Bank of Commerce Holdings
Form 10-Q
November 02, 2018

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

Commission file number 0-25135

Bank of Commerce Holdings

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

Outstanding shares of Common Stock, no par value, as of October 18, 2018: 16,333,502

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Index to Form 10-Q

Part I. FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	33
Item 3. Quantitative and Qualitative Disclosures About Market Risk	56
Item 4. Controls and Procedures	56
Part II. OTHER INFORMATION	
Item 1. Legal Proceedings	57
Item 1a. Risk Factors	57
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	57
Item 3. Defaults Upon Senior Securities	57
Item 4. Mine Safety Disclosures	57
Item 5. Other Information	57
Item 6. Exhibits	57
SIGNATURES	58

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets (Unaudited)

September 30, 2018 and December 31, 2017

(Amounts in thousands, except share information)	**September 30, 2018**	**December 31, 2017**
Assets:		
Cash and due from banks	$21,316	$17,979
Interest-bearing deposits in other banks	69,920	48,991
Total cash and cash equivalents	91,236	66,970
Securities available-for-sale, at fair value	239,633	267,954
Loans, net of deferred fees and costs	929,237	881,545
Allowance for loan and lease losses	(12,392)	(11,925)
Net loans	916,845	869,620
Premises and equipment, net	13,495	14,748
Other real estate owned	136	35
Life insurance	22,282	21,898
Deferred tax asset, net	8,084	6,505
Goodwill and core deposit intangible, net	1,864	2,030
Other assets	21,894	19,661
Total assets	$1,315,469	$1,269,421
Liabilities and shareholders' equity:		
Liabilities:		
Demand - noninterest-bearing	$361,516	$305,650
Demand - interest-bearing	510,553	496,990
Savings	111,388	110,837
Certificates of deposit	161,304	189,255
Total deposits	1,144,761	1,102,732
Term debt:		

Other borrowings	14,396	17,096
Less unamortized debt issuance costs	(103)	(138)
Net term debt	14,293	16,958
Junior subordinated debentures	10,310	10,310
Other liabilities	13,136	12,157
Total liabilities	1,182,500	1,142,157
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common stock, no par value, 50,000,000 shares authorized: issued and outstanding - 16,329,902 as of September 30, 2018 and 16,271,563 as of December 31, 2017	52,191	51,830
Retained earnings	84,857	75,700
Accumulated other comprehensive loss, net of tax	(4,079)	(266)
Total shareholders' equity	132,969	127,264
Total liabilities and shareholders' equity	$1,315,469	$1,269,421

See accompanying notes to consolidated financial statements.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

For the three and nine months ended September 30, 2018 and 2017

(Amounts in thousands, except per share information)	**For the Three Months Ended September 30, 2018**	**2017**	**For the Nine Months Ended September 30, 2018**	**2017**
Interest income:				
Interest and fees on loans	$11,568	$9,887	$33,461	$29,029
Interest on taxable securities	1,209	1,049	3,696	2,710
Interest on tax-exempt securities	400	551	1,276	1,615
Interest on interest-bearing deposits in other banks	254	278	518	548
Total interest income	13,431	11,765	38,951	33,902
Interest expense:				
Interest on demand deposits	276	196	712	528
Interest on savings deposits	73	52	196	146
Interest on certificates of deposit	465	567	1,448	1,641
Interest on Federal Home Loan Bank of San Francisco borrowings	121	—	435	3
Interest on other borrowings	265	292	825	880
Interest on junior subordinated debentures	104	74	283	211
Total interest expense	1,304	1,181	3,899	3,409
Net interest income	12,127	10,584	35,052	30,493
Provision for loan and lease losses	—	—	—	500
Net interest income after provision for loan and lease losses	12,127	10,584	35,052	29,993
Noninterest income:				
Service charges on deposit accounts	170	132	521	401
ATM and point of sale fees	282	273	848	827
Fees on payroll and benefit processing	159	147	474	485
Life insurance	128	134	384	915
Gain on sale of investment securities, net	1	38	41	139
Federal Home Loan Bank of San Francisco dividends	104	80	279	237
(Loss) gain on sale of OREO	(7)	81	9	22
Other income	106	191	331	516
Total noninterest income	943	1,076	2,887	3,542
Noninterest expense:				
Salaries and related benefits	4,529	4,291	13,897	13,296
Premises and equipment	1,017	1,067	3,104	3,169
Federal Deposit Insurance Corporation insurance premium	94	78	283	230
Data processing fees	518	437	1,421	1,294
Professional service fees	336	276	995	1,119
Telecommunications	55	219	449	653
Other expenses	1,085	989	3,189	3,312
Total noninterest expense	7,634	7,357	23,338	23,073
Income before provision for income taxes	5,436	4,303	14,601	10,462

Provision for income taxes	1,404	1,427	3,710	3,125
Net income	$4,032	$2,876	$10,891	$7,337
Earnings per share - basic	$0.25	$0.18	$0.67	$0.49
Weighted average shares - basic	16,252	16,191	16,242	14,884
Earnings per share - diluted	$0.25	$0.18	$0.67	$0.49
Weighted average shares - diluted	16,342	16,288	16,327	14,984

See accompanying notes to consolidated financial statements.

4

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

For the three and nine months ended September 30, 2018 and 2017

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
(Amounts in thousands)	**2018**	**2017**	**2018**	**2017**
Net income	$4,032	$2,876	$10,891	$7,337
Available-for-sale securities:				
Unrealized (losses) gains arising during the period	(906)	(13)	(5,297)	2,114
Income taxes	268	5	1,566	(870)
Change in unrealized (losses) gains, net of tax	(638)	(8)	(3,731)	1,244
Reclassification adjustment for realized gains included in net income	(1)	(38)	(41)	(139)
Income taxes	—	14	11	56
Realized gains, net of tax	(1)	(24)	(30)	(83)
Net (decrease) increase in unrealized gains on available-for-sale securities	(639)	(32)	(3,761)	1,161
Held-to-maturity securities:				
Amortization of held-to-maturity fair value adjustment	—	(16)	—	(52)
Income taxes	—	7	—	21
Net change in fair value adjustment on held-to-maturity securities	—	(9)	—	(31)
Other comprehensive (loss) income	(639)	(41)	(3,761)	1,130
Comprehensive income – Bank of Commerce Holdings	$3,393	$2,835	$7,130	$8,467

See accompanying notes to consolidated financial statements.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

For the twelve months ended December 31, 2017 and nine months ended September 30, 2018 (Unaudited)

(Amounts in thousands except per share information)	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comprehensive (Loss) Income Net of Tax**	**Total**
Balance at January 1, 2017	13,373	$ 24,547	$ 70,218	$ (659)	$ 94,106
Net income	—	—	7,344	—	7,344
Other comprehensive income, net of tax	—	—	—	393	393
Comprehensive income	—	—	—	—	7,737
Dividend on common stock ($0.12 per share)	—	—	(1,862)	—	(1,862)
Stock issued pursuant to public offering, net of underwriting discounts and expenses of $1.7 million	2,738	26,778	—	—	26,778
Stock compensation grants	4	41	—	—	41
Common stock issued under employee plans	30	—	—	—	—
Stock options exercised	52	245	—	—	245
Compensation expense associated with stock options	—	23	—	—	23
Compensation expense associated with restricted stock, net of cash paid when directly withholding shares for tax withholding purposes	—	196	—	—	196
Balance at December 31, 2017 (1)	16,197	$ 51,830	$ 75,700	$ (266)	$ 127,264

(1) Excludes 74 unvested restricted shares

(Amounts in thousands except per share information)	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comprehensive (Loss) Net of Tax**	**Total**
Balance at January 1, 2018	16,197	$ 51,830	$ 75,700	$ (266)	$ 127,264
Net income	—	—	10,891	—	10,891
Reclassification of accumulated other comprehensive income due to tax rate change	—	—	52	(52)	—
Other comprehensive loss, net of tax	—	—	—	(3,761)	(3,761)
Comprehensive income	—	—	—	—	7,130

Dividend on common stock ($0.11 per share)	—	—	(1,786)	—	(1,786)
Stock compensation grants	5	45	—	—	45
Common stock issued under employee plans	23	—	—	—	—
Stock options exercised	34	197	—	—	197
Compensation expense associated with stock options	—	8	—	—	8
Compensation expense associated with restricted stock, net of cash paid when directly withholding shares for tax withholding purposes	—	111	—	—	111
Balance at September 30, 2018 [1]	16,259	$ 52,191	$ 84,857	$ (4,079)	$ 132,969

[1] Excludes 71 unvested restricted shares

See accompanying notes to consolidated financial statements.

6

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

For the nine months ended September 30, 2018 and September 30, 2017

(Amounts in thousands)	**For the Nine Months Ended September 30, 2018**	**2017**
Cash flows from operating activities:		
Net income	$10,891	$7,337
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	—	500
Provision for depreciation and amortization	1,361	1,555
Amortization of core deposit intangible	166	166
Amortization of debt issuance costs	35	34
Compensation expense associated with stock options	8	18
Compensation expense associated with restricted stock	214	124
Tax benefits from vesting of restricted stock	(43)	(47)
Net gain on sale or call of securities	(41)	(139)
Amortization of investment premiums and accretion of discounts, net	1,448	1,502
Amortization of held-to-maturity fair value adjustments	—	(52)
(Gain) loss on disposal of fixed assets	(5)	1
Write-down of other real estate owned	—	52
Increase in cash surrender value of life insurance	(384)	(413)
Life insurance death benefit	—	(502)
Increase in deferred compensation and salary continuation plans	—	38
Increase in deferred loan fees and costs	(47)	(446)
Decrease in other assets	658	865
Increase (decrease) in other liabilities	937	(330)
Net cash provided by operating activities	15,198	10,263
Cash flows from investing activities:		
Proceeds from maturities and payments of available-for-sale securities	23,932	16,560
Proceeds from sale of available-for-sale securities	27,567	47,892
Purchases of available-for-sale securities	(31,293)	(121,616)
Proceeds from maturities and payments of held-to-maturity securities	—	679
Investment in qualified affordable housing partnerships	(32)	(18)
Net purchase of Federal Home Loan Bank of San Francisco stock	(1,355)	(72)
Loan originations, net of principal repayments	(54,014)	(27,189)
Net repayment on loan pools	6,696	5,228
Purchase of premises and equipment	(281)	(369)
Proceeds from the sale of other real estate owned	48	1,067
Proceeds from life insurance policy	—	2,249
Net cash used in investing activities	(28,732)	(75,589)

See accompanying notes to consolidated financial statements.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)

(Amounts in thousands)	**For the Nine Months Ended September 30,**	
	2018	**2017**
Cash flows from financing activities:		
Net increase in demand deposits and savings accounts	$69,980	$72,966
Net decrease in certificates of deposit	(27,951)	(14,847)
Advances on term debt	230,160	30,259
Repayment of term debt	(232,860)	(31,476)
Proceeds from stock options exercised	197	245
Net proceeds from issuance of common stock	—	26,778
Cash paid when directly withholding shares for tax-withholding purposes	(103)	(85)
Cash dividends paid on common stock	(1,623)	(1,290)
Net cash provided by financing activities	37,800	82,550
Net increase in cash and cash equivalents	24,266	17,224
Cash and cash equivalents at beginning of year	66,970	68,407
Cash and cash equivalents at end of period	$91,236	$85,631

See accompanying notes to consolidated financial statements.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)

For the nine months ended September 30, 2018 and September 30, 2017

(Amounts in thousands)	**For the Nine Months Ended September 30, 2018**	**2017**
Supplemental disclosures of cash flow activity:		
Cash paid during the period for:		
Income taxes	$2,725	$2,521
Interest	$3,735	$3,233
Supplemental disclosures of non cash investing activities:		
Transfer of loans to other real estate owned	$140	$946
Unrealized (loss) gain on investment securities available-for-sale	$(5,338)	$1,975
Changes in net deferred tax asset related to changes in unrealized loss (gain) on investment securities available-for-sale	1,577	(814)
Changes in accumulated other comprehensive income due to changes in unrealized (loss) gain on investment securities available-for-sale	$(3,761)	$1,161
Accretion of held-to-maturity investment securities from other comprehensive income to interest income	$—	$(52)
Changes in deferred tax related to accretion of held-to-maturity investment securities	—	21
Changes in accumulated other comprehensive income due to accretion of held-to-maturity investment securities	$—	$(31)
Reclassification of accumulated other comprehensive income due to tax rate change	$52	$—
Supplemental disclosures of non cash financing activities:		
Stock issued under employee plans	$45	$41
Cash dividend declared on common shares and payable after period-end	$650	$486

See accompanying notes to consolidated financial statements.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bank of Commerce Holdings (“Company,” “Holding Company,” “we,” or “us”), is a bank holding company (“BHC”) with its principal offices in Sacramento, California. The Holding Company’s principal business is to serve as a holding company for Redding Bank of Commerce (the “Bank” and together with the Holding Company, the “Company”) which operates under two separate names (Redding Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce) and for Bank of Commerce Mortgage (inactive). The Company has an unconsolidated subsidiary in Bank of Commerce Holdings Trust II. The consolidated *Balance Sheets* as of September 30, 2018 and December 31, 2017 are derived from the unaudited interim consolidated financial statements and audited consolidated financial statements and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. The Company believes that all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included and the disclosures made are adequate to make the information not misleading.

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 consolidated 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 dates of the Balance Sheets 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 goodwill and 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 net income or shareholders' equity. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2017 Annual Report on Form 10-K. The consolidated results of operations and cash flows for the 2018 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year.

