these loans by selling or disposing of the underlying real estate collateral would be adversely impacted by any decline in real estate values, which increases the likelihood that we would suffer losses on defaulted loans secured by real estate beyond the amounts provided for in the ALLL. Any increase in net charge-offs and in the ALLL could also have a material adverse effect on our business, financial condition, and results of operations and prospects.

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

We generally do not record interest income on nonperforming loans or other real estate owned, thereby adversely affecting our income, and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may result in a loss. An increase in the level of nonperforming assets increases our risk profile and consequently may impact the capital levels our regulators believe are appropriate.

While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. We expect the level of non-performing assets and losses relating to such assets to continue to decline, however there can be no assurance that we will not experience future increases in nonperforming assets.

Future loan and lease losses may exceed the allowance for loan and lease losses.

We have established an allowance for possible losses expected in connection with loans in the credit portfolio. This allowance reflects estimates of the collectability of certain identified loans, as well as an overall risk assessment of gross loans outstanding.

The determination of the amount of the allowance for loan and lease losses is subjective. Although the method for determining the amount of the allowance uses criteria such as risk ratings and historical loss rates, these factors may not be adequate predictors of future loan performance. Accordingly, we cannot offer assurances that these estimates ultimately will prove correct or that the loan and lease loss allowance will be sufficient to protect against losses that ultimately may occur. If the allowance for loan and lease losses proves to be inadequate, we will need to make additional provisions to the allowance, which is accounted for as charges to income, which would adversely impact results of operations and financial condition. Moreover, federal and state banking regulators, as an integral part of their supervisory function, periodically review our loan portfolio and the adequacy of our allowance. These regulatory authorities may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be different from our judgments. Any increase in the allowance could have an adverse effect, which could be material, on our financial condition and results of operations.

Additionally, the changes in accounting standards described immediately below will change the current historical method of providing allowances for credit losses that are probable, and may require us to increase the amount of the allowance for loan and lease losses.

Changes in how we provide for credit losses may have a material impact on our financial condition or results of operations.

In June 2016, the FASB issued Accounting Standards Update ("ASU") 2016-13, *Measurement of Credit Losses on Financial Instruments*. The ASU introduces a new impairment model based on current expected credit losses ("CECL") rather than incurred losses. The CECL model will apply to most financial assets measured at amortized cost, including loans receivable, loan commitments and held-to-maturity debt securities.

Under the CECL model, we would recognize an impairment allowance equal to our current estimate of expected credit losses for financial instruments as of the end of the reporting period. Measuring expected credit losses will likely be a significant challenge for all entities, including us. Additionally, to estimate expected credit losses, we have incurred one-time and recurring costs, some of which are related to system changes and data collection.

Further, the impairment allowance measured under a CECL model could differ materially from the impairment allowance measured under our incurred loss model. To initially apply the CECL amendments, for most debt instruments, we would record a cumulative-effect adjustment to its statement of financial condition as of the beginning of the first reporting period in which the guidance is effective (a modified retrospective approach). The amendments in ASU 2016-13 are effective for us as of January 1, 2023, and are required to be adopted through a modified retrospective approach, with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the ASU is effective.

The impact of certain provisions of the CECL model regarding loan portfolios of acquired financial institutions could result in earnings volatility, as any adjustments to the ALLL with respect to the acquired loans are required to be made immediately subsequent to the acquisition.

More information on this ASU can be found under the heading *Recent Accounting Pronouncements*, in Note 2 *Summary of Significant Accounting Policies* in the *Notes to Consolidated Financial Statements*.

Defaults may negatively impact us.

Risk arises from the possibility that losses will be sustained if a significant number of borrowers, guarantors and related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the adequacy of the allowance for loan and lease losses, which management believes are appropriate to minimize risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying the loan portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially affect our results of operations.

Interest rate fluctuations, which are out of our control, could harm profitability.

Our income is highly dependent on “interest rate spreads” (i.e., the difference between the interest income earned on our interest-earning assets such as loans and securities, and the interest expense paid on our interest-bearing liabilities such as deposits and borrowings). The underlying interest rates are highly sensitive to many factors, many of which are beyond our control, including general economic conditions, inflation, recession and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board.. In recent years, we originated higher volumes of longer term fixed rate loans. These loans, combined with the structure of our investment portfolio and funding mix caused the Company to become slightly to moderately liability sensitive to rising interest rates. However, our loan and investment portfolio contain a significant amount of floating rate assets which reprice faster in a decreasing rate environment than our liabilities and cause the Company to be slightly asset sensitive to falling rates.

The interest rates we pay on deposits and the interest rates we earn on loans are determined in large part by the rates paid and charged by our competitors. In addition, changes in monetary policy including changes in interest rates influence the origination of loans, the purchase of investments and the generation of deposits. These changes affect the rates received on loans and securities and paid on deposits, which could have a material adverse effect on our business, financial condition and results of operations.

We may be impacted by the retirement of LIBOR as a reference rate.

In July 2017, the United Kingdom Financial Conduct Authority announced that the London Interbank Offered Rate (“LIBOR”) may no longer be published after 2021. LIBOR is used extensively in the U.S and globally as a “benchmark” or “reference rate” for various commercial and financial contracts. In response, the Alternative Reference Rates Committee (“ARRC”), made up of financial and capital market institutions, was convened to address the replacement of LIBOR in the U.S. The ARRC identified a potential successor to LIBOR in the Secured Overnight Financing Rate (“SOFR”) and crafted a plan to facilitate the transition. However, there are significant conceptual and technical differences between LIBOR and SOFR. The Financial Stability Oversight Committee has stated that the end or waning use of LIBOR has the potential to significantly disrupt trading in many important types of financial contracts.

At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based securities and variable rate loans, subordinated debentures or other securities or financial arrangements. The replacement of LIBOR with one or more alternative rates may impact the availability and cost of hedging instruments and borrowings, including the rates we pay on our subordinated debentures and derivative financial instruments. If LIBOR rates are no longer available, and we are required to implement substitute indices for the calculation of interest rates under contracts or financial instruments to which we are a party, we may incur significant expenses in effecting the transition.

Changes in the fair value of our securities may reduce our shareholders’ equity and net income.

We increase or decrease our shareholders’ equity by the amount of change in the unrealized gain or loss (the difference between the fair value and the amortized cost) of our available-for-sale securities portfolio, net of related tax, under the category of accumulated other comprehensive income (loss). A decline in the fair value of this portfolio will result in a decline in reported shareholders’ equity, as well as book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the event there are credit loss related impairments, the credit loss component is recognized in earnings.

We own shares of Federal Home Loan Bank of San Francisco stock which are recorded in other assets. The stock is carried at cost and subject to recoverability testing under applicable accounting standards. As of December 31, 2019, we did not recognize an impairment charge related to our Federal Home Loan Bank of San Francisco stock holdings; however, potential negative changes to the financial condition of the Federal Home Loan Bank of San Francisco could require us to recognize an impairment charge with respect to such stock holdings. Any such impairment charge would have an adverse impact on our results of operations and financial condition.

We own investments in Qualified Zone Academy Bonds (“QZAB”) which are recorded in other assets. The investments are carried at cost and are subject to recoverability testing under applicable accounting standards. As of December 31, 2019, we did not recognize an impairment charge related to our QZAB investment holdings; however, potential negative changes to the financial condition of the issuing institutions could require us to recognize an impairment charge with respect to such holdings in the future. Any such impairment charge would have an adverse impact on our results of operations and financial condition.

Credit quality for private label mortgage backed securities we hold may deteriorate creating additional credit risk in our investment portfolio.

Our securities portfolio contains private label mortgage backed securities. These securities have more credit risk than the securities in our portfolio that are obligations of the U.S. Government or obligations guaranteed by the U.S. Government. We monitor the credit characteristics of the underlying mortgages to identify potential credit losses, if any, in the portfolio. If there is a decline in fair value due to credit quality concerns for a security we may be required to recognize an other-than-temporarily-impairment in earnings. Our Investment Policy requires that securities at the time of purchase, be rated A3/A- or higher by Moody's, S&P and Fitch rating agencies.

Conditions in the financial markets may limit our access to additional funding to meet our liquidity needs.

Liquidity is essential to our business, as we must maintain sufficient funds to respond to the needs of depositors and borrowers. An inability to raise funds through deposits, repurchase agreements, federal funds purchased, Federal Home Loan Bank of San Francisco advances, the sale or pledging as collateral of securities, loans, and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could negatively affect our access to liquidity sources include negative operating results, a decrease in the level of our business activity due to a market downturn or negative regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole. An inability to borrow funds to meet our liquidity needs could have an adverse impact on our results of operations and financial condition.

The condition of other financial institutions could negatively affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, public perceptions and other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients.

Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

Competition in our market areas may limit future success.

Community banking is a highly competitive business and a consolidating industry. We compete for loans and deposits with other commercial banks, savings and loans, credit unions, finance, insurance and other non-depository companies operating in our market areas. Some of our competitors are not subject to the same regulations and restrictions as are we, and some of our competitors have greater financial resources. If we are unable to effectively compete in our market areas, the Company's business, results of operations, and prospects could be adversely affected.

Derivative financial instruments subject the Company to credit and market risk

We may use derivatives to hedge the risk of changes in market interest rates in order to limit the impact on earnings and cash flows relating to specific groups of assets and liabilities. Our use of derivatives in our risk management activities could expose the Company to mark-to-market losses if interest rates move in a materially different way than we expected when we entered into the related derivative contracts. In addition, we would be exposed to credit risk should the counterparty fail to perform under the terms of the derivative contracts. This could cause us to forfeit the payments due to us or result in settlement delays with the attendant credit and operational risk as well as increased costs to us. Derivative contracts may contain a provision which allows the counterparty to terminate the derivative contract if we failed to maintain our status as a well/adequately capitalized institution or if specific regulatory events occurred. If these contracts were terminated by the counterparty, we would be required to settle our obligations under the agreements, which could also cause operational risk and increased costs to us.

We rely heavily on our management team and the loss of key officers may adversely affect operations.

We are dependent on the successful recruitment and retention of highly qualified personnel. Our ability to implement our business strategies is closely tied to the strengths of our chief executive officer and other key officers. Additionally, business banking, one of our principal lines of business, is dependent on relationship banking in which our personnel develop professional relationships with small business owners and officers of larger business customers who are responsible for the financial management of the companies they represent. If management team members or other key employees were to leave the Company and become employed by a competing bank, we could potentially lose business customers. In addition, we rely on our customer service staff to effectively serve the needs of our customers. The loss of key employees to competitors or otherwise could have an adverse effect on our results of operation and financial condition.

Our future performance will depend on our ability to respond to technological change.

The financial services industry is experiencing rapid technological changes with frequent introductions of new technology-driven products and services. Effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Many of our competitors have substantially greater resources to invest in technological improvements than we do. Our future success will depend, to some degree, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as create additional efficiencies in our operations, We may not be able to effectively implement new technology-driven products or service, or be successful in marketing such products and services. Additionally, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may cause services interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. There can be no assurance that we will be able to successfully manage the risks associated with increased dependency on technology.

Internal control systems could fail to detect certain events.

We are subject to many operating risks, including, without limitation, data processing system failures and errors, and customer or employee fraud. There can be no assurance that such an event will not occur, and if such an event is not prevented or detected by our internal controls and does occur, and it is uninsured or is in excess of applicable insurance limits, it could have a significant adverse impact on our reputation in the business community and our business, financial condition, and results of operations.

Our operations could be interrupted if third party technology service providers experience difficulty, terminate their services or fail to comply with banking regulations.

We depend, and will continue to depend to a significant extent, on a number of relationships with third party technology service providers. Specifically, we utilize software and hardware systems for transaction processing, essential web hosting, debit and credit card processing, merchant bankcard processing, internet banking systems and other processing services from third party service providers. If these third party service providers experience difficulties or terminate their services, and we are unable to replace them with other qualified service providers, our operations could be interrupted. If an interruption were to continue for a significant period of time, our business, financial condition and results of operations could be materially adversely affected.

Confidential customer information transmitted through the Bank's online banking service is vulnerable to security breaches and computer viruses which could expose the Bank to litigation and adversely affect its reputation and ability to generate deposits.

We provide our customers the ability to bank online. We rely heavily on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. The secure transmission of confidential information over the Internet is a critical element of online banking. Our network could be vulnerable to unauthorized access, computer hacking, cyber-attacks, electronic fraudulent activity, attempted theft of financial assets, computer viruses, phishing schemes and other security problems. We cannot guarantee that any such failures, interruption or security breaches will not occur, or if they do occur, that they will be adequately addressed. While we have certain protective policies and procedures in place, the nature and sophistication of the threats continue to evolve. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, alleviate problems caused by security breaches or viruses or to modify and enhance our protective measures. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent cyber-attacks, security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

We are subject to extensive regulation which could adversely affect our business.

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to modification and change. There are currently proposed laws, rules and regulations that, if adopted, would impact our operations. For more information on these issues, refer to the material set forth above under the heading "*Government Supervision and Regulation.*"

The requirements imposed by our regulators and other laws, rules or regulations applicable to us are designed to ensure the integrity of the financial markets and to protect customers and other third parties that transact business with us, and are not designed to protect our shareholders. Consequently, these regulations may: (1) make compliance much more difficult or expensive, (2) restrict our ability to originate, broker or sell loans or accept certain deposits, (3) further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by us, or (4) otherwise adversely affect our business or prospects for business. Moreover, banking regulators have significant discretion and authority to address what regulators perceive to be unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority by banking regulators over us may have a negative impact on our financial condition and results of operations. Additionally, in order to conduct certain activities, including acquisitions, we are required to obtain regulatory approval. There can be no assurance that any required approvals can be obtained, or obtained without conditions or on a timeframe acceptable to us.

Changes in accounting standards may impact how we report our consolidated financial condition and consolidated results of operations.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the FASB changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in a restatement of prior period financial statements.

Natural disasters and other uncontrollable events, such as earthquakes, volcanic eruptions, tsunami, wildfires, droughts, floods, mudslides, hurricanes, tornados and other geologic processes could harm our business.

We are susceptible to the risks of natural disasters such as earthquakes, volcanic eruptions, tsunami, wildfires, droughts, floods, mudslides, hurricanes, tornados and other geologic processes. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. California has also historically experienced energy shortages, which, if they recur, could impair our business operation and the value of real estate in the areas affected.

Although we have implemented several back-up systems and protections and maintain business interruption insurance, these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters or energy shortages in California could have a material adverse effect on our business, prospects, financial condition and results of operations.

A natural disaster outside California could negatively impact our purchased loan portfolio or our third party loan servicers.

Our purchased loan portfolio includes a significant amount of loans made to borrowers outside California. We also rely on third party loan servicers located outside of California. Therefore, we are susceptible to the risks of natural disasters outside California. Natural disasters could impact the operations of our loan servicers directly through interference with communications, including the interruption or loss of websites, destruction of facilities, operational, financial and management information systems which could prevent them from servicing our portfolio. Natural disasters outside California could also impact the underlying collateral and borrower's ability to repay the loans for our purchased loan portfolios.

The economic effects of the coronavirus disease 2019 or similar pandemic diseases could adversely affect our future results of operations or the market price of our stock.

Although the scope of the recent outbreak of the coronavirus disease 2019 cannot be predicted, either internationally or within the United States, it has already resulted in significant volatility in world and national trading markets. Any significant spread of the coronavirus disease 2019 or similar disease within the United States could have an adverse effect on the national economy generally, the markets that we serve, our future results of operations or the market price of our stock.

No assurance can be given that the Subordinated Notes will continue to qualify as Tier 2 Capital.

We believe that our Subordinated Notes meet the requirements of Tier 2 Capital in accordance with the Final Rules and current statutory guidance provided by the Federal Reserve Board. The Federal Reserve Board does not provide prior approval for the Subordinated Notes to be classified as Tier 2 Capital however, we did not receive any indication that the Subordinated Notes did not qualify as tier 2 capital during our most recent examination process with the Federal Reserve Bank of San Francisco. In the event that the Subordinated Notes do not qualify, the Federal Reserve Bank of San Francisco may require the Holding Company to amend certain terms and conditions of the Subordinated Notes in order for such instruments to qualify as Tier 2 Capital. Under the terms of the Subordinated Notes, the Holding Company also has the option to redeem the Subordinated Notes upon the occurrence of such an event.

We cannot give any assurance as to whether the applicable requirements for Tier 2 Capital will change in the future. Even if the Subordinated Notes initially meet the requirements of Tier 2 Capital under the current regulations, if changes are made in the future, and unless the Subordinated Notes are grandfathered into the new regulations, they could become disqualified as Tier 2 Capital.

Our deposits are subject to volatility

Our depositors can always choose to withdraw their deposits from the Bank and place them into alternative investments, which might cause an increase in our funding costs and reduce our net interest income. Checking, savings and money market account balances can decrease when customers perceive that alternative investments provide a better risk/return tradeoff.

At December 31, 2019, time certificates of deposit in excess of $250,000, excluding brokered time deposits, represented approximately 5% of our total deposit balances. Because these deposits are not covered by FDIC deposit insurance, they are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits could adversely affect our liquidity, profitability, business prospects, results of operations and cash flows. Our 25 largest deposit relationships account for 21% of our deposits.

Our exposure to operational, technological, and organization risk may adversely affect us.

Similar to other financial institutions, we are exposed to many types of operational and technological risk, including reputation, legal and compliance risk. Our ability to grow and compete is dependent on our ability to build or acquire the necessary operational and technological infrastructure and to manage the cost of that infrastructure while we expand and integrate acquired businesses. Operational risk can manifest itself in many ways, such as errors related to failed or inadequate processes, faulty or disabled computer systems, occurrences of fraud by employees or persons outside our company, and exposure to external events. We are dependent on our operational infrastructure to help manage these risks. From time to time, we may need to change or upgrade our technological infrastructure. We may experience disruption, and we may face additional exposure to these risks during the course of making such changes. If we acquire another financial institution or bank branch operations, we would face additional challenges when integrating different operational platforms, causing integration efforts to be more disruptive and /or more costly than anticipated.

Shareholders

In addition to risks and uncertainties that may affect the Company's business, financial condition and the future results, shareholders may also be subject to the following risks:

There can be no assurance we will be able to continue paying cash dividends on our common stock at recent levels.

We may not be able to continue paying quarterly cash dividends commensurate with recent levels, given that the ability to pay cash dividends on our common stock depends on a variety of factors. The payment of dividends is subject to government regulation in that regulatory authorities may prohibit banks and bank holding companies from paying dividends that would constitute an unsafe or unsound banking practice. The Federal Reserve Board generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a financial services holding company's financial position. The Board of Governors of the Federal Reserve System policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions.

Our ability to pay cash dividends to our shareholders is dependent on our receipt of cash dividends from our subsidiary Bank. In addition to the restrictions imposed under federal law, banks chartered under California law generally may only pay a cash dividend to the extent such payment does not exceed the lesser of (i) retained earnings of the bank or (ii) the bank's net income for its last three fiscal years less any distributions to shareholders during such period. The Bank is also prohibited from paying a dividend to the holding company if it is in default on its federal deposit insurance assessment.

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

Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations;
- Recommendations by securities analysts;
- Operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions;

- Perceptions in the marketplace regarding the Company and/or our competitors;
- Public sentiments toward the financial services and banking industry generally;
- New technology used, or services offered, by competitors;
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or our competitors;
- Changes in government regulations; and
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results as evidenced by the recent volatility and disruption of capital and credit markets.

Our common stock is traded on the NASDAQ Global Market under the trading symbol "BOCH" and historically has been a low trading volume stock. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our common stock. Future sales of substantial amounts of common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of the common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue.

Anti-takeover provisions in our articles of incorporation could make a third party acquisition of us difficult.

In order to approve a merger or similar business combination with the owner of 20% or more of our common stock (an "Interested Shareholder"), our Articles of Incorporation contain provisions that require a supermajority vote of 66.7% of the outstanding shares of the common stock (excluding the shares held by the Interested Shareholder or its affiliates). These provisions further require that the per share consideration to be paid in such a transaction be equal or exceed the greater of (1) the highest per share price paid by the Interested Shareholder (a) within two years of the transaction proposal announcement date, or (b) the date the Interested Shareholder acquired a 20% -plus ownership interest (if the acquisition occurred less than two years before the transaction announcement) and (2) the fair market value of the Common Stock on (a) the transaction proposal announcement date, or (b) the date the Interested Shareholder acquired a 20% -plus ownership interest (if the acquisition occurred less than two years before the transaction announcement).

These provisions could result in the Company becoming a less attractive target for a would-be acquirer. As a consequence, it is possible that shareholders would lose an opportunity to be paid a premium for their shares in an acquisition transaction, even in circumstances where such action is favored by a majority of the Company's shareholders.

There may be future sales or other dilutions of our equity which may adversely affect the market price of our common stock.

We are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive our common stock. In addition, we are not prohibited from issuing additional securities which are senior to our common stock. Because our decision to issue securities in any future offering will depend in part on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings.

Future issuance of shares of our common stock, including those that may be issued in connection with our various stock option and equity compensation plans, in acquisitions or in any other offering of our common stock for cash, could have a dilutive effect on the tangible book value of our common stock and could adversely affect our market price. Any future issuances of shares of our common stock may be dilutive to existing shareholders.

The holders of our trust preferred securities have rights that are senior to those of our holders of common stock and that may impact our ability to pay dividends on our common stock to our common shareholders.

At December 31, 2019, our subsidiary Bank of Commerce Holdings Trust II had outstanding [$10.3 million] of trust preferred securities. These securities are effectively senior to shares of common stock due to the priority of the underlying junior subordinated debentures. As a result, we must make dividend payments on our trust preferred securities before any dividends can be paid on our common stock; moreover, in the event of our bankruptcy, dissolution, or liquidation, all obligations outstanding with respect to our trust preferred securities must be satisfied before any distributions can be made to our shareholders. While we have the right to defer dividends on the trust preferred securities for a period of up to five years, no dividends may be paid to our common shareholders during that time if any such election has been made.

Our subordinated debt agreement has provisions that may impact our ability to pay dividends on our common stock to our common shareholders

On December 10, 2015, we issued and sold $10.0 million in aggregate principal amount of fixed to floating rate Subordinated Notes pursuant to a private placement with certain institutional investors. The Notes limit the payment of cash dividends to our common shareholders if the Company is not well capitalized or if there is an event of default as described by the agreement.

Item 1b - Unresolved Staff Comments

None to report.

Item 2 - Properties

- The Company's principal executive office is located at 555 Capitol Mall, Suite 1255, Sacramento, California 95814; the lease agreement expires in 2024.
- The Bank owns eight and leases space for two, full service banking offices in Northern California.
- The Bank has one limited service branch in Carmichael, Sacramento, California.
- The Bank leases space to operate one free standing remote ATM in Northern California.
- The Bank has office space in leased and bank owned locations in Redding, California and leased office space in Roseville, California.

Item 3 - Legal Proceedings

We are subject to various pending and threatened legal actions arising in the ordinary course of business and, if necessary, maintain reserves for losses from legal actions that are both probable and estimable. There are no legal proceedings adverse to the Company that we believe will have a material effect on our consolidated financial position or results of operations.

Item 4 - Mine Safety Disclosures

Not applicable.

Part II

Item 5 - Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

The principal market on which our common stock is traded is the NASDAQ Global Market. The Holding Company's common stock is listed under the trading symbol "BOCH." There were 2,368 shareholders of the Holding Company's common stock as of December 31, 2019, including those held in street name, and the market price on that date was $11.57 per share.

Cash Dividends

We declared cash dividends of $0.19 and $0.15 during the years ended December 31, 2019 and 2018, respectively. Our ability to pay dividends is subject to certain regulatory requirements. The Federal Reserve Board generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a financial services holding company's financial position. The Board of Governors of the Federal Reserve System policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions.

Our ability to pay dividends is subject to certain contractual requirements. Our trust preferred securities and subordinated debt agreements contain provisions that prohibit us from declaring or paying a dividend if the Company is not "well-capitalized" for regulatory purposes or there exists an event of default as defined by the agreements.

Purchases of equity securities

On September 18, 2019, we announced that our Board of Directors had authorized a stock purchase program. The stock purchase program authorizes the Company to purchase up to one million shares of its common stock over a period ending March 31, 2020 and was effective immediately. Purchases may be made in the open market, including in block trades, or through privately negotiated transactions, from time to time when management determines that market conditions and other factors warrant such purchases. There is no guarantee as to the exact number of shares to be purchased, and the stock purchase program may be modified, suspended, or terminated without prior notice. On February 21, 2020 we announced that our Board of Directors increased the number of shares that may be purchased from 1,000,000 to 1,500,000 shares of common stock, and extended the program by one year to March 31, 2021. The following table provides information regarding purchases under the program.

Period	Total Number Of Common Shares Purchased	Average Price Paid Per Common Share [1]	Total Number of Shares Purchased As Part Of Publicly Announced Plan	Maximum Number Of Shares That May Yet Be Purchased Under The Plan
10/1/19-10/31/19	71,499	$ 11.13	71,499	1,428,501
11/1/19-11/30/19	13,493	$ 11.26	13,493	1,415,008
12/1/19-12/31/19	5,509	$ 11.28	5,509	1,409,499
Total	90,501	$ 11.16	90,501	

1 - Average price paid per common share includes commissions.

Item 6 - Selected Financial Data

The selected consolidated financial data set forth below for the five years ended December 31, 2019, have been derived from the Company's audited Consolidated Financial Statements and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's audited Consolidated Financial Statements and notes thereto, included elsewhere in this report.

Amounts in thousands (except ratios and per share data)	2019	2018	2017	2016	2015
Statements of income					
Interest income	$ 59,563	$ 52,701	$ 45,949	$ 41,009	$ 38,753
Net interest income	$ 53,535	$ 47,546	$ 41,362	$ 36,231	$ 33,770
Provision for loan and lease losses	$ —	$ —	$ 950	$ —	$ —
Noninterest income	$ 4,184	$ 4,019	$ 4,824	$ 3,486	$ 3,183
Noninterest expense	$ 37,255	$ 32,206	$ 30,964	$ 32,500	$ 24,905
Net income available to common shareholders	$ 14,961	$ 15,730	$ 7,344	$ 5,259	$ 8,295
Balance sheets					
Total assets	$ 1,479,616	$ 1,307,104	$ 1,269,421	$ 1,140,992	$ 1,015,441
Average total assets	$ 1,458,112	$ 1,288,841	$ 1,198,251	$ 1,079,750	$ 992,731
Total gross loans	$ 1,032,903	$ 946,251	$ 879,835	$ 804,211	$ 716,639
Allowance for loan and lease losses	$ 12,231	$ 12,292	$ 11,925	$ 11,544	$ 11,180
Total deposits	$ 1,267,171	$ 1,131,716	$ 1,102,732	$ 1,004,666	$ 803,735
Total shareholders' equity	$ 174,478	$ 138,321	$ 127,264	$ 94,106	$ 90,522
Ratios [1]					
Return on average assets [2]	1.03 %	1.22 %	0.61 %	0.49 %	0.86 %
Return on average shareholders' equity [3]	9.09 %	12.08 %	6.34 %	5.68 %	8.10 %
Average equity to average assets	11.29 %	10.10 %	9.67 %	8.57 %	10.68 %
Common equity tier 1 capital ratio [4]	13.19 %	12.79 %	12.26 %	9.43 %	10.06 %
Tier 1 capital ratio [4]	14.04 %	13.71 %	13.23 %	10.42 %	11.16 %
Total capital ratio [4]	15.97 %	15.82 %	15.44 %	12.68 %	13.52 %
Tier 1 leverage ratio [4]	11.30 %	11.21 %	10.86 %	9.13 %	10.03 %
Net interest margin [5]	3.94 %	3.90 %	3.68 %	3.60 %	3.64 %
Average earning assets to total average assets	93.29 %	94.67 %	93.85 %	93.34 %	93.43 %
Nonperforming assets to total assets [6]	0.38 %	0.32 %	0.46 %	1.06 %	1.53 %
Net charge-offs (recoveries) to average loans	0.01 %	(0.04) %	0.07 %	(0.05) %	(0.05) %
Allowance for loan and lease losses to gross loans	1.18 %	1.30 %	1.36 %	1.44 %	1.56 %
Nonperforming loans to allowance for loan and lease losses	45.92 %	33.73 %	48.63 %	98.64 %	126.09 %
Efficiency ratio [7]	64.5 %	62.5 %	67.0 %	81.8 %	67.4 %
Share data					
Average common shares outstanding – basic	17,956	16,248	15,207	13,367	13,331
Average common shares outstanding – diluted	18,024	16,332	15,310	13,425	13,365
Book value per common share	$ 9.62	$ 8.47	$ 7.82	$ 7.00	$ 6.76
Book value per common share - tangible [8]	$ 8.71	$ 8.36	$ 7.70	$ 6.83	$ 6.76
Basic earnings per share	$ 0.83	$ 0.97	$ 0.48	$ 0.39	$ 0.62
Diluted earnings per share	$ 0.83	$ 0.96	$ 0.48	$ 0.39	$ 0.62
Cash dividends per common share	$ 0.19	$ 0.15	$ 0.12	$ 0.12	$ 0.12

1 - With the exception of end of period ratios, all ratios are based on average daily balances during the indicated period.

2 - Return on average assets is net income (which included preferred stock costs in 2015) divided by average total assets.

3 - Return on average shareholders' equity is net income (which included preferred stock costs in 2015) divided by average shareholders' equity.

4 - See Item 7 - Management's Discussion And Analysis Of Financial Condition And Results Of Operations and Note 17 Regulatory Capital in the Notes to Consolidated Financial Statements in this document for a discussion of the regulatory capital guidelines.

5 - Net interest margin is net interest income expressed as a percentage of average interest-earning assets.

6 - Nonperforming assets include all nonperforming loans (nonaccrual loans, loans 90 days past due and still accruing interest and restructured loans that are nonperforming) and real estate acquired by foreclosure or transfer to OREO.

7 - The efficiency ratio is calculated by dividing noninterest expense by the sum of net interest income and noninterest income and presented based on results from continuing operations.

8 - Tangible book value per share is computed by dividing total shareholders' equity less goodwill and other intangible assets, net by shares outstanding. Management believes that tangible book value per share is meaningful because it is a measure that the Company and investors commonly use to assess capital adequacy.

Item 7 - Management's Discussion And Analysis Of Financial Condition And Results Of Operations

The following discussion and analysis of our financial condition as of December 31, 2019 and 2018 and results of operations for those years should be read together with our Consolidated Financial Statements and related notes, included in Part II Item 8 of this report. Average balances, including balances used in calculating certain financial ratios, are comprised of average daily balances.

The disclosures set forth in this item are qualified by important factors detailed in Part I captioned *Forward-Looking Statements* and Item 1A captioned *Risk Factors* of this report and other cautionary statements set forth elsewhere in the report.

This section of this Form 10-K generally discusses 2019 and 2018 items and year-to-year comparisons between 2019 and 2018. Discussions of 2017 items and year-to-year comparisons between 2018 and 2017 that are not included in this Form 10-K can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2018.

EXECUTIVE OVERVIEW

Net income for the years ended December 31, 2019 and 2018 was $15.0 million or $0.83 per share diluted and $15.7 million or $0.96 per share-diluted, respectively.

The current year includes the benefits of our January 31, 2019 acquisition of The Merchants National Bank of Sacramento ("Merchants"). In May, we successfully converted all of Merchant's computer records onto our core system. As previously announced, the Company's subsidiary bank, which had been operating under multiple names, simultaneously changed the name for all locations to Merchants Bank of Commerce. During 2019 acquisition related costs totaled $2.2 million and costs related to the name change totaled $503 thousand. All significant costs for these two projects have now been absorbed.

Financial performance for 2018 and 2017 includes "selected tax items" which complicates reporting period comparisons. The 2018 results include a $1.5 million decrease in our income tax provision composed of a $988 thousand reversal of our reserve for uncertain tax position and a $484 thousand benefit as a result of our cost segregation study and tangible property review. The 2017 results include a $2.5 million increase in our income tax provision as a result of the Tax Cuts and Jobs Act of 2017.

Non-GAAP Financial Measures

In addition to results presented in accordance with generally accepted accounting principles in the United States of America (GAAP), this Annual Report on Form 10-K contains certain non-GAAP financial measures. We believe that these non-GAAP financial measures provide investors with information useful in understanding the Company's financial performance; however, readers of this document are urged to review these non-GAAP financial measures in conjunction with the GAAP results as reported.

