Bank of Commerce Holdings
Form 10-Q
November 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

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

Bank of Commerce Holdings

California	94-2823865
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
1901 Churn Creek Road Redding, California	96002
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (530) 722-3952

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

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

Yes No

Outstanding shares of Common Stock, no par value, as of October 21, 2014: 13,293,777

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

September 30, 2014 and December 31, 2013

(Dollars in Thousands)	**September 30, 2014 (Unaudited)**	**December 31, 2013 (Audited)**
ASSETS		
Cash and due from banks	$ 31,151	$ 38,369
Interest bearing due from banks	15,272	20,146
Total cash and cash equivalents	46,423	58,515
Securities available-for-sale, at fair value	189,379	216,640
Securities held-to-maturity, at amortized cost	36,888	36,696
Portfolio loans	649,879	598,298
Allowance for loan losses	(10,400)	(14,172)
Net loans	639,479	584,126
Bank premises and equipment, net	12,510	10,893
Other real estate owned	393	913
Other assets	52,685	48,559
Total Assets	$ 977,757	956,342
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand - noninterest bearing	$ 151,684	$ 133,984
Demand - interest bearing	265,308	273,390
Savings accounts	91,589	90,442
Certificates of deposit	258,939	248,477

Total deposits	767,520	746,293
Federal Home Loan Bank borrowings	75,000	75,000
Junior subordinated debentures	15,465	15,465
Other liabilities	17,812	17,797
Total Liabilities	875,797	854,555
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
Stockholders' Equity:		
Preferred stock, no par value, 2,000,000 shares authorized: Series B (liquidation preference $1,000 per share) issued and outstanding: 20,000 in 2014 and 20,000 in 2013	19,931	19,931
Common stock, no par value, 50,000,000 shares authorized; 17,013,267 issued; 13,293,777 outstanding as of September 30, 2014 and 13,977,005 outstanding on December 31, 2013	23,874	28,304
Retained earnings	58,633	55,944
Accumulated other comprehensive (loss), net of tax	(478)	(2,392)
Total Stockholders' Equity	101,960	101,787
Total Liabilities and Stockholders' Equity	$ 977,757	$ 956,342

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Operations (Unaudited)

Three and nine months ended September 30, 2014 and 2013

(Dollars in thousands)	**For the Three Months Ended September 30, 2014**	**2013**	**For the Nine Months Ended September 30, 2014**	**2013**
INTEREST INCOME:				
Interest and fees on loans	$7,350	$7,487	$21,632	$22,486
Interest on securities	998	1,031	3,223	3,120
Interest on tax-exempt securities	629	673	1,916	1,952
Interest on interest bearing deposits	125	130	393	402
Total interest income	9,102	9,321	27,164	27,960
INTEREST EXPENSE:				
Interest on demand deposits	123	113	362	364
Interest on savings deposits	59	61	173	194
Interest on certificates of deposit	650	639	1,985	1,990
Interest on securities sold under repurchase agreements	-	-	-	6
Interest on other borrowings	322	12	333	117
Total interest expense	1,154	825	2,853	2,671
Net interest income	7,948	8,496	24,311	25,289
Provision for loan losses	1,050	300	2,500	2,750
Net interest income after provision for loan losses	6,898	8,196	21,811	22,539
NONINTEREST INCOME:				
Service charges on deposit accounts	50	46	135	146
Payroll and benefit processing fees	127	113	371	355
BOLI income	171	133	459	401
Gain (loss) on investment securities, net	32	336	(252)	931
Merchant credit card service income, net	25	33	80	98
Other income	266	313	2,378	892
Total noninterest income	671	974	3,171	2,823
NONINTEREST EXPENSE:				
Salaries and related benefits	3,474	2,865	10,513	8,863
Occupancy and equipment expense	749	549	2,069	1,651
Write down of other real estate owned	-	-	290	-
FDIC assessments	204	202	584	535
Data processing fees	217	127	629	397
Professional service fees	309	364	911	926
Deferred compensation expense	115	58	345	58
Other expenses	964	1,772	4,586	4,118

Total noninterest expense	6,032	5,937	19,927	16,548
Income before provision for income taxes	1,537	3,233	5,055	8,814
Provision for income taxes	264	1,431	1,011	2,966
Net income	$1,273	$1,802	$4,044	$5,848
Less: Preferred dividends on preferred stock	50	50	150	150
INCOME AVAILABLE TO COMMON SHAREHOLDERS	$1,223	$1,752	$3,894	$5,698
Basic earnings per share	$0.09	$0.12	$0.29	$0.37
Average basic shares	13,294	14,829	13,536	15,208
Diluted earnings per share	$0.09	$0.12	$0.29	$0.37
Average diluted shares	13,339	14,853	13,582	15,230

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

Three and nine months ended September 30, 2014 and 2013

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(Dollars in thousands)	**2014**	**2013**	**2014**	**2013**
Net income	$1,273	$1,802	$4,044	$5,848
Available-for-sale securities:				
Unrealized gains (losses) arising during the period	528	(3,217)	5,253	(6,245)
Reclassification adjustments for net gains (loss) realized in earnings (net of tax expense (benefit) of $11 and $139 for the three months ended September 30, 2014 and 2013, respectively, and net of tax expense (benefit) of $(106) and $384 for the nine months ended September 30, 2014 and 2013 respectively)	(21)	(197)	146	(547)
Income tax (expense) benefit related to unrealized (gains) losses	(217)	1,324	(2,162)	2,570
Net change in unrealized gains (losses)	290	(2,090)	3,237	(4,222)
Held-to-maturity securities:				
Accretion of held-to-maturity other comprehensive income to tax-exempt yield	(22)	(22)	(68)	(68)
Net change in other comprehensive income relating to held-to-maturity securities	(22)	(22)	(68)	(68)
Derivatives:				
Unrealized gains (losses) arising during the period	296	(102)	(233)	1,240
Reclassification adjustments for net gains realized in earnings (net of tax expense of $9 and $62 for the three months ended September 30, 2014 and 2013 and net of tax expense of $782 and $185 for the nine months ended September 30, 2014 and 2013 respectively)	(13)	(88)	(1,118)	(265)
Income tax (expense) benefit related to unrealized gains (losses)	(122)	42	96	(510)
Net unrealized change in derivatives	161	(148)	(1,255)	465
Other comprehensive income (loss), net of tax	429	(2,260)	1,914	(3,825)
Comprehensive income (loss) – Bank of Commerce Holdings	$1,702	$(458)	$5,958	$2,023

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

Twelve months ended December 31, 2013 and nine months ended September 30, 2014 (Unaudited)

(Dollars in thousands)	**Preferred Amount**	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comp-income (loss) net of tax**	**Total**
BALANCE AT JANUARY 1, 2013	$ 19,931	15,972	$ 38,871	$ 50,261	$ 1,258	$ 110,321
Net Income	-	-	-	7,935	-	7,935
Other comprehensive loss, net of tax	-	-	-	-	(3,650)	(3,650)
Comprehensive income	-	-	-	-	-	4,285
Preferred stock dividend	-	-	-	(200)	-	(200)
Repurchase of common stock	-	(2,000)	(10,614)	-	-	(10,614)
Common cash dividend ($0.14 per share)	-	-	-	(2,052)	-	(2,052)
Restricted stock Granted	-	1				
Common stock issued under employee plans and related tax benefit	-	4	17	-	-	17
Compensation expense associated with stock options	-	-	30	-	-	30
BALANCE AT DECEMBER 31, 2013	$ 19,931	13,977	$ 28,304	$ 55,944	$ (2,392)	$ 101,787

(Dollars in thousands)	**Preferred Amount**	**Common Shares**	**Common Stock Amount**	**Retained Earnings**	**Accumulated Other Comp-income (loss) net of tax**	**Total**
BALANCE AT JANUARY 1, 2014	$ 19,931	13,977	$ 28,304	$ 55,944	$ (2,392)	$ 101,787
Net income	-	-	-	4,044	-	4,044
Other comprehensive income, net of tax	-	-	-	-	1,914	1,914
Comprehensive income	-	-	-	-	-	5,958

Preferred stock dividend	-	-	-	(150)	-	(150)
Repurchase of common stock	-	(700)	(4,562)	-	-	(4,562)
Common cash dividend ($0.09 per share)	-	-	-	(1,205)	-	(1,205)
Common stock issued under employee plans and related tax benefit	-	14	66	-	-	66
Stock options exercised	-	3	23	-	-	23
Compensation expense associated with stock options	-	-	43	-	-	43
BALANCE AT SEPTEMBER 30, 2014	$ 19,931	13,294	$ 23,874	$ 58,633	$ (478)	$ 101,960

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

Nine months ended September 30, 2014 and September 30, 2013

(Dollars in thousands)	**September 30, 2014**	**September 30, 2013**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,044	$ 5,848
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,500	2,750
Provision for unfunded commitments	-	200
Provision for depreciation and amortization	962	746
Compensation expense associated with stock options	43	24
Net loss (gain) on sale of securities available-for-sale	252	(931)
Amortization of investment premiums and accretion of discounts, net	1,199	748
Amortization of held-to-maturity fair value adjustment	(116)	(116)
Gain on sale of fixed assets	4	-
Write down of other real estate owned	290	-
Loss on sale of other real estate owned	11	126
(Increase) in deferred income taxes	-	(1,356)
(Increase) in cash surrender value of BOLI	(459)	(576)
(Increase) in other assets	(577)	(2,177)
Increase (decrease) in deferred compensation	275	(77)
Decrease in deferred loan fees	119	30
Increase (decrease) in other liabilities	1,177	347
Net cash provided by operating activities	9,724	5,586
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and payments of available-for-sale securities	13,608	9,148
Proceeds from sale of available-for-sale securities	81,820	77,845
Purchases of available-for-sale securities	(64,247)	(106,369)
Proceeds from maturities and payments of held-to-maturity securities	186	61
Purchases of held-to-maturity securities	(244)	(3,301)
Cash paid for low income housing investments	(1,764)	(369)
(Purchase) redemption of FHLB stock	(1,902)	346
Loan (originations), net of principal repayments	(9,159)	67,691
Purchase of loan pools, net of principal repayments	(49,250)	-
Purchase of BOLI	(5,000)	-
Purchase of premises and equipment, net	(2,583)	(1,546)
Proceeds from settlement of note to former mortgage subsidiary	686	-
Payments to derivative counterparties for the termination of interest rate swaps	-	(503)
Proceeds from the sale of other real estate owned	656	3,464

Net cash (used) provided by investing activities	(37,193)	46,467
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits and savings accounts	10,765	31,302
Net increase (decrease) in certificates of deposit	10,462	(6,831)
Net decrease in securities sold under agreements to repurchase	-	(13,095)
Advances on term debt	75,000	900,000
Repayment of term debt	(75,000)	(950,000)
Repurchase of common stock	(4,562)	(7,834)
Cash dividends paid on common stock	(1,227)	(1,388)
Cash dividends paid on preferred stock	(150)	(296)
Proceeds from stock options exercised	23	16
Stock issued under employee and director stock purchase plan	66	-
Net cash provided (used) in financing activities	15,377	(48,126)
Net increase (decrease) in cash and cash equivalents	(12,092)	3,927
Cash and cash equivalents at beginning of year	58,515	45,068
Cash and cash equivalents at end of period	$ 46,423	$ 48,995

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)

Nine months ended September 30, 2014 and September 30, 2013

(Dollars in thousands)	**September 30, 2014**	**September 30, 2013**
SUPPLEMENTAL DISCLOSURES OF CASH FLOW ACTIVITY:		
Cash paid during the period for:		
Income taxes	$ -	$ 5,842
Interest	$ 2,648	$ 2,706
SUPPLEMENTAL DISCLOSURES OF NON CASH INVESTING ACTIVITIES:		
Transfer of loans to other real estate owned	$ 437	$ 1,487
Changes in unrealized gain on investment securities available-for-sale	$ 5,505	$ (7,180)
Changes in net deferred tax asset related to changes in unrealized gain on investment securities	(2,268)	2,958
Changes in accumulated other comprehensive income due to changes in unrealized gain on investment securities	$ 3,237	$ (4,222)
Changes in unrealized gain loss (gain) on derivatives	$ (233)	$ 1,241
Changes in net deferred tax asset related to changes in unrealized loss on derivatives	96	(511)
Changes in accumulated other comprehensive income due to changes in unrealized gain (loss) on derivatives	$ (137)	$ 730
Reclassification of earnings from gains on derivatives	$ (1,900)	$ (450)
Changes in net deferred tax asset related to reclassification of earnings from gains on derivatives	782	185
Changes in accumulated other comprehensive income due to reclassification of earnings from gain on derivatives	$ (1,118)	$ (265)
Accretion of held-to-maturity from other comprehensive income to interest income	(116)	(116)
Changes in deferred tax related to accretion of held-to-maturity investment securities	48	48
Changes in accumulated other comprehensive income due to reclassification adjustment to investments held-to-maturity	$ (68)	$ (68)
SUPPLEMENTAL DISCLOSURES OF NON CASH FINANCING ACTIVITIES:		
Cash dividend declared on common stock and payable after period-end	$ 399	$ 723
Cash dividend declared on preferred stock and payable after period-end	$ 50	$ 50

See accompanying notes to consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bank of Commerce Holdings (the "Holding Company"), is a bank holding company ("BHC") with its principal offices in Redding, California. The Holding Company's principal business is to serve as a holding company for Redding Bank of Commerce (the "Bank" and together with the Holding Company, the "Company") which operates under two separate names (Redding Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce). The Company has unconsolidated subsidiaries in Bank of Commerce Holdings Trust and Bank of Commerce Holdings Trust II. The balance sheet as of December 31, 2013, which has been derived from audited financial statements, and the unaudited interim financial statements as of September 30, 2014 and for the 3 and 9 month periods ended September 30, 2014 and 2013, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although the Company believes that all adjustments (all of which are normal and recurring in nature) considered necessary for a fair presentation have been included and the disclosures made are adequate to make the information not misleading.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and with prevailing practices within the banking and securities industries. In preparing such financial statements, management is required to make certain estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses for the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan and lease losses ("ALLL"), the valuation of Other Real Estate Owned ("OREO"), and fair value measurements. Certain amounts for prior periods have been reclassified to conform to the current financial statement presentation. The results of reclassifications are not considered material and have no effect on previously reported net income. The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2013 Annual Report on Form 10-K. The results of operations and cash flows for the 2014 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Holding Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. As of September 30, 2014, the Company had two wholly-owned trusts ("Trusts") that were formed to issue trust preferred securities and related common securities of the Trusts. The Company has not consolidated the accounts of the Trusts in its consolidated financial statements in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB") ASC 810, *Consolidation* ("ASC 810"). As a result, the junior subordinated debentures issued by the Company to the Trusts are reflected on the Company's *Consolidated Balance Sheets* as junior subordinated debentures.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern.* The amendments in the ASU are intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Company does not expect the ASU to have a material impact on the Company's consolidated financial statements.

In June 2014 the FASB issued ASU No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period.* The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition. A reporting entity should apply existing stock compensation guidance, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this ASU either: (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this ASU as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. In addition, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. The Company does not expect the ASU to have a material impact on the Company's consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

In January 2014, the FASB issued ASU No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure a consensus of the FASB Emerging Issues Task Force.* The amendments in this Update clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted update using either a modified retrospective transition method or a prospective transition method. The Company does not expect the ASU to have a material impact on the Company’s consolidated financial statements..

In January 2014, the FASB issued ASU No. 2014-01, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects a consensus of the FASB Emerging Issues Task Force.* The amendments in this Update permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this Update should be applied retrospectively to all periods presented. The amendments in this Update are effective for annual periods beginning after December 15, 2014, and interim periods within annual reporting periods beginning after December 15, 2015. Early adoption is permitted. The Company has implemented the proportional amortization method according to the guidance and the impact has been immaterial.

NOTE 3. NOTE RECEIVABLE

Pursuant to the terms of a note receivable received in conjunction with the Company’s disposal of the former mortgage subsidiary, the Company received note payments (the “Note”) that commenced in 2013 and were due quarterly over a consecutive five year period. The Note carried a zero rate of interest and the obligation was guaranteed by the continuing shareholder of the Mortgage Company. As of March 31, 2014, the Company received all principal amounts due under the original Note agreement, and the Note carried an outstanding principal balance of $2.7 million.

Recent changes in the regulatory requirements under the Dodd-Frank Act and increasing mortgage interest rates have created significant uncertainty in the mortgage lending industry, and have lead to lower origination volume. Consequently, during the first quarter of 2014, the Company’s management became increasingly concerned about whether remaining principal due under the original terms of the Note would be collectible. As a result, during April 2014, the Company executed a promissory note compromise settlement agreement (the “Agreement”) with the Mortgage Company. The Agreement settled and determined all the respective rights and obligations under the Note.

Under the terms of the Agreement, the Mortgage Company paid cash in the amount of $686 thousand and transferred a 1-4 family mortgage note with a principal balance of $560 thousand to the Company. Simultaneously, the Company applied a portion of the cash proceeds to pay off the outstanding balance of the Mortgage Company’s warehouse line of credit held with the Bank. As a result of the Agreement, the Company recognized a loss of $1.4 million in full and complete satisfaction of the Note.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

The table below presents the details of the closing transaction:

(Dollars in thousands)	**Amount**
Proceeds	
Cash received	$ 686
1-4 family mortgage note (fair value)	560
Net proceeds received	$ 1,246
Assets derecognized	
Note due from the Mortgage Company	$ 2,753
Warehouse line of credit	259
Discount on the Note	(374)
Total Assets derecognized	$ 2,638
Loss on settlement of the Note	$ 1,392

NOTE 4. EARNINGS PER SHARE

Basic Earnings Per Share (“EPS”) is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period, respectively. Diluted EPS 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 is a computation of basic and diluted EPS for the three and nine months ended September 30, 2014 and 2013

	For the Three Months Ended	**For the Nine Months Ended**

(Dollars in thousands, except per share data)	**September 30, 2014**	**2013**	**September 30, 2014**	**2013**
Earnings Per Share				
NUMERATORS:				
Net income	$1,273	$1,802	$4,044	$5,848
Less preferred stock dividends	50	50	150	150
Net income available to common shareholders	$1,223	$1,752	$3,894	$5,698
DENOMINATORS:				
Weighted average number of common shares outstanding - basic	13,294	14,829	13,536	15,208
Effect of potentially dilutive common shares (1)	45	24	46	22
Weighted average number of common shares outstanding - diluted	13,339	14,853	13,582	15,230
EARNINGS PER COMMON SHARE:				
Basic attributable to operations	$0.09	$0.12	$0.29	$0.37
Diluted attributable to operations	$0.09	$0.12	$0.29	$0.37
Anti-dilutive options not included in earnings per share calculation	103,411	116,837	110,575	126,837

(1) Represents the effects of the assumed exercise of stock options.

On January 16, 2013, the Company announced that its Board of Directors authorized the purchase of up to 1,000,000 or 6% of its outstanding shares over a twelve-month period. The stock repurchase plan authorized the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the plan, the Company repurchased and subsequently retired 17,827 and 1,000,000 common shares during the three and nine months ended September 30, 2013, respectively.

On August 21, 2013, the Company announced that its Board of Directors authorized the purchase of up to 1,000,000 or 7% of its outstanding shares over a twelve-month period. The stock repurchase plan authorizes the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the plan, the Company purchased and subsequently retired 513,668 common shares during the three months ended September 30, 2013. The remaining shares authorized under the plan were purchased and retired during the three months ended December 31, 2013.

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On March 20, 2014, the Company announced that its Board of Directors authorized the purchase of up to 700,000 or 5% of its outstanding shares over a twelve-month period. The stock repurchase plan authorizes the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the plan, the Company repurchased and subsequently retired 700,000 common shares during the six months ended June 30, 2014.

The decrease in weighted average shares from the stock repurchases positively contributed to earnings per common share, and return on common equity.

NOTE 5. SECURITIES

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

Debt securities are classified as held-to-maturity if the Company has both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives.

