

Bank of Commerce Holdings  
Form 10-Q  
August 08, 2008

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**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 June 30, 2008**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-25135**

California  
(State or other jurisdiction of incorporation or organization)  
1901 Churn Creek Road Redding, California

94-2823865  
(I.R.S. Employer Identification No.)

(Address of principal executive offices) 96002  
(Zip code)

Registrant's telephone number, including area code: (530) 722-3955

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

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

Common Stock, no par value per share

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One)

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

(Do not check if a smaller reporting company)

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 June 30, 2008: 8,711,495

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Condensed Consolidated Balance Sheets****(Unaudited)**

*The following condensed balance sheet and income statement as of December 31, 2007, which has been derived from audited financial statements audited by Moss Adams, LLP, independent public accountants, as indicated in their report not included herein, and the unaudited condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission.*

<i>Dollars in thousands</i>	June 30, 2008	Dec. 31, 2007	June 30, 2007
<b>ASSETS</b>			
Cash and due from banks	\$ 16,660	\$ 13,839	\$ 18,206
Federal funds sold and securities purchased under agreements to resell	11,585	8,395	14,115
Cash and cash equivalents	28,245	22,234	32,321
Securities available-for-sale (including pledged collateral of \$68,165 at June 30, 2008, \$61,329 at December 31, 2007 and \$93,790 at June 30, 2007)	66,728	67,906	94,029
Securities held-to-maturity, at cost (estimated fair value of \$10,285 at June 30, 2008, \$10,632 at December 31, 2007 and \$10,369 at June 30, 2007)	10,385	10,559	10,637
Loans, net of the allowance for loan losses of \$5,017 at June 30, 2008, \$8,233 at December 31, 2007 and \$4,943 at June 30, 2007	507,651	486,283	437,821
Bank premises and equipment, net	11,068	10,964	10,329
Other assets	22,531	20,381	20,440
<b>TOTAL ASSETS</b>	<b>\$ 646,608</b>	<b>\$ 618,327</b>	<b>\$ 605,577</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Demand noninterest bearing	\$ 68,625	\$ 75,718	\$ 69,842
Demand interest bearing	128,994	142,821	114,530
Savings accounts	52,453	41,376	45,082
Certificates of deposit	218,303	213,716	211,794
Total deposits	468,375	473,631	441,248
Securities sold under agreements to repurchase	14,343	15,513	46,655
Federal Home Loan Bank borrowings	95,000	60,000	50,000
Other liabilities	7,396	7,554	7,114
Junior subordinated debt payable to unconsolidated subsidiary grantor trust	15,465	15,465	15,465

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Total Liabilities	600,579	572,163	560,482
Commitments and contingencies			
Stockholders' Equity:			
Preferred stock, no par value, 2,000,000 authorized no shares issued and outstanding in 2008 and 2007			
Common stock, no par value, 50,000,000 shares authorized; 8,711,495 shares issued and outstanding at June 30, 2008, 8,757,445 at December 31, 2007 and 8,908,880 at June 30, 2007	9,590	9,996	11,966
Retained earnings	37,344	36,605	34,997
Accumulated other comprehensive loss, net of tax	(905)	(437)	(1,868)
Total stockholders' equity	46,029	46,164	45,095
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 646,608	\$ 618,327	\$ 605,577

*See accompanying notes to condensed consolidated financial statements.*

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**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**  
**Condensed Consolidated Statements of Income (Unaudited)**  
**Three and six months ended June 30, 2008 and 2007**

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
<i>Amounts in thousands, except for per share data</i>				
Interest income:				
Interest and fees on loans	\$ 8,171	\$ 8,965	\$ 17,302	\$ 17,429
Interest on tax exempt securities	302	334	576	612
Interest on U.S. government securities	533	816	1,014	1,648
Interest on federal funds sold and securities purchased under agreements to resell	90	190	148	390
Interest on other securities	23	9	45	45
<b>Total interest income</b>	<b>9,119</b>	<b>10,314</b>	<b>19,085</b>	<b>20,124</b>
Interest expense:				
Interest on demand deposits	498	587	1,248	1,144
Interest on savings deposits	360	355	650	526
Interest on time deposits	2,238	2,627	4,614	5,232
Securities sold under agreements to repurchase	35	381	119	723
Interest on FHLB and other borrowing expense	781	632	1,512	1,171
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	161	271	476	540
<b>Total interest expense</b>	<b>4,073</b>	<b>4,853</b>	<b>8,619</b>	<b>9,336</b>
Net interest income	5,046	5,461	10,466	10,788
Provision for loan and lease losses	1,000	0	1,600	6
<b>Net interest income after provision for loan losses</b>	<b>4,046</b>	<b>5,461</b>	<b>8,866</b>	<b>10,782</b>
Noninterest income:				
Service charges on deposit accounts	50	76	112	145
Payroll and benefit processing fees	99	89	228	197
Earnings on cash surrender value - Bank owned life insurance	85	99	168	194
Net gain on sale of securities available-for-sale	194	0	436	46
Net loss on sale of derivative swap transaction	0	0	(225)	0
Merchant credit card service income, net	97	96	180	188
Mortgage brokerage fee income	5	29	15	35
Other income	187	229	368	311
<b>Total non-interest income</b>	<b>717</b>	<b>618</b>	<b>1,282</b>	<b>1,116</b>
Noninterest expense:				
Salaries and related benefits	1,892	1,959	3,841	4,056



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Occupancy and equipment expense	640	543	1,284	1,001
FDIC insurance premium	113	13	171	26
Data processing fees	65	90	143	145
Professional service fees	133	252	251	447
Payroll and benefit fees	27	25	60	56
Deferred compensation expense	113	101	224	198
Stationery and supplies	80	46	142	107
Postage	38	34	72	67
Directors expense	94	76	142	121
Other expenses	418	562	847	965
Total non-interest expense	3,613	3,701	7,177	7,189
Income before provision for income taxes	1,150	2,378	2,971	4,709
Provision for income taxes	244	778	835	1,622
Net Income	\$ 906	\$ 1,600	\$ 2,136	\$ 3,087
Basic earnings per share	\$ 0.10	\$ 0.18	\$ 0.25	\$ 0.35
Weighted average shares basic	8,748	8,908	8,714	8,887
Diluted earnings per share	\$ 0.10	\$ 0.18	\$ 0.24	\$ 0.34
Weighted average shares diluted	8,751	9,063	8,732	8,985

*See accompanying notes to condensed consolidated financial statements.*

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**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**  
**Condensed Consolidated Statements of Stockholders' Equity**  
**Six months ended June 30, 2008**

	Comprehensive Income	Common Shares	Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net of tax	Total
Balance at December 31, 2007		8,757	\$ 9,996	\$ 36,605	(\$437)	\$ 46,164
Comprehensive Income: Net Income	1,229			1,229		1,229
Other Comprehensive Income: Other Comprehensive Income, net of tax Unrealized losses arising during the period on derivative transactions, net	(423)					
Less: reclassification adjustment for losses included in net income, net of tax	132					
Net holding loss on derivatives	(291)					
Unrealized gains on securities	569					
Net of reclassification adjustment for gains included in net income, net of tax	(142)					
Other Comprehensive Income	136				136	136
Total Comprehensive Income	\$ 1,365					

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Cash dividends (\$0.08 per share)				(699)		(699)
Compensation expense associated with stock options				29		29
Share Repurchase	(59)			(504)		(504)
Stock options exercised	9			29		29
Balance at March 31, 2008	8,707	\$	9,550	\$ 37,135	(\$301)	\$ 46,384
Comprehensive Income:						
Net Income	906			906		906
Other Comprehensive Income:						
Other Comprehensive Income, net of tax						
Unrealized gains on securities	(538)					
Net of reclassification adjustment for gains included in net income, net of tax	(66)					
Other Comprehensive Income	(604)				(604)	(604)
Total Comprehensive Income	\$ 302					
Cash dividends (\$0.08 per share)				(697)		(697)
Compensation expense associated with stock options				28		28
Stock options exercised	4			12		12
Balance at June 30, 2008	8,711	\$	9,590	\$ 37,344	(\$905)	\$ 46,029

See accompanying notes to condensed consolidated financial statements.

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**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows (Unaudited)**  
**Six months ended June 30, 2008 and 2007**

<i>Dollars in thousands</i>	June 30, 2008	June 30, 2007
Cash flows from operating activities:		
Net Income	\$ 2,136	\$ 3,087
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	1,600	6
Provision for depreciation and amortization	598	469
Compensation expense associated with stock options	57	36
Tax benefits from the exercise of stock options	0	(118)
Gain on sale of securities available for sale	(436)	(46)
Loss on sale of derivative	225	0
Amortization of investment premiums and accretion of discounts, net	18	(5)
Gain on sale of fixed assets	(5)	(16)
Deferred income taxes	(707)	(955)
Changes in operating assets and liabilities:		
Increase in Cash Surrender Value	(141)	(176)
Increase in Other Assets	(860)	1,333
Changes in Deferred Compensation	219	207
Decrease in Deferred loan fees	(31)	(47)
Decrease in Other liabilities	(378)	(331)
Net cash provided by operating activities	2,295	3,444
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale securities	4,071	3,121
Proceeds from sales of available-for-sale securities	26,444	20,569
Proceeds from maturities of held-to-maturity securities	172	171
Purchases of available-for-sale securities	(30,052)	(23,495)
Loan originations, net of principal repayments	(22,938)	(28,790)
Purchases of premises and equipment	(697)	(2,239)
Net cash used by investing activities	(23,000)	(30,663)
Cash flows from financing activities:		
Net (decrease) increase in deposits	(5,255)	1,840
Net (decrease) increase in securities sold under agreement to repurchase	(1,170)	9,538
Proceeds from Federal Home Loan Bank advances	65,000	10,000
Repayments of Federal Home Loan Bank advances	(30,000)	(0)
Cash dividends paid on common stock	(1,396)	(1,517)
Proceeds from stock options exercised	41	295
Common Stock Repurchased	(504)	0
Excess tax benefits from the exercise of stock options	0	118

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Net cash provided by financing activities	26,716	20,274
Net increase (decrease) in cash and cash equivalents	6,011	(6,945)
Cash and cash equivalents, beginning of period	22,234	39,266
Cash and cash equivalents, end of period	\$ 28,245	\$ 32,321
Supplemental disclosures:		
Cash paid during the period for:		
Income taxes	\$	\$ 1,618
Interest	8,970	8,836

*See accompanying notes to condensed consolidated financial statements.*

**Table of Contents****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements****1. Consolidation and Basis of Presentation**

The unaudited condensed consolidated financial statements include the accounts of Bank of Commerce Holdings (the Holding Company ) and its subsidiaries Redding Bank of Commerce , Roseville Bank of Commerce and Sutter Bank of Commerce ( BOC or the Bank ) and Bank of Commerce Mortgage (collectively the Company ). All significant inter-company balances and transactions have been eliminated. The condensed balance sheet as of December 31, 2007, which has been derived from audited financial statements audited by Moss Adams, LLP, independent public accountants, as indicated in their report not included herein, and the unaudited condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. The financial information contained in this report reflects all adjustments that in the opinion of management are necessary for a fair presentation of the results of the interim periods. All such adjustments are of a normal recurring nature. Certain reclassifications have been made to the prior period condensed consolidated financial statements to conform to the current financial statement presentation with no effect on previously reported equity and net income.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America and general practices within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts for prior periods have been reclassified to conform to the current financial statement presentation.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2007 Annual Report on Form 10-K. The results of operations and cash flows for the 2008 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year. For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. Generally, federal funds are sold for a one-day period and securities purchased under agreements to resell are for no more than a 90-day period.

**2. Recent Accounting pronouncements**

**On September 15, 2006, the FASB issued FAS 157, *Fair Value Measurements***, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. FAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. FAS 157 is effective for the year beginning January 1, 2008. The adoption of FAS 157 did not have a material effect on our consolidated financial statements.