SELECTED NON-GAAP FINANCIAL INFORMATION - UNAUDITED

(amounts in thousands except per share data)

	For The Twelve Months Ended December 31,		
Reconciliation of Net Income (GAAP) to Net Income Excluding Selected Tax Items (non-GAAP):	**2019**	**2018**	**2017**
Net income (GAAP)	$ 14,961	$ 15,730	$ 7,344
Selected tax items:			
Reversal of uncertain tax position (GAAP)	—	(988)	—
Benefit from cost segregation study and tangible property review (GAAP)	—	(484)	—
Deferred tax asset write-down (GAAP)	—	—	2,490
Total selected tax items	—	(1,472)	2,490
Net income excluding selected tax items (non-GAAP)	$ 14,961	$ 14,258	$ 9,834
Earnings per share - diluted (GAAP)	$ 0.83	$ 0.96	$ 0.48
Effect of selected tax items	—	(0.09)	0.16
Earnings per share - diluted excluding selected tax items (non-GAAP)	$ 0.83	$ 0.87	$ 0.64
GAAP Information:			
Return on average assets	1.03 %	1.22 %	0.61 %
Return on average equity	9.09 %	12.08 %	6.34 %
Effective tax rate	26.9 %	18.7 %	48.5 %
Non-GAAP Information:			
Return on average assets excluding selected tax items	1.03 %	1.11 %	0.82 %
Return on average equity excluding selected tax items	9.09 %	10.95 %	8.48 %
Effective tax rate excluding selected tax items	26.9 %	26.3 %	31.1 %

Financial Highlights for the year ended December 31, 2019 were as follows:

Performance

- Net income of $15.0 million was a decrease of $769 thousand (5%) from $15.7 million earned during the same period in the prior year. Earnings of $0.83 per share – diluted was an decrease of $0.13 (14%) from $0.96 per share – diluted earned during the same period in the prior year and reflects the impact of the following:
    - 1,834,142 shares of common stock issued during the first quarter of 2019 as part of our acquisition of Merchants and
    - 90,501 shares of common stock repurchased during the fourth quarter of 2019 as part of our previously announced share repurchase program.
- Net interest income increased $6.0 million (13%) to $53.5 million compared to $47.5 million for the same period in the prior year.
- Net interest margin improved to 3.94% compared to 3.90% for the same period in the prior year.
- Return on average assets decreased to 1.03% compared to 1.22% for the same period in the prior year.
- Return on average equity decreased to 9.09% compared to 12.08% for the same period in the prior year.
- Average loans totaled $1.021 billion, an increase of $105 million (12%) compared to average loans for the same period in the prior year.
- Average earning assets totaled $1.360 billion, an increase of $140 million (11%) compared to average earning assets for the same period in the prior year.
- Average deposits totaled $1.245 billion, an increase of $146 million (13%) compared to average deposits for the same period in the prior year.
    - Average non-maturing deposits totaled $1.084 billion, an increase of $154 million (17%) compared to the same period in the prior year.
    - Average certificates of deposit totaled $160.6 million, a decrease of $7.6 million (5%) compared to same period in the prior year.
- The Company's efficiency ratio was 64.5% compared to 62.5% during the same period in the prior year.
    - The Company's efficiency ratio of 64.5% for 2019 includes $2.2 million in acquisition costs and $503 thousand in name change costs. The efficiency ratio excluding these non-recurring costs is 59.9%.
    - The Company's efficiency ratio of 62.5% for 2018 includes $844 thousand in acquisition costs. The efficiency ratio excluding these non-recurring costs is 60.8%.

Capital

- Declared cash dividends of $0.19 per share for 2019 compared to $0.15 per share in 2018.
- Book value per common share was $9.62 at December 31, 2019 compared to $8.47 at December 31, 2018. Tangible book value per common share (non-GAAP) which excludes goodwill and other intangible assets, net from shareholders' equity was $8.71 at December 31, 2019 compared to $8.36 at December 31, 2018. Management believes that tangible book value per share is meaningful because it is a measure that the Company and investors commonly use to assess capital adequacy.
- Average total equity increased by $34.4 million (26%) to $164.6 million for the year ended December 31, 2019, compared to $130.2 million for the year ended December 31, 2018.
- The Bank maintained capital levels in excess of the "well-capitalized" standards at December 31, 2019 under the regulatory framework for prompt corrective action.

Credit Quality

- Nonperforming assets at December 31, 2019 totaled $5.7 million or 0.38% of total assets, an increase of $1.5 million since December 31, 2018. The increase was primarily caused by loans to one commercial real estate borrower that were in nonaccrual status and had zero calculated impairment at December 31, 2019.
- There was no provision for loan and lease losses during the current year, net loan loss charge-offs totaled $61 thousand for the year.

Vision and Objectives

We seek to provide competitive, long-term returns to our shareholders while serving the financial needs of the communities in our market. Management strives to provide those returns while exercising prudent risk management practices and maintaining adequate levels of capital and reserves.

Our vision is to remain independent, expanding our presence with organic growth and the addition of new strategically important locations. We will pursue attractive opportunities to enter related lines of business and to acquire financial institutions with complementary lines of business when it is beneficial to do so. During 2019, with the purchase of Merchants, our growth in average assets totaled $169.3 million or 13%.

Our long-term success rests on the shoulders of the leadership team and its ability to effectively enhance the performance of the Company. As a financial services company, we are in the business of taking and managing risks. Whether we are successful depends largely upon whether we take the right risks and are rewarded appropriately for those risks. Our governance structure enables us to manage all major aspects of our business effectively through an integrated process that includes financial, strategic, risk and leadership planning.

We define risks to include not only credit, market and liquidity risk, the traditional concerns for financial institutions, but also operational risks, including risks related to systems, processes or external events, as well as legal, regulatory and reputation risks. Our management processes, structures, and policies help to ensure compliance with laws and regulations and provide clear lines for decision-making and accountability. Results are important, but equally important is how we achieve those results. Our core values and commitment to high ethical standards are essential to maintaining public trust and confidence in our Company.

RESULTS OF OPERATIONS

The following discussion and analysis provides a comparison of the results of operations for the two years ended December 31, 2019. This discussion should be read in conjunction with the Consolidated Financial Statements and related notes.

Overview

The current year includes the benefits of our January 31, 2019 acquisition of Merchants. In May, we successfully converted all of Merchant's computer records onto our core system. As previously announced, the Company's subsidiary bank, which had been operating under multiple names, simultaneously changed the name for all locations to Merchants Bank of Commerce. During 2019 acquisition related costs totaled $2.2 million and costs related to the name change totaled $503 thousand. All significant costs for these two projects have now been absorbed.

The Year Ended December 31, 2019 Compared to the Year Ended December 31, 2018

Net income was $15.0 million for the year ended December 31, 2019, compared to $15.7 million for the year ended December 31, 2018. For 2019, increases in net interest income and noninterest income were offset by increased noninterest expenses and provision for income taxes.

Diluted earnings per share were $0.83 for the year ended December 31, 2019 compared with $0.96 for the same period a year previous.

We declared cash dividends of $0.19 per share in 2019 and $0.15 per share in 2018. In determining the amount of dividend to be paid, we give consideration to capital preservation objectives, expected asset growth, projected earnings, the overall dividend pay-out ratio and the dividend yield.

Return on Average Assets and Return on Average Equity

The following table presents the return on average assets and return on average equity for the years ended December 31, 2019, 2018 and 2017. For each of the periods presented, the table includes the calculated ratios based on reported net income as shown in the *Consolidated Statements* of *Income* incorporated in this document.

	2019	2018	2017
Return on average assets	1.03 %	1.22 %	0.61 %
Return on average equity	9.09 %	12.08 %	6.34 %

Net Interest Income and Net Interest Margin

Net interest income is our largest source of operating income. Net interest income for the years ended December 31, 2019 and 2018 was $53.5 million and $47.5 million, respectively.

Interest income for the year ended December 31, 2019 was $59.6 million, an increase of $6.9 million or 13% compared to a year previous. The increase in interest income was derived from our loan portfolio ($5.6 million), our investment securities portfolio ($1.1 million) and our interest bearing cash balances ($160 thousand). All of our earning assets benefited from increases in both volume and yield.

Interest expense for the year ended December 31, 2019 was $6.0 million, an increase of $873 thousand or 17% compared to a year previous.

- Interest on interest-bearing deposits increased $1.3 million during 2019. Average interest-bearing core deposit balances increased $85.6 million while average time deposit balances decreased $7.6 million. The cost of all interest-bearing deposits was 0.54% for 2019 compared with 0.43% for 2018.
- Interest on senior and subordinated term debt decreased $271 thousand during 2019. During the second quarter of 2019, we completed the early repayment of our variable senior debt.
- Interest on FHLB term debt decreased $188 thousand during 2019. FHLB term debt averaged $9.6 million in 2019 and $22.5 million in 2018. In addition, the cost of FHLB term debt was 2.56% in 2019 compared with 1.94% in 2018.
- Interest on junior subordinated debentures increased $41 thousand during 2019.

The net interest margin for the year ended December 31, 2019 was 3.94% an increase of four basis points as compared to 2018.

Maintaining our net interest margin in the future will be challenging as current market pressures are anticipated to cause our yield on average interest-earning assets to decline.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Average Balances, Interest Income/Expense and Yields Earned/Rates Paid

	Years Ended December 31,								
	2019			2018			2017		
(Amounts in thousands)	Average Balance	Interest[1]	Yield/ Rate[5]	Average Balance	Interest[1]	Yield/ Rate[5]	Average Balance	Interest[1]	Yield/ Rate[5]
Interest-earning assets:									
Net loans [2]	$ 1,020,801	$ 50,534	4.95 %	$ 915,360	$ 44,955	4.91 %	$ 818,119	$ 39,112	4.78 %
Taxable securities	246,723	6,673	2.70 %	207,407	5,165	2.49 %	165,333	3,921	2.37 %
Tax-exempt securities [3]	38,706	1,244	3.21 %	50,330	1,629	3.24 %	74,231	2,144	2.89 %
Interest-bearing deposits in other banks	54,095	1,112	2.06 %	47,038	952	2.02 %	66,872	772	1.15 %
Average interest-earning assets	1,360,325	59,563	4.38 %	1,220,135	52,701	4.32 %	1,124,555	45,949	4.09 %
Cash and due from banks	22,806			20,468			18,301		
Premises and equipment, net	15,598			13,952			15,567		
Goodwill and other intangible assets, net	15,565			1,917			2,136		
Other assets	43,818			32,369			37,692		
Average total assets	$ 1,458,112			$ 1,288,841			$ 1,198,251		
Interest-bearing liabilities:									
Demand - interest-bearing	$ 242,516	480	0.20 %	$ 238,328	414	0.17 %	$ 209,792	274	0.13 %
Money market	304,340	1,599	0.53 %	250,685	646	0.26 %	224,913	470	0.21 %
Savings	136,733	493	0.36 %	109,025	288	0.26 %	111,376	200	0.18 %
Certificates of deposit	160,550	1,977	1.23 %	168,183	1,910	1.14 %	205,648	2,188	1.06 %
Federal Home Loan Bank of San Francisco borrowings	9,644	247	2.56 %	22,466	435	1.94 %	302	3	0.99 %
Other borrowings	10,895	806	7.40 %	15,143	1,077	7.11 %	17,981	1,165	6.48 %
Junior subordinated debentures	10,310	426	4.13 %	10,310	385	3.73 %	10,310	287	2.78 %
Average interest-bearing liabilities	874,988	6,028	0.69 %	814,140	5,155	0.63 %	780,322	4,587	0.59 %
Noninterest-bearing demand	400,588			332,197			289,735		
Other liabilities	17,894			12,286			12,293		
Shareholders’ equity	164,642			130,218			115,901		
Average liabilities and shareholders’ equity	$ 1,458,112			$ 1,288,841			$ 1,198,251		
Net interest income and net interest margin[4]		$ 53,535	3.94 %		$ 47,546	3.90 %		$ 41,362	3.68 %

[1] Interest income on loans includes deferred fees and costs of approximately $657 thousand and $465 thousand and $546 thousand for the years ended December 31, 2019, 2018 and 2017, respectively.

[2] Net loans includes average nonaccrual loans of $11.7 million and $4.2 million and $8.9 million for the years 2019, 2018 and 2017, respectively.

[3] Interest income and yields on tax-exempt securities are not presented on a taxable equivalent basis.

[4] Net interest margin is net interest income expressed as a percentage of average interest-earning assets. Net interest income for the year ended December 31, 2019 included $620 thousand in accretion of the discount on the loans acquired from Merchants Holding Company, which improved the net interest margin by 6 basis points.

[5] Yields and rates are calculated by dividing the income or expense by the average balance of the assets or liabilities, respectively.

The following table sets forth a summary of the changes in net interest income due to changes in average asset and liability balances (volume variance) and changes in average rates (rate variance) for 2019 compared to 2018 and 2018 compared to 2017. Changes in interest income and expense, which are not specifically attributable to either volume or rate, are allocated proportionately between both variances. Interest income and yields on tax-exempt securities are not presented on a taxable equivalent basis.

Analysis of Changes in Net Interest Income

	Years Ended December 31,					
	2019 over 2018			2018 over 2017		
(Amounts in thousands)	Volume	Rate	Net Change	Volume	Rate	Net Change
Increase (decrease) in interest income:						
Net loans	$ 5,217	$ 362	$ 5,579	$ 4,752	$ 1,091	$ 5,843
Taxable securities	1,037	471	1,508	1,040	204	1,244
Tax-exempt securities [(1)]	(374)	(11)	(385)	(823)	308	(515)
Interest-bearing deposits in other banks	145	15	160	(117)	297	180
Total increase (decrease)	6,025	837	6,862	4,852	1,900	6,752
Increase (decrease) in interest expense:						
Interest-bearing demand and money market	7	59	66	41	99	140
Money market	163	790	953	58	118	176
Savings	84	121	205	(4)	92	88
Certificates of deposit	(78)	145	67	(441)	163	(278)
Federal Home Loan Bank of San Francisco borrowings	(433)	245	(188)	426	6	432
Other borrowings	(316)	45	(271)	(231)	143	(88)
Junior subordinated debentures	—	41	41	—	98	98
Total increase	(573)	1,446	873	(151)	719	568
Net increase (decrease)	$ 6,598	$ (609)	$ 5,989	$ 5,003	$ 1,181	$ 6,184

[(1)] Interest income on tax-exempt securities are not presented on a taxable equivalent basis.

Noninterest Income

The following table presents the key components of noninterest income for the years ended December 31, 2019, 2018 and 2017.

	Years Ended December 31,							
	2019 Compared to 2018				2018 Compared to 2017			
(Amounts in thousands)	2019	2018	Change Amount	Change Percent	2018	2017	Change Amount	Change Percent
Noninterest income:								
Service charges on deposit accounts	$ 730	$ 682	$ 48	7 %	$ 682	$ 542	$ 140	26 %
ATM and point of sale fees	1,158	1,131	27	2 %	1,131	1,093	38	3 %
Payroll and benefit processing fees	669	652	17	3 %	652	658	(6)	(1) %
Life insurance	536	512	24	5 %	512	1,050	(538)	(51) %
Gains on sales of investment securities, net	186	44	142	323 %	44	137	(93)	(68) %
Federal Home Loan Bank of San Francisco dividends	507	480	27	6 %	480	318	162	51 %
Gain (loss) on sale of OREO	62	73	(11)	(15) %	73	368	(295)	(80) %
Insured cash sweep fees	—	—	—	— %	—	197	(197)	(100) %
Other	336	445	(109)	(24) %	445	461	(16)	(3) %
Total noninterest income	$ 4,184	$ 4,019	$ 165	4 %	$ 4,019	$ 4,824	$ (805)	(17) %

Noninterest income in 2019 was $4.2 million, an increase of $165 thousand or 4% compared to 2018. During 2018, we recognized a $96 thousand special dividend on Federal Home Loan Bank of San Francisco stock that did not recur in 2019.

Noninterest Expense

The following table presents the key components of noninterest expense for the years ended December 31, 2019, 2018 and 2017.

	Years Ended December 31,							
	2019 Compared to 2018				2018 Compared to 2017			
(Amounts in thousands)	2019	2018	Change Amount	Change Percent	2018	2017	Change Amount	Change Percent
Noninterest expense:								
Salaries & related benefits	$ 20,804	$ 18,709	$ 2,095	11 %	$ 18,709	$ 17,819	$ 890	5 %
Premises & equipment	3,752	3,983	(231)	(6) %	3,983	4,178	(195)	(5) %
Federal Deposit Insurance Corporation insurance premium	91	376	(285)	(76) %	376	318	58	18 %
Data processing	2,535	1,997	538	27 %	1,997	1,813	184	10 %
Professional services	1,539	1,431	108	8 %	1,431	1,398	33	2 %
Telecommunications	737	594	143	24 %	594	879	(285)	(32) %
Acquisition and merger	2,193	844	1,349	160 %	844	—	844	100 %
Other	5,604	4,272	1,332	31 %	4,272	4,559	(287)	(6) %
Total noninterest expense	$ 37,255	$ 32,206	$ 5,049	16 %	$ 32,206	$ 30,964	$ 1,242	4 %

Noninterest expense for the year ended December 31, 2019 was $37.3 million, an increase of $5.0 million or 16% compared to 2018.

For the year ended December 31, 2019 compared to the prior year:

- Salaries and related benefit costs increased $2.1 million thousand primarily as a result of additional employees from the Merchants acquisition.
- Federal Deposit Insurance Corporation insurance premium decreased $285 thousand due to Small Bank Assessment Credits from the FDIC in 2019.
- Costs related to the name change totaled $503 thousand in 2019.
- Amortization of the core deposit intangible for the deposits acquired from Merchants totaled $499 thousand in 2019.
- Premises and equipment costs decreased $231 thousand due to accelerated or final depreciation on certain assets recognized during 2018.

Income Taxes

Our provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to our income before taxes. The following table reflects our tax provision and the related effective tax rate for the periods indicated.

	Years Ended December 31,		
(Amounts in thousands)	2019	2018	2017
Income before provision for income taxes	$ 20,464	$ 19,359	$ 14,272
Provision for income taxes	$ 5,503	$ 3,629	$ 6,928
Effective tax rate	26.9 %	18.7 %	48.5 %

The following table presents a reconciliation of income taxes computed at the federal statutory rate to the actual effective rate for the years ended December 31, 2019, 2018, and 2017.

	2019	2018	2017
Income tax at the federal statutory rate	21.0 %	21.0 %	34.0 %
State franchise tax, net of federal tax benefit	8.6 %	8.3 %	6.5 %
Amortization of affordable housing credit partnerships	2.4 %	2.7 %	4.8 %
Officer life insurance	(0.5) %	(0.6) %	(2.5) %
Tax-exempt interest	(1.3) %	(1.8) %	(5.2) %
Affordable housing credits and benefits	(3.5) %	(3.8) %	(5.7) %
Accelerated depreciation - cost segregation study	— %	(2.5) %	— %
Reversal of uncertain tax position	— %	(5.1) %	— %
Deferred tax asset write-down	— %	— %	17.5 %
Other	0.2 %	0.5 %	(0.8) %
Effective Tax Rate	26.9 %	18.7 %	48.5 %

Cost Segregation Study and Tangible Property Review

We completed a cost segregation study and a tangible property review during 2018, which shortened the depreciable lives of certain assets and accelerated the tax depreciation deduction on our 2017 federal income tax return. We recorded an expense of $293 thousand in other noninterest expense and a benefit to our 2018 book provision for income taxes of $484 thousand in the fourth quarter of 2018 upon completion of these projects.

Amended Tax Returns

In September of 2016, we filed amended federal and state tax returns for tax years 2011, 2012, 2013, and 2014. The amendments were filed to properly recognize tax events in years 2011 and 2013 that were improperly recognized in years 2011 through 2014. The IRS rejected the 2011 amended tax return citing the statute for assessment had expired. Accordingly, in early 2017, $988 thousand of taxes due to the taxing authorities pursuant to the 2011 amended federal tax return was returned to us. We maintained the liability for the taxes due on the rejected 2011 tax return which created an uncertain tax position. During 2018, the statute of limitations on the 2014 amended federal tax return passed, we reversed the reserve for our uncertain tax position and recognized the $988 thousand in our provision for income taxes which reduced our effective tax rate.

FINANCIAL CONDITION

Consolidated Balance Sheets

As of December 31, 2019, we had total consolidated assets of $1.480 billion, gross loans of $1.033 billion, allowance for loan and lease losses ("ALLL") of $12.2 million, total deposits of $1.267 billion, and shareholders' equity of $174 million.

We continued to maintain a strong liquidity position during the reporting period. As of December 31, 2019, we maintained noninterest-bearing cash positions at the Federal Reserve Bank and correspondent banks in the amount of $21.3 million. We also held interest-bearing deposits in the amount of $59.3 million.

Available-for-sale investment securities totaled $287.0 million at December 31, 2019, compared with $257.0 million at December 31, 2018. Our available-for-sale investment portfolio provides a secondary source of liquidity to fund other higher yielding asset opportunities, such as loan originations. During 2019, we purchased securities with a par value of $96.8 million and the Merchants acquisition added securities with a par value of $107.4 million. During 2019, we sold securities with a par value of $118.0 million resulting in $186 thousand in net realized gains. During 2019, we also received $64.2 million in proceeds from principal payments, calls and maturities within the available-for-sale securities portfolio.

At December 31, 2019, our net unrealized gains on available-for-sale securities were $3.7 million compared with $4.3 million net unrealized losses at December 31, 2018. The changes in the net unrealized losses to net unrealized gains was primarily driven by significant changes in market interest rates.

We recorded gross loan balances of $1.033 billion at December 31, 2019, compared with $946.3 million at December 31, 2018, an increase of $87 million. The increase in gross loans included $80.1 million in loans received from the acquisition of Merchants.

The ALLL at December 31, 2019 decreased $61 thousand to $12.2 million compared to $12.3 million at December 31, 2018. At December 31, 2019, relying on our ALLL methodology, which uses criteria such as risk factors and historical loss rates, and given the ongoing improvements in asset quality, we believe the ALLL is adequate. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses.

Nonperforming loans, which include nonaccrual loans and accruing loans past due over 90 days, increased by $1.5 million to $5.6 million, or 0.54% of gross loans, as of December 31, 2019, compared to $4.1 million, or 0.44% of gross loans as of December 31, 2018. The increase in nonperforming loans was primarily caused by loans to one commercial real estate borrower that were placed on nonaccrual and had zero calculated impairment at December 31, 2019.

Past due loans as of December 31, 2019 decreased to $4.9 million, compared to $13.9 million as of December 31, 2018. The decrease in past due loans was primarily due to the sale of a $9.9 million nonaccrual commercial real estate loan. We believe that risk grading for past due and nonperforming loans appropriately reflects the risk associated with the past due loans. See Note 5 *Loans* in the *Notes to Consolidated Financial Statements* in this document for further detail on the ALLL and the loan portfolio.

Premises and equipment totaled $15.9 million at December 31, 2019, an increase of $2.8 million compared to $13.1 million at December 31, 2018. The increase included $2.2 million in premises and equipment acquired from Merchants.

Our OREO balance at December 31, 2019 was $35 thousand compared to $31 thousand at December 31, 2018. For the year ended December 31, 2019, we transferred three foreclosed properties in the amount of $74 thousand to OREO. During 2019, we sold three properties with balances of $70 thousand for a net gain of $62 thousand.

Bank-owned life insurance increased $1.3 million during the year ended December 31, 2019 to $23.7 million compared to $22.4 million at December 31, 2018. The increase included $755 thousand in bank-owned life insurance acquired from Merchants.

Our net deferred tax assets were $4.6 million at December 31, 2019 compared to $7.0 million at December 31, 2018. The decrease was primarily due to unrealized gains in the investment portfolio and core deposit intangibles related to the acquisition of Merchants.

Goodwill and other intangible assets, net increased $14.7 million during the year ended December 31, 2019 to $16.5 million compared to $1.8 million at December 31, 2018. The increase was due to $11.0 million of goodwill and $4.1 million in net core deposit intangibles related to the acquisition of Merchants.

Other assets which include the Bank's investment in qualified zone academy bonds, Federal Home Loan Bank of San Francisco stock, right-of-use lease asset and low income housing tax credit partnerships totaled $28.6 million at December 31, 2019 compared to $22.5 million at December 31, 2018. The increase included $1.5 million in Federal Home Loan Bank of San Francisco stock acquired from Merchants and a $4.0 million (net of $458 thousand recognized previously as part of the single lease cost) right-of-use lease asset recorded upon the adoption of ASU No. 2016-02.

Total deposits at December 31, 2019, increased $135 million or 12% to $1.267 billion compared to December 31, 2018.

- Total non-maturing deposits increased $136.1 million compared to December 31, 2018.
  - The Merchants Holding Company acquisition provided an additional $152.2 million in non-maturing deposits.
- Certificates of deposit decreased $596 thousand compared to December 31, 2018.
  - The Merchants Holding Company acquisition provided an additional $38.0 million in certificates of deposit.
  - During the year of 2019, $21.8 million of wholesale time deposits matured and were not renewed.

Other liabilities which include the Bank's supplemental executive retirement plan, operating leases and funding obligation for investments in qualified affordable housing partnerships increased $4.3 million to $17.7 million as of December 31, 2019 compared to $13.4 million at December 31, 2018. The increase included the $4.4 million operating lease liability recorded upon the adoption of ASU No. 2016-02.

Investment Securities

The composition of our investment securities portfolio reflects management's investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of interest income.

The investment securities portfolio also:

- Partially mitigates interest rate risk;
- Diversifies the credit risk inherent in the loan portfolio;
- Provides a vehicle for the investment of excess liquidity;
- Provides a source of liquidity when pledged as collateral for lines of credit;
- Is used as collateral for certain public funds.

Our available-for-sale investment securities totaled $287.0 million at December 31, 2019, compared to $257.0 million at December 31, 2018. The Merchants acquisition added 231 securities with a par value of $107.4 million to our investment securities portfolio. During the first quarter of 2019, we sold a portion of our investment securities portfolio to provide liquidity for our seasonal decline in deposit balances and our planned reduction of wholesale certificates of deposit.

The following table presents the carrying value of the investment securities portfolio by classification and major type as of December 31, for each of the last three years.

(Amounts in thousands)	2019	2018	2017
Available-for-sale securities:			
U.S. government & agencies	$ 38,733	$ 40,087	$ 40,369
Obligations of state and political subdivisions	42,098	50,530	78,844
Residential mortgage-backed securities and collateralized mortgage obligations	180,835	138,503	114,592
Corporate securities	2,966	2,922	4,992
Commercial mortgage-backed securities	19,307	24,762	26,641
Other asset-backed securities	3,011	124	1,505
Total	$ 286,950	$ 256,928	$ 266,943

The following table presents information regarding the amortized cost, and maturity structure of the investment portfolio at December 31, 2019.

	Maturities Within One Year		Maturities Over One Through Five Years		Maturities Over Five Through Ten Years		Maturities Over Ten Years		Total	
(Amounts in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available-for-sale securities: [(1)]										
U.S. government & agencies	$ 1,250	3.01 %	$ 51	3.01 %	$ 18,143	3.33 %	$ 18,847	2.97 %	$ 38,291	3.14 %
Obligations of state and political subdivisions	902	3.31 %	11,011	3.55 %	14,107	3.02 %	14,682	3.25 %	40,702	3.25 %
Residential mortgage-backed securities and collateralized mortgage obligations	2,385	2.23 %	126,361	2.77 %	34,995	2.96 %	15,373	2.84 %	179,114	2.80 %
Corporate securities	2,005	3.01 %	1,000	2.00 %	—	—%	—	—%	3,005	2.67 %
Commercial mortgage-backed securities	—	—%	1,019	2.43 %	7,406	2.42 %	10,701	2.78 %	19,126	2.62 %
Other asset-backed securities	—	—%	—	—%	—	—%	3,019	2.82 %	3,019	2.82 %
Total	$ 6,542	2.77 %	$ 139,442	2.82 %	$ 74,651	3.01 %	$ 62,622	2.96 %	$ 283,257	2.90 %

(1) The maturities for the collateralized mortgage obligations and mortgage-backed securities are presented by expected average life, rather than contractual maturity. The yield on tax-exempt securities has not been adjusted to a tax-equivalent yield basis.

Loan Portfolio

Loan Concentrations

Historically, we have concentrated our loan origination activities primarily within El Dorado, Placer, Sacramento, and Shasta counties in California. In recent years, our loan origination activity has expanded to include other portions of California and northern Nevada. We manage our credit risk through various diversifications of our loan portfolio, the application of sound underwriting policies and procedures, and ongoing credit monitoring practices. Generally, the loans are secured by real estate or other assets located in California. Repayment is expected from the borrower's cash flows or cash flows from real estate investments.

The following table presents the composition of the loan portfolio as of December 31 for each of the last five years.

(Amounts in thousands)	As of December 31,									
Loan Portfolio	**2019**	**%**	**2018**	**%**	**2017**	**%**	**2016**	**%**	**2015**	**%**
Commercial	$ 141,197	14 %	$ 135,543	14 %	$ 142,405	16 %	$ 146,881	18 %	$ 125,394	17 %
Commercial real estate:										
Real estate – construction and land development	26,830	3 %	22,563	2 %	15,902	2 %	36,792	5 %	28,319	4 %
Real estate – commercial non-owner occupied	493,920	48 %	433,708	46 %	377,668	43 %	292,615	36 %	228,174	32 %
Real estate – commercial owner occupied	218,833	21 %	204,622	22 %	192,023	22 %	174,298	22 %	178,910	25 %
Residential real estate:										
Real estate – residential - ITIN	33,039	3 %	37,446	4 %	41,188	5 %	45,566	6 %	49,106	7 %
Real estate – residential - 1-4 family mortgage	63,661	6 %	34,366	4 %	30,377	3 %	20,425	3 %	17,268	2 %
Real estate – residential - equity lines	22,099	2 %	26,958	3 %	30,347	3 %	35,953	4 %	39,595	6 %
Consumer and other	33,324	3 %	51,045	5 %	49,925	6 %	51,681	6 %	49,873	7 %
Gross loans	1,032,903	100 %	946,251	100 %	879,835	100 %	804,211	100 %	716,639	100 %
Deferred fees and costs	2,162		1,927		1,710		1,324		870	
Loans, net of deferred fees and costs	1,035,065		948,178		881,545		805,535		717,509	
Allowance for loan and lease losses	(12,231)		(12,292)		(11,925)		(11,544)		(11,180)	
Net loans	$ 1,022,834		$ 935,886		$ 869,620		$ 793,991		$ 706,329	

The following table sets forth the maturity and distribution of our loan portfolio as of December 31, 2019.

(Amounts in thousands)	**Within One Year**	**After One Through Five Years**	**After Five Years**	**Total**
Commercial	$ 66,951	$ 65,288	$ 9,792	$ 142,031
Commercial real estate:				
Real estate - construction and land development	4,374	11,089	11,273	26,736
Real estate - commercial non-owner occupied	37,145	204,633	251,714	493,492
Real estate - commercial owner occupied	25,638	85,196	109,423	220,257
Residential real estate:				
Real estate - residential - ITIN	3,401	13,411	16,227	33,039
Real estate - residential - 1-4 family mortgage	6,301	20,544	36,918	63,763
Real estate - residential - equity lines	718	2,002	19,678	22,398
Consumer and other	1,296	2,348	29,705	33,349
Loans, net of deferred fees and costs	$ 145,824	$ 404,511	$ 484,730	$ 1,035,065
Loans with:				
Fixed rates	49,959	$ 190,871	199,155	439,985
Variable rates	95,865	213,640	285,575	595,080
Total	145,824	$ 404,511	$ 484,730	$ 1,035,065

Loans with unique credit characteristics

ITIN Loans

We own a pool of Individual Tax Identification Number ("ITIN") residential mortgage loans. The ITIN loans are geographically disbursed throughout the United States and are made to legal United States residents who do not possess a social security number. The ITIN loan portfolio is serviced by a third party. The majority of the ITIN loans are variable rate loans and may have an increased default risk in a rising rate environment. Worsening economic conditions in the United States may cause us to suffer higher default rates on our ITIN loans and reduce the value of the assets that we hold as collateral. In addition, if we become responsible for servicing of these ITIN loans, then we may realize additional monitoring, servicing and appraisal costs due to the geographic disbursement of the portfolio which will adversely affect our noninterest expense.

SFC Loans

Between May of 2014 and December of 2018, we purchased unsecured retail installment home improvement loans that were originated by Service Finance Company, LLC (SFC). The loans were made through a network of over 8,000 approved home improvement dealers throughout the United States and Puerto Rico. Loans within the portfolio have a wide range of terms, interest rates and purchase discounts or premiums. Some of the loans contain promotional periods designed to allow the consumer to use the financing as a cash flow tool. The loans are serviced by SFC and have an average FICO credit score over 750. The servicing agreement with SFC will remain in effect until payment in full of the unpaid principal balance of the loans. In addition, if we become responsible for servicing of these loans, then we may realize additional monitoring and servicing costs due to the geographic disbursement of the portfolio which would adversely affect our noninterest expense.

Purchased Loans

In addition to loans we have originated or acquired through our acquisition of Merchants, the loan portfolio includes purchased loan pools and purchased participations. Purchased loans are recorded at their fair value at the acquisition date.

The following table presents the recorded investment in purchased loan pools and purchased participations at December 31, 2019 and 2018.

	For The Years Ended December 31,			
	2019		2018	
(Amounts in thousands) **Loan Type**	**Balance**	**% of Gross Loan Portfolio**	**Balance**	**% of Gross Loan Portfolio**
Commercial	$ —	—%	$ 66	— %
Commercial real estate	19,506	2 %	29,096	3 %
Residential real estate	45,494	4 %	51,164	5 %
Consumer and other	28,579	3 %	46,049	5 %
Total purchased loans	$ 93,579	9 %	$ 126,375	13 %

Asset Quality

Nonperforming Assets

Our loan portfolio is heavily concentrated in real estate and a significant portion of our borrowers' ability to repay their loans is dependent upon the professional services, commercial real estate market and the residential real estate development industry sectors. Loans secured by real estate or other assets primarily located in California are expected to be repaid from cash flows of the borrower or proceeds from the sale of collateral. As such, our dependence on real estate secured loans could increase the risk of loss in our loan portfolio in a market of declining real estate values. Furthermore, declining real estate values would negatively impact holdings of OREO.