Transfers of securities from available-for-sale to held-to-maturity are accounted for at fair value as of the date of the transfer. The difference between the fair value and the amortized cost at the date of transfer is considered a premium or discount and is accounted for accordingly. Any unrealized gain or loss at the date of the transfer is reported in OCI, and is amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount, and will offset or mitigate the effect on interest income of the amortization of the premium or discount for that held to maturity security. The Company did not have any transfers in or out of the various securities classifications for the nine months ended September 30, 2014.

The following table presents the amortized costs, gross unrealized gains, gross unrealized losses and approximate fair values of investment securities at September 30, 2014, and December 31, 2013:

	As of September 30, 2014			
(Dollars in thousands)	**Amortized Costs**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Available-for-sale securities				
U.S. government & agencies	$7,841	$ 32	$ (48)	$7,825
Obligations of state and political subdivisions	55,567	1,683	(89)	57,161
Residential mortgage backed securities and collateralized mortgage obligations	46,390	371	(263)	46,498
Corporate securities	39,523	398	(204)	39,717
Commercial mortgage backed securities	11,235	29	(164)	11,100
Other asset backed securities	27,039	325	(286)	27,078
Total	$187,595	$ 2,838	$ (1,054)	$189,379
Held-to-maturity securities				
Obligations of state and political subdivisions	$36,888	$ 551	$ (623)	$36,816

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(Dollars in thousands)	**As of December 31, 2013** **Amortized Costs**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Available-for-sale securities				
U.S. government & agencies	$6,580	$ -	$ (316)	$6,264
Obligations of state and political subdivisions	60,370	672	(1,833)	59,209
Residential mortgage backed securities and collateralized mortgage obligations	64,026	318	(1,353)	62,991
Corporate securities	48,836	282	(888)	48,230
Commercial mortgage backed securities	10,828	24	(380)	10,472
Other asset backed securities	29,717	388	(631)	29,474
Total	$220,357	$ 1,684	$ (5,401)	$216,640
Held-to-maturity securities				
Obligations of state and political subdivisions	$36,696	$ 36	$ (2,707)	$34,025

The amortized cost and estimated fair value of available-for-sale and held-to-maturity securities as of September 30, 2014, are shown below.

(Dollars in thousands)	**Available-for-sale** **Amortized Cost**	**Fair Value**	**Held-to-maturity** **Amortized Cost**	**Fair Value**
AMOUNTS MATURING IN:				
One year or less	$1,216	$1,236	$367	$367
One year through five years	53,813	54,329	1,482	1,502
Five years through ten years	58,470	58,791	15,368	15,407
After ten years	74,096	75,023	19,671	19,540
Total	$187,595	$189,379	$36,888	$36,816

The amortized cost and fair value of collateralized mortgage obligations and mortgage backed securities are presented by their expected average life, rather than contractual maturity, in the preceding table. Expected maturities may differ from contractual maturities.

The Company held $54.2 million in securities with safekeeping institutions for pledging purposes. Of this amount, $20.7 million were pledged as of September 30, 2014. The following table presents the fair market value of the securities held, segregated by purpose, as of September 30, 2014:

(Dollars in thousands)	**Amount**	
Public funds collateral	$	24,532
Federal Home Loan Bank borrowings		25,206
Interest rate swap contracts		4,488
Total securities held for pledging purposes	$	54,226

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The following table presents the cash proceeds from sales of securities and their associated gross realized gains and gross realized losses that have been included in earnings for the three and nine months ended September 30, 2014 and 2013

(Dollars in thousands)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Proceeds from sales of securities	$13,036	$32,502	$81,820	$77,845
Gross realized gains on sales of securities:				
Obligations of state and political subdivisions	$44	$35	$215	$212
Residential mortgage backed securities and collateralized mortgage obligations	7	135	75	240
Corporate securities	82	419	309	780
Commercial mortgage backed securities	-	-	5	-
Other asset backed securities	10	-	73	52
Total gross realized gains on sales of securities	$143	$589	$677	$1,284
Gross realized losses on sales of securities				
U.S. government & agencies	$-	$(73)	$(114)	$(100)
Obligations of state and political subdivisions	(50)	(108)	(209)	(118)
Residential mortgage backed securities and collateralized mortgage obligations	(61)	(13)	(543)	(63)
Corporate securities	-	(12)	(8)	(25)
Commercial mortgage backed securities	-	-	(33)	-
Other asset backed securities	-	(47)	(22)	(47)
Total gross realized losses on sales of securities	$(111)	$(253)	$(929)	$(353)
(Loss) gain on investment securities, net	$32	$336	$(252)	$931

The following tables present the current fair value and associated unrealized losses on investments with unrealized losses at September 30, 2014, and December 31, 2013. The tables also illustrate whether these securities have had unrealized losses for less than 12 months or for 12 months or longer.

	As of September 30, 2014					
	Less than 12 months		12 months or more		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities						
U.S. government & agencies	$-	$ -	$2,853	$ (48)	$2,853	$ (48)
Obligations of states and political subdivisions	6,528	(21)	5,942	(68)	12,470	(89)
Residential mortgage backed securities and collateralized mortgage obligations	15,434	(107)	5,623	(156)	21,057	(263)
Corporate securities	5,078	(36)	9,916	(168)	14,994	(204)
Commercial mortgage backed securities	2,869	(37)	2,600	(127)	5,469	(164)
Other asset backed securities	5,972	(67)	7,012	(219)	12,984	(286)
Total temporarily impaired securities	$35,881	$ (268)	$33,946	$ (786)	$69,827	$ (1,054)
Held-to-maturity securities						
Obligations of states and political subdivisions	$3,662	$ (18)	$15,565	$ (605)	$19,227	$ (623)

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	As of December 31, 2013					
	Less than 12 months		12 months or more		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities						
U.S. government & agencies	$5,446	$(147)	$819	$(169)	$6,265	$(316)
Obligations of states and political subdivisions	29,943	(1,578)	2,727	(255)	32,670	(1,833)
Residential mortgage backed securities and collateralized mortgage obligations	44,197	(1,214)	3,271	(139)	47,468	(1,353)
Corporate securities	32,649	(792)	2,960	(96)	35,609	(888)
Commercial mortgage backed securities	5,543	(205)	1,437	(175)	6,980	(380)
Other asset backed securities	15,303	(518)	1,723	(113)	17,026	(631)
Total temporarily impaired securities	$133,081	$(4,454)	$12,937	$(947)	$146,018	$(5,401)
Held-to-maturity securities						
Obligations of states and political subdivisions	$23,800	$(1,524)	$7,533	$(1,183)	$31,333	$(2,707)

At September 30, 2014, 93 securities were in unrealized loss positions and at December 31, 2013, 196 securities were in unrealized loss positions.

The unrealized losses on obligations of political subdivisions and corporate securities were caused by changes in market interest rates and / or the widening of market spreads subsequent to the initial purchase of these securities. Management monitors published credit ratings of these securities and there have been no adverse ratings changes below investment grade since the date of purchase. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Company does not intend to sell the securities in these classes, and it is more likely than not that the Company will not be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

The residential mortgage backed securities, commercial backed securities, collateralized mortgage obligations, and other asset backed securities portfolios in an unrealized loss position at September 30, 2014, were issued by both public and private agencies. The unrealized losses on residential mortgage backed securities, commercial backed securities and collateralized mortgage obligations were caused by changes in market interest rates and / or the widening of market spreads subsequent to the initial purchase of these securities, and not by the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates and or widening market spreads and not credit quality, and because the Company does not intend to sell the securities in this class, and it is more likely than not the Company will not be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment ("OTTI") or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether we intend to sell a security or if it is more likely than not that we will be required to sell the security before recovery of our amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if we intend to sell the security or it is more likely than not we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is more likely than not we will not be required to sell the security, but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to OCI. Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment, and would not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above. For the three and nine months ended September 30, 2014 and the year ended December 31, 2013, the Company did not recognize impairment losses.

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NOTE 6. LOANS

Outstanding loan balances consist of the following at September 30, 2014, and December 31, 2013:

(Dollars in thousands)	**September 30, 2014**	**December 31, 2013**
Commercial	$ 160,024	$ 170,429
Real estate – construction loans	25,579	18,545
Real estate – commercial (investor)	216,204	205,384
Real estate – commercial (owner occupied)	105,889	83,976
Real estate – ITIN loans	53,805	56,101
Real estate – mortgage	13,779	14,590
Real estate – equity lines	45,050	45,462
Consumer	28,998	3,472
Other	367	36
Gross portfolio loans	$ 649,695	$ 597,995
Less:		
Deferred loan costs, net	(184)	(303)
Allowance for loan losses	10,400	14,172
Net portfolio loans	$ 639,479	$ 584,126

Gross loan balances in the table above include net discounts of $378 thousand and net premiums of $53 thousand as of September 30, 2014, and December 31, 2013, respectively.

Loans are reported as past due when any portion of the principal and interest are not received on the due date. The days past due will continue to increase for each day until full principal and interest are received (i.e. if payment is not received within thirty days of the due date, the loan will be considered thirty days past due; if payment is not received within sixty days of the due date, the loan will be considered sixty days past due, etc). Loans that become ninety days past due may be placed in nonaccrual status.

Age analysis of past due loans, segregated by class of loans, as of September 30, 2014, and December 31, 2013, were as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total	Recorded Investment > 90 Days and Accruing
September 30, 2014							
Commercial	$655	$1,950	$-	$2,605	$157,419	$160,024	$ -
Commercial real estate:							
Construction	-	-	-	-	25,579	25,579	-
Other	67	-	8,516	8,583	313,510	322,093	-
Residential:							
1-4 family	767	240	3,445	4,452	63,132	67,584	-
Home equities	283	-	25	308	44,742	45,050	-
Consumer	-	-	-	-	29,365	29,365	-
Total	$1,772	$2,190	$11,986	$15,948	$633,747	$649,695	$ -

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(Dollars in thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days**	**Total Past Due**	**Current**	**Total**	**Recorded Investment > 90 Days and Accruing**
December 31, 2013							
Commercial	$-	$-	$-	$-	$170,429	$170,429	$ -
Commercial real estate:							
Construction	-	-	-	-	18,545	18,545	-
Other	-	-	-	-	289,360	289,360	-
Residential:							
1-4 family	3,125	436	3,167	6,728	63,963	70,691	-
Home equities	131	25	-	156	45,306	45,462	-
Consumer	-	-	-	-	3,508	3,508	-
Total	$3,256	$461	$ 3,167	$6,884	$591,111	$597,995	$ -

A loan is considered impaired when based on current information and events; the Company determines it is probable that it will not be able to collect all amounts due according to the original loan contract, including scheduled interest payments. Generally, when the Company identifies a loan as impaired, it measures the loan for potential impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, the current fair value of collateral is used, less selling costs.

The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated every six to twelve months. The Company obtains appraisals from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. At a minimum, it is ascertained that the appraiser is: (1) currently licensed in the state in which the property is located, (2) is experienced in the appraisal of properties similar to the property being appraised, (3) is actively engaged in the appraisal work, (4) has knowledge of current real estate market conditions and financing trends, (5) is reputable, and (6) is not on Freddie Mac's nor the Bank's Exclusionary List of appraisers and brokers. In certain cases appraisals will be reviewed by another independent third party to ensure the quality of the appraisal and the expertise and independence of the appraiser.

Upon receipt and review, an external appraisal is utilized to measure a loan for potential impairment. The Company's impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. An appraisal over one year old in most cases will be considered stale dated and an updated or new appraisal will be required. Any adjustments from appraised value to net realizable value are detailed and justified in the impairment analysis, which is reviewed and approved by the Company’s Chief Credit Officer.

Although an external appraisal is the primary source to value collateral dependent loans, the Company may also utilize values obtained through purchase and sale agreements, negotiated short sales, broker price opinions, or the sales price of the note. These alternative sources of value are used only if deemed to be more representative of value based on updated information regarding collateral resolution. Impairment analyses are updated, reviewed and approved on a quarterly basis at or near the end of each reporting period. Based on these processes, the Company does not believe there are significant time lapses for the recognition of additional loan loss provisions or charge offs from the date they become known.

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The following table summarizes impaired loans by loan class as of September 30, 2014, and December 31, 2013:

	As of September 30 2014		
(Dollars in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance recorded:			
Commercial	$5,381	$ 9,294	$ -
Commercial real estate:			
Other	11,121	15,649	-
Residential:			
1-4 family	9,163	11,905	-
Home equities	310	316	-
Consumer	-	-	-
Total with no related allowance recorded	$25,975	$ 37,164	$ -
With an allowance recorded:			
Commercial	3,269	3,273	290
Commercial real estate:			
Other	844	844	9
Residential:			
1-4 family	3,671	3,804	642
Home equities	584	584	292
Total with an allowance recorded	$8,368	$ 8,505	$ 1,233
Subtotal:			
Commercial	$8,650	$ 12,567	$ 290
Commercial real estate	$11,965	$ 16,493	$ 9
Residential	$13,728	$ 16,609	$ 934
Consumer	$ -	$ -	$ -
Total impaired loans	$34,343	$ 45,669	$ 1,233

	As of December 31 2013		
(Dollars in thousands)	**Recorded Investment**	**Principal Balance**	**Related Allowance**
With no related allowance recorded:			

Commercial real estate:			
Other	$15,736	$ 18,184	$ -
Residential:			
1-4 family	3,714	6,091	-
Home equities	539	545	-
Total with no related allowance recorded	$19,989	$ 24,820	$ -
With an allowance recorded:			
Commercial	$6,590	$ 6,808	$ 2,988
Commercial real estate:			
Other	6,011	6,020	814
Residential:			
1-4 family	8,805	9,804	963
Home equities	746	746	229
Total with an allowance recorded	$22,152	$ 23,378	$ 4,994
Subtotal:			
Commercial	$6,590	$ 6,808	$ 2,988
Commercial real estate	$21,747	$ 24,204	$ 814
Residential	$13,804	$ 17,186	$ 1,192
Total impaired loans	$42,141	$ 48,198	$ 4,994

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The Company’s practice is to place an asset on nonaccrual status when one of the following events occurs: (1) any installment of principal or interest is 90 days or more past due (unless in management’s opinion the loan is well-secured and in the process of collection), (2) management determines the ultimate collection of principal or interest to be unlikely or, (3) the terms of the loan have been renegotiated due to a serious weakening of the borrower’s financial condition. Nonperforming loans may be on nonaccrual, 90 days past due and still accruing, or have been restructured. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when the loan is estimated to be fully collectible or when the loan becomes “well secured” and “in the process of collection”. Restructured loans are those loans on which concessions in terms have been granted because of the borrower’s financial difficulties. Interest is generally accrued on such loans in accordance with the new terms, after a period of sustained performance by the borrower. When a loan returns to accrual status, interest income is recognized based on the effective yield to maturity on the loan. The effective interest rate is the discount rate that would equate the present value of the future cash payments to the recorded amount of the loan. This results in accreting the amount of interest applied to principal over the remaining term of the loan.

One exception to the 90 days past due policy for nonaccruals is the Bank’s pool of home equity loans and lines. Regarding this specific home equity loan pool, the Bank will charge off any loans that go more than 90 days past due. Management believes that at the time these loans become 90 days past due, it is likely that the Company will not collect the remaining principal balance on the loan. In accordance with this policy, management does not expect to classify any of the loans from this pool as nonaccrual.

Had nonaccrual loans performed in accordance with their contractual terms, the Company would have recognized additional interest income, net of tax, of approximately $212 thousand and $314 thousand for the three months ended September 30, 2014 and 2013, respectively. The Company would have recognized additional interest income, net of tax, of approximately $541 thousand and $559 thousand for the nine months ended September 30, 2014 and 2013, respectively.

Nonaccrual loans, segregated by loan class, were as follows at September 30, 2014 and December 31, 2013:

(Dollars in thousands)	**September 30, 2014**	**December 31, 2013**

Commercial	$ 7,065	$ 6,527
Commercial real estate:		
Other	9,896	14,539
Residential:		
1-4 family	7,438	8,217
Home equities	89	513
Total	$ 24,488	$ 29,796

The following table summarizes average recorded investment and interest income recognized on impaired loans by loan class for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014		**Three Months Ended September 30, 2013**	
(Dollars in thousands)	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial	$6,511	$ 13	$10,606	$ 38
Commercial real estate:				
Other	15,326	31	20,954	45
Residential:				
1-4 family	12,197	30	14,092	18
Home equities	1,155	8	1,233	11
Consumer	29	-	-	-
Total	$35,218	$ 82	$46,885	$ 112

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	Nine Months Ended September 30, 2014		**Nine Months Ended September 30, 2013**	
(Dollars in thousands)	**Average Recorded Investment**	**Interest Income Recognized**	**Average Recorded Investment**	**Interest Income Recognized**
Commercial	$5,848	$ 15	$6,665	$ 58
Commercial real estate:				
Other	18,060	213	25,413	200
Residential:				
1-4 family	12,179	83	14,285	58
Home equities	1,238	25	789	18
Consumer	19	-		
Total	$37,344	$ 336	$47,152	$ 334

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

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

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

Maturity – A modification in which the maturity date, timing of payments or frequency of payments is modified.

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

The following tables present the period ended balances of newly restructured loans that occurred during the three and nine months ended September 30, 2014 and 2013, respectively:

	For the three months ended September 30, 2014				For the three months ended September 30, 2013			
(Dollars in thousands)	**Rate**	**Rate & Maturity**	**Rate & Payment Deferral**	**Total**	**Rate**	**Rate & Maturity**	**Rate & Payment Deferral**	**Total**
Commercial	$-	$ 5,165	$ -	$5,165	$-		$ -	$-
Commercial real estate:								
Other	-	-	-	-	-	6,057	-	6,057
Residential:								
1-4 family	57	-	38	95	73	-	274	347
Home equities	-	-	-	-	-	91	-	91
Total	$57	$ 5,165	$ 38	$5,260	$73	$ 6,148	$ 274	$6,495

	For the nine months ended September 30, 2014				For the nine months ended September 30, 2013			
(Dollars in thousands)	**Rate**	**Rate & Maturity**	**Rate & Payment Deferral**	**Total**	**Rate**	**Rate & Maturity**	**Rate & Payment Deferral**	**Total**
Commercial	$-	$ 5,165	$ -	$5,165	$-	$ -	$ -	$-
Commercial real estate:								
Other	-	-	-	-	-	6,057	-	6,057
Residential:								
1-4 family	209	-	39	248	490	208	389	1,087
Home equities	-	-	-	-	-	163	-	163
Total	$209	$ 5,165	$ 39	$5,413	$490	$ 6,428	$ 389	$7,307

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The tables below provide information regarding the number of loans where the contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties for the three and nine months ended September 30, 2014 and 2013.

(Dollars in thousands)	**For the three months ended September 30, 2014**			**For the three months ended September 30, 2013**		
Troubled Debt Restructurings	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial	2	$ 9,070	$ 9,070	-	$ -	$ -
Commercial real estate:						
Other	-	-	-	2	6,002	6,057
Residential:						
1-4 family	2	113	113	3	292	280
Home equities	-	-	-	1	91	91
Total	4	$ 9,183	$ 9,183	6	$ 6,385	$ 6,428

(Dollars in thousands)	**For the nine months ended September 30, 2014**			**For the nine months ended September 30, 2013**		
Troubled Debt Restructurings	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Commercial	2	$ 9,070	$ 9,070	-	$ -	$ -
Commercial real estate:						
Other	-	-	-	2	6,002	6,057
Residential:						
1-4 family	4	263	267	11	985	1,041
Home equities	-	-	-	2	165	166

Total	6	$ 9,333	$ 9,337	15	$ 7,152	$ 7,264

At September 30, 2014 and December 31, 2013, impaired loans of $9.1 million and $8.8 million were classified as performing restructured loans, respectively. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

In order for a restructured loan to be considered performing and on accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. The Company had no obligations to lend additional funds on the restructured loans as of September 30, 2014 and December 31, 2013.