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 September 30, 2018 and December 31, 2017, the Company had one wholly-owned trust ("Trust") formed in 2005 to issue trust-preferred securities and related common securities. The Company has not consolidated the accounts of the Trust in its Consolidated Financial Statements in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB") ASC 810, *Consolidation* ("ASC 810"). As a result, the junior subordinated debentures issued by the Company to the Trust are reflected in our *Consolidated Balance Sheets*.

Application of new accounting guidance

ASU No. 2014-09

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 was initially effective for the Company's reporting period beginning on January 1, 2017. However, in August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers - Deferral of the Effective Date*, which defers the effective date by one year. For financial reporting purposes, the standard allows for either a full retrospective or modified retrospective adoption. The FASB has also issued additional updates to provide further clarification to specific implementation issues associated with ASU 2014-09. These updates include ASU 2016-08, *Principal versus Agent Considerations*, ASU 2016-10, *Identifying Performance Obligations and Licensing*, ASU 2016-12, *Narrow-Scope Improvements and Practical Expedients*, and ASU 2016-20, *Technical Corrections and Improvements to Topic 606*. We adopted the standard on January 1, 2018, using the modified retrospective method, which resulted in no adjustment or significant impact to the timing of revenue recognition.

Under Topic 606, we must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) we satisfy the performance obligations. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

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. 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 charged to the customer account.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

ASU No. 2016-01

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The new guidance is intended to improve the recognition and measurement of financial instruments. This ASU requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. This ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. We adopted the standard on January 1, 2018. Adoption of the standard resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 8 – *Fair Values* for further information regarding the valuation of these loans.

ASU No. 2018-02

In February 2018, FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220)*. The amendments in this update allow a reclassification from retained earnings to accumulated other comprehensive income for stranded tax effects resulting from the Tax Cuts and Jobs Act. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this update is permitted, including adoption in any interim period. The amendments in this update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. We elected the early adoption of ASU 2018-02 as of January 1, 2018 and reclassified $52 thousand from accumulated other comprehensive income to retained earnings.

NOTE 2. COMMON STOCK OUTSTANDING AND EARNINGS PER SHARE

On May 10, 2017, the Company announced the closing of its underwritten public offering, at the public offering price of $10.50 per share. The total number of shares of common stock sold by the Company was 2,738,096. Net proceeds raised in the offering, after underwriting discounts and expenses of the offering, were $26.8 million.

Basic earnings per share excludes dilution and is computed by dividing net 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 subsequently 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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

The following is a computation of basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017.

(Amounts in thousands, except per share information)	**For the Three Months Ended September 30,**		**For the Nine Months Ended September 30,**	
Earnings Per Share	**2018**	**2017**	**2018**	**2017**
Numerators:				
Net income	$4,032	$2,876	$10,891	$7,337
Denominators:				
Weighted average number of common shares outstanding - basic [1]	16,252	16,191	16,242	14,884
Effect of potentially dilutive common shares [2]	90	97	85	100
Weighted average number of common shares outstanding - diluted	16,342	16,288	16,327	14,984
Earnings per common share:				
Basic	$0.25	$0.18	$0.67	$0.49
Diluted	$0.25	$0.18	$0.67	$0.49
Anti-dilutive options not included in diluted earnings per share calculation	—	70	—	74
Anti-dilutive restricted shares not included in diluted earnings per share calculation	—	42	—	43

[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.

NOTE 3. SECURITIES

The following tables present the amortized costs, unrealized gains, unrealized losses and estimated fair values of our investment securities as of September 30, 2018, and December 31, 2017.

	As of September 30, 2018			
(Amounts in thousands)	**Amortized Cost**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**
Available-for-sale securities:				
U.S. government & agencies	$36,057	$ 111	$ (512)	$35,656
Obligations of state and political subdivisions	51,468	1,003	(909)	51,562
Residential mortgage-backed securities and collateralized mortgage obligations	128,703	6	(4,600)	124,109
Corporate securities	4,042	5	(73)	3,974
Commercial mortgage-backed securities	24,990	9	(832)	24,167
Other asset-backed securities	164	1	—	165
Total	$245,424	$ 1,135	$ (6,926)	$239,633

	As of December 31, 2017			
(Amounts in thousands)	**Amortized Cost**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**
Available-for-sale securities:				

U.S. government & agencies	$40,319	$ 196	$ (146)	$40,369
Obligations of state and political subdivisions	77,412	1,910	(478)	78,844
Residential mortgage-backed securities and collateralized mortgage obligations	116,062	69	(1,539)	114,592
Corporate securities	5,079	18	(105)	4,992
Commercial mortgage-backed securities	26,995	24	(378)	26,641
Other asset-backed securities	2,540	4	(28)	2,516
Total	$268,407	$ 2,221	$ (2,674)	$267,954

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

The following table presents the expected maturities of investment securities at September 30, 2018.

(Amounts in thousands)	**Available-For-Sale** **Amortized Cost**	**Fair Value**
Amounts maturing in:		
One year or less	$1,550	$1,554
After one year through five years	79,378	77,506
After five years through ten years	91,285	88,761
After ten years	73,211	71,812
Total	$245,424	$239,633

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 the underlying loans may be repaid without prepayment penalties.

At September 30, 2018 and December 31, 2017 securities with a fair value of $70.1 million and $62.6 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 securities and the associated gross realized gains and gross realized losses that have been included in earnings for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(Amounts in thousands)	**2018**	**2017**	**2018**	**2017**
Proceeds from sales of securities	$7,062	$20,640	$27,567	$47,892

Gross realized gains on sales of securities:				
Obligations of state and political subdivisions	$104	$31	$260	$112
Residential mortgage-backed securities and collateralized mortgage obligations	—	16	—	53
Corporate securities	—	20	—	30
Commercial mortgage-backed securities	—	3	—	3
Total gross realized gains on sales of securities	104	70	260	198
Gross realized losses on sales of securities:				
U.S. government & agencies	(43)	—	(43)	—
Obligations of state and political subdivisions	(1)	(10)	(72)	(10)
Residential mortgage-backed securities and collateralized mortgage obligations	(40)	(22)	(40)	(46)
Corporate securities	—	—	—	(3)
Commercial mortgage-backed securities	(19)	—	(19)	—
Other asset-backed securities	—	—	(45)	—
Total gross realized losses on sales of securities	(103)	(32)	(219)	(59)
Gain on investment securities, net	$1	$38	$41	$139

Investment securities that were in an unrealized loss position as of September 30, 2018 and December 31, 2017 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position.

	As of September 30, 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	$16,501	$ (225)	$9,060	$ (287)	$25,561	$ (512)
Obligations of states and political subdivisions	10,394	(257)	13,126	(652)	23,520	(909)
Residential mortgage-backed securities and collateralized mortgage obligations	43,278	(1,250)	72,572	(3,350)	115,850	(4,600)
Corporate securities	—	—	2,953	(73)	2,953	(73)
Commercial mortgage-backed securities	5,215	(159)	17,313	(673)	22,528	(832)
Total temporarily impaired securities	$75,388	$ (1,891)	$115,024	$ (5,035)	$190,412	$ (6,926)

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

	As of December 31, 2017					
	Less Than 12 Months		**12 Months or More**		**Total**	
(Amounts in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Available-for-sale securities:						
U.S. government & agencies	$18,140	$ (102)	$2,131	$ (44)	$20,271	$ (146)
Obligations of states and political subdivisions	15,030	(255)	8,368	(223)	23,398	(478)
Residential mortgage-backed securities and collateralized mortgage obligations	75,323	(827)	31,036	(712)	106,359	(1,539)
Corporate securities	—	—	2,934	(105)	2,934	(105)
Commercial mortgage-backed securities	11,162	(151)	10,026	(227)	21,188	(378)
Other asset-backed securities	2,167	(28)	—	—	2,167	(28)
Total temporarily impaired securities	$121,822	$ (1,363)	$54,495	$ (1,311)	$176,317	$ (2,674)

At September 30, 2018 and December 31, 2017, the number of securities that were in an unrealized loss position was 174 and 138, 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 that at the time of purchase, securities are 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 September 30, 2018 and December 31, 2017.

Available-for-sale securities:	**Characteristics of securities in unrealized loss positions at September 30, 2018 and December 31, 2017**
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 September 30, 2018 and December 31, 2017, 61% and 56% 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 September 30, 2018 and December 31, 2017, 90% were issued or guaranteed by U.S. government sponsored entities.
Other asset-backed securities	Obligations secured by high quality loans with good credit enhancements issued by non-governmental issuers.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 4. LOANS

Outstanding loan balances consisted of the following at September 30, 2018, and December 31, 2017.

(Amounts in thousands) **Loan Portfolio**	**September 30, 2018**	**December 31, 2017**
Commercial	$ 132,091	$ 142,405
Commercial real estate:		
Real estate - construction and land development	20,496	15,902
Real estate - commercial non-owner occupied	431,246	377,668
Real estate - commercial owner occupied	195,608	192,023
Residential real estate:		
Real estate - residential - Individual Tax Identification Number ("ITIN")	38,353	41,188
Real estate - residential - 1-4 family mortgage	33,473	30,377
Real estate - residential - equity lines	28,713	30,347
Consumer and other	47,500	49,925
Gross loans	927,480	879,835
Deferred fees and costs	1,757	1,710
Loans, net of deferred fees and costs	929,237	881,545
Allowance for loan and lease losses	(12,392)	(11,925)
Net loans	$ 916,845	$ 869,620

Certain loans are pledged as collateral with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank. Pledged loans totaled $441.4 million and $420.0 million at September 30, 2018 and December 31, 2017, respectively.

When we purchase loans, they are typically purchased at a discount to enhance yield and compensate for credit risk. Gross loan balances in the table above include net purchase discounts of $2.6 million and $2.8 million as of September 30, 2018, and December 31, 2017.

Past Due Loans

An age analysis of past due loans (gross), segregated by class, as of September 30, 2018, and December 31, 2017, was as follows.

(Amounts in thousands) Past Due Loans at September 30, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total	Recorded Investment > 90 Days and Accruing
Commercial	$—	$—	$ —	$—	$132,091	$132,091	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	20,496	20,496	—
Real estate - commercial non-owner occupied	—	—	—	—	431,246	431,246	—
Real estate - commercial owner occupied	—	—	—	—	195,608	195,608	—
Residential real estate:							
Real estate - residential - ITIN	412	76	260	748	37,605	38,353	—
Real estate - residential - 1-4 family mortgage	—	179	—	179	33,294	33,473	—
Real estate - residential - equity lines	120	—	—	120	28,593	28,713	—
Consumer and other	197	37	—	234	47,266	47,500	—
Total	$729	$292	$ 260	$1,281	$926,199	$927,480	$ —

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(Amounts in thousands) **Past Due Loans at December 31, 2017**	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days Past Due**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
Commercial	$—	$—	$ —	$—	$142,405	$142,405	$ —
Commercial real estate:							
Real estate - construction and land development	—	—	—	—	15,902	15,902	—
Real estate - commercial non-owner occupied	—	—	—	—	377,668	377,668	—
Real estate - commercial owner occupied	142	—	—	142	191,881	192,023	—
Residential real estate:							
Real estate - residential - ITIN	555	122	462	1,139	40,049	41,188	—
Real estate - residential - 1-4 family mortgage	290	173	—	463	29,914	30,377	—
Real estate - residential - equity lines	141	—	—	141	30,206	30,347	—
Consumer and other	281	123	—	404	49,521	49,925	—
Total	$1,409	$418	$ 462	$2,289	$877,546	$879,835	$ —

Nonaccrual Loans

Nonaccrual loans, segregated by loan class, were as follows as of September 30, 2018 and December 31, 2017.

(Amounts in thousands) **Nonaccrual Loans**	**September 30, 2018**	**December 31, 2017**
Commercial	$ 899	$ 1,603
Commercial real estate:		
Real estate - commercial owner occupied	—	600
Residential real estate:		
Real estate - residential - ITIN	2,571	2,909
Real estate - residential - 1-4 family mortgage	179	606
Real estate - residential - equity lines	44	45

Consumer and other	24	36
Total	$ 3,717	$ 5,799

Had nonaccrual loans performed in accordance with their contractual terms, we would have recognized additional interest income, net of tax, of approximately $40 thousand and $75 thousand for the three months ended September 30, 2018 and 2017, respectively. We would have recognized additional interest income, net of tax, of approximately $121 thousand and $222 thousand for the nine months ended September 30, 2018 and 2017, respectively.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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 class as of September 30, 2018, and December 31, 2017.

	As of September 30, 2018		
(Amounts in thousands)		**Unpaid**	
Impaired Loans	**Recorded Investment**	**Principal Balance**	**Related Allowance**
With no related allowance recorded:			
Commercial	$59	$ 76	$ —
Residential real estate:			
Real estate - residential - ITIN	6,451	7,973	—
Real estate - residential - 1-4 family mortgage	179	220	—
Real estate - residential - equity lines	44	48	—
Total with no related allowance recorded	$6,733	$ 8,317	$ —
With an allowance recorded:			
Commercial	$2,131	$ 2,236	$ 635
Commercial real estate:			
Real estate - commercial non-owner occupied	797	797	208
Residential real estate:			
Real estate - residential - ITIN	655	692	83
Real estate - residential - equity lines	367	367	184
Consumer and other	24	24	8
Total with an allowance recorded	$3,974	$ 4,116	$ 1,118
By loan class:			
Commercial	$2,190	$ 2,312	$ 635
Commercial real estate	797	797	208
Residential real estate	7,696	9,300	267
Consumer and other	24	24	8
Total impaired loans	$10,707	$ 12,433	$ 1,118

	As of December 31, 2017		
(Amounts in thousands)	Recorded	Principal	Related
Impaired Loans	**Investment**	**Balance**	**Allowance**
With no related allowance recorded:			
Commercial	$672	$ 1,205	$ —
Commercial real estate:			
Real estate - commercial owner occupied	600	665	—
Residential real estate:			
Real estate - residential - ITIN	5,895	7,516	—
Real estate - residential - 1-4 family mortgage	414	897	—
Real estate - residential - equity lines	45	49	—
Total with no related allowance recorded	$7,626	$ 10,332	$ —
With an allowance recorded:			
Commercial	$2,482	$ 2,540	$ 690
Commercial real estate:			
Real estate - commercial non-owner occupied	803	803	77
Residential real estate:			
Real estate - residential - ITIN	1,628	1,678	199
Real estate - residential - 1-4 family mortgage	192	226	2
Real estate - residential - equity lines	380	380	190
Consumer and other	36	36	11
Total with an allowance recorded	$5,521	$ 5,663	$ 1,169
By loan class:			
Commercial	$3,154	$ 3,745	$ 690
Commercial real estate	1,403	1,468	77
Residential real estate	8,554	10,746	391
Consumer and other	36	36	11
Total impaired loans	$13,147	$ 15,995	$ 1,169

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

The following tables summarize our average recorded investment and interest income recognized on impaired loans by loan class for the three and nine months ended September 30, 2018 and 2017.