We manage asset quality and mitigate credit risk through the application of policies designed to promote sound underwriting and loan monitoring practices. Our Loan Committee is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. The provision for loan and lease losses charged to earnings is based upon management's judgment of the amount necessary to maintain the allowance at a level adequate to absorb probable incurred losses. The amount of provision charge is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of loan portfolio quality, general economic conditions that can impact the value of collateral, and other trends. The evaluation of these factors is performed through an analysis of the adequacy of the ALLL. Reviews of nonperforming, past due loans and larger credits, designed to identify potential charges to the ALLL, and to determine the adequacy of the allowance, are conducted on a monthly basis. These reviews consider such factors as the financial strength of borrowers, the value of the applicable collateral, loan and lease loss experience, estimated loan and lease losses, growth in the loan portfolio, prevailing economic conditions and other factors.

A loan is considered impaired when, based on current information and events, we determine it is probable that we will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Generally, when we identify a loan as impaired, we measure the loan for potential impairment using discount cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of collateral, less selling costs. The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated every twelve months. We obtain appraisals from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. At a minimum, it is ascertained that the appraiser is: (1) currently licensed in the state in which the property is located, (2) is experienced in the appraisal of properties similar to the property being appraised, (3) is actively engaged in the appraisal work, (4) has knowledge of current real estate market conditions and financing trends, (5) is reputable, and (6) is not on Freddie Mac's nor our Exclusionary List of appraisers and brokers. In most cases, appraisals will be reviewed by another independent third party to ensure the quality of the appraisal and the expertise and independence of the appraiser. Upon receipt and review, an external appraisal is utilized to measure a loan for potential impairment.

Our impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. An appraisal over one year old in most cases will be considered stale dated and an updated or new appraisal will be required. Any adjustments from appraised value to net realizable value are detailed and justified in the impairment analysis, which is reviewed and approved by our Chief Credit Officer. Although an external appraisal is the primary source to value collateral dependent loans, we may also utilize values obtained through purchase and sale agreements, negotiated short sales, broker price opinions, or the sales price of the note. These alternative sources of value are used only if deemed to be more representative of value based on updated information regarding collateral resolution. Impairment analyses are updated, reviewed and approved on a quarterly basis at or near the end of each reporting period. Based on these processes, we do not believe there are significant time lapses for the recognition of additional provision for loan and lease losses or charge-offs from the date they become known.

Loans are classified as nonaccrual when collection of principal or interest is doubtful; generally these are loans that are past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. Additionally, all loans that are impaired are considered for nonaccrual status. Loans placed on nonaccrual will typically remain in nonaccrual status until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement appear certain.

Upon acquisition of real estate collateral, typically through the foreclosure process, we promptly begin to market the property for sale. If we do not receive offers or indications of interest within a reasonable timeframe, we will review market conditions to assess the pricing level that would enable us to sell the property. At the time of foreclosure, OREO is recorded at fair value less costs to sell ("cost"), which becomes the property's new basis. Unless a current appraisal is available, an appraisal will be ordered prior to a loan migrating to OREO. Any write-downs based on the asset's fair value at the date of acquisition are charged to the ALLL. After foreclosure, management periodically performs valuations and the property is carried at the lower of the cost or fair value less expected selling costs. We obtain updated appraisals on OREO property every six to twelve months. Valuation adjustments recorded in a period are primarily based on (1) updated appraisals received during the period, or (2) management's authorization to reduce the selling price of the property during the period.

The following table summarizes our nonperforming assets as of December 31 for each of the last five years.

(Amounts in thousands)	As of December 31,				
Nonperforming Assets	**2019**	**2018**	**2017**	**2016**	**2015**
Commercial	$ 61	$ 959	$ 1,603	$ 2,749	$ 1,994
Commercial real estate:					
Real estate - commercial non-owner occupied	—	548	—	1,196	5,488
Real estate - commercial owner occupied	3,103	—	600	784	1,071
Total commercial real estate	3,103	548	600	1,980	6,559
Residential real estate:					
Real estate - residential - ITIN	2,221	2,388	2,909	3,576	3,649
Real estate - residential - 1-4 family mortgage	191	185	606	1,914	1,775
Real estate - residential - equity lines	—	43	45	917	—
Total residential real estate	2,412	2,616	3,560	6,407	5,424
Consumer and other	40	23	36	250	32
Total nonaccrual loans	5,616	4,146	5,799	11,386	14,009
90 days past due and still accruing	—	—	—	—	88
Total nonperforming loans	5,616	4,146	5,799	11,386	14,097
Other real estate owned	35	31	35	759	1,423
Total nonperforming assets	$ 5,651	$ 4,177	$ 5,834	$ 12,145	$ 15,520
Nonperforming loans to gross loans	0.54 %	0.44 %	0.66 %	1.42 %	1.97 %
Nonperforming assets to total assets	0.38 %	0.32 %	0.46 %	1.06 %	1.53 %

We regularly perform thorough reviews of the commercial real estate portfolio, including semi-annual stress testing. These reviews are performed on both our non-owner and owner occupied credits. These reviews are completed to verify leasing status, to ensure the accuracy of risk ratings, and to develop proactive action plans with borrowers on projects. Stress testing is performed to determine the effect of rising cap rates, interest rates, and vacancy rates on the portfolio. Based on our analysis, we believe we are effectively managing the risks in this portfolio. There can be no assurance that declines in economic conditions, such as potential increases in retail or office vacancy rates, will not exceed the projected assumptions utilized in stress testing resulting in additional nonperforming loans in the future.

Loans are reported as troubled debt restructurings when we grant a concession(s) to a borrower experiencing financial difficulties that we would not otherwise consider. Examples of such concessions include a reduction in the loan rate, forgiveness of principal or accrued interest, extending the maturity date(s) significantly, or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, restructured loans are impaired as we will not collect all amounts due, either principal or interest, in accordance with the terms of the original loan agreement. Impairment reserves on non-collateral dependent troubled debt restructured loans are measured by comparing the present value of expected future cash flows of the restructured loans, discounted at the effective interest rate of the original loan agreement to the loans carrying value. These impairment reserves are recognized as a specific component to be provided for in the ALLL.

As of December 31, 2019, we had $6.5 million in troubled debt restructurings compared to $9.6 million as of December 31, 2018. As of December 31, 2019, we had 98 restructured loans that qualified as troubled debt restructurings, of which 94 loans were performing according to their restructured terms. Troubled debt restructurings represented 0.63% of gross loans as of December 31, 2019, compared with 1.01% at December 31, 2018.

Impaired loans of $4.8 million and $6.9 million were classified as accruing troubled debt restructurings at December 31, 2019 and December 31, 2018, respectively. For a restructured loan to be on accrual status, the loan's collateral coverage must generally be greater than or equal to 100% of the loan balance, the loan payments must be current, and the borrower must demonstrate the ability to make payments from a verified source of cash flow. As of December 31, 2019, we had no obligations to lend additional funds on any restructured loans. As of December 31, 2018, we had one restructured commercial line of credit in nonaccrual status that had $313 thousand in available credit.

The following table sets forth a summary of our restructured loans that qualify as troubled debt restructurings for each of the last five years.

(Amounts in thousands)	As of December 31,				
Troubled Debt Restructurings	**2019**	**2018**	**2017**	**2016**	**2015**
Accruing troubled debt restructurings					
Commercial	$ 595	$ 1,224	$ 1,551	$ 776	$ 49
Commercial real estate:					
Real estate - commercial non-owner occupied	—	795	803	808	824
Residential real estate:					
Real estate - residential - ITIN	3,957	4,484	4,614	5,033	5,458
Real estate - residential - equity lines	231	363	380	454	558
Total accruing troubled debt restructurings	4,783	6,866	7,348	7,071	6,889
Nonaccruing troubled debt restructurings					
Commercial	47	877	863	1,940	863
Commercial real estate:					
Real estate - commercial non-owner occupied	—	—	—	—	4,292
Real estate - commercial owner occupied	—	—	—	—	1,071
Residential real estate:					
Real estate - residential - ITIN	1,593	1,793	2,396	2,691	2,538
Real estate - residential - 1-4 family mortgage	—	—	296	335	219
Consumer and other	40	23	26	29	32
Total nonaccruing troubled debt restructurings	1,680	2,693	3,581	4,995	9,015
Total troubled debt restructurings					
Commercial	642	2,101	2,414	2,716	912
Commercial real estate:					
Real estate - commercial non-owner occupied	—	795	803	808	5,116
Real estate - commercial owner occupied	—	—	—	—	1,071
Residential real estate:					
Real estate - residential - ITIN	5,550	6,277	7,010	7,724	7,996
Real estate - residential - 1-4 family mortgage	—	—	296	335	219
Real estate - residential - equity lines	231	363	380	454	558
Consumer and other	40	23	26	29	32
Total troubled debt restructurings	$ 6,463	$ 9,559	$ 10,929	$ 12,066	$ 15,904
Total troubled debt restructuring to gross loans outstanding at period end	0.63 %	1.01 %	1.24 %	1.50 %	2.22 %

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The ALLL at December 31, 2019 decreased $61 thousand to $12.2 million compared to $12.3 million at December 31, 2018. As a result of continued improved asset quality, no provision for loan and lease losses was necessary during the year ended December 31, 2019 and 2018.

The loans acquired from Merchants were recorded at fair value, which included a discount for credit risk adjustments, which is not a part of the ALLL. No ALLL is required for these acquired loans on the date of acquisition. As a result, our ALLL as a percentage of gross loans declined to 1.18% as of December 31, 2019 compared to 1.30% as of December 31, 2018.

The following table summarizes the ALLL roll forward for each of the five years ended December 31. This table also includes impaired loan information for each of the five years as of December 31.

	For the Years Ended December 31,				
(Amounts in thousands)	2019	2018	2017	2016	2015
Beginning balance ALLL	$ 12,292	$ 11,925	$ 11,544	$ 11,180	$ 10,820
Provision for loan and lease loss charged to expense	—	—	950	—	—
Loans charged off	(1,500)	(1,248)	(1,502)	(2,784)	(2,376)
Loan and lease loss recoveries	1,439	1,615	933	3,148	2,736
Ending balance ALLL	12,231	12,292	11,925	11,544	11,180

	At December 31,				
	2019	2018	2017	2016	2015
Nonaccrual loans:					
Commercial	61	959	1,603	2,749	1,994
Real estate - commercial non-owner occupied	—	548	—	1,196	5,488
Real estate - commercial owner occupied	3,103	—	600	784	1,071
Real estate - residential - ITIN	2,221	2,388	2,909	3,576	3,649
Real estate - residential - 1-4 family mortgage	191	185	606	1,914	1,775
Real estate - residential - equity lines	—	43	45	917	—
Consumer and other	40	23	36	250	32
Total nonaccrual loans	5,616	4,146	5,799	11,386	14,009
Accruing troubled-debt restructured loans:					
Commercial	595	1,224	1,551	776	49
Real estate - commercial non-owner occupied	—	795	803	808	824
Real estate - residential - ITIN	3,957	4,484	4,614	5,033	5,458
Real estate - residential - equity lines	231	363	380	454	558
Total accruing restructured loans	4,783	6,866	7,348	7,071	6,889
All other accruing impaired loans	—	—	—	337	492
Total impaired loans	10,399	11,012	13,147	18,794	21,390
Gross loans outstanding	$ 1,032,903	$ 946,251	$ 879,835	$ 804,211	$ 716,639
Ratio of ALLL to gross loans outstanding	1.18 %	1.30 %	1.36 %	1.44 %	1.56 %
Nonaccrual loans to gross loans outstanding	0.54 %	0.44 %	0.66 %	1.42 %	1.95 %

As of December 31, 2019, impaired loans totaled $10.4 million, of which $5.6 million were in nonaccrual status. Of the total impaired loans, $6.2 million or 100 were ITIN loans with an average balance of approximately $62 thousand per loan. The remaining impaired loans consist of four commercial loans, two commercial real estate loans, two residential mortgages, two consumer loans and five home equity loans.

At December 31, 2019, impaired loans had a corresponding specific allowance of $324 thousand. The specific allowance on impaired loans represents the impairment reserves on performing restructured loans, other accruing loans, and nonaccrual loans.

The following table sets forth the allocation of the ALLL for each of the five years as of December 31.

(Amounts in thousands)	At December 31,									
ALLL	**2019**	**%**	**2018**	**%**	**2017**	**%**	**2016**	**%**	**2015**	**%**
Commercial	$ 1,822	15 %	$ 2,205	18 %	$ 2,397	20 %	$ 2,748	24 %	$ 2,373	21 %
Commercial real estate:										
Real estate - construction and land development	131	1 %	107	1 %	82	1 %	177	2 %	246	2 %
Real estate - commercial non-owner occupied	5,907	47 %	5,169	42 %	4,698	40 %	3,637	32 %	3,014	27 %
Real estate - commercial owner occupied	2,058	17 %	1,840	15 %	1,734	15 %	1,865	16 %	2,643	24 %
Residential real estate:										
Real estate - residential - ITIN	569	5 %	660	5 %	602	5 %	973	8 %	998	9 %
Real estate - residential - 1-4 family mortgage	185	2 %	162	1 %	151	1 %	106	1 %	111	1 %
Real estate - residential - equity lines	278	2 %	351	3 %	416	3 %	637	5 %	469	4 %
Consumer and other	933	8 %	1,356	11 %	1,435	12 %	955	8 %	770	7 %
Unallocated	348	3 %	442	4 %	410	3 %	446	4 %	556	5 %
Total ALLL	$ 12,231	100 %	$ 12,292	100 %	$ 11,925	100 %	$ 11,544	100 %	$ 11,180	100 %

The unallocated portion of ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk grading-based component, or in the specific reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of December 31, 2019, the unallocated allowance amount represented 3% of the ALLL, compared to 4% at December 31, 2018. While the ALLL composition is an indication of specific amounts or loan categories in which future charge-offs may occur, actual amounts may differ.

Reserve for Unfunded Commitments

The reserve for unfunded commitments, which is included in *Other Liabilities* on the *Consolidated Balance Sheets*, was $695 thousand at December 31, 2019 and 2018. The adequacy of the reserve for unfunded commitments is reviewed on a quarterly basis, based upon changes in the amount of commitments, loss experience, and economic conditions. Any provision adjustment is recorded in *Other Expenses* in the *Consolidated Statements of Income.*

Deposits

Total deposits as of December 31, 2019 were $1.267 billion compared to $1.132 billion at December 31, 2018, an increase of $135 million or 12%. The following table presents deposit balances by major category as of December 31 for the last two years.

(Amounts in thousands)	At December 31,			
Deposits	**2019**	**%**	**2018**	**%**
Noninterest-bearing demand	$ 432,680	34 %	$ 347,199	31 %
Interest-bearing demand	239,258	19 %	252,202	22 %
Money market	307,559	24 %	265,093	23 %
Savings	135,888	11 %	114,840	10 %
Certificates of deposit, $100,000 or greater	120,282	10 %	119,376	11 %
Certificates of deposit, less than $100,000	31,504	2 %	33,006	3 %
Total	$ 1,267,171	100 %	$ 1,131,716	100 %

The following table sets forth the distribution of average deposits and their respective average rates for the periods indicated.

	Years Ended December 31,					
	2019		2018		2017	
(Amounts in thousands)	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
Interest-bearing demand	$ 242,516	0.20 %	$ 238,328	0.17 %	$ 209,792	0.13 %
Money market	304,340	0.53 %	250,685	0.26 %	224,913	0.21 %
Savings	136,733	0.36 %	109,025	0.26 %	111,376	0.18 %
Certificates of deposit	160,550	1.23 %	168,183	1.14 %	205,648	1.06 %
Interest-bearing deposits	844,139	0.54 %	766,221	0.43 %	751,729	0.42 %
Noninterest-bearing demand	400,588		332,197		289,735	
Total deposits	$ 1,244,727	0.37 %	$ 1,098,418	0.30 %	$ 1,041,464	0.30 %

Deposit Maturity Schedule

The following table sets forth the maturities of certificates of deposit in the amounts of $100,000 or more as of December 31, 2019.

(Amounts in thousands)

Maturing in:	2019
Three months or less	$ 20,991
Three through six months	22,871
Six through twelve months	28,714
Over twelve months	47,706
Total	$ 120,282

We have an agreement with Promontory Interfinancial Network LLC (“Promontory”) which facilitates provision of FDIC deposit insurance to balances in excess of current FDIC deposit insurance limits. Promontory’s Certificate of Deposit Account Registry Service (“CDARS”) and Insured Cash Sweep (“ICS”) products use a deposit-matching program to exchange Bank deposits in excess of the current deposit insurance limits for excess balances at other participating banks, on a dollar-for-dollar basis (reciprocal arrangement). These products are designed to enhance our ability to attract and retain customers and increase deposits, by providing additional FDIC coverage to customers. CDARS and ICS deposits can also be arranged on a non-reciprocal basis.

Borrowings

The following table sets forth the distribution of our year-to-date average balances for borrowings and their respective average rates for the periods indicated.

	Years Ended December 31,					
	2019		2018		2017	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Federal Home Loan Bank of San Francisco borrowings	$ 9,644	2.56 %	$ 22,466	1.94 %	$ 302	0.99 %
Other borrowings, net	10,895	7.40 %	15,143	7.11 %	17,981	6.48 %
Junior subordinated debentures	10,310	4.13 %	10,310	3.73 %	10,310	2.78 %
Total borrowings	$ 30,849	4.80 %	$ 47,919	3.96 %	$ 28,593	5.09 %

Term Debt

At December 31, 2019, we had term debt outstanding with a carrying value of $10.0 million compared to $13.4 million at December 31, 2018. Term debt consisted of the following:

Federal Home Loan Bank of San Francisco Borrowings

As of December 31, 2019 and 2018, the Bank had no Federal Home Loan Bank of San Francisco advances outstanding. The average balances outstanding on Federal Home Loan Bank of San Francisco term advances during 2019 and 2018 were $9.6 million and $22.5 million, respectively. *See Note 10 Term Debt* in the *Notes to Consolidated Financial Statements* for information on our Federal Home Loan Bank of San Francisco borrowings.

Senior Debt

In December of 2015, we entered into a senior debt loan agreement to borrow $10.0 million. During the second quarter of 2019, we completed the early repayment and termination of this variable-rate debt agreement.

Subordinated Debt

In December of 2015, we issued $10.0 million of fixed to floating rate Subordinated Notes. The subordinated debt initially bears interest at 6.88% per annum for a five-year term. Thereafter, interest on the subordinated debt will be paid at a variable rate equal to three month LIBOR plus 526 basis points, resetting quarterly. At December 31, 2019 the subordinated debt had a balance of $10.0 million net of unamortized debt issuance costs. The notes are due in 2025.

Junior Subordinated Debentures

Bank of Commerce Holdings Trust II

During July of 2005, we participated in a $10.0 million private placement of fixed rate trust-preferred securities (the "Trust-Preferred Securities") through a wholly owned Delaware trust affiliate, Bank of Commerce Holdings Trust II (the "Trust II"). Trust II simultaneously issued $310 thousand common securities to the Holding Company. Rates paid on the Trust-Preferred Securities have transitioned from fixed to floating and are now paid on a quarterly basis at a rate equal to three month LIBOR plus 158 basis point 3.47% at December 31, 2019. The Trust-Preferred Securities mature on September 15, 2035, and the covenants allow for redemption of the securities at our option during any quarter prior to maturity.

The proceeds from the sale of the Trust-Preferred Securities were used by Trust II to purchase from the Holding Company the aggregate principal amount of $10.3 million of the Holding Company’s junior subordinate debentures (the "Notes"). The net proceeds to the Holding Company from the sale of the Notes to Trust II were partially distributed to the Bank. The proceeds from the Notes qualify as Tier 1 capital under Federal Reserve Board guidelines.

SOURCES OF INCOME

We derive our income primarily from net interest income, which is the difference between the interest income we receive on interest-earning assets and the interest expense we pay on interest-bearing liabilities. Net interest income is impacted by many factors that are beyond our control, including general economic conditions and the policies of various governmental and regulatory agencies, the Federal Reserve Board in particular. In recent years, we originated higher volumes of longer term fixed rate loans. These loans, combined with the structure of our investment portfolio and funding mix caused the Company to become slightly to moderately liability sensitive to rising interest rates. However, our floating rate assets reprice faster than our liabilities in a decreasing rate environment and cause the Company to be slightly asset sensitive to falling rates.

Net interest income reflects both the amount of earning assets we hold and our net interest margin, which is the difference between the yields we receive on our earning assets and the interest rates we pay to fund those assets. As a result, changes in either our net interest margin or the amount of earning assets we hold will affect our net interest income and earnings.

Increases or decreases in interest rates could adversely affect our net interest margin. Although our asset yields and funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, and cause our net interest margin to expand or contract. Many of our assets are tied to indexes, which adjust in response to changes in interest rates.

Changes in the slope of the yield curve, and the spread between short-term and long-term interest rates could also reduce our net interest margin. Normally, the yield curve is upward sloping, which means that short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets.

We assess our interest rate risk by estimating the effect of interest rate changes on our earnings under various simulated scenarios. The scenarios differ based on assumptions including the direction, magnitude and speed of interest rate changes, and the slope of the yield curve.

There is always the risk that changes in interest rates could reduce our net interest income and earnings in material amounts, especially if actual conditions turn out to be materially different than simulated scenarios. For example, if interest rates rise or fall faster than we assumed or the slope of the yield curve changes, we may incur significant losses on debt securities we hold as investments. To reduce our interest rate risk, we may rebalance our investment and loan portfolios, refinance our debt and take other strategic actions, which may result in losses or expenses.

The following table summarizes as of December 31, 2019 when loans are projected to reprice by year and by rate index.

(Amounts in thousands)	Year 1	Year 2	Year 3	Year 4	Year 5	Years 6 Through Year 10	Beyond Year 10	Total
Rate Index:								
Fixed	$ 49,959	$ 52,191	$ 33,501	$ 72,871	$ 32,308	$ 166,641	$ 32,514	$ 439,985
Variable:								
Prime	92,508	5,534	9,682	4,616	6,759	4,752	—	123,851
5 Year Treasury	24,733	66,548	83,684	66,329	77,812	54,490	—	373,596
7 Year Treasury	858	7,024	9,292	480	5,597	13,828	—	37,079
1 Year LIBOR	20,988	—	—	—	—	—	—	20,988
Other Indexes	4,146	2,946	2,062	1,733	5,716	16,730	617	33,950
Nonaccrual	625	551	529	513	492	1,988	918	5,616
Total	$ 193,817	$ 134,794	$ 138,750	$ 146,542	$ 128,684	$ 258,429	$ 34,049	$ 1,035,065

Non Interest Income

We also earn noninterest income. Sources of noninterest income include fees earned on deposit related services, ATM and point of sale fees, payroll and benefit processing fees, earnings on bank-owned life insurance, gains on sale of available-for-sale securities, and dividends on Federal Home Loan Bank of San Francisco stock. Most of these sources of income do not vary significantly from quarter to quarter. Possible exceptions include gains on sale of available-for-sale securities and death proceeds from bank-owned life insurance.

LIQUIDITY AND CASH FLOW

Merchants Bank of Commerce

On January 31, 2019 we completed the acquisition of Merchants Holding Company located in Sacramento, California. The transaction was attractive to us because it expanded our presence in the Sacramento market, provided a new source of low cost core deposits and a quality loan portfolio. The acquisition provided approximately $104.5 million of additional liquidity ($119.8 cash and investment securities less $15.3 million paid to Merchants shareholders). Management elected to sell securities with a par value of $118.0 million during 2019 to provide liquidity for our decline in deposit balances and our planned reduction of wholesale certificates of deposit. The sales also included the elimination of certain securities acquired from Merchants Holding Company that did not fit our investment strategy.

The principal objective of our liquidity management program is to maintain our ability to meet the day-to-day cash flow requirements of our customers who either wish to withdraw funds on deposit or to draw upon their credit facilities.

We monitor the sources and uses of funds on a daily basis to maintain an acceptable liquidity position. One source of funds includes public deposits. We may be required to collateralize a portion of public deposits that exceed FDIC insurance limitations based on the state of California's risk assessment of the Bank. Public deposits represent 2% of total deposits at December 31, 2019 and December 31, 2018.

In addition to liquidity provided by core deposits, loan repayments and cash flows from securities, the Bank can borrow on established conditional federal funds lines of credit, sell securities, borrow on a secured basis from the Federal Home Loan Bank of San Francisco, borrow on a secured basis from the Federal Reserve Bank, or issue subscription / brokered certificates of deposit.

At December 31, 2019, the Bank had the following credit arrangements:

- We have an available line of credit with the Federal Home Loan Bank of San Francisco of $460.5 million; credit availability is subject to certain collateral requirements, namely the amount of pledged loans and investment securities.
- We have an available line of credit with the Federal Reserve Bank of $22.3 million subject to collateral requirements, namely the amount of pledged loans.
- We have entered into nonbinding federal funds line of credit agreements with three financial institutions. The available credit on these lines totaled $35.0 million at December 31, 2019 and had interest rates ranging from 1.80% to 2.58%. Advances under the lines are subject to funds availability, continued borrower eligibility, and may have consecutive day usage restrictions.

Bank of Commerce Holdings

The Holding Company is a separate entity from the Bank and must provide for its own liquidity. At December 31, 2019, the Holding Company had cash balances of $6.8 million. Our principal source of cash is dividends received from the Bank. During 2019, the Bank paid a dividend of $12.5 million to the Holding Company. There are statutory and regulatory provisions that could limit the ability of the Bank to pay dividends to the Holding Company in the future.

Consolidated Statement of Cash Flows

Net cash of $16.6 million was provided by operating activities for the year ended December 31, 2019. As disclosed in the *Consolidated Statements of Cash Flows* The primary difference between net income and cash provided by operating activities, was non-cash items including:

- $2.1 million in depreciation, accretion and amortization

Net cash of $79.1 million provided by investing activities during the year ended December 31, 2019 consisted principally of:

- $117.3 million in proceeds from sale of investment securities.
- $64.2 million in proceeds from maturities and payments of investment securities.

These sources of cash were partially offset by:

- $97.7 million in purchases of investment securities.
- $2.9 million of net cash paid for the acquisition of Merchants.

Net cash of $62.5 million used by financing activities during the year ended December 31, 2019 principally consisted of:

- $16.2 million decrease in deposits excluding $152.2 million in deposits provided by the acquisition of Merchants.
- $38.6 million decrease in certificates excluding $38.0 million in certificates provided by the acquisition of Merchants.
- $3.5 million decrease in net term debt.
- $3.2 million dividends paid on common stock

CAPITAL RESOURCES

Equity capital is available to support organic and strategic growth, pay dividends and repurchase shares. The objective of effective capital management is to produce competitive long-term returns for our shareholders. Our sources of capital include retained earnings, common and preferred stock issuance, and issuance of subordinated debt or trust notes.

REGULATORY CAPITAL GUIDELINES

Federal bank regulatory agencies use capital adequacy guidelines in the examination and regulation of bank holding companies and banks. The guidelines are "risk-based," meaning that they are designed to make capital requirements more sensitive to differences in risk profiles among banks and bank holding companies. The current rules (commonly known as Basel III) require the Bank and the Company to meet a capital conservation buffer requirement in order to avoid constraints on capital distributions, such as dividends and equity repurchases, and certain bonus compensation for executive officers. The capital conservation buffer of 2.50% is added to the minimum capital ratios.

The Basel III minimum capital requirements plus the conservation buffer exceed the prior regulatory "well-capitalized" capital thresholds by 0.5 percentage points. This 0.5 percentage-point cushion allows institutions to dip into a portion of their capital conservation buffer before reaching a status that is considered less than well capitalized for prompt corrective action purposes.

For certain qualifying institutions, the FDIC has substituted a Community Bank Leverage Ratio in lieu of the Basel III capital requirements. The FDIC has set the Community Bank Leverage Ratio at 9%. The ratio will be defined as the ratio of Tier 1 capital to average total consolidated assets. Banks that meet the following criteria will only be required to report one ratio effective January 1, 2020:

- Community Bank Leverage Ratio above 9%,
- Consolidated assets less than $10 billion,
- Off-balance-sheet exposures of 25% or less of consolidated assets and
- Total trading assets and liabilities of 5% or less of assets.

Any qualifying depository institution or its holding company that exceeds the Community Bank Leverage Ratio will be considered to have met generally applicable leverage and risk-based regulatory capital requirements and considered to be "well capitalized" under the prompt corrective action rules. Based on management's review and analysis of Basel III and the Crapo Bill, management believes that the Holding Company and the Bank will exceed the standards under these rules.

CAPITAL ADEQUACY

Overall capital adequacy is monitored on a day-to-day basis by management and reported to our Board of Directors on a monthly basis.

As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's risk category. The Holding Company and the Bank's capital amounts and ratios as of December 31, 2019, are presented in the following table.

	December 31, 2019					
(Amounts in thousands)	Capital	Actual Ratio	Well Capitalized Requirement	Minimum Capital Requirement	Applicable 2019 Capital Conservation Buffer	Minimum Capital Requirement Plus Capital Conservation Buffer
Holding Company:						
Common equity tier 1 capital ratio	$ 156,587	13.19 %	n/a	4.50 %	2.50 %	7.00 %
Tier 1 capital ratio	$ 166,587	14.04 %	n/a	6.00 %	2.50 %	8.50 %
Total capital ratio	$ 189,513	15.97 %	n/a	8.00 %	2.50 %	10.50 %
Tier 1 leverage ratio	$ 166,587	11.30 %	n/a	4.00 %	n/a	4.00 %
Bank:						
Common equity tier 1 capital ratio	$ 170,568	14.39 %	6.50 %	4.50 %	2.50 %	7.00 %
Tier 1 capital ratio	$ 170,568	14.39 %	8.00 %	6.00 %	2.50 %	8.50 %
Total capital ratio	$ 183,494	15.48 %	10.00 %	8.00 %	2.50 %	10.50 %
Tier 1 leverage ratio	$ 170,568	11.58 %	5.00 %	4.00 %	n/a	4.00 %

On December 10, 2015, the Holding Company issued $10.0 million in aggregate principal amount of Subordinated Notes to certain institutional investors. The Subordinated Notes qualify as Tier 2 Capital under the Final Rules. See Item 1a - *Risk Factors*, in our Annual Report on Form 10-K for the year ended December 31, 2019 for further detail on potential risks relating to the Subordinated Notes.

Capital ratios for the Holding Company include the benefit derived from issuing 1,834,142 shares of common stock valued at $19.6 million during the first quarter of 2019 as part of our acquisition of Merchants.

On September 18, 2019, we announced that our Board of Directors had authorized a stock purchase program. The stock purchase program authorizes the Company to purchase up to one million shares of its common stock over a period ending March 31, 2020 and is effective immediately. Purchases may be made in the open market, including in block trades, or through privately negotiated transactions, from time to time when management determines that market conditions and other factors warrant such purchases. There is no guarantee as to the exact number of shares to be purchased, and the stock purchase program may be modified, suspended, or terminated without prior notice. On February 21, 2020 we announced that our Board of Directors increased the number of shares that may be repurchased from 1,000,000 to 1,500,000 shares of common stock, and extended the program by one year to March 31, 2021. During the fourth quarter of 2019, we repurchased 90,501 shares under the plan.

Goodwill and other intangible assets, net totaled $16.5 million at December 31. 2019 and primarily consisted of goodwill and core deposit intangibles recorded as part of previous acquisitions. See Note 7, *Goodwill and Other Intangibles* in the *Notes to Consolidated Financial Statements* in this document for additional detail goodwill and other intangible assets. When calculating capital ratios, goodwill and other intangible assets, net are deducted from Tier 1 capital. Under the Basel III risk based capital rules, the deduction for core deposit intangibles was initially subject to a phase in period which has now expired.

Goodwill and other intangible assets, net are deducted from tangible equity as part of the calculation of tangible book value per share.

CASH DIVIDENDS AND PAYOUT RATIOS PER COMMON SHARE

The following table presents cash dividends declared and dividend pay-out ratios (dividends declared per common share divided by basic earnings per common share) for the years ended December 31. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, capital preservation and expected growth. The dividend rate will be reassessed periodically by the Board of Directors in accordance with the dividend policy. There is no assurance that future cash dividends on common shares will be declared or increased.

	2019	2018	2017
Dividends declared per common share for the quarter ended March 31,	$ 0.04	$ 0.03	$ 0.03
Dividends declared per common share for the quarter ended June 30,	0.05	0.04	0.03
Dividends declared per common share for the quarter ended September 30,	0.05	0.04	0.03
Dividends declared per common share for the quarter ended December 31,	0.05	0.04	0.03
Total	$ 0.19	$ 0.15	$ 0.12
Dividend payout ratio	23 %	15 %	25 %

TANGIBLE BOOK VALUE PER SHARE

We have recorded goodwill and other intangible assets, net of $16.5 million which are subtracted from equity as part of the calculation of tangible book value per share. Management believes that tangible book value per share is meaningful because it is a measure that the Company and investors commonly use to assess the value of the Company. Tangible book value per common share was $8.71 at December 31, 2019 compared to $8.36 at December 31, 2018.

OFF-BALANCE SHEET ARRANGEMENTS

Information regarding Off-Balance Sheet Arrangements is included in Note 14, *Commitments and Contingencies* in the *Notes to Consolidated Financial Statements* in this document.

CONCENTRATION OF CREDIT RISK

Information regarding Concentration of Credit Risk is included in Note 14, *Commitments and Contingencies,* in the *Notes to Consolidated Financial Statements* incorporated in this document.

LENDING TRANSACTIONS WITH RELATED PARTIES

The business we conduct with directors, officers, significant shareholders and other related parties (collectively, “Related Parties”) is restricted and governed by various laws and regulations, including 12 CFR Part 215 (Regulation O). Furthermore, it is our policy to conduct business with Related Parties on an arm’s length basis at current market prices with terms and conditions no more favorable than we provide in the normal course of business. See Note 23, *Related Party Transactions* in the *Notes to Consolidated Financial Statements* in this document for additional detail on lending transactions with related parties.