As of September 30, 2014, the Company had $25.7 million in TDRs compared to $33.4 million as of December 31, 2013. As of September 30, 2014, the Company had one hundred eighteen loans that qualified as TDRs, of which one hundred were performing according to their restructured terms. TDRs represented 3.95% of gross portfolio loans as of September 30, 2014, compared with 5.59% at December 31, 2013. The decrease in TDR balances during the nine months ended September 30, 2014 is primarily due to $3.4 million in chargeoffs of Commercial and Industrial loans for one borrowing relationship and $1.4 million in chargeoffs of Commercial Real Estate and Farmland loans for a second borrowing relationship and $1.0 million in Commercial Real Estate loans to a third relationship. The loans were previously recorded as TDRsthat were adequately reserved for at December 31, 2013, and subsequently charged off during the second quarter of 2014..

The following tables represent loans modified as TDRs within the previous 12 months for which there was a payment default during the three and nine months ended September 30, 2014 and 2013, respectively:

(Dollars in thousands)	**For the three months ended September 30, 2014**		**For the three months ended September 30, 2013**	
Troubled Debt Restructurings that Subsequently Defaulted	**Number of Contracts**	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
Residential:				
1-4 family	1	$ 53	8	$ 592
Total	1	$ 53	8	$ 592

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(Dollars in thousands)	**For the nine months ended September 30, 2014**		**For the nine months ended September 30, 2013**	
Troubled Debt Restructurings that Subsequently Defaulted	**Number of Contracts**	**Recorded Investment**	**Number of Contracts**	**Recorded Investment**
Commercial	-	$ -	1	$ 447
Commercial real estate:				
Other	-	-	1	734
Residential:				
1-4 family	2	139	8	592
Total	2	$ 139	10	$ 1,773

The foundation or primary factor in determining the appropriate credit quality indicators is the degree of a debtor's willingness and ability to perform as agreed. The Company defines a performing loan as a loan where any installment of principal or interest is not 90 days or more past due, and management believes the ultimate collection of original contractual principal and interest is likely. The Company defines a nonperforming loan as an impaired loan which may be on nonaccrual, 90 days past due and still accruing, or has been restructured and is not in compliance with its modified terms, and our ultimate collection of original contractual principal and interest is uncertain.

Performing and nonperforming loans, segregated by class of loans, are as follows at September 30, 2014 and December 31, 2013:

	September 30, 2014		
(Dollars in thousands)	**Performing**	**Nonperforming**	**Total**
Commercial	$152,959	$ 7,065	$160,024
Commercial real estate:			
Construction	25,579		25,579
Other	312,197	9,896	322,093
Residential:			
1-4 family	60,146	7,438	67,584

Home equities	44,961	89	45,050
Consumer	29,365	-	29,365
Total	$625,207	$ 24,488	$649,695

	December 31, 2013		
(Dollars in thousands)	**Performing**	**Nonperforming**	**Total**
Commercial	$163,902	$ 6,527	$170,429
Commercial real estate:			
Construction	18,545	-	18,545
Other	274,821	14,539	289,360
Residential:			
1-4 family	62,474	8,217	70,691
Home equities	44,949	513	45,462
Consumer	3,508	-	3,508
Total	$568,199	$ 29,796	$597,995

In conjunction with evaluating the performing versus nonperforming nature of the Company's loan portfolio, management evaluates the following credit risk and other relevant factors in determining the appropriate credit quality indicator (grade) for each loan class:

Pass Grade - Borrowers classified as Pass Grades specifically demonstrate:

Strong Cash Flows – borrower's cash flows must meet or exceed the Company's minimum debt service coverage ratio.

Collateral Margin – generally, the borrower must have pledged an acceptable collateral class with an adequate collateral margin.

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

Qualitative Factors – in addition to meeting the Company's minimum cash flow and collateral requirements, a number of other qualitative factors are also factored into assigning a pass grade including the borrower's level of leverage (debt to equity), prospects, history and experience in their industry, credit history, and any other relevant factors including a borrower's character.

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Watch Grade – Generally, borrowers classified as Watch exhibit some level of deterioration in one or more of the following:

Adequate Cash Flows – borrowers in this category demonstrate adequate cash flows and debt service coverage ratios, but also exhibit one or more less than positive conditions such as declining trends in the level of cash flows, increasing or sole reliance on secondary sources of cash flows, and/or do not meet the Company's minimum debt service coverage ratio. However, cash flow remains at acceptable levels to meet debt service requirements.

Adequate Collateral Margin – the collateral securing the debt remains adequate but also exhibits a declining trend in value or expected volatility due to macro or industry specific conditions. The current collateral value, less selling costs, remains adequate to cover the outstanding debt under a liquidation scenario.

Qualitative Factors – while the borrower's cash flow and collateral margin generally remain adequate, one or more quantitative and qualitative factors may also factor into assigning a Watch Grade including the borrower's level of leverage (debt to equity), deterioration in prospects, limited experience in their industry, newly formed company, overall deterioration in the industry, negative trends or recent events in a borrower's credit history, deviation from core business, and any other relevant factors.

Special Mention Grade – Generally, borrowers classified as Special Mention exhibit a greater level of deterioration than Watch graded loans and warrant management's close attention. If left uncorrected, the potential weaknesses could threaten repayment prospects in the future. Special Mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant an adverse risk grade.

The following represents potential characteristics of a Special Mention Grade but do not necessarily generate automatic reclassification into this loan grade:

Adequate Cash Flows – borrowers in this category demonstrate adequate cash flows and debt service coverage ratios, but also reflect adverse trends in operations or continuing financial deterioration that, if it does not stabilize and reverse in a reasonable timeframe, retirement of the debt may be jeopardized.

Adequate Collateral Margin – the collateral securing the debt remains adequate but also exhibits a continuing declining trend in value or volatility due to macro or industry specific conditions. The current collateral value, less selling costs, remains adequate, but should the negative collateral trend continue, the full recovery of the outstanding debt under a liquidation scenario could be jeopardized.

Qualitative Factors – while the borrower's cash flow and/or collateral margin continue to deteriorate but generally remain adequate, one or more quantitative and qualitative factors may also be factoring into assigning a Special Mention Grade including inadequate or incomplete loan documentation, perfection of collateral, inadequate credit structure, borrower unable or unwilling to produce current and adequate financial information, and any other relevant factors.

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

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

Sustained or substantial deteriorating financial trends,

Unresolved management problems,

Collateral is insufficient to repay debt; collateral is not sufficiently supported by independent sources, such as asset-based financial audits, appraisals, or equipment evaluations,

Improper perfection of lien position, which is not readily correctable,

Unanticipated and severe decline in market values, High reliance on secondary source of repayment,

Legal proceedings, such as bankruptcy or a divorce, which has substantially decreased the borrower’s capacity to repay the debt,

Fraud committed by the borrower,

IRS liens that take precedence,

Forfeiture statutes for assets involved in criminal activities,

Protracted repayment terms outside of policy that are for longer than the same type of credit in the Company portfolio,

Any other relevant quantitative or qualitative factor that negatively affects the current net worth and paying capacity of the borrower or of the collateral pledged, if any.

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

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

Generally, a Doubtful grade does not remain outstanding for a period greater than six months. After six months, the pending events should have either occurred or not occurred. The credit grade should have improved or the principal balance charged against the ALLL.

Credit grade definitions, including qualitative factors, for all credit grades are reviewed and approved annually by the Company’s Loan Committee. The following table summarizes internal risk rating by loan class as of September 30, 2014, and December 31, 2013:

	September 30, 2014					
(Dollars in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$118,702	$23,440	$ 4,254	$ 13,628	$ -	$160,024
Commercial real estate:						
Construction	20,990	4,589	-	-	-	25,579
Other	282,190	25,526	900	13,477	-	322,093
Residential:						
1-4 family	55,111	-	-	12,473	-	67,584
Home equities	41,069	2,889	-	1,092	-	45,050
Consumer	28,936	370	22	37	-	29,365
Total	$546,998	$56,814	$ 5,176	$ 40,707	$ -	$649,695

	December 31, 2013					
(Dollars in thousands)	**Pass**	**Watch**	**Special Mention**	**Substandard**	**Doubtful**	**Total**
Commercial	$131,042	$24,274	$ 7,177	$ 7,936	$ -	$170,429
Commercial real estate:						
Construction	18,048	497	-	-	-	18,545
Other	247,656	18,343	2,309	21,052	-	289,360
Residential:						
1-4 family	56,832	1,340	-	12,519	-	70,691
Home equities	41,147	2,311	25	1,979	-	45,462
Consumer	3,307	38	130	33	-	3,508
Total	$498,032	$46,803	$ 9,641	$ 43,519	$ -	$597,995

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The following tables below summarize the Allowance for Credit Losses and Recorded Investment in Financing Receivables as of September 30, 2014, and December 31, 2013:

	As of September 30, 2014					
(Dollars in thousands)	**Commercial**	**Commercial Real Estate**	**Consumer**	**Residential**	**Unallocated**	**Total**
Allowance for credit losses:						
Beginning balance	$7,057	$ 2,784	$ 35	$ 2,493	$ 1,803	$14,172
Charge offs	(4,105)	(2,525)	(1)	(313)	-	(6,944)
Recoveries	500	1	-	171	-	672
Provision	(9)	3,991	327	(148)	(1,661)	2,500
Ending balance	$3,443	$ 4,251	$ 361	$ 2,203	$ 142	$10,400
Ending balance ALLL for receivables individually evaluated for impairment	$9	$ 290	$ -	$ 934	$ -	$1,233
Ending balance ALLL for receivables collectively evaluated for impairment	$3,433	$ 3,961	$ 362	$ 1,269	$ 142	$9,167
Financing receivables						
Ending balance	$160,024	$ 347,672	$ 29,365	$ 112,634	$ -	$649,695
Ending balance receivables individually evaluated for impairment	$8,650	$ 11,965	$ -	$ 13,728	$ -	$34,343
Ending balance receivables collectively evaluated for impairment	$151,374	$ 335,707	$ 29,365	$ 98,906	$ -	$615,352

	As of December 31, 2013					
(Dollars in thousands)	**Commercial**	**Commercial Real Estate**	**Consumer**	**Residential**	**Unallocated**	**Total**
Allowance for credit losses:						
Beginning balance	$4,168	$ 2,783	$ 28	$ 3,335	$ 789	$11,103
Charge offs	(882)	(230)	(25)	(1,633)	-	(2,770)
Recoveries	58	2,483	1	547	-	3,089
Provision	3,713	(2,252)	31	244	1,014	2,750

Ending balance	$7,057	$ 2,784	$ 35	$ 2,493	$ 1,803	$14,172
Ending balance ALLL for receivables individually evaluated for impairment	$2,988	$ 814	$ -	$ 1,192	$ -	$4,994
Ending balance ALLL for receivables collectively evaluated for impairment	$4,069	$ 1,970	$ 35	$ 1,301	$ 1,803	$9,178
Financing receivables						
Ending balance	$170,429	$ 307,905	$ 3,508	$ 116,153	$ -	$597,995
Ending balance receivables individually evaluated for impairment	$6,590	$ 21,747	$ -	$ 13,804	$ -	$42,141
Ending balance receivables collectively evaluated for impairment	$163,839	$ 286,158	$ 3,508	$ 102,349	$ -	$555,854

The ALLL totaled $10.4 million or 1.60% of total portfolio loans at September 30, 2014 and $14.2 million or 2.37% at December 31, 2013. In addition, as of September 30, 2014, the Company had $206.6 million in commitments to extend credit, and recorded a reserve for unfunded commitments of $696 thousand in *other liabilities* in the *Consolidated Balance Sheets*.

During the nine months ended September 30, 2014, the Company realized net charge offs of $6.3 million compared with net recoveries of $319 thousand in the period ended December 31, 2013. The increase in net charge offs in the current year and the decrease in the ALLL allocation is primarily due to chargeoffs related to three significant borrowing relationships; the first included $3.4 million in chargeoffs of Commercial and Industrial loans and the second included $1.4 million in chargeoffs of Commercial Real Estate and Farmland loans. The third included $1.0 million in chargeoffs for three Commercial Real Estate loans. Allocations for the amounts charged off for these relationships were included in the ALLL balance as of December 31, 2013.

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

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

Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

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

Management believes that the ALLL was adequately funded as of September 30, 2014. There is, however, no assurance that future loan losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan losses. In addition, bank regulatory authorities, as part of their periodic examination of the Bank, may require additional charges to the provision for loan losses in future periods if warranted as a result of their review.

Approximately 71% of our gross loan portfolio is secured by real estate, and a significant decline in real estate market values may require an increase in the ALLL. The recent U.S. recession, the housing market downturn, and depressed real estate values in our markets have negatively impacted aspects of our residential development, commercial real estate, commercial construction and commercial loan portfolios. A continued deterioration in our markets may adversely affect our loan portfolio and may lead to additional charges to the provision for loan losses.

All impaired loans are individually evaluated for impairment. If the measurement of each impaired loan's value is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL. This can be accomplished by charging off the impaired portion of the loan or establishing a specific component within the ALLL. If the Bank determines the sources of repayment will not result in a reasonable probability that the carrying value of a loan can be recovered, the amount of a loan's specific impairment is charged off against the ALLL. Impairment reserves on non-collateral dependent restructured loans are measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value. These impairment reserves are recognized as a specific component to be provided for in the ALLL.

The unallocated portion of ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component, or in the specific impairment reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of September 30, 2014, the unallocated allowance amount represented 1% of the ALLL, compared to 13% at December 31, 2013. The change in the unallocated portion of the allowance is primarily due to $3.4 million in chargeoffs of Commercial and Industrial loans for one borrowing relationship and $1.4 million in chargeoffs of Commercial Real Estate and Farmland loans for a second borrowing relationship. The loans charged off for these two relationships were adequately reserved for at December 31, 2013, and subsequently charged off during the second quarter of 2014..

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

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

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

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Most commercial loans are generally secured by the assets being financed and other business assets such as accounts receivable or inventory. Management may also incorporate a personal guarantee; however, some short term loans may be extended on an unsecured basis. Repayment of commercial loans secured by accounts receivable may be substantially dependent on the ability of the borrower to collect amounts due from its customers. In addition, the Company maintains a commercial loan with its former mortgage subsidiary in which mortgage loans are pledged as collateral.

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

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

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

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

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

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

In accordance with ASC 450, historical valuation allowances are established for loan pools with similar risk characteristics common to each loan grouping. The Company’s loan portfolio is evaluated by general loan class including commercial, commercial real estate (which includes construction and other real estate), residential real estate (which includes 1-4 family and home equity loans), consumer and other loans.

These loan pools are similarly risk-graded and each portfolio is evaluated by identifying all relevant risk characteristics that are common to these segmented groups of loans. These characteristics include a significant emphasis on historical losses within each loan group, inherent risks for each, and specific loan class characteristics such as trends related to nonaccrual loans, past due loans, criticized loans, net charge offs or recoveries, among other relevant credit risk factors. Management periodically reviews and updates its historical loss ratios based on net charge off experience for each loan class. Other credit risk factors are also reviewed periodically and adjusted as necessary to account for any changes in potential loss exposure.

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

NOTE 7. OTHER REAL ESTATE OWNED

Other Real Estate Owned – Represents real estate which the Bank has taken control of in partial or full satisfaction of loans. At the time of foreclosure, OREO is recorded at the lower of cost or fair value less costs to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the ALLL. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell.

Subsequent valuation adjustments are recognized within net loss of OREO. Revenue and expenses from operations and subsequent adjustments to the carrying amount of the property are included in other noninterest expense in the *Consolidated Statements of Operations*. In some instances, the Bank may make loans to facilitate the sales of OREO. Management reviews all sales for which it is the lending institution for compliance with sales treatment under provisions established within ASC 360-20, *Real Estate Sales*. Any gains related to sales of OREO may be deferred until the buyer has a sufficient initial and continuing investment in the property.

At September 30, 2014, and December 31, 2013, the recorded investment in OREO was $393 thousand and $913 thousand, respectively. For the nine months ended September 30, 2014, the Company transferred foreclosed property from five loans in the amount of $437 thousand to OREO. During the nine months ended September 30, 2014, further impairment was deemed necessary for an improved commercial land property in the amount of $290 thousand. The property was transferred to OREO in 2010 and was written down to its fair value in the first quarter of 2014 in anticipation of its pending sale which occurred during the third quarter of 2014. During the nine months ended September 30, 2014 the Company sold four properties with a balance of $668 thousand for a net loss of $11 thousand. The September 30, 2014 OREO balance consists of four properties, of which three are secured with 1-4 family residential real estate in the amount of $232 thousand and one property secured by a commercial real estate property in the amount of $161 thousand..

NOTE 8. ACCOUNTING FOR INCOME TAX AND UNCERTAINTIES

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 income before taxes. The principal difference between statutory tax rates and the Company's effective tax rate is the benefit derived from investing in tax-exempt securities; bank owned life insurance, federal tax credits afforded through the Company’s participation in qualified affordable housing project investments.

Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company’s income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized.

The Company applies the provisions of FASB ASC 740, *Income Taxes*, relating to the accounting for uncertainty in income taxes. The Company periodically reviews its income tax positions based on tax laws and regulations, and financial reporting considerations, and records adjustments as appropriate. This review takes into consideration the status of current taxing authorities’ examinations of the Company’s tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment. The Company’s uncertain tax positions were nominal in amount as of September 30, 2014.

The Company’s effective income tax rate was 20% for the nine months ended September 30, 2014, compared with 28% for the same period a year ago. The Company’s effective tax rate is derived from the sum of income tax expense divided by pretax income.

The decrease in the effective tax rate during the nine months ended September 30, 2014 compared to the same period a year ago was primarily driven by increased investments in affordable housing projects. Investments in these projects afford the Company certain federal and state tax credits that in turn lower the Company’s effective tax rate. The Company began to realize the benefits of these tax credits during the nine months ended September 30, 2014. See Note 9 below for further detail regarding the Company’s investments in affordable housing project investments.

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NOTE 9. QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company's investment in Qualified Affordable Housing Projects that generate Low Income Housing Tax Credits ("LIHTC") at September 30, 2014 was $5.0 million recorded in other assets with a corresponding recorded liability in other liabilities of $3.0 million in funding obligations recorded in other liabilities. The Company has invested in three separate LIHTC projects which provide the Company with CRA credit. Additionally, the investment in LIHTC projects provides the Company with tax credits and with operating loss tax benefits over an approximately sixteen year period. None of the original investment will be repaid. The tax credits and the operating loss tax benefits that are generated by each of the properties are expected to exceed the total value of the investment made by the Company and provide a return on the investment between 4.76% and 7.18%. The investment in LIHTC projects is being accounted for using the proportional amortization method, under which the Company amortizes the initial cost of the investment in proportion to the amount of the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit).

The following table presents the Company's original investment in the LIHTC projects accounted for using the proportional amortization method, the current recorded investment balance, and the unfunded liability balance of each investment at September 30, 2014 and December 31, 2013. In addition, the table reflects the tax credits and tax benefits recorded by the Company during 2014 and 2013, the amortization of the investment and the net impact to the Company's income tax provision for 2014 and 2013:

(Dollars in thousands) **Qualified Affordable Housing Projects at September 30, 2014**	**Original Investment Value**	**Current Recorded Investment**	**Unfunded Liability Obligation**	**Tax Credits and Benefits (1)**	**Amortization of Investments (2)**	**Net Income Tax Benefit**
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 1,892	$ 1,119	$ 120	$ 107	$ 23
WNC Institutional Tax Credit Fund 38, L.P.	1,000	906	364	98	94	24
Merritt Community Capital Corporation Fund XV, L.P.	2,500	2,185	1,548	255	315	44
Total – Investments in Qualified Affordable Housing Projects	$ 5,500	$ 4,983	$ 3,031	$ 473	$ 516	$ 91

(Dollars in thousands)	**Original**	**Current**	**Unfunded**	**Tax Credits**	**Amortization**	**Net**
Qualified Affordable Housing Projects at	**Investment**	**Recorded**	**Liability**	**and**	**of**	**Income Tax**
December 31, 2013	**Value**	**Investment**	**Obligation**	**Benefits (1)**	**Investments (2)**	**Benefit**
Raymond James California Housing Opportunities Fund II	$ 2,000	$ 2,000	$ 1,858	$ 30	$ -	$ 6
WNC Institutional Tax Credit Fund 38, L.P.	1,000	1,000	592	49	-	12
Merritt Community Capital Corporation Fund XV, L.P.	2,500	2,500	2,346	203	-	35
Total – Investments in Qualified Affordable Housing Projects	$ 5,500	$ 5,500	$ 4,796	$ 282	$ -	$ 53

(1) The amounts reflected in this column represent both the tax credits, as well as the tax benefits generated by the Qualified Affordable Housing Projects operating loss for the year.