(Amounts in thousands)	**Three Months Ended September 30, 2018**		**Three Months Ended September 30, 2017**	
Average Recorded Investment and Interest Income	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial	$2,254	$ 19	$3,140	$ 9
Commercial real estate:				
Real estate - commercial non-owner occupied	798	11	1,381	12
Real estate - commercial owner occupied	—	—	624	—
Residential real estate:				
Real estate - residential - ITIN	7,154	43	7,907	40
Real estate - residential - 1-4 family mortgage	181	—	634	—
Real estate - residential - equity lines	412	5	1,291	5
Consumer and other	30	—	38	—
Total	$10,829	$ 78	$15,015	$ 66

(Amounts in thousands)	**Nine Months Ended September 30, 2018**		**Nine Months Ended September 30, 2017**	
Average Recorded Investment and Interest Income	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial	$2,508	$ 60	$3,249	$ 29
Commercial real estate:				
Real estate - commercial non-owner occupied	799	35	1,796	35
Real estate - commercial owner occupied	—	—	692	2
Residential real estate:				
Real estate - residential - ITIN	7,272	126	8,080	120
Real estate - residential - 1-4 family mortgage	231	—	1,155	—
Real estate - residential - equity lines	418	15	1,330	14
Consumer and other	33	—	83	—
Total	$11,261	$ 236	$16,385	$ 200

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, 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 September 30, 2018 and December 31, 2017, impaired loans of $7.0 million and $7.3 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 September 30, 2018 and December 31, 2017, we had one restructured commercial line of credit in nonaccrual status that had $455 thousand and $33 thousand in available credit, respectively.

As of September 30, 2018, we had $9.7 million in troubled debt restructurings compared to $10.9 million as of December 31, 2017. As of September 30, 2018, we had 107 loans that qualified as troubled debt restructurings, all of which were modified in prior years and are performing according to their restructured terms. Troubled debt restructurings represented 1.05% of gross loans as of September 30, 2018, compared to 1.24% at December 31, 2017. For the nine months ended September 30, 2017 there was one payment deferral modification with a pre-modification recorded investment of $81 thousand and a post-modification outstanding investment of $61 thousand. There were no loans modified as troubled debt restructuring during the 12 months ended September 30, 2018 or 2017, for which there was a subsequent payment default during the three and nine months ended September 30, 2018 and 2017.

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, 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.

18

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

Performing and nonperforming loans, segregated by loan portfolio, were as follows at September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$131,192	$ 899	$132,091
Commercial real estate:			
Real estate - construction and land development	20,496	—	20,496
Real estate - commercial non-owner occupied	431,246	—	431,246
Real estate - commercial owner occupied	195,608	—	195,608
Residential real estate:			
Real estate - residential - ITIN	35,782	2,571	38,353
Real estate - residential - 1-4 family mortgage	33,294	179	33,473
Real estate - residential - equity lines	28,669	44	28,713
Consumer and other	47,476	24	47,500
Total	$923,763	$ 3,717	$927,480

(Amounts in thousands)	**December 31, 2017**		
Performing and Nonperforming Loans	**Performing**	**Nonperforming**	**Total**
Commercial	$140,802	$ 1,603	$142,405
Commercial real estate:			
Real estate - construction and land development	15,902	—	15,902
Real estate - commercial non-owner occupied	377,668	—	377,668
Real estate - commercial owner occupied	191,423	600	192,023
Residential real estate:			
Real estate - residential - ITIN	38,279	2,909	41,188
Real estate - residential - 1-4 family mortgage	29,771	606	30,377
Real estate - residential - equity lines	30,302	45	30,347
Consumer and other	49,889	36	49,925
Total	$874,036	$ 5,799	$879,835

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 pledged 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

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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 tables summarize loans by internal risk grades and by loan class as of September 30, 2018 and December 31, 2017.

	As of September 30, 2018					
(Amounts in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$113,743	$16,508	$ 31	$ 1,809	$ —	$132,091
Commercial real estate:						
Real estate - construction and land development	20,471	25	—	—	—	20,496
Real estate - commercial non-owner occupied	414,540	10,908	382	5,416	—	431,246
Real estate - commercial owner occupied	175,909	12,590	2,190	4,919	—	195,608
Residential real estate:						
Real estate - residential - ITIN	32,497	—	—	5,856	—	38,353
Real estate - residential - 1-4 family mortgage	32,524	770	—	179	—	33,473
Real estate - residential - equity lines	27,086	1,313	—	314	—	28,713
Consumer and other	47,469	—	—	31	—	47,500
Total	$864,239	$42,114	$ 2,603	$ 18,524	$ —	$927,480

	As of December 31, 2017					
(Amounts in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$117,087	$22,213	$ 40	$ 3,065	$ —	$142,405
Commercial real estate:						
Real estate - construction and land development	14,762	—	1,140	—	—	15,902
Real estate - commercial non-owner occupied	364,230	9,160	2,900	1,378	—	377,668
Real estate - commercial owner occupied	171,005	15,198	3,907	1,913	—	192,023
Residential real estate:						
Real estate - residential - ITIN	34,923	—	—	6,265	—	41,188
Real estate - residential - 1-4 family mortgage	28,981	791	—	605	—	30,377

Real estate - residential - equity lines	28,457	1,501	63	326	—	30,347
Consumer and other	49,887	—	2	36	—	49,925
Total	$809,332	$48,863	$ 8,052	$ 13,588	$ —	$879,835

The recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure was $210 thousand at September 30, 2018.

Allowance for Loan and Lease Losses

The following tables summarize the ALLL by portfolio for the three and nine months ended September 30, 2018 and 2017.

	For the Three Months Ended September 30, 2018					
(Amounts in thousands)		**Commercial**	**Residential**			
ALLL by Loan Portfolio	**Commercial**	**Real Estate**	**Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$2,442	$ 7,091	$ 1,111	$ 1,317	$ 427	$12,388
Charge-offs	—	—	—	(198)	—	(198)
Recoveries	35	—	89	78	—	202
Provision	(248)	116	12	90	30	—
Ending balance	$2,229	$ 7,207	$ 1,212	$ 1,287	$ 457	$12,392

21

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

	For the Three Months Ended September 30, 2017					
(Amounts in thousands)		**Commercial**	**Residential**			
ALLL by Loan Portfolio	**Commercial**	**Real Estate**	**Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$2,850	$ 6,072	$ 1,197	$ 1,137	$ 432	$11,688
Charge-offs	—	—	(86)	(159)	—	(245)
Recoveries	148	—	13	88	—	249
Provision	(354)	232	60	134	(72)	—
Ending balance	$2,644	$ 6,304	$ 1,184	$ 1,200	$ 360	$11,692

	For the Nine Months Ended September 30, 2018					
(Amounts in thousands)		**Commercial**	**Residential**			
ALLL by Loan Portfolio	**Commercial**	**Real Estate**	**Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$2,397	$ 6,514	$ 1,169	$ 1,435	$ 410	$11,925
Charge-offs	(132)	—	(164)	(673)	—	(969)
Recoveries	838	—	382	216	—	1,436
Provision	(874)	693	(175)	309	47	—
Ending balance	$2,229	$ 7,207	$ 1,212	$ 1,287	$ 457	$12,392

	For the Nine Months Ended September 30, 2017					
(Amounts in thousands)		**Commercial**	**Residential**			
ALLL by Loan Portfolio	**Commercial**	**Real Estate**	**Real Estate**	**Consumer**	**Unallocated**	**Total**
Beginning balance	$2,849	$ 5,578	$ 1,716	$ 955	$ 446	$11,544
Charge-offs	(50)	—	(370)	(631)	—	(1,051)
Recoveries	383	27	107	182	—	699
Provision	(538)	699	(269)	694	(86)	500
Ending balance	$2,644	$ 6,304	$ 1,184	$ 1,200	$ 360	$11,692

The following tables summarize the ALLL and the recorded investment in loans and leases as of September 30, 2018 and December 31, 2017.

As of September 30, 2018

(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$635	$ 208	$ 267	$ 8	$ —	$1,118
Collectively evaluated for impairment	1,594	6,999	945	1,279	457	11,274
Total	$2,229	$ 7,207	$ 1,212	$ 1,287	$ 457	$12,392
Gross loans:						
Individually evaluated for impairment	$2,190	$ 797	$ 7,696	$ 24	$ —	$10,707
Collectively evaluated for impairment	129,901	646,553	92,843	47,476	—	916,773
Total gross loans	$132,091	$ 647,350	$ 100,539	$ 47,500	$ —	$927,480

	As of December 31, 2017					
(Amounts in thousands)	**Commercial**	**Commercial Real Estate**	**Residential Real Estate**	**Consumer**	**Unallocated**	**Total**
ALLL:						
Individually evaluated for impairment	$690	$ 77	$ 391	$ 11	$ —	$1,169
Collectively evaluated for impairment	1,707	6,437	778	1,424	410	10,756
Total	$2,397	$ 6,514	$ 1,169	$ 1,435	$ 410	$11,925
Gross loans:						
Individually evaluated for impairment	$3,154	$ 1,403	$ 8,554	$ 36	$ —	$13,147
Collectively evaluated for impairment	139,251	584,190	93,358	49,889	—	866,688
Total gross loans	$142,405	$ 585,593	$ 101,912	$ 49,925	$ —	$879,835

The ALLL totaled $12.4 million or 1.34% of total gross loans at September 30, 2018 and $11.9 million or 1.36% at December 31, 2017. As of September 30, 2018 and December 31, 2017, we had commitments to extend credit of $238.6 million and $227.7 million, respectively. The reserve for unfunded commitments recorded in *Other Liabilities* in the *Consolidated Balance Sheets* at September 30, 2018 and December 31, 2017 was $695 thousand.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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 monthly 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.

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.

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 September 30, 2018. 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 September 30, 2018, approximately 81% 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.

Impaired loans are individually evaluated for impairment. 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 September 30, 2018 and December 31, 2017, the unallocated allowance amount represented 4% and 3% of the ALLL, respectively.

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.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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 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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

NOTE 5. QUALIFIED AFFORDABLE HOUSING PARTNERSHIP INVESTMENTS

Our investments in Qualified Affordable Housing Partnerships that generate Low Income Housing Tax Credits ("LIHTC") and deductible operating losses totaled $3.1 million at September 30, 2018. These investments are recorded in *Other Assets* with a corresponding funding obligation of $329 thousand recorded in *Other Liabilities* in our *Consolidated Balance Sheets*. We have invested in four separate LIHTC partnerships, 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. None of the original investments will be repaid. 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 6% over the life of the investment. 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 table presents our original investment in LIHTC partnerships, the current recorded investment balance, and the unfunded liability balance of each investment at September 30, 2018 and December 31, 2017. 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 nine months ended September 30, 2018 and 2017.

(Amounts in thousands)	**At September 30, 2018**			**For the Nine Months Ended September 30, 2018**		
Qualified Affordable Housing Partnerships	**Original Investment Value**	**Current Recorded Investment**	**Unfunded Liability Obligation**	**Tax Credits and Benefits**	**Amortization of Investments**	**Net Income Tax Benefit (expense)**
Raymond James California Housing Opportunities Fund II	$2,000	$ 1,049	$ 14	$150	$ 133	$ 17
WNC Institutional Tax Credit Fund 38, L.P.	1,000	510	—	95	79	16
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,309	315	170	167	3
California Affordable Housing Fund	2,454	246	—	23	36	(13)
Total	$7,954	$ 3,114	$ 329	$438	$ 415	$ 23

	At December 31, 2017			For the Nine Months Ended September 30, 2017		
(Amounts in thousands)	Original Investment	Current Recorded	Unfunded Liability	Tax Credits and	Amortization of	Net Income Tax
Qualified Affordable Housing Partnerships	Value	Investment	Obligation	Benefits	Investments	Benefit
Raymond James California Housing Opportunities Fund II	$2,000	$ 1,182	$ 20	$168	$ 140	$ 28
WNC Institutional Tax Credit Fund 38, L.P.	1,000	589	—	104	79	25
Merritt Community Capital Corporation Fund XV, L.P.	2,500	1,476	341	203	166	37
California Affordable Housing Fund	2,454	282	—	132	127	5
Total	$7,954	$ 3,529	$ 361	$607	$ 512	$ 95

The following tables present our generated tax credits and tax benefits from investments in qualified affordable housing partnerships for the three and nine months ended September 30, 2018 and 2017.