IMPACT OF INFLATION

Inflation affects our financial position as well as operating results. It is our opinion that the effect of inflation on our financial statements for the two years ended December 31, 2019 has not been material.

RISK MANAGEMENT

Overview

Through our corporate governance structure, risk and return are evaluated to produce sustainable revenues, reduce risk of earnings volatility and increase shareholder value. The financial services industry is exposed to four major categories or types of risks; liquidity, credit, market and operational. Liquidity risk is the inability to meet liability maturities and withdrawals, fund asset growth and otherwise meet contractual obligations at reasonable market rates. Credit risk is the inability of a customer to meet their repayment obligations or the inability of a bond issuer to meet their contractual repayment obligations. Market risk is the fluctuation in asset and liability values caused by changes in market prices and yields, and operational risk is the potential for losses resulting from events involving people, processes, technology, legal issues, external events, regulation, or reputation.

Board Committees

Our corporate governance structure begins with our Board of Directors. The Board of Directors evaluates risk through the Chief Risk Officer and our Enterprise Risk Management reporting and monitoring process (ERM). Our ERM is updated quarterly and compares our risk appetite and key risk indicators to actual results and to peer data. The Board of Directors also evaluates risk through a number of Board Committees including the following:

- Audit and Qualified Legal Compliance Committee reviews the scope and coverage of internal and external audit activities.
- Loan Committee reviews credit risks in the loan portfolio and the adequacy of the Allowance for Loan and Lease Losses (“ALLL”).
- Asset/Liability Management Committee (“ALCO”) reviews liquidity risk, credit risk in the investment bond portfolio and market risk.
- Nominating and Corporate Governance Committee evaluates corporate governance structure, committee performance and evaluates recommendations for the appointment of director nominees.
- Technology Committee provides oversight with respect to technology and innovation and the related risk assessment and risk management process.

These committees review reports from management, our auditors, and other outside sources. On the basis of materials that are available to them and on which they rely, the committees review the performance of our management and personnel, and establish policies, but neither the committees nor their individual members (in their capacities as members of the Board of Directors) is responsible for daily operations of the Company.

Management Committees

To ensure that our risk management goals and objectives are accomplished, oversight of our risk taking and risk management activities are conducted through a number of management committees comprised of members of management including the following:

- The Senior Management Committee establishes short and long-term strategies and operating plans. The committee establishes performance measures and reviews performance to plan on a monthly basis. The committee is also responsible for evaluating operational risk assessments and approving and implementing mitigating action plans.
- The Asset Liability Roundtable establishes and monitors liquidity ranges, pricing, maturities, investment goals, and interest spread on balance sheet accounts.
- The SOX 404 Compliance Committee has established the master plan for full documentation of our internal controls and compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

Risk Management Controls

We use various controls and our ERM to manage risk exposure within the Company. Budgeting and variance analyses and key performance indicators provide an early indication of unfavorable results or heightened risk levels. Models are used to estimate market risk and net interest income sensitivity. Segmentation analysis is an important tool used to estimate expected and unexpected credit losses. Compliance with regulatory guidelines plays a significant role in risk management as well as corporate culture and the actions of management. Our code of ethics provides guidelines for all employees to use to ensure that they conduct themselves with the highest integrity in the delivery of service to our clients.

Liquidity Risk Management

Liquidity Risk

Liquidity risk is the inability to meet liability maturities, deposit withdrawals, fund asset growth or otherwise meet contractual obligations at reasonable market rates. Liquidity management involves maintaining ample and diverse funding capacity, liquid assets and other sources of cash to accommodate fluctuations in asset and liability levels due to business shocks or unanticipated events. ALCO is responsible for establishing our liquidity policy and the Bank’s internal ALCO Roundtable group is responsible for planning and executing the funding activities and strategies.

The Bank’s liquid assets consist of cash and amounts due from banks, cash from repayments and maturities of loans, short-term money market investments, sales of available-for-sale securities and cash flows from principal repayment and maturities of investments. Liquidity is generated from liabilities through deposit growth and term debt borrowings. Deposit marketing strategies are reviewed for consistency with liquidity policy objectives.

The Bank has secondary sources of liquidity available from correspondent banking lines of credit, a secured line of credit with the Federal Reserve Bank and a secured borrowing line with the Federal Home Loan Bank of San Francisco. While these sources are expected to continue to provide significant amounts of secondary liquidity in the future, their availability, as well as the possible use of other sources, is dependent on future economic and market conditions, pledging of acceptable collateral and maintenance of required minimum capital ratios.

The Holding Company’s principal source of cash is dividends received from the Bank, which it has consistently received for many years. See Item 1A *Risk Factors* and Note 17 *Regulatory Capital* in the *Notes to Consolidated Financial Statements* in this document for a discussion of the restrictions on the Bank’s ability to pay dividends.

To accommodate future growth and business needs, we develop an annual capital expenditure budget during strategic planning sessions. Based on our budgets and forecasts, we believe that our earnings, acquisition of core deposits and wholesale borrowing arrangements will be sufficient to support liquidity needs in 2020.

Term Debt

Federal Home Loan Bank of San Francisco borrowings

We periodically utilize Federal Home Loan Bank of San Francisco advances as a source of wholesale funding to provide temporary liquidity. As of December 31, 2019 and 2018, the Bank had no Federal Home Loan Bank of San Francisco advances outstanding. See Note *10 Term Debt in the Notes to Consolidated Financial Statements* for information on our Federal Home Loan Bank of San Francisco borrowings and our remaining line of credit.

Senior Debt

In December of 2015, the Holding Company, entered into a senior debt loan agreement to borrow $10.0 million. During the second quarter of 2019, we completed the early repayment and termination of this debt agreement. The original loan terms required monthly principal installments of $83 thousand, plus accrued and unpaid interest, commencing on January 1, 2016 and continuing to and including December 10, 2020. A final scheduled payment of $5.0 million is due on the maturity date of December 10, 2020. The loan could be prepaid in whole or in part at any time without any prepayment premium or penalty. The principal amount of the loan bore interest at a variable rate, resetting monthly that was equal to the sum of the then current three month LIBOR plus 400 basis points. The Holding Company incurred senior debt issuance costs of $15 thousand which are being amortized over the life of the loan as additional interest expense.

Subordinated Debt

In December of 2015, the Holding Company issued $10.0 million in aggregate principal amount of fixed to floating rate Subordinated Notes due December 10, 2025. The Subordinated Debt initially bears interest at 6.88% per annum for a five-year term, payable semi-annually. Thereafter, interest on the Subordinated Debt will be paid at a variable rate equal to three month LIBOR plus 526 basis points, payable quarterly until the maturity date. The notes qualify as Tier 2 capital under the capital adequacy rules and regulations issued by the Federal Reserve. The Holding Company incurred subordinated debt issuance costs of $210 thousand which are being amortized over the initial five year term as additional interest expense.

Term debt at December 31, 2019, 2018 and 2017 consisted of the following:

(Amounts in thousands)	2019	2018	2017
Senior debt	$ —	$ 3,496	$ 7,096
Less unamortized debt issuance cost	—	(2)	(6)
Subordinated debt	10,000	10,000	10,000
Less unamortized debt issuance cost	(43)	(89)	(132)
Total term debt at December 31,	$ 9,957	$ 13,405	$ 16,958

The following table presents the weighted average contractual interest rates on outstanding borrowings during the years ended December 31, 2019, 2018 and 2017.

	2019	2018	2017
Federal Home Loan Bank of San Francisco borrowings	2.57 %	1.94 %	0.88 %
Senior debt	6.73 %	6.18 %	5.21 %
Subordinated debt	6.88 %	6.88 %	6.88 %

The following table presents the maximum outstanding balance at any month end, average balance during the year and effective weighted average interest rate during the year on outstanding term debt for the years ended December 31, 2019, 2018 and 2017.

(Amounts in thousands)	2019	2018	2017
Federal Home Loan Bank of San Francisco borrowings:			
Maximum outstanding at any month end	$ 40,000	$ 70,000	$ 10,000
Average balance during the year	$ 9,644	$ 22,466	$ 302
Effective weighted average interest rate during year	2.56 %	1.94 %	0.99 %
Senior debt net of unamortized debt issuance costs:			
Maximum outstanding at any month end	$ 3,195	$ 6,890	$ 8,822
Average balance during the year	$ 960	$ 5,239	$ 8,132
Effective weighted average interest rate during year	7.22 %	6.51 %	5.34 %
Subordinated debt net of unamortized debt issuance costs:			
Maximum outstanding at any month end	$ 9,957	$ 9,911	$ 9,868
Average balance during the year	$ 9,934	$ 9,890	$ 9,849
Effective weighted average interest rate during year	7.38 %	7.38 %	7.38 %

Credit Risk Management

Credit risk arises from the inability of a loan customer to meet their repayment obligations or the inability of a bond issuer to meet their contractual repayment obligations. Credit risk exists in our outstanding loans, letters of credit, Federal Home Loan Bank of San Francisco affordable housing grant sponsorships, unfunded loan commitments, deposits with other institutions and investment bond portfolio. In all of these areas we manage credit risk based on the risk profile of the borrower/grantee/issuer, repayment sources and the nature of the underlying collateral given current events and conditions. We rely on various controls including our underwriting standards, loan policies, internal loan monitoring, ALLL methodology and credit reviews to manage credit risk.

Concentrations of credit risk

We grant real estate construction, commercial, and installment loans to customers throughout northern California. In our judgment, a concentration exists in real estate related loans, which represented approximately 83% and 81% of our gross loan portfolio at December 31, 2019 and December 31, 2018.

Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in our principal market areas in particular, could have an adverse impact on the repayment of these loans. Personal and business incomes, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

We recognize the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to other depository institutions in aggregate or to any single correspondent, we have established general standards for selecting correspondent banks as well as internal limits for allowable exposure to other depository institutions in aggregate or to any single correspondent. In addition, we have an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer.

Loan portfolio

Credit risk management for the loan portfolio begins with an assessment of the credit risk profile of each individual borrower based on an analysis of the borrower's financial position in light of current industry, economic or geopolitical trends. As part of the overall credit risk assessment of a borrower, each credit is assigned a risk grade and is subject to approval based on our existing credit approval standards. Risk grading is a significant factor in determining the adequacy of the ALLL.

Credit decisions are made by our Credit Administration subject to certain limitations and, when those limitations are encountered, the approvals are made by the Board Loan Committee. Credit risk is continuously monitored by Credit Administration for possible adjustment of a loan risk grade if there has been a change in the borrower's ability to perform under the terms of their obligation. Additionally, we may manage the size of our credit exposure through loan sales and loan participation agreements.

Our specific underwriting standards and methods for each principal line of lending include industry-accepted analysis and modeling and certain proprietary techniques. Our underwriting criteria are designed to comply with applicable regulatory guidelines, including required loan-to-value ratios. Our credit administration policies contain mandatory lien position and debt service coverage requirements, and we generally require a guarantee from individuals owning 20% or more of the borrowing entity. Our evaluations of our borrowers' are facilitated by management's knowledge of local market conditions and periodic reviews by a consultant of our credit administration policies.

Allowance for loan and lease losses

The ALLL represents management's best estimate of probable losses in the loan portfolio. Within the allowance, reserves are allocated to segments of the portfolio based on specific formula components. Changes to the ALLL are reported in the *Consolidated Statements of Income* in the line item provision for loan and lease losses.

We perform periodic and systematic detailed evaluations of our lending portfolio to identify and estimate the inherent risks and assess the overall collectability. We evaluate the following:

- General conditions such as the portfolio composition, size and maturities of various segmented portions of the portfolio such as secured, unsecured, construction, and Small Business Administration.
- Concentrations of borrowers, industries, geographical sectors, loan product, loan classes and collateral types.
- Volume and trends in the aggregate of loan delinquencies, nonaccruals, and watch, criticized and classified loans

Our ALLL is the accumulation of various components that are calculated based upon independent methodologies. All components of the ALLL represent an estimation based on certain observable data that management believes most reflects the underlying credit losses being estimated. Changes in the amount of each component of the ALLL are directionally consistent with changes in the observable data, taking into account the interaction of the components over time.

An essential element of the methodology for determining the ALLL is our credit risk evaluation process, which includes credit risk grading of individual, commercial, construction, commercial real estate, and consumer loans. Loans are assigned credit risk grades based on our assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrower's current financial information, historical payment experience, credit documentation, public information, and other information specific to each individual borrower. Loans are reviewed on an annual or rotational basis or as management becomes aware of information affecting the borrower's ability to fulfill its obligations. Credit risk grades carry a dollar weighted risk percentage.

For individually impaired loans, we measure impairment based on the present value of expected future principal and interest cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price or the fair value of collateral, if the loan is collateral dependent. When developing the estimate of future cash flows for a loan, we consider all available information reflecting past events and current conditions, including the effect of existing environmental factors. In addition to the ALLL, an allowance for unfunded loan commitments and letters of credit is determined using estimates of the probability of funding and the associated inherent credit risk. This reserve is carried as a liability on the *Consolidated Balance Sheets*.

We make provisions to the ALLL as necessary through charges to operations that are reflected in our *Consolidated Statements of Income* as provision for loan and lease loss expense. When a loan is deemed uncollectible, it is charged against the allowance. Any recoveries of previously charged off loans and leases are credited back to the allowance. There is no precise method of predicting specific losses or amounts that ultimately may be charged off on particular categories of the loan and lease portfolio.

Various regulatory agencies periodically review our ALLL as an integral part of their examination process. Such agencies may require us to provide additions to the allowance based on their judgment of information available to them at the time of their examination. There is uncertainty concerning future economic trends. Accordingly, it is not possible to predict the effect future economic trends may have on the level of the provisions for loan and lease losses in future periods. The ALLL should not be interpreted as an indication that charge-offs in future periods will occur in the stated amounts or proportions.

Federal Home Loan Bank of San Francisco Affordable Housing Grant and Access to Housing and Economic Assistance for Development Grant Sponsorships

As part of satisfying our CRA responsibilities, we are a sponsor for various nonprofit organizations which receive cash grants from the Federal Home Loan Bank of San Francisco. Those grants require the nonprofit organization to comply with stipulated conditions of the grant over specified periods of time which typically vary from 10 to 15 years. If the nonprofit organization fails to comply, Federal Home Loan Bank of San Francisco can require us to refund the amount of the grant to Federal Home Loan Bank of San Francisco. To mitigate this contingent credit risk, Credit Administration underwrites the financial strength of the nonprofit organization and reviews their systems of internal control to determine, as best as is possible, that they will not fail to comply with the conditions of the grant.

Securities Portfolio

To manage credit risk in the securities portfolio, we have an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer. We perform a pre-purchase analysis on all bonds not secured by the U.S. Government or Agency of the U.S. Government to ensure that the investment meets our credit risk requirements and repayment expectations. We perform annual and quarterly credit reviews to ensure our investments continue to meet our credit risk requirements and repayment expectations.

Deposits With Other Institutions

We recognize the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to other depository institutions in aggregate or to any single correspondent, we have established general standards for selecting correspondent banks as well as internal limits for allowable exposure to other depository institutions in aggregate or to any single correspondent.

Market Risk Management

General

Market risk is the potential loss due to adverse changes in market prices and interest rates. Market risk is inherent in our operating positions and activities including customers' loans, deposit accounts, securities and long-term debt. Loans and deposits generate income and expense, respectively, and the value of cash flows changes based on general economic levels, and most importantly, the level of interest rates.

The goal for managing our assets and liabilities is to optimize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The absolute level and volatility of interest rates can have a significant impact on our profitability. Market risk arises from exposure to changes in interest rates, exchange rates, commodity prices, and other relevant market rate or price risk. We do not operate a trading account, and do not hold a position with exposure to foreign currency exchange.

We face market risk through interest rate volatility. Net interest income, or margin risk, is measured based on rate shocks over varying time horizons versus a current stable interest rate environment. Assumptions used in these calculations are similar to those used in the planning and budgeting model. The overall interest rate risk position and strategies are reviewed on an ongoing basis with ALCO.

Securities Portfolio

The securities portfolio is central to our asset liability management strategies. The decision to purchase or sell securities is based upon our assessment of current and projected economic and financial conditions, including the interest rate environment, liquidity, changes in a security's credit rating, the risk weighting of a security and other regulatory requirements. We classify our securities as "*available-for-sale*" or "*held-to-maturity*" at the time of purchase. We do not engage in trading activities. Securities *held-to-maturity* are carried at amortized cost. Securities *available-for-sale* may be sold to implement our asset liability management strategies and in response to changes in interest rates, prepayment rates, and similar factors. Securities *available-for-sale* are recorded at fair value and unrealized gains or losses, net of income taxes, are reported as a component of accumulated other comprehensive income (loss), in a separate component of shareholders' equity. Gain or loss on sale of securities is calculated on the specific identification method.

Operational Risk Management

Operational risk is the potential for loss resulting from events involving people, processes, technology, legal or regulatory issues, external events, and reputation. In keeping with the corporate governance structure, the Senior Leadership committee is responsible for operational risk controls. Operational risks are managed through specific policies and procedures, controls and monitoring tools. Examples of these include reconciliation processes, transaction monitoring and analysis and system audits. Operational risks fall into two major categories, business specific and company-wide. The Senior Leadership committee works to ensure consistency in policies, processes and assessments. With respect to company-wide risks, the Senior Leadership committee works directly with members of our Board of Directors to develop policies and procedures for information security, business resumption plans, compliance and legal issues.

SUMMARY OF CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 2 *Summary of Significant Accounting Policies* in the *Notes to Consolidated Financial Statements* in this document. Some of these significant accounting policies are considered critical and require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

Valuation of Investments and Impairment of Securities

At the time of purchase, we designate a security as held-to-maturity or available-for-sale, based on our investment objectives, operational needs and intent to hold. We do not engage in trading activity. Securities designated as held-to-maturity are carried at amortized cost. We have the ability and intent to hold these securities to maturity. Securities designated as available-for-sale may be sold to implement our asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. Securities designated as available-for-sale are recorded at fair value and unrealized gains or losses, net of income taxes, are reported as part of accumulated other comprehensive income (loss), a separate component of shareholders' equity. Gains or losses on sale of securities are based on the specific identification method. The market value and underlying rating of the security is monitored to identify changes in quality.

Securities may be adjusted to reflect changes in valuation as a result of other-than-temporary declines in value. Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed rate investments, from changes in interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends.

When an investment is other-than-temporarily impaired, we assess whether we intend to sell the security, or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. If we intend to sell the security or if it is more likely than not that we will be required to sell security before recovery of the amortized cost basis, the entire amount of other-than-temporary impairment is recognized in earnings.

For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is calculated as the difference between the investment's amortized cost basis and the present value of its expected future cash flows.

The remaining differences between the investment's fair value and the present value of future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income. Significant judgment is required in the determination of whether other-than-temporary impairment has occurred for an investment. We follow a consistent and systematic process for determining other-than-temporary impairment loss. We have designated the ALCO responsible for the other-than-temporary evaluation process.

The ALCO's assessment of whether other-than-temporary impairment loss should be recognized incorporates both quantitative and qualitative information including, but not limited to: (1) the length of time and the extent of which the fair value has been less than amortized cost, (2) the financial condition and near term prospects of the issuer, (3) our intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value, (4) whether the debtor is current on interest and principal payments, and (5) general market conditions and industry or sector specific outlook. See Note 4 *Securities* in the *Notes to Consolidated Financial Statements* in this document for further detail on other-than-temporary impairment and the securities portfolio.

Allowance for Loan and Lease Losses

The ALLL is based upon estimates of loan and lease losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. The allowance is increased by provisions charged to expense and reduced by net charge-offs. In periodic evaluations of the adequacy of the allowance balance, management considers our past loan and lease loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors.

Management reviews the ALLL on a monthly basis and conducts a formal assessment of the adequacy of the ALLL on a quarterly basis. These assessments include the periodic re-grading of classified loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment and other factors as warranted. Loans are initially graded when originated. Loans are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies. Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for unimpaired loan categories are based on analysis of historical losses adjusted for changing environmental factors applicable to each loan category. Allowances for changing environmental factors are management's best estimate of the probable impact these changes would have on the loan portfolio as a whole. See Note 5 *Loans* in the *Notes to Consolidated Financial Statements* in this document for further detail on the ALLL and the loan portfolio.

Income Taxes

Income taxes reported in the consolidated financial statements are computed based on an asset and liability approach. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences that have been recognized in the consolidated financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the consolidated financial statements and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, management considers all available positive and negative evidence, including projected future taxable income, tax planning strategies and recent financial operations.

In projecting future taxable income, management develops assumptions including the amount of future state and federal pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. We file consolidated federal and state income tax returns.

ASC 740-10-55 *Income Taxes* requires a two-step process that separates recognition from measurement of tax positions. We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination by a taxing authority. The measurement process is applied only after satisfying the recognition requirement and determines what amount of a tax position will be sustainable upon a potential examination or settlement. If upon measuring, the tax position produces a range of potential tax benefits, we may claim the highest tax benefit from that range as long as it is over 50% likely to be realized using a probability analysis.

We believe that all of the tax positions we have taken, meet the more likely than not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities. See Note 19 *Income Taxes* in the *Notes to Consolidated Financial Statements* in this document for further detail on our income taxes.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities, and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available-for-sale and derivatives are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a nonrecurring basis, such as certain impaired loans held for investment, ("OREO"), core deposit intangible and goodwill. These nonrecurring fair value adjustments typically involve write-downs of individual assets due to application of lower of cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, we use our best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these consolidated financial statements. Additional information on our use of fair value measurements and our related valuation methodologies is provided in Note 18 *Fair Values* in the *Notes to Consolidated Financial Statements* incorporated in this document.

Item 7a - Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk that values of assets and liabilities or revenues will be adversely affected by changes in market conditions such as interest rates. The risk is inherent in the financial instruments associated with our operations and activities including loans, deposits, securities, short-term borrowings and long-term debt. We do not operate a securities trading account and do not hold a position with exposure to foreign currency exchange or commodities. Market-sensitive assets and liabilities are generated through loans and deposits associated with our banking business, our asset liability management process, and credit risk mitigation activities. Traditional loan and deposit products are reported at amortized cost for assets or the amount owed for liabilities. These positions are subject to changes in economic value based on varying market conditions. Interest rate risk is the effect of changes in economic value of our loans and deposits, as well as our other interest rate sensitive instruments and is reflected in the levels of future income and expense produced by these positions versus levels that would be generated by current levels of interest rates. We seek to mitigate interest rate risk as part of the asset liability management process.

The Board of Directors has overall responsibility for our interest rate risk management policies. We have an Asset/Liability Management Committee ("ALCO") which establishes and monitors guidelines to control our sensitivity of earnings to changes in interest rates. Our internal ALCO Roundtable group forecasts net interest income using different rate scenarios via a simulation model. This group updates the net interest income forecast for changing assumptions and differing outlooks based on economic and market conditions.

The simulation model includes expected re-pricing characteristics of our rate sensitive assets and liabilities. These re-pricing characteristics recognize the relative sensitivity of assets and liabilities to changes in market interest rates, as demonstrated through current and historical experience and recognizing the timing differences of rate changes. In the simulation of net interest margin and net interest income the forecast balance sheet is processed against nine possible rate scenarios. These nine rate scenarios include a flat rate environment, which assumes interest rates are unchanged in the future and eight additional rate ramp scenarios ranging from +400 to -400 basis points in 100 basis point increments. The model does not simulate for rates below zero.

The formal policies and practices we have adopted to monitor and manage interest rate risk exposure rely on measuring risk in two ways: (1) the impact of changes in rates on net interest income, and (2) the impact of changes in rates on the fair value of equity. In moderately rising interest rate scenarios the model indicates that the company is slightly liability sensitive. In more rapidly rising interest rate scenarios however, the model indicates that the company is somewhat more liability sensitive.

On March 3, 2020, the Federal Reserve lowered the target range to between 100 and 125 basis points in response to risks posed by the coronavirus disease 2019. We are focused primarily on the effects of small changes in interest rates, either up or down. The most recent model results as of December 31, 2019, indicate the estimated annualized decrease in net interest income attributable to a 100 or 200 basis point increase in the federal funds rate was $441 thousand and $2.2 million, respectively. The model also shows an annualized decrease in net interest income attributable to a 300 or 400 basis point increase in the fed funds rate of $4.7 million and $6.5 million, respectively. In a declining rate environment, the most recent model results as of December 31, 2019, indicate the estimated annualized reduction in net interest income attributable to a 100 or 200 basis point decline in the federal funds rate was $66 thousand and $530 thousand, respectively. Given that the model assumes a static balance sheet, relies on historic betas and assumes immediate parallel rate changes, no assurance can be given that future performance will mirror the model.

We believe that the short duration of our rate-sensitive assets and liabilities contributes to our ability to re-price a significant amount of our rate-sensitive assets and liabilities and mitigate the impact of rate changes in excess of 100, 200, 300, or 400 basis points. The model's primary benefit to management is its assistance in evaluating the impact that future strategies with respect to our mix and level of rate-sensitive assets and liabilities will have on our net interest income.

Our approach to managing interest rate risk may include the use of derivatives, including interest rate swaps, caps and floors. This helps to minimize significant, unplanned fluctuations in earnings, fair values of assets and liabilities and cash flows caused by interest rate volatility. This approach involves a financial instrument with the same characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on the net interest margin and cash flows.

The following table sets forth as of December 31, 2019 the distribution of re-pricing opportunities for our earning assets and interest-bearing liabilities. It also reports the GAP (different volumes of rate sensitive assets and liabilities) re-pricing interest-earning assets and interest-bearing liabilities at different time intervals, the cumulative GAP, the ratio of rate sensitive assets to rate sensitive liabilities for each re-pricing interval, and the cumulative GAP to total assets.

	Gap Analysis				
(Amounts in thousands)	**Within 3 Months**	**3 Months To One Year**	**One Year To Five Years**	**Over Five Years**	**Total**
Interest-earning assets					
AFS securities	$ 51,424	$ 41,679	$ 116,161	$ 77,686	$ 286,950
Other investments	49,266	—	—	—	49,266
Loans, net of deferred fees and costs	83,955	109,862	548,770	292,478	1,035,065
Total earning assets	184,645	151,541	664,931	370,164	$ 1,371,281
Interest-bearing liabilities					
Demand - interest-bearing	239,258	—	—	—	$ 239,258
Money market	307,559	—	—	—	307,559
Savings	135,888	—	—	—	135,888
Certificates of deposit	27,926	63,975	59,847	38	151,786
Term debt and junior subordinated debentures, net	10,298	9,969	—	—	20,267
Total interest-bearing deposits and borrowings	$ 720,929	$ 73,944	$ 59,847	$ 38	$ 854,758
Re-pricing GAP	$ (536,284)	$ 77,597	$ 605,084	$ 370,126	$ 516,523
Cumulative re-pricing GAP	$ (536,284)	$ (458,687)	$ 146,397	$ 516,523	
Gap ratio	0.26	2.05	11.11	9,741.16	1.60
Cumulative gap ratio	0.26	0.42	1.17	1.60	
Gap as % of earning assets	(39) %	6 %	44 %	27 %	38 %
Cumulative GAP as % of earning assets	(39) %	(33) %	11 %	38 %	

Item 8 - Financial Statements and Supplementary Data

Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Bank of Commerce Holdings

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Bank of Commerce Holdings and subsidiaries (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control– Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, and the consolidated results of its operations and its cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control–Integrated Framework (2013)* issued by COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Moss Adams LLP

Sacramento, California
March 6, 2020

We have served as the Company's auditor since 2004.

To the Shareholders:

Management's Report on Internal Control over Financial Reporting

Management of Bank of Commerce Holdings and its subsidiaries ("the Company") is responsible for establishing and maintaining internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control system is designed to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with the authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework (2013)*. Based on our assessment and those criteria, we believe that, as of December 31, 2019, the Company maintained effective internal control over financial reporting.

The Company's independent registered public accounting firm has audited the Company's consolidated financial statements that are included in this annual report and the effectiveness of our internal control over financial reporting as of December 31, 2019 and issued their Report of Independent Registered Public Accounting Firm, which appears on the previous page. The audit report expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019.

/s/ Randall S. Eslick

Randall S. Eslick, President and Chief Executive Officer

/s/ James A. Sundquist

James A. Sundquist, EVP and Chief Financial Officer

Consolidated Balance Sheets

December 31, 2019 and 2018

(Amounts in thousands, except share information)

	2019	2018
Assets:		
Cash and due from banks	$ 21,338	$ 23,692
Interest-bearing deposits in other banks	59,266	23,673
Total cash and cash equivalents	80,604	47,365
Securities available-for-sale, at fair value	286,950	256,928
Loans, net of deferred fees and costs	1,035,065	948,178
Allowance for loan and lease losses	(12,231)	(12,292)
Net loans	1,022,834	935,886
Premises and equipment, net	15,906	13,119
Other real estate owned	35	31
Life insurance	23,701	22,410
Deferred tax asset, net	4,553	7,039
Goodwill	11,671	665
Other intangible assets, net	4,809	1,176
Other assets	28,553	22,485
Total assets	$ 1,479,616	$ 1,307,104
Liabilities and shareholders' equity:		
Liabilities:		
Demand - noninterest-bearing	$ 432,680	$ 347,199
Demand - interest-bearing	239,258	252,202
Money market	307,559	265,093
Savings	135,888	114,840
Certificates of deposit	151,786	152,382
Total deposits	1,267,171	1,131,716
Term debt:		
Other borrowings	10,000	13,496
Less unamortized debt issuance costs	(43)	(91)
Net term debt	9,957	13,405
Junior subordinated debentures	10,310	10,310
Other liabilities	17,700	13,352
Total liabilities	1,305,138	1,168,783
Commitments and contingencies (Note 14)		
Shareholders’ equity:		
Common stock, no par value, 50,000,000 shares authorized; issued and outstanding - 18,137,167 as of December 31, 2019 and 16,333,502 as of December 31, 2018	71,311	52,284
Retained earnings	100,566	89,045
Accumulated other comprehensive income (loss), net of tax	2,601	(3,008)
Total shareholders’ equity	174,478	138,321
Total liabilities and shareholders’ equity	$ 1,479,616	$ 1,307,104

See accompanying Notes to Consolidated Financial Statements.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Income
For the years ended December 31, 2019 and 2018

(Amounts in thousands, except per share information)

	2019	2018
Interest income:		
Interest and fees on loans	$ 50,534	$ 44,955
Interest on taxable securities	6,673	5,165
Interest on tax-exempt securities	1,244	1,629
Interest on interest-bearing deposits in other banks	1,112	952
Total interest income	59,563	52,701
Interest expense:		
Interest on demand - interest-bearing	480	414
Interest on money market	1,599	646
Interest on savings	493	288
Interest on certificates of deposit	1,977	1,910
Interest on Federal Home Loan Bank of San Francisco borrowings	247	435
Interest on other borrowings	806	1,077
Interest on junior subordinated debentures	426	385
Total interest expense	6,028	5,155
Net interest income	53,535	47,546
Provision for loan and lease losses	—	—
Net interest income after provision for loan and lease losses	53,535	47,546
Noninterest income:		
Service charges on deposit accounts	730	682
ATM and point of sale fees	1,158	1,131
Payroll and benefit processing fees	669	652
Life insurance	536	512
Gain on sale of investment securities, net	186	44
Federal Home Loan Bank of San Francisco dividends	507	480
Gain on sale of OREO	62	73
Other income	336	445
Total noninterest income	4,184	4,019
Noninterest expense:		
Salaries and related benefits	20,804	18,709
Premises and equipment	3,752	3,983
Federal Deposit Insurance Corporation insurance premium	91	376
Data processing	2,535	1,997
Professional services	1,539	1,431
Telecommunications	737	594
Acquisition and merger	2,193	844
Other expenses	5,604	4,272
Total noninterest expense	37,255	32,206
Income before provision for income taxes	20,464	19,359
Provision for income taxes	5,503	3,629
Net income	$ 14,961	$ 15,730
Earnings per share - basic	$ 0.83	$ 0.97
Weighted average shares - basic	17,956	16,248
Earnings per share - diluted	$ 0.83	$ 0.96
Weighted average shares - diluted	18,024	16,332

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income
For the years ended December 31, 2019 and 2018

(Amounts in thousands)

	2019	2018
Net income	$ 14,961	$ 15,730
Available-for-sale securities:		
Changes in unrealized gain (loss) arising during the period	8,149	(3,774)
Income taxes	(2,409)	1,115
Change in unrealized gain (loss), net of tax	5,740	(2,659)
Reclassification adjustment for realized gains included in net income	(186)	(44)
Income taxes	55	13
Realized gains, net of tax	(131)	(31)
Net change in unrealized gain (loss) on available-for-sale securities	5,609	(2,690)
Other comprehensive income (loss)	5,609	(2,690)
Comprehensive income – Bank of Commerce Holdings	$ 20,570	$ 13,040

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Equity
For the years ended December 31, 2018 and 2019