**On February 15, 2007 the FASB issued FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement 115***. FAS 159 provides an alternative measurement treatment for certain financial assets and financial liabilities, under an instrument-by-instrument election, that permits fair value to be used for both initial and subsequent measurement, with changes in fair values recognized in earnings. FAS 159 is effective beginning January 1, 2008. The adoption of FAS 159 did not have a material impact on our consolidated financial statements.

**In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133***. SFAS No. 161 expands disclosure requirements regarding an entity's derivative instruments and hedging activities. Expanded qualitative disclosures that will be required under SFAS No. 161 include: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations; and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 also requires several added quantitative disclosures in financial statements. SFAS No. 161 will be effective for the Company on January 1, 2009. Management

is currently evaluating the effect that the provisions of SFAS No. 161 will have on the Company's financial statements.

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Basic earnings per share exclude dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. 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 entity. The following table displays the computation of earnings per share for the three and six months ended June 30, 2008 and 2007.

(Amounts in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June	June 30,	June	June 30,
	30,	2007	30,	2007
	2008		2008	
Basic EPS Calculation:				
Numerator (net income)	\$ 906	\$ 1,600	\$ 2,136	\$ 3,087
Denominator (average common shares outstanding)	8,748	8,908	8,714	8,887
Basic earnings per Share	\$ 0.10	\$ 0.18	\$ 0.25	\$ 0.35
Diluted EPS Calculation:				
Numerator (net income)	\$ 906	\$ 1,600	\$ 2,136	\$ 3,087
Denominator:				
Average common shares outstanding	8,748	8,908	8,714	8,887
Dilutive effect of Stock Options	3	155	18	98
Adjusted average common shares outstanding diluted	8,751	9,063	8,732	8,985
Diluted earnings per Share	\$ 0.10	\$ 0.18	\$ 0.24	\$ 0.34

Stock options totaling 209,485 were outstanding at June 30, 2008 at an average exercise price of \$6.31. 146,167 of these options were not included in the above EPS calculation as they were anti-dilutive.

**4. Stock Option Plans**

For the first six months of 2008, stock option compensation expense charged against income was \$56,799 compared to \$35,751 at June 30, 2007. At June 30, 2008, there was \$275,197 of total unrecognized compensation costs related to non-vested share based payments which is expected to be recognized over a period of 3.3 years. No options were granted during the first six months of 2008.

During the six months ended June 30, 2008 and 2007 the Company realized income tax benefits of \$0 and \$117,925 respectively, related to the exercise of nonqualified stock options. The income tax benefit is reflected in net cash provided by financing activities in the consolidated statements of cash flow for the same period.

During the six months ended June 30, 2008 and 2007 the Company received cash of \$41,506 and \$294,506 respectively, upon exercise of stock-based compensation arrangements.



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The Company's total comprehensive income was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net income as reported	\$ 906	\$ 1,600	\$ 2,136	\$ 3,087
Other comprehensive income:				
Holding gain (loss) arising during period on AFS securities, net of tax	(538)	(1,076)	(159)	(931)
Reclassification adjustment on AFS securities, net of tax	(66)	0	(310)	(27)
Holding gain (loss) arising during period on derivative transactions, net of tax	0	(105)	0	51
Reclassification adjustment on derivative transactions, net of tax	0	(24)	3	(24)
Total comprehensive income	\$ 302	\$ 395	\$ 1,667	\$ 2,156

**6. Junior Subordinated Debt Payable to Unconsolidated Subsidiary Grantor Trust**

During the first quarter 2003, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust (the grantor trust), which issued \$5.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings' junior subordinated debentures (the trust notes) to the public and \$155,000 common securities to the Company. These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines.

The proceeds from the issuance of the trust notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital. The trust notes accrue and pay distributions on a quarterly basis at 3 month London Interbank Offered Rate (LIBOR) plus 3.30%. The rate at June 30, 2008 was 6.01%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the trust note is March 18, 2033, and the debt allows for prepayment after five years on the quarterly payment date.

On July 29, 2005, Bank of Commerce Holdings (the Company) participated in a private placement to an institutional investor of \$10 million of fixed rate trust preferred securities (the Trust Preferred Securities); through a newly formed Delaware trust affiliate, Bank of Commerce Holdings Trust II (the Trust). The Trust Preferred Securities mature on September 15, 2035, and are redeemable at the Company's option on any March 15, June 15, September 15 or December 15 on or after September 15, 2010.

In addition, the Trust Preferred Securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a rate of 6.12%, until September 10, 2010 after which the rate will reset quarterly to equal 3-Month LIBOR plus 1.58%. The Trust simultaneously issued \$310,000 of the Trust's common securities of beneficial interest to the Company.

The proceeds from the sale of the Trust Preferred Securities were used by the Trust to purchase from the Company the aggregate principal amount of \$10,310,000 of the Company's floating rate junior subordinate notes (the Notes). The net proceeds to the Company from the sale of the Notes to the Trust will be used by the Company for general corporate purposes, including funding the growth of the Company's various financial services.

**Table of Contents****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

The Notes were issued pursuant to a Junior Subordinated Indenture (the Indenture), dated July 29, 2005, by and between the Company and J.P. Morgan Chase Bank, National Association, as trustee. Like the Trust Preferred Securities, the Notes bear interest at a floating rate, at 6.12% until September 10, 2010, after which the rate will reset on a quarterly basis to equal 3-Month LIBOR plus 1.58%. The interest payments by the Company will be used to pay the quarterly distributions payable by the Trust to the holder of the Trust Preferred Securities.

However, so long as no event of default, as described below, has occurred under the Notes, the Company may, at any time and from time to time, defer interest payments on the Notes (in which case the Trust will be entitled to defer distributions otherwise due on the Trust Preferred Securities) for up to twenty (20) consecutive quarters.

The Notes are subordinated to the prior payment of other indebtedness of the Company that, by its terms, is not similarly subordinated. Although the Notes will be recorded as a long term liability on the Company's balance sheet, for regulatory purposes, the Notes are expected to be treated as Tier 1 or Tier 2 capital under rulings of the Federal Reserve Board, the Company's primary federal regulatory agency.

The Notes mature on September 15, 2035, but may be redeemed at the Company's option at any time on or after September 15, 2010, or at any time upon certain events, such as a change in the regulatory capital treatment of the Notes, the Trust being deemed to be an investment company or the occurrence of certain adverse tax events. In each case, the Company may redeem the Notes for their aggregate principal amount, plus accrued interest.

**7. Commitments and contingent liabilities**

**Lease Commitments** The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under all non-cancelable operating leases as of June 30, 2008 are below:

(Dollars in thousands)

2008	\$ 282
2009	\$ 558
2010	\$ 524
2011	\$ 454
2012	\$ 279
Thereafter	\$ 761
Total	\$ 2,858

Minimum rental due in the future

Under non-cancelable subleases \$ 24

**Legal Proceedings** The Company is involved in various pending and threatened legal actions arising in the ordinary course of business. The Company maintains reserves for losses from legal actions, which are both probable and estimable. In the opinion of management, the disposition of claims, currently pending will not have a material adverse affect on the Company's financial position or results of operations.

**Table of Contents****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

**FHLB Advances** The Company has advances from the Federal Home Loan Bank of San Francisco ( FHLB ) totaling \$95,000,000 as of June 30, 2008 and \$50,000,000 as of June 30, 2007. The FHLB advances bear fixed and floating interest rates ranging from 2.82% to 3.97%. Interest is payable quarterly. The following table illustrates borrowings outstanding at the end of the period:

Amount	Interest Rate	Maturity
\$15,000,000	2.87%	01/26/2009
\$15,000,000	2.89%	01/22/2009
\$35,000,000	3.97%	11/23/2009
\$15,000,000	2.82%	01/22/2010
\$15,000,000	3.41%	04/29/2011

\$95,000,000

These borrowings are secured by an investment in FHLB stock and certain real estate mortgage loans which have been specifically pledged to the FHLB pursuant to their collateral requirements. Based upon the level of FHLB advances, the Company was required to hold a minimum investment in FHLB stock of \$4,755,800 and to pledge \$71,682,101 of its real estate mortgage loans to the FHLB as collateral as of June 30, 2008. At June 30, 2008, the Bank had available borrowing lines at the FHLB of \$15,018,689 and additional federal fund borrowing lines at two correspondent banks totaling \$25,000,000.

**Off-Balance Sheet Financial Instruments** - In the ordinary course of business, the Company enters various types of transactions, which involve financial instruments with off-balance sheet risk. These instruments include commitments to extend credit and standby letter of credits, which are not reflected in the accompanying consolidated balance sheets. These transactions may involve, to varying degrees, credit and interest rate risk more than the amount, if any recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Company if certain conditions of the contract are violated. Although currently subject to draw down, many of the commitments do not necessarily represent future cash requirements. Collateral held relating to these commitments varies, but generally includes real estate, securities and cash. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Bank upon default of performance.

Collateral held for standby letters of credit is based on an individual evaluation of each customer's creditworthiness, but may include cash and securities. Commitments to extend credit and standby letters of credit bear similar credit risk characteristics as outstanding loans.

The Company's commitments to extend credit are illustrated below:

	June 30, 2008	June 30, 2007
Unfunded loan commitments	\$ 150,784,540	\$ 170,281,351
Standby letters of credit	6,074,834	8,334,120
Guaranteed commitments outstanding	1,357,724	1,375,999
	\$ 158,217,098	\$ 179,991,470



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**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Unaudited)**

**8. Accounting for Income Tax Uncertainties (FIN 48)**

In June 2006, the FASB issued Interpretation 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting and reporting for income taxes where interpretation of the law is uncertain. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted this Statement on January 1, 2007. As a result of the implementation of Interpretation 48, it was not necessary for the Company to recognize any increase in the liability for unrecognized tax benefits.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and California state jurisdiction. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense.

**6. Fair Value Measurement**

SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurement. Effective 1/1/08 the Company adopted SFAS No. 157, which enhances the disclosures about financial instruments carried at fair value.

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

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

The Company's 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 table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2008, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

**Table of Contents****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Unaudited)**

(Dollars in thousands)

Description	Fair Value Measurements at June 30, 2008, Using			
	Fair Value June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	\$ 66,728	\$	\$ 66,728	
To Total assets measured at fair value	\$ 66,728	\$	\$ 66,728	\$
Derivative Liabilities	\$ 119		119	
Total liabilities measured at fair value	\$ 119	\$	\$ 119	\$

The following methods were used to estimate the fair value of each class of financial instrument above:

**Securities available-for-sale** - Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains 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.

**Derivatives** - Derivatives are valued using internal models, most of which are primarily based on market observable input including interest rate curves and both forward Derivatives are reported at fair value utilizing Level 2 inputs, and are provided to the Company by an independent pricing source. The fair market value of the derivative is based on the present value of the expected cash flows over the life of the instrument.

Expected cash flows are determined by evaluating transactions with a pricing model using a specific market environment. The fair values disclosed were estimated using the closing mid-market market/price environment as of June 30, 2008. These values do not take into account liquidity, hedging cost, bid/offer, credit or other considerations that are specific to each counterparty and transaction, and that vary over time.

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.



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**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**  
**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**  
**(Unaudited)**

(Dollars in thousands)

June 30, 2008	Total	Level 1	Level 2	Level 3
Impaired Loans	\$ 18,870	\$	\$	\$ 18,870
Total assets at fair value	\$ 18,870	\$	\$	\$ 18,870
Total liabilities at fair value	\$	\$	\$	\$

**Impaired loans** When available, we use observable market data, including pricing on recent closed market transactions, to value loans. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral.

In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

The Company had outstanding balances of \$18.9 and \$12.4 million in impaired loans as of June 30, 2008 and December 31, 2007, respectively. Impairment allowances totaled \$415,425 and \$3.2 million at June 30, 2008 and December 31, 2007, respectively.

**The fair value measurements recorded during the period**

The Company recognized a \$4.8 million write-down related to non-recurring fair value measurements of impaired loans during the six months of 2008. Interest reversed from income during this six month period due to impaired loans was \$148,534.