(2) This amount reduces the tax credits and benefits generated by the Qualified Affordable Housing Projects.

The Company's investments in affordable housing projects generated tax credits recorded by the Company of $120 thousand for the quarter ended September 30, 2014 and $0 for the quarter ended September 30, 2013. Additional tax benefits from the operating losses generated by the projects were $38 thousand and $0 for the quarter ended September 30, 2014 and 2013 respectively. The tax credits and benefits were partially offset by the amortization of the principal investment balances of $516 thousand and $0 for the nine months ended September 30, 2014 and 2013 respectively.

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The following table reflects the anticipated net income tax benefit at September 30, 2014 that is expected to be recognized by the Company over the remaining life of the investment:

(Dollars in thousands)	**Raymond James California Housing Opportunities**	**WNC Institutional Tax Credit**	**Merritt Community Capital Corporation**	**Total Net Income Tax**
Qualified Affordable Housing Projects	**Fund II**	**Fund 38, L.P.**	**Fund XV, L.P**	**Benefit**
Anticipated net income tax benefit less amortization of investments:				
2014	$ 8	$ 8	$ 14	$ 30
2015	45	35	47	127
2016	45	35	47	127
2017	44	34	45	123
2018 and thereafter	290	177	283	750
Total	$ 432	$ 289	$ 436	$ 1,157

NOTE 10. FEDERAL FUNDS PURCHASED

At September 30, 2014 and December 31, 2013, the Company had no outstanding federal funds purchased balances. The Bank had available lines of credit with the Federal Home Loan Bank (“FHLB”) totaling $146.6 million at September 30, 2014. The Bank had available lines of credit with the Federal Reserve totaling $19.1 million subject to certain collateral requirements, namely the amount of certain pledged loans. The Bank had uncommitted federal funds line of credit agreements with three financial institutions totaling $40.0 million at September 30, 2014. At September 30, 2014, the lines of credit had interest rates ranging from 0.31% to 1.14%. Availability of the lines is subject to federal funds balances available for loan, continued borrower eligibility and are reviewed and renewed periodically throughout the year. These lines are intended to support short-term liquidity needs, and the agreements may restrict consecutive day usage.

NOTE 11. TERM DEBT

The Bank had outstanding secured advances from the FHLB at September 30, 2014 and December 31, 2013 of $75.0 million.

Future contractual maturities of FHLB term advances at September 30, 2014 are as follows:

(Dollars in thousands)

Year	**Amount**
2015	$ 75,000
Thereafter	-
Total FHLB advances	$ 75,000

The maximum amount outstanding from the FHLB under term advances at any month end during the nine months ended September 30, 2014, and the year ended December 31, 2013 was $75.0 million and $135.0 million, respectively. The average balance outstanding on FHLB term advances during the nine months ended September 30, 2014 and year ended December 31, 2013 was $78.4 million and $109.7 million, respectively. The weighted average interest rate on the borrowings at September 30, 2014 and December 31, 2013 was 0.25% and 0.23%, respectively.

The FHLB borrowings are secured by an investment in FHLB stock, certain real estate mortgage loans which have been specifically pledged to the FHLB pursuant to their collateral requirements, and securities held in the Bank's investment securities portfolio. As of September 30, 2014, based upon the level of FHLB advances, the Company was required to hold an investment in FHLB stock of $6.4 million. Furthermore, the Company has pledged $274.4 million of its commercial and real estate mortgage loans, and has borrowed $75.0 million against the pledged loans. As of September 30, 2014, the Company held $25.2 million in securities with the FHLB for pledging purposes. All of the securities pledged to the FHLB were unused as collateral as of September 30, 2014.

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NOTE 12. COMMITMENTS AND CONTINGENCIES

Lease Commitments – The Company leases four sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term.

Rent expense for the three months ended September 30, 2014 and 2013 was $142 thousand and $106 thousand, respectively. Rent expense was offset by rent income during the three and nine months ended September 30, 2014, of $3 thousand and $11 thousand, respectively, compared to $4 thousand and $12 thousand, respectively, in the comparable periods of 2013.

The following table sets forth, as of September 30, 2014, the future minimum lease payments under non-cancelable operating leases:

(Dollars in thousands)	
Amounts due in:	
2014	$138
2015	562
2016	576
2017	517
2018	398
Thereafter	1,555
Total	$3,746

Financial Instruments with Off-Balance Sheet Risk – The Company's financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of the Bank's business and involve elements of credit, liquidity, and interest rate risk.

The following table presents a summary of the Bank's commitments and contingent liabilities at September 30, 2014 and December 31, 2013:

(Dollars in thousands)	**September 30, 2014**	**December 31, 2013**
Commitments to extend credit	$ 201,907	$ 192,351
Standby letters of credit	2,764	4,583
Guaranteed commitments outstanding	1,865	1,871
Total commitments	$ 206,536	$ 198,805

The Bank is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees. Those instruments involve elements of credit and interest rate risk similar to the amounts recognized in the *Consolidated Balance Sheets*. The contract or notional amounts of those instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, standby letters of credit, and financial guarantees written, is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any covenant or condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

While most standby letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral varies but may include cash, accounts receivable, inventory, premises and equipment and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including international trade finance, commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. The Bank was not required to perform on any financial guarantees for the nine months ended September 30, 2014, and the year ended December 31, 2013. At September 30, 2014 approximately $1.3 million of standby letters of credit expire within one year, and $1.4 thousand expire thereafter.

The reserve for unfunded commitments, which is included in other liabilities on the *Consolidated Balance Sheets*, was $696 thousand at September 30, 2014 and December 31, 2013. The adequacy of the reserve for unfunded commitments is reviewed on a quarterly basis, based upon changes in the amount of commitments, loss experience, and economic conditions. During the nine months ended September 30, 2014, the Company made no additional provision to the reserve for unfunded commitments. During the nine months ended September 30, 2013, the Company made additional provisions of $200 thousand to the reserve for unfunded commitments. When necessary, the provision expense is recorded in other noninterest expense in the *Consolidated Statements of Operations.*

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.

Concentrations of Credit Risk –The Company grants real estate construction, commercial, and installment loans to customers throughout northern California. In management’s judgment, a concentration exists in real estate-related loans, which represented approximately 71% of the Company’s gross loan portfolio at both September 30, 2014 and December 31, 2013. Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in the Company’s primary market areas in particular, as we witnessed with the deterioration in the residential development market during the most recent recession, could have an adverse impact on the repayment of these loans. Personal and business incomes, proceeds from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

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

NOTE 13. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents activity in accumulated other comprehensive income for the nine months ended September 30, 2014:

(Dollars in thousands)	**Unrealized Gains (Losses) on Securities**	**Unrealized Gains (Losses) on Derivatives**	**Accumulated Other Comprehensive Income (Loss)**
Accumulated other comprehensive loss as of December 31, 2013	$ (1,809)	$ (583)	$ (2,392)
Comprehensive income three months ended March 31, 2014	1,786	(120)	1,666
Comprehensive loss three months ended June 30, 2014	1,115	(1,296)	(181)
Comprehensive income three months ended September 30, 2014	267	162	429
Accumulated other comprehensive loss as of September 30, 2014	$ 1,359	$ (1,837)	$ (478)

The following table presents activity in accumulated other comprehensive income for the nine months ended September 30, 2013:

(Dollars in thousands)	**Unrealized Gains (Losses) on Securities**	**Unrealized Gains (Losses) on Derivatives**	**Accumulated Other Comprehensive Income (Loss)**
Accumulated other comprehensive income as of December 31, 2012	$ 2,189	$ (931)	$ 1,258
Comprehensive income three months ended March 31, 2013	219	(37)	182
Comprehensive loss three months ended June 30, 2013	(2,397)	650	(1,747)
Comprehensive loss three months ended September 30, 2013	(2,110)	(150)	(2,260)
Accumulated other comprehensive loss as of September 30, 2013	$ (2,099)	$ (468)	$ (2,567)

Accumulated other comprehensive income is reported net of related tax effects. Detailed information on the tax effects of the individual components of comprehensive income are presented in the *Consolidated Statements of Comprehensive Income* incorporated in this document.

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NOTE 14. DERIVATIVES

In the normal course of business the Company is subject to risk from adverse fluctuations in interest rates. To mitigate interest rate risk and market risk, we enter into interest rate swaps with counterparties. Derivative instruments are used to manage interest rate risk relating to specific groups of assets and liabilities, and are presently being used to hedge interest expenses associated with certain FHLB wholesale borrowings. The Company does not use derivative instruments for trading or speculative purposes. The counterparties to the interest rate swaps and forwards are major financial institutions.

The Company's objective in managing exposure to market risk is to limit the impact on earnings and cash flow. The extent to which the Company uses such instruments is dependent on its access to these contracts in the financial markets.

Derivative financial instruments contain an element of credit risk if counterparties are unable to meet the terms of the agreements. Credit risk associated with derivative financial instruments is measured as the net replacement cost should the counterparties that owe us under the contract completely fail to perform under the terms of those contracts, assuming no recoveries of underlying collateral as measured by the market value of the derivative financial instrument.

ASC 815-10, *Derivatives and Hedging* ("ASC 815") requires companies to recognize all derivative instruments as assets or liabilities at fair value in the *Consolidated Balance Sheets*. In accordance with ASC 815-10, the Company designates interest rate swaps as cash flow hedges of forecasted variable rate FHLB advances.

No components of the hedging instruments are excluded from the assessment of hedge effectiveness. All changes in fair value of outstanding derivatives in cash flow hedges, except any ineffective portion, are recorded in OCI until earnings are impacted by the hedged transaction. Classification of the gain or loss in the *Consolidated Statements of Operations* upon release from OCI is the same as that of the underlying exposure.

When the Company discontinues hedge accounting because it is no longer probable that an anticipated transaction will occur in the originally expected period, or within an additional two-month period thereafter, changes to fair value accumulated in OCI are recognized immediately in earnings.

During August 2010, the Company entered into five forward starting interest rate swap contracts (“IR”), to hedge interest rate risk associated with forecasted variable interest rate payments from FHLB advances. The hedge strategy converted the LIBOR based floating rate of interest on certain forecasted FHLB advances to fixed interest rates, thereby protecting the Company from floating interest rate variability. Contracts outstanding at February 3, 2011, had effective dates and maturities ranging from March 1, 2012 through March 1, 2017.

On February 4, 2011, the Company terminated the forward starting interest rate swap positions and realized $3.0 million in cash from the counterparty, equal to the carrying amount of the derivative at the date of termination. In addition, upon termination of the hedge contract, the Company received the full amount of the collateral posted pursuant to the hedge contract. Concurrent with the termination of the hedge contract, management removed the cash flow hedge designation, but continued to conclude the forecasted FHLB advances as probable.

The IR’s were terminated due to continuing uncertainty regarding future economic conditions including the corresponding uncertainty on the timing and extent of future changes in the three month LIBOR rate index. The $3.0 million in cash received from the counterparty reflected gains to be reclassified into earnings. Accordingly, the net gains from this transaction have been reclassified from OCI to earnings as a credit to interest expense and other noninterest income in the same periods during which the hedged forecasted transaction affected earnings.

The Company performed on the first three legs of the forecasted transactions by executing forecasted FHLB advances of $75.0 million, with maturities that aligned with the respective terminated IR’s. During June 2014, the Company concluded the remaining hedged forecasted FHLB advances associated with the final two legs of the IR’s were no longer probable. Accordingly, the remaining gains recorded in OCI relating to the final two legs of the IR’s were immediately recognized in earnings. As a result of the transaction, the Company reclassified $952 thousand from OCI to earnings, which are included in other noninterest income in the *Consolidated Statement of Operations*.

Since March 1, 2012, $814 thousand and $952 thousand of net gains relating to the IR’s were reclassified out of accumulated OCI and netted with other borrowing expense and other noninterest income, respectively. During the three months ended September 30, 2014, the remaining net gains of $13 thousand were reclassified out of accumulated OCI and netted with other borrowing interest expense.

During August 2011, the Company entered into four IR contracts, to hedge interest rate risk associated with forecasted variable rate FHLB advances. The hedge strategy converts the LIBOR based floating rate of interest on certain forecasted FHLB advances to fixed interest rates, thereby protecting the Company from floating interest rate variability.

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During June 2013, the Company discontinued the hedge treatment associated with the first leg of the IR swap. Subsequently, in July 2013, the Company decided not to obtain an additional $75.0 million in FHLB borrowings whose interest payments were forecasted to be used as the hedged item. Simultaneously, the Company terminated the IR resulting in a $503 thousand loss recognized in other expenses in the *Consolidated Statements of Operations*, representing the fair value of the IR at the termination date. Immediately upon termination of the IR, the Company reclassified $296 thousand of accumulated losses from OCI to earnings.

The following table summarizes the notional amount, effective dates and maturity dates of the IR contracts the Company had outstanding with counterparties as of September 30, 2014. Furthermore, the disclosure indicates the maximum length of time over which the Company is hedging its exposure to variability in future cash flows for forecasted interest payment transactions.

(Dollars in thousands)

Description	**Notional Amount**	**Effective Date**	**Maturity**
Forward starting interest rate swap	$ 75,000	August 1, 2014	August 3, 2015
Forward starting interest rate swap	$ 75,000	August 3, 2015	August 1, 2016
Forward starting interest rate swap	$ 75,000	August 1, 2016	August 1, 2017

The Company has agreements with its derivative counterparties that contain a provision where if the Company fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and the Company would be required to settle its obligations under the agreements. Similarly, the Company could be required to settle its obligations under certain of its agreements if specific regulatory events occur, such as if the Company were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels.

The Company has minimum collateral posting thresholds with certain of its derivative counterparties, and has been required to post collateral against its obligations under these agreements of $3.1 million as of September 30, 2014. Accordingly, the Company pledged three mortgage backed securities with an aggregate par value of $4.3 million and an aggregate fair market value of $4.5 million. If the Company had breached any of these provisions at September 30, 2014, it could have been required to settle its obligations under the agreements at the termination value. The collateral posted by the Company exceeds the aggregate fair value of additional assets that would be required to be posted as collateral if the instrument were to be settled immediately.

The following table summarizes the types of derivatives, separately by assets and liabilities, their locations on the *Consolidated Balance Sheets*, and the fair values of such derivatives as of September 30, 2014, and December 31, 2013. See Note 15, *Fair Values* in these *Notes to Unaudited Consolidated Financial Statements* for additional detail on the valuation of the Company's derivatives. The contracts are made with a single issuer and include the right of offset however all of the outstanding IR contracts have a liability position as of September 30, 2014 and December 31, 2013.

(Dollars in thousands)	**Balance Sheet**	**Asset Derivatives**		**Liability Derivatives**	
		September 30,	**December 31,**	**September 30,**	**December 31,**
Description	**Location**	**2014**	**2013**	**2014**	**2013**
Forward starting interest rate swaps [1]	Other liabilities	$ -	$ -	$1,170	$ 1,071
Forward starting interest rate swaps [1]	Other liabilities	-	-	1,157	1,134
Forward starting interest rate swaps [1]	Other liabilities	-	-	796	685
Total		$ -	$ -	$3,123	$ 2,890

(1) Derivative designated as hedging instrument.

The following table summarizes the types of derivatives, their locations within the *Consolidated Statements of Operations*, and the gains recorded for the three and nine months ended September 30, 2014 and 2013:

(Dollars in thousands)

	Consolidated Statement of	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
Description	**Operations Location**	**2014**	**2013**	**2014**	**2013**
Forward starting interest rate swaps [1]	Interest on FHLB borrowings	$22	$150	$283	$450
Forward starting interest rate swaps [1]	Other noninterest income	-	-	1,617	-
Total		$22	$150	$1,900	$450

(1) Cash flow hedge designation removed. Gains represent tax adjusted amounts reclassified from accumulated OCI pertaining to the terminated forward starting interest rate swap.

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NOTE 15. FAIR VALUES

The following table presents estimated fair values of the Company’s financial instruments as of September 30, 2014, and December 31, 2013, whether or not recognized or recorded at fair value in the *Consolidated Balance Sheets*. The table indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such 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.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company’s entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

Non-financial assets and non-financial liabilities defined by the FASB ASC 820, *Fair Value Measurement*, such as Bank premises and equipment, deferred taxes and other liabilities are excluded from the table. In addition, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements of FASB ASC 825, *Financial Instruments*, such as Bank-owned life insurance policies.

(Dollars in thousands)	**Carrying**	**Fair Value Measurements Using**			
September 30, 2014	**Amounts**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets					
Cash and cash equivalents	$46,423	$46,423	$-	$-	$46,423
Securities available-for-sale	189,379	-	189,379	-	189,379
Securities held-to-maturity	36,888	-	36,816	-	36,816
Portfolio loans, net	639,479	-	-	641,568	641,568
Federal Home Loan Bank Stock	6,432	6,432	-	-	6,432
Financial liabilities					
Deposits	$767,520	$-	$767,601	$-	$767,601
Federal Home Loan Bank advances	75,000	-	75,000	-	75,000
Subordinated debenture	15,465	-	8,424	-	8,424
Derivatives	3,123	-	3,123	-	3,123

(Dollars in thousands)	**Carrying**	**Fair Value Measurements Using**			
December 31, 2013	**Amounts**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets					
Cash and cash equivalents	$58,515	$58,515	$-	$-	$58,515
Securities available-for-sale	216,640	-	216,640	-	216,640
Securities held-to-maturity	36,696	-	34,025	-	34,025
Portfolio loans, net	584,126	-	-	591,315	591,315
Promissory note due from the former mortgage subsidiary	2,607	-	-	2,607	2,607
Federal Home Loan Bank Stock	4,531	4,531	-	-	4,531
Financial liabilities					
Deposits	$746,293	$-	$746,332	$-	$746,332
Federal Home Loan Bank advances	75,000	-	75,000	-	75,000
Subordinated debenture	15,465	-	8,754	-	8,754
Derivatives	2,890	-	2,890	-	2,890

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Fair Value Hierarchy

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

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

Level 3 valuations are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

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

The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. 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 methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practical to estimate that value:

Cash and cash equivalents – The carrying amounts reported in the *Consolidated Balance Sheet*s for cash and cash equivalents are a reasonable estimate of fair value. The carrying amount is a reasonable estimate of fair value because of the relatively short term between the origination of the instrument and its expected realization. Therefore, the Company believes the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

Securities – For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices or matrix pricing which is a mathematical technique used widely by the industry that relies on the securities relationship to other benchmark securities and are classified as Level 2.

Portfolio loans, net – For variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. For fixed rate loans, projected cash flows are discounted back to their present value based on specific risk adjusted spreads to the U.S. Treasury Yield Curve, with the rate determined based on the timing of the cash flows. The ALLL is considered to be a reasonable estimate of loan discount for credit quality concerns. Given that there are commercial loans with specific terms that are not readily available; the Company believes the fair value of portfolio loans is derived from Level 3 inputs.

FHLB stock – The carrying value of FHLB stock approximates fair value as the shares can only be redeemed by the issuing institution at par. The Company measures the fair value of FHLB stock using Level 1 inputs.

Promissory note due from Mortgage Company – To determine the fair value of the promissory note, the Company discounts the expected future cash flows after each payment based on a discount rate derived by the average of the bid/ask yields on debt issued by a large mortgage lender with similar risk characteristics, whose debt is currently traded in an active open market. In addition, a risk premium adjustment was added to incorporate certain inherent risks and credit risks associated with the payment of certain cash flows from the former mortgage subsidiary. Accordingly, the Company derived a 10% discount rate to discount the future expected cash flows over the remaining life of the loan. The Company believes the fair value of the promissory note is derived from Level 3 inputs. See Note 3, *Note Receivable* in these *Notes to Unaudited Consolidated Financial Statements* for additional detail on the promissory note due.