(Amounts in thousands except per share information)	Common Shares	Common Stock Amount	Retained Earnings	Accumulated Comprehensive Income (Loss) Net of Tax	Total
Balance at December 31, 2017	16,272	$ 51,830	$ 75,700	$ (266)	$ 127,264
2018					
Net income	—	—	15,730	—	15,730
Reclassification of accumulated other comprehensive income due to tax rate change	—	—	52	(52)	—
Other comprehensive loss, net of tax	—	—	—	(2,690)	(2,690)
Comprehensive income	—	—	—	—	13,040
Dividends declared on common stock ($0.15 per share)	—	—	(2,437)	—	(2,437)
Stock compensation grants	5	45	—	—	45
Restricted stock granted, net	20	—	—	—	—
Stock options exercised	37	216	—	—	216
Compensation expense associated with stock options	—	8	—	—	8
Compensation expense associated with restricted stock, net of cash paid for shares surrendered for tax-withholding purposes	—	185	—	—	185
Balance at December 31, 2018	16,334	$ 52,284	$ 89,045	$ (3,008)	138,321
2019					
Net income	—	—	14,961	—	14,961
Other comprehensive income, net of tax	—	—	—	5,609	5,609
Comprehensive income	—	—	—	—	20,570
Dividends declared on common stock ($0.19 per share)	—	—	(3,440)	—	(3,440)
Stock issued for Merchants acquisition	1,834	19,607	—	—	19,607
Repurchase of common stock	(91)	(1,010)	—	—	(1,010)
Stock compensation grants	6	58	—	—	58
Restricted stock granted, net	43	—	—	—	—
Stock options exercised	11	52	—	—	52
Compensation expense associated with restricted stock, net of cash paid for shares surrendered for tax-withholding purposes	—	320	—	—	320
Balance at December 31, 2019	18,137	$ 71,311	$ 100,566	$ 2,601	$ 174,478

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows
For the years ended December 31, 2019 and 2018

(Amounts in thousands)

	2019	2018
Cash flows from operating activities:		
Net income	$ 14,961	$ 15,730
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for depreciation and amortization	1,367	1,738
Amortization of core deposit intangibles	720	221
Amortization of debt issuance costs	48	48
Compensation expense associated with stock options	—	8
Compensation expense associated with restricted stock	414	288
Tax benefits from vesting of restricted stock	(9)	(46)
Net gain on sale or call of securities	(186)	(44)
Amortization of premiums and accretion of discounts on investment securities, net	1,477	1,845
Amortization of premiums and accretion of discounts on acquired loans, net	(1,598)	(355)
Gain on sale of OREO	(62)	(73)
Increase in cash surrender value of life insurance	(536)	(512)
Deferred compensation and salary continuation plan payments	(1,507)	(905)
Increase in deferred compensation and salary continuation plans	1,853	972
Increase in deferred loan fees and costs	(235)	(217)
Decrease in deferred income taxes	154	595
Decrease in other assets	1,079	345
(Decrease) increase in other liabilities	(1,292)	1,094
Net cash provided by operating activities	16,648	20,732
Cash flows from investing activities:		
Proceeds from maturities and payments of available-for-sale securities	64,183	31,538
Proceeds from sale of available-for-sale securities	117,299	30,235
Purchases of available-for-sale securities	(97,741)	(57,616)
Investment in qualified affordable housing partnerships	(6)	(38)
Net purchase of Federal Home Loan Bank of San Francisco stock	(34)	(1,355)
Loan originations, net of principal repayments	(32,707)	(57,690)
Net repayment on (purchase of) purchased loans	32,796	(8,499)
Purchase of premises and equipment	(1,958)	(351)
Proceeds from the sale of OREO	132	217
Acquisition of Merchants Holding Company, net of cash paid	(2,875)	—
Net cash provided (used) by investing activities	79,089	(63,559)
Cash flows from financing activities:		
Net (decrease) increase in demand deposits, money market and savings	$ (16,162)	$ 65,857
Net decrease in certificates of deposit	(38,599)	(36,873)
Advances on term debt	180,160	230,160
Repayment of term debt	(183,656)	(233,761)
Proceeds from stock options exercised	52	216
Repurchase of common stock	(1,010)	—
Cash paid for common stock surrendered for tax-withholding purposes	(94)	(103)
Cash dividends paid on common stock	(3,189)	(2,274)
Net cash (used in) provided by financing activities	(62,498)	23,222
Net increase (decrease) cash and cash equivalents	33,239	(19,605)
Cash and cash equivalents at the beginning of year	47,365	66,970
Cash and cash equivalents at the end of year	$ 80,604	$ 47,365

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows (Continued)

(Amounts in thousands)

Supplemental disclosures of cash flow activity:

		2019		2018
Cash paid during the period for:				
Income taxes	$	6,007	$	2,727
Interest	$	6,029	$	5,171
Operating leases	$	897	$	809
Supplemental disclosures of non cash investing activities:				
Transfer of loans to other real estate owned	$	74	$	140
Unrealized gain (loss) on investment securities available-for-sale, net of gains included in net income	$	7,963	$	(3,818)
Changes in net deferred tax asset related to changes in unrealized (gain) loss on investment securities available-for-sale		(2,354)		1,128
Changes in accumulated other comprehensive income (loss) due to changes in unrealized (loss) gain on investment securities available-for-sale	$	5,609	$	(2,690)
Reclassification of accumulated other comprehensive income due to tax rate change	$	—	$	52
Supplemental disclosures of non cash financing activities:				
Stock issued under employee plans	$	58	$	45
Cash dividend declared on common stock and payable after period-end	$	902	$	651
Right-of-use lease asset recorded on new leases	$	267	$	—
Right-of-use lease asset recorded on adoption of ASU No. 2016-03	$	3,905	$	—
Lease liability recorded on adoption of ASU No. 2016-02	$	4,363	$	—
Transactions Related to Acquisition:				
Assets acquired - fair value	$	215,055	$	—
Goodwill	$	11,006	$	—
Liabilities assumed - fair value	$	191,154	$	—

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

NOTE 1. THE BUSINESS OF THE COMPANY

Bank of Commerce Holdings ("Company," "Holding Company," "we," or "us"), is a corporation organized under the laws of California and a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended ("BHC Act") with its principal offices in Sacramento, California. The Holding Company's principal business is to serve as a holding company for Merchants Bank of Commerce (the "Bank" and together with the Holding Company, the "Company") and for Bank of Commerce Mortgage (inactive). The Bank, which previously operated under three separate names, changed its name for all operations to Merchants Bank of Commerce effective May 20, 2019. The Company has an unconsolidated subsidiary in Bank of Commerce Holdings Trust II. The Bank is principally supervised and regulated by the California Department of Business Oversight ("CDBO") and the Federal Deposit Insurance Corporation ("FDIC"). Substantially all of the Company's activities are carried out through the Bank. The Bank was incorporated as a California banking corporation on November 25, 1981 and opened for business on October 22, 1982.

We operate ten full service offices and one limited service office and consider northern California to be our major market. We also operate a "cyber office" as identified in our summary of deposits reporting filed with the FDIC. The services offered by the Bank include those traditionally offered by banks of similar size and character in California. Our principal deposit products include the following types of accounts; checking, interest-bearing checking, savings, money market deposits and certificates of deposit. We also offer sweep arrangements, commercial loans, construction loans, consumer loans, safe deposit boxes, collection services and electronic banking services. The primary focus of the Bank is to provide banking services to the communities in our major market area, including Small Business Administration loans and payroll processing. The Bank does not offer trust services or international banking services. Our customers are mostly small to medium sized businesses and retail customers.

On January 31, 2019, we completed the acquisition of Merchants Holding Company ("Merchants"), to extend our presence in the Sacramento marketplace. Merchants, headquartered in Sacramento, California, was the parent company of The Merchants National Bank of Sacramento ("Merchants Bank"), a 97-year-old bank with approximately $211.7 million in assets as of January 31, 2019. Merchants Bank operated one full service branch and one limited service branch in the Sacramento metropolitan area. See Note 21 *Acquisition* in these *Notes to Consolidated Financial Statements* for additional information on the acquisition.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Application of new accounting guidance

ASU No. 2016-02

In February of 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This update was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements on a retrospective basis. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases.

Methods and timing of adoption – For public companies, the amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In July of 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842)*. The standard contained improvements to ASU No. 2016-02 that permitted presentation on a prospective basis.

Financial statement impact – We implemented the new leasing standard on January 1, 2019 on a prospective basis and recorded a new lease asset and related lease liability of approximately $4.4 million related to our current operating leases. The right-of-use asset was also reduced by $458 thousand for amounts recognized previously as part of the single lease cost.

We determine if an arrangement is a lease at inception. Operating leases are included in *Other Assets* and *Other Liabilities* in our *Consolidated Balance Sheets*. Operating lease right-of-use assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. As most of our leases do not provide an incremental borrowing rate, we use the borrowing rates for terms similar to the lease terms available under our existing line of credit with the Federal Home Loan Bank of San Francisco as our incremental borrowing rate in determining the present value of future payments. Our lease terms may include options to extend or terminate the lease which we recognize when it is reasonably certain that we will exercise that option. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term.

Recent Accounting Pronouncement

ASU No. 2016-13

Description - In June of 2016, the FASB issued ASU No. 2016-13*, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates.

Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances.

The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting guidance for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

Methods and timing of adoption – The FASB has voted to delay until January 2023 the implementation of the ASU No. 2016-13 for smaller reporting companies as defined by the SEC. The FASB affirmed that the one-time determination of whether an entity is eligible to be an smaller reporting company will be based on an entity's most recent assessment in accordance with SEC regulations as of the date that a final update on effective dates is issued (for example, November 20, 2019). We qualify as a smaller reporting company and in light of this very recent delay, management has not yet determined when to implement the new ASU or the expected financial impact.

Basis of Financial Statement Presentation

The Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and with prevailing practices within the banking and securities industries. In preparing such financial statements, management is required to make certain estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the valuation of investments and impairments of securities, the determination of the allowance for loan and lease losses ("ALLL"), income taxes, the valuation of other real estate owned ("OREO"), and fair value measurements. Certain amounts for prior periods have been reclassified to conform to the current financial statement presentation. The results of reclassifications are not considered material and have no effect on previously reported equity or net income.

Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of the Holding Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. As of December 31, 2019 and 2018, the Company had one wholly-owned trust formed in 2005 to issue trust preferred securities and related common securities. We have not consolidated the accounts of the Trust in our Consolidated Financial Statements in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB") ASC 810, *Consolidation* ("ASC 810"). We are not considered the primary beneficiary of the Trust (variable interest entity). As a result, the junior subordinated debentures issued by the Holding Company to the Trust are reflected on the Company's *Consolidated Balance Sheets*.

Subsequent Events

We have evaluated events and transactions subsequent to December 31, 2019 for potential recognition or disclosure.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include amounts due from correspondent banks including interest-bearing deposits in correspondent banks and the Federal Reserve Bank.

Investment Securities

Securities are classified as held-to-maturity if we have both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. Unrealized holding gains or losses are excluded from other comprehensive income (loss). Realized gains or losses, determined on the basis of the cost of specific securities sold or called, are included in earnings. Dividend and interest income are recognized when earned.

Securities are classified as available-for-sale if we intend and have the ability to hold those securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available-for-sale are carried at fair value. Unrealized holding gains or losses are included in other comprehensive income (loss) as a separate component of shareholders' equity, net of tax. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. Premiums and discounts are amortized or accreted over the estimated life of the related investment security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

Transfers of securities from available-for-sale to held-to-maturity are accounted for at fair value as of the date of the transfer. The difference between the fair value and the amortized cost at the date of transfer is considered a premium or discount and is accounted for accordingly. Any unrealized gain or loss at the date of the transfer is reported in other comprehensive income (loss), and is amortized over the estimated remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount, and will offset or mitigate the effect on interest income of the amortization of the premium or discount for that held-to-maturity security. Transfers of securities from held-to-maturity to available-for-sale to are accounted for at fair value at the date of the reclassification. Any remaining unamortized fair value adjustments are reclassified from other comprehensive income (loss) and the unrealized holding gain (loss) at the date of transfer is recorded in other comprehensive income net of tax.

We review investment securities on an ongoing basis for the presence of other-than-temporary impairment or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is more likely than not that we will be required to sell the security before recovery of our amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if we intend to sell the security or it is more likely than not we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an other-than-temporary impairment. If we do not intend to sell the security and it is more likely than not we will not be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential other-than-temporary impairment. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss). For investment securities held-to-maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the other-than-temporary impairment amount recorded in other comprehensive income (loss) will increase the carrying value of the investment, and would not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above.

Loans

Loans are stated at the principal amounts outstanding, net of deferred loan fees, deferred loan costs, and the ALLL. Interest on loans is accrued daily based on the principal outstanding. Loan origination and commitment fees and certain origination costs are deferred and the net amount is amortized or accreted over the contractual life of the loans as an adjustment of their yield.

A loan is impaired when, based on current information and events, management believes it is probable that we will not be able to collect all amounts due according to the loan contract. Impairment is measured based upon the present value of expected future cash flows discounted at the loan's effective rate, the loan's observable market price, or the fair value of collateral if the loan is collateral dependent. Interest on impaired loans is recognized on a cash basis, and only when the principal is not considered impaired. The CCO reviews and approves loans recommended for impaired status or their removal from impaired status.

Our practice is to place an asset in nonaccrual status when one of the following events occurs: (1) any installment of principal or interest is 90 days or more past due (unless in management's opinion the loan is well-secured and in the process of collection), (2) management determines the ultimate collection of the original principal or interest to be unlikely or, (3) the terms of the loan have been renegotiated due to a serious weakening of the borrower's financial condition. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when the loan is estimated to be fully collectible. One exception to the 90 days past due policy for nonaccruals is our purchased pool of home equity loans and purchased consumer loans. For these specific loan pools, we will charge-off any loans that are more than 90 days past due. We believe that at the time these loans become 90 days past due, it is likely that we will not collect the remaining principal balance on the loan. In accordance with this policy, we do not expect to classify any of the loans from these pools as nonaccrual.

Nonperforming loans are loans which may be on nonaccrual, 90 days past due and still accruing, or have been restructured.

Restructured loans are those loans where concessions in terms have been granted because of the borrower's financial or legal difficulties. Interest is generally accrued on such loans in accordance with the new terms, after a period of sustained performance by the borrower.

Purchased Loans

Purchased loans are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an ALLL is not recorded at the acquisition date.

Allowance for Loan and Lease Losses

The adequacy of the ALLL is monitored on a regular basis and is based on management's evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio's risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all impaired loans; historical charge-off and recovery experience; and other pertinent information.

We perform regular credit reviews of the loan portfolio to determine the credit quality of the portfolio and the adherence to underwriting standards. When loans are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan through the credit review process. Our risk rating methodology assigns risk ratings ranging from 1 to 8, where a higher rating represents higher risk. The 8 risk rating categories are a primary factor in determining an appropriate amount for the ALLL. Our Chief Credit Officer (CCO) is responsible for regularly reviewing the ALLL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The Board of Directors reviews and approves the adequacy of the ALLL quarterly.

We have divided the loan portfolio into sub-categories of similar type loans. Each category is assigned an historical loss factor and additional qualitative factors. The sub-categories are also further segmented by risk rating. Each risk rating is assigned an additional loss factor to account for the additional risk in those loans with higher risk levels.

Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the CCO who reviews and approves designated loans as impaired. A loan is considered impaired when, based on current information and events, we determine that it is probable that we will not be able to collect all amounts due according to loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan when using the cash flow method, we recognize this impairment reserve as a specific component to be provided for in the ALLL. If the value of the impaired loan is less than the recorded investment in the loan when using the collateral dependent method, we charge-off the impaired balance. The combination of the risk rating-based allowance component and the impairment reserve allowance component leads to an allocated ALLL.

We may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 4% of the allowance, but may be maintained at higher levels during times of economic conditions characterized by unstable real estate values. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews and overall economic trends.

As adjustments to the ALLL become necessary, they are reported in earnings in the periods in which they become known as a charge or credit to the provision for loan and lease losses. Loans, or portions thereof, deemed uncollectible are charged to the ALLL. Recoveries on loans previously charged-off, are added to the ALLL.

We believe that the ALLL was adequate as of December 31, 2019. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Company, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review. Approximately 83% of our loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL.

Reserve for Unfunded Commitments

A reserve for unfunded commitments is maintained at a level that, in our opinion, is adequate to absorb probable losses associated with our commitment to lend funds under existing agreements such as letters or lines of credit. We determine the adequacy of the reserve for unfunded commitments based upon the category of loan, current economic conditions, the risk characteristics of the various categories of commitments and other relevant factors. The reserve is based on estimates, and ultimate losses may vary from the current estimates.

These estimates are evaluated on a regular basis and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Draws on unfunded commitments that are considered uncollectible at the time funds are advanced are charged to the reserve for unfunded commitments. Provisions for unfunded commitment losses, and recoveries on loan and lease commitments previously charged off, are added to the reserve for unfunded commitments, which is included in the *Other Liabilities* line item of the *Consolidated Balance Sheets.* See Note 14, *Commitments and Contingencies* in these *Notes to Consolidated Financial Statements* for additional disclosures on the reserve for unfunded commitments.

Premises and Equipment

Premises and equipment are recorded at cost. Depreciation for equipment is provided over the estimated useful lives of the related assets, generally three to seven years, using the straight-line method for financial statement purposes. Depreciation for premises is provided over the estimated useful life up to 39 years, on a straight-line basis. We use other depreciation methods (generally accelerated depreciation methods) for tax purposes where appropriate. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements. Repairs and maintenance are expensed as incurred. Expenditures that increase the value or productive capacity of assets are capitalized. When premises and equipment are retired, sold, or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is recorded in *other noninterest income* or *other noninterest expense* in the *Consolidated Statements of Income*, respectively.

Goodwill and Other Intangibles

Intangible assets are comprised of goodwill and other intangibles acquired in business combinations. Goodwill and intangible assets with indefinite useful lives are not amortized. Intangible assets with definite useful lives are amortized to their estimated residual values over their respective estimated useful lives, and also reviewed for impairment. Amortization of intangible assets is included in *non-interest expense* in the *Consolidated Statements of Income*. We perform an impairment analysis on an annual basis for goodwill and other intangible assets. Additionally, we perform an impairment analysis on an interim basis when events or circumstances indicate impairment potentially exists.

Other Real Estate Owned ('OREO")

OREO Represents real estate of which we have taken control in partial or full satisfaction of loans. At the time of foreclosure, OREO is recorded at fair value less costs to sell, plus costs for improvements that prepare the property for sale, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the ALLL. After foreclosure, management periodically performs valuations and the property is carried at the lower of the cost or fair value less expected selling costs. Subsequent valuation adjustments are recognized under the line item *other expenses* in the *Consolidated Statements of Income*. Revenue and expenses incurred from OREO property are recorded in *noninterest income* or *noninterest expense*, in the *Consolidated Statements of Income*, respectively.

Income Taxes

Income taxes reported in the *Consolidated Financial Statements* are computed based on an asset and liability approach. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, management considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations.

In projecting future taxable income, management develops assumptions including the amount of future state and federal pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. We file consolidated federal and combined state income tax returns.

We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. For tax positions that meet the more likely than not threshold, we may recognize only the largest amount of tax benefit that is greater than fifty percent likely to be realized upon ultimate settlement with the taxing authority. We believe that all of our tax positions taken meet the more likely than not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities. Interest and penalties related to unrecognized tax benefits are recorded in other noninterest expense. See Note 19, *Income Taxes* in these *Notes to Consolidated Financial Statements* for more information on income taxes.

Revenue Recognition

Our primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606 (Revenue from Contracts with Customers). We have evaluated the nature of our contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. For revenue sources that are within the scope of Topic 606, we fully satisfy our performance obligations and recognize revenue in the period it is earned as services are rendered. Transaction prices are typically fixed; charged on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with our customers.

All of our revenue from contracts with customers in the scope of ASC 606 is recognized in Non-Interest Income. Sources of revenue from contracts with customers that are in the scope of ASC 606 include the following:

- Service Charges on Deposit accounts - We earn monthly account fees and transaction-based fees from our customers for services rendered on deposit accounts. Fees charged to deposit accounts on a monthly basis are recognized as the performance obligation is satisfied at the end of the service period.
- Transaction-based fees are based on specific services provided to our customer. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.
- ATM and Point of Sale fees – We earn fees when debit cards we issued are used in transactions through card processing networks. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' account. The fees are recognized monthly.
- Fees on Payroll and benefit processing – We earn fees by processing payroll and benefit payments for our business customers. The performance obligation is satisfied and the fees are recognized as each transaction is processed.

Share Based Payments

We have one active stock-based compensation plan that provides for equity awards including stock, stock options, restricted stock units and restricted stock to eligible employees and directors. The Bank of Commerce Holdings 2019 Equity Incentive Plan, was approved by the Holding Company's shareholders on May 21, 2019 and replaced the Amended and Restated 2010 Equity Incentive Plan.

In accordance with FASB ASC 718, *Stock Compensation,* we recognize in the *Consolidated Statements of Income* the grant-date fair value of stock, stock options, restricted stock and other equity-based forms of compensation issued to employees over the employees' requisite service period. We account for forfeitures as they occur.

The fair value of each option grant is estimated as of the grant date using the Black-Scholes option-pricing model using the following assumptions:

- Volatility represents the historical volatility in the Holding Company's common stock price, for a period consistent with the expected life of the option.
- Risk free rate was derived from the U.S. Treasury rate at the time of the grant, which coincides with the expected life of the option.
- Expected dividend yield is based on dividend trends and the market value of the Holding Company's common stock at the time of grant.
- Annual dividend rate is the ratio of the expected annual dividends to the Holding Company's common stock price on the grant date.
- Assumed forfeiture rate based on expected forfeiture rates.
- Expected life is estimated based on the history of the Holding Company's stock option holders and expectations regarding future forfeitures giving consideration to the contractual terms and vesting schedules, and represents the period of time that options granted are expected to be outstanding.

The fair value of stock grants and restricted stock grants are estimated as of the grant date using the fair value of the Company's stock at the date of the grant.

Advertising Costs

For the years ended December 31, 2019 and 2018, advertising costs were $160 thousand and $47 thousand, respectively. Advertising costs are expensed as incurred.

Earnings per Share

Earnings per share is an important measure of our performance for investors and other users of financial statements. Certain of our securities, such as stock options or restricted stock, permit the holders to become common shareholders or add to the number of shares of common stock already held. Because there is potential reduction, called *dilution*, of earnings per share figures inherent in our capital structure, we are required to present a dual presentation of earnings per share - basic earnings per share and diluted earnings per share.

Basic earnings per share excludes dilution and is computed by dividing income by the weighted-average number of common shares outstanding for the period, excluding unvested restricted stock awards which do not have voting rights or share in dividends. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Holding Company. The computation of diluted earnings per share does not assume conversion, exercise, or contingent issuance of securities that would have an anti-dilutive effect on earnings per share.

We present both basic and diluted earnings per share on the face of the *Consolidated Statements of Income*. In addition, a detailed presentation of the earnings per share calculation is provided in Note 22, *Earnings Per Common Share* in these *Notes to Consolidated Financial Statements.*

Fair Value Measurements

FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC 820 establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. In general, fair values determined by Level 1 inputs utilize quoted prices for identical assets or liabilities traded in active markets that we have the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Operating Segments

Public enterprises are required to report certain information about their operating segments in a complete set of financial statements to shareholders. They are also required to report certain enterprise-wide information about their products and services, their activities in different geographic areas, and their reliance on major customers. The basis for determining operating segments is the manner in which management operates the business. As of December 31, 2019, we operated under one primary business segment: Community Banking.

Business Combinations

We record acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques and third party evaluations to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets including identifiable intangible assets and liabilities assumed is recorded as goodwill.

NOTE 3. RESTRICTIONS ON CASH AND DUE FROM BANKS

We have a Fed Funds line of credit with one correspondent bank which requires us to hold compensating cash balances of $450 thousand. We maintained the required compensating balance of $450 thousand throughout 2019 and 2018.

The Bank is required by federal regulations to set aside specified amounts of cash as reserves against transaction and time deposits. The cash reserve required as of December 31, 2019 and December 31, 2018 was $1.8 million and $1.4 million, respectively which was satisfied by vault cash balances.

NOTE 4. SECURITIES

The following table presents the amortized costs, unrealized gains, unrealized losses and estimated fair values of our investment securities as of December 31, 2019, and December 31, 2018.

	As of December 31, 2019			
(Amounts in thousands)	**Amortized Costs**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Available-for-sale securities:				
U.S. government & agencies	$ 38,291	$ 469	$ (27)	$ 38,733
Obligations of state and political subdivisions	40,702	1,422	(26)	42,098
Residential mortgage-backed securities and collateralized mortgage obligations	179,114	2,163	(442)	180,835
Corporate securities	3,005	6	(45)	2,966
Commercial mortgage-backed securities	19,126	221	(40)	19,307
Other asset-backed securities	3,019	—	(8)	3,011
Total	$ 283,257	$ 4,281	$ (588)	$ 286,950

	As of December 31, 2018			
(Amounts in thousands)	**Amortized Costs**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Available-for-sale securities:				
U.S. government & agencies	$ 40,215	$ 202	$ (330)	$ 40,087
Obligations of state and political subdivisions	50,037	1,082	(589)	50,530
Residential mortgage-backed securities and collateralized mortgage obligations	142,355	129	(3,981)	138,503
Corporate securities	3,022	—	(100)	2,922
Commercial mortgage-backed securities	25,446	17	(701)	24,762
Other asset-backed securities	123	1	—	124
Total	$ 261,198	$ 1,431	$ (5,701)	$ 256,928

The following table presents the expected maturities of investment securities at December 31, 2019.

	Available-For-Sale	
(Amounts in thousands)	**Amortized Cost**	**Fair Value**
Amounts maturing in:		
One year or less	$ 6,542	$ 6,567
One year through five years	139,442	141,580
Five years through ten years	74,651	75,295
After ten years	62,622	63,508
Total	$ 283,257	$ 286,950

The amortized cost and fair value of residential mortgage-backed securities, collateralized mortgage obligations and commercial mortgage securities are presented by their expected average life, rather than contractual maturity, because repayment of the underlying loans may be accelerated without prepayment penalties.

At December 31, 2019 and 2018, securities with a fair value of $81.4 million and $68.8 million, respectively, were pledged as collateral to secure public fund deposits, Federal Home Loan Bank of San Francisco borrowings and for other purposes as required by law.

The following table presents the cash proceeds from sales of investment securities and the associated gross realized gains and gross realized losses that have been included in earnings for the years ended December 31, 2019 and 2018.

	For Years Ended December 31,	
(Amounts in thousands)	**2019**	**2018**
Proceeds from sales of investment securities	$ 117,299	$ 30,235
Gross realized gains on sales of investments securities:		
U.S. government & agencies	$ 49	$ —
Obligations of state and political subdivisions	482	262
Residential mortgage-backed securities and collateralized mortgage obligations	108	—
Corporate securities	—	1
Commercial mortgage-backed securities	34	—
Total gross realized gains on sales of investment securities	673	263
Gross realized losses on sales of investment securities		
U.S. government & agencies	(16)	(43)
Obligations of state and political subdivisions	(95)	(71)
Residential mortgage-backed securities and collateralized mortgage obligations	(321)	(40)
Commercial mortgage-backed securities	(54)	(19)
Other asset-backed securities	(1)	(46)
Total gross realized losses on sales of investment securities	(487)	(219)
Gains on sales of investment securities, net	$ 186	$ 44

Investment securities that were in an unrealized loss position as of December 31, 2019 and December 31, 2018 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position.

	As of December 31, 2019					
	Less Than 12 Months		12 Months or More		Total	
(Amounts in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Available-for-sale securities:						
U.S. government & agencies	$ 6,473	$ (25)	$ 380	$ (2)	$ 6,853	$ (27)
Obligations of states and political subdivisions	2,249	(26)	—	—	2,249	(26)
Residential mortgage-backed securities and collateralized mortgage obligations	31,817	(207)	22,166	(235)	53,983	(442)
Corporate securities	—	—	955	(45)	955	(45)
Commercial mortgage-backed securities	1,464	(1)	4,549	(39)	6,013	(40)
Other asset-backed securities	3,011	(8)	—	—	3,011	(8)
Total temporarily impaired securities	$ 45,014	$ (267)	$ 28,050	$ (321)	$ 73,064	$ (588)

	As of December 31, 2018					
	Less Than 12 Months		12 Months or More		Total	
(Amounts in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
U.S. government & agencies	$ 7,223	$ (39)	$ 12,274	$ (291)	$ 19,497	$ (330)
Obligations of states and political subdivisions	5,545	(40)	16,320	(549)	21,865	(589)
Residential mortgage-backed securities and collateralized mortgage obligations	21,791	(183)	93,038	(3,798)	114,829	(3,981)
Corporate securities	—	—	2,922	(100)	2,922	(100)
Commercial mortgage-backed securities	1,548	(7)	20,176	(694)	21,724	(701)
Total temporarily impaired securities	$ 36,107	$ (269)	$ 144,730	$ (5,432)	$ 180,837	$ (5,701)

At December 31, 2019 and December 31, 2018, the number of securities in an unrealized loss position was 63 and 163, respectively. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral. Our Investment Policy requires securities at the time of purchase to be rated A3/A- or higher by Moody's, S&P and Fitch rating agencies. Management monitors the published credit ratings of our investment portfolio for material rating or outlook changes. For all private-label securities collateralized by mortgages, management also monitors the credit characteristics of the underlying mortgages to identify potential credit losses, if any, in the portfolio. Because the decline in fair value is not due to credit quality concerns, and because we have no plans to sell the securities before the recovery of their amortized cost, and we believe the bank has the ability to hold the securities to maturity these investments are not considered other-than-temporarily impaired.

The following table presents the characteristics of our securities that are in unrealized loss positions at December 31, 2019 and December 31, 2018.

Available-for-sale securities:	**Characteristics of securities in unrealized loss positions at December 31, 2019 and December 31, 2018**
U.S. government & agencies	Direct obligations of the U.S. Government or obligations guaranteed by U.S. Government agencies.
Obligations of states and political subdivisions	General obligation issuances or revenue securities secured by revenues from specific sources issued by municipalities and political subdivisions located within the U.S.
Residential mortgage-backed securities and collateralized mortgage obligations	Obligations of U.S. government sponsored entities or non-governmental entities collateralized by high quality mortgages on residential properties. Issuances by non-governmental entities usually include good credit enhancements. Of the residential mortgage-backed securities and collateralized mortgage obligations that we owned at December 31, 2019 and December 31, 2018, 79% and 66% were issued or guaranteed by U.S. government sponsored entities, respectively.
Corporate securities	Debt obligations generally issued or guaranteed by large U.S. corporate institutions.
Commercial mortgage-backed securities	Obligations of U.S. government sponsored entities or non-governmental entities collateralized by high quality mortgages on commercial properties. Issuances by non-governmental entities usually include good credit enhancements. Of the commercial mortgage-backed securities that we owned at December 31, 2019 and December 31, 2018, 100% and 90% were issued or guaranteed by U.S. government sponsored entities, respectively.
Other asset-backed securities	Obligations secured by high quality loans with good credit enhancements issued by non-governmental issuers.

NOTE 5. LOANS

Outstanding loan balances consist of the following at December 31, 2019, and December 31, 2018.

(Amounts in thousands)	As of December 31	
Loan Portfolio	**2019**	**2018**
Commercial	$ 141,197	$ 135,543
Commercial real estate:		
Real estate – construction and land development	26,830	22,563
Real estate – commercial non-owner occupied	493,920	433,708
Real estate – commercial owner occupied	218,833	204,622
Residential real estate:		
Real estate – residential - Individual Tax Identification Number ("ITIN")	33,039	37,446
Real estate – residential - 1-4 family mortgage	63,661	34,366
Real estate – residential - equity lines	22,099	26,958
Consumer and other	33,324	51,045
Gross loans	1,032,903	946,251
Deferred fees and costs	2,162	1,927
Loans, net of deferred fees and costs	1,035,065	948,178
Allowance for loan and lease losses	(12,231)	(12,292)
Net loans	$ 1,022,834	$ 935,886

Certain loans are pledged as collateral with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank. Pledged loans totaled $542.1 million and $490.2 million at December 31, 2019 and December 31, 2018, respectively.

When we purchase loans they are typically purchased at a discount to enhance yield and compensate for credit risk. We have no purchased credit impaired loans as of December 31, 2019, and December 31, 2018. Gross loan balances in the table above include net purchase discounts of $1.5 million and $2.5 million as of December 31, 2019, and December 31, 2018, respectively.

Gross loan balances in the table above at December 31, 2019 include a fair value discount of $1.7 million for loans acquired from Merchants during the first quarter of 2019. We recorded $620 thousand in accretion of the discount for these loans during the year ended December 31, 2019.

Past Due Loans

Past due loans (gross), segregated by loan portfolio were as follows, as of December 31, 2019, and December 31, 2018.

(Amounts in thousands) **Past Due Loans at December 31, 2019**	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 or Greater Days Past Due**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
Commercial	$ 71	$ —	$ —	$ 71	$ 141,126	$ 141,197	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	26,830	26,830	—
Real estate - commercial non-owner occupied	—	—	—	—	493,920	493,920	—
Real estate - commercial owner occupied	655	—	3,103	3,758	215,075	218,833	—
Residential real estate:							
Real estate - residential - ITIN	371	323	43	737	32,302	33,039	—
Real estate - residential - 1-4 family mortgage	—	—	—	—	63,661	63,661	—
Real estate - residential - equity lines	100	—	—	100	21,999	22,099	—
Consumer and other	200	50		250	33,074	33,324	—
Total	$ 1,397	$ 373	$ 3,146	$ 4,916	$ 1,027,987	$ 1,032,903	$ —

(Amounts in thousands) **Past Due Loans at December 31, 2018**	**30-59 Days Past Due**	**60-89 Days Past Due**	**90 or Greater Days Past Due**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
Commercial	$ —	$ —	$ —	$ —	$ 135,543	$ 135,543	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	22,563	22,563	—
Real estate - commercial non-owner occupied	10,878	—	548	11,426	422,282	433,708	—
Real estate - commercial owner occupied	688	—	—	688	203,934	204,622	—
Residential real estate:							
Real estate - residential - ITIN	184	279	259	722	36,724	37,446	—
Real estate - residential - 1-4 family mortgage	—	—	185	185	34,181	34,366	—
Real estate - residential - equity lines	90	—	—	90	26,868	26,958	—
Consumer and other	534	263	—	797	50,248	51,045	—
Total	$ 12,374	$ 542	$ 992	$ 13,908	$ 932,343	$ 946,251	$ —

Nonaccrual Loans

Nonaccrual loans, segregated by loan portfolio, were as follows as of December 31, 2019, and December 31, 2018.