**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward Looking Statements and Risk Factors**

*An investment in the Company has risk. The discussion below and elsewhere in this Report and in other documents the Company files with the SEC incorporates various risk factors that could cause the Company's financial results and condition to vary significantly from period to period. Information in the accompanying financial statements contains certain forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We caution the investor that such statements are subject to risks and uncertainties that could cause actual results to differ materially from those stated. These risks and uncertainties include the Company's ability to maintain or expand its market share and net interest margins, or to implement its marketing and growth strategies. Further, actual results may be affected by the Company's ability to compete on price and other factors with other financial institutions; customer acceptance of new products and services; and general trends in the banking and the regulatory environment, as they relate to the Company's cost of funds and return on assets. The reader is advised that this list of risks is not exhaustive and should not be construed as any prediction by the Company as to which risks would cause actual results to differ materially from those indicated by the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.*

***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, 2007 under the heading***

***Risk factors that may affect results.*** *Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. 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, 2007 to June 30, 2008. Also discussed are significant trends and changes in the Company's results of operations for the three and six months ended June 30, 2008, compared to the same period in 2007. The consolidated financial statements and related notes appearing elsewhere in this report are condensed and unaudited. The following discussion and analysis is intended to provide greater detail of the Company's financial condition and results.*

**Company Overview**

Bank of Commerce Holdings (the Holding Company) is a corporation organized under the laws of California and a financial holding company (FHC) 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, Roseville Bank of Commerce, Sutter Bank of Commerce and Bank of Commerce Mortgage, and for other banking or banking-related subsidiaries which the Holding Company may establish or acquire (collectively the Company). The Holding Company also has two unconsolidated subsidiaries, Bank of Commerce Holdings Trust and Bank of Commerce Holdings Trust II. The Company is listed on the NASDAQ National Market under the trading symbol BOCH (Bank of Commerce Holdings).

The Bank was incorporated as a California banking corporation on November 25, 1981, and received its certificate of authority to begin banking operations on October 22, 1982. The Bank operates five full service facilities in three diverse markets in Northern California. Bank of Commerce is proud of its reputation as Northern California's premier bank for business. During 2007, the Company re-branded Bank of Commerce as *Bank of Choice* reflecting a renewed commitment to making Bank of Commerce the *bank of choice* for local businesses with a fresh focus on family and personal finances.

The Mortgage subsidiary, Bank of Commerce Mortgage, an affiliate of Bank of Commerce, principal business is mortgage brokerage services. The subsidiary has an affiliated business agreement with BWC Mortgage Services. Under the terms of the agreement, BWC Mortgage Services underwrites or brokers mortgage products, manages the independent contractors, supporting staff and broker relationships with secondary market lenders. Bank of Commerce Mortgage, through this agreement, provides office space, equipment, and marketing support for the mortgage brokerage business. All loans are sold in the secondary market. Bank of Commerce Mortgage pays ten percent of

gross premiums earned to BWC Mortgage Services.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The Company will provide free of charge upon request, or through links to publicly available filings accessed through its Internet website, the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, if any, as soon as reasonably practical after such reports have been filed with the Securities and Exchange Commission. The Internet addresses of the Company are [www.bankofcommerceholdings.com](http://www.bankofcommerceholdings.com), [www.reddingbankofcommerce.com](http://www.reddingbankofcommerce.com), [www.rosevillebankofcommerce.com](http://www.rosevillebankofcommerce.com), [www.sutterbankofcommerce.com](http://www.sutterbankofcommerce.com) and [www.bankofcommcemortgage.com](http://www.bankofcommcemortgage.com). Reports may also be obtained through the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).

The Holding Company's principal source of income is dividends from its subsidiaries. The Holding Company conducts its corporate business operations at the administrative office of the Bank located at 1901 Churn Creek Road, Redding, California. The Company conducts its business operations in two geographic market areas, Redding and Roseville, California. The Company considers Upstate California to be the major market area of the Bank.

The Bank is principally supervised and regulated by the California Department of Financial Institutions (DFI) and the Federal Deposit Insurance Corporation (FDIC), and conducts a general commercial banking business in the counties of El Dorado, Placer, Shasta, Sacramento, Sutter and Yuba, California. Through the Bank and mortgage subsidiaries, the Company provides a wide range of financial services and products for business and consumer banking. The services offered by the Bank include those traditionally offered by banks of similar size and character in California. Products such as free checking, interest-bearing checking (NOW) and savings accounts, money market deposit accounts, sweep arrangements, commercial, construction, term loans, travelers checks, safe deposit boxes, collection services and electronic banking activities. The Bank currently does not offer trust services or international banking services.

The services offered by the Mortgage Company include single and multi-family residential new financing, refinancing and equity lines of credit. All mortgage products are brokered and are not maintained on the Bank's books.

Most of the Bank's customers are small to medium sized businesses, professionals and other individuals with medium to high net worth, and most of the Bank's deposits are obtained from such customers. The primary business strategy of the Bank is to focus on its lending activities. The Bank's principal lines of lending are (i) commercial, (ii) real estate construction and (iii) commercial real estate.

The majority of the loans of the Bank are direct loans made to individuals and small businesses in the major market area of the Bank. The Mortgage Company provides residential real estate new financing, refinancing and equity lines of credit, 100% sold in the secondary market. A relatively small portion of the loan portfolio of the Bank consists of loans to individuals for personal, family or household purposes. The Bank accepts the following as collateral for loans: real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery and equipment and other general business assets such as accounts receivable and inventory.

The commercial loan portfolio of the Bank consists of a mix of revolving credit facilities and intermediate term loans. The loans are generally made for working capital, asset acquisition, business-expansion purposes, and are generally secured by a lien on the borrowers' assets. The Bank also makes unsecured loans to borrowers who meet the Bank's underwriting criteria for such loans. The Bank manages its commercial loan portfolio by monitoring its borrowers' payment performance and their respective financial condition, and makes periodic and appropriate adjustments, if necessary, to the risk grade assigned to each loan in the portfolio. The primary sources of repayment of the commercial loans of the Bank are the borrower's conversion of short-term assets to cash and operating cash flow. The net assets of the borrower or guarantor and/or the liquidation of collateral are usually identified as a secondary source of repayment.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The principal factors affecting the Bank's risk of loss from commercial lending include each borrower's ability to manage its business affairs and cash flows, local and general economic conditions and real estate values in the Bank's service area. The Bank manages risk through its underwriting criteria, which includes strategies to match the borrower's cash flow to loan repayment terms, and periodic evaluations of the borrower's operations. The Bank's evaluations of its borrowers are facilitated by management's knowledge of local market conditions and periodic reviews by a consultant of the credit administration policies of the Bank.

The real estate construction loan portfolio of the Bank consists of a mix of commercial and residential construction loans, which are principally secured by the underlying projects. The real estate construction loans of the Bank are predominately made for projects, which are intended to be owner occupied. The Bank also makes real estate construction loans for speculative projects. The principal sources of repayment of the Bank's construction loans are sale of the underlying collateral or permanent financing provided by the Bank or another lending source. The principal risks associated with real estate construction lending include project cost overruns that absorb the borrower's equity in the project and deterioration of real estate values as a result of various factors, including competitive pressures and economic downturns.

The Bank manages its credit risk associated with real estate construction lending by establishing maximum loan-to-value ratios on projects on an as-completed basis, inspecting project status in advance of controlled disbursements and matching maturities with expected completion dates. Generally, the Bank requires a loan-to-value ratio of no more than 80% on single-family residential construction loans.

The commercial and construction loan portfolio of the Bank consists of loans secured by a variety of commercial and residential real property. The Mortgage Company makes real estate mortgage loans for both owner-occupied properties and investor properties. The Mortgage Company brokers and sells the residential real estate loans directly in the secondary market, servicing included. The Bank does not provide for warehouse funding.

The specific underwriting standards of the Bank and methods for each of its principal lines of lending include industry-accepted analysis and modeling, and certain proprietary techniques. The Bank's underwriting criteria is designed to comply with applicable regulatory guidelines, including required loan-to-value ratios. The credit administration policies of the Bank contain mandatory lien position and debt service coverage requirements, and the Bank generally requires a guarantee from the owners of its private corporate borrowers.

The Company continuously searches for expansion possibilities, through internal growth, strategic alliances, acquisitions or new office and product opportunities. Systematically, the Company will reevaluate the short and long-term profitability of all lines of business, and will not hesitate to reduce or eliminate unprofitable locations or lines of business. The Company remains a viable, independent bank by enhancing stockholder value. This has been realized by proactive management and commitment to staff, customers, and the markets served.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)*****Risk Factors******Economic Conditions and Geographic Concentration***

An economic slowdown could reduce demand for the Company's products and services and lead to lower revenues and lower earnings. A change in California's economic and business conditions may adversely affect the ability of our borrowers to repay their loans, causing us to incur higher credit losses. The Company earns revenue from interest and fees charged on loans and financial services. When the economy slows, the demand for these products and services may fall, reducing our interest and fee income, and our earnings. In addition, during periods of economic slowdown or recession, the Bank may experience a decline in collateral values and an increase in delinquencies and defaults due to the borrower's ability to repay their loans. Several factors could cause the economy to slow down or even recede, including higher energy costs, higher interest rates, reduced consumer or corporate spending, a slowdown in housing, natural disasters, terrorist activities, military conflicts, and the normal cyclical nature of the economy.

The Company's primary lending focus has historically been commercial real estate, commercial lending and, to a lesser extent, construction lending. At June 30, 2008, all of the Company's real estate mortgage, real estate construction loans, and commercial real estate loans, were secured fully or in part by deeds of trust on underlying real estate. The Company's dependence on real estate increases the risk of loss in the loan portfolio of the Company and its holdings of other real estate owned if economic conditions in California deteriorate in the future. Deterioration of the real estate market in California has had an adverse effect on the Company's business, financial condition and results of operations.

***Changes in Interest Rates could reduce the Company's Net Interest Income and Earnings***

The Company's net interest income is the interest earned on loans, debt securities and other assets minus the interest paid on deposits, long-term and short-term debt and other liabilities. Net interest income reflects both our net interest margin—the difference between the yield on earning assets and the interest paid on deposits and other sources of funding—and the amount (volume) of earning assets we hold. As a result, changes in either the net interest margin or the volume of earning assets could adversely affect our net interest income and earnings.

Changes in interest rates, up or down, could adversely affect the net interest margin. The yield we earn on our deposits and our 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 (timing differences). A significant portion of the Company's assets are tied to variable rate pricing and the Company is considered to be asset sensitive. As a result, the Company is generally adversely affected by declining interest rates. In addition, changes in monetary policy, including changes in interest rates, influence the origination of loans, the purchase of investments and the generation of deposits, thereby affecting the rates received on loans and securities and paid on deposits, which could have a material adverse effect on the Company's business, financial condition and results of operations. See **Quantitative and Qualitative Disclosure about Market Risk**.

Changes in the slope of the yield-curve, or the spread between short-term and long-term interest rates could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning 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, the Company will experience pressure on the net interest margin as the cost of funds increases relative to the yield that can be earned on assets. The Company assesses interest rate risk by estimating the effect on earnings in various scenarios that differ based on assumptions about the direction, magnitude and speed of interest rate changes and the slope of the yield curve. The Company may hedge some interest rate risk with interest rate derivatives. The Company does not hedge all of its interest rate risk. There is 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 the assumptions used in the model. One example: If interest rates rise or fall faster than assumed or the slope of the yield curve changes, the Company may incur losses on debt securities held as investments.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

To reduce the interest rate risk, the Company may choose to rebalance the investment and loan portfolio, refinance debt outstanding or take other strategic actions. The Company may incur losses or expenses when taking such actions.

*Lending Risks Associated with Commercial Banking and Construction Activities*

The business strategy of the Company is to focus on commercial, single family and multi-family real estate loans, construction loans and commercial business loans. Loans secured by commercial real estate are generally larger and involve a greater degree of credit and transaction risk than residential mortgage (one-to-four family) loans. Because payments on loans secured by commercial and multi-family real estate properties are often dependent on successful operation or management of the underlying properties, repayment of such loans may be subject to a greater extent to the then prevailing conditions in the real estate market or the economy. Moreover, real estate construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development compared to the estimated cost (including interest) of construction. If the estimate of value proves to be inaccurate, the Company may be confronted with a project which, when completed, has a value which is insufficient to assure full repayment of the construction loan. Although the Company manages lending risks through its underwriting and credit administration policies, no assurance can be given that such risks would not materialize, in which event the Company's financial condition, results of operations, cash flows and business prospects could be materially adversely affected.