	For the Three Months Ended			
	September 30, 2018		September 30, 2017	
(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	$43	$ 8	$44	$ 12
WNC Institutional Tax Credit Fund 38, L.P.	28	4	28	6
Merritt Community Capital Corporation Fund XV, L.P.	48	8	54	14
California Affordable Housing Fund	1	6	31	13
Total	$120	$ 26	$157	$ 45

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(Amounts in thousands)	For the Nine Months Ended September 30, 2018		September 30, 2017	
Qualified Affordable Housing Partnerships	**Generated Tax Credits**	**Tax Benefits From Taxable Losses**	**Generated Tax Credits**	**Tax Benefits from Taxable Losses**
Raymond James California Housing Opportunities Fund II	$127	$ 23	$132	$ 36
WNC Institutional Tax Credit Fund 38, L.P.	84	11	85	19
Merritt Community Capital Corporation Fund XV, L.P.	144	26	162	41
California Affordable Housing Fund	4	19	94	38
Total	$359	$ 79	$473	$ 134

The tax credits and benefits were partially offset by the amortization of the principal investment balances of $138 thousand and $415 thousand for the three and nine months ended September 30, 2018 respectively, compared to $177 thousand and $512 thousand for the comparable periods of 2017.

The following table reflects the anticipated net income tax benefit and expense at September 30, 2018 that is expected to be recognized over the remaining life of the investments.

(Amounts in thousands)

Qualified Affordable Housing Partnerships: Anticipated net income tax benefit (expense) 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 Net Income Tax Benefit**
2018	$ 5	$ 5	$ 1	$ (4)	$ 7
2019	23	18	3	(14)	30
2020	23	17	3	(14)	29
2021	23	16	3	(14)	28
2022 and thereafter	41	42	9	(43)	49
Total	$ 115	$ 98	$ 19	$ (89)	$ 143

NOTE 6. TERM DEBT

Term debt at September 30, 2018 and December 31, 2017 consisted of the following.

(Amounts in thousands)	**September 30, 2018**	**December 31, 2017**
Senior debt	$ 4,396	$ 7,096
Unamortized debt issuance costs	(3)	(6)
Subordinated debt	10,000	10,000
Unamortized debt issuance costs	(100)	(132)
Net term debt	$ 14,293	$ 16,958

Future contractual maturities of term debt at September 30, 2018 are as follows.

(Amounts in thousands)	**2018**	**2019**	**2020**	**2021**	**2022**	**Thereafter**	**Total**
Senior debt	$250	$1,000	$3,146	$ —	$ —	$ —	$4,396
Subordinated debt	—	—	—	—	—	10,000	10,000
Total future maturities	$250	$1,000	$3,146	$ —	$ —	$ 10,000	$14,396

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 $397.7 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 September 30, 2018 and December 31, 2017. The average balance outstanding on Federal Home Loan Bank of San Francisco term advances during the nine months ended September 30, 2018 and year ended December 31, 2017 was $30.0 million and $302 thousand respectively. The maximum amount outstanding from the Federal Home Loan Bank of San Francisco at any month end during the nine months ended September 30, 2018 and year ended December 31, 2017 was $70.0 million and $10.0 million respectively.

As of September 30, 2018, the Bank was required to hold an investment in Federal Home Loan Bank of San Francisco stock of $5.9 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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

We have pledged $449.0 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 September 30, 2018, we also pledged $31.9 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. 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 may be prepaid in whole or in part at any time without any prepayment penalty. The principal amount of the loan bears interest at a variable rate, resetting monthly that is 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 are being amortized over the initial term of the loan as additional interest expense. The loan is secured by a pledge from the Holding Company of all of the outstanding stock of Redding Bank of Commerce.

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.

Other lines of credit

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 September 30, 2018 and had interest rates ranging from 2.39% to 3.06%. 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.

Federal Reserve Bank

We have an available line of credit with the Federal Reserve Bank totaling $27.2 million subject to collateral requirements, namely the amount of certain pledged loans.

NOTE 7. COMMITMENTS AND CONTINGENCIES

Lease Commitments

We lease nine 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 the lease term one or more times following expiration of the initial term.

The following table sets forth rent expense and rent income for the three and nine months ended September 30, 2018 and 2017

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Amounts in thousands)	**2018**	**2017**	**2018**	**2017**
Rent income [1]	$—	$9	$—	$40
Rent expense	230	218	692	612
Net rent expense	$230	$209	$692	$572

[1] Rental income is derived from OREO properties.

27

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

The following table sets forth, as of September 30, 2018, the future minimum lease payments under non-cancelable operating leases.

(Amounts in thousands)	
Amounts due in:	
2018	$213
2019	866
2020	884
2021	899
2022	807
Thereafter	1,367
Total	$5,036

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 September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**	**December 31, 2017**
Commitments to extend credit	$ 228,359	$ 217,714
Standby letters of credit	6,948	6,692
Affordable housing grants	3,338	3,338

Total commitments and contingent liabilities	$ 238,645	$ 227,744

We were not required to perform on any financial guarantees during the nine months ended September 30, 2018, or during the year ended December 31, 2017. At September 30, 2018 approximately $6.4 million of standby letters of credit expire within one year, and $547 thousand expire thereafter.

Affordable Housing Grants

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 September 30, 2018 and December 31, 2017. 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. 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.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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 81% and 77% of our gross loan portfolio at September 30, 2018 and December 31, 2017, 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 8. FAIR VALUES

The following table presents estimated fair values of our financial instruments as of September 30, 2018 and December 31, 2017, 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. The prior period fair values for loans disclosed are not determined in a manner consistent with the current period fair values disclosed because of a change in the methodology.

(Amounts in thousands)	**Carrying**	**Fair Value Measurements Using**		
September 30, 2018	**Amounts**	**Level 1**	**Level 2**	**Level 3**
Financial assets				
Cash and cash equivalents	$91,236	$91,236	$—	$—
Securities available-for-sale	$239,633	$—	$239,633	$—
Net loans	$916,845	$—	$—	$910,262
Federal Home Loan Bank of San Francisco stock	$5,892	$5,892	$—	$—
Financial liabilities				
Deposits	$1,144,761	$—	$1,142,046	$—
Term debt	$14,293	$—	$14,285	$—
Junior subordinated debenture	$10,310	$—	$10,254	$—

(Amounts in thousands)	**Carrying**	**Fair Value Measurements Using**		
December 31, 2017	**Amounts**	**Level 1**	**Level 2**	**Level 3**
Financial assets				
Cash and cash equivalents	$66,970	$66,970	$—	$—
Securities available-for-sale	$267,954	$—	$267,954	$—
Net loans	$869,620	$—	$—	$873,660
Federal Home Loan Bank of San Francisco stock	$4,536	$4,536	$—	$—
Financial liabilities				
Deposits	$1,102,732	$—	$1,101,523	$—
Term debt	$16,958	$—	$16,918	$—
Junior subordinated debenture	$10,310	$—	$10,206	$—

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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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.

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 September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**Fair Value at September 30, 2018**			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$35,656	$ —	$35,656	$ —
Obligations of states and political subdivisions	51,562	—	51,562	—
Residential mortgage-backed securities and collateralized mortgage obligations	124,109	—	124,109	—
Corporate securities	3,974	—	3,974	—
Commercial mortgage-backed securities	24,167	—	24,167	—
Other asset-backed securities	165	—	165	—
Total assets measured at fair value	$239,633	$ —	$239,633	$ —

(Amounts in thousands)	**Fair Value at December 31, 2017**			
Recurring Basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$40,369	$ —	$40,369	$ —
Obligations of states and political subdivisions	78,844	—	78,844	—
Residential mortgage-backed securities and collateralized mortgage obligations	114,592	—	114,592	—
Corporate securities	4,992	—	4,992	—
Commercial mortgage-backed securities	26,641	—	26,641	—

Other investment securities [1]	2,516		—	2,516		—
Total assets measured at fair value	$267,954	$	—	$267,954	$	—

[1] Principally consists of asset-backed securities and CRA qualified mutual fund investments.

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.

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 three and nine months ended September 30, 2018 or the year ended December 31, 2017.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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. The following tables present information about our assets and liabilities at September 30, 2018 and December 31, 2017 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 September 30, 2018**
Nonrecurring basis	**Total**

		Level 1	Level 2	Level 3
Other real estate owned	$136	$ —	$ —	$136
Total assets measured at fair value	$136	$ —	$ —	$136

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(Amounts in thousands)	**Fair Value at December 31, 2017**			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$60	$ —	$ —	$ 60
Other real estate owned	35	—	—	35
Total assets measured at fair value	$95	$ —	$ —	$ 95

The following table presents the losses resulting from nonrecurring fair value adjustments for the three and nine months ended September 30, 2018 and 2017 related to assets outstanding at September 30, 2018 and 2017.

(Amounts in thousands)	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Fair value adjustments	**2018**	**2017**	**2018**	**2017**
Collateral dependent impaired loans	$ —	$ 43	$ —	$ 63
Other real estate owned	—	35	138	35
Total	$ —	$ 78	$ 138	$ 98

During the nine months ended September 30, 2018, four OREO properties with an aggregate carrying value of $274 thousand outstanding at period end were written down to their fair value of $136 thousand, resulting in a $138 thousand adjustment to the 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.

The OREO amount above represents 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 that are based off the adjusted fair value are between 28% and 50%. We record OREO as a nonrecurring Level 3.

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 on current on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. 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 9. PURCHASE OF FINANCIAL ASSETS

During the second quarter of 2018 we terminated an agreement to purchase a maximum par value of $50.0 million in unsecured consumer home improvement loans from a third party originator. Prior to the termination, as we received principal payments on these purchased loans, new loans were purchased and the outstanding par value remained at approximately $50.0 million. Our agreement requires us to continue purchasing loans for six months following the notice of termination.

Since inception through September 30, 2018, we have paid aggregate cash totaling $132.1 million, and received aggregate cash repayments of $87.3 million for $44.8 million in net loans outstanding. The acquired loans were purchased without recourse or servicing rights and were recorded at fair value at the time of the purchase.

NOTE 10. BUSINESS COMBINATION

Proposed Merger with Merchants Holding Company

On October 4, 2018, the Company and Merchants Holding Company, a California corporation (“Merchants”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) pursuant to which Merchants will be merged with and into the Company, with the Company as the surviving corporation (the “Merger”). Management expects the acquisition to close in the first quarter of 2019, subject to the satisfaction of customary closing conditions, including regulatory and shareholder approvals. The Merger Agreement provides that immediately after the Merger, Merchant’s bank subsidiary, The Merchants National Bank of Sacramento (“Merchants National Bank”), will merge with and into the Company’s bank subsidiary, Redding Bank of Commerce, with Redding Bank of Commerce as the surviving bank (the “Bank Merger”). The Merger and Bank Merger are collectively referred to as the “Proposed Transaction.”

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

Under the terms of the Merger Agreement, and subject to certain adjustments, Merchants shareholders may for each share of common stock held, elect to receive 3.8703 shares of the Company, or a cash amount of $48.43, or a combination of 2.3223 shares of the Company and a cash amount of $19.37. The Merger Agreement further provides that the shareholder elections are subject to adjustment, and the Company will issue no more than 1,834,173 shares of common stock and $15.3 million in cash.

Based on the closing price of the Company's common stock of $11.80 on October 4, 2018, the consideration value was approximately $37.0 million in aggregate. The value of the merger consideration will fluctuate until closing based on the value of the Company's stock. Upon consummation of the Merger, the shareholders of Merchants will own approximately 10% of the combined company.

The Merger Agreement includes a provision that the merger consideration will be adjusted if stipulated minimum average core deposit totals are not maintained as of the closing date. Core deposit balances currently total approximately $151 million. If at the close, core deposit balances have declined no more than 7.50%, no adjustment will be made to the merger consideration previously described. If at the close, core deposit balances have declined more than 15%, the Company may unilaterally terminate the transaction. Between these two percentages, the merger consideration will be adjusted according to a contractual schedule.

The consummation of the Merger is subject to a number of conditions, which include: (i) the approval of the Merger Agreement by Merchant's shareholders; (ii) the receipt of all necessary regulatory approvals for the Proposed Transaction, without the imposition of conditions or requirements that the Company's Board of Directors reasonably determines in good faith would, individually or in the aggregate, materially reduce the economic benefits of the Proposed Transaction; (iii) the absence of any regulation, judgment, decree, injunction or other order by a governmental authority which prohibits the consummation of the Proposed Transaction or which prohibits or makes illegal the consummation of the Proposed Transaction; (iv) all representations and warranties made by the Company and Merchants in the Merger Agreement must remain true and correct, except for certain inaccuracies that would not have, or would not reasonably be expected to have, a material adverse effect; and (v) the Company and Merchants have performed their respective obligations under the Merger Agreement in all material respects.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements and Risk Factors

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" 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;

Difficulties in integrating Merchants Holding Company, a California corporation ("Merchants") and Merchant's bank subsidiary, The Merchants National Bank of Sacramento ("Merchants National Bank");

Our failure to realize all of the anticipated benefits of our pending merger;
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 and tariffs imposed by the US government or foreign governments;
Volatility in the capital or credit markets;
Changes in the financial performance and/or condition of our borrowers;
Our concentration in real estate lending;
Our reliance on a third party originator to supply us with consumer loans;
Developments and changes in laws and regulations, including the recent federal "Tax Cuts and Jobs Act", "Economic Growth, Regulatory Relief, and Consumer Protection Act" 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;
A natural disaster, 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;
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.

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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-looking statements should not be viewed as predictions, and should not be the primary basis upon which investors evaluate us. Any investor in our common stock should consider all risks and uncertainties discussed in "RISK FACTORS" and in "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS".