(Amounts in thousands)	**As of December 31**	
Nonaccrual Loans	**2019**	**2018**
Commercial	$ 61	$ 959
Commercial real estate:		
Real estate - commercial non-owner occupied	—	548
Real estate - commercial owner occupied	3,103	—
Residential real estate:		
Real estate - residential - ITIN	2,221	2,388
Real estate - residential - 1-4 family mortgage	191	185
Real estate - residential - equity lines	—	43
Consumer and other	40	23
Total	$ 5,616	$ 4,146

Had nonaccrual loans performed in accordance with their contractual terms, we would have recognized additional interest income, net of tax, of approximately $254 thousand and $166 thousand for the years ended December 31, 2019 and 2018, respectively.

Impaired Loans

A loan is considered impaired when, based on current information and events, we determine it is probable that we will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. The following tables summarize impaired loans by loan portfolio as of December 31, 2019, and December 31, 2018.

(Amounts in thousands) **Impaired Loans**	**As of December 31, 2019** **Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance recorded:			
Commercial	$ 94	$ 251	$ —
Commercial real estate:			
Real estate - commercial owner-occupied	3,103	3,103	—
Residential real estate:			
Real estate - residential - ITIN	5,723	7,386	—
Real estate - residential - 1-4 family mortgage	191	313	—
Total with no related allowance recorded	$ 9,111	$ 11,053	$ —
With an allowance recorded:			
Commercial	$ 562	$ 563	$ 159
Residential real estate:			
Real estate - residential - ITIN	455	455	38
Real estate - residential - equity lines	231	231	116
Consumer and other	40	40	11
Total with an allowance recorded	$ 1,288	$ 1,289	$ 324
By loan portfolio:			
Commercial	$ 656	$ 814	$ 159
Commercial real estate	3,103	3,103	—
Residential real estate	6,600	8,385	154
Consumer and other	40	40	11
Total impaired loans	$ 10,399	$ 12,342	$ 324

(Amounts in thousands) **Impaired Loans**	**As of December 31, 2018** **Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance recorded:			
Commercial	$ 51	$ 69	$ —
Commercial real estate:			
Real estate - commercial owner-occupied	548	$ 548	—
Residential real estate:			
Real estate - residential - ITIN	6,138	7,676	—
Real estate - residential - 1-4 family mortgage	185	223	—
Real estate - residential - equity lines	43	48	—
Total with no related allowance recorded	$ 6,965	$ 8,564	$ —
With an allowance recorded:			
Commercial	$ 2,132	$ 2,256	$ 748
Commercial real estate:			
Real estate - commercial non-owner occupied	795	795	209
Residential real estate:			
Real estate - residential - ITIN	734	772	91
Real estate - residential - equity lines	363	363	182
Consumer and other	23	23	7
Total with an allowance recorded	$ 4,047	$ 4,209	$ 1,237
By loan portfolio:			
Commercial	$ 2,183	$ 2,325	$ 748
Commercial real estate	1,343	1,343	209
Residential real estate	7,463	9,082	273
Consumer and other	23	23	7
Total impaired loans	$ 11,012	$ 12,773	$ 1,237

The following table summarizes average recorded investment and interest income recognized on impaired loans by loan portfolio for the years ended December 31, 2019 and 2018.

(Amounts in thousands) **Average Recorded Investment and Interest Income**	**2019** **Average Recorded Investment**	**Interest Income Recognized**	**2018** **Average Recorded Investment**	**Interest Income Recognized**
Commercial	$ 1,201	$ 51	$ 2,455	$ 78
Commercial real estate:				
Real estate - commercial non-owner occupied	9,400	30	890	46
Real estate - commercial owner- occupied	259	—	—	—
Residential real estate:				
Real estate - residential - ITIN	6,574	161	7,198	170
Real estate - residential - 1-4 family mortgage	193	—	218	—
Real estate - residential - equity lines	288	18	415	20
Consumer and other	25	—	31	—
Total	$ 17,940	$ 260	$ 11,207	$ 314

The increase in the average recorded investment in impaired loans for 2019 compared to 2018 was due to a $9.9 million commercial real estate loan which was placed in nonaccrual status in the first quarter and sold in the fourth quarter of 2019.

The impaired loans on which these interest income amounts were recognized are primarily accruing troubled debt restructured loans. Loans are reported as troubled debt restructurings when we grant a concession(s) to a borrower experiencing financial difficulties that we would not otherwise consider. Examples of such concessions include a reduction in the loan rate, forgiveness of principal or accrued interest, extending the maturity date(s) significantly, or providing a lower interest rate than would be normally available for a transaction of similar risk. As a result of these concessions, troubled debt restructured loans are impaired as we will not collect all amounts due, either principal or interest, in accordance with the terms of the original loan agreement.

Troubled Debt Restructurings

At December 31, 2019 and December 31, 2018, impaired loans of $4.8 million and $6.9 million, respectively, were classified as performing restructured loans.

For a restructured loan to be on accrual status, the loan's collateral coverage must generally be greater than or equal to 100% of the loan balance, the loan payments must be current, and the borrower must demonstrate the ability to make payments from a verified source of cash flow. As of December 31, 2019, we had no obligations to lend additional funds on any restructured loans. As of December 31, 2018, we had only one restructured commercial line of credit in nonaccrual status that had $313 thousand in available credit.

As of December 31, 2019, we had $6.5 million in troubled debt restructurings compared to $9.6 million as of December 31, 2018. As of December 31, 2019, we had 98 loans that qualified as troubled debt restructurings, of which 94 loans were performing according to their restructured terms. Troubled debt restructurings represented 0.63% of gross loans as of December 31, 2019, compared with 1.01% at December 31, 2018.

The types of modifications offered can generally be described in the following categories:

Rate – A modification in which the interest rate is changed.

Maturity – A modification in which the maturity date is changed.

Payment deferral – A modification in which a portion of the principal is deferred.

Principal reduction – A modification in which a portion of the owing principal is decreased.

The following table presents the period ended balances of newly restructured loans and the types of modifications that occurred during the year ended December 31, 2019. We did not have any newly restructured loans or modifications for the year ended December 31, 2018.

	For The Year Ended December 31, 2019			
(Amounts in thousands) **Troubled Debt Restructuring Modification Types**	**Rate & Maturity**	**Rate & Payment Deferral**	**Maturity**	**Total**
Commercial	$ —	$ —	$ 47	$ 47
Consumer and other	20	—	—	20
Total	$ 20	$ —	$ 47	$ 67

For the year ended December 31, 2019, the table below provides information regarding the number of loans where the contractual terms have been restructured.

	2019		
(Amounts in thousands) **Troubled Debt Restructurings**	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial	1	$ 99	$ 99
Consumer and other	1	20	20
Total	2	$ 119	$ 119

We had one $20 thousand consumer loan that was modified as a troubled debt restructuring during the 12 months ended December 31, 2019, for which there was a subsequent payment default during the period from date of restructuring to December 31, 2019. There were no loans modified as troubled debt restructuring during the 12 months ended December 31, 2018 for which there was a subsequent payment default during the period from the date of restructuring to December 31, 2018.

Performing and Nonperforming Loans

We define a performing loan as a loan where any installment of principal or interest is not 90 days or more past due, and management believes the ultimate collection of original contractual principal and interest is likely. We define a nonperforming loan as an impaired loan, which may be on nonaccrual, or is 90 days past due and still accruing, or has been restructured and does not comply with its modified terms, and our ultimate collection of original contractual principal and interest is uncertain.

Performing and nonperforming loans, segregated by loan portfolio, are as follows at December 31, 2019 and 2018.

(Amounts in thousands)	December 31, 2019		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$ 141,136	$ 61	$ 141,197
Commercial real estate:			
Real estate - construction and land development	26,830	—	26,830
Real estate - commercial non-owner occupied	493,920	—	493,920
Real estate - commercial owner occupied	215,730	3,103	218,833
Residential real estate:			
Real estate - residential - ITIN	30,818	2,221	33,039
Real estate - residential - 1-4 family mortgage	63,470	191	63,661
Real estate - residential - equity lines	22,099	—	22,099
Consumer and other	33,284	40	33,324
Total	$ 1,027,287	$ 5,616	$ 1,032,903

(Amounts in thousands)	December 31, 2018		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$ 134,584	$ 959	$ 135,543
Commercial real estate:			
Real estate - construction and land development	22,563	—	22,563
Real estate - commercial non-owner occupied	433,160	548	433,708
Real estate - commercial owner occupied	204,622	—	204,622
Residential real estate:			
Real estate - residential - ITIN	35,058	2,388	37,446
Real estate - residential - 1-4 family mortgage	34,181	185	34,366
Real estate - residential - equity lines	26,915	43	26,958
Consumer and other	51,022	23	51,045
Total	$ 942,105	$ 4,146	$ 946,251

Credit Quality Ratings

Management assigns a credit quality rating (risk grade) to each loan. The foundation or primary factor in determining the appropriate credit quality rating is the degree of a debtor's willingness and ability to perform as agreed. In conjunction with evaluating the performing versus nonperforming nature of our loan portfolio, management evaluates the following credit risk and other relevant factors in determining the appropriate credit quality indicator (rating) for each loan portfolio:

Pass Grade: A Pass loan is a strong credit with no existing or known weaknesses that may require management's close attention. Some pass loans require short-term enhanced monitoring to determine when the credit relationship would merit either an upgrade or a downgrade. Loans classified as Pass Grade specifically demonstrate:

- Strong Cash Flows – borrower's cash flows must meet or exceed our minimum debt service coverage ratio.
- Collateral Margin – generally, the borrower must have pledged an acceptable collateral class with an adequate collateral margin.
- Qualitative Factors – in addition to meeting our minimum cash flow and collateral requirements, a number of other qualitative factors are also factored into assigning a Pass Grade including the borrower's level of leverage (debt to equity), prospects, history and experience in their industry, credit history, and any other relevant factors including a borrower's character.

Those borrowers who qualify for unsecured loans must fully demonstrate above average cash flows and strong secondary sources of repayment to mitigate the lack of unpledged collateral.

Watch Grade: The credit is acceptable but the borrower has experienced a temporary setback or adverse information has been received, and may exhibit one or more of the characteristics shown in the list below. This risk grade could apply to credits on a temporary basis pending a full review. Credits with this risk grade will require more handling time and increased management. The list below contains characteristics of this risk grade, but individually do not automatically cause the loan to be assigned a Watch Grade.

- The primary source of repayment may be weakening causing greater reliance on the secondary source of repayment or
- The primary source of repayment is adequate, but the secondary source of repayment is insufficient
- In-depth financial analysis would compare to the lower quartile in two or more of the major components of the Risk Management Association Annual Statement Studies
- Volatile or deteriorating collateral
- Management decisions may be called into question
- Delinquencies in bank credits or other financial/trade creditors

- Frequent overdrafts
- Significant change in management/ownership

Special Mention Grade: Credits in this grade are potentially weak and deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects of the credit. Special Mention credits are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. The list below exhibits the characteristics of this grade, but individually do not automatically cause the borrower to be assigned a grade of Special Mention:

- Inadequate or incomplete loan documentation or perfection of collateral, or any other deviation from prudent lending practices
- Credit is structured in a manner in which the timing of the repayment source does not match the payment schedule or maturity, materially jeopardizing repayment
- Current economic or market conditions exist which may affect the borrower's ability to perform or affect the Bank's collateral position
- Adverse trends in the borrower's operations or continued deterioration in the borrower's financial condition that has not yet reached a point where the retirement of debt is jeopardized. A credit in this grade should have favorable prospects of the deteriorating financial trends reversing within a reasonable timeframe.
- The borrower is less than cooperative or unable to produce current and adequate financial information

Substandard Grade: A Substandard credit is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Substandard credits have a well-defined weakness or weaknesses that jeopardize the liquidation or timely collection of the debt. Substandard credits are characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. However, a potential loss does not have to be recognizable in an individual credit for it to be considered a substandard credit. As such, substandard credits may or may not be graded as impaired.

The following represents, but is not limited to, the potential characteristics of a Substandard Grade and do not necessarily generate automatic reclassification into this loan grade:

- Sustained or substantial deteriorating financial trends,
- Unresolved management problems,
- Collateral is insufficient to repay debt; collateral is not sufficiently supported by independent sources, such as asset-based financial audits, appraisals, or equipment evaluations,
- Improper perfection of lien position, which is not readily correctable,
- Unanticipated and severe decline in market values,
- High reliance on secondary source of repayment,
- Legal proceedings, such as bankruptcy or a divorce, which has substantially decreased the borrower's capacity to repay the debt,
- Fraud committed by the borrower,
- IRS liens that take precedence,
- Forfeiture statutes for assets involved in criminal activities,
- Protracted repayment terms outside of policy that are for longer than the same type of credit in our portfolio,
- Any other relevant quantitative or qualitative factor that negatively affects the current net worth and paying capacity of the borrower or of the collateral pledged, if any.

Doubtful Grade: A Doubtful loan has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain pending factors that may work to the advantage and strengthening of the credit, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors may include, but are not limited to:

- Proposed merger(s),
- Acquisition or liquidation procedures,
- Capital injection,
- Perfecting liens on additional collateral,
- Refinancing plans.

Generally, a Doubtful Grade does not remain outstanding for a period greater than six months. Within six months, the pending events should have been resolved. Based on resolution of the pending events, the credit grade should have improved or the principal balance charged against the ALLL.

The following table summarizes loans by internal risk grades and by loan class as of December 31, 2019, and December 31, 2018

	December 31, 2019					
(Amounts in thousands)	Pass	Watch	Special Mention	Substandard	Doubtful	Total
Commercial	$ 125,222	$ 14,974	$ 833	$ 168	$ —	$ 141,197
Commercial real estate:						
Real estate - construction and land development	26,810	20	—	—	—	26,830
Real estate - commercial non-owner occupied	454,493	32,902	5,424	1,101	—	493,920
Real estate - commercial owner occupied	195,950	7,224	1,220	14,439	—	218,833
Residential real estate:						
Real estate - residential - ITIN	28,609	—	—	4,430	—	33,039
Real estate - residential - 1-4 family mortgage	62,485	985	—	191	—	63,661
Real estate - residential - equity lines	22,012	—	—	87	—	22,099
Consumer and other	33,283	—	—	41	—	33,324
Total	$ 948,864	$ 56,105	$ 7,477	$ 20,457	$ —	$ 1,032,903

	December 31, 2018					
(Amounts in thousands)	Pass	Watch	Special Mention	Substandard	Doubtful	Total
Commercial	$ 118,643	$ 15,247	$ —	$ 1,653	$ —	$ 135,543
Commercial real estate:						
Real estate - construction and land development	22,539	24	—	—	—	22,563
Real estate - commercial non-owner occupied	409,157	21,698	—	2,853	—	433,708
Real estate - commercial owner occupied	179,154	14,075	—	11,393	—	204,622
Residential real estate:						
Real estate - residential - ITIN	31,805	—	—	5,641	—	37,446
Real estate - residential - 1-4 family mortgage	33,388	793	—	185	—	34,366
Real estate - residential - equity lines	25,336	1,313	—	309	—	26,958
Consumer and other	51,016	—	—	29	—	51,045
Total	$ 871,038	$ 53,150	$ —	$ 22,063	$ —	$ 946,251

The recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure was $100 thousand at December 31, 2019.

Allowance for Loan and Lease Losses

The following tables below summarize the ALLL by portfolio for the years ended December 31, 2019 and 2018.

(Amounts in thousands)	As of December 31, 2019					
ALLL by Loan Portfolio	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 2,205	$ 7,116	$ 1,173	$ 1,356	$ 442	$ 12,292
Charge-offs	(238)	(233)	(181)	(848)	—	(1,500)
Recoveries	927	—	261	251	—	1,439
Provision	(1,072)	1,213	(221)	174	(94)	—
Ending balance	$ 1,822	$ 8,096	$ 1,032	$ 933	$ 348	$ 12,231

(Amounts in thousands)	As of December 31, 2018					
ALLL by Loan Portfolio	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$ 2,397	$ 6,514	$ 1,169	$ 1,435	$ 410	$ 11,925
Charge-offs	(132)	—	(226)	(890)	—	(1,248)
Recoveries	865	—	435	315	—	1,615
Provision	(925)	602	(205)	496	32	—
Ending balance	$ 2,205	$ 7,116	$ 1,173	$ 1,356	$ 442	$ 12,292

The following tables summarize the ALLL and the recorded investment in loans and leases as of December 31, 2019 and 2018.

	As of December 31, 2019					
(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$ 159	$ —	$ 154	$ 11	$ —	$ 324
Collectively evaluated for impairment	1,663	8,096	878	922	348	11,907
Total	1,822	8,096	1,032	933	348	12,231
Gross loans:						
Individually evaluated for impairment	$ 656	$ 3,103	$ 6,600	$ 40	$ —	$ 10,399
Collectively evaluated for impairment	140,541	736,480	112,199	33,284	—	1,022,504
Total gross loans	$ 141,197	$ 739,583	$ 118,799	$ 33,324	$ —	$ 1,032,903

	As of December 31, 2018					
(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$ 748	$ 209	$ 273	$ 7	$ —	$ 1,237
Collectively evaluated for impairment	1,457	6,907	900	1,349	442	11,055
Total	2,205	7,116	1,173	1,356	442	12,292
Gross loans:						
Individually evaluated for impairment	$ 2,183	$ 1,343	$ 7,463	$ 23	$ —	$ 11,012
Collectively evaluated for impairment	133,360	659,550	91,307	51,022	—	935,239
Total gross loans	$ 135,543	$ 660,893	$ 98,770	$ 51,045	$ —	$ 946,251

The ALLL totaled $12.2 million at December 31, 2019 and $12.3 million at December 31, 2018. The loans acquired from Merchants were recorded at fair value, which included a discount for credit risk adjustments, which is not a part of the ALLL. No ALLL is required for these acquired loans on the date of acquisition. As a result, our ALLL as a percentage of gross loans declined to 1.18% as of December 31, 2019 compared to 1.30% as of December 31, 2018. As of December 31, 2019 and December 31, 2018, we had commitments to extend credit of $275.1 million and $235.8 million, respectively. The reserve for unfunded commitments recorded in *Other Liabilities* in the *Consolidated Balance Sheets* at December 31, 2019 and 2018 was $695 thousand.

The ALLL is based upon estimates of future loan and lease losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. Our ALLL methodology incorporates management's current judgments, and reflects management's estimate of future loan and lease losses and risks inherent in the loan portfolio in accordance with ASC Topic 450 *Contingencies* and ASC Topic 310 *Receivables.*

The allowance is increased by provisions charged to expense and reduced by net charge-offs. In periodic evaluations of the adequacy of the allowance balance, management considers past loan and lease loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. We formally assess the adequacy of the ALLL on a quarterly basis. These assessments include the periodic re-grading of classified loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment and other factors as warranted. Loans are initially rated when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies.

Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan categories are based on analysis of local economic factors applicable to each loan category. Allowances for changing environmental factors are management's best estimate of the probable impact these changes have had on the loan portfolio as a whole.

We believe that the ALLL was adequate as of December 31, 2019. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses. In addition, bank regulatory authorities, as part of their periodic examination of the Company, may require additional charges to the provision for loan and lease losses in future periods if warranted as a result of their review.

As of December 31, 2019, 83% of our gross loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL. Deterioration in economic conditions particularly in our markets may adversely affect our loan portfolio and may lead to additional charges to the provision for loan and lease losses.

Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, a formal impairment measurement is performed at least quarterly on a loan-by-loan basis. If the measurement of each impaired loans' value is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL. For collateral dependent loans, this can be accomplished by charging off the impaired portion of the loan based on the underlying value of the collateral. For non-collateral dependent loans, we establish a specific component within the ALLL based on the present value of the future cash flows. If we determine the sources of repayment will not result in a reasonable probability that the carrying value of a loan can be recovered, the amount of a loan's specific impairment is charged off against the ALLL. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the ALLL.

The unallocated portion of the ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component, or in the specific impairment reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of December 31, 2019, the unallocated allowance amount represented 3% of the ALLL, compared to 4% at December 31, 2018.

While the ALLL composition is an indication of specific amounts or loan categories in which future charge-offs may occur, actual amounts may differ.

We have lending policies and procedures in place with the objective of optimizing loan income within an accepted risk tolerance level. We review and approve these policies and procedures annually. Monitoring and reporting systems supplement the review process with regular frequency as related to loan production, loan quality, concentrations of credit, potential problem loans, loan delinquencies, and nonperforming loans.

The following is a brief summary, by loan type, of management's evaluation of the general risk characteristics and underwriting standards:

Commercial Loans – Commercial loans are underwritten after evaluating the borrower's financial ability to maintain profitability including future expansion objectives. In addition, the borrower's qualitative qualities are evaluated, such as management skills and experience, ethical traits, and overall business acumen. Commercial loans are primarily extended based on the cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The borrower's cash flow may deviate from initial projections, and the value of collateral securing these loans may change.

Most commercial loans are generally secured by the assets being financed and other business assets such as accounts receivable or inventory. Management may also incorporate a personal guarantee; however, some short-term loans may be extended on an unsecured basis. Repayment of commercial loans secured by accounts receivable may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate ("CRE") Loans – CRE loans are subject to similar underwriting standards and processes as commercial loans. CRE loans are viewed predominantly as cash flow loans and secondarily as loans collateralized by real estate. Generally, CRE lending involves larger principal amounts with repayment largely dependent on the successful operation of the property securing the loan or the business conducted on the collateralized property. CRE loans tend to be more adversely affected by conditions in the real estate markets or by general economic conditions.

The properties securing the CRE portfolio are diverse in terms of type and primary source of repayment. This diversity helps reduce our exposure to adverse economic events that affect any single industry. We monitor and evaluate CRE loans based on occupancy status (investor versus owner occupied), collateral, geography, and risk grade criteria.

Generally, CRE loans are made to developers and builders that are secured by non-owner occupied properties require the borrower to have had an existing relationship with the Company and a proven record of success. Construction loans are underwritten utilizing feasibility studies, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of cost and value associated with the complete project (as-is value). These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment largely dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property, or an interim loan commitment from the Company until permanent financing is secured. These loans are closely monitored by on-site inspections, and are considered to have higher inherent risks than other CRE loans due to their ultimate repayment sensitivity to interest rate changes, governmental regulation of real property, general economic conditions, and the availability of long-term financing.

Residential Real Estate Loans – We do not originate consumer real estate mortgage loans. The majority of our loans secured by non owner occupied residential real estate are made either as part of a commercial relationship and subject to similar underwriting standards and processes as the CRE portfolio, or loans that were purchased in a prior year as part of a pool of loans. Purchased loan pools are evaluated based on risk characteristics established for each segmented group of loans. These characteristics include a significant emphasis on historical losses within each loan group, inherent risks for each, and specific loan class characteristics such as trends related to nonaccrual loans, past due loans, criticized loans, net charge-offs or recoveries, among other relevant credit risk factors. Residential equity lines of credit are included in the discussion of consumer loans below.

We originate some single family residence construction loans. The loan amounts are no greater than $1 million and are short term real estate secured financing for the construction of a single family residence to be occupied by the owner. The loans have a draw down feature with interest only payments, and a balloon payment at the 12-month maturity. All of these loans are refinanced and paid-off by the borrower's permanent mortgage lender who provided the initial pre-approved mortgage financing. These loans are underwritten utilizing financial analysis of the borrower and are generally based upon estimates of cost and value associated with the complete project (as-is value). These estimates may be inaccurate. The loan disbursement and monitoring process is controlled utilizing similar processes as our CRE construction loans.

Consumer Loans – Our consumer loan originations are generally limited to home equity loans with nominal originations in unsecured personal loans. The portfolio also includes unsecured consumer home improvement loans and residential solar panel loans secured by UCC filings. We are highly dependent on third party credit scoring analysis to supplement the internal underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by management and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time, and documentation requirements.

We maintain an independent loan review program that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to the Board of Directors, Loan Committee and Audit Committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as our policies and procedures.

Management's continuing evaluation of all known relevant quantitative and qualitative internal and external risk factors provides the foundation for the three major components of the ALLL: (1) historical valuation allowances established in accordance with ASC 450, Contingencies ("ASC 450") for groups of similarly situated loan pools; (2) general valuation allowances established in accordance with ASC 450 that are based on qualitative credit risk factors; and (3) specific valuation allowances established in accordance with ASC 310, Receivables ("ASC 310") that are based on estimated probable losses on specific impaired loans. All three components are aggregated and constitute the ALLL; while portions of the allowance may be allocated to specific credits, the allowance net of specific reserves is available for the remaining credits that management deems as "loss." It is our policy to classify a credit as loss with a concurrent charge-off when management considers the credit uncollectible and of such little value that its continuance as a bankable asset is not warranted. A loss classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer recognizing the likely credit loss of a valueless asset even though partial recovery may occur in the future.

Our loan portfolio is evaluated by general loan class including commercial, commercial real estate (which includes construction and other real estate), residential real estate (which includes 1-4 family and home equity loans), consumer and other loans. In accordance with ASC 450, historical valuation allowances are established for loan pools with similar risk characteristics common to each loan grouping. These loan pools are similarly risk-graded and each portfolio is evaluated by identifying all relevant risk characteristics that are common to these segmented groups of loans. These characteristics include a significant emphasis on historical losses within each loan group, inherent risks for each, and specific loan class characteristics such as trends related to nonaccrual loans, past due loans, criticized loans, net charge-offs or recoveries, among other relevant credit risk factors. We periodically review and update our historical loss ratios based on net charge-off experience for each loan and lease class. Other credit risk factors are also reviewed periodically and adjusted as necessary to account for any changes in potential loss exposure.

General valuation allowances, as prescribed by ASC 450, are based on qualitative factors such as changes in asset quality trends, concentrations of credit or changes in concentrations of credit, changes in underwriting standards, changes in experience or depth of lending staff or management, the effectiveness of loan grading and the internal loan review function, and any other relevant factors. Management evaluates each qualitative component quarterly to determine the associated risks to the quality of our loan portfolio.

NOTE 6. PREMISES AND EQUIPMENT

The following table presents the major components of premises and equipment at December 31, 2019 and 2018.

(Amounts in thousands)

Premises and Equipment	**2019**	**2018**
Land	$ 2,523	$ 2,063
Land improvements	243	241
Bank buildings	15,222	13,076
Furniture, fixtures and equipment	13,341	12,682
Software	1,624	1,624
Assets not yet placed in service	860	72
Total premises and equipment	33,813	29,758
Less: accumulated depreciation and amortization	(17,907)	(16,639)
Premises and equipment, net	$ 15,906	$ 13,119

We record depreciation expense on a straight-line basis for all depreciable assets. Depreciation expense totaled $1.4 million and $1.7 million, for the years ended December 31, 2019 and 2018, respectively. We have entered into a number of non-cancelable lease agreements with respect to various premises. See Note 12, *Leases* for minimum annual rental commitments under non-cancelable lease agreements.

NOTE 7. GOODWILL AND OTHER INTANGIBLES

In February of 2019, as part of our Merchants acquisition, we recorded a core deposit intangible of $4.4 million and goodwill of $11.0 million. The core deposit intangible is being amortized on a straight-line basis over the estimated useful life of the deposits, which is eight years, with no expected residual value. For tax purposes, the core deposit intangible and goodwill are not being amortized.

In December of 2018, we purchased a domain name for $32 thousand. The purchase of the domain name created an intangible asset with an indefinite life that is not being amortized for book purposes. For tax purposes the domain name is being amortized over 15 years.

In March of 2016, as part of our branch acquisition, we recorded a core deposit intangible of $1.8 million and goodwill of $665 thousand. The core deposit intangible is being amortized on a straight-line basis over the estimated useful life of the deposits, which is eight years, with no expected residual value. For tax purposes, the core deposit intangible and goodwill are being amortized over 15 years.

Goodwill is calculated as the amount of cash paid in excess of the fair value of the net assets acquired in the transaction. Goodwill is not amortized, but is annually reviewed for impairment. No impairment of goodwill was deemed necessary based on the 2019 and 2018 annual reviews.

The acquired core deposits provide value as a source of below market rate funds and the realization of interest cost savings is a fundamental rationale for assuming these deposit liabilities. The cost savings is defined as the difference between the cost of funds on our new deposits (i.e., interest and net maintenance costs) and the cost of an equal amount of funds from an alternative source having a similar term as the new deposit base. Our core deposit intangibles were recorded at fair value which was derived by using the income approach and represent the present value of the cost savings over the projected term of our new deposit base.

Goodwill and Other Intangibles, net consisted of the following at December 31, 2019 and 2018.

(Amounts in thousands)

Goodwill and Other Intangibles	**2019**	**2018**
Goodwill	$ 11,671	$ 665
Core deposit intangibles	6,125	1,772
Domain name	32	32
Accumulated amortization	(1,348)	(628)
Goodwill and other intangibles, net	$ 16,480	$ 1,841

The following table sets forth, as of December 31, 2019, the total estimated future amortization of intangible assets:

(Amounts in thousands)

For the year ended December 31,	**Amount**
2020	$ 766
2021	766
2022	766
2023	766
2024	580
2025 and thereafter	1,133
Total	$ 4,777

NOTE 8. OTHER ASSETS

Other assets consist of the following at December 31, 2019 and 2018.

(Amounts in thousands)	**2019**	**2018**
Federal Home Loan Bank of San Francisco stock	$ 7,380	$ 5,892
Qualified Zone Academy Bonds	4,740	4,740
Interest receivable	4,678	4,609
Right-of-use lease	3,464	—
Investments in affordable housing partnerships	2,529	3,020
Income taxes receivable	1,925	541
Investment in CRA fund	1,066	1,036
Prepaid expenses	991	1,075
SBA payments in process	701	411
Loan servicing receivables	415	625
Investment in Bank of Commerce Holdings Trust II	310	310
Other	354	226
Total	$ 28,553	$ 22,485

NOTE 9. INTEREST-BEARING DEPOSITS

The following table presents the major types of interest-bearing deposits at December 31, 2019 and 2018.

(Amounts in thousands)	As of December 31,	
Interest-bearing deposits	**2019**	**2018**
Interest-bearing demand	$ 239,258	$ 252,202
Money market	307,559	265,093
Savings	135,888	114,840
Certificates of deposit, less than $250,000	82,769	96,510
Certificates of deposit, $250,000 and over	69,017	55,872
Total interest-bearing deposits	$ 834,491	$ 784,517

The following table presents interest expense for the major types of interest-bearing deposits for the years ended December 31, 2019 and 2018.

(Amounts in thousands)	For the year ended December 31,	
Deposit Interest Expense	**2019**	**2018**
Interest-bearing demand	$ 480	$ 414
Money market	1,599	646
Savings	493	288
Certificates of deposit, less than $250,000	1,127	1,100
Certificates of deposit, $250,000 and over	850	810
Total interest-bearing deposits	$ 4,549	$ 3,258

The following table presents the scheduled maturities of all certificates of deposit as of December 31, 2019.

(Amounts in thousands)

Due in:	**Amount**
2020	$ 91,880
2021	40,670
2022	12,236
2023	3,330
2024	3,632
Thereafter	38
Total certificates of deposit	$ 151,786

The following table presents the scheduled maturities of certificates of deposit of $250 thousand or more as of December 31, 2019.

(Amounts in thousands)

Due in:	**Amount**
Three months or less	$ 11,493
Over three months through six months	14,830
Over six months through twelve months	16,117
Over twelve months	26,577
Total certificates of deposit of $250 thousand or more	$ 69,017

NOTE 10. TERM DEBT

Term debt at December 31, 2019 and 2018 consisted of the following.

(Amounts in thousands)	**2019**	**2018**
Senior debt	$ —	$ 3,496
Unamortized debt issuance costs	—	(2)
Subordinated debt	10,000	10,000
Unamortized debt issuance costs	(43)	(89)
Net term debt	$ 9,957	$ 13,405

Future contractual maturities of term debt at December 31, 2019 are as follows.

(Amounts in thousands)	2020	2021	2022	2023	2024	Thereafter	Total
Subordinated debt	$ —	$ —	$ —	$ —	$ —	$ 10,000	$ 10,000
Total future maturities	$ —	$ —	$ —	$ —	$ —	$ 10,000	$ 10,000

Federal Home Loan Bank of San Francisco Borrowings

We have an available line of credit with the Federal Home Loan Bank of San Francisco of $460.5 million subject to certain collateral requirements, namely the amount of pledged loans and investment securities. The line of credit is secured by an investment in Federal Home Loan Bank of San Francisco stock, certain real estate secured loans that have been specifically pledged to the Federal Home Loan Bank of San Francisco pursuant to collateral requirements, and certain pledged securities held in the Bank's investment securities portfolio.