*Adequacy of Allowance for Loan and Lease Losses (ALLL)*

Higher credit losses could require the Company to increase the allowance for loan and lease losses through a charge to earnings. When the Company loans money or commits to loan money it incurs credit risk or the risk of losses if our borrowers do not repay their loans. The Company provides a reserve for credit risk by establishing an allowance through a charge to earnings. The amount of the allowance is based on an assessment of credit losses inherent in the loan portfolio (including unfunded credit commitments). The process for determining the amount of the allowance is critical to our financial results and condition. It requires difficult, subjective and complex judgments about the future, including forecasts of economic or market conditions that might impair our borrower's ability to repay their loans. The Company might increase the allowance because of changing economic conditions or unexpected events. The Company's allowance for loan and lease losses was approximately \$5.0 million, or 0.98% of total loans at June 30, 2008.

*Potential Volatility of Deposits*

The Bank's depositors could choose to take their money out of the bank and put it into alternative investments, causing an increase in funding costs and reducing net interest income. Checking, savings and money market account balances can decrease when customers perceive that alternative investments, such as the stock market, as providing a better risk/return tradeoff. When customers move funds out of bank deposits into other investments, the Bank will lose a relatively low cost source of funds, increasing funding costs.

At June 30, 2008, time certificates of deposit in excess of \$100,000 represented approximately 28% of the dollar value of the total deposits of the Company. As such, these deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits could adversely affect the liquidity of the Company, profitability, business prospects, results of operations and cash flows. The Company monitors activity of volatile liability deposits on a quarterly basis.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)***Dividends*

Bank of Commerce Holdings, the parent holding company, is a separate and distinct legal entity from its subsidiaries. The Company conducts no other significant activity than the management of its investment in the Bank and Mortgage Company and as such, the Company is dependent on these subsidiaries for income. The ability of the Bank and Mortgage Company to pay cash dividends in the future depends on the profitability, growth and capital needs of the Bank and Mortgage Company. These dividends are used to pay dividends on common stock and interest and principal on debt. In addition, the California Financial Code restricts the ability of the Bank to pay dividends. No assurance can be given that the Company or the Bank will pay any dividends in the future or, if paid, such dividends will not be discontinued.

*Changes in Accounting Policies or Accounting Standards, and Changes in How Accounting Standards are interpreted or applied, Could Materially Affect How the Company Reports its Financial Results and Condition*

The Company's accounting policies are fundamental to understanding our financial results and condition. Some of these policies require use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Three of our accounting policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amount would be reported under different conditions or using different assumptions (refer to *Critical Accounting Policies* ).

From time to time the Financial Accounting Standards Board ( FASB ) and the SEC change the financial accounting and reporting standards that govern the preparation of financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, SEC, banking regulators and outside auditors) may change or even reverse their previous interpretations or positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond the Company's control, can be hard to predict and could materially impact how we report our financial results and condition. The Company could be required to apply a new or revised standard retroactively or apply an existing standard differently, also retroactively, in each case resulting in restating prior period financial statements.

*Government Regulation and Legislation*

The Company and the Bank are subject to extensive state and federal regulation, supervision and legislation, which govern almost all aspects of the operations of the Company and the Bank. The business of the Company is particularly susceptible to being affected by the enactment of federal and state legislation which may have the effect of increasing or decreasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Such laws are subject to change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds and not for the protection of shareholders of the Company. The Company cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on the business and prospects of the Company, but it could be material and adverse.

Recent high-profile events have resulted in additional regulations. For example, Sarbanes-Oxley limits the types of non-audit services our outside auditors may provide to the company in order to preserve the independence of our auditors. If our auditors were found not to be independent under SEC rules, we could be required to engage new auditors and file new financial statements and audit reports with the SEC.

The Patriot Act which was enacted in the wake of the September 2001 terrorist attacks, requires the Company to implement new or revised policies and procedures related to anti-money laundering, compliance, suspicious activities, currency transaction reports and due diligence on customers. The Patriot Act also requires federal bank regulators to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve a proposed bank acquisition.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

From time to time, Congress considers legislation that could significantly change our regulatory environment, potentially increasing the cost of doing business, limiting activities or affecting the competitive balance among banks, savings associations, credit unions and other financial institutions.

*Certain Ownership Restrictions under California and Federal Law*

Federal law prohibits a person or group of persons acting in concert from acquiring control of a bank holding company unless the FRB has been given 60 days prior written notice of such proposed acquisition and within that time period the FRB has not issued a notice disapproving the proposed acquisition or extending for up to another 30 days, the period during which such a disapproval may be issued. An acquisition may be made before the expiration of the disapproval period if the FRB issues written notice of its intent not to disapprove the action.

Under a rebuttal presumption established by the FRB, the acquisition of more than 10% of a class of voting stock of a bank with a class of securities registered under Section 12 of the Exchange Act (such as the common stock), would, under the circumstances set forth in the presumption, constitute the acquisition of control. In addition, any company would be required to obtain the approval of the FRB under the BHCA, before acquiring 25% (5% in the case of an acquirer that is, or is deemed to be, a bank holding company) or more of the outstanding shares of the Company's common stock, or such lesser number of shares as constitute control. See Regulation and Supervision of Bank Holding Companies in the Company's 2007 Annual Report on Form 10-K.

Under the California Financial Code, no person shall, directly or indirectly, acquire control of a California licensed bank or a bank holding company unless the Commissioner has approved such acquisition of control. A person would be deemed to have acquired control of the Company and the Bank under this state law if such person, directly or indirectly, has the power (i) to vote 25% or more of the voting power of the Company or (ii) to direct or cause the direction of the management and policies of the Company. For purposes of this law, a person who directly or indirectly owns or controls 10% or more of the common stock would be presumed to direct or cause the direction of the management and policies of the Company and thereby control the Company.

*Negative Publicity could Damage our Reputation*

Reputation risk, or the risk to the Company's earnings and capital from negative public opinion, is inherent in the financial services business. Negative public opinion could adversely affect our ability to keep and attract customers and expose us to adverse legal and regulatory consequences. Negative public opinion could result from actual or alleged conduct in any number of activities, including lending practices, corporate governance, acquisitions, and from actions taken by government regulators and community organizations in response to that conduct.

*Environmental Risks*

The Company, in its ordinary course of business, acquires real property securing loans that are in default, and there is a risk that hazardous substance or waste, contaminants or pollutants could exist on such properties. The Company may be required to remove or remediate such substances from the affected properties at its expense, and the cost of such removal or remediation may substantially exceed the value of the affected properties or the loans secured by such properties. Furthermore, the Company may not have adequate remedies against the prior owners or other responsible parties to recover its costs. Finally, the Company may find it difficult or impossible to sell the affected properties either before or following any such removal. In addition, the Company may be considered liable for environmental liabilities concerning its borrowers' properties, if, among other things, it participates in the management of its borrowers' operations. The occurrence of such an event could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.



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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

*Shares Eligible for Future Sale*

As of June 30, 2008, the Company had 8,711,495 shares of Common Stock outstanding, of which 6,012,623 shares are eligible for sale in the public market without restriction and 2,819,975 shares are eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, as amended (the "Securities Act"). Future sales of substantial amounts of the Company's common stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the common stock. In addition, options to acquire 209,485 shares of the issued and outstanding shares of common stock at exercise prices ranging from \$5.42 to \$11.59 have been issued to directors and certain employees of the Company under the Company's 1998 Stock Option Plan. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company's common stock.

*Technology and Computer Systems*

Advances and changes in technology can significantly affect the business and operations of the Company. The Company faces many challenges including the increased demand for providing computer access to bank accounts and the systems to perform banking transactions electronically. The Company's ability to compete depends on its ability to continue to adapt its technology on a timely and cost-effective basis to meet these requirements. In addition, the Company's business and operations are susceptible to negative impacts from computer system failures, communication and energy disruption and unethical individuals with the technological ability to cause disruptions or failures of the Company's data processing systems.

*Company Stock Price may be volatile due to Other Factors*

The Company's stock price can fluctuate widely in response to a variety of factors, in addition to those described above, including:

General business and economic conditions;

Recommendations by securities analysts;

New technologies introduced or services offered by our competitors;

News reports relating to trends, concerns and other issues in the financial services industry;

Natural disasters; and

Geopolitical conditions, such as acts or threats of terrorism or military conflicts.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Executive Overview**

Our Company was established to make a profitable return while serving the financial needs of the communities of our markets. We are in the financial services business, and no line of financial services is beyond our charter as long as it serves the needs of businesses and professionals in our communities. The mission of our Company is to provide its stockholders with a safe, profitable return on their investment, over the long term. Management will attempt to minimize risk to our stockholders by making prudent business decisions, will maintain adequate levels of capital and reserves, and will maintain effective communications with stockholders. Our Company's most valuable asset is its customers. We will consider their needs first when we design our products and services. The *high-quality* customer experience is an important mission of our Company, and how well we accomplish this mission will have a direct influence on our profitability.

Our vision is to embrace changes in the industry and develop profitable business strategies that allow us to maintain our customer relationships and build new ones. Our competitors are no longer just banks. We must compete with financial powerhouses that want our core business. The flexibility provided by the Financial Holding Company Act will become increasingly important. We have developed strategic plans that evaluate additional financial services and products that can be delivered to our customers efficiently and profitably. Producing quality returns is, as always, a top priority.

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

We define risks to include not only credit, market and liquidity risk—the traditional concerns for financial institutions but also operational risks, including risks related to systems, processes or external events, as well as legal, regulatory and reputation risks.

Our management processes, structures and policies help to ensure compliance with laws and regulations and provide clear lines for decision-making and accountability. Results are important, but equally important is how we achieve those results. Our core values and commitment to high ethical standards is material to sustaining public trust and confidence in our Company. 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, 2007, under the heading "Risk Management".

**Sources of Income**

The Company derives its income from two principal sources: (i) net interest income, which is the difference between the interest income it receives on interest-earning assets and the interest expense it pays on interest-bearing liabilities, and (ii) fee income, which includes fees earned on deposit services, income from SBA lending, electronic-based cash management services, mortgage brokerage fee income and merchant credit card processing services. The income of the Bank depends to a great extent on net interest income. These interest rate factors are highly sensitive to many factors, which are beyond the Company's control, including general economic conditions, inflation, recession, and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Because of the Bank's predisposition to variable rate pricing and non-interest bearing demand deposit accounts, the Bank is considered asset sensitive. As a result, the Company is adversely affected by declining interest rates.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

	June 30, 2008	June 30, 2007
<b>Profitability Ratios</b>		
Net Interest Income to Average Assets	3.22%	3.76%
Net Income to Average Equity	9.05%	13.69%
<b>Efficiency Ratio<sup>2</sup></b>	61.09%	60.39%
<b>Capital Ratios</b>		
Leverage Ratio	8.81%	9.74%
Risk Based Capital	\$62,725,450	\$62,286,773
Tier 1 Capital	9.75%	10.79%
Total Capital	10.67%	11.80%
<b>Per Common Share Data</b>		
Dividend Payout Ratio	65.40%	38.75%
Book Value	\$ 5.28	\$ 5.06
Market Price	\$ 6.96	\$ 10.82
High	\$ 11.64	\$ 11.63
Low	\$ 6.00	\$ 10.82

**Financial Highlights Results of Operations**

Net income for the second quarter of 2008 totaled \$906,000, a decrease of 43.3% from the \$1,600,000 reported for the same quarterly period of 2007. On the same basis, diluted earnings per common share for the second quarter of 2008 were \$0.10, compared to \$0.18 for the same period of 2007, a decrease of 44.0%. Return on average assets (ROA) and return on average equity (ROE) for the second quarter of 2008 were 0.56% and 7.71%, respectively, compared with 1.10% and 14.00%, respectively, for the second quarter of 2007.