Deposits – The Company measures fair value of maturing deposits using Level 2 inputs. The fair values of deposits were derived by discounting their expected future cash flows based on the FHLB yield curves, and maturities. The Company obtained FHLB yield curve rates as of the measurement date, and believes these inputs fall under Level 2 of the fair value hierarchy. Deposits with no defined maturities, the fair values are the amounts payable on demand at the respective reporting date.

FHLB variable rate advances – For variable rate FHLB borrowings, the carrying value approximates fair value. The Company measures the fair value of FHLB advances using Level 2 inputs.

Subordinated debenture – The fair value of the subordinated debenture is estimated by discounting the future cash flows using market rates at the reporting date, of which similar debentures would be issued with similar credit ratings as ours and similar remaining maturities. At September 30, 2014, future cash flows were discounted at 6.23%. The Company measures the fair value of subordinated debentures using Level 2 inputs.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

Commitments – Loan commitments and standby letters of credit generate ongoing fees, which are recognized over the term of the commitment period. In situations where the borrower's credit quality has declined, we record a reserve for these unfunded commitments. Given the uncertainty in the likelihood and timing of a commitment being drawn upon, a reasonable estimate of the fair value of these commitments is the carrying value of the related unamortized loan fees plus the reserve, which is not material. As such, no disclosures are made on the fair value of commitments.

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available-for-sale securities and derivatives are recorded at fair value on a recurring basis. From time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as collateral dependent impaired loans and certain other assets including OREO. These nonrecurring fair value adjustments involve the application of lower of cost or fair value accounting or write downs of individual assets.

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value, as of September 30, 2014 and December 31, 2013.

(Dollars in thousands)	**Fair Value at September 30, 2014**			
Recurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$7,825	$ -	$7,825	$ -
Obligations of states and political subdivisions	57,161	-	57,161	-
Residential mortgage backed securities and collateralized mortgage obligations	46,498	-	46,498	-
Corporate securities	39,717	-	39,717	-
Commercial mortgage backed securities	11,100	-	11,100	-
Other investment securities [(1)]	27,078	-	27,078	-
Total assets measured at fair value	$189,379	$ -	$189,379	$ -
Derivatives – forward starting interest rate swap	$3,123	$ -	$3,123	$ -
Total liabilities measured at fair value	$3,123	$ -	$3,123	$ -

(Dollars in thousands)	**Fair Value at December 31, 2013**			
Recurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale securities				
U.S. government and agencies	$6,264	$ -	$6,264	$ -
Obligations of states and political subdivisions	59,209	-	59,209	-
Residential mortgage backed securities and collateralized mortgage obligations	62,991	-	62,991	-
Corporate securities	48,230	-	48,230	-
Commercial mortgage backed securities	10,472	-	10,472	-
Other investment securities (1)	29,474	-	29,474	-
Total assets measured at fair value	$216,640	$ -	$216,640	$ -
Derivatives – forward starting interest rate swap	$2,890	$ -	$2,890	$ -
Total liabilities measured at fair value	$2,890	$ -	$2,890	$ -

(1) Principally represents residential mortgage backed securities issued by both by governmental and nongovernmental agencies, and SBA pool securities.

Recurring Items

Debt Securities – The available-for-sale securities amount in the recurring fair value table above represents securities that have been adjusted to their fair values. For these securities, 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. The Company has determined that the source of these fair values falls within Level 2 of the fair value hierarchy.

Forward starting interest rate swaps – The valuation of the Company's interest rate swaps were obtained from third party pricing services. The fair values of the interest rate swaps were determined by using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis was based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves. The Company has determined that the source of these derivatives' fair values falls within Level 2 of the fair value hierarchy.

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Notes to Unaudited Consolidated Financial Statements

There were no assets or liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis for the nine months ended September 30, 2014 and three months ended September 30, 2014 and no transfers in or out of level 3 during the nine months ended September 30, 2014 and three months ended September 30, 2014. The following table provides a reconciliation of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) on a recurring basis for the nine months ended September 30, 2013. The amount included in the "Beginning balance" column represents the beginning balance of an item in the period for which it was designated as a Level 3 fair value measure.

(Dollars in thousands)	**Beginning balance**	**Transfers into Level 3**	**Change included in earnings**	**Purchases and issuances**	**Sales and settlements**	**Transfers out**	**Ending balance**	**Net change in unrealized gains or (losses) relating to items held at end of period**
Nine Months Ended September 30, 2013								
Obligations of states and political subdivisions	$ 1,131	$ -	$ -	$ -	$ -	$ (1,131)	$ -	$ -
Mortgage backed securities	$ 13,747	$ -	$ -	$ -	$ (749)	$ (12,998)	$ -	$ -

During the nine months ended September 30, 2013, the Company transferred $1.1 million and $13.0 million in municipal bonds and non-agency mortgage backed securities from Level 3 to Level 2, the Company determined the fair values of these securities were derived from observable inputs.

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. These adjustments to fair value generally result from the application of lower of cost or fair value accounting or write-downs of individual assets due to impairment. The following table presents information about the Company's assets and liabilities at September 30, 2014 and December 31, 2013 measured at fair value on a nonrecurring basis for which a nonrecurring change in fair value has been recorded during the reporting period. The amounts disclosed below represent the fair values at the time the nonrecurring fair value measurements were made, and not necessarily the fair values as of the date reported upon.

(Dollars in thousands)	**Fair Value at September 30, 2014**			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$12,550	$ -	$ -	$12,550
Total assets measured at fair value	$12,550	$ -	$ -	$12,550

(Dollars in thousands)	**Fair Value at December 31, 2013**			
Nonrecurring basis	**Total**	**Level 1**	**Level 2**	**Level 3**
Collateral dependent impaired loans	$2,317	$ -	$ -	$2,317
Other real estate owned	913	-	-	913
Total assets measured at fair value	$3,230	$ -	$ -	$3,230

The following table presents the losses resulting from nonrecurring fair value adjustments for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(Dollars in thousands)	**2014**	**2013**	**2014**	**2013**
Collateral dependent impaired loans	$ -	$ 95	$4,988	$486
Total	$ -	$ 95	$4,988	$486

For the nine months ended September 30, 2014:

Collateral dependent impaired loans with a carrying amount of $17.5 million were written down to their fair value of $12.6 million resulting in a $5.0 million adjustment to the ALLL.

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

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Notes to Unaudited Consolidated Financial Statements

The loss represents charge offs or impairments on collateral dependent loans for fair value adjustments based on the fair value of collateral. The carrying value of loans fully charged off is zero. When the fair value of the collateral is based on a current appraised value, 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 OREO amount above represents impaired real estate that has been adjusted to fair value during the respective reporting period. The loss represents impairments on OREO for fair value adjustments based on the fair value of the real estate. The determination of fair value is generally based on recent appraisals of the foreclosed properties, which take into account recent sales prices adjusted for unobservable inputs, such as opinions provided by local real estate brokers and other real estate experts. The Company records OREO as a nonrecurring Level 3.

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

Fair value estimates are based on current on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax assets and liabilities, and property, plant and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

NOTE 16. PURCHASE OF FINANCIAL ASSETS

On September 23, 2014, the Company agreed to purchase $18.1 million of owner-occupied commercial real estate loans secured by first deeds of trust originated under the SBA 504 loan program. The loans will be serviced by the Company and were purchased without recourse. As of September 30, 2014 the Company has purchased a total par value of $18.1 million in loans with accrued interest at the settlement date of $77 thousand at a net premium of $377 thousand in exchange for a cash payment of $18.5 million. The Company initially measured the acquired loan portfolio at fair value of $18.1 million. The fair value was equal to the price paid to acquire the portfolio as the difference between the par value and cash purchase price represents the fair value adjustment.

On May 12, 2014, the Company agreed to purchase $40 million of unsecured consumer home improvement loans. The loans were purchased without recourse or servicing rights. The agreement calls for purchases up to $4 million per month up to a maximum par value of $40 million. As of September 30, 2014 the Company has recorded a total par value of $17.6 million in loans at a net discount of $714 thousand in exchange for cash payments totaling $16.9 million. The Company initially measured the acquired loan portfolio at a fair equal to the price paid to acquire the portfolio as the difference between the par value and cash purchase price represents the fair value adjustment.

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Notes to Unaudited Consolidated Financial Statements

On February 27, 2014, the Company completed a loan purchase transaction which included the purchase of a pool of residential solar panel loans secured by UCC filing with a par value of $12.9 million. The solar panel loans portfolio (“portfolio”) was purchased from an unrelated bank in exchange for cash of $12.7 million. The loans and the related servicing were purchased without recourse. The Company initially measured the acquired loan portfolio at fair value of $12.7 million. The fair value was equal to the price paid to acquire the portfolio as the difference between the par value and cash purchase price represents the fair value adjustment.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

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

Forward Looking Statements and Risk Factors

This Report contains certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbor for “forward-looking statements” provided by the Private Securities Litigation Reform Act of 1995. These statements may include statements that expressly or implicitly predict future results, performance or events. Statements other than statements of historical fact are forward-looking statements. You can find many of these statements by looking for words such as “anticipates,” “expects,” “believes,” “estimates” and “intends” and words or phrases of similar meaning. We ma forward-looking statements regarding projected sources of funds, use of proceeds, availability of acquisition and growth opportunities, dividends, adequacy of our allowance for loan and lease losses (“ALLL”) and provision for loan losses, our commercial real estate portfolio and subsequent charge offs, among others. Forward-looking statements involve substantial risks and uncertainties, many of which are difficult to predict and are generally beyond our control. There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. Risks and uncertainties include those set forth in our filings with the Securities and Exchange Commission (“SEC”), and the following factors that might cause actual results to differ materially from those presented:

Our ability to attract new deposits and loans

Demand for financial services in our market areas

Competitive market pricing factors

Deterioration of economic conditions that could result in increased loan losses

Risks associated with concentrations of real estate related loans

Market interest rate volatility

Stability of funding sources and continued availability of borrowing

Changes in legal or regulatory requirements or the results of regulatory examinations that could restrict growth

Our ability to recruit and maintain key management staff

Our ability to raise capital and incur debt on reasonable terms

Regulatory limits on the Bank’s ability to pay dividends to the Company

The impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) and related rules and regulations on the Company’s business operations and competitiveness, including the impact of executive compensation restrictions, which may affect the Company’s ability to retain and recruit executives in competition with firms in other industries who do not operate under those restrictions

The impact of the Dodd-Frank Act on the Company’s interchange fee revenue, interest expense, FDIC deposit insurance assessments and regulatory compliance expense

Continued consolidation in the financial services industry resulting in larger financial institutions that may have greater resources could change the competitive landscape

There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. We do not intend to update these forward-looking statements. Readers should consider any forward-looking statements in light of this explanation, and we caution readers about relying on 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, 2013 under the heading "Risk factors". The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following sections discuss significant changes and trends in the financial condition, capital resources and liquidity of the Company from December 31, 2013 to September 30, 2014. Also discussed are significant trends and changes in the Company's results of operations for the nine months ended September 30, 2014, compared to the same period in 2013. The consolidated financial statements and related notes appearing elsewhere in this report are unaudited. The following discussion and analysis is intended to provide greater detail of the Company's financial condition and results.

GENERAL

Bank of Commerce Holdings ("Company," "Holding Company," "We," or "Us") is a corporation organized under the laws of California and a bank holding company ("BHC") registered under the Bank Holding Company Act of 1956, as amended ("BHC Act"). Our principal business is to serve as a holding company for Redding Bank of Commerce ("Bank"), which operates under two separate names (Redding Bank of Commerce and Sacramento Bank of Commerce, a division of Redding Bank of Commerce). We also have two unconsolidated subsidiaries, Bank of Commerce Holdings Trust and Bank of Commerce Holdings Trust II, which were organized in connection with our prior issuances of trust preferred securities. Our common stock is traded on the NASDAQ Global Market under the symbol "BOCH."

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

The Company commenced banking operations in 1982 and currently operates four full service facilities in two diverse markets in Northern California. We are proud of the Bank’s reputation as one of Northern California’s premier banks for business banking. We provide 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 in California.

Our principal executive offices are located at 1901 Churn Creek Road, Redding, California and the telephone number is (530) 722-3939.

Executive Overview

Significant items for the nine months ended September 30, 2014 were as follows:

Financial Position

Total consolidated assets were $977.8 million as of September 30, 2014, compared to $956.3 million as of December 31, 2013. Cash from increased deposits and sales of available for sale investment securities was used to, purchase $49.3 million in consumer and SBA loan pools, fund $9.2 million in loan origination net of repayment, $5.0 million of BOLI and repurchase $4.6 million of Company common stock.

Capital

The Company repurchased 700,000 common shares at a weighted average cost of $6.52 per share, pursuant to the Company’s publicly announced stock repurchase plan.

The Company paid preferred stock cash dividends of $150 thousand compared to $150 thousand during the same period in 2013.

The Company declared a regular cash dividend of $0.03 for each of the quarters ended September 30, 2014, June30, 2014 and March 31, 3014.

The Company concluded the remaining hedged forecasted FHLB advances associated with the final two legs of the forward starting interest rate swap contracts (“IR”) were no longer probable. As a result, the Company reclassified $1.6 million from other comprehensive income (“OCI”) and deferred tax liability to earnings, which are included in other noninterest income in the *Consolidated Statement of Operations*.

Financial Performance

Net income available to common shareholders was $3.9 million for the nine months ended September 30, 2014, compared with $5.7 million for the same period a year ago. The decrease in net income available to common shareholders in the current quarter was attributable to the following:

Net interest margin, on a tax equivalent basis, was 3.64% for the nine months ended September 30, 2014 compared to 3.86% at December 31, 2013, and 3.84% for the nine months ended September 30, 2013.

Provision for loan loss was increased $750 thousand to$1.1 million compared to $300 thousand for the same period a year ago.

Securities gains decreased $304 thousand to $32 thousand compared to $336 for the same period a year ago.

Credit Quality

Nonperforming assets decreased $6.2 million to $24.9 million, or 2.54% of total assets, as of September 30, 2014, compared to $30.7 million, or 3.21% of total assets as of December 31, 2013.

Nonperforming loans decreased $5.3 million to $24.5 million, or 3.77% of total loans, as of September 30, 2014, compared to $29.8 million, or 4.98% of total loans as of December 31, 2013.

Net charge offs were $6.3 million compared to net recoveries of $311 thousand during the same period a year ago.

The ALLL balance was $10.4 million as of September 30, 2014 compared to $14.2 as of December 31, 2013. The ratio of ALLL to total loans was 1.6% at September 30, 2014, compared to 2.4% at December 31, 2013.

Summary of Critical Accounting Policies

Our significant accounting policies are described in Note 2 of the *Notes to the Consolidated Financial Statements* included in the Form 10-K for the year ended December 31, 2013 filed with the SEC on March 11, 2014. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC's definition.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

Valuation of Investments and Impairment of Securities

At the time of purchase, the Company designates the security as held-to-maturity or available-for-sale, based on its investment objectives, operational needs and intent to hold. The Company does not engage in trading activity. Securities designated as held-to-maturity are carried at cost adjusted for the accretion of discounts and amortization of premiums. The Company has the ability and intent to hold these securities to maturity. Securities designated as available-for-sale may be sold to implement the Company’s asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. Securities designated as available-for-sale are recorded at fair value and unrealized gains or losses, net of income taxes, are reported as part of accumulated other comprehensive income OCI (loss), a separate component of shareholders’ equity. Gains or losses on sale of securities are based on the specific identification method. The market value and underlying rating of the security is monitored for quality. Securities may be adjusted to reflect changes in valuation as a result of other-than-temporary declines in value. Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed rate investments, from changes in interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other-than-temporary based upon the positive and negative evidence available. Evidence evaluated includes, but is not limited to, industry analyst reports, credit market conditions, and interest rate trends.

When an investment is other-than-temporarily impaired, the Company assesses whether it intends to sell the security, or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses.

If the Company intends to sell the security or if it more likely than not that the Company will be required to sell security before recovery of the amortized cost basis, the entire amount of other than temporary impairment (“OTTI”) is recognized in earnings.

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

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

The ALCO Committee's assessment of whether OTTI loss should be recognized incorporates both quantitative and qualitative information including, but not limited to: (1) the length of time and the extent of which the fair value has been less than amortized cost, (2) the financial condition and near term prospects of the issuer, (3) the intent and ability of the Company to retain its investment for a period of time sufficient to allow for an anticipated recovery in value, (4) whether the debtor is current on interest and principal payments, and (5) general market conditions and industry or sector specific outlook.

Allowance for Loan and Lease Losses

ALLL is based upon estimates of loan losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. The allowance is increased by provisions charged to expense and reduced by net charge offs. In periodic evaluations of the adequacy of the allowance balance, management considers our past loan loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. Management reviews the ALLL on a monthly basis and conducts a formal assessment of the adequacy of the ALLL on a quarterly basis. These assessments include the periodic re-grading of classified loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment and other factors as warranted. Loans are initially graded when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies. Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

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

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

Income Taxes

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

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

We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. For tax positions that meet the more likely than not threshold, we may recognize only the largest amount of tax benefit that is greater than fifty percent likely to be realized upon ultimate settlement with the taxing authority.

Management believes that all of our tax positions taken meet the more likely than not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities.

Derivative Financial Instruments and Hedging Activities

In the normal course of business the Company is subject to risk from adverse fluctuations in interest rates. The Company manages these risks through a program that includes the use of derivative financial instruments, primarily swaps and forwards. Counterparties to these contracts are major financial institutions. The Company is exposed to credit loss in the event of nonperformance by these counterparties. The Company does not use derivative instruments for trading or speculative purposes.

The Company's objective in managing exposure to market risk is to limit the impact on earnings and cash flow. The extent to which the Company uses such instruments is dependent on its access to these contracts in the financial markets.

All of the Company's outstanding derivative financial instruments are recognized in the *Consolidated Balance Sheets* at their fair values. The effect on earnings from recognizing the fair values of these derivative financial instruments depends on their intended use, their hedge designation, and their effectiveness in offsetting changes in the fair values of the exposures they are hedging. Changes in the fair values of instruments designated to reduce or eliminate adverse fluctuations in the fair values of recognized assets and liabilities and unrecognized firm commitments are reported in earnings along with changes in the fair values of the hedged items. Changes in the effective portions of the fair values of instruments used to reduce or eliminate adverse fluctuations in cash flows of anticipated or forecasted transactions are reported in equity as a component of accumulated OCI. Amounts in accumulated OCI are reclassified to earnings when the related hedged items affect earnings or the anticipated transactions are no longer probable. Changes in the fair values of derivative instruments that are not designated as hedges or do not qualify for hedge accounting treatment are reported currently in earnings. Amounts reported in earnings are classified consistent with the item being hedged.

For derivative financial instruments accounted for as hedging instruments, the Company formally designates and documents, at inception, the financial instrument as a hedge of a specific underlying exposure, the risk management objective, and the manner in which effectiveness of the hedge will be assessed. The Company formally assesses both at inception and at each reporting period thereafter, whether the derivative financial instruments used in hedging transactions are effective in offsetting changes in fair value or cash flows of the related underlying exposures. Any ineffective portion of the change in fair value of the instruments is recognized immediately into earnings.

The Company discontinues the use of hedge accounting prospectively when (1) the derivative instrument is no longer effective in offsetting changes in fair value or cash flows of the underlying hedged item; (2) the derivative instrument expires, is sold, terminated, or exercised; or (3) designating the derivative instrument as a hedge is no longer appropriate.

Types of derivative transactions currently recorded by the Company as of September 30, 2014:

Interest Rate Swap Agreements – As part of the Company’s risk management strategy, the Company enters into interest rate swap agreements or other derivatives to mitigate the interest rate risk inherent in certain assets and liabilities. These derivative instruments are accounted for as cash flow hedges, with the changes in fair value reflected in OCI and subsequently reclassified to earnings when earnings are realized on the hedged item. At September 30, 2014, the Company maintained a notional amount of $75.0 million in forward starting interest rate swap agreements which were in an aggregate unrealized loss position of $3.4 million.

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Fair Value Measurements

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

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of management’s judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. Additional information on our use of fair value measurements and our related valuation methodologies is provided in Note 15 of the *Notes to the Unaudited Consolidated Financial Statements* incorporated in this document.