For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2017 under the heading "Risk factors". The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following sections discuss significant changes and trends in the financial condition, capital resources and liquidity of the Company from December 31, 2017 to September 30, 2018. Also discussed are significant trends and changes in the Company's results of operations for the three and nine months ended September 30, 2018, compared to the same period in 2017. The consolidated financial statements and related notes appearing elsewhere in this report are unaudited. The following discussion and analysis is intended to provide greater detail of the Company's financial condition and results.

GENERAL

Bank of Commerce Holdings ("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"). The Holding Company's principal business is to serve as a holding company for Redding Bank of Commerce (the "Bank") which operates under two separate names (Redding Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce) and Bank of Commerce Mortgage ("BOCM") (inactive). The Holding Company together with the bank and BOCM are the ("Company"). 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 we now operate nine full service facilities and three free standing remote ATMs in northern California. We also operate a full service “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.

On October 4, 2018, we entered into an Agreement and Plan of Merger with Merchants that we expect to close in the first quarter of 2019, subject to the satisfaction of customary closing conditions, including regulatory and shareholder approvals. Upon completion of the merger, we expect the combined company will have approximately $1.5 billion in assets, $1.3 billion in deposits, and operate 11 branch offices throughout northern California. See Note 10 *Business Combination* in these *Notes to Consolidated Financial Statements* and our press release filed on form 8-k on October 5, 2018 announcing the signing of the definitive merger agreement for additional information.

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

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

EXECUTIVE OVERVIEW

Financial highlights for the third quarter of 2018 compared to the same quarter a year ago:

Performance

Net income of $4.0 million ($0.25 per share –diluted) was an increase of $1.1 million (40%) from $2.9 million ($0.18 per share – diluted) earned during the same period in the prior year.
Net interest income increased $1.5 million (15%) to $12.1 million compared to $10.6 million for the same period in the prior year.
Return on average assets improved to 1.23% compared to 0.93% for the same period in the prior year.
Return on average equity improved to 12.16% compared to 9.01% for the same period in the prior year.
Average loans totaled $930.9 million, an increase of $125.7 million (16%) compared to average loans for the same period in the prior year.
Average earning assets totaled $1.2 billion, an increase of $83.6 million (7%) compared the same period in the prior year.
Average deposits totaled $1.1 billion, an increase of $55.2 million (5%) compared the same period in the prior year.

- o Average non-maturing deposits totaled $946.2 million, an increase of $96.0 million (11%) compared to the same period in the prior year.
- o Average certificates of deposit totaled $163.3 million, a decrease of $40.7 million (20%) compared to the same period in the prior year.

The Company’s efficiency ratio was 58.4% compared to 63.1% for the same period in the prior year.
Book value per common share was $8.14 at September 30, 2018 compared to $7.89 at September 30, 2017.
Tangible book value per common share was $8.03 at September 30, 2018 compared to $7.77 at September 30, 2017. Tangible book value per share is computed by dividing total shareholders’ equity less goodwill and core deposit intangible, 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.

Credit Quality

Nonperforming assets at September 30, 2018 totaled $3.9 million or 0.29% of total assets, a decrease of $4.5 million (54%) compared to September 30, 2017.
Net loan recoveries were $4 thousand in the third quarter of 2018 and for the same period in 2017.

Acquisition

Entered into a definitive merger agreement with Merchants, including approximately $218.0 million in assets headquartered in downtown Sacramento.
During the third quarter of 2018, we expensed $42 thousand of acquisition costs.

Financial highlights for the first nine months of 2018 compared to the same period a year ago:

Performance

Net income of $10.9 million was an increase of $3.6 million (48%) from $7.3 million earned during the same period in the prior year. Earnings of $0.67 per share – diluted was an increase of $0.18 (37%) from $0.49 per share – diluted earned during the same period in the prior year and reflects the impact of 2,738,096 shares of common stock sold and issued in the second quarter of 2017.
Net interest income increased $4.6 million (15%) to $35.1 million compared to $30.5 million for the same period in the prior year.
Return on average assets improved to 1.14% compared to 0.83% for the same period in the prior year.
Return on average equity improved to 11.29% compared to 8.80% for the same period in the prior year.
Average loans totaled $912.6 million, an increase of $101.6 million (13%) compared to average loans for the same period in the prior year.
Average earning assets totaled $1.2 billion, an increase of $100.3 million (9%) compared to average earning assets for the same period in the prior year.
Average deposits totaled $1.1 billion, an increase of $50.1 million (5%) compared to average deposits for the same period in the prior year.

- o Average non-maturing deposits totaled $906.5 million, an increase of $88.3 million (11%) compared to average non-maturing deposits for the same period in the prior year.
- o Average certificates of deposit totaled $171.9 million, a decrease of $37.3 million (18%) compared to average certificates of deposit for the same period in the prior year.

The Company’s efficiency ratio was 61.5% compared to 67.8% during the same period in the prior year.
Nonperforming assets at September 30, 2018 totaled $3.9 million or 0.29% of total assets, a decrease of $2.0 million (45% annualized) since December 31, 2017.
Book value per common share was $8.14 at September 30, 2018 compared to $7.82 at December 31, 2017.
Tangible book value per common share was $8.03 at September 30, 2018 compared to $7.70 at December 31, 2017. Tangible book value per share is computed by dividing total shareholders’ equity less goodwill and core deposit intangible, 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.

Credit Quality

Nonperforming assets at September 30, 2018 totaled $3.9 million or 0.29% of total assets, a decrease of $2.0 million (45% annualized) since December 31, 2017.

Net loan recoveries were $467 thousand for the first nine months of 2018 compared with net charge-offs of $352 thousand for the same period in the prior year.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SUMMARY OF CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 2 of the *Notes to the Consolidated Financial Statements* included in the Form 10-K for the year ended December 31, 2017 filed with the SEC on March 9, 2018. 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 and Impairment of Investment 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. During the fourth quarter of 2017, we reclassified the entire HTM securities portfolio to AFS. As a result of this transfer we are precluded from classifying any investment securities as held-to-maturity for two years from the date of the transfer.

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 3 *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 4 *Loans* in the *Notes to Consolidated Financial Statements* in this document for further detail on the ALLL and the loan portfolio.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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.

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 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") 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 8 *Fair Values* in the *Notes to Consolidated Financial Statements* incorporated in this document.

RECENT ACCOUNTING PRONOUNCEMENTS

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 amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

Expected financial statement impact – We are currently evaluating the provisions of the ASU and have formed a committee for the purpose of developing a model that is compliant with the requirements under the ASU. The committee is also gathering pertinent data, consulting with outside professionals and evaluating our IT systems. Management expects to recognize a one–time cumulative effect adjustment to the allowance for loan and lease losses as of the first reporting period in which the new standard is effective. An estimate of the magnitude of the one-time adjustment or the overall impact of this standard has not yet been determined.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ASU No. 2016-02

Description - In February of 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 812)*. 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. 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 permit presentation on a prospective basis.

Expected financial statement impact – We estimate the new leasing standard will be implemented on a prospective basis and result in a new lease asset and related lease liability of approximately $4.2 million related to our current operating leases.

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 our funding mix have caused the Company to be more liability sensitive, which could negatively impact earnings in a rapidly rising interest rate environment.

Net interest income reflects both the amount of earning assets we hold and our net interest margin, which is the difference between the yield we on our earning assets and the interest rate 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 prime rate, so they may adjust faster in response to changes in interest rates. As a result, when interest rates fall, the yield we earn on our assets may fall faster than our ability to reprice a large portion of our liabilities, causing our net interest margin to contract.

Changes in the slope of the yield curve, 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 on our earnings under various simulated scenarios that 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 September 30, 2018 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**	**Year 6 Through Year 10**	**Beyond Year 10**	**Total**
Rate:								
Fixed	$38,003	$38,357	$55,840	$30,395	$55,642	$122,938	$14,875	$356,050
Variable:								
Prime	113,739	6,398	4,464	4,216	7,937	4,281	—	141,035
5 Year Treasury	45,350	22,058	50,833	62,378	93,673	41,740	—	316,032
7 Year Treasury	874	913	3,552	8,712	4,818	19,534	—	38,403
1 Year LIBOR	25,526	—	—	—	—	—	—	25,526
Other Indexs	5,884	5,316	4,917	1,832	6,394	22,356	1,775	48,474
Nonaccrual	1,210	331	304	276	268	934	394	3,717

Total	$230,586	$73,373	$119,910	$107,809	$168,732	$211,783	$17,044	$929,237

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, gain on sale of available-for-sale securities, and dividends on Federal Home Loan Bank of San Francisco stock.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

OVERVIEW

Third Quarter of 2018 Compared With Third Quarter of 2017

Net income for the third quarter of 2018 increased $1.2 million compared to the third quarter of 2017. In the current quarter, net interest income was $1.5 million higher and the provision for income taxes was $23 thousand lower. These positive changes were offset by noninterest income that was $133 thousand lower, and noninterest expenses that were $277 thousand higher.

First Nine Months of 2018 Compared with First Nine Months of 2017

Net income for the first nine months of 2018 increased $3.6 million compared to the first nine months of 2017. In the current year, net interest income was $4.6 million higher and provision for loan and lease losses was $500 thousand lower. These positive changes were offset by noninterest income that was $655 thousand lower, noninterest expense was $265 thousand higher and a provision for income taxes that was $585 thousand higher.

Return on Average Assets and Average Total Equity

The following table presents the returns on average assets and average total equity for the three and nine months ended September 30, 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.

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Return on average assets	1.23 %	0.93 %	1.14 %	0.83 %
Return on average total equity	12.16 %	9.01 %	11.29 %	8.80 %

NET INTEREST INCOME AND NET INTEREST MARGIN

For the three months ended September 30, 2018 compared to the same period a year ago, net interest income increased $1.5 million.

Interest income for the third quarter of 2018 increased $1.7 million or 14% to $13.4 million:

Interest and fees on loans increased $1.7 million due to a $125.7 million increase in average loan balances and a six basis point increase in the average yield on the loan portfolio.

Interest on investment securities increased $9 thousand due to a 10 basis point increase in average yield on the securities portfolio partially offset by an $8.2 million decrease in average securities balances.

Interest on interest-bearing deposits due from banks decreased $24 thousand due to a $33.9 million decrease in average interest-bearing deposit balances, partially offset by a 69 basis point increase in average yield.

Interest expense for the third quarter of 2018 increased $123 thousand or 10% to $1.3 million:

Interest expense on interest bearing deposits decreased $1 thousand. Average interest-bearing demand and savings deposit balances increased $55.3 million, while average certificate of deposit balances decreased $40.7 million. The average rate paid on interest-bearing deposits decreased one basis point.

Interest expense on other interest bearing liabilities increased $124 thousand due to increased borrowing from the Federal Home Loan Bank of San Francisco.

For the nine months ended September 30, 2018 compared to the same period a year ago, net interest income increased $4.6 million.

Interest income for the nine months ended September 30, 2018 increased $5.0 million or 15% to $39.0 million.

Interest and fees on loans increased $4.4 million due to a $101.6 million increase in average loan balances and an 11 basis point increase in the average yield on the loan portfolio.

Interest on investment securities increased $647 thousand due to a six basis point increase in average yield and a $28.0 million increase in average securities balances.

Interest on interest-bearing deposits due from banks decreased $30 thousand due to a $29.3 million decrease in average balance partially offset by a 75 basis point increase average yields.

Interest expense for the nine months ended September 30, 2018 increased $490 thousand or 14% to $3.9 million.

Interest expense on deposits increased $41 thousand as average interest-bearing demand and savings deposit balances increased $48.5 million, while average certificate of deposit balances declined $37.3 million. The average rate paid on interest-bearing deposits was unchanged.

Interest expense on other interest bearing liabilities increased $449 thousand. Federal Home Loan Bank of San Francisco borrowings averaged $30.0 million compared to an average balance of $403 thousand in the prior year.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following tables present condensed average balance sheet information, together with interest income and yields earned on average interest-earning assets, and interest expense and rates paid on average interest-bearing liabilities for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30, 2018			**Three Months Ended September 30, 2017**		
(Amounts in thousands)	**Average Balance**	**Interest(1)**	**Yield/ Rate(5)**	**Average Balance**	**Interest(1)**	**Yield/ Rate(5)**
Interest-earning assets:						
Net loans (2)	$930,863	$ 11,568	4.93 %	$805,144	$ 9,887	4.87 %
Taxable securities	199,883	1,209	2.40 %	179,362	1,049	2.32 %
Tax-exempt securities	48,561	400	3.27 %	77,303	551	2.83 %
Interest-bearing deposits in other banks	50,397	254	2.00 %	84,323	278	1.31 %
Average interest-earning assets	1,229,704	13,431	4.33 %	1,146,132	11,765	4.07 %
Cash and due from banks	21,834			19,143		
Premises and equipment, net	13,768			15,362		
Goodwill and core deposit intangible, net	1,888			2,109		
Other assets	33,084			38,154		
Average total assets	$1,300,278			$1,220,900		
Interest-bearing liabilities:						
Interest-bearing demand	$494,906	276	0.22 %	$436,614	196	0.18 %
Savings deposits	107,349	73	0.27 %	110,305	52	0.19 %
Certificates of deposit	163,302	465	1.13 %	204,044	567	1.10 %
Federal Home Loan Bank of San Francisco borrowings	22,283	121	2.15 %	—	—	— %
Other borrowings	14,681	265	7.16 %	17,804	292	6.51 %
Junior subordinated debentures	10,310	104	4.00 %	10,310	74	2.85 %
Average interest-bearing liabilities	812,831	1,304	0.64 %	779,077	1,181	0.60 %
Noninterest-bearing demand	343,948			303,314		
Other liabilities	12,000			11,935		
Shareholders' equity	131,499			126,574		
Average liabilities and shareholders' equity	$1,300,278			$1,220,900		
Net interest income and net interest margin (4)		$ 12,127	3.91 %		$ 10,584	3.66 %

Tax equivalent net interest income and net interest margin [3]	$ 12,233	3.95 %	$ 10,868	3.76 %

[1]Interest income on loans includes deferred fees and costs of approximately $75 thousand and $95 thousand for the three months ended September 30, 2018 and 2017, respectively.
[2] Net loans includes average nonaccrual loans of $3.8 million and $8.6 million for the three months ended September 30, 2018 and 2017, respectively.
[3] Tax-exempt income has been adjusted to a tax equivalent basis at a 21% for 2018 and at a 34% tax rate for 2017. The amount of such adjustments was an addition to recorded income of approximately $106 thousand and $284 thousand for the three months ended September 30, 2018 and 2017.
[4] Net interest margin is net

interest income expressed as a percentage of average interest-earning assets.