Net income for the six-month period ended June 30, 2008 totaled \$2,136,000, a decrease of 30.8% over net income of \$3,087,000 reported for the same six-month period ended June 30, 2007. On the same basis, diluted earnings per common share for the six-months ended June 30, 2008 was \$0.24, compared to \$0.34 for the same six-month period in 2007, a 26.0% decrease. ROA was 0.66% and ROE was 9.05% for the first six-months of 2008 compared with 1.07% and 13.69%, respectively, for the same six-month period of 2007.

**Net Interest Income and Net Interest Margin**

Net interest income is the primary source of the Company's income. Net interest income represents the excess of interest and fees earned on interest-earning assets (loans, securities and Federal Funds sold) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets. Net interest income for the quarter ended June 30, 2008 was \$5.05 million compared with \$5.46 million for the same period in 2007, a decrease of 7.6%. Net interest income for the six-months ended June 30, 2008 was \$10.47 million compared with \$10.79 million for the same six-month period in 2007, a decrease of 3.0%.

Average earning assets for the six-months ended June 30, 2008 increased \$76.0 million or 14.2% compared with the same period in the prior year. Average loans, the largest component of average earning assets, increased \$100.8 million or 24.2% on average compared with the prior year period. Average securities including federal funds sold decreased \$23.4 million or 19.7% over the prior period. Investments were sold to fund loan growth. The yield on earning assets decreased to 6.23% for the six-month period ended June 30, 2008 compared to 7.50% for the same period in the prior year.

<sup>2</sup> The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income)

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The decrease is primarily due to multiple interest rate drops during the period.

Average interest-bearing deposits for the six-months ended June 30, 2008 increased \$74.9 million or 16.4% compared with the prior year period. Average non-interest bearing deposits have decreased by \$5.7 million or 7.9% over the prior year six-month period. Average borrowings have increased by \$48.6 million or 112.4% when compared with the prior year period; the increase is directly related to the substantial loan growth and increase in FHLB borrowings to support such growth.

The overall cost of interest-bearing liabilities for the first six-months 2008 was 3.25% compared with 4.10% for the first six-months of 2007. The decreased cost was primarily a result of the drop in interest rates during the period coupled with refinancing of FHLB borrowings at lower interest rates. The net effect of the changes discussed above resulted in a decrease of \$322,000 or 3.0% in net interest income for the six-month period ended June 30, 2008 from the same period in 2007. The net interest margin decreased 60 basis points to 3.42% from 4.02% over the same period a year ago.

**Liquidity**

The objective of liquidity management is to ensure that the Company can efficiently meet the borrowing needs of our customers, withdrawals of our depositors and other cash commitments under both normal operating conditions and under unforeseen and unpredictable circumstances of industry or market stress.

The Asset Liability Management Committee (ALCO) establishes and monitors liquidity guidelines that require sufficient asset-based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. In addition to the immediately liquid resources of cash and due from banks and federal funds sold, asset liquidity is supported by debt securities in the available for sale security portfolio and wholesale lines of credit with the Federal Home Loan Bank and borrowing lines with other financial institutions. Customer core deposits have historically provided the Company with a source of relatively stable and low-cost funds.

The Company's consolidated liquidity position remains adequate to meet short-term and long-term future contingencies. At June 30, 2008, the Company had overnight investments of \$11.6 million and available lines of credit at the Federal Home Loan bank of approximately \$15.0 million, and two federal funds borrowing line with correspondent banks of \$25.0 million.

**Capital Management**

The Company has an active program for managing stockholder capital. Capital is used to fund organic growth, acquisitions, pay dividends and repurchase shares. The objective of effective capital management is to produce above market long-term returns by using capital when returns are perceived to be high and issuing capital when costs are perceived to be low.

Periodically, the Board of Directors authorizes the Company to repurchase shares. Share repurchase announcements are published in press releases and SEC 8-K filings. Typically we do not give any public notice before repurchasing shares. Various factors determine the amount and timing of our share repurchases, including our capital requirements, market conditions and legal considerations. These factors can change at any time and there can be no assurance as to the number of shares repurchased or the timing of the repurchases.

Our policy has been to repurchase shares under the safe harbor conditions of Rule 10b-18 of the Exchange Act including a limitation on the daily volume of repurchases. The Company's potential sources of capital include retained earnings, common and preferred stock issuance and issuance of subordinated debt and trust notes.

The Company and bank are subject to various regulatory capital adequacy requirements as prescribed by the Federal Reserve Bank. Risk-based capital guidelines establish a risk-adjusted ratio relating capital to difference categories of assets and off-balance sheet exposures.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

At June 30, 2008, the Company and Bank were well capitalized under applicable regulatory capital adequacy guidelines.

June 30, 2008	Capital	Actual Ratio	Well Capitalized Requirement	Minimum Capital Requirement
The Company				
Leverage	\$56,934,000	8.68%	n/a	4.0%
Tier 1 Risk-Based	56,934,000	9.68%	n/a	4.0%
Total Risk-Based	62,333,922	10.60%	n/a	8.0%
Redding Bank of Commerce				
Leverage	\$57,325,528	8.81%	5.0%	4.0%
Tier 1 Risk-Based	57,325,528	9.75%	6.0%	4.0%
Total Risk-Based	62,725,450	10.67%	10.00%	8.0%

**Short and Long Term Borrowings**

The Company actively uses Federal Home Loan Bank ( FHLB ) advances as a source of wholesale funding to support growth strategies as well as to provide liquidity. At June 30, 2008, the Company's FHLB advances were a combination of fixed term and variable borrowings without call or put option features.

At June 30, 2008, the Bank had \$95 million in FHLB term advances outstanding at an average rate of 3.50% compared to \$50 million at an average rate of 5.42% at June 30, 2007.

**Provision for Loan and Lease Losses**

The Allowance for Loan and Lease Losses, which consists of the allowance for loan losses, is management's estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Company has established a process using several analytical tools and benchmarks, to calculate a range of probable outcomes and determine the adequacy of the allowance. No single statistic or measurement determines the adequacy of the allowance. Loan recoveries and the provision for credit losses increase the allowance, while loan charge-offs decrease the allowance.

The allowance for loan and lease losses is the Company's *most significant* management accounting estimate. The Company follows a methodology for calculating the appropriate level for the allowance for loan and lease losses as discussed under Asset Quality and Allowance for Loan and Lease Losses (ALLL) in this document. The entire allowance is used to absorb credit losses inherent in the loan portfolio. The allowance includes an amount for imprecision or uncertainty to incorporate a range of probable outcomes inherent in estimates used for the allowance, which may change from period to period. This portion of the total allowance is the results of the Company's judgment of risks inherent in the portfolio, economic uncertainties, historical loss experience and other subjective factors, including industry trends. The methodology used is refined to calculate a portion of the allowance for each portfolio type to reflect our view of the risk in these portfolios.

Changes in the estimate of the allowance for loan and lease losses and the related provision expense can materially affect net income. Determining the allowance for loan and lease losses requires management to make forecasts of losses that are highly uncertain and require a high degree of judgment.

Provision for loan and lease losses of \$1,600,000 were provided for the six-months ended June 30, 2008 compared with \$6,000 for the same period of 2007. The Company's allowance for loan and lease losses was 0.98% of total loans at June 30, 2008 and 1.12% at June 30, 2007, while its ratio of non-performing assets to total assets was 2.88% at June 30, 2008, compared to 2.01% at December 31, 2007 and 0.00% at June 30, 2007. Provisions have increased due to weakening economic conditions, the continued downturn in housing and higher loan charge-offs during the period.



**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Factors that may affect future results**

As a financial services company, our earnings are significantly affected by general business and economic conditions. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and local economies in which we operate. For example, an economic downturn, increase in unemployment, or other events that negatively impact household and/or corporate incomes could decrease the demand for the Company's loan and non-loan products and services and increase the number of customers who fail to pay interest or principal on their loans. Geopolitical conditions can also affect our earnings. Acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and our military conflicts including the aftermath of the war with Iraq, could impact business conditions in the United States.

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part our cost of funds for lending and investing and the return we earn on those loans and investments, both of which impact our net interest margin, and can materially affect the value of financial instruments we hold. Its policies can also affect our borrowers, potentially increasing the risk of failure to repay their loans. Changes in Federal Reserve Board policies are beyond our control and hard to predict or anticipate.

We operate in a highly competitive industry that could become even more competitive because of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can now merge creating a financial holding company that can offer virtually any type of financial service, including banking, securities underwriting, insurance (agency and underwriting) and merchant banking. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and some have lower cost structures.

The holding company, subsidiary bank and non-bank subsidiary are heavily regulated at the federal and state levels. This regulation is to protect depositors, federal deposit insurance funds and the banking system as a whole, not investors. Congress and state legislatures and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies including changes in interpretation and implementation could affect us in substantial and unpredictable ways including limiting the types of financial services and products we may offer. Our failure to comply with the laws, regulations or policies could result in sanctions by regulatory agencies and damage our reputation. For more information, refer to the "Supervision and Regulation" section in the Company's 2007 Annual Report on Form 10-K.

Our success depends, in part, on our ability to adapt our products and services to evolving industry standards. There is increasing pressure on financial services companies to provide products and services at lower prices. This can reduce our net interest margin and revenues from fee-based products and services. In addition, the widespread adoption of new technologies, including internet-based services, could require us to make substantial expenditures to modify or adapt our existing products and services. Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people can be intense.

The holding company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenues from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the holding company's common stock and interest and principal on its debt. Various federal and state laws and regulations limit the amount of dividends that our bank may pay to the holding company. For more information, refer to "Dividends and Other Distributions" in the Company's 2007 Annual Report on Form 10-K.

**Critical Accounting Policies**

The Securities and Exchange Commission (SEC) issued disclosure guidance for critical accounting policies. The SEC defines critical accounting policies as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods.





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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

Our accounting policies are integral to understanding the results reported. Accounting policies are described in detail in Note 2 of the NOTES TO CONSOLIDATED FINANCIAL STATEMENTS in the Company's 2007 Annual Report on Form 10-K. Not all of the significant accounting policies presented in Note 2 to the Consolidated Financial Statements contained in the Company's 2007 Annual Report on Form 10-K require management to make difficult, subjective or complex judgments or estimates.

*Preparation of financial statements*

The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses. On an ongoing basis, management evaluates the estimates used. Estimates are based upon historical experience, current economic conditions and other factors that management considers reasonable under the circumstances.

*Use of estimates*

These estimates result in judgments regarding the carrying values of assets and liabilities when these values are not readily available from other sources, as well as assessing and identifying the accounting treatments of contingencies and commitments. Actual results may differ from these estimates under different assumptions or conditions.

*Accounting Principles Generally Accepted in the United States of America*

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Company's significant accounting policies are presented in Note 2 to the Consolidated Financial Statements contained in the Company's 2007 Annual Report on Form 10-K.

The Company follows accounting policies typical to the commercial banking industry and in compliance with various regulations and guidelines as established by the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA) and the Bank's primary federal regulator, the Federal Deposit Insurance Corporation (FDIC). The following is a brief description of the Company's current accounting policies involving significant management judgments.

*Allowance for Loan and Lease Losses (ALLL)*

The allowance for loan and lease losses is the Company's most significant management accounting estimate. The allowance for loan and lease losses is management's best estimate of the probable losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting. (1) SFAS No.5 which requires that losses be accrued when they are probable of occurring and estimable and (2) SFAS No. 114, which requires that losses on impaired loans be accrued based on the differences between that value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The Company's allowance for loan and lease losses is the accumulation of various components that are calculated based upon independent methodologies. All components of the allowance for loan losses represent an estimation performed pursuant to Statement of Financial Accounting Standards (SFAS) Statement No. 5, *Accounting for Contingencies* or SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*. Management's estimate of each SFAS No. 5 component is based on certain observable data that management believes is the most reflective of the underlying credit losses being estimated. Changes in the amount of each component of the allowance for loan losses are directionally consistent with changes in the observable data, taking into account the interaction of the SFAS No. 5 components over time.