Sources of Income

We derive our income from two principal sources: (1) net interest income, which is the difference between the interest income we receive on interest earning assets and the interest expense we pay on interest bearing liabilities, and (2) fee income, which includes fees earned on deposit services, income from payroll processing, electronic-based cash management services, mortgage banking income, and merchant credit card processing services.

Our income depends to a great extent on net interest income, which correlates strongly with certain interest rate characteristics. These interest rate characteristics are highly sensitive to many factors, which are beyond our control, including general economic conditions, inflation, recession, and the policies of various governmental and regulatory agencies, the Federal Reserve Board in particular. Because of our predisposition to variable rate pricing on our assets and level of time deposits, we are frequently considered asset sensitive, and generally we are affected adversely by declining interest rates. However, in the current interest rate environment, many of our variable rate loans are priced at their floors. As a result, we would not experience an immediate benefit in a rising rate environment.

Net interest income reflects both our net interest margin, which is the difference between the yield we earn on our assets and the interest rate we pay for deposits and other sources of funding, and the amount of earning assets we hold. As a result, changes in either our net interest margin or the amount of earning assets we hold could affect our net interest income and earnings.

Increases or decreases in interest rates could adversely affect our net interest margin. Although the yield we earn on our assets and funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, and cause our net interest margin to expand or contract. Many of our assets are tied to prime rate, so they may adjust faster in response to changes in interest rates. As a result, when interest rates fall, the yield we earn on our assets may fall faster than our ability to reprice a large portion of our liabilities, causing our net interest margin to contract.

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

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

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

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RESULTS OF OPERATIONS

OVERVIEW

Net income available to common shareholders was $3.9 million during the nine months ended September 30, 2014 compared to net income of $5.7 million during the same period a year ago. The decrease was principally attributable to the following;

Decreased net interest income primarily as a result of decreased yields in the loan portfolio and increased interest expense on FHLB borrowings.

Decreased gains recognized on sale of securities; the Company recorded loss of $252 thousand on the sale of investment securities as part of a strategy for repositioning of the portfolio to reduce interest rate risk.

The negotiated settlement of the note receivable from our former mortgage subsidiary, (the “Note”) which resulted in a loss of $1.4 million recorded in other expenses during the quarter ended June 30, 2014.

Increased other noninterest expense driven by an increase in the number of employees, costs related to the addition of a new SBA Lending Department and further impairment on an OREO property that was subsequently sold.

The decrease in net income available to common shareholders was partially offset by $1.6 million in gains reclassified from OCI to earnings based on the determination that the remaining hedged forecasted FHLB advances associated with the final two legs of the IR’s were no longer probable. The decrease in income before provision for income taxes resulted in a decrease in the provision for income taxes of $2.0 million for the nine months ended September 30, 2014

Diluted Earnings Per Share (“EPS”) were $ 0.29 for the nine months ended September 30, 2014 compared with $0.37 for the same period a year ago. The decrease in diluted EPS compared to the same period a year ago, primarily resulted from decreased net income, partially offset by a decrease in weighted average shares resulting from common stock repurchases.

The Company continued its quarterly cash dividends of $0.03 per share during the quarter ended September 30, 2014. In determining the amount of dividends to be paid, management gives consideration to capital preservation objectives, expected asset growth, projected earnings, and the overall dividend pay-out ratio.

Return on Average Assets, Average Total Equity and Common Shareholders' Equity

The following table presents the returns on average assets, average total equity and average common shareholders' equity for the three months ended September 30, 2014 and 2013. For each of the periods presented, the table includes the calculated ratios based on reported net earnings available to common shareholders and net income attributable to Bank of Commerce Holdings as shown in the Consolidated Statements of Operations incorporated in this document. Our return on average common shareholders' equity is positively impacted by lower average common shareholder equity.

	September 30, 2014		**September 30, 2013**	
Returns on average assets:				
Net income	0.55	%	0.81	%
Income available to common shareholders	0.53	%	0.79	%
Returns on average total equity:				
Net income	5.29	%	7.25	%
Income available to common shareholders	5.09	%	7.06	%
Return on average common shareholders’ equity:				
Net income	6.57	%	8.90	%
Income available to common shareholders	6.33	%	8.67	%

NET INTEREST INCOME AND NET INTEREST MARGIN

Net interest income for the nine months ended September 30, 2014 was $24.3 million compared to $25.3 million during the same period a year ago.

Interest income for the nine months ended September 30, 2014 was $27.2 million, a decrease of $796 thousand or 3% compared to the same period a year ago. The decrease in interest income during the nine months of 2014 compared to the same period a year ago was primarily driven by decreased yields in the loan portfolio and decreased volume in the investment securities portfolio, partially offset by increased volume in the loan portfolio and increased yield of investment securities. Decreases in loan portfolio yield resulted in a $1.5 million decrease in loan interest income partially offset by an increase of $653 thousand in loan interest income due to increased loan portfolio volume.

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Interest income recognized from the investment securities portfolio increased $67 thousand during the nine months ended September 30, 2014 compared to the same period a year ago. The increase in investment securities interest income was primarily attributable to increased yields, partially offset by decreased volume. Average securities balances and weighted average tax equivalent yields at September 30, 2014 and 2013 were $234.8 million and 3.48% compared to $250.8 million and 3.24%, respectively.

Interest expense for the nine months ended September 30, 2014 was $2.9 million, an increase of $182 thousand or 7% compared to the same period a year ago. During the second quarter the Company concluded the remaining hedged forecasted FHLB advances associated with the final two legs of the IR’s were no longer probable. Accordingly, the remaining gains recorded in OCI relating to the final two legs of the IR’s were immediately recognized in earnings and are no longer being reclassified from OCI to earnings as a credit to interest expense. During the nine months ended September 30, 2014, the Company continued to benefit from the re-pricing of deposits, partially offset by increased deposit volume.

The net interest margin (net interest income as a percentage of average interest earning assets) on a fully tax-equivalent basis was 3.64% for the nine months ended September 30, 2014, a decrease of 20 basis points as compared to the same period a year ago. The decrease in net interest margin primarily resulted from a 18 basis point decline in tax equivalent yield on average earning assets and a 2 basis point increase in interest expense to average earning assets. With decreasing elasticity in managing our funding costs and historically low interest rates, maintaining net interest margins in the foreseeable future will be challenging. Accordingly, management will continue to pursue organic loan growth, wholesale loan purchases, and actively manage the investment securities portfolio within our accepted risk tolerance to maximize yield on earning assets.

The following tables present condensed average balance sheet information, together with interest income and yields on average interest earning assets, and interest expense and rates paid on average interest bearing liabilities for the nine months ended September 30, 2014 and 2013:

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

(Dollars in thousands)	Nine Months Ended September 30, 2014 Average Balance	Interest	Yield/ Rate	Nine Months Ended September 30, 2013 Average Balance	Interest	Yield/ Rate
Portfolio loans [(1)]	$629,879	$21,632	4.58 %	$619,188	$22,486	4.84 %
Tax-exempt securities [(2)]	84,560	2,903	4.58 %	93,388	2,958	4.22 %
Taxable securities	150,216	3,223	2.86 %	157,429	3,128	2.65 %
Interest bearing due from banks	63,036	393	0.83 %	41,991	394	1.25 %
Average Earning Assets	927,691	$28,151	4.05 %	911,996	$28,966	4.23 %
Cash & due from banks	10,907			10,330		
Bank premises	11,984			10,175		
Other assets	36,333			27,145		
Average Total Assets	$986,915			$959,646		
Interest bearing demand	$269,832	$362	0.18 %	$239,308	$364	0.20 %
Savings deposits	91,484	173	0.25 %	92,351	194	0.28 %
Certificates of deposit	260,986	1,985	1.01 %	248,825	1,990	1.07 %
Repurchase agreements	-	-	- %	7,728	6	0.10 %
Other borrowings	93,853	333	0.47 %	137,886	117	0.11 %
Average Interest Liabilities	$716,155	$2,853	0.53 %	$726,098	$2,671	0.49 %
Noninterest bearing demand	136,082			117,830		
Other liabilities	32,723			8,140		
Shareholders' equity	101,955			107,578		
Average Liabilities and Shareholders' Equity	$986,915			$959,646		
Net Interest Income and Net Interest Margin		$25,298	3.64 %		$26,295	3.84 %

Interest income on loans includes fee expense of approximately $(242) thousand and $(224) thousand for the nine months ended September 30, 2014 and 2013, respectively.

(1) Average nonaccrual loans of $27.1 million and $38.9 million for the nine months ended September 30, 2014 and 2013 are included, respectively.

(2) Tax-exempt income has been adjusted to a tax equivalent basis at a 34% tax rate. The amount of such adjustments was an addition to recorded income of approximately $987 thousand and $1.0 million for the nine months ended September 30, 2014 and 2013, respectively.

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The following table sets forth a summary of the changes in tax equivalent net interest income due to changes in average asset and liability balances (volume) and changes in average rates (rate) for the three months ended September 30, 2014 and September 30, 2013. Changes in tax equivalent interest income and expense, which are not attributable specifically to either volume or rate, are allocated proportionately between both variances.

Analysis of Changes in Net Interest Income

	September 30, 2014 over September 30, 2013		
(Dollars in thousands)	**Variance due to Average Volume**	**Variance due to Average Rate**	**Total**
(Decrease) Increase			
Interest Income:			
Portfolio loans	$653	$(1,507)	$(854)
Tax-exempt securities [1]	(539)	484	(55)
Taxable securities	(275)	370	95
Interest bearing due from banks	233	(234)	(1)
Total Increase (Decrease)	72	(887)	(815)
Increase (Decrease)			
Interest Expense:			
Interest bearing demand	73	(75)	(2)
Savings accounts	(3)	(18)	(21)
Certificates of deposit	164	(169)	(5)
Repurchase agreements	-	(6)	(6)
Other borrowings	(54)	270	216
Total Increase (Decrease)	180	2	182
Net Increase (Decrease)	$(109)	$(889)	$(997)

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

NONINTEREST INCOME

Noninterest income for the nine months ended September 30, 2014 was $3.2 million, an increase of $348 thousand, or 12%, compared to the same period a year ago. The following table presents the key components of noninterest income for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
(Dollars in thousands)	**2014**	**2013**	**Change Amount**	**Change Percent**	**2014**	**2013**	**Change Amount**	**Change Percent**
Noninterest income:								
Service charges on deposit accounts	$50	$46	$ 4	9 %	$135	$146	$(11)	(8)%
Payroll and benefit processing fees	127	113	14	12 %	371	355	16	5 %
Earnings on cash surrender value – BOLI	171	133	38	29 %	459	401	58	14 %
Gain (loss) on investment securities, net	32	336	(304)	(90)%	(252)	931	(1,183)	(127)%
Merchant credit card service income, net	25	33	(8)	(24)%	80	98	(18)	(18)%
Other income	266	313	(47)	(15)%	2,378	892	1,486	167 %
Total noninterest income	$671	$974	$ (303)	(31)%	$3,171	$2,823	$348	12 %

Gains on the sale of investment securities decreased $304 thousand to $32 thousand for the three months ended September 30, 2014, compared to $336 thousand for the same period a year ago. During the three months ended September 30, 2014, the Company purchased thirteen securities with weighted average yields of 2.26%. During the same period the Company sold seventeen securities with weighted average yields 2.56%. During the first nine months of 2014, the Company purchased fifty-two securities with a weighted average yield of 2.77%, and sold seventy-nine securities with a weighted average yield of 2.31%. Generally, securities purchased had relatively short durations with solid credit quality.

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The major components of other income are fees earned on ATM transactions, mortgage fee income, online banking services, wire transfers, and FHLB dividends. The increase in current year compared to the same period a year ago is primarily driven by $1.6 million in gains recorded in other income during the quarter ended June 30, 2014, as a result of the Company’s determination that the remaining hedged forecasted FHLB advances associated with the final two legs of the IR’s were no longer probable. Changes in the other components of other income are a result of normal operating activities. See Note 14, *Derivatives* in the *Notes to Unaudited Consolidated Financial Statements* for additional detail on the Company’s hedged transactions.

NONINTEREST EXPENSE

Noninterest expense for the nine months ended September 30, 2014 was $19.9 million, an increase of $3.4 million or 20% compared to the same period a year ago. The following table presents the key elements of noninterest expense for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
(Dollars in thousands)	**2014**	**2013**	**Change Amount**	**Change Percent**	**2014**	**2013**	**Change Amount**	**Change Percent**
Noninterest expense:								
Salaries & related benefits	$3,474	$2,865	$ 609	21 %	$10,513	$8,863	$ 1,650	19 %
Occupancy & equipment expense	749	549	200	36 %	2,069	1,651	418	25 %
Write down of OREO	-	-	-	- %	290	-	290	100 %
FDIC insurance premium	204	202	2	1 %	584	535	49	9 %
Data processing fees	217	127	90	71 %	629	397	232	58 %
Professional service fees	309	364	(55)	(15)%	911	926	(15)	(2)%
Deferred compensation expense	115	58	57	98 %	345	58	287	495 %
Other expenses	964	1,772	(808)	(46)%	4,586	4,118	468	11 %
Total noninterest expense	$6,032	$5,937	$ 95	2 %	$19,927	$16,548	$ 3,379	20 %

Salaries and related benefits expense for the three and nine months ended September 30, 2014 were $3.5 million and 10.5 million, an increase of $609 thousand or 21% and $1.7 million or 19% compared to the same periods a year ago, respectively. The increase in salaries and related benefits was primarily driven by an increase in the number of employees including the addition of a new SBA Lending Department, increased Supplemental Executive Retirement Plan (“SERP”) costs, increased health insurance costs and an increase in contributions to the Company’s employee profit sharing plan.

Occupancy and equipment expenses increased $200 thousand and $418 thousand for the three and nine months ended September 30, 2014, respectively, compared to the same periods a year ago. The increase in occupancy and equipment expenses is due to increased rent expenses, furniture fixture, and equipment costs related to the expansion of the Sacramento Bank of Commerce branch and remodel of the Churn Creek branch.

Data processing expense for the three and nine months ended September 30, 2014 was $217 thousand and $629 thousand respectively an increase of $90 thousand or 71% and $232 thousand or 58% compared to the same periods a year ago. The increases in data processing expense compared to the same periods a year ago is primarily driven by increases in software maintenance and licensing expenses. The Bank continues to strive to make improvements in network infrastructure and systems, and expects to realize continued increased costs in these expenses for the foreseeable future.

Deferred compensation expense was $115 thousand and $345 thousand for the three and nine months ended September 30, 2014 respectively, compared to $58 thousand for the same periods a year ago. During June of the prior period, the Company’s board of directors approved a revision to SERP resulting in a reduction in accrued deferred compensation expenses of $357 thousand. For disclosure purposes, in the table above and in the *Consolidated Statement of Operations*, the benefit in deferred compensation expense is included in the line item other expenses.

Other expenses for the three and nine months ended September 30, 2014 were $964 thousand and $4.6 million, an decrease of $808 thousand and increase of $468 thousand respectively, compared to the same periods a year ago. The decrease in other expenses for the three months ended September 30, 2014 is primarily due to a $503 thousand loss recognized in other expenses during the three months ended September 30, 2013, resulting from the discontinued the hedge treatment associated with an interest rate swap. The increase in other expenses for the nine months ended September 30, 2014 was primarily due to the negotiated settlement of the Note from the former mortgage subsidiary which resulted in a pretax loss recorded in other expenses of $1.4 million during the period ended June 30, 2014. The increase in other expenses for the nine months ended September 30, 2014 are partially offset by a decrease in the amount of off balance sheet provision of $200 thousand, and a decrease in OREO expenses of $115 thousand.

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INCOME TAXES

Our provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to our income before taxes. The following table reflects the Company's tax provision and the related effective tax rate for the three and nine months ended September 30, 2014 and 2013:

	For the three months ended September 30,		**For the nine months ended September 30,**	
(*Dollars in thousands*)	**2014**	**2013**	**2014**	**2013**
Income tax provision	$264	$1,431	$1,011	$2,966
Effective tax rate	17 %	44 %	20 %	34 %

The Company’s effective income tax rate was 17% and 44% three months ended September 30, 2014 and 2013 respectively. The effective tax rates differed from the federal statutory rate of 34% and the state rate of 10.84% principally because of non-taxable income arising from bank-owned life insurance, income on tax-exempt investment securities, and tax credits arising from Low Income Housing Tax Credits (“LIHTC”). The Company’s effective tax rate is derived from income tax expense divided by income before provision for income taxes.

The decrease in the effective tax rate for the three and nine months ended September 30, 2014 was driven by increased investments in Qualified Affordable Housing Projects The Company made investments in Qualified Affordable Housing Projects during 2013, which generated low income housing tax credit and benefits net of Investment amortization of $91 thousand and $0 for the year ended September 30, 2014 and 2013 respectively. See Note 9. “Qualified Affordable Housing Project Investments” in the *Notes to the Unaudited Consolidated Financial Statements* in this document for a discussion on LIHTC. Additionally, in the prior year the provision for income tax included the correction of an under-accrual of taxes that resulted from incorrectly accounting for the book tax timing differences relating to the sale of the Company’s former mortgage subsidiary. As a result, the Company recognized additional income tax, interest and penalties expense totaling $429 thousand, relating to 2012 tax year during the three months ended September 30, 2013.

FINANCIAL CONDITION

BALANCE SHEET

As of September 30, 2014, the Company had total consolidated assets of $977.8 million, total net portfolio loans of $639.5 million, an ALLL of $10.4 million, deposits outstanding of $767.5 million, and stockholders' equity of $102.0 million.

The Company continued to maintain a strong liquidity position during the reporting period. As of September 30, 2014, the Company maintained cash positions at the Federal Reserve Bank and correspondent banks in the amount of $31.2 million. The Company also held certificates of deposits with other financial institutions in the amount of $15.3 million.

Available-for-sale investment securities totaled $189.4 million at September 30, 2014, compared with $216.6 million at December 31, 2013. The Company's available-for-sale investment portfolio is currently being utilized as a secondary source of liquidity to fund other higher yielding asset opportunities, such as commercial and commercial real estate loan originations and wholesale loan purchases. During the first nine months of 2014, the Company purchased fifty-two securities with a par value of $62.4 million, weighted average yield of 2.77%, and weighted average duration of 4.37. During the first nine months of 2014 the Company sold seventy-nine securities with a par value of $78.8 million and a weighted average yield of 2.31%. The net sales activity resulted in $252 thousand realized loss.

The Company's purchases continue to focus on moderate term maturity securities such as shorter term mortgage-backed securities and moderate term tax exempt municipal bonds which allow the company to take advantage of the steepness of the yield curve to moderate the Company's exposure to rising interest rates, while still providing an acceptable yield. Sales were focused on longer term municipal and corporate bonds, as well as mortgage-backed and asset-backed securities with extended cash flows or with a high probability of cash flows extending as interest rates increase.

Overall, management's investment strategy reflects the continuing expectation of rising rates across the yield curve. As such, management will continue to actively seek out opportunities to reduce the overall duration of the portfolio and improve cash flows. Given the current shape of the yield curve, this strategy could entail absorbing small losses within the portfolio to meet this longer term objective.

At September 30, 2014, the Company’s net unrealized gain on available-for-sale securities were $1.8 million, compared with $3.7 million net unrealized losses at December 31, 2013. The favorable change in net unrealized losses was primarily due to increases in the fair values of the Company’s municipal bond, mortgage backed securities and corporate bond, portfolios. The increases in the fair values of the Company’s investment securities portfolio were primarily driven by the narrowing of market spreads and changes in market interest rates.

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Overall, the net portfolio loan balance increased during the first nine months of 2014. The Company recorded net portfolio loans of $639.5 million at September 30, 2014, compared with $584.1 million at December 31, 2013, an increase of $55.4 million, or 9%. The increase in net portfolio loans was primarily attributable commercial real estate loan originations and $44.2 million in consumer and SBA loans associated with the purchase of three loan pools. See Note 16, *Transfer of Financial Assets* in the *Notes to the Unaudited Consolidated Financial Statements* in this document for further information regarding the purchase of these pools.