The Bank had no borrowings outstanding under secured lines of credit from the Federal Home Loan Bank of San Francisco at December 31, 2019 and December 31, 2018. The average balance outstanding on Federal Home Loan Bank of San Francisco term advances during the year ended December 31, 2019 and year ended December 31, 2018 was $9.6 million and $22.5 million, respectively. The maximum amount outstanding from the Federal Home Loan Bank of San Francisco at any month end during the year ended December 31, 2019 and year ended December 31, 2018 was $40.0 million and $70.0 million, respectively.

As of December 31, 2019, the Bank was required to hold an investment in Federal Home Loan Bank of San Francisco stock of $7.4 million recorded in *Other Assets* in the *Consolidated Balance Sheets*. Our investments in Federal Home Loan Bank of San Francisco stock are restricted investment securities, carried at cost, evaluated for impairment, and excluded from securities accounted for under ASC Topic 320 and ASC Topic 321.

We have pledged $516.4 million of our commercial real estate and residential real estate loans as collateral for the line of credit with the Federal Home Loan Bank of San Francisco. As of December 31, 2019, we also pledged $28.8 million in securities to the Federal Home Loan Bank of San Francisco.

Senior Debt

In December of 2015, the Holding Company entered into a senior debt loan agreement to borrow $10.0 million from another financial institution. During the second quarter of 2019, we completed the early repayment and termination of this variable-rate debt agreement. The original loan terms required monthly principal installments of $83 thousand, plus accrued and unpaid interest, commencing on January 1, 2016, continuing to, and including December 10, 2020 and a final scheduled payment of $5.0 million due on the maturity date of December 10, 2020. The loan was secured by a pledge from the Holding Company of all of the outstanding stock of Merchants Bank of Commerce. The loan could be prepaid in whole or in part at any time without any prepayment penalty. The principal amount of the loan bore interest at a variable rate, resetting monthly that was equal to the sum of the current three-month LIBOR plus 400 basis points. In December of 2015, the Holding Company incurred senior debt issuance costs of $15 thousand, which were being amortized over the initial term of the loan as additional interest expense.

Subordinated Debt

In December of 2015, the Holding Company issued $10.0 million in aggregate principal amount of fixed to floating rate Subordinated Notes due in 2025. The Subordinated Debt initially bears interest at 6.88% per annum for a five-year term, payable semi-annually. Thereafter, interest on the Subordinated Debt will be paid at a variable rate equal to three month LIBOR plus 526 basis points, payable quarterly until the maturity date. In December of 2015, the Holding Company incurred subordinated debt issuance costs of $210 thousand, which are being amortized over the initial five-year-term as additional interest expense.

The Subordinated Debt is subordinate and junior in right of payment to the prior payment in full of all existing and future claims of creditors and depositors of the Holding Company and its subsidiaries, whether now outstanding or subsequently created. The Subordinated Debt ranks equally with all other unsecured subordinated debt, except any which by its terms is expressly stated to be subordinated to the Subordinated Debt. The Subordinated Debt ranks senior to all preferred stock and common stock of the Holding Company and all future junior subordinated debt obligations. The Subordinated Debt is recorded as term debt on the Holding Company's balance sheet; however, for regulatory purposes, it is treated as Tier 2 capital by the Holding Company.

The Subordinated Debt will mature on December 10, 2025 but may be prepaid at the Holding Company's option and with regulatory approval at any time on or after five years after the Closing Date or at any time upon certain events, such as a change in the regulatory capital treatment of the Subordinated Debt or the interest on the Subordinated Debt is no longer deductible by the Holding Company for United States federal income tax purposes.

Federal Funds

We have entered into nonbinding federal funds line of credit agreements with three financial institutions to support short-term liquidity needs. The lines totaled $35.0 million at December 31, 2019 and had interest rates ranging from 1.80% to 2.58%. Advances under the lines are subject to funds availability, continued borrower eligibility, and may have consecutive day usage restrictions. The credit arrangements are reviewed and renewed annually. At December 31, 2019 and 2018, we had no outstanding federal funds purchased balances and no outstanding advances on any of the Bank's lines of credit.

Federal Reserve Bank

We have an available line of credit with the Federal Reserve Bank totaling $22.3 million subject to collateral requirements, namely the amount of certain pledged loans. As of December 31, 2019, we have pledged $25.7 million of our commercial loans as collateral for the credit line with the Federal Reserve Bank.

NOTE 11. JUNIOR SUBORDINATED DEBENTURES

The Company has one wholly-owned trust formed in 2005 to issue trust preferred securities and related common securities. The following table presents information about the Trust as of December 31, 2019 and 2018.

(Amounts in thousands)

Trust Name	Issue Date	Issued Amount	Rate	Effective Rate	Maturity Date	Redemption Date
Bank of Commerce Holdings Trust II	July 29, 2005	$ 10,310	Floating [1]	[2]	September 15, 2035	[3]

[1] Contractual interest rate of junior subordinated debentures based on three month LIBOR plus 1.58% adjusted quarterly.
[2] Effective rate as of December 31, 2019 and 2018 of 3.47% and 4.37%, respectively.
[3] Redeemable at the Company's option on any March 15, June 15, September 15, or December 15.

The $10.3 million of junior subordinated debentures issued to Trust II as of December 31, 2019 and 2018, are reflected in the *Consolidated Balance Sheets*. The common stock issued by Trust II in the amount of $310 thousand is recorded in *Other Assets* in the *Consolidated Balance Sheets*, at December 31, 2019 and 2018. All of the debentures issued to Trust II, less the common stock of Trust II, qualified as Tier 1 capital as of December 31, 2019 and 2018, under guidance issued by the Federal Reserve Board.

NOTE 12. LEASES

We lease ten sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates based on predetermined escalation schedules. Substantially all of the leases include the option to extend or terminate the lease term one or more times following expiration of the initial term at a rental rate established in the lease. For leases where we are reasonably certain that we will exercise the option to renew the lease, we have recognized those options in our right-of-use lease asset and liability. We had no other (financing, short-term or variable) lease arrangements during the current period or the prior year.

We have applied ASC Topic 842 as of January 1, 2019 and elected the practical expedients package for all of our leases. In accordance with the practical expedients package we were not required to reassess whether any expired or existing contracts are leases or contain leases. We were also not required to reassess the lease classification for existing or expired leases between operating and finance leases. On January 1, 2019, we recorded $4.4 million in *Other Liabilities* representing the present value of the remaining minimum lease payments and we recorded an offsetting right-of-use asset in *Other Assets*. The present value calculation uses a discount rate, which is based on our incremental borrowing rate. The right-of-use asset was also reduced by $458 thousand on January 1, 2019 for amounts recognized under the previous accounting requirements. During the year ended December 31, 2019, we recorded $267 thousand in *Other Liabilities* and an offsetting right-of-use asset in *Other Assets* for additional office space leased during the year. The table below presents information regarding our leases as of December 31, 2019.

(Amounts in thousands)	December 31, 2019
Right-of-use lease asset	$ 3,464
Lease liability	$ 3,855
Weighted Average Remaining Lease Term	5.54
Weighted Average Discount Rate	2.96 %

Lease expenses are recorded on a straight-line basis over the life of each lease. Lease expense and cash paid on leases are presented in the table below for the periods indicated.

	For the year ended December 31,	
(Amounts in thousands)	2019	2018
Operating lease expense	$ 830	$ 793
Cash paid for operating leases	$ 897	$ 809

The following table sets forth, as of December 31, 2019, the future minimum lease cash payments under non-cancelable operating leases and a reconciliation of the undiscounted cash flows to the operating lease liability.

(Amounts in thousands) **Due in:**		**Amount**
2020	$	961
2021		979
2022		888
2023		342
2024		295
Thereafter		737
Total undiscounted future minimum lease cash payments		4,202
Present value adjustment		(347)
Lease liability	$	3,855

Our election to utilize the practical expedients package did not result in the recognition of any additional leases, changes in lease terms, changes in classification or in the assessment of initial direct costs. ASC 842 was applied as a change in accounting principle and did not result in any adjustment to equity. The significant judgment made in applying the requirements in ASC Topic 842 is the determination of the incremental borrowing rate for the lease. We used the borrowing rates for terms similar to the lease terms available under our existing line of credit with the Federal Home Loan Bank of San Francisco as our incremental borrowing rate.

NOTE 13. OTHER LIABILITIES

Other liabilities consist of the following at December 31, 2019 and 2018.

(Amounts in thousands)		**2019**		**2018**
Salary continuation	$	4,691	$	3,462
Deferred compensation – directors fees		3,873		3,846
Leases		3,855		459
Accrued employee incentives		967		1,522
Dividend payable on common stock		902		651
Severance payable		818		760
Reserve for unfunded commitments		695		695
Delayed equity contributions - affordable housing tax credit partnerships		338		343
Other loan servicing liabilities		162		188
Deferred income		99		283
Other		1,300		1,143
Total	$	17,700	$	13,352

NOTE 14. COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance Sheet Risk

Our consolidated financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of our business and involve elements of credit, liquidity, and interest rate risk. In the normal course of business we are party to financial instruments with off-balance sheet credit risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. These instruments involve elements of credit and interest rate risk similar to the amounts recognized in the *Consolidated Balance Sheets*. The contract or notional amounts of these instruments reflect the extent of our involvement in particular classes of financial instruments.

The following table presents a summary of our commitments and contingent liabilities at December 31.

(Amounts in thousands)		**2019**		**2018**
Commitments to extend credit	$	267,248	$	223,882
Standby letters of credit		4,406		8,548
Affordable housing grant sponsorships		3,338		3,338
Access to housing and economic assistance for development grant sponsorships		110		100
Total commitments and contingent liabilities	$	275,102	$	235,868

We were not required to perform on any financial guarantees for the years ended December 31, 2019 and 2018. At December 31, 2019, approximately $3.7 million of standby letters of credit expire within one year, and $744 thousand expire thereafter.

Affordable Housing Grant and Access to Housing and Economic Assistance for Development Grant Sponsorships

In fulfilling our CRA responsibilities, we are a sponsor for various nonprofit organizations that receive cash grants from the Federal Home Loan Bank of San Francisco. Those grants require the nonprofit organization to comply with stipulated conditions of the grant over specified periods of time which typically vary from 10 to 15 years. If the nonprofit organization fails to comply, Federal Home Loan Bank of San Francisco can require us to refund the amount of the grant to Federal Home Loan Bank of San Francisco. To mitigate this contingent credit risk, Credit Administration underwrites the financial strength of the nonprofit organization and reviews their systems of internal control to determine, as best as possible, that they will not fail to comply with the conditions of the grant.

Reserve for Unfunded Commitments

The reserve for unfunded commitments, which is included in *Other Liabilities* on the *Consolidated Balance Sheets*, was $695 thousand at December 31, 2019 and 2018. The adequacy of the reserve for unfunded commitments is reviewed on a quarterly basis, based upon changes in the amount of commitments, loss experience, and economic conditions. When necessary, the provision expense is recorded in other noninterest expense in the *Consolidated Statements of Income.*

Death Benefit Agreement

The Company has entered into agreements with certain employees to pay a cash benefit to designated beneficiaries following the death of the employee. The payment will be made only if, at the time of death, the deceased employee was employed by the Bank and the Bank owned a life insurance policy on the employee's life. Depending on specific facts and circumstances, the payment amount can vary up to a maximum of $225 thousand per employee and may be taxable to the recipient. Neither the employee nor the designated recipient has a claim against the Bank's life insurance policy on the employee's life.

Legal Proceedings

We are involved in various pending and threatened legal actions arising in the ordinary course of business and if necessary, we maintain reserves for losses from legal actions, which are both probable and estimable. In our opinion, the disposition of claims currently pending will not have a material adverse effect on our financial position or results of operations.

Concentrations of Credit Risk

We grant many loans collateralized by real estate. In our judgment, a concentration exists in real estate related loans, which represented approximately 83% and 81% of our gross loan portfolio at December 31, 2019 and December 31, 2018, respectively. We underwrite real estate loans in accordance with loan policies that set underwriting criteria, including property types, loan-to-value limits and minimum debt service coverage ratios. We employ a variety of real estate concentration risk management tools including monitoring of limits on concentration levels, limits by property type and geography, annual property reviews including site visits and portfolio stress testing.

Although we believe such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in our principal market areas in particular, could have an adverse impact on the repayment of these loans. Business and personal incomes, cash flows from rental operations, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

We recognize the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to other depository institutions in aggregate or individually, we have established general standards for selecting correspondent banks as well as internal limits for allowable exposure to other depository institutions in aggregate or individually. In addition, we have an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer.

NOTE 15. EMPLOYEE BENEFITS AND RETIREMENT PLANS

401(k) plan – In 1985, we adopted a profit sharing 401(k) plan for eligible employees to be funded out of the earnings of the Company. The employees' contributions are limited to the maximum amount allowable under IRS Section 402(G). The Company's safe harbor contributions include a matching contribution of 100% of the first 3% of salary deferred and 50% of the next 2% of salary deferred. We made matching contributions aggregating $627 thousand and $549 thousand for the years ended December 31, 2019 and 2018, respectively. Discretionary contributions are also permitted however, there were no discretionary contributions were made over the two year reporting period.

Salary continuation plan – The Board of Directors has approved the implementation of the Supplemental Executive Retirement Plan (SERP), which is a non-qualified executive benefit plan under which we agree to pay certain executives covered by the SERP plan additional benefits in the future in return for continued satisfactory performance.

Benefits under the salary continuation plan differ by participating executive and include a benefit generally payable commencing upon a designated retirement date for a fixed period of ten years, disability or termination of employment, and a death benefit for the participants' designated beneficiaries. Whole life insurance policies were purchased as an investment to provide for our contractual obligation to pay pre-retirement death benefits and to recover our cost of providing benefits. The executive is the insured under the policy, while we are the owner and beneficiary.

The Company accrues for these future benefits from the effective date of the agreements until the executives' expected final payment date. The amount of accrued benefits approximates the present value of the benefits expected to be provided at retirement. Compensation expense under the salary continuation plan totaled $547 thousand and $532 thousand for the years ended December 31, 2019 and 2018, respectively. As of December 31, 2019, and 2018, the vested benefit payable was $4.7 million and $3.5 million, respectively. We use the FTSE Pension Liability Index as a guideline to establish the discount rate used to present value the benefits under the salary continuation plan.

During the first quarter of 2019 as part of our acquisition of Merchants we recorded an additional salary continuation liability of $968 thousand.

Directors deferred fee compensation – On December 19, 2013, the Board of Directors adopted a Directors Deferred Compensation Plan, which was amended and restated on February 20, 2018, (the "2013 Plan") to replace the Directors Deferred Compensation Plan dated January 1, 1993 as amended (the "1993 Plan"). Both plans allow the eligible Director to voluntarily elect to defer some or all of his or her current fees in exchange for the Company's promise to pay a deferred benefit. The deferred fees are credited with interest and the accrued liability is paid to the Director following retirement. Directors must stop the deferral of compensation once their total deferred benefit reaches $500 thousand.

The interest rate in the 2013 Plan is equal to the Bloomberg 20-year Investment Grade Financial Institutions Index (IGFII) rate (or a similar reference rate we select if that rate is not published) in effect on the interest accrual date, plus two percent. The 2013 Plan is only available to independent directors and, as a nonqualified deferred compensation plan, is not subject to nondiscrimination requirements applicable to qualified plans. No deferred compensation is payable to a director until separation from service, whereupon all such compensation, together with interest thereon shall be provided to such Director, or his beneficiary within thirty (30) days. The Director may designate payments to be made in a lump sum or in monthly installments over a period not to exceed 120 months.

Although deferrals under the 1993 Plan have ceased, the 1993 Plan remains in effect for all amounts previously deferred in the plan. The interest rate in the 1993 Plan is equal to the Wall Street Journal prime plus 3.00% or at a fixed rate of 10%. Under the 1993 Plan, at retirement, Directors are granted the option of continuing to accrue interest on deferred fees. The Director may designate payments to be made in a lump sum or in monthly installments over a period not to exceed 120 months.

Deferred compensation expense recorded in other noninterest expense totaled $324 thousand and $309 thousand for the years ended December 31, 2019 and 2018, respectively. As of December 31, 2019, and 2018, the vested benefit payable recorded in *Other Liabilities* in the *Consolidated Balance Sheets* was $3.9 million.

NOTE 16. SHAREHOLDERS' EQUITY AND STOCK PLANS

On January 31, 2019 we issued 1,834,142 shares of common stock, and paid $15.3 million in cash as part of our acquisition of Merchants Holding Company ("Merchants") at which point Merchants shareholders held, in the aggregate, approximately 10% of our outstanding common stock. The acquisition added $190.2 million in deposits, $85.3 million in loans and $107.4 million in investment securities on January 31, 2019. See Note 21 *Acquisition* in these *Notes to Consolidated Financial Statements* for additional information on the acquisition.

On May 10, 2017, we completed the sale of 2,738,096 shares of our common stock at a public offering price of $10.50 and received net proceeds of $26.8 million. These proceeds were used to fund our acquisition of Merchants Holding Company and to repay certain borrowings.

During the fourth quarter of 2019 we paid $1.0 million to repurchase 90,501 shares of common stock as part of our previously announced share repurchase program.

Stock Plans – The Bank of Commerce Holdings 2019 Equity Incentive Plan (the "Plan"), was approved by the Holding Company's shareholders on May 21, 2019 and replaced the Amended and Restated 2010 Equity Incentive Plan. The Plan provides for equity awards including options, stock appreciation rights, and restricted awards to employees and non-employee directors of the Company. Vesting may be accelerated in case of a participant's death or disability, or in case of a change in control. At December 31, 2019, 486,900 common shares were available for future grants under the Plan.

We recognized $9 thousand in tax benefits from vesting of restricted stock during the year ended December 31, 2019. Proceeds from exercise of stock options exercised were $52 thousand and $216 thousand for the years ended December 31, 2019 and 2018, respectively.

Stock Option Activity

The following tables summarize information about stock option activity for the years ended December 31, 2019, and 2018.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value At Time Of Grant	Weighted Average Remaining Contractual Term
Options outstanding December 31, 2017	134,500	$ 5.24	$ 704,350	4.76
Exercised	(37,100)	$ 5.82	$ 215,685	n/a
Options outstanding December 31, 2018	97,400	$ 5.02	$ 488,665	4.11
Exercised	(11,000)	$ 4.70	$ 51,670	n/a
Options outstanding December 31, 2019	86,400	$ 5.06	$ 436,995	3.09
Exercisable at December 31, 2018	93,400	$ 5.02	$ 488,665	4.11
Exercisable at December 31, 2019	86,400	$ 5.06	$ 436,995	3.09

There were no new stock options awarded during the two years ended December 31, 2019 and there are no unrecognized compensation costs for stock options. There was no stock option expense for the current year compared to $8 thousand for the year ended December 31, 2018. Stock options vested at 20% per year from the date of grant and, at December 31, 2019, all options are fully vested.

Restricted Stock Activity

The following tables summarize information about unvested restricted shares and restricted shares granted for the years ended December 31, 2019 and 2018.

	Number of Shares	Weighted Average Grant Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Unvested restricted shares December 31, 2017	74,489	$ 8.60	$ 640,255	1.03
Granted	29,913	$ 11.50	$ 344,000	1.07
Vested	(37,634)	$ 7.53	$ 283,433	n/a
Unvested restricted shares December 31, 2018	66,768	$ 10.50	$ 700,820	0.97
Granted	57,292	$ 11.02	$ 631,336	1.32
Vested	(27,243)	$ 11.14	$ 303,593	n/a
Forfeited	(5,096)	$ 11.12	$ 56,659	n/a
Unvested restricted shares December 31, 2019	91,721	$ 10.91	$ 1,000,954	1.12

	For the Years Ended December 31,	
(Amounts in thousands, except per share information)	2019	2018
Restricted stock compensation expense	$ 414	$ 288
Restricted stock awards weighted average grant date fair value per share	$ 11.02	$ 11.50

	At December 31,	
	2019	2018
Unrecognized compensation costs related to non-vested restricted stock payments	$ 642	$ 470

Restricted shares vest over a three to five year service period. Unvested restricted shares have no dividend or voting rights. The unrecognized compensation costs for unvested restricted shares are expected to be recognized over a weighted average period of one year.

Stock Grant Activity

The following tables summarize information about shares granted as employee compensation for the years ended December 31, 2019 and 2018. Stock grants are fully vested and expensed in the period awarded

	Number of Shares	Weighted Average Grant Price	Stock Grant Compensation Expense
Shares granted during the year ended December 31, 2019	6,169	$ 11.04	$ 68,106
Shares granted during the year ended December 31, 2018	4,653	$ 11.50	$ 53,510

Dividends

Presented below is a summary of cash dividends paid to common shareholders, recorded as a reduction of retained earnings. The holders of unvested restricted stock awards are not entitled to dividends on unvested shares. On December 18, 2019, we declared a cash dividend of $0.05 per share, payable on January 10, 2020 to shareholders of record at the close of business on December 31, 2019.

	For the Years Ended December 31,	
(Amounts in thousands, except per share information)	2019	2018
Cash dividends paid to common shareholders	$ 3,189	$ 2,274
Cash dividends paid per common share	$ 0.19	$ 0.15

Our principal source of cash for the Holding Company is dividends received from the Bank, which are subject to government regulation and limitations on the Bank's ability to pay dividends. We also have trust preferred securities and subordinated debt agreements with provisions that may impact our ability to pay dividends on our common stock to our common shareholders.

NOTE 17. REGULATORY CAPITAL

The Holding Company and the Bank are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that if undertaken, could have a direct material effect on our Consolidated Financial Statements.

The capital amounts and the Bank's prompt corrective action classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies. Quantitative measures established by regulation to ensure capital adequacy, require the Company and the Bank to maintain minimum amounts and ratios set forth in the following table as defined in the regulations. Management believes as of December 31, 2019 that the Company and the Bank met all capital adequacy requirements to which they are subject.

In May 2018 the Crapo bill was signed into law which simplified the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than $10 billion and instructed the federal banking regulators to establish a single Community Bank Leverage Ratio ("CBLR") which has been set at 9%. Any qualifying depository institution or its holding company that exceeds the Community Bank Leverage Ratio will be considered to have met generally applicable leverage and risk-based regulatory capital requirements and considered to be "well capitalized" under the prompt corrective action rules discussed above.

As of December 31, 2019, the most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", an institution must maintain minimum ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's capital rating category.

The Holding Company's and the Bank's actual capital amounts and ratios as of December 31, 2019 and 2018 are presented in the following table.

	Capital	Actual	Well Capitalized Requirement		Minimum Capital Requirement		Applicable Capital Conservation	Minimum Capital Requirement plus Conservation Buffer	
(Amounts in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Buffer	Amount	Ratio
At December 31, 2019:									
Company									
Common equity tier 1 capital ratio	$ 156,587	13.19 %	n/a	n/a	$ 53,409	4.50 %	2.50 %	$ 83,081	7.00 %
Tier 1 capital ratio	$ 166,587	14.04 %	n/a	n/a	$ 71,212	6.00 %	2.50 %	$ 100,884	8.50 %
Total capital ratio	$ 189,513	15.97 %	n/a	n/a	$ 94,949	8.00 %	2.50 %	$ 124,621	10.50 %
Tier 1 leverage ratio	$ 166,587	11.30 %	n/a	n/a	$ 58,945	4.00 %	n/a	$ 58,945	4.00 %
Bank									
Common equity tier 1 capital ratio	$ 170,568	14.39 %	$ 77,072	6.50 %	$ 53,358	4.50 %	2.50 %	$ 83,001	7.00 %
Tier 1 capital ratio	$ 170,568	14.39 %	$ 94,858	8.00 %	$ 71,144	6.00 %	2.50 %	$ 100,787	8.50 %
Total capital ratio	$ 183,494	15.48 %	$ 118,573	10.00 %	$ 94,858	8.00 %	2.50 %	$ 124,502	10.50 %
Tier 1 leverage ratio	$ 170,568	11.58 %	$ 73,646	5.00 %	$ 58,917	4.00 %	n/a	$ 58,917	4.00 %
At December 31, 2018:									
Company									
Common equity tier 1 capital ratio	$ 139,488	12.79 %	n/a	n/a	$ 49,072	4.50 %	1.875 %	$ 69,519	6.375 %
Tier 1 capital ratio	$ 149,488	13.71 %	n/a	n/a	$ 65,429	6.00 %	1.875 %	$ 85,876	7.875 %
Total capital ratio	$ 172,475	15.82 %	n/a	n/a	$ 87,239	8.00 %	1.875 %	$ 107,686	9.875 %
Tier 1 leverage ratio	$ 149,488	11.21 %	n/a	n/a	$ 53,079	4.00 %	n/a	$ 53,079	4.00 %
Bank									
Common equity tier 1 capital ratio	$ 144,245	13.23 %	$ 70,856	6.50 %	$ 49,054	4.50 %	1.875 %	$ 69,493	6.375 %
Tier 1 capital ratio	$ 144,245	13.23 %	$ 87,207	8.00 %	$ 65,405	6.00 %	1.875 %	$ 85,844	7.875 %
Total capital ratio	$ 157,232	14.42 %	$ 109,009	10.00 %	$ 87,207	8.00 %	1.875 %	$ 107,646	9.875 %
Tier 1 leverage ratio	$ 144,245	10.81 %	$ 66,712	5.00 %	$ 53,369	4.00 %	n/a	$ 53,369	4.00 %

NOTE 18. FAIR VALUES

The following tables present estimated fair values of our financial instruments as of December 31, 2019 and 2018, whether or not recognized or recorded at fair value in the *Consolidated Balance Sheets*. The table indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value. Non-financial assets and non-financial liabilities defined by the FASB ASC 820, Fair Value Measurement, such as Bank premises and equipment, deferred taxes and other liabilities are excluded from the table. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of FASB ASC 825, Financial Instruments, such as bank-owned life insurance policies.

(Amounts in thousands)	Carrying	Fair Value Measurements Using		
December 31, 2019	**Amounts**	**Level 1**	**Level 2**	**Level 3**
Financial assets				
Cash and cash equivalents	$ 80,604	$ 80,604	$ —	$ —
Securities available-for-sale	$ 286,950	$ —	$ 286,950	$ —
Net loans	$ 1,022,834	$ —	$ —	$ 1,025,520
Federal Home Loan Bank of San Francisco stock	$ 7,380	$ 7,380	$ —	$ —
Financial liabilities				
Deposits	$ 1,267,171	$ —	$ 1,267,153	$ —
Term Debt	$ 9,957	$ —	$ 10,006	$ —
Junior subordinated debenture	$ 10,310	$ —	$ 13,471	$ —

(Amounts in thousands)	Carrying	Fair Value Measurements Using		
December 31, 2018	**Amounts**	**Level 1**	**Level 2**	**Level 3**
Financial assets				
Cash and cash equivalents	$ 47,365	$ 47,365	$ —	$ —
Securities available-for-sale	$ 256,928	$ —	$ 256,928	$ —
Net loans	$ 935,886	$ —	$ —	$ 936,697
Federal Home Loan Bank of San Francisco stock	$ 5,892	$ 5,892	$ —	$ —
Financial liabilities				
Deposits	$ 1,131,716	$ —	$ 1,129,795	$ —
Term Debt	$ 13,405	$ —	$ 13,323	$ —
Junior subordinated debenture	$ 10,310	$ —	$ 14,183	$ —

Fair Value Hierarchy

Level 1 valuations utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access.

Level 2 valuations utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 valuations include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3

Valuations are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety.

We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Recurring Items

Debt Securities – The available-for-sale securities amount in the recurring fair value table above represents securities that have been adjusted to their fair values. For these securities, we obtain fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions among other things. We have determined that the source of these fair values falls within Level 2 of the fair value hierarchy.

The following tables present information about our assets and liabilities measured at fair value on a recurring basis, and indicate the fair value hierarchy of the valuation techniques we utilized to determine such fair value, as of December 31, 2019 and December 31, 2018.

(Amounts in thousands)	Fair Value at December 31, 2019			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$ 38,733	$ —	$ 38,733	$ —
Obligations of states and political subdivisions	42,098	—	42,098	—
Residential mortgage-backed securities and collateralized mortgage obligations	180,835	—	180,835	—
Corporate securities	2,966	—	2,966	—
Commercial mortgage-backed securities	19,307	—	19,307	—
Other investment securities	3,011	—	3,011	—
Total assets measured at fair value	$ 286,950	$ —	$ 286,950	$ —

(Amounts in thousands)	Fair Value at December 31, 2018			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$ 40,087	$ —	$ 40,087	$ —
Obligations of states and political subdivisions	50,530	—	50,530	—
Residential mortgage-backed securities and collateralized mortgage obligations	138,503	—	138,503	—
Corporate securities	2,922	—	2,922	—
Commercial mortgage-backed securities	24,762	—	24,762	—
Other investment securities	124	—	124	—
Total assets measured at fair value	$ 256,928	$ —	$ 256,928	$ —

Transfers Between Fair Value Hierarchy Levels

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer. There were no transfers between levels of the fair value hierarchy during the years ended December 31, 2019 or 2018.

Nonrecurring items

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These adjustments to fair value generally result from the application of lower of cost or fair value accounting or write-downs of individual assets due to impairment.

Collateral Dependent Loans - When we identify a collateral dependent loan as impaired, we measure the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL. When the fair value of the collateral is based on an appraisal or other estimate and there is no observable market price, we record the impaired loan as nonrecurring Level 3 fair value.

OREO - The OREO amounts below represent impaired real estate that has been adjusted to fair value during the respective reporting period. The loss represents impairments on OREO for fair value adjustments based on the fair value of the real estate. The determination of fair value is based on recent appraisals of the foreclosed properties, which take into account recent sales prices adjusted for unobservable inputs, such as opinions provided by local real estate brokers and other real estate experts. OREO fair values are adjusted for estimated selling costs of 41% based off the adjusted fair value of the property. We record OREO as a nonrecurring Level 3 fair value.

The following tables present information about our assets and liabilities at December 31, 2019 and December 31, 2018 measured at fair value on a nonrecurring basis for which a nonrecurring change in fair value has been recorded during the reporting period. The amounts disclosed below present the fair values at the time the nonrecurring fair value measurements were made, and not necessarily the fair values as of the date reported upon.

(Amounts in thousands)	Fair Value at December 31, 2019			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$ 33	$ —	$ —	$ 33
Other real estate owned	35	—	—	35
Total assets measured at fair value	$ 68	$ —	$ —	$ 68

(Amounts in thousands)	Fair Value at December 31, 2018			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 31	$ —	$ —	$ 31
Total assets measured at fair value	$ 31	$ —	$ —	$ 31

The following table presents the losses resulting from nonrecurring fair value adjustments for the years ended December 31, 2019 and 2018 related to assets outstanding at December 31, 2019 and 2018.

(Amounts in thousands)	December 31,	
Fair value adjustments	**2019**	**2018**
Collateral dependent impaired loans	$ 66	$ —
Other real estate owned	43	21
Total	$ 109	$ 21

For the year ended December 31, 2019, collateral dependent impaired loans with a carrying value of $99 thousand were written down to their fair value of $33 thousand resulting in a $66 thousand adjustment to the ALLL.

For the year ended December 31, 2019, one property is included in the OREO balance with an aggregate carrying value of $78 thousand that was written down to fair value of $35 thousand, resulting in a $43 thousand adjustment to ALLL.

The loan amounts above represent impaired, collateral dependent loans that have been adjusted to fair value during the respective reporting period. When we identify a collateral dependent loan as impaired, we measure the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and other information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time, our entire holdings of a particular financial instrument. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based only on current on and off-balance sheet financial instruments. Our fair value estimates do not include any adjustment for anticipated future business. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

NOTE 19. INCOME TAXES

The following table presents components of income tax expense included in the *Consolidated Statements of Income* for each of the past two years.

(Amounts in thousands)	**Current**	**Deferred**	**Total**
Year ended December 31, 2019:			
Federal	$ 2,732	$ 47	$ 2,779
State	2,126	107	2,233
Affordable housing partnership amortization	491	—	491
Total	$ 5,349	$ 154	$ 5,503
Year ended December 31, 2018:			
Federal	$ 773	$ 292	$ 1,065
State	1,733	303	2,036
Affordable housing partnership amortization	528	—	528
Total	$ 3,034	$ 595	$ 3,629

Our effective tax rate is calculated as our provision for income taxes divided by income before provision for income taxes. Income tax expense attributable to income before income taxes differed from the amounts computed by applying the U.S. federal income tax rate of 21% for 2019 and 2018 to income before income taxes.

The following table presents a reconciliation of income taxes computed at the federal statutory rate to the actual effective rate for the years ended December 31, 2019 and 2018.

	2019	2018
Income tax at the federal statutory rate	21.0 %	21.0 %
State franchise tax, net of federal tax benefit	8.6 %	8.3 %
Amortization of affordable housing credit partnerships	2.4 %	2.7 %
Officer life insurance	(0.5) %	(0.6) %
Tax-exempt interest	(1.3) %	(1.8) %
Affordable housing credits and benefits	(3.5) %	(3.8) %
Accelerated depreciation - cost segregation study	— %	(2.5) %
Reversal of uncertain tax position	— %	(5.1) %
Other	0.2 %	0.5 %
Effective Tax Rate	26.9 %	18.7 %

The following table reflects the effects of temporary differences that give rise to the components of the net deferred tax asset as of December 31, 2019 and 2018.