An essential element of the methodology for determining the allowance for loan and lease losses is the Company's credit risk evaluation process, which includes credit risk grading individual, commercial, construction, commercial real estate, and consumer loans. Loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

That process includes reviewing borrower's current financial information, historical payment experience, credit documentation, public information, and other information specific to each individual borrower. Loans are reviewed on an annual or rotational basis and/or as management become aware of information affecting the borrower's ability to fulfill its obligations. Credit risk grades carry a dollar weighted risk percentage.

For individually impaired loans, SFAS No. 114 provides guidance on the acceptable methods to measure impairment. Specifically, SFAS No. 114 states that when a loan is impaired, we measure impairment based on the present value of expected future principal and interest cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price or the fair value of collateral, if the loan is collateral dependent. When developing the estimate of future cash flows for a loan, we consider all available information reflecting past events and current conditions, including the effect of existing environmental factors. In addition to the ALLL, an allowance for unfunded loan commitments and letters of credit is determined using estimates of the probability of funding. This reserve is carried as a liability on the consolidated balance sheet.

*Revenue recognition*

The Company's primary source of revenue is interest income. Interest income is recorded on an accrual basis. Note 2 to the Consolidated Financial Statements contained in the Company's 2007 Annual Report on Form 10-K offers an explanation of the process for determining when the accrual of interest income is discontinued on an impaired loan.

*Stock-based Compensation*

Statement of Financial Accounting Standards No. 123 (revised 2004); ***Accounting for Stock Based Compensation*** was adopted by the Company as of January 1, 2006, using the modified prospective transition method. Under the modified prospective transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards, for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under Statement No. 123 for either recognition or pro forma disclosures.

The amount of the reduction for the fiscal years 2005 through 2007 is disclosed in Note 13 to the Consolidated Financial Statements contained in the Company's 2007 Annual Report on Form 10-K, based upon the assumptions listed therein. Accounting principles generally accepted in the United States of America (GAAP), itself may change over time, having impact over the reporting of the Company's financial activity. Although the economic substance of the Company's transactions would not change, alterations in GAAP could affect the timing or manner of accounting or reporting.

*Income Taxes*

The Company files a consolidated federal and state income tax return. The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If future income should prove non-existent or less than the amount of deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced. The Company's deferred tax assets are described further in Note 12 of the Notes to Consolidated Financial Statements in the Company's 2007 Annual Report on Form 10-K.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The following table presents the Company's daily average balance sheet information together with interest income and yields earned on average interest-bearing assets and interest expense and rates paid on average interest-bearing liabilities. Average balances are average daily balances.

**Table 1. Average Balances, Interest Income/Expense and Yields/Rates Paid**  
(Unaudited, Dollars in thousands)

	Average Balance	Six Months Ended June 30, 2008		Six Months Ended June 30, 2007		Yield/ Rate
		Interest	Yield/ Rate	Average Balance	Interest	
<b>Earning Assets</b>						
Portfolio Loans	\$ 516,938	\$ 17,302	6.69%	\$ 416,141	\$ 17,429	8.38%
Tax-exempt Securities	30,402	576	3.79%	30,548	612	4.01%
US Government Securities	45,561	1,014	4.45%	72,937	1,648	4.52%
Federal Funds Sold	17,561	148	1.69%	14,823	390	5.26%
Other Securities	2,000	45	4.50%	2,000	45	4.50%
<b>Average Earning Assets</b>	<b>\$ 612,462</b>	<b>\$ 19,085</b>	<b>6.23%</b>	<b>\$ 536,449</b>	<b>\$ 20,124</b>	<b>7.50%</b>
<b>Assets</b>						
Cash & Due From Banks	\$ 13,252			\$ 13,473		
Bank Premises	11,264			9,742		
Allowance for Loan and Lease Losses	( 5,946)			( 4,890)		
Other Assets	17,745			19,690		
<b>Average Total Assets</b>	<b>\$ 648,777</b>			<b>\$ 574,464</b>		
<b>Interest Bearing Liabilities</b>						
Demand Interest Bearing	\$ 132,543	\$ 1,248	1.88%	\$ 110,668	\$ 1,144	2.07%
Savings Deposits	48,987	650	2.65%	35,957	526	2.93%
Certificates of Deposit	229,245	4,614	4.03%	213,721	5,232	4.90%
Repurchase Agreements	12,925	119	1.84%	37,064	723	3.90%
FHLB Borrowings	91,869	1,512	3.29%	43,260	1,171	5.41%
Trust Preferred Borrowings	15,000	476	6.35%	15,000	540	7.20%
<b>Average Interest Bearing Liabilities</b>	<b>530,569</b>	<b>\$ 8,619</b>	<b>3.25%</b>	<b>455,670</b>	<b>\$ 9,336</b>	<b>4.10%</b>
<b>Non interest Demand Other Liabilities</b>						
Non interest Demand	66,606			72,321		
Other Liabilities	4,391			1,370		
Shareholder Equity	47,211			45,103		
<b>Average Liabilities and Stockholders Equity</b>	<b>\$ 648,777</b>			<b>\$ 574,464</b>		

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Net Interest Income and Net Interest Margin	\$ 10,466	3.42%	\$ 10,788	4.02%
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Interest income on loans includes fee income of approximately \$10,610 and \$135,554 for the period ended June 30, 2008 and 2007, respectively.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The following tables set forth changes in interest income and expense for each major category of earning assets and interest-bearing liabilities, and the amount of change attributable to volume and rate changes for the periods indicated. Changes attributable to rate/volume have been allocated to volume changes.

**Table 2. Analysis of Changes in Net Interest Income and Interest Expense  
(Unaudited)**

	June 30, 2008 Volume	over Rate	June 30, 2007 Total
(Dollars in thousands)			
Increase(Decrease) In Interest Income			
Portfolio Loans	\$ 3,374	\$ (3,501)	\$ (127)
Tax-exempt Securities	(3)	(33)	(36)
US Government Securities	(609)	(25)	(634)
Federal Funds Sold	23	(265)	(242)
Other Securities	0	0	0
<b>Total Increase</b>	<b>\$ 2,785</b>	<b>\$ (3,824)</b>	<b>\$ (1,039)</b>
Increase(Decrease) In Interest Expense			
Interest Bearing Demand	\$ 206	\$ (102)	\$ 104
Savings Deposits	173	(49)	124
Certificates of Deposit	312	(930)	(618)
Repurchase Agreements	(222)	(382)	(604)
FHLB Borrowings	800	(459)	341
Trust Preferred Borrowings	0	(64)	(64)
<b>Total Increase</b>	<b>\$ 1,269</b>	<b>\$ (1,986)</b>	<b>\$ (717)</b>
<b>Net Increase</b>	<b>\$ 1,516</b>	<b>\$ (1,838)</b>	<b>\$ (322)</b>

Average earning assets for the six-months ended June 30, 2008 increased \$76.0 million or 14.2% compared with the same period in the prior year. Average loans, the largest component of average earning assets, increased \$100.8 million or 24.2% on average compared with the prior year period. Average securities including federal funds sold decreased \$24.8 million or 21.0% over the prior period. Investments were sold to fund loan growth. The yield on earning assets decreased to 6.23% for the six-month period ended June 30, 2008 compared to 7.50% for the same period in the prior year.

The decrease is primarily due to multiple interest rate drops during the period.

Average interest-bearing liabilities for the six-months ended June 30, 2008 increased \$74.9 million or 16.4% compared with the prior year period. Average non-interest bearing deposits have decreased by \$5.7 million or 7.9% over the prior year six-month period. Average borrowings have increased by \$48.6 million or 112.4% when compared with the prior year period; the increase is directly related to the substantial loan growth and increase in FHLB borrowings to support such growth.

The overall cost of interest-bearing liabilities for the first six-months 2008 was 3.25% compared with 4.10% for the first six-months of 2007. The decreased cost was primarily a result of the drop in interest rates during the period

coupled with refinancing of FHLB borrowings at lower interest rates. The net effect of the changes discussed above resulted in a decrease of \$322,000 or 3.0% in net interest income for the six-month period ended June 30, 2008 from the same period in 2007. The net interest margin decreased 60 basis points to 3.42% from 4.02% over the same period a year ago.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Noninterest Income**

The Company's non-interest income consists of service charges on deposit accounts, other fee income, processing fees for credit card payments and gains or losses on security sales. The following table sets forth a summary of noninterest income for the periods indicated.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Noninterest income				
Service charges on deposit accounts	\$ 50	\$ 76	\$ 112	\$ 145
Payroll and benefit processing fees	99	89	228	197
Earnings on cash surrender value - Bank owned insurance	85	99	168	194
Net gain on sale of securities available-for-sale	194	0	436	46
Net loss on sale of derivative swap transaction	0	0	(225)	0
Merchant credit card service income, net	97	96	180	188
Mortgage brokerage fee income	5	29	15	35
Other Income	187	229	368	311
Total Noninterest income	\$ 717	\$ 618	\$ 1,282	\$ 1,116

Noninterest income increased \$99,000 or 16.0% for the quarter ended June 30, 2008 over June 30, 2007. The increase is primarily related to gains on available-for-sale investment securities that were sold during the period to fund loan growth.

Noninterest income increased \$166,000 or 14.9% for the six-months ended June 30, 2008 over June 30, 2007. The increase for the six-month period is related to the aforementioned gains less a loss on the sale of a SWAP during the period.

**Noninterest Expense**

(Dollars in Thousands)	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Noninterest Expense				
Salaries and related benefits	\$ 1,892	\$ 1,959	\$ 3,841	\$ 4,056
Occupancy and equipment expense	640	543	1,284	1,001
FDIC insurance premium	113	13	171	26
Data processing fees	65	90	143	145
Professional service fees	133	252	251	447
Payroll and Benefit fees	27	25	60	56
Deferred compensation expense	113	101	224	198
Stationery and Supplies	80	46	142	107
Postage	38	34	72	67



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Directors' expense	94	76	142	121
Other expenses	418	562	847	965
Total Noninterest expense	\$ 3,613	\$ 3,701	\$ 7,177	\$ 7,189

Noninterest expense for the quarter ended June 30, 2008 was \$3.6 million, a decrease of \$88,000 or 2.4% over the same period a year ago. The decrease is primarily related to lower professional fees in relation to new branding marketing campaigns in 2007 and tightened control over other expenditures.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

Non-interest expense for the six-months ended June 30, 2008 was \$7.2 million compared to \$7.2 million in the same period a year ago, an modest decrease of \$12,000 or 0.17% over the same six-month period a year ago.

**Income Taxes**

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using currently enacted tax rates applied to such taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company's effective tax rate varies with changes in the relative amounts of its non-taxable income and non-deductible expenses. The decrease in the Company's tax provision is attributable to increases in non-taxable income related to a reduction in the municipal security portfolio and reclassification of enterprise zone qualified credits. The principal difference between statutory tax rates and the Company's effective tax rate is the benefit derived from key life proceeds, investing in tax-exempt securities and preferential state tax treatment for qualified enterprise zone loans.

During 2007, the Company has participated in a California Affordable Housing project which affords federal and state tax credits.

The following table reflects the Company's tax provision and the related effective tax rate for the periods indicated.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Income Taxes				
Tax provision	\$ 244	\$ 778	\$ 835	\$ 1,622
Effective tax rate	21.20%	32.72%	28.11%	34.44%

The Company's provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to the Company's net income before taxes. Increases and decreases in the provision for taxes reflect changes in the Company's net income before tax, and takes into consideration strategies to increase tax exempt income and tax credits.