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

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	Nine Months Ended September 30, 2018			**Nine Months Ended September 30, 2017**		
(Amounts in thousands)	**Average Balance**	**Interest[(1)]**	**Yield/ Rate[(5)]**	**Average Balance**	**Interest[(1)]**	**Yield/ Rate[(5)]**
Interest-earning assets:						
Net loans [(2)]	$912,648	$ 33,461	4.90 %	$811,080	$ 29,029	4.79 %
Taxable securities	203,791	3,696	2.42 %	153,702	2,710	2.36 %
Tax-exempt securities	52,844	1,276	3.23 %	74,932	1,615	2.88 %
Interest-bearing deposits in other banks	37,515	518	1.85 %	66,818	548	1.10 %
Average interest-earning assets	1,206,798	38,951	4.32 %	1,106,532	33,902	4.10 %
Cash and due from banks	19,801			17,802		
Premises and equipment, net	14,161			15,776		
Goodwill and core deposit intangible, net	1,943			2,164		
Other assets	32,666			37,876		
Average total assets	$1,275,369			$1,180,150		
Interest-bearing liabilities:						
Interest-bearing demand	$477,755	712	0.20 %	$426,365	528	0.17 %
Savings deposits	108,382	196	0.24 %	111,258	146	0.18 %
Certificates of deposit	171,941	1,448	1.13 %	209,275	1,641	1.05 %
Federal Home Loan Bank of San Francisco borrowings	30,037	435	1.94 %	403	3	1.00 %
Other borrowings	15,601	825	7.07 %	18,241	880	6.45 %
Junior subordinated debentures	10,310	283	3.67 %	10,310	211	2.74 %
Average interest-bearing liabilities	814,026	3,899	0.64 %	775,852	3,409	0.59 %
Noninterest-bearing demand	320,316			280,559		
Other liabilities	12,094			12,206		
Shareholders’ equity	128,933			111,533		
Average liabilities and shareholders’ equity	$1,275,369			$1,180,150		
Net interest income and net interest margin [(4)]		$ 35,052	3.88 %		$ 30,493	3.68 %
Tax equivalent net interest income and net interest margin [(3)]		$ 35,391	3.92 %		$ 31,325	3.78 %

[(1)] Interest income on loans includes deferred fees and costs of approximately $356 thousand and $423

thousand for the nine months ended September 30, 2018 and 2017, respectively.

[2] Net loans includes average nonaccrual loans of $4.3 million and $9.7 million for the nine months ended September 30, 2018 and 2017, respectively.

[3] Tax-exempt income has been adjusted to a tax equivalent basis at a 21% tax rate for 2018 and at a 34% tax rate for 2017. The amount of such adjustments was an addition to recorded income of approximately $339 thousand and $832 thousand for the nine months ended September 30, 2018 and 2017, respectively.

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

[5] Yields and rates are

calculated by dividing the income or expense by the average balance of the assets or liabilities, respectively, and annualizing the result.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Analysis of Changes in Net Interest Income

The following tables set forth a summary of the changes in tax equivalent net interest income due to changes in average asset and liability balances (volume variance) and changes in average rates (rate variance) for the three and nine months ended September 30, 2018 and 2017. Changes in tax equivalent interest income and expense, which are not attributable specifically to either volume or rate, are allocated proportionately between both variances.

	Three Months Ended September 30, 2018 Over Three Months Ended September 30, 2017		
(Amounts in thousands)	**Volume**	**Rate**	**Net Change**
Increase (decrease) in interest income:			
Net loans	$1,561	$120	$ 1,681
Taxable securities	123	37	160
Tax-exempt securities [1]	(301)	(28)	(329)
Interest-bearing deposits in other banks	(111)	87	(24)
Total increase	1,272	216	1,488
Increase (decrease) in interest expense:			
Interest-bearing demand	28	52	80
Savings deposits	(1)	22	21
Certificates of deposit	(116)	14	(102)
Federal Home Loan Bank of San Francisco borrowings	121	—	121
Other borrowings	(63)	36	(27)
Junior subordinated debentures	—	30	30
Total (decrease) increase	(31)	154	123
Net increase	$1,303	$62	$ 1,365

[1] Tax-exempt income has been adjusted to tax equivalent

basis at a 21% tax rate for 2018 and 34% for 2017.

(Amounts in thousands)	**Nine Months Ended September 30, 2018 Over Nine Months Ended September 30, 2017**		
	Volume	**Rate**	**Net Change**
Increase (decrease) in interest income:			
Net loans	$3,709	$723	$4,432
Taxable securities	906	80	986
Tax-exempt securities [1]	(683)	(149)	(832)
Interest-bearing deposits in other banks	(241)	211	(30)
Total increase	3,691	865	4,556
Increase (decrease) in interest expense:			
Interest-bearing demand	68	116	184
Savings deposits	(4)	54	50
Certificates of deposit	(330)	137	(193)
Federal Home Loan Bank of San Francisco borrowings	427	5	432
Other borrowings	(164)	109	(55)
Junior subordinated debentures	—	72	72
Total (decrease) increase	(3)	493	490
Net increase (decrease)	$3,694	$372	$4,066

(1) Tax-exempt income has been adjusted to tax equivalent basis at a 21% tax rate for 2018 and 34% for 2017.

PROVISION FOR LOAN AND LEASE LOSSES

As a result of improved asset quality and net loan loss recoveries, no provision for loan and lease losses was necessary during the nine months ended September 30, 2018. We recorded a $500 thousand provision for loan and lease losses during the nine months ended September 30, 2017. See Note 4 *Loans* in the *Notes to Consolidated Financial Statements* for further discussion.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NONINTEREST INCOME

The following table presents the key components of noninterest income for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30,				Nine Months Ended September 30,			
(Amounts in thousands)	**2018**	**2017**	**Change Amount**	**Change Percent**	**2018**	**2017**	**Change Amount**	**Change Percent**
Noninterest income:								
Service charges on deposit accounts	$170	$132	$ 38	29 %	$521	$401	$ 120	30 %
ATM and point of sale	282	273	9	3 %	848	827	21	3 %
Payroll and benefit processing fees	159	147	12	8 %	474	485	(11)	(2)%
Life insurance	128	134	(6)	(4)%	384	915	(531)	(58)%
Gain on investment securities, net	1	38	(37)	(97)%	41	139	(98)	(71)%
Federal Home Loan Bank of San Francisco dividends	104	80	24	30 %	279	237	42	18 %
(Loss) gain on sale of OREO	(7)	81	(88)	(109)%	9	22	(13)	(59)%
Other	106	191	(85)	(45)%	331	516	(185)	(36)%
Total noninterest income	$943	$1,076	$ (133)	(12)%	$2,887	$3,542	$ (655)	(18)%

Noninterest income for the three months ended September 30, 2018 decreased $133 thousand compared to the third quarter for 2017, a variance not concentrated in any one item. Noninterest income for the nine months ended September 30, 2018 decreased $655 thousand compared to the first nine months of 2017. During the first quarter of 2017, we recognized income from life insurance death benefit proceeds of $502 thousand.

NONINTEREST EXPENSE

The following table presents the key components of noninterest expense for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30,				Nine Months Ended September 30,			
(Amounts in thousands)	**2018**	**2017**	**Change Amount**	**Change Percent**	**2018**	**2017**	**Change Amount**	**Change Percent**
Noninterest expense:								
Salaries & related benefits	$4,529	$4,291	$ 238	6 %	$13,897	$13,296	$ 601	5 %
Premises & equipment	1,017	1,067	(50)	(5)%	3,104	3,169	(65)	(2)%
Federal Deposit Insurance Corporation insurance premium	94	78	16	21 %	283	230	53	23 %
Data processing fees	518	437	81	19 %	1,421	1,294	127	10 %
Professional service fees	336	276	60	22 %	995	1,119	(124)	(11)%
Telecommunications	55	219	(164)	(75)%	449	653	(204)	(31)%
Other	1,085	989	96	10 %	3,189	3,312	(123)	(4)%
Total noninterest expense	$7,634	$7,357	$ 277	4 %	$23,338	$23,073	$ 265	1 %

Noninterest expense for the three months ended September 30, 2018 increased $277 thousand compared to the same period a year previous. Noninterest expense for the nine months ended September 30, 2018 increased $265 thousand compared to the same period a year previous. The variance for both periods reflects increased compensation costs in our Sacramento market offset by reduced reliance on professional consultants and reductions in various other nonrecurring expenses. We received refunds from a Telecommunication vendor totaling $97 thousand during the third quarter of 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.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Amounts in thousands)	**2018**	**2017**	**2018**	**2017**
Income before provision for income taxes	$5,436	$4,303	$14,601	$10,462
Provision for income taxes	$1,404	$1,427	$3,710	$3,125
Effective tax rate	25.8 %	33.2 %	25.4 %	29.9 %

For the three months ended September 30, 2018, our income tax provision of $1.4 million on pre-tax income of $5.4 million was an effective tax rate of 25.8%. The current quarter effective tax rate reflects the benefits of the Tax Cuts and Jobs Act of 2017, which reduced the federal corporate tax rate from a graduated rate of 35% to a flat rate of 21%. This compares with a provision for income taxes for the third quarter of the prior year of $1.4 million on pre-tax income of $4.3 million, which was an effective tax rate of 33.2%.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the nine months ended September 30, 2018, our income tax provision of $3.7 million on pre-tax income of $14.6 million was an effective tax rate of 25.4%. The effective tax rate for the nine months ended September 30, 2017, of 29.9% included life insurance death benefits of $502 thousand, which were not subject to income tax. If the death benefits were excluded from pretax income, the effective tax rate would have been 31.4%. The lower effective tax rate in 2018 again reflects the benefits of the Tax Cuts and Jobs Act of 2017.

Cost Segregation Study and Tangible Property Review

We have initiated a cost segregation study and a tangible property review, which will shorten the depreciable lives of certain assets and accelerate the tax depreciation deduction on our 2017 federal income tax return. We expect to record the expense of approximately $293 thousand and a benefit to our 2018 book provision for income taxes exceeding that amount 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. However, we have continued to recognize 100% of the tax liability relating to our 2011 amended federal tax return because of our belief that under the concept of equitable recoupment our tax position would be sustained upon reexamination by the IRS or through the litigation process. This has created an uncertain tax position.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FINANCIAL CONDITION

CONSOLIDATED BALANCE SHEETS

As of September 30, 2018, we had total consolidated assets of $1.3 billion, gross loans of $927.5 million, allowance for loan and lease losses (“ALLL”) of $12.4 million, total deposits of $1.1 billion, and shareholders’ equity of $133.0 million.

As of September 30, 2018, 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 $69.9 million.

Available-for-sale investment securities totaled $239.6 million at September 30, 2018, compared to $268.0 million at December 31, 2017. Our investment portfolio provides a secondary source of liquidity to fund other higher yielding asset opportunities, such as loan originations.

During the first nine months of 2018, we purchased 18 securities with a par value of $30.5 million and weighted average yield of 3.30% and sold 40 securities with a par value of $27.1 million and weighted average yield of 2.45%. The sales activity on available-for-sale securities resulted in $41 thousand in net realized gains for the nine months ended September 30, 2018. During the nine months ended September 30, 2018, we also received $23.9 million in proceeds from principal payments, calls and maturities within the available-for-sale securities portfolio.

At September 30, 2018, our net unrealized losses on available-for-sale investment securities were $5.8 million compared to net unrealized losses of $452 thousand at December 31, 2017. The unrealized losses arising during the nine months ended September 30, 2018 were driven by significant changes in market interest rates and no investments were considered other-than-temporarily impaired.

We recorded gross loan balances of $927.5 million at September 30, 2018, compared to $879.8 million at December 31, 2017 an increase of $47.6 million. The increase in gross loans compared to December 31, 2017 was organic and did not rely on loan pool purchases.

The ALLL at September 30, 2018 increased $467 thousand to $12.4 million compared to $11.9 million at December 31, 2017. At September 30, 2018, relying on our ALLL methodology, which uses criteria such as risk weighting 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 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, decreased by $2.1 million to $3.7 million, or 0.40% of gross loans, as of September 30, 2018, compared to $5.8 million, or 0.66% of gross loans as of December 31, 2017. The decrease in nonperforming loans was primarily due to repayments totaling $1.2 million from one commercial loan and one commercial real estate loan.

Past due loans as of September 30, 2018 decreased $1.0 million to $1.3 million, compared to $2.3 million as of December 31, 2017. The decrease in past due loans was primarily due to the sale of two residential real estate loans for $290 thousand and the transfer of five residential real estate loans to OREO. We believe that risk grading for past due loans appropriately reflects the risk associated with the past due loans. See Note 4 *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 $13.5 million at September 30, 2018 a decrease of $1.2 million compared to $14.7 million at December 31, 2017.