(Amounts in thousands)	2019	2018
Deferred tax assets:		
Allowance for loan and lease losses	$ 3,616	$ 3,634
Deferred compensation plan and salary continuation plan	2,773	2,385
Acquired loan fair value	494	—
State franchise tax	457	474
Acquisition costs	274	274
Unrealized loss on securities available-for-sale	—	1,262
Interest received on non-accrual loans	92	86
Lease liability	1,024	—
Other	700	403
Total deferred tax assets	9,430	8,518
Deferred tax liabilities:		
Deferred loan origination costs and fees	(568)	(579)
Unrealized gains on securities available-for-sale	(582)	—
Core deposit intangible	(1,139)	—
Basis difference in fixed assets	(1,336)	(874)
Lease asset	(1,024)	—
Other	(228)	(26)
Total deferred tax liabilities	(4,877)	(1,479)
Net deferred tax asset	$ 4,553	$ 7,039

We are not required to establish a valuation allowance for the deferred tax assets as management believes it is more likely than not that the deferred tax assets of $9.4 million and $8.5 million at December 31, 2019 and 2018, respectively will be realized principally through future reversals of existing taxable temporary differences. We further believe that future taxable income will be sufficient to realize the benefits of temporary deductible differences that cannot be realized through the reversal of future temporary taxable differences.

We have investments in Qualified Zone Academy Bonds ("QZAB") of $4.7 million at December 31, 2019 and 2018 recorded in *Other Assets* in the *Consolidated Balance Sheets.* We also have investments in QZAB of $1.0 million at December 31, 2019 and 2018 recorded in *Securities available-for-sale* in the *Consolidated Balance Sheets*. The investments provide funds for capital improvements at local schools and are repaid at maturity in 2031, 2033 and 2046. In exchange for the investment we receive a federal tax credit at a rate determined at the settlement of the investment by the US Treasury. We account for the benefit for these tax credit investments using the deferred cost reduction method.

See Note 20 *Qualified Affordable Housing Partnership Investments* in these *Notes to Consolidated Financial Statements*, for further details on our affordable housing project investments.

We have no unrecognized tax benefits at December 31, 2019 or 2018.

We file income tax returns in the U.S. federal jurisdiction, and the State of California. Income tax returns filed are subject to examination by the U.S. federal, state, and local income tax authorities. While no income tax returns are currently being examined, we are no longer subject to tax examination by tax authorities for years prior to fiscal year 2016 for federal tax returns and fiscal year 2015 for state and local tax returns.

During 2018, we completed a cost segregation study and a tangible property review, to shorten the depreciable lives of certain assets and accelerate the tax depreciation deduction on our 2017 federal income tax return. As a result, we recorded a benefit to our 2018 book provision for income taxes of $484 thousand.

In September of 2016, we filed amended federal and state tax returns for tax years 2011, 2012, 2013, and 2014. The amendments were filed to properly recognize tax events in years 2011 and 2013 that were improperly recognized in years 2011 through 2014. The IRS rejected the 2011 amended tax return citing the statute for assessment had expired. Accordingly, $988 thousand of taxes due to the taxing authorities pursuant to the 2011 amended federal tax return was returned to us. The statute of limitations on the 2014 amended federal tax return passed in 2018 and we reversed our uncertain tax position and recognized the $988 thousand benefit in our provision for income taxes.

The following table presents our uncertain tax position at December 31, 2018.

(Amounts in thousands)		**2018**
Balance, beginning of period	$	988
Tax positions resolved during the year		(988)
Balance, end of period	$	—

NOTE 20. QUALIFIED AFFORDABLE HOUSING PARTNERSHIP INVESTMENTS

We have invested in four separate Qualified Affordable Housing Partnerships that generate Low Income Housing Tax Credits ("LIHTC"), which provide the Company with CRA credit. Additionally, the investments in LIHTC partnerships provide us with tax credits and with operating loss tax benefits over an approximately 18-year period. The tax credits and the operating loss tax benefits that are generated by each of the properties are expected to exceed the total value of the investments we made and provide returns on the investments of between 3% and 5% over the life of the investment. None of the original investments will be repaid.

Our investments in LIHTC totaled $2.5 million at December 31, 2019. These investments are recorded in *Other Assets* with a corresponding funding obligation of $338 thousand recorded in *Other Liabilities* in our *Consolidated Balance Sheets*. The investments in LIHTC partnerships are being accounted for using the proportional amortization method, under which we amortize the initial cost of an investment in proportion to the amount of the tax credits and other tax benefits received, and recognize the net investment performance in the *Consolidated Statements of Income* as a component of income tax expense.

The following tables present our original investment in LIHTC partnerships, the current recorded investment balance, and the unfunded liability balance of each investment at December 31, 2019 and 2018. In addition, the table reflects the tax credits and tax benefits, amortization of the investment and the net impact to our income tax provision for the years ended December 31, 2019 and 2018.

	At December 31, 2019			**For the year ended December 31, 2019**		
(Amounts in thousands) **Qualified Affordable Housing Partnerships**	**Original Investment Value**	**Current Recorded Investment**	**Unfunded Liability Obligation**	**Tax Credits and Benefits**	**Amortization of Investments**	**Net Income Tax Benefit**
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 852	$ 22	$ 199	$ 170	$ 29
WNC Institutional Tax Credit Fund 38, L.P.	1,000	400	—	108	89	19
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,067	316	224	203	21
California Affordable Housing Fund	2,454	210	—	25	29	(4)
Total	$ 7,954	$ 2,529	$ 338	$ 556	$ 491	$ 65

	At December 31, 2018			**For the year ended December 31, 2018**		
(Amounts in thousands) **Qualified Affordable Housing Partnerships**	**Original Investment Value**	**Current Recorded Investment**	**Unfunded Liability Obligation**	**Tax Credits and Benefits**	**Amortization of Investments**	**Net Income Tax Benefit**
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 1,022	$ 28	$ 200	$ 179	$ 21
WNC Institutional Tax Credit Fund 38, L.P.	1,000	489	—	126	100	26
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,270	315	226	206	20
California Affordable Housing Fund	2,454	239	—	31	43	(12)
Total	$ 7,954	$ 3,020	$ 343	$ 583	$ 528	$ 55

The following table presents our generated tax credits and tax benefits from investments in qualified affordable housing partnerships for the years ended December 31, 2019 and 2018.

	For the Years Ended December 31,			
	2019		2018	
(Amounts in thousands)	Generated	Tax Benefits from	Generated	Tax Benefits from
Qualified Affordable Housing Partnerships	Tax Credits	Taxable Losses	Tax Credits	Taxable Losses
Raymond James California Housing Opportunities Fund II	$ 170	$ 29	$ 170	$ 30
WNC Institutional Tax Credit Fund 38, L.P.	93	15	111	15
Merritt Community Capital Corporation Fund XV, L.P.	192	32	192	34
California Affordable Housing Fund	—	25	5	26
Total	$ 455	$ 101	$ 478	$ 105

The following table reflects the anticipated net income tax benefit and (expense) at December 31, 2019, that is expected to be recognized over the remaining lives of the investments.

(Amounts in thousands) **Qualified Affordable Housing Partnerships: Anticipated income tax benefit, net less amortization of investments**	Raymond James California Housing Opportunities Fund II	WNC Institutional Tax Credit Fund 38, L.P.	Merritt Community Capital Corporation Fund XV, L.P	California Affordable Housing Fund	Total Income Tax Benefit, Net
2020	$ 14	$ 12	$ 3	$ (10)	$ 19
2021	19	16	4	(14)	25
2022	19	14	3	(13)	23
2023	18	13	3	(36)	(2)
2024 and thereafter	16	14	4	—	34
Total	$ 86	$ 69	$ 17	$ (73)	$ 99

NOTE 21. ACQUISITION

On January 31, 2019 we completed the acquisition of Merchants Holding Company (“Merchants”), to extend our presence in the Sacramento marketplace. Merchants, headquartered in Sacramento, California, was the parent company of The Merchants National Bank of Sacramento (“Merchants Bank”), a 97-year-old bank with approximately $211.7 million in assets as of January 31, 2019. Merchants Bank operated one full service branch and one limited service branch in the Sacramento metropolitan area. In May of 2019, we successfully converted all of Merchant’s computer records onto our core system.

We paid $15.3 million in cash and issued 1,834,142 shares of common stock to Merchants shareholders who held, in the aggregate, approximately 10% of our outstanding common stock on January 31, 2019. One former member of the Merchants board now serves on our board of directors. The acquisition, after fair value adjustments added $190.2 million in deposits, $107.4 million in investment securities and $85.3 million in loans to our Bank as of January 31, 2019.

The acquisition of Merchants constituted a business combination and has been accounted for using the acquisition method of accounting. The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of the acquisition date in accordance with ASC 805, Business Combinations. The Bank engaged third party specialists to assist in valuing certain assets, including investment securities, loans, real estate and the core deposit intangible that resulted from the acquisition. The acquisition was treated as a "reorganization" within the definition of section 368(a) of the Internal Revenue Code and is generally considered tax-free for U.S. federal income tax purposes.

The calculation of goodwill recorded during 2019 is detailed below.

(Amounts in thousands)	As Recorded by Merchants Holding Company	Fair Value And Other Acquisition Related Adjustments	As Recorded by the Company
Consideration paid:			
Cash			$ 15,300
Stock 1,834,142 shares at $10.69 per share			19,607
Total consideration			$ 34,907
Assets acquired:			
Cash and fed funds sold	$ 12,425	$ —	$ 12,425
Investment securities	107,931	(551)	107,380
Loans, gross	87,570	(2,292)	85,278
Allowance for loan and lease losses	(1,286)	1,286	—
Interest receivable	688	—	688
Premises and equipment, net	378	1,856	2,234
Deferred tax assets, net	1,374	(1,352)	22
Federal Home Loan Bank of San Francisco stock	1,454	—	1,454
Life insurance	755	—	755
Other assets	371	95	466
Core deposit intangible	—	4,353	4,353
Total assets acquired	$ 211,660	$ 3,395	$ 215,055
Liabilities assumed:			
Demand, money market and savings	$ 152,213	$ —	$ 152,213
Certificates of deposit	38,003	—	38,003
Total deposits	190,216	—	190,216
Other liabilities	916	22	938
Total liabilities assumed	$ 191,132	$ 22	$ 191,154
Net identifiable assets acquired over liabilities assumed	$ 20,528	$ 3,373	$ 23,901
Goodwill			$ 11,006

Goodwill

As a result of the Merchants acquisition, we recorded goodwill totaling $11.0 million. Goodwill reflects the expected value of Merchants reputation in the community, stable customer base and expected synergies created through the combined operations with our Company and was calculated as the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. We perform a goodwill impairment analysis on an annual basis. Additionally, we perform a goodwill impairment evaluation on an interim basis when events or circumstances indicate impairment potentially exists.

The following is a description of the methods used to determine the fair values of significant assets and liabilities whose fair values are different from their carrying amounts on Merchants' books at acquisition date presented above.

Investment Securities

Fair values for securities were obtained from an independent pricing service and were based on quoted market prices, where available. If quoted market prices were not available, fair value estimates were based on observable inputs including quoted market prices for similar instruments, quoted market prices that were not in an active market, other inputs that were observable in the market or a discounted cash flow model.

Loans

We engaged a third party to assist us in determining the fair values for the loans acquired from Merchants based upon the present values of the expected cash flows and market-derived discount rates. There were no loans acquired with evidence of deterioration of credit quality since origination for which we believe it is probable that we will be unable to collect all contractually required payments receivable. A fair value discount of $2.3 million was recorded for loans acquired from Merchants and is being accreted over the life of the loans as a yield adjustment. We recorded $620 thousand in accretion of the discount for these loans during the year ended December 31, 2019.

Premises and Equipment

We engaged an independent licensed appraiser to determine the fair value of the acquired branch located in Sacramento. The fair value of tangible personal property was not material.

Deferred Tax Assets

Deferred income tax assets were recorded to reflect the difference between the carrying values of the acquired assets and liabilities for financial reporting purposes and the basis for income tax purposes using the Company's statutory federal and state income tax rates. During 2019 the final tax returns were completed for Merchants and the net deferred tax assets were adjusted to fair value.

Core Deposit Intangible

We engaged an independent third party to assist us in determining the core deposit intangible asset of $4.4 million associated with non-maturity deposits acquired from Merchants. The core deposit intangible represents the estimated future benefits of acquired deposits and is booked separately from the related deposits. The value of the core deposit intangible asset was determined using a discounted cash flow approach to arrive at the cost differential between the core deposits (non-maturity deposits such as transaction, savings and money market accounts) and alternative funding sources. It was calculated as the present value of the difference in cash flows between maintaining the core deposits (interest and net maintenance costs) and the cost of an equal amount of funds with a similar term from an alternative source. The core deposit intangible is being amortized on a straight line basis over an estimated eight-year life, and is evaluated periodically for impairment. No impairment loss was recognized in 2019. Core deposit intangible amortization from this acquisition is not deductible for tax purposes. We recorded amortization of the core deposit intangible totaling $499 thousand during the year ended December 31, 2019. The future estimated amortization expense on the core deposit intangible from the Merchants acquisition at December 31, 2019 is as follows:

(Amounts in thousands)	**2020**	**2021**	**2022**	**2023**	**2024**	**Thereafter**	**Total**
Core deposit intangible amortization	$ 544	$ 544	$ 544	$ 544	$ 544	$ 1134	$ 3,854

Pro Forma Results of Operations

The following table presents pro forma information of the combined entity as if the acquisition occurred on January 1, 2018. The pro forma information does not necessarily reflect the results of operations that would have resulted had the acquisition been completed at the beginning of the periods presented, nor is it indicative of the results of operations in future periods. Furthermore, cost savings and other business synergies related to the acquisition are not reflected in the pro forma amounts.

Pro forma revenue and earnings	**For the Twelve Months Ended December 31,**	
(Amounts in thousands)	**2019**	**2018**
Net interest income	$ 53,730	$ 52,948
Net income [(1)]	$ 14,924	$ 16,313

[(1)] Net income includes acquisition-related costs for both entities of $1.3 million and $2.2 million for 2018 and 2019, respectively.

It is impracticable to separately provide information regarding the amount of revenue and earnings from Merchants included in our *Consolidated Statement of Income* because the operations of Merchants were substantially comingled with the operations of the Company as of the acquisition date.

NOTE 22. EARNINGS PER COMMON SHARE

The following table presents a computation of basic and diluted earnings per share for the years ended December 31, 2019 and 2018.

(Amounts in thousands, except per share information)

Earnings Per Share	2019	2018
Numerators:		
Net income	$ 14,961	$ 15,730
Denominators:		
Weighted average number of common shares outstanding - basic [(1)]	17,956	16,248
Effect of potentially dilutive common shares [(2)]	68	84
Weighted average number of common shares outstanding - diluted	18,024	16,332
Earnings per common share:		
Basic	$ 0.83	$ 0.97
Diluted	$ 0.83	$ 0.96
Anti-dilutive options not included in earnings per share calculation	—	—
Anti-dilutive restricted shares not included in diluted earnings per share calculation	—	—

(1) Excludes unvested restricted shares because they do not have dividend or voting rights.

(2) Represents the effects of the assumed exercise of stock options and vesting of non-participating restricted shares.

During the fourth quarter of 2019 we repurchased 90,501 shares of common stock as part of our previously announced share repurchase program.

NOTE 23. RELATED PARTY TRANSACTIONS

Some of the directors and executive officers (and their associated or affiliated companies) were customers of and had banking transactions with us in the ordinary course of our business and we expect to have such transactions in the future. All deposits, loans and commitments to fund loans included in such transactions were made in compliance with the applicable laws on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of similar creditworthiness.

The following table presents a summary of aggregate activity involving related party borrowers for the years ended December 31, 2019 and 2018.

(Amounts in thousands)	2019	2018
Balance at beginning of year	$ 9,490	$ 13,230
New loan additions	3,513	—
Advances on existing lines of credit	213	31,281
Principal repayments	(9,449)	(34,150)
Reclassifications [(1)]	—	(871)
Balance at end of year	$ 3,767	$ 9,490

(1) Represents loans that were once considered related party but are no longer considered related party, or loans that were not related party that subsequently became related party loans.

At December 31, 2019 and 2018, deposits of related parties amounted to $12.0 million and $11.8 million, respectively. As of December 31, 2019 and 2018, there were no related party loans which were past due or adversely classified. At December 31, 2019 and 2018 there was $11.1 million, and $9.9 million, respectively, in outstanding loan commitments to related parties. In our opinion, these transactions did not involve more than a normal risk of collectability or present other unfavorable terms.

NOTE 24. PARENT COMPANY FINANCIAL STATEMENTS

Condensed Balance Sheets
Year ended December 31,

(Amounts in thousands)	2019	2018
Assets:		
Cash	$ 6,814	$ 19,425
Investment in:		
Merchants Bank of Commerce	188,459	143,078
Bank of Commerce Mortgage	(64)	(64)
Bank of Commerce Holdings Trust II	310	310
Other assets	423	157
Total Assets	$ 195,942	$ 162,906
Liabilities and shareholders' equity:		
Term debt:		
Senior debt, net	$ —	$ 3,494
Subordinated debt, net	9,957	9,911
Junior subordinated debentures	10,310	10,310
Other liabilities	1,197	870
Total liabilities	21,464	24,585
Shareholders' equity	174,478	138,321
Total liabilities and shareholders' equity	$ 195,942	$ 162,906

Condensed Statements of Income
Year Ended December 31,

(Amounts in thousands)	2019	2018
Income:		
Other income	$ 13	$ 12
Dividends from subsidiaries	12,500	4,000
Total income	12,513	4,012
Expenses:		
Management fees paid to subsidiaries	310	303
Interest expense	1,233	1,461
Noninterest expense	844	1,433
Total expenses	2,387	3,197
Income before income taxes and equity in undistributed net income of subsidiaries	10,126	815
Income tax expense	1	1
Income before equity in undistributed net income of subsidiaries	10,125	814
Equity in undistributed net income of subsidiaries	4,836	14,916
Net income	$ 14,961	$ 15,730

Condensed Statements of Cash Flows
Year Ended December 31,

(Amounts in thousands)	2019	2018
Cash flows from operating activities:		
Net income	$ 14,961	$ 15,730
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed net income of subsidiaries	(4,836)	(14,916)
Amortization of debt issuance costs	48	49
Provision for depreciation and amortization	18	18
Decrease (increase) in other assets	13	(7)
(Decrease) increase in other liabilities	(164)	227
Net cash provided by operating activities	10,040	1,101
Cash flows from investing activities:		
Cash received from acquisition of Merchants Holding Company	292	—
Cash paid for acquisition of Merchants Holding Company	(15,300)	—
Net cash used by investing activities	(15,008)	—
Cash flows from financing activities:		
Repayment of term debt	(3,496)	(3,602)
Repurchase of common stock	(1,010)	—
Cash dividends paid on common stock	(3,189)	(2,274)
Proceeds from stock options exercised	52	216
Net cash used in financing activities	(7,643)	(5,660)
Net decrease in cash and cash equivalents	(12,611)	(4,559)
Cash and cash equivalents at the beginning of year	19,425	23,984
Cash and cash equivalents at the end of year	$ 6,814	$ 19,425
Supplemental disclosures of non cash financing activities:		
Stock issued under employee plans	$ 58	$ 45

Item 9 - Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

There have been no changes in or disagreements with accountants or auditors on accounting and financial disclosure.

Item 9a - Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company’s management, including its President and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity’s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal controls can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the Company’s Chief Executive Officer and the Chief Financial Officer and implemented by the Company’s Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

The Company’s internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

On a quarterly basis, we carry out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Financial Officer (whom is also our Principal Accounting Officer) of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. As of December 31, 2019, our management, including our Chief Executive Officer, and Principal Financial Officer, concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us that is required to be included in our periodic SEC filings.

Although we change and improve our internal controls over financial reporting on an ongoing basis, we do not believe that any such changes occurred in the fourth quarter of 2019 that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

This annual report includes an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting.

Item 9b - Other Information

The Boards of Directors of the Company and the Bank recently approved Second Amendments (each, an “Amendment”) to our Employment Agreements with Randall S. Eslick, our President and Chief Executive Officer, James A. Sundquist, our Executive Vice President and Chief Financial Officer, and Robert H. Muttera, our Executive Vice President and Chief Credit Officer (the “Executives”). Under each Amendment, each Executive’s employment with the Company and the Bank will continue for a period of three (3) years and, on the third anniversary, the Executive’s Employment Agreement will automatically extend for a period of one (1) year (unless otherwise agreed between the parties). Under Mr. Sundquist’s Amendment, Mr. Sundquist will also be entitled to receive retention bonuses in the amount of $25,000 in July 2021, $75,000 in July 2022, and $50,000 in July 2023 (provided he is still employed on those dates and has satisfactorily performed his job). Under Mr. Eslick’s Amendment, Mr. Eslick’s Employment Agreement was also amended to increase the amount payable to Mr. Eslick in the event of a Change in Control from 2x to 2.99x his Total Compensation Package (as defined in his Employment Agreement).

Part III

Item 10 - Directors, Executive Officers and Corporate Governance

The response to this item is incorporated by reference to Bank of Commerce Holdings Proxy Statement for the 2020 Annual Meeting of shareholders (the "Proxy Statement") under the captions "Information about the Director Nominees", "Director Qualifications and Nominations for Directors", "The Board and Governance Matters", "Committees of the Board of Directors", "Report of the Audit and Qualified Legal Compliance Committee", "Director Independence, Certain Relationships and Related Transactions", "Named Executive Officers of the Company", "Delinquent Section 16(a) Reports", "Voting Securities and Ownership of Certain Beneficial Holders", and "Code of Conduct, Code of Ethics, and Corporate Governance Documents".

Item 11 - Executive Compensation

The response to this item is incorporated by reference to the Proxy Statement, under the captions "Compensation Discussion and Analysis", "Executive Compensation", "Report of the Executive Compensation Committee on Executive Compensation", and "Director Compensation".

Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The response to this item is incorporated by reference to the Proxy Statement, under the caption "Voting Securities and Ownership of Certain Beneficial Holders".

Item 13 - Certain Relationships and Related Transactions and Director Independence

The response to this item is incorporated by reference to the Proxy Statement, under the caption "Certain Relationships and Related Transactions".

Item 14 - Principal Accounting Fees and Services

The response to this item is incorporated by reference to the Proxy Statement, under the caption "Report of the Audit and Qualified Legal Compliance Committee."

Part IV

Item 15 - Exhibits and Financial Statement Schedules

(a) The following documents are filed as a part of this Form 10-K:

(1) Financial Statements:

Reference is made to the Index to Consolidated Financial Statements under Item 8 in Part II of this Form 10-K.

(2) Financial Statement Schedules:

All schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(3) Exhibits:

Exhibit No.	Exhibit Description	Form	SEC File No.	Original Exhibit No.	Filing Date	Filed Herewith
3.1	Restated Articles of Incorporation	10-Q	000-25135	3.1	8/5/2016	
3.2	Amended and Restated Bylaws	8-K	000-25135	3.2	8/21/2019	
4.1	Form of 6.875% Fixed to Floating Rate Subordinated Note due December 10, 2025	8-K	000-25135	4.2	12/14/2015	
4.2	Description of Bank of Commerce Holdings' Securities Registered Pursuant to Section 12 of the Securities Exchange Act					X
10.1*	1993 Directors Deferred Compensation Plan	10-12G	000-25135	10.7	12/4/1998	
10.2*	Form of Deferred Compensation Agreement used in connection with 1993 Directors Deferred Compensation Plan	10-12G	000-25135	10.8	12/4/1998	
10.3*	Amendments to Form of 1993 Deferred Compensation Plan	10-K	000-25135	10.8	3/11/2014	
10.4*	Amended and Restated 2013 Directors Deferred Compensation Plan and Participant Election Form	10-K	000-25135	10.12	3/9/2018	
10.5*	Amended and Restated 2010 Equity Incentive Plan ("2010 Equity Incentive Plan")	DEF 14A	000-25135	Appendix A	3/9/2012	
10.6*	Form of Stock Option Agreement used in connection with 2010 Equity Incentive Plan	10-K	000-25135	10.7	3/8/2016	
10.7*	Form of Notice of Exercise of Stock Option used in connection with 2010 Equity Incentive Plan	10-K	000-25135	10.8	3/8/2016	
10.8*	Form of Restricted Stock Agreement used in connection with 2010 Equity Incentive Plan	10-K	000-25135	10.9	3/8/2016	
10.9*	Form of Stock Grant Agreement used in connection with 2010 Equity Incentive Plan	10-K	000-25135	10.10	3/8/2016	
10.10*	Bank of Commerce Holdings 2019 Equity Incentive Plan	8-K	000-25135	10.1	5/23/19	
10.11*	Form of Restricted Stock Agreement for 2019 Equity Incentive Plan					X
10.12*	Amended and Restated Salary Continuation Agreement with Randall S. Eslick, dated November 19, 2013	10-K	000-25135	10.10	3/11/14	
10.13*	Salary Continuation Agreement with Robert H. Muttera, dated January 17, 2014	10-K	000-25135	10.18	3/11/2014	
10.14*	Amendment to the Salary Continuation Agreements	10-Q	000-25135	10.1	4/28/2017	
10.15*	Amended and Restated Employment Agreement with Randall S. Eslick dated February 21, 2017.	10-K	000-25135	10.20	3/15/2017	
10.16*	Amended and Restated Employment Agreement with James A. Sundquist dated February 21, 2017.	10-K	000-25135	10-21	3/15/17	
10.17*	Amended and Restated Employment Agreement with Robert H. Muttera dated February 21, 2017.	10-K	000-25135	10-23	3/15/17	
10.18*	Amendment to Amended and Restated Employment Agreement with Randall S. Eslick dated May 3, 2018	10-Q	000-2513	10.1	5/4/2018	

10.19*	Amendment to Amended and Restated Employment Agreement with James A. Sundquist dated May 3, 2018	10-Q	000-2513	10.2	5/4/201/	
10.20*	Amendment to Amended and Restated Employment Agreement with Robert H. Muttera dated May 3, 2018	10-Q	000-2513	10.4	5/4/2018	
10.21*	Second Amendment to Employment Agreement with Randall S. Eslick dated March 6, 2020					X
10.22*	Second Amendment to Employment Agreement with James A. Sundquist dated March 6, 2020					X
10.23*	Second Amendment to Employment Agreement with Robert H. Muttera dated March 6, 2020					X
10.24*	Severance and Release Agreement with Samuel D. Jimenez effective January 28, 2020					X
10.25*	Form of Indemnification Agreement	8-K	000-2513	10.1	12/20/2017	
10.26*	Subordinated Note Purchase Agreement between Bank of Commerce Holdings and The Purchasers named Herein, dated December 10, 2015	8-K	000-2513	10.3	12/14/2015	
21.1	Subsidiaries of the Company					X
23.1	Consent of Moss Adams LLP					X
24	Power of Attorney (included on signature page to this report)					X
31.1	Certification of Randall S. Eslick pursuant to Exchange Act Rule 13a-14(a) or 15d — 14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of James A. Sundquist pursuant to Exchange Act Rule 13a-14(a) or 15d — 14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1	Certification pursuant to Section 1350					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X
* Executive Contract, Compensatory Plan or Arrangement						

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 6, 2020.

BANK OF COMMERCE HOLDINGS

By /s/ *Randall S. Eslick*

Randall S. Eslick
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Randall S. Eslick and James A. Sundquist, and each of them, his true and lawful attorneys-in-fact, each with full power of substitution, for him in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Randall S. Eslick	President and Chief Executive Officer	March 6, 2020
/s/ James A. Sundquist	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 6, 2020
/s/ Lyle L. Tullis	Chairman of the Board	March 6, 2020
/s/ Orin N. Bennett	Director	March 6, 2020
/s/ Gary R. Burks	Director	March 6, 2020
/s/ Joseph Q. Gibson	Director	March 6, 2020
/s/ Jon W. Halfhide	Director	March 6, 2020
/s/ David J. Inderkum	Director	March 6, 2020
/s/ Linda J. Miles	Director	March 6, 2020
/s/ Karl L. Silberstein	Director	March 6, 2020
/s/ Terence J. Street	Director	March 6, 2020

Exhibit 21.1

Subsidiaries of the Company as of December 31, 2019

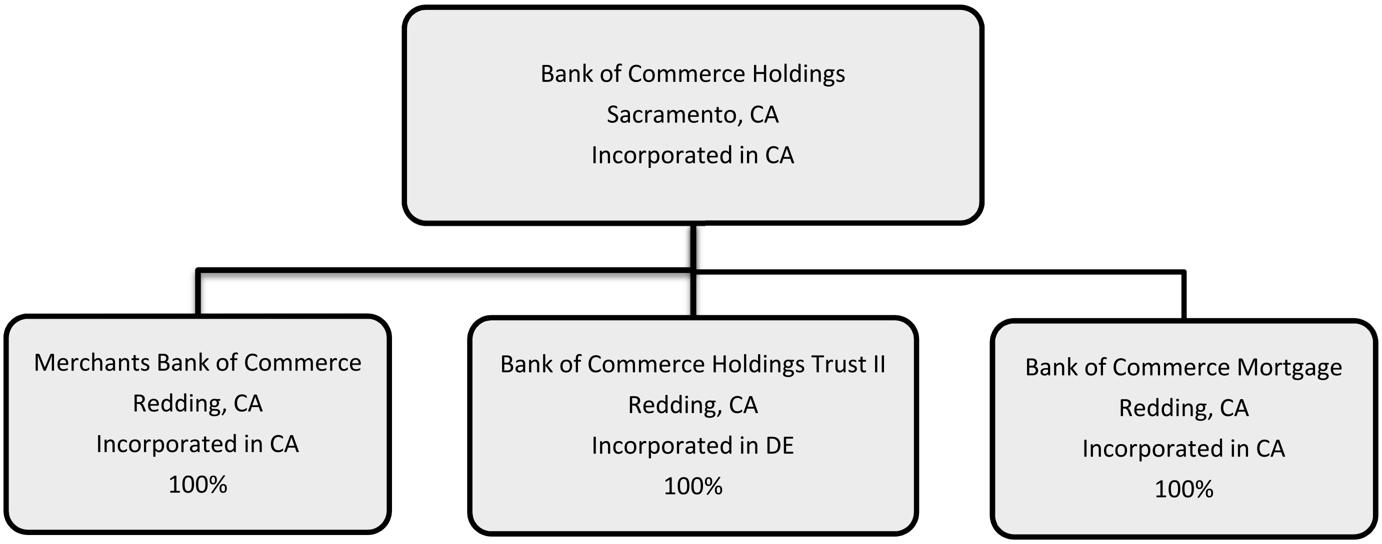


Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements No. 333-143321 and 333 71683 on Form S-8 of Bank of Commerce Holdings of our report dated March 6, 2020, relating to the consolidated financial statements and the effectiveness of internal control over financial reporting appearing in this Annual Report on Form 10-K of Bank of Commerce Holdings for the year ended December 31, 2019.

/s/ Moss Adams LLP

Sacramento, California
March 6, 2020

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Randall S. Eslick, certify that:

1) I have reviewed this Annual Report on Form 10-K of Bank of Commerce Holdings (the “registrant”);

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, registrant’s internal control over financial reporting; and;

5) The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

/s/ RANDALL S. ESLICK
Randall S. Eslick
President and Chief Executive Officer
(Principal Executive Officer)

Dated March 6, 2020

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, James A. Sundquist, certify that:

1) I have reviewed this Annual Report on Form 10-K of Bank of Commerce Holdings (the "registrant");

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and;

5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JAMES A. SUNDQUIST
James A. Sundquist
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)
Dated March 6, 2020

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE AND FINANCIAL OFFICERS PURSUANT TO SECTION 906

The following certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of Bank of Commerce Holdings, a California corporation, for the year ended December 31, 2019, as filed with the Securities and Exchange Commission, each of the undersigned officers of Bank of Commerce Holdings certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his respective knowledge:

(1) the accompanying report on Form 10-K of the Company for the year ended December 31, 2019, as filed with the Securities and Exchange Commission (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended,; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Bank of Commerce Holdings for the periods presented therein.

Date: March 6, 2020

/s/ Randall S. Eslick
Chief Executive Officer

Date: March 6, 2020

/s/ James A. Sundquist
Chief Financial Officer

A signed original of the above certification has been provided to Bank of Commerce Holdings and will be retained by Bank of Commerce Holdings and furnished to the Securities and Exchange Commission or its staff upon request.

CORPORATE INFORMATION

Transfer Agent and Registrar

Broadridge Corporate Issuer Solutions
P.O. Box 1342
Brentwood, NY 11717

877.830.4936
shareholder@broadridge.com

Independent Auditors

Moss Adams LLP
Sacramento, CA

Legal Counsel

Miller Nash Graham & Dunn LLP
Seattle, WA

Investment Banker

Raymond James & Associates, Inc.
San Francisco, CA

NASDAQ SYMBOL

BOCH

Annual Meeting

11:00 a.m. Pacific Time
May 20, 2020

Bank of Commerce Holdings

555 Capitol Mall
Third Floor Boardroom
Sacramento, CA 95814

Reports

The Company's annual report for 2019 on Form 10-K, which is required to be filed with the SEC, is available to any shareholder without charge. The report is available on the Company's website at: bankofcommerceholdings.com.

The report also may be obtained by written request to:

Corporate Secretary, Bank of Commerce Holdings
1901 Churn Creek Road, Redding, CA 96002

...thanks to the HARD WORK of our DEDICATED EMPLOYEES our company remains WELL POSITIONED for continued success.

— **Randall S. Eslick** | PRESIDENT & CEO, BANK OF COMMERCE HOLDINGS

bank of commerce
HOLDINGS

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Sacramento, CA 95814

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