On January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods and disclosure and transition issues. The Company has analyzed filing positions of federal and state jurisdictions, as well as all open tax years in these jurisdictions. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to FIN 48. In addition, the Company did not record a cumulative effect adjustment related to the adoption of FIN 48.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The Company has a deferred tax asset of \$4.0 million for the six months ended June 30, 2008. The Company does not reasonably estimate that the unrecognized tax benefit will change significantly within the next twelve months. Deferred tax assets are recognized subject to management judgment that realization is more likely than not. The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company files a consolidated federal and state income tax return. The Company determines deferred income tax assets and liabilities using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between book and tax basis of assets and liabilities, and recognizes enacted changes in tax rates and laws.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2008 consist of the following:

	June 30, 2008	June 30, 2007
Deferred Tax Assets		
State Franchise taxes	(87,095)	133,741
Deferred compensation	2,078,634	1,833,076
Loan loss reserves	2,284,938	2,005,505
Other Comprehensive Income	633,449	1,312,265
Other	(37,979)	383,764
<b>Total Deferred Tax Assets</b>	<b>4,871,947</b>	<b>5,668,351</b>
Deferred Tax Liabilities		
Depreciation	(132,760)	(90,171)
Deferred loan origination costs	(466,348)	(491,421)
Deferred state taxes	(316,661)	(265,455)
Other	0	(158,240)
<b>Total Deferred Tax Liabilities</b>	<b>(915,769)</b>	<b>(1,005,287)</b>
<b>Total Net Deferred Tax Asset</b>	<b>\$ 3,956,178</b>	<b>\$ 4,663,064</b>

**Asset Quality**

The Company concentrates its lending activities primarily within El Dorado, Placer, Sacramento, Shasta, Tehama, Sutter and Yuba counties, California, and the location of the Bank's five full services branches, specifically identified as Upstate California. The Company manages its credit risk through diversification of its loan portfolio and the application of underwriting policies and procedures and credit monitoring practices.

Although The Company has a diversified loan portfolio, a significant portion of its borrowers' ability to repay the loans is dependent upon the professional services, commercial real estate market and the residential real estate development industry sectors. Generally, the loans are secured by real estate or other assets located in California and are expected to be repaid from cash flows of the borrower or proceeds from the sale of collateral.

The Company's dependence on real estate increases the risk of loss in the loan portfolio of the Company and its holdings of other real estate owned as economic conditions in California continue to deteriorate in the future.

Deterioration of the real estate market in California has had an adverse effect on the Company's business, financial condition and results of operations. The recent slowdown in residential development and construction markets has led to an increase in nonperforming loans which has made it prudent to strengthen our reserve position at this time.

Management has taken cautious steps to ensure the proper funding of loan reserves. Credit quality, expense control and the bottom line remain top focus. The most significant factors impacting the financial sector originated in the U.S. residential real estate markets. A number of larger institutions have announced significant losses. These losses stemmed from securities collateralized with sub-prime mortgages and other troubled assets. It is important to note that *Redding Bank of Commerce does not originate or hold sub-prime loans, nor do we hold collateralized debt obligations or asset backed securities backed by sub-prime loans in our securities portfolio.* However, as a lending institution, we are not immune to the residential real estate slowdown.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The following table sets forth the amounts of loans outstanding by category as of the dates indicated:

	June 30, 2008	December 31, 2007
Portfolio Loans		
Commercial and financial loans	\$ 176,680	\$ 173,704
Real estate-construction loans	88,037	106,977
Real estate-commercial	189,762	175,013
Real estate-mortgage	20,443	10,787
Real estate-other	35,367	26,818
Installment	128	226
Other loans	2,453	1,223
Less:		
Net deferred loan fees	(202)	(232)
Allowance for loan losses	(5,017)	(8,233)
Total net loans	\$ 507,651	\$ 486,283

The Company's practice is to place an asset on nonaccrual status when one of the following events occur: (i) any installment of principal or interest is 90 days or more past due (unless in management's opinion the loan is well secured and in the process of collection). (ii) Management determines the ultimate collection of principal or interest to be unlikely or (iii) the terms of the loan have been renegotiated due to a serious weakening of the borrower's financial condition. Nonperforming loans are loans that are on nonaccrual, are 90 days past due and still accruing or have been restructured.

The portfolio mix reflects increases in production in commercial and financial loans, commercial real estate, other real estate, and the all other category. Construction and development loans have declined significantly, representing 17.3% of the portfolio compared to 22.0% at December 31, 2007.

Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due and payable. The Bank had outstanding balances of \$18.9 and \$12.4 in impaired loans that had impairment allowances of \$400,000 and \$242,285 as of June 30, 2008 and December 31, 2007, respectively.

The following table sets forth a summary of the Company's nonperforming assets as of the dates indicated:

(Dollars in thousands)	June 30, 2008	December 31, 2007
Non performing assets		
Nonaccrual loans	\$ 18,870	\$ 12,409
90 days past due and still accruing interest	0	0
Total nonaccrual loans	18,870	12,409
Other Real Estate Owned	0	0
Total non performing assets	\$ 18,870	\$ 12,409

The Company's OREO remained at \$0 through the second quarter of 2008 and 2007. Management has taken aggressive action by placing two real estate development related loans into nonaccrual status. In addition, an

impairment review of one Sacramento development loan has resulted in a \$3.0 million write-down during the first quarter 2008. Reserves were previously allocated in anticipation of this impairment review. Additional aggressive actions include write-downs of \$1.8 million during the second quarter 2008.

Material future additions to the allowance for loan losses might be necessary if material adverse changes in economic conditions occur and the performance of the loan portfolio of the Company deteriorates. Future additions to the Company's allowance for loan and lease losses may also be required in order to reflect changes in the markets for real estate in which the Company's real estate related portfolios are located and other factors which may result in adjustments which are necessary to ensure that the Company's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties. Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Company's allowance for loan and lease losses and the carrying value of its assets. The Bank was most recently examined by the FDIC in this regard during the second quarter of 2008. No adjustments were made to management's estimates for the allowance for loan and lease losses during the examination. Non-performing loans were 3.67% of total loans as of June 30, 2008 compared to 2.55% at December 31, 2007 and 0% one year ago.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Allowance for Loan and Lease Losses (ALLL)**

The allowance for loan and lease losses is management's estimate of the amount of probable loan losses in the loan portfolio. The Company determines the allowance for loan losses based on an ongoing evaluation. The evaluation is inherently subjective because it requires material estimates, including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The Company makes provisions to the ALLL on a regular basis through charges to operations that are reflected in the Company's statements of income as a provision for loan losses. When a loan is deemed uncollectible, it is charged against the allowance. Any recoveries of previously charged-off loans are credited back to the allowance. There is no precise method of predicting specific losses or amounts that ultimately may be charged-off on particular categories of the loan portfolio. Material future additions to the allowance for loan losses might be necessary if material adverse changes in economic conditions occur and the performance of the loan portfolio of the Company deteriorates. Future additions to the Company's allowance for loan and lease losses may also be required in order to reflect changes in the markets for real estate in which the Company's real estate related portfolios are located and other factors which may result in adjustments which are necessary to ensure that the Company's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties.

Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Company's allowance for loan and lease losses and the carrying value of its assets. The Bank was most recently examined by the FDIC in this regard during the second quarter of 2008. No adjustments were made to management's estimates for the allowance for loan and lease losses during the examination.

The Company's allowance for loan and lease losses is the accumulation of various components that are calculated based upon independent methodologies. All components of the allowance for loan losses represent an estimation performed pursuant to SFAS No. 5, *Accounting for Contingencies* or SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*. Management's estimate of each SFAS No. 5 *Accounting for Contingencies* component is based on certain observable data that management believes is the most reflective of the underlying loan losses being estimated. Changes in the amount of each component of the allowance for loan losses are directionally consistent with changes in the observable data, taking into account the interaction of the SFAS No. 5 components over time.

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

The ALLL is a general reserve available against the total loan portfolio. It is maintained without any inter-allocation to the categories of the loan portfolio, and the entire allowance is available to cover loan losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination. Accordingly, it is not possible to predict the effect future economic trends may have on the level of the provision for loan losses in future periods. In addition to the ALLL, an allowance for unfunded loan commitments and letters of credit is determined using estimates of the probability of funding. This reserve is carried as a liability on the condensed consolidated balance sheet.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The ALLL should not be interpreted as an indication that charge-offs in future periods will occur in the stated amounts or proportions.

The following table summarizes the activity in the ALLL reserves for the periods indicated.

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Allowance for Loan Losses				
Beginning balance for Loan Losses	\$ 5,815	\$ 4,933	\$ 8,233	\$ 4,904
Provision for Loan Losses	1,000	0	1,600	6
Charge offs:				
Commercial	(733)	(0)	(733)	(0)
Real Estate	(1,067)	(0)	(4,087)	(0)
Other	(0)	(0)	(0)	(0)
Total Charge offs	(1,800)	(0)	(4,820)	(0)
Recoveries:				
Commercial	0	9	0	30
Real Estate	0	0	0	0
Other	2	1	4	3
Total Recoveries	2	10	4	33
Ending Balance	\$ 5,017	\$ 4,943	\$ 5,017	\$ 4,943
ALLL to total loans	0.98%	1.11%	0.98%	1.12%
Net Charge offs to average loans	0.35%	0.00%	0.93%	0.00%

The allowance for loan and lease losses, including unfunded commitments, totaled \$5.0 million at June 30, 2008 compared to \$8.2 million at December 31, 2008 and \$4.9 million at June 30, 2007. The Company's allowance for loan losses was 0.98% of total loans at June 30, 2008 and 1.12% at June 30, 2007. Provisions for loan losses for the quarter ended June 2008 were \$1,000,000 compared to \$6,000 for the same quarter in 2007. Provision for loan and lease losses of \$1,600,000 were provided for the six-months ended June 30, 2008 compared with \$6,000 for the same six-month period of 2007.

The Company continues to be aggressive in identifying non-performing assets. Since the beginning of the fourth quarter 2007, the Company has provided \$4.6 million in provisions for loan and lease losses. Elevated provisions are associated with a reclassification of loans, following completion of a total portfolio review, and management's aggressive stance in recognizing impaired loans.

Impairment reviews have resulted in write-downs of \$1.8 million during the second quarter 2008, and \$4.8 million during the first six months of 2008. These write-downs are largely related with two non-performing residential tract sub-divisions which have been in non accrual status since year end 2007.

The Company's ratio of non-performing assets to total assets was 2.88% at June 30, 2008, compared to 2.01% at December 31, 2007 and 0.00% at June 30, 2007. During the first week in July, one non-performing loan in the amount of \$3.4 million was resolved.



The Company's OREO remained at \$0 through the first half of 2008 and 2007. The capital ratios of Redding Bank of Commerce continue to be above the well-capitalized guidelines established by bank regulatory agencies.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Securities Portfolio**

The Company's available-for-sale securities consists of both debt and marketable equity securities. The portfolio is comprised of U.S. Treasury securities, U.S. Agency securities, mortgage-backed securities, and obligations of states and political subdivisions. Securities classified as available-for-sale are recorded at fair value. Unrealized gains and losses, after applicable income taxes, are reported in cumulative other comprehensive income. The Company uses the most current quotations to estimate the fair value of these securities.

Securities classified as held-to-maturity are recorded at cost. Portions of the securities portfolio are used for pledging requirements for deposits of state and local subdivisions, securities sold under repurchase agreements, and FHLB advances.

The Company does not include federal funds sold as securities. These investments are included in cash and cash equivalents. Debt securities in the securities available-for-sale portfolio provide asset liquidity, in addition to the immediately liquid resources of cash and due from banks and federal funds sold.

Total available-for-sale securities decreased \$1,178,000 or 1.7% at June 30, 2008 compared to December 31, 2007. As of June 30, 2008, the Company has pledged a total of \$63.4 million of securities for treasury, tax and loan accounts; public funds collateral; collateralized repurchase agreements and Federal Home Loan Bank borrowings.

The following table summarizes the amortized cost of the Company's available-for-sale securities held on the dates indicated.

*(Dollars in thousands)*

	Amortized Costs	as of June 30, 2008		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. government & agencies	\$ 13,012	\$ 0	\$ (226)	\$ 12,786
Obligations of state and political subdivisions	22,193	38	(476)	21,755
Mortgage backed securities	30,961	10	(775)	30,196
Other securities	2,000	0	(9)	1,991
<b>Total</b>	<b>\$ 68,166</b>	<b>\$ 48</b>	<b>\$ (1,486)</b>	<b>\$ 66,728</b>

*(Dollars in thousands)*

	Amortized Costs	as of December 31, 2007		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
U.S. government & agencies	\$ 15,989	\$ 26	\$ (104)	\$ 15,911
Obligations of state and political subdivisions	19,017	28	(263)	18,782
Mortgage backed securities	31,638	10	(354)	31,294
Corporate Bonds	2,000	0	(81)	1,919
<b>Total</b>	<b>\$ 68,644</b>	<b>\$ 64</b>	<b>\$ (802)</b>	<b>\$ 67,906</b>

Economic factors may affect market pricing over the stated maturity of the security. The unrealized losses associated with securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. Security income is accrued when earned and included in interest income.