Our OREO balance at September 30, 2018 was $136 thousand compared to $35 thousand at December 31, 2017. For the nine months ended September 30, 2018, we transferred five foreclosed properties in the amount of $140 thousand to OREO. During the nine months ended September 30, 2018, we sold two properties with a balance of $48 thousand for a net gain of $9 thousand.

Bank-owned life insurance increased $384 thousand during the nine months ended September 30, 2018 to $22.3 million compared to $21.9 million at December 31, 2017.

Other assets, which include the Bank’s investment qualified zone academy bonds, Federal Home Loan Bank of San Francisco stock and low-income housing tax credit partnerships totaled $21.9 million at September 30, 2018 compared to $19.7 million at December 31, 2017.

Total deposits at September 30, 2018, increased $42.0 million or 5% annualized to $1.1 billion compared to December 31, 2017.

- Total non-maturing deposits increased $121.2 million or 14% compared to the same date a year ago and increased $70.0 million or 10% annualized compared to December 31, 2017.
- Certificates of deposit decreased $39.2 million or 20% compared to the same date a year ago and decreased $28.0 million or 20% annualized compared to December 31, 2017.

Other liabilities which include the Bank's income tax liabilities, supplemental executive retirement plan and funding obligation for investments in qualified affordable housing partnerships increased $900 thousand to $13.1 million as of September 30, 2018 compared to $12.2 million at December 31, 2017.

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;

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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.

The carrying value of our available-for-sale investment securities totaled $239.6 million at September 30, 2018, compared to $268.0 million at December 31, 2017. The following table presents information at carrying value of the investment securities portfolio by classification and major type as of September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**		**December 31, 2017**	
Available-for-sale securities: [1]				
U.S. government & agencies	$	35,656	$	40,369
Obligations of state and political subdivisions		51,562		78,844
Residential mortgage-backed securities and collateralized mortgage obligations		124,109		114,592
Corporate securities		3,974		4,992
Commercial mortgage-backed securities		24,167		26,641
Other asset-backed securities		165		2,516
Total	$	239,633	$	267,954

[1] Available-for-sale securities are reported at fair value.

The following table presents information at amortized cost, regarding the maturity structure and average yield of the investment portfolio at September 30, 2018.

	Maturing Within One Year		**Maturing Over One Through Five Years**		**Maturing Over Five Through Ten Years**		**Maturing 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	$—	— %	$—	— %	$5,532	3.10 %	$30,525	2.82 %	$36,057	2.86 %
Obligations of state and political subdivisions	33	5.62 %	12,377	3.37 %	21,109	3.43 %	17,949	2.99 %	51,468	3.26 %
Residential mortgage-backed securities and collateralized mortgage obligations	501	3.80 %	64,975	2.58 %	58,958	2.93 %	4,269	3.68 %	128,703	2.78 %
Corporate securities	1,016	3.39 %	2,026	4.09 %	1,000	2.15 %	—	— %	4,042	3.43 %
Commercial mortgage-backed securities	—	— %	—	— %	4,686	2.24 %	20,304	2.55 %	24,990	2.49 %
Other asset-backed securities	—	— %	—	— %	—	— %	164	4.42 %	164	4.42 %
Total	$1,550	3.55 %	$79,378	2.74 %	$91,285	3.01 %	$73,211	2.84 %	$245,424	2.88 %

[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 and we have purchased loans from third party originators made to borrowers who are located throughout the United States. 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. Repayment is expected from the borrower's cash flows or cash flows from real estate investments.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table presents the composition of the loan portfolio as of September 30, 2018 and December 31, 2017.

(Amounts in thousands) **Loan Portfolio**	**September 30, 2018**	**%**	**December 31, 2017**	**%**
Commercial	$ 132,091	14 %	$ 142,405	16 %
Commercial real estate:				
Real estate - construction and land development	20,496	2	15,902	2
Real estate - commercial non-owner occupied	431,246	47	377,668	43
Real estate - commercial owner occupied	195,608	21	192,023	22
Residential real estate:				
Real estate - residential - ITIN	38,353	4	41,188	5
Real estate - residential - 1-4 family mortgage	33,473	4	30,377	3
Real estate - residential - equity lines	28,713	3	30,347	3
Consumer and other	47,500	5	49,925	6
Gross loans	927,480	100%	879,835	100%
Deferred loan fees and costs	1,757		1,710	
Loans, net of deferred fees and costs	929,237		881,545	
Allowance for loan and lease losses	(12,392)		(11,925)	
Net loans	$ 916,845		$ 869,620	

The following table sets forth the maturity and fixed or variable rate distribution of our loan portfolio as of September 30, 2018.

(Amounts in thousands)	**Within One Year**	**After One Through Five Years**	**After Five Years**	**Total**
Commercial	$35,572	$54,096	$43,316	$132,984
Commercial real estate:				
Real estate - construction and land development	4,817	3,763	11,865	20,445
Real estate - commercial non-owner occupied	5,659	116,911	308,090	430,660

Real estate - commercial owner occupied	10,862	19,769	164,044	196,675
Residential real estate:				
Real estate - residential - ITIN	—	—	38,353	38,353
Real estate - residential - 1-4 family mortgage	495	2,247	30,804	33,546
Real estate - residential - equity lines	39	2,659	26,350	29,048
Consumer and other	282	45,863	1,381	47,526
Loans, net of deferred fees and costs	$57,726	$245,308	$626,203	$929,237
Loans with:				
Fixed rates	$38,003	$180,234	$137,813	$356,050
Variable rates	19,723	65,074	488,390	573,187
Loans, net of deferred fees and costs	$57,726	$245,308	$626,203	$929,237

Loans with unique characteristics

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, we may realize additional monitoring, servicing and appraisal 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, the loan portfolio includes purchased loan pools and purchased participations. Purchased loans are recorded at their fair value at the acquisition date. Additional information regarding the individual purchased loan pools can be found in Note 9 *Purchase of Financial Assets* in the *Notes to Consolidated Financial Statements* in this document.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table presents the recorded investment in purchased loans at September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**			**December 31, 2017**		
Loan Type	**Balance**	**% of Gross Loan Portfolio**		**Balance**	**% of Gross Loan Portfolio**	
Commercial	$79	—	%	$108	—	%
Commercial real estate	29,396	3	%	30,195	3	%
Residential real estate	52,888	6	%	56,735	6	%
Consumer and other	45,815	5	%	47,836	5	%
Total purchased loans	$128,178	14	%	$134,874	14	%

During the second quarter of 2018 we terminated an agreement to purchase a maximum par value of $50.0 million in unsecured consumer home improvement loans from a third party originator. Our agreement requires us to continue purchasing loans for six months following the notice of termination.

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 loss 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 on 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.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table summarizes our nonperforming assets as of September 30, 2018 and December 31, 2017.

(Amounts in thousands) **Nonperforming Assets**	**September 30, 2018**	**December 31, 2017**
Commercial	$ 899	$ 1,603
Commercial real estate:		
Real estate - commercial owner occupied	—	600
Total commercial real estate	—	600
Residential real estate:		
Real estate - residential - ITIN	2,571	2,909
Real estate - residential - 1-4 family mortgage	179	606
Real estate - residential - equity lines	44	45
Total residential real estate	2,794	3,560
Consumer and other	24	36
Total nonaccrual loans	3,717	5,799
90 days past due and still accruing	—	—
Total nonperforming loans	3,717	5,799
Other real estate owned	136	35
Total nonperforming assets	$ 3,853	$ 5,834
Nonperforming loans to gross loans	0.40 %	0.66 %
Nonperforming assets to total assets	0.29 %	0.46 %

We regularly perform thorough reviews of the commercial real estate portfolio, including semi-annual stress testing. These reviews are performed on both our nonowner 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 risings, interest rates and rising 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 September 30, 2018, we had $9.7 million in troubled debt restructurings compared to $10.9 million as of December 31, 2017. As of September 30, 2018, we had 107 restructured loans that qualified as troubled debt restructurings, of which all loans were performing according to their restructured terms. Troubled debt restructurings represented 1.05% of gross loans as of September 30, 2018, compared to 1.24% at December 31, 2017.

Impaired loans of $7.0 million and $7.3 million were classified as accruing troubled debt restructurings at September 30, 2018 and December 31, 2017, 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 September 30, 2018 and December 31, 2017, we had one restructured commercial line of credit in nonaccrual status that had $455 thousand and $33 thousand in available credit, respectively.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth a summary of our restructured loans that qualify as troubled debt restructurings as of September 30, 2018 and December 31, 2017.

(Amounts in thousands) **Troubled Debt Restructurings**	**September 30, 2018**	**December 31, 2017**
Accruing troubled debt restructurings		
Commercial	$ 1,291	$ 1,551
Commercial real estate:		
Real estate - commercial non-owner occupied	797	803
Residential real estate:		
Real estate - residential - ITIN	4,535	4,614
Real estate - residential - equity lines	367	380
Total accruing troubled debt restructurings	$ 6,990	$ 7,348
Nonaccruing troubled debt restructurings		
Commercial	$ 807	$ 863
Residential real estate:		
Real estate - residential - ITIN	1,889	2,396
Real estate - residential - 1-4 family mortgage	—	296
Consumer and other	24	26
Total nonaccruing troubled debt restructurings	$ 2,720	$ 3,581
Total troubled debt restructurings		
Commercial	$ 2,098	$ 2,414
Commercial real estate:		
Real estate - commercial non-owner occupied	797	803
Residential real estate:		
Real estate - residential - ITIN	6,424	7,010
Real estate - residential - 1-4 family mortgage	—	296
Real estate - residential - equity lines	367	380
Consumer and other	24	26
Total troubled debt restructurings	$ 9,710	$ 10,929
Total troubled debt restructurings to gross loans outstanding at period end	1.05 %	1.24 %

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The ALLL at September 30, 2018 increased $467 thousand to $12.4 million compared to $11.9 million at December 31, 2017. As a result of improved asset quality and net loan recoveries, no provision for loan and lease losses was deemed necessary during the nine months ended September 30, 2018. During the year ended December 31, 2017, we recorded a $950 thousand provision for loan and lease losses.

We recorded net loan loss recoveries of $467 thousand for the nine months ended September 30, 2018 compared to net loan charge-offs of $569 thousand for the year ended December 31, 2017. Recoveries of $1.4 million during the nine months ended September 30, 2018 occurred primarily from two commercial loans partially offset by charge-offs of $646 thousand primarily from purchased consumer loans. Our ALLL as a percentage of gross loans was 1.34% and 1.36% as of September 30, 2018 and December 31, 2017, respectively.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table summarizes the ALLL roll forward for the nine months ended September 30, 2018, twelve months ended December 31, 2017 and the nine months ended September 30, 2017. This table also includes impaired loan information at September 30, 2018, December 31, 2017 and September 30, 2017.

(Amounts in thousands)	**For The Nine Months Ended September 30, 2018**	**For The Twelve Months Ended December 31, 2017**	**For The Nine Months Ended September 30, 2017**
Beginning balance ALLL	$ 11,925	$ 11,544	$ 11,544
Provision for loan and lease loss charged to expense	—	950	500
Loans charged off	(969)	(1,502)	(1,051)
Loan and lease loss recoveries	1,436	933	699
Ending balance ALLL	$ 12,392	$ 11,925	$ 11,692

	At September 30, 2018	**At December 31, 2017**	**At September 30, 2017**
Nonaccrual loans:			
Commercial	$ 899	$ 1,603	$ 2,309
Real estate - commercial owner occupied	—	600	617
Real estate - residential - ITIN	2,571	2,909	3,201
Real estate - residential - 1-4 family mortgage	179	606	626
Real estate - residential - equity lines	44	45	815
Consumer and other	24	36	37
Total nonaccrual loans	3,717	5,799	7,605
Accruing troubled-debt restructured loans:			
Commercial	1,291	1,551	671
Real estate - commercial non-owner occupied	797	803	805
Real estate - residential - ITIN	4,535	4,614	4,655
Real estate - residential - equity lines	367	380	441
Total accruing restructured loans	6,990	7,348	6,572
All other accruing impaired loans	—	—	—
Total impaired loans	$ 10,707	$ 13,147	$ 14,177
Gross loans outstanding	$ 927,480	$ 879,835	$ 824,874

Ratio of ALLL to gross loans outstanding	1.34	%	1.36	%	1.42	%
Nonaccrual loans to gross loans outstanding	0.40	%	0.66	%	0.92	%

As of September 30, 2018, impaired loans totaled $10.7 million, of which $3.7 million were in nonaccrual status. Of the total impaired loans, $7.1 million or 107 were ITIN loans with an average balance of approximately $66 thousand. The remaining impaired loans consist of six commercial loans, one commercial real estate loan, one residential mortgage, eight home equity loans and one consumer loan.

At September 30, 2018, impaired loans had a corresponding specific allowance of $1.1 million. 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 as of September 30, 2018 and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**			**December 31, 2017**		
ALLL	**Amount**	**% Loan Category**		**Amount**	**% Loan Category**	
Commercial	$2,229	18	%	$2,397	20	%
Commercial real estate:						
Real estate - construction and land development	97	1		82	1	
Real estate - commercial non-owner occupied	5,363	43		4,698	40	
Real estate - commercial owner occupied	1,747	14		1,734	15	
Residential real estate:						
Real estate - residential - ITIN	687	6		602	5	
Real estate - residential - 1-4 family mortgage	162	1		151	1	
Real estate - residential - equity lines	363	3		416	3	
Consumer and other	1,287	10		1,435	12	
Unallocated	457	4		410	3	
Total ALLL	$12,392	100	%	$11,925	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 September 30, 2018 and December 31, 2017, the unallocated allowance amount represents 4% and 3%, respectively. While the ALLL composition is an indication of specific amounts or loan categories in which future charge-offs may occur, actual amounts may differ.