The Company continued to monitor credit quality during the period, and adjust the ALLL accordingly. As such, the Company made $ 2.5 million additional provision for loan losses during the first nine months of 2014, compared with $2.8 million during the same period a year ago. The Company's ALLL as a percentage of portfolio loans was 1.60% as of September 30, 2014 compared with 2.37% as of December 31, 2013 and 2.28%, as of September 30, 2013.

Net charge offs were $6.3 million during the first nine months of 2014, compared with net charge offs of $310 thousand during the same period a year ago. The charge offs in the current year were primarily focused in three separate relationships. The first included $3.4 million in chargeoffs of Commercial and Industrial loans. The second included $1.4 million in charge offs of Commercial Real Estate and Farmland loans and the third included $1.0 Commercial Real Estate loans. The loans charged off for these three relationships were collateral dependent loans that were adequately reserved for at December 31, 2013, and subsequently charged off during the second quarter of 2014.

Despite the charge offs related to these three loans, during the first nine months of 2014 the trend in asset quality of the Bank's loan portfolio improved relative to fiscal years 2013 and 2012. Management is cautiously optimistic that given continuing improvements in local and national economic conditions, the Company's impaired assets will continue to trend down. However, the commercial real estate and commercial loan portfolio's continue to be influenced by weak real estate values and the effects of relatively high unemployment levels in our local markets. Accordingly, management will continue to work diligently to identify and dispose of problematic assets which could lead to an elevated level of charge offs. At September 30, 2014, management believes the Company's ALLL is adequately funded given the current level of credit risk.

Nonperforming loans, which include nonaccrual loans and accruing loans past due over 90 days, decreased by $5.3 million to $24.5 million, or 3.77% of total loans, as of September 30, 2014, compared to $29.8 million, or 4.98% of total loans as of December 31, 2013. Past due loans as of September 30, 2014 increased to $15.9 million, compared to $6.9 million as of December 31, 2013. The increase in past due loans was primarily attributable to increases in the past due commercial and commercial real estate portfolios related to one relationship that was included in nonaccrual loan balances at December 31, 2013 and September 30, 2014. The increase in past due loans was partially offset by decreases in past due loans in the residential loan portfolio. Management believes that risk grading for past due loans appropriately reflects the risk associated with the past due loans.

The Company's OREO balance at September 30, 2014 was $393 thousand compared to $913 thousand at December 31, 2013. During the third quarter of 2014, the sale of one commercial property and two properties from the ITIN portfolio were partially offset by the addition of two ITIN portfolio properties. See Note 7, *Other Real Estate Owned* in the *Notes to Consolidated Financial Statements* in this document, for further details relating to the Company's OREO portfolio. The Company remains committed to working with customers who are experiencing financial difficulties to find potential solutions.

Total deposits as of September 30, 2014 were $767.5 million compared to $746.3 million at December 31, 2013, an increase of $21.2 million. During the first nine months of 2014, increases in noninterest bearing demand and certificate of deposit accounts were partially offset by decreases in interest bearing demand.

Brokered certificates of deposits totaled $13.5 million at September 30, 2014, and were structured with both fixed rate terms and adjustable rate terms and had remaining maturities ranging from less than one year to 5.75 years. Furthermore, brokered certificates of deposits with adjustable rate terms were structured with call features allowing the Company to call the certificate should interest rates move in an unfavorable direction. These call features are generally exercisable within six to twelve months of issuance date and quarterly thereafter.

On March 20, 2014, the Company announced that its Board of Directors had authorized the purchase of up to 700,000 or 5% of its outstanding shares over a twelve-month period. The stock repurchase plan authorizes the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the stock repurchase plan, the Company repurchased 700,000 common shares during the nine months ended September 30, 2014. The shares were retired subsequent to purchase. The decrease in weighted average shares from the stock repurchases positively contributed to earnings per common share, and return on common equity.

INVESTMENT SECURITIES

The composition of our investment securities portfolio reflects management's investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of interest income. The investment securities portfolio also mitigates interest rate risk and a portion of credit risk inherent in the loan portfolio, while providing a vehicle for the investment of available funds, a source of liquidity (by pledging as collateral) and collateral for certain public funds deposits.

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Available-for-sale investment securities totaled $189.4 million at September 30, 2014, compared with $216.6 million at December 31, 2013. Purchases of available-for-sale securities of $64.2 million were offset by sales of $82.1 million, pay downs of $11.3 million, amortization of net purchase price premiums of $1.8 million, and an increase in fair value of $5.5 million. During the first nine months of 2014, the Company purchased fifty-one available for sale securities and sold eighty-one securities.

The Company’s held-to-maturity investment portfolio is generally utilized to hold longer term securities that may have greater price risk many of which are pledged as collateral for the bank’s local agency deposit program. This portfolio includes securities with longer durations and higher coupons than securities held in the available-for-sale securities portfolio. Held-to-maturity investment securities had carrying amounts of $36.9 million at September 30, 2014, compared with $36.7 million at December 31, 2013. During the nine months ended September 30, 2014, purchases of $244 thousand of held-to-maturity securities were offset by $134 thousand net discount accretion and $187 thousand of calls and maturities.

The following table presents the investment securities portfolio by classification and major type as of September 30, 2014 and December 31, 2013:

(Dollars in thousands)	**September 30, 2014**	**December 31, 2013**
Available-for-sale securities (1)		
U.S. government & agencies	$ 7,825	$ 6,264
Obligations of state and political subdivisions	57,161	59,209
Residential mortgage backed securities and collateralized mortgage obligations	46,498	62,991
Corporate securities	39,717	48,230
Commercial mortgage backed securities	11,100	10,472
Other asset backed securities	27,078	29,474
Total	$ 189,379	$ 216,640
Held-to-maturity securities (1)		
Obligations of state and political subdivisions	$ 36,888	$ 36,696

(1) Available-for-sale securities are reported at estimated fair value, and held-to-maturity securities are reported at amortized cost.

The following table presents information regarding the amortized cost and maturity structure of the investment portfolio at September 30, 2014:

	Within One Year		Over One through Five Years		Over Five through Ten Years		Over Ten Years		Total	
(Dollars in thousands)	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
Available-for-sale securities										
U.S. government & agencies	$-	- %	$5,411	2.96 %	$2,430	2.49 %	$-	- %	$7,841	2.81 %
Obligations of state and political subdivisions	-	- %	4,876	2.87 %	15,315	3.17 %	35,376	2.78 %	55,567	2.90 %
Mortgage backed securities and collateralized mortgage obligations	205	5.89 %	26,305	2.96 %	19,232	2.68 %	648	4.03 %	46,390	2.87 %
Corporate securities	1,011	3.27 %	17,221	2.74 %	19,675	3.00 %	1,616	2.48 %	39,523	2.87 %
Commercial mortgage backed securities	-	- %	-	- %	1,125	2.06 %	10,110	3.16 %	11,235	3.05 %
Other asset backed securities	-	- %	-	- %	693	1.86 %	26,346	2.68 %	27,039	2.66 %
Total	$1,216	3.71 %	$53,813	2.88 %	$58,470	2.88 %	$74,096	2.80 %	$187,595	2.86 %
Held-to-maturity securities										
Obligations of state and political subdivisions	$367	1.50 %	$1,482	3.38 %	$15,368	3.04 %	$19,671	3.06 %	$36,888	3.01 %

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

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LOANS AND PORTFOLIO CONCENTRATIONS

Loans and Portfolio Concentration

We concentrate our portfolio lending activities primarily within El Dorado, Placer, Sacramento, and Shasta counties in California, and the location of the Bank's four full service branches, specifically identified as Northern California. We manage our credit risk through diversification of our loan portfolio and the application of underwriting policies and procedures and credit monitoring practices. Generally, the loans are secured by real estate or other assets located in California; repayment is expected from the borrower’s business cash flows or cash flows from real estate investments.

Overall, the net portfolio loan balance increased during the first nine months of 2014. The Company recorded net portfolio loans of $639.5 million at September 30, 2014, compared with $584.1 million at December 31, 2013, an increase of 55.4 million, or 9%. The increase in net portfolio loans was primarily attributable wholesale purchase activity and organic loan originations during the nine months ended September, 30 2014. See Note 16, *Transfer of Financial Assets* in the *Notes to the Unaudited Consolidated Financial Statements* in this document for further information regarding the purchased loans.

The following table presents the composition of the loan portfolio as of September 30, 2014 and December 31, 2013:

(Dollars in thousands)	**September 30, 2014**	**% of gross portfolio loans**		**December 31, 2013**	**% of gross portfolio loans**	
Commercial	$ 160,024	25	%	$ 170,429	29	%
Real estate – construction loans	25,579	4	%	18,545	3	%
Real estate – commercial (investor)	216,204	33	%	205,384	34	%
Real estate – commercial (owner occupied)	105,889	16	%	83,976	14	%
Real estate – ITIN loans	53,805	8	%	56,101	9	%
Real estate – mortgage	13,779	2	%	14,590	2	%
Real estate – equity lines	45,050	8	%	45,462	8	%
Consumer	28,998	4	%	3,472	1	%
Other	367	-	%	36	-	%
Gross portfolio loans	$ 649,695	100	%	$ 597,995	100	%
Less:						
Deferred loan fees, net	(184)			(303)		

Allowance for loan losses	10,400	14,172
Net portfolio loans	$ 639,479	$ 584,126

The following table provides a breakdown of the Company's real estate construction portfolio as of September 30, 2014:

(Dollars in thousands)

Loan Type	**Balance**	**% of total**
Commercial lots	$ 5,347	21 %
Commercial real estate – construction	14,928	58 %
1-4 family subdivision loans	2,971	12 %
1-4 family individual residential lots	2,056	8 %
1-4 family construction speculative	277	1 %
Total real estate-construction	$ 25,579	100 %

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The following table sets forth the maturity and re-pricing distribution of our loans outstanding as of September 30, 2014, which, based on remaining scheduled repayments of principal, were due within the periods indicated:

(Dollars in thousands)	**Within One Year**	**After One Through Five Years**	**After Five Years**	**Total**
Commercial	$69,562	$51,438	$39,024	$160,024
Real estate - construction loans	8,890	10,120	6,569	25,579
Real estate - commercial (investor)	20,703	37,020	158,481	216,204
Real estate - commercial (owner occupied)	3,079	23,646	79,164	105,889
Real estate - ITIN loans	-	-	53,805	53,805
Real estate - mortgage	310	1,614	11,855	13,779
Real estate - equity lines	1,640	3,856	39,554	45,050
Consumer	18,574	1,060	9,364	28,998
Other	-	367	-	367
Gross portfolio loans	$122,758	$129,121	$397,816	$649,695
Loans due after one year with:				
Fixed rates		$60,015	$102,676	$162,691
Variable rates		69,106	295,140	364,246
Total		$129,121	$397,816	$526,937

Loans with unique credit characteristics

On April 17, 2009, the Company transferred certain nonperforming loans, without recourse, and cash in exchange for the acquisition of a pool of Individual Tax Identification Number (“ITIN”) residential mortgage loans. The ITIN loans are loans made to legal United States residents without a social security number, and are geographically dispersed throughout the United States. The ITIN loan portfolio is serviced through a third party. Worsening economic conditions in the United States may cause us to suffer higher default rates on our ITIN loans and reduce the value of the assets that we hold as collateral. In addition, if we are forced to foreclose and service these ITIN properties ourselves, we may realize additional monitoring, servicing and appraisal costs due to the geographic disbursement of the portfolio which will adversely affect our noninterest expense. As of September 30, 2014, and December 31, 2013, the specific ITIN ALLL allocation represented approximately 1.97% and 1.30% of the total outstanding principal, respectively.

ASSET QUALITY

Nonperforming Assets

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

Deterioration of the California real estate market has had an adverse effect on the Company's business, financial condition, and results of operations. The residential development and construction markets have yet to fully recover from their depressed states experienced during the recent economic recession. Consequently, our loan portfolio continues to reflect an elevated level of nonperforming loans which have resulted in elevated provisions to the ALLL. Management has taken cautious yet decisive steps to ensure the proper funding of loan reserves. Given the current business environment, management's top focus is on credit quality, expense control, and bottom line net income. All of these are affected either directly or indirectly by the Company's management of its asset quality.

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

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Our loan portfolio continues to be impacted by the repercussions from the recent economic recession. Nonperforming loans, which include nonaccrual loans and accruing loans past due over 90 days, totaled $24.5 million or 3.77% of total portfolio loans as of September 30, 2014, as compared to $29.8 million, or 4.98% of total loans, at December 31, 2013. Nonperforming assets, which include nonperforming loans and foreclosed real estate (“OREO”), totaled $24.9 million, or 2.54% of total assets as of September 30, 2014, compared with $30.7 million, or 3.21% of total assets as of December 31, 2013. Nonperforming loans decreased $5.3 million during the nine months ended September 30, 2014. The Company recorded additional provision expense of $2.5 million during the nine months ended September 30, 2014.

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

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

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

The Company practices one exception to the nonaccrual policy for the Arrow loan pool which has unique credit characteristics, and is made up of subordinated home equity lines of credits and home equity loans. The Arrow credits are considered uncollectable when they become 90 days past due. Accordingly, loans in this pool are charged off when they become 90 days past due.

Upon acquisition of real estate collateral, typically through the foreclosure process, we promptly begin to market the property for sale. If we do not begin to receive offers or indications of interest we will analyze the price and review market conditions to assess the pricing level that would enable us to sell the property. In addition, we obtain updated appraisals on OREO property every six to twelve months. Increases in valuation adjustments recorded in a period are primarily based on (1) updated appraisals received during the period, or (2) management’s authorization to reduce the selling price of the property during the period. Unless a current appraisal is available, an appraisal will be ordered prior to a loan migrating to OREO. Foreclosed properties held as OREO are recorded at the lower of the recorded investment in the loan or market value of the property less expected selling costs. OREO at September 30, 2014 totaled $393 thousand and consisted of four properties.

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The following table summarizes our nonperforming assets as of September 30, 2014 and December 31, 2013:

(Dollars in thousands) **Nonperforming assets**	**September 30, 2014**	**December 31, 2013**
Commercial	$ 7,065	$ 6,527
Total real estate construction	7,065	6,527
Real estate mortgage		
ITIN 1-4 family loan pool	5,281	6,895
1-4 family, closed end 1st lien	2,157	1,322
1-4 family revolving	89	513
Total real estate mortgage	7,527	8,730
Commercial real estate	9,896	14,539
Consumer	-	-
Total nonaccrual loans	24,488	29,796
90 days past due and still accruing	-	-
Total nonperforming loans	24,488	29,796
Other real estate owned	393	913
Total nonperforming assets	$ 24,881	$ 30,709
Nonperforming loans to total loans	3.77 %	4.98 %
Nonperforming assets to total assets	2.54 %	3.21 %

As of September 30, 2014, nonperforming assets of $24.9 million have been written down by 24%, or $5.9 million, from their original balance of $37.9 million.

The Company is continually performing extensive reviews of the commercial real estate portfolio, including stress testing. These reviews are being performed on both the investor credits and owner occupied credits. These reviews are being completed to verify leasing status, to ensure the accuracy of risk ratings, and to develop proactive action plans with borrowers on projects. Stress testing has been performed to determine the effect of rising cap rates, interest rates, and vacancy rates on the portfolio. Based on our analysis, the Company believes our lending teams are effectively managing the risks in this portfolio. There can be no assurance that any further declines in economic conditions, such as potential increases in retail or office vacancy rates, will not exceed the projected assumptions utilized in stress testing resulting in additional nonperforming loans in the future.

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

As of September 30, 2014, the Company had $25.7 million in TDRs compared to $33.4 million as of December 31, 2013. As of September 30, 2014, the Company had one hundred eighteen restructured loans that qualified as TDRs, of which one hundred were performing according to their restructured terms. TDRs represented 3.95% of gross portfolio loans as of September 30, 2014, compared with 5.59% at December 31, 2013.

At September 30, 2014 and December 31, 2013, impaired loans of $9.1 million and $8.8 million were classified as accruing TDRs, respectively. The restructured loans on accrual status represent the majority of impaired loans accruing interest at each respective date. In order for a restructured loan to be on accrual status, the loan’s collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. The Company had no obligations to lend additional funds on the restructured loans as of September 30, 2014. As of September 30, 2014, there were $8.1 million of ITINs which were classified as TDRs, of which $2.9 million were on nonaccrual status.

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The following table sets forth a summary of the Company's restructured loans that qualify as TDRs as of September 30, 2014 and December 31, 2013:

(Dollars in thousands) **Troubled debt restructurings**	**September 30, 2014**	**December 31, 2013**
Accruing troubled debt restructurings		
Commercial	$ 1,585	$ 63
Commercial real estate:		
Other	1,707	3,864
Residential:		
1-4 family	5,222	4,303
Home equities	584	598
Total accruing troubled debt restructurings	$ 9,098	$ 8,828
Nonaccruing troubled debt restructurings		
Commercial	$ 3,830	$ 6,458
Commercial real estate:		
Other	9,598	14,024
Residential:		
1-4 family	3,128	4,114
Total nonaccruing troubled debt restructurings	$ 16,556	$ 24,596
Total troubled debt restructurings		
Commercial	$ 5,415	$ 6,521
Commercial real estate:		
Other	11,305	17,888
Residential:		
1-4 family	8,350	8,417
Home equities	584	598
Total troubled debt restructurings	$ 25,654	$ 33,424
Percentage of gross portfolio loans	3.95 %	5.59 %

Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments

The ALLL at September 30, 2014 decreased $3.8 million to $10.4 million compared to $14.2 million at December 31, 2013. The Company recorded net chargeoffs of $6.3 million for the nine months ended September 30, 2014 compared to net recoveries of $319 thousand for the year ended December 31, 2013 and net charge-offs of $311 thousand for the same period a year ago. During the first nine months of 2013, the Company made additional provisions for loan losses of $2.5 million compared to provision expense of $2.8 million during the same period a year ago.

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The following table summarizes the activity in the ALLL reserves at September 30, 2014, December 31, 2013 and September 30, 2013

(Dollars in thousands)	**September 30, 2014**	**December 31, 2013**	**September 30, 2013**
Beginning balance allowance for loan losses	$ 14,172	$ 11,103	$ 11,103
Provision for loan loss charged to expense	2,500	2,750	2,750
Loans charged off	(6,944)	(2,770)	(1,954)
Loan loss recoveries	672	3,089	1,643
Ending balance allowance for loan losses	$ 10,400	$ 14,172	$ 13,542
Gross portfolio loans outstanding at period end	$ 649,695	$ 597,995	$ 594,562
Ratio of allowance for loan losses to total loans	1.60 %	2.37 %	2.28 %
Nonaccrual loans at period end:			
Commercial	$ 7,065	$ 6,527	$ 7,501
Commercial real estate	9,896	14,539	16,895
Residential real estate	7,438	8,217	10,953
Home equity	89	513	517
Consumer	-	-	-
Total nonaccrual loans	$ 24,488	$ 29,796	$ 35,866
Accruing troubled-debt restructured loans			
Commercial	$ 1,585	$ 63	$ 65
Commercial real estate	1,707	3,864	1,742
Residential real estate	5,222	4,303	2,996
Home equity	584	598	604
Total accruing restructured loans	$ 9,098	$ 8,828	$ 5,407
All other accruing impaired loans	757	3,517	4,190
Total impaired loans	$ 34,343	$ 42,141	$ 45,463
Allowance for loan losses to nonaccrual loans at period end	42.47 %	47.56 %	37.76 %
Nonaccrual loans to total loans	3.77 %	4.98 %	6.03 %

As of September 30, 2014, impaired loans totaled $34.3 million, of which $24.5 million were in nonaccrual status. Of the total impaired loans, $10.7 million or one hundred thirty were ITIN loans with an average balance of approximately $82 thousand. The remaining impaired loans consist of sixteen commercial loans, ten commercial real estate loans, seven residential mortgages and sixteen home equity loans.

All impaired loans are individually evaluated for impairment. If the measurement of each impaired loan's value is less than the recorded investment in the loan, we recognize this impairment and adjust the carrying value of the loan to fair value through the ALLL. For collateral dependent loans, this can be accomplished by charging off the impaired portion of the loan based on the underlying value of the collateral. For non collateral dependant loans the Company establishes a specific component within the ALLL based on the present value of the future cash flows. If in management's assessment the sources of repayment will not result in a reasonable probability that the carrying value of a loan can be recovered, the amount of a loan's specific impairment is charged off against the ALLL.