**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

The following table presents the current fair value and associated unrealized losses on available-for-sale and held-to-maturity investments with unrealized losses at June 30, 2008. The table also discloses whether these securities have had unrealized losses for less than 12 months or for 12 months or longer.

	<b>Less than 12 months</b>		<b>12 months or more</b>		<b>Total</b>	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and Obligations of U. S. Agencies	\$ 12,785,725	(\$ 225,950)	\$ 0	\$ 0	\$ 12,785,725	(\$ 225,950)
Obligations of state and political subdivisions	\$ 21,230,777	(\$ 518,464)	\$ 909,805	(\$ 96,023)	\$ 22,140,582	(\$ 614,487)
Mortgage-backed securities	\$ 22,111,834	(\$ 474,047)	\$ 7,435,534	(\$ 331,422)	\$ 29,547,368	(\$ 805,469)
Corporate Bonds	\$ 0	\$ 0	\$ 1,991,577	(\$ 8,470)	\$ 1,991,577	(\$ 8,470)
Total temporarily impaired securities	\$ 56,128,336	(\$ 1,218,461)	\$ 10,336,916	(\$ 435,915)	\$ 66,465,252	(\$ 1,654,376)

Economic factors may affect market pricing over the stated maturity of the security. The unrealized losses associated with securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. Security income is accrued when earned and included in interest income. The Company requires a credit rating of A or higher on its initial acquisition of investments and maintains an average rating of AA on the overall securities portfolio.

Management has evaluated each security in an unrealized loss position to determine if the impairment is other-than-temporary. Management has determined that no security is other than temporarily impaired. The unrealized losses are due to interest rate changes and the Company has the ability and intent to hold all securities with identified impairments to the earlier of the forecasted recovery or the maturity of the underlying security.

**Table of Contents****BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Quarterly Income Statement June 30, 2008, March 31, 2008, December 31, 2007 and September 2007**

	June 30, 2008	March 31, 2008	December 31, 2007	September 30, 2007
<i>Dollars in thousands, except for per share data</i>				
Interest income:				
Interest and fees on loans	\$ 8,171	\$ 9,131	\$ 9,355	\$ 9,350
Interest on tax-exempt securities	302	274	293	324
Interest on U.S. government securities	533	481	639	798
Interest on federal funds sold and securities purchased under agreements to resell	90	58	101	190
Interest on other securities	23	22	23	22
Total interest income	9,119	9,966	10,411	10,684
Interest expense:				
Interest on demand deposits	498	750	800	791
Interest on savings deposits	360	290	331	359
Interest on certificates of deposit	2,238	2,376	2,637	2,702
Securities sold under repurchase agreements	35	84	165	289
Interest on FHLB and other borrowings	781	731	623	628
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	161	315	271	274
Total interest expense	4,073	4,546	4,827	5,043
Net interest income	5,046	5,420	5,584	5,641
Provision for loan and lease losses	1,000	600	3,170	115
Net interest income after provision for loan and lease losses	4,046	4,820	2,414	5,526
Noninterest income:				
Service charges on deposit accounts	50	62	63	70
Payroll and benefit processing fees	99	129	212	90
Earnings on cash surrender value - Bank owned life insurance	85	83	96	100
Life insurance policy benefits	0	0	2,437	0
Net gain on sale of securities available-for-sale	194	242	0	0
Net loss on sale of derivative swap transaction	0	(225)	0	0
Merchant credit card service income, net	97	83	91	109
Mortgage brokerage fee income	5	10	0	21
Other income	187	181	(6)	136
Total noninterest income	717	565	2,893	526
Noninterest expense:				

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Salaries and related benefits	1,892	1,949	2,208	2,402
Occupancy and equipment expense	640	644	737	635
FDIC insurance premium	113	58	12	13
Data processing fees	65	78	169	82
Professional service fees	133	118	365	216
Payroll processing fees	27	33	27	25
Deferred compensation expense	113	111	108	105
Stationery and supplies	80	62	116	34
Postage	38	34	32	39
Directors expense	94	48	105	86
Other expenses	418	430	649	391
Total noninterest expense	3,613	3,565	4,528	4,028
Income before provision for income taxes	1,150	1,820	779	2,024
Provision for income taxes	244	591	(910)	693
Net income	\$ 906	\$ 1,229	\$ 1,689	\$ 1,331
Basic earnings per share	\$ 0.10	\$ 0.14	\$ 0.19	\$ 0.15
Weighted average shares basic	8,748	8,719	8,755	8,904
Diluted earnings per share	\$ 0.10	\$ 0.14	\$ 0.19	\$ 0.15
Weighted average shares diluted	8,751	8,748	8,802	8,929
Cash dividends per share	\$ 0.08	\$ 0.08	\$ 0.08	\$ 0.08

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Market risk is the risk that values of assets and liabilities or revenues will be adversely affected by changes in market conditions such as market movements. The risk is inherent in the financial instruments associated with our operations and activities including loans, deposits, securities, short-term borrowings, long-term debt and derivatives.

Market-sensitive assets and liabilities are generated through loans and deposits associated with our banking business, our Asset Liability Management ( ALM ) process, and credit risk mitigation activities. Traditional loan and deposit products are reported at amortized cost for assets or the amount owed for liabilities. These positions are subject to changes in economic value based on varying market conditions. Interest rate risk is the effect of changes in economic value of our loans and deposits, as well as our other interest rate sensitive instruments and is reflected in the levels of future income and expense produced by these positions versus levels that would be generated by current levels of interest rates. We seek to mitigate interest rate risk as part of the ALM process.

Interest rate risk, which potentially can have a significant earnings impact, is an integral part of financial services. The Company is subject to interest rate risk for the following reasons:

Assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates fall, earnings will initially decline);

Assets and liabilities may reprice at the same time but by different amounts (for example, the level of interest rates in the market is falling and the Company may reduce rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market rates);

Short-term and long-term market interest rates may change by different amounts (for example, the shape of the yield curve may affect new loan yields and funding costs differently); or

The remaining maturities of various assets and liabilities may shorten or lengthen as interest rates change (for example, if long-term mortgage rates decline sharply, mortgage-backed securities held in the securities available-for-sale may prepay significantly earlier than anticipated, which could reduce portfolio income.)

Our overall goal is to manage interest rate sensitivity so that movements in interest rates do not adversely affect net interest income. Interest rates risk is measured as the potential volatility in our net interest income caused by changes in market interest rates. Lending and deposit taking create interest rate sensitive positions on our balance sheet.

Interest rate risk from these activities as well as the impact of ever changing market conditions is mitigated using the ALM process. The Company does not operate a trading account and does not hold a position with exposure to foreign currency exchange or commodities. The Company faces market risk through interest rate volatility.

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

The simulation model used includes measures of the expected repricing characteristics of administered rate (NOW, savings and money market accounts) and non-related products (demand deposit accounts, other assets and other liabilities). These measures recognize the relative sensitivity of these accounts to changes in market interest rates, as demonstrated through current and historical experience, recognizing the timing differences of rate changes. In the simulation of net interest margin and net income the forecast balance sheet is processed against five rate scenarios. These five rate scenarios include a flat rate environment, which assumes interest rates are unchanged in the future and four additional rate ramp scenarios ranging for + 200 to - 200 basis points in 100 basis point increments, unless the rate environment cannot move in these basis point increments before reaching zero.

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The formal policies and practices adopted by the Company to monitor and manage interest rate risk exposure measure risk in two ways: (i) repricing opportunities for earning assets and interest-bearing liabilities and (ii) changes in net interest income for declining interest rate shocks of 100 to 200 basis points. Because of the Company's predisposition to variable rate, pricing and noninterest bearing demand deposit accounts the Company is asset sensitive. As a result, management anticipates that, in a declining interest rate environment, the Company's net interest income and margin would be expected to decline, and, in an increasing interest rate environment, the Company's net interest income and margin would be expected to increase. However, no assurance can be given that under such circumstances the Company would experience the described relationships to declining or increasing interest rates. Because the Company is asset sensitive, the Company is adversely affected by declining rates rather than rising rates.

To estimate the effect of interest rate shocks on the Company's net interest income, management uses a model to prepare an analysis of interest rate risk exposure. Such analysis calculates the change in net interest income given a change in the federal funds rate of 100 or 200 basis points up or down. All changes are measured in dollars and are compared to projected net interest income. Management's most recent calculation estimated an annualized reduction in net interest income attributable to a 50 and 100 basis point decline in the federal funds rate at \$222,812 and \$300,207, respectively. At December 31, 2007, the estimated annualized reduction in net interest income attributable to a 100 and 200 basis point decline in the federal funds rate was \$330,889 and \$675,089, respectively, with a similar and opposite result attributable to a 100 and 200 basis point increase in the federal funds rate.

The ALCO has established a policy limitation to interest rate risk of -14% of net interest margin and -12% of the present value of equity.

The securities portfolio is integral to our asset liability management process. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity, regulatory requirements and the relative mix of our cash positions.

The Company's approach to managing interest rate risk may include the use of derivatives. This helps to minimize significant, unplanned fluctuations in earnings, fair values of assets and liabilities and cash flows caused by interest rate volatility. This approach involves modifying the repricing characteristics of certain assets and liabilities so that changes in interest rates do not have a significant adverse effect on the net interest margin and cash flows. As a result of interest rate fluctuations, hedged assets and liabilities will gain or lose market value. In a fair value hedging strategy, the effect of this unrealized gain or loss will generally be offset by income or loss on the derivatives linked to the hedged assets and liabilities. For a cash flow hedge, the change in the fair value of the derivative to the extent that it is effective is recorded through other comprehensive income.

The Company may use derivatives as part of our interest rate risk management, including interest rate swaps, caps and floors. At inception, the relationship between hedging instruments and hedged items is formally documented with our risk management objective, strategy and our evaluation of effectiveness of the hedge transactions. This includes linking all derivatives designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific transactions. Periodically, as required, we formally assess whether the derivative we designated in the hedging relationship is expected to be and has been highly effective in offsetting changes in fair values or cash flows of the hedged item. The Company's use of derivatives is monitored by the Directors ALCO committee.



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**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information required to be disclosed is accumulated and communicated to management in a timely manner. Management has reviewed this system of disclosure controls and procedures as of the end of the period covered by this report and believe that the system is operating effectively to ensure appropriate disclosure.

During the quarter ended June 30, 2008, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

**PART II. Other Information**

**Item 1. Legal proceedings**

The Company is involved in various pending and threatened legal actions arising in the ordinary course of business. The Company maintains reserves for losses from legal actions, which are both probable and estimable. In the opinion of management, the disposition of claims, currently pending will not have a material adverse affect on the Company's financial position or results of operations.

**Item 1a. Risk Factors**

There have been no material changes from the risk factors previously disclosed in the registrant's Form 10-K.

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

None

**Item 3. Defaults upon Senior Securities**

N/A.

**Item 4. Submission of Matters to a vote of Security Holders**

The Annual Shareholder meeting of the Registrant was held on May 20, 2008.

7,483,441 shares or 86% of the outstanding voting stock was available for quorum.

Proposal #1 = 7,336,189 or 98% of the votes cast voted FOR the election of eleven directors named in the proxy statement for terms expiring on the date of the annual meeting in 2008.

Proposal #2 = 7,383,383 or 99% of the votes cast voted FOR the ratification of the appointment of Moss Adams, LLP as the Company's independent auditors.

**Item 5. Other Information**

**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

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**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: August 08, 2008

/s/ Linda J. Miles  
Linda J. Miles  
Executive Vice President &  
Chief Financial Officer

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