51

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Natural Disasters

Wildfires

We have extended credit to borrowers in California where devastating fires have recently caused widespread destruction, especially in the Redding area.

As of September 30, 2018, we have loans with balances totaling $301 thousand that are secured by real estate damaged by the recent fires. We believe that these properties are adequately insured and we do not expect to experience losses on these loans.

In addition, we have extended credit totaling $2.7 million to borrowers whose homes or businesses are not collateral for our loan but were in the fire area. This may impact our borrower’s ability to repay our loans.

Hurricanes

Many of the loans that we have acquired from third party originators were made to borrowers who are located throughout the United States, other than in California. Some of those borrowers reside in areas where hurricanes have caused severe damage. The loans that were affected are primarily ITIN loans, which are secured by first deeds of trust and consumer home improvement loans, which are unsecured. These loans are not serviced by us and we are dependent on third party servicers for collection efforts, processing payment deferral requests and obtaining loss information. We have not seen any significant increase in losses as a result of the hurricanes.

Deposits

Total deposits as of September 30, 2018 were $1.1 billion compared to $1.1 billion at December 31, 2017, an increase of $42.0 million or 5% annualized. The following table presents the deposit balances by major category as of September 30, 2018, and December 31, 2017.

(Amounts in thousands)	**September 30, 2018**		**December 31, 2017**	
Deposits	**Amount**	**Percentage**	**Amount**	**Percentage**
Noninterest-bearing demand	$361,516	32 %	$305,650	28 %
Interest-bearing demand	251,323	22	260,221	24
Money market accounts	259,230	23	236,769	21
Savings	111,388	10	110,837	10
Certificates of deposit, $100,000 or greater	126,948	10	148,438	13
Certificates of deposit, less than $100,000	34,356	3	40,817	4
Total	$1,144,761	100 %	$1,102,732	100 %

The following table sets forth the distribution of our year-to-date average daily balances and their respective average rates for the nine months ended September 30, 2018, and the year ended December 31, 2017.

	For the Nine Months Ended September 30, 2018		**For the Year Ended December 31, 2017**	
(Amounts in thousands)	**Average Balance**	**Rate**	**Average Balance**	**Rate**
Interest-bearing demand	$231,958	0.16%	$209,792	0.13%
Money market accounts	245,797	0.24%	224,913	0.21%
Savings	108,382	0.24%	111,376	0.18%
Certificates of deposit	171,941	1.13%	205,648	1.06%
Interest-bearing deposits	758,078	0.42%	751,729	0.42%
Noninterest-bearing demand	320,316		289,735	
Average total deposits	$1,078,394	0.29%	$1,041,464	0.30%
Federal Home Loan Bank of San Francisco borrowings	$30,037	1.94%	$302	0.99%
Other borrowings, net	15,601	7.07%	17,981	6.48%
Junior subordinated debentures	10,310	3.67%	10,310	2.78%
Average total borrowings	$55,948	3.69%	$28,593	5.09%

Deposit Maturity Schedule

The following table sets forth the maturities of certificates of deposit in amounts of $100,000 or more as of September 30, 2018.

(Amounts in thousands)	**September 30,**

Maturing in:	**2018**
Three months or less	$ 16,650
Three through six months	33,893
Six through twelve months	19,783
Over twelve months	56,622
Total	$ 126,948

We have an agreement with Promontory Interfinancial Network LLC ("Promontory") allowing 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") 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, that would be fully insured at the Bank. 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 be reciprocal or one-way.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For calendar quarters prior to June 30, 2018, CDARS/ ICS reciprocal deposits were considered to be brokered deposits by regulatory authorities and were reported as such on quarterly Call Reports. With passage of The Economic Growth, Regulatory Relief and Consumer Protection Act in May 2018, this is no longer so.

Included in our certificates of deposit balances are $24.4 million of subscription time deposits obtained in prior years through online deposit listing services. We no longer utilize online deposit listing services. As they mature, these legacy deposits are not being renewed.

Borrowings

Term Debt

At September 30, 2018, we had total term debt outstanding with a carrying value of $14.3 million compared to $17.0 million at December 31, 2017. Term debt consisted of the following:

Federal Home Loan Bank of San Francisco Borrowings

As of September 30, 2018 and December 31, 2017 the Bank had no Federal Home Loan Bank of San Francisco advances outstanding. The average balance outstanding on Federal Home Loan Bank of San Francisco term advances during the nine months ended September 30, 2018 or the year ended December 31, 2017 was $30.0 million and $302 thousand, respectively. Strong loan growth combined with seasonal decreases in deposits necessitated Federal Home Loan Bank of San Francisco borrowings during the first two quarters of 2018. The borrowings were repaid during the third quarter from strong organic core deposit growth. See Note 6 *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. The debt is secured by a pledge from the Holding Company of all of the outstanding stock of Redding Bank of Commerce, matures in 2020, and at September 30, 2018, had a balance of $4.4 million net of unamortized debt issuance costs. Interest on the senior debt is paid at a variable rate equal to three month LIBOR plus 400 basis points resetting monthly. The effective interest rate at September 30, 2018, was 6.34%.

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 September 30, 2018, the Subordinated Debt had a balance of $9.9 million net of unamortized debt issuance costs. The notes are due in 2025.

Junior Subordinated Debentures

Bank of Commerce Holdings Trust II

During July 2005, we participated in a $10.0 million private placement of 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. Interest on the Trust-Preferred Securities is paid quarterly at a rate equal to three month LIBOR plus 158 basis points resetting quarterly (3.91% at September 30, 2018).

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 the 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.

LIQUIDITY AND CASH FLOW

Redding Bank of Commerce

The principal objective of the Bank’s liquidity management program is to maintain its ability to meet the day-to-day cash flow requirements of its customers who wish either 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 is 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 our total deposits at September 30, 2018 and December 31, 2017.

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. The Bank’s tight liquidity position during the second quarter necessitated the use of its Federal Home Loan Bank of San Francisco credit line. The borrowings were repaid during the third quarter as a result of strong organic core deposit growth and the seasonal increase in deposits.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

At September 30, 2018, the Bank has the following credit arrangements:

We have an available line of credit with the Federal Home Loan Bank of San Francisco of $397.7 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 $27.2 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 lines totaled $35.0 million at September 30, 2018 and had interest rates ranging from 2.39% to 3.06%. 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. We currently hold $19.8 million from our May 2017 public offering. Historically, our principal source of cash has been dividends received from the Bank. During 2018, the Bank paid a dividend of $1.5 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 Statements of Cash Flows

As disclosed in the *Consolidated Statements of Cash Flows*, net cash of $15.2 million was provided by operating activities during the nine months ended September 30, 2018. The primary difference between net income and cash provided by operating activities was non-cash items including depreciation and amortization totaling $1.6 million and net amortization of investment premiums and accretion of discounts of $1.4 million.

Net cash of $28.7 million used in investing activities consisted principally of $31.3 million in purchases of investment securities and $47.3 million in net loan purchases and originations partially offset by $27.6 million in proceeds from sale of investment securities and $23.9 million in proceeds from maturities and payments of investment securities.

Net cash of $37.8 million provided by financing activities consisted of an increase in deposits of $42.0 million partially offset by a $2.7 million decrease in net term debt.

CAPITAL RESOURCES

We use equity capital to support growth and pay dividends. The objective of effective capital management is to produce above market 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 and is being phased in between 2016 and 2019. For 2018, the partially phased in buffer is 1.875%.

When the capital rule is fully phased in, the minimum capital requirements plus the conservation buffer will exceed the well-capitalized thresholds by 0.5 percentage points. This 0.5-percentage-point cushion will allow 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.

The Economic Growth, Regulatory Relief, and Consumer Protection Act was signed into law during the second quarter of 2018. The act amends the Federal Deposit Insurance Act to require federal banking agencies to develop a specified Community Bank Leverage Ratio (the ratio of a bank's equity capital to its consolidated assets) for banks with assets of less than $10.0 billion. Banks that exceed this ratio shall be deemed to comply with all other capital and leverage requirements.

CAPITAL ADEQUACY

Overall capital adequacy is monitored regularly by management and reported to our Board of Directors on a monthly basis. Our regulators measure capital adequacy by using a risk-based capital framework and by monitoring compliance with minimum leverage ratio guidelines. As illustrated on the table below, the Holding Company and the Bank exceed the standards under these rules.

As of September 30, 2018, 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 September 30, 2018, are presented in the following table.

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	September 30, 2018					
(Amounts in thousands)	**Capital**	**Actual Ratio**	**Well Capitalized Requirement**	**Minimum Capital Requirement**	**Applicable 2018 Capital Conservation Buffer**	**Minimum Capital Ratio plus Capital Conservation Buffer**
Holding Company:						
Common Equity Tier 1 Capital Ratio	$135,184	12.65 %	n/a	4.50 %	1.875 %	6.375 %
Tier 1 Capital Ratio	$145,184	13.59 %	n/a	6.00 %	1.875 %	7.875 %
Total Capital Ratio	$168,271	15.75 %	n/a	8.00 %	1.875 %	9.875 %
Tier 1 Leverage Ratio	$145,184	11.18 %	n/a	4.00 %	n/a	n/a
Bank:						
Common Equity Tier 1 Capital Ratio	$140,436	13.14 %	6.50 %	4.50 %	1.875 %	6.375 %
Tier 1 Capital Ratio	$140,436	13.14 %	8.00 %	6.00 %	1.875 %	7.875 %
Total Capital Ratio	$153,523	14.36 %	10.00 %	8.00 %	1.875 %	9.875 %
Tier 1 Leverage Ratio	$140,436	10.78 %	5.00 %	4.00 %	n/a	n/a

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, 2017 for further detail on potential risks relating to the Subordinated Notes.

As part of a branch acquisition in 2016, we recorded a core deposit intangible of $1.8 million and goodwill of $665 thousand. When calculating capital ratios, goodwill and core deposit intangibles are subtracted from Tier 1 capital. Both of these intangible assets are subtracted from tangible equity as part of the calculation of tangible book value per share.

Cash Dividends and Payout Ratios per Common Share

We declared a cash dividend of $0.04 per common share for the three months ended September 30, 2018 and June 30, 2018. During the three months ended March 31, 2018 and the year ended December 31, 2017, we declared quarterly cash dividends of $0.03 per common share.

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.

The following table presents cash dividends declared and dividend payout ratios (dividends declared per common share divided by basic earnings per common share) for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Dividends declared per common share	$0.04	$0.03	$0.11	$0.09
Dividend payout ratio	16 %	17 %	16 %	18 %

OFF-BALANCE SHEET ARRANGEMENTS

Information regarding Off-Balance Sheet Arrangements is included in Note 7, *Commitments and Contingencies,* in the *Notes to Consolidated Financial Statements* incorporated in this document.

CONCENTRATION OF CREDIT RISK

Information regarding Concentration of Credit Risk is included in Note 7, *Commitments and Contingencies,* in the *Notes to Consolidated Financial Statements* incorporated in this document.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our assessment of market risk as of September 30, 2018 indicates there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. 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 consolidated 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 consolidated 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 consolidated 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 September 30, 2018, 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 first nine months of 2018 that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1a. Risk Factors

The risks described below, as well as the risk factors previously disclosed in the our Form 10-K for the period ended December 31, 2017, filed with the SEC on March 9, 2018 should be carefully considered. The risks described may not be the only risks facing us. Additional risks and uncertainties not currently known to us or that are currently considered to not be material also may materially adversely affect our business, financial condition and/or operating results. Our risk factors regarding our pending merger have been added to specifically address the risks related to the pending merger.

On October 4, 2018, the Company and Merchants Holding Company, a California corporation ("Merchants"), entered into an Agreement and Plan of Merger (the "Merger Agreement") pursuant to which Merchants will be merged with and into the Company, with the Company as the surviving corporation (the "Merger"). Management expects the acquisition to close in the first quarter of 2019, subject to the satisfaction of customary closing conditions, including regulatory and shareholder approvals. The Merger Agreement provides that immediately after the Merger, Merchant's bank subsidiary, The Merchants National Bank of Sacramento ("Merchants National Bank"), will merge with and into the Company's bank subsidiary, Redding Bank of Commerce, with Redding Bank of Commerce as the surviving bank (the "Bank Merger"). Merchants Bank is a 97-year-old bank with approximately $212.4 million in assets as of September 30, 2018 and is headquartered in downtown Sacramento.

We may fail to realize all of the anticipated benefits of our pending Merger.

Although we previously acquired five branches from Bank of America in 2016, we have not previously been involved in a whole-bank acquisition such as the proposed merger. We expect to complete the acquisition of Merchants Holding Company in the first quarter of 2019. Inherent uncertainties exist in integrating the operations of the acquired company. In addition, the markets and industries in which it operates are highly competitive. We may lose existing customers or key personnel from our company or from Merchants National Bank; and we may not be able to control

the incremental increase in noninterest expense arising from the acquisition in a manner that improves our overall operating efficiencies. Our ability to achieve anticipated results from the acquisition is also dependent on the extent of deposit and loan attrition and our ability to successfully deploy the new deposits into loans, which are, in part, related to the state of economic and financial markets. These factors could contribute to not achieving the expected benefits from the acquisitions within desired time frames, if at all. If the merger is completed and unexpected costs are incurred, the merger could have a dilutive effect on our earnings per share, meaning earnings per share could be less than they would be if the merger had not been completed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

a) Not Applicable

b) Not Applicable

c) Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

31.1	Certification of Chief Executive Officer pursuant to Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002
32.0	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

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

BANK OF COMMERCE HOLDINGS

(Registrant)

Date: November 2, 2018 */s/ James A. Sundquist*
James A. Sundquist
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

58