At September 30, 2014, impaired loans had a corresponding valuation allowance of $1.2 million. The valuation allowance on impaired loans represents the impairment reserves on performing restructured loans, other accruing loans, and nonaccrual loans. At December 31, 2013, the total recorded investment in impaired loans was $42.1 million, with a corresponding valuation allowance of $5.0 million.

The Company realized net charge offs of $6.3 million for the nine months ended September 30, 2014 compared with net recoveries of $319 thousand in the prior year end and net charge offs of $311 thousand in the same period a year ago. Management does not feel that the increase in net charge offs in the current year is indicative of a trend as the increase in net charge offs and the decrease in the ALLL allocation is primarily due to chargeoffs related to three significant borrowing relationships. The first relationship included $3.4 million in chargeoffs of Commercial and Industrial loans and the second included $1.4 million in chargeoffs of Commercial Real Estate and Farmland loans. The third included $1.0 million in chargeoffs for three Commercial Real Estate loans. The loans charged off for these three relationships were collateral dependent loans that were adequately reserved for at December 31, 2013, and subsequently charged off during the second quarter of 2014.. Management has individually evaluated each impaired loan and believes that the remaining loan portfolio including past due loans is properly risk graded and that the reserve level and allocations are appropriate at September 30, 2014.

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The commercial real estate and commercial loan portfolio’s continue to be influenced by weak real estate values, the effects of relatively high unemployment levels in our local markets, and overall sluggish economic conditions. Although past due loans as of September 30, 2014 increased to $15.9 million, compared to $6.9 million as of December 31, 2013, overall credit quality improved as nonperforming loans, which include nonaccrual loans and accruing loans past due over 90 days, decreased by $5.3 million during the same period. The increase in past due loans was primarily due to increases in the past due commercial and commercial real estate portfolios related to one relationship which was included in the nonaccrual loan balances at December 31, 2013 and September 30, 2014. The increase in past due loans was partially offset by decreases in the past due residential loan portfolio during the nine months ended September 30, 2014. Management continues to work diligently to identify and dispose of problematic assets, which could lead to an elevated level of chargeoffs.

The following table sets forth the allocation of the ALLL and percent of loans in each category to total loans (excluding deferred loan fees) as of September 30, 2014 and December 31, 2013:

	September 30, 2014			**December 31, 2013**		
(Dollars in thousands)	**Amount**	**% Loan Category**		**Amount**	**% Loan Category**	
Balance at end of period applicable to:						
Commercial	$3,731	36	%	$7,057	50	%
Commercial real estate:						
Construction	469	5	%	173	1	%
Other	3,492	34	%	2,611	18	%
Residential:						
1-4 family	1,391	13	%	1,685	12	%
Home equities	813	8	%	808	6	%
Consumer	362	3	%	35	0	%
Unallocated	142	1	%	1,803	13	%
Total allowance for loan and lease losses	$10,400	100	%	$14,172	100	%

The unallocated portion of ALLL provides for coverage of credit losses inherent in the loan portfolio but not captured in the credit loss factors that are utilized in the risk rating-based component, or in the specific impairment reserve component of the ALLL, and acknowledges the inherent imprecision of all loss prediction models. As of September 30, 2014, the unallocated allowance amount represented 1% of the ALLL, compared to 13% at December 31, 2013.

The decrease in the unallocated ALLL during the nine months ended September 30, 2014 is primarily due to $3.4 million in chargeoffs of Commercial and Industrial loans for one borrowing relationship and $1.4 million in chargeoffs of Commercial Real Estate and Farmland loans for a second borrowing relationship. The loans were previously recorded as TDRs that were adequately reserved for at December 31, 2013, and subsequently charged off during the second quarter of 2014.. The level in unallocated ALLL in both the current period and prior year reflects management’s evaluation of the current business and economic conditions, credit risk, and depressed collateral values of real estate in our markets. The ALLL composition should not be interpreted as an indication of specific amounts or loan categories in which future charge offs may occur.

DEPOSITS

Total deposits as of September 30, 2014 were $767.5 million compared to $746.3 million at December 31, 2013, an increase of $21.2 million. During the first nine months of 2014, increases in savings, certificate of deposit and noninterest bearing demand accounts were partially offset by decreases in interest bearing demand.

The following table presents the deposit balances by major category as of September 30, 2014, and December 31, 2013:

	September 30, 2014			**December 31, 2013**		
(Dollars in thousands)	**Amount**	**Percentage**		**Amount**	**Percentage**	
Noninterest bearing demand	$151,684	20	%	$133,984	18	%
Interest bearing demand	265,308	34	%	273,390	37	%
Savings	91,589	12	%	90,442	12	%
Time, $100,000 or greater	216,380	28	%	201,340	27	%
Time, less than $100,000	42,559	6	%	47,137	6	%
Total	$767,520	100	%	$746,293	100	%

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The following table sets forth the distribution of our average daily balances and their respective yields as of September 30, 2014, and December 31, 2013.

	September 30, 2014		**December 31, 2013**	
(Dollars in thousands)	**Amount**	**Yield**	**Amount**	**Yield**
Interest bearing demand	$137,967	0.17 %	$115,342	0.19 %
Savings	91,484	0.25 %	92,502	0.27 %
Money market accounts	131,865	0.19 %	128,783	0.20 %
Certificates of deposit	260,986	1.01 %	249,500	1.05 %
Interest bearing deposits	622,302	0.54 %	586,127	0.57 %
Noninterest bearing demand	136,082		126,017	
Average total deposits	$758,384		$712,144	
Average other borrowings	$93,853	0.47 %	$130,924	0.09 %

The following table sets forth the remaining maturities of certificates of deposit in amounts of $100,000 or more as of September 30, 2014:

Deposit Maturity Schedule

(Dollars in thousands)	**September 30, 2014**
Maturing in:	
Three months or less	$ 29,153
Three through six months	27,926
Six through twelve months	50,295

Over twelve months	109,006
Total	$ 216,380

The Company has an agreement with Promontory Interfinancial Network LLC (“Promontory”) allowing our Bank to provide FDIC deposit insurance to balances in excess of current FDIC deposit insurance limits. Promontory’s Certificate of Deposit Account Registry Service (“CDARS”) and Insured Cash Sweep (“ICS”) use a deposit-matching program to exchange Bank deposits in excess of the current deposit insurance limits for excess balances at other participating banks, on a dollar-for-dollar basis, that would be fully insured at the Bank. These products are designed to enhance our ability to attract and retain customers and increase deposits, by providing additional FDIC coverage to customers. CDARS deposits can be reciprocal or one-way, and ICS deposits can only be reciprocal. All of the Bank’s CDARS and ICS deposits are reciprocal. At September 30, 2014 and December 31, 2013, the Company’s CDARS and ICS balances totaled $65.3 million and $53.2 million, respectively. Of these totals, at September 30, 2014 and December 31, 2013, there were no time deposits equal to or greater than the $250,000 fully insured under current deposit insurance limits.

BORROWINGS

At September 30, 2014, the Bank had term debt outstanding with a carrying value of $75.0 million compared to $75.0 million December 31, 2013. Advances from the FHLB amounted to 100% of the total term debt and are secured by commercial real estate loans, and residential mortgage loans. The FHLB advance has a floating contractual interest rate of 0.25% with maturity in August, 2015.

Junior Subordinate Debentures

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 thousand 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 three month LIBOR plus 3.30%. The effective interest rate at September 30, 2014 was 3.53%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the trust notes is April 7, 2033, and the debt allows for prepayment on the quarterly payment date.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

On July 29, 2005, 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 simultaneously issued $310 thousand common securities 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 $10.3 million of the Company's floating rate junior subordinate debentures (the "Notes"). The net proceeds to the Company from the sale of the Notes to the Trust were used by the Company for general corporate purposes, including funding the growth of the Company's various financial services, and providing the Bank additional regulatory capital.

The Trust Preferred Securities mature on September 15, 2035, and are redeemable at the Company's option quarterly until maturity. The Trust Preferred Securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a rate that resets quarterly to equal three month LIBOR plus 1.58%. The effective interest rate at September 30, 2014 was 1.81%. 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.

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 which resets on a quarterly basis to three 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, 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. The Notes mature on September 15, 2035, and may be redeemed at the Company's option quarterly until maturity. The Company may redeem the Notes for their aggregate principal amount, plus accrued interest, if any.

Although the Notes are recorded as a liability on the Company's *Consolidated Balance Sheets*, for regulatory purposes, the Notes are treated as Tier 1 capital under rulings of the Federal Reserve Board, the Company's primary federal regulatory agency.

LIQUIDITY AND CASH FLOW

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

We monitor the sources and uses of funds on a daily basis to maintain an acceptable liquidity position. One source of funds includes public deposits. Individual state laws require banks to collateralize public deposits, typically as a percentage of their public deposit balance in excess of FDIC insurance. In addition to liquidity from core deposits and the repayments and maturities of loans and investment securities, the Bank can utilize established uncommitted federal funds lines of credit, borrow from available lines of credit with the Federal Reserve, borrow on a secured basis from the FHLB or issue brokered certificates of deposit.

The Bank had available lines of credit with the FHLB totaling $146.6 million as of September 30, 2014; credit availability is subject to certain collateral requirements, namely the amount of pledged loans and investment securities. The Bank had available lines of credit with the Federal Reserve totaling $19.1 million subject to certain collateral requirements, namely the amount of certain pledged loans. The Bank had uncommitted federal funds line of credit agreements with additional financial institutions totaling $40.0 million at September 30, 2014. Availability of lines is subject to federal funds balances available for loan and continued borrower eligibility. These lines are intended to support short-term liquidity needs, and the agreements may restrict consecutive day usage.

The Holding Company is a separate entity from the Bank and must provide for its own liquidity. Substantially all of the Holding Company's revenues are obtained from dividends declared and paid by the Bank. The Bank paid $5.0 million in dividends to the Holding Company during the nine months ended September 30, 2014. The dividends were primarily used to fund treasury stock purchases and pay dividends to shareholders. There are statutory and regulatory provisions that could limit the ability of the Bank to pay dividends to the Holding Company. We believe that such restrictions will not have an adverse impact on the ability of the Holding Company to fund its quarterly cash dividend distributions to common shareholders and meet its ongoing cash obligations, which consist principally of debt service on the $15.5 million (issued amount) of outstanding junior subordinated debentures. As of September 30, 2014, the Holding Company did not have any borrowing arrangements of its own.

As disclosed in the *Consolidated Statements of Cash Flows*, net cash of $9.7 million was provided by operating activities for the nine months ended September 30, 2014. The material differences between cash provided by operating activities and net income consisted of non-cash items including: $2.5 million of loan loss provision, $1.2 million of net amortization of investment premiums and accretion of discounts, and $962 thousand in provision for depreciation and amortization.

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Net cash of $37.2 million used by investing activities consisted principally of $49.3 million in purchase of loan pools, $9.2 million in net loan originations, $5 million purchase of BOLI, and $2.6 million investment in premise and equipment partially offset by $17.6 million in net proceeds from purchase and sales of available for sale investment securities, $13.6 million in proceeds from maturities and payments from available-for-sale investment securities.

Net cash of $15.4 million provided million provided by financing activities consisted principally of $10.8 million increase in demand deposit and savings accounts and $10.5 million increase certificates of deposits partially offset by $4.6 million in purchases of common stock and $1.4 million in dividends on common and preferred stock.

CAPITAL RESOURCES

We use capital to fund organic growth, pay dividends and repurchase our 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. Our potential sources of capital include retained earnings, common and preferred stock issuance, and issuance of subordinated debt and trust notes.

Overall capital adequacy is monitored on a day-to-day basis by management and reported to our Board of Directors on a monthly basis. The regulators of the Bank measure capital adequacy by using a risk-based capital framework and by monitoring compliance with minimum leverage ratio guidelines. Under the risk-based capital standard, assets reported on our *Consolidated Balance Sheets* and certain off-balance sheet items are assigned to risk categories, each of which is assigned a risk weight.

This standard characterizes an institution's capital as being "Tier 1" capital (defined as principally comprising shareholders' equity) and "Tier 2" capital (defined as principally comprising the qualifying portion of the ALLL). The minimum ratio of total risk-based capital to risk-adjusted assets, including certain off-balance sheet items, is 8%. At least one-half (4%) of the total risk-based capital is to be comprised of common equity; the remaining balance may consist of debt securities and a limited portion of the ALLL.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes that the Company and the Bank met all capital adequacy requirements to which they are subject to, as of September 30, 2014.

As of September 30, 2014, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum Total Risk-Based, Tier 1 Risk-Based and Tier 1 Leverage ratios as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Company and the Bank’s capital amounts and ratios as of September 30, 2014, are presented in the table.

(Dollars in thousands)	**Capital**	**Actual Ratio**	**Well Capitalized Requirement**	**Minimum Capital Requirement**
The Holding Company				
Leverage	$117,823	11.87 %	n/a	4 %
Tier 1 Risk-Based	117,823	14.74 %	n/a	4 %
Total Risk-Based	127,829	15.99 %	n/a	8 %
The Bank				
Leverage	$117,826	11.84 %	5 %	4 %
Tier 1 Risk-Based	117,826	14.68 %	6 %	4 %
Total Risk-Based	127,286	15.93 %	10 %	8 %

On July 2, 2013, the federal banking regulators approved the final proposed rules that revise the regulatory capital rules to incorporate certain revisions by the Basel Committee on Banking Supervision to the Basel capital framework ("Basel III"). The phase-in period for the final rules will begin for the Company on January 1, 2015, with full compliance with the final rules entire requirement phased in on January 1, 2019.

The final rules, among other things, include a new common equity Tier 1 capital ("CET1") to risk-weighted assets ratio, including a capital conservation buffer, which will gradually increase from 4.5% on January 1, 2015 to 7.0% on January 1, 2019. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% on January 1, 2015 to 8.5% on January 1, 2019, as well as require a minimum leverage ratio of 4.0%.

The final rules also provide for a number of adjustments to and deductions from the new CET1, as well as changes to the calculation of risk-weighted assets which is expected to increase the absolute level. Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under Basel III, the effects of certain accumulated other comprehensive items are not excluded; however, banks with $250 billion or less in total assets, may make a one-time permanent election to continue to exclude these items. The Company and Bank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Company's securities portfolio. In addition, deductions include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in nonconsolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

Based on management's review and analysis of Basel III, management believes that the Company and the Bank will remain in excess of the "well-capitalized" standards under these new rules.

Total shareholders' equity at September 30, 2014 was $102.0 million, compared to shareholder's equity of $101.8 million reported at December 31, 2013. During the nine months ended September 30, 2014, the increase in shareholders' equity due income from operations and increased other comprehensive was partially offset by the repurchase of common stock.

On September 28, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which the Company issued and sold to the Treasury 20,000 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), having a liquidation preference of $1,000 per share, for aggregate proceeds net of issuance costs of $19.9 million. The issuance was pursuant to the Treasury's SBLF program, a $30 billion fund established under the Small Business Jobs Act of 2010, which encourages lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The Series B Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1. The dividend rate, was calculated on the aggregate Liquidation Amount, and was initially set at 5% per annum based upon the initial level of Qualified Small Business Lending ("QSBL") by the Bank. The dividend rate for future dividend periods was set based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the commencement of the Agreement. As a result of increased qualified lending, preferred stock dividends for the SBLF program are fixed at the current rate of 1% through January 2016.

If the Series B Preferred Stock remains outstanding beyond January 2016, the dividend rate will be fixed at 9%. Depending on the Company's condition this increase in the Series B Preferred Stock annual dividend rate could have a material adverse effect on our earnings and could also adversely affect our ability to pay dividends on our common shares.

Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series B Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series B Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities. In addition, if (1) the Company has not timely declared and paid dividends on the Series B Preferred Stock for six dividend periods or more, whether or not consecutive, and (2) shares of Series B Preferred Stock with an aggregate liquidation preference of at least $20.0 million are still outstanding, the Treasury (or any successor holder of Series B Preferred Stock) may designate two additional directors to be elected to the Company's Board of Directors.

As more completely described in the Certificate of Designation, holders of the Series B Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series B Preferred Stock and on certain corporate transactions. Except with respect to such matters and, if applicable, the election of the additional directors described above, the Series B Preferred Stock does not have voting rights.

The Company may redeem the shares of Series B Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the Liquidation Amount per share and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Company's primary federal banking regulator.

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.

On January 16, 2013, the Company announced that its Board of Directors had authorized the purchase of up to 1,000,000 or 6% of its outstanding shares over a twelve-month period. The stock repurchase plan authorized the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the stock repurchase plan, the Company repurchased and subsequently retired 662,977 shares during the three months ended March 31, 2013.

On August 21, 2013, the Company announced that its Board of Directors had authorized the purchase of up to 1,000,000 or 7% of its outstanding shares over a twelve-month period. The stock repurchase plan authorized the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the stock repurchase plan, the Company repurchased and subsequently retired 1,000,000 shares during the year ended December 31, 2013.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

On March 20, 2014, the Company announced that its Board of Directors had authorized the purchase of up to 700,000 or 5% of its outstanding shares over a twelve-month period. The stock repurchase plan authorizes the Company to conduct open market purchases or privately negotiated transactions from time to time when, at management's discretion, it was determined that market conditions and other factors warrant such purchases. Pursuant to the stock repurchase plan, the Company repurchased and subsequently retired 700,000 common shares during the six months ended June 30, 2014.

During the nine months ended September 30, 2014 and, 2013 respectively, the Company's Board of Directors declared a quarterly cash dividend of $0.03 per common share per quarter plus an additional special cash dividend of $0.02 during the quarter ended September 30, 2013. These dividends were made pursuant to our existing dividend policy and in consideration of, among other things, earnings, regulatory capital levels, capital preservation, expected growth, and the overall payout ratio. We expect that the dividend rate will be reassessed on a quarterly basis by the Board of Directors in accordance with the dividend policy. There is no assurance that future cash dividends on common shares will be declared or increased.

The following table presents cash dividends declared and dividend payout ratios (dividends declared per common share divided by basic earnings per common share) for the three and nine months ended September 30, 2014 and 2013.

Cash Dividends and Payout Ratios per Common Share

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Dividends declared per common share	$0.03	$0.05	$0.09	$0.11
Dividend payout ratio	33 %	42 %	31 %	29 %

OFF-BALANCE SHEET ARRANGEMENTS

Information regarding Off-Balance Sheet Arrangements is included in Note 12, *Commitments and Contingencies,* in the *Notes to Unaudited Consolidated Financial Statements* incorporated in this document.

CONCENTRATION OF CREDIT RISK

Information regarding Concentration of Credit Risk is included in Note 12, *Commitments and Contingencies,* in the *Notes to Unaudited Consolidated Financial Statements* incorporated in this document.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's assessment of market risk as of September 30, 2014 indicates there are no material changes in the quantitative and qualitative disclosures from those in our Annual Report on Form 10-K for the year ended December 31, 2013.

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including its President and Chief Executive Officer and its Chief Financial Officer, of the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity's disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision making can be faulty, and that breakdowns in internal controls can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of, the Company's Chief Executive Officer and the Chief Financial Officer, and implemented by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

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

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

On a quarterly basis, we carry out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Financial Officer (whom is also our Principal Accounting Officer) of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934. As of September 30, 2014, our management, including our Chief Executive Officer and Principal Financial Officer, concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us that is required to be included in our periodic SEC filings.

Although we change and improve our internal controls over financial reporting on an ongoing basis, we do not believe that any such changes occurred in the first quarter of 2014 that materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

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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 significant changes in the risk factors previously disclosed in the Company’s Form 10-K for the period ended December 31, 2013, filed with the SEC on March 11, 2014.

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

a) Not Applicable

b) Not Applicable

c) Not Applicable

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

Not Applicable

Item 6. Exhibits

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

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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: November 7, 2014 */s/ Samuel D. Jimenez*
Samuel D. Jimenez
Executive Vice President and
Chief Operating Officer and Chief Financial Officer