Table of Contents

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

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2011

OR

o **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 000-23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

California (State or Other Jurisdiction of Incorporation or Organization)	**77-0469558** (I.R.S. Employer Identification No.)
150 Almaden Boulevard, San Jose, California (Address of Principal Executive Offices)	**95113** (Zip Code)

(408) 947-6900
(Registrant's Telephone Number, Including Area Code)

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 ý NO o

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 o NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ý

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO ý

The Registrant had 26,233,001 shares of Common Stock outstanding on April 15, 2011.

HERITAGE COMMERCE CORP
QUARTERLY REPORT ON FORM 10-Q
TABLE OF CONTENTS

Table of Contents

Cautionary Note Regarding Forward-Looking Statements

This Report on Form 10-Q contains various statements that may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward- looking. These forward-looking statements often can be, but are not always, identified by the use of words such as "assume," "expect," "intend," "plan," "project," "believe," "estimate," "predict," "anticipate," "may," "might," "should," "could," "goal," "potential" and similar expressions. We base these forward-looking statements on our current expectations and projections about future events, our assumptions regarding these events and our knowledge of facts at the time the statements are made. These statements include statements relating to our projected growth, anticipated future financial performance, and management's long-term performance goals, as well as statements relating to the anticipated effects on results of operations and financial condition.

These forward-looking statements are subject to various risks and uncertainties that may be outside our control and our actual results could differ materially from our projected results. In addition, our past results of operations do not necessarily indicate our future results. The forward-looking statements could be affected by many factors, including but not limited to:

- Competition for loans and deposits and failure to attract or retain deposits and loans;
- Local, regional, and national economic conditions and events and the impact they may have on us and our customers, and our assessment of that impact on our estimates including, the allowance for loan losses;
- Risks associated with concentrations in real estate related loans;
- Changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of the Company's allowance for loan losses and the Company's provision for loan losses;
- The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;
- Stability of funding sources and continued availability of borrowings;
- Our compliance with and the effects of the regulatory Written Agreement the Company and Heritage Bank of Commerce, its subsidiary bank, have entered into with their regulators;
- The effect of changes in laws and regulations with which the Company and Heritage Bank of Commerce must comply, including any increase in FDIC insurance premiums;
- Our ability to raise capital or incur debt on reasonable terms;
- Regulatory limits on Heritage Bank of Commerce's ability to pay dividends to the Company;

Future legislative or administrative changes to the U.S. Treasury Capital Purchase Program enacted under the Emergency Economic Stabilization Act of 2008;

The impact of the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009 and related rules and regulations on our business operations and competitiveness, including the impact of executive compensation restrictions, which may affect our ability to retain and recruit executives in competition with other firms who do not operate under those restrictions;

Table of Contents

- The impact of the Dodd Frank Wall Street Reform and Consumer Protection Act signed by President Obama on July 21, 2010;
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- Changes in the deferred tax asset valuation allowance in future quarters;
- The costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;
- The ability to increase market share and control expenses; and
- Our success in managing the risks involved in the foregoing items.

We are not able to predict all the factors that may affect future results. You should not place undue reliance on any forward looking statement, which speaks only as of the date of this Report on Form 10-K. Except as required by applicable laws or regulations, we do not undertake any obligation to update or revise any forward looking statement, whether as a result of new information, future events or otherwise.

Table of Contents

Part I FINANCIAL INFORMATION

ITEM 1 CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

HERITAGE COMMERCE CORP

CONSOLIDATED BALANCE SHEETS (Unaudited)

	March 31, 2011	December 31, 2010
	(Dollars in thousands, except per share data)	
Assets		
Cash and due from banks	$ 18,928	$ 7,692
Interest-bearing deposits in other financial institutions	88,540	64,485
Total cash and cash equivalents	107,468	72,177
Securities available-for-sale, at fair value	250,132	232,165
Loans held-for-sale SBA, at lower of cost or market, including deferred costs	7,141	8,750
Loans held-for-sale other, at lower of cost or market, including deferred costs	2,223	2,260
Loans, including deferred costs	803,350	846,049
Allowance for loan losses	(24,009)	(25,204)
Loans, net	779,341	820,845
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	9,038	9,174
Company owned life insurance	44,107	43,682
Premises and equipment, net	8,219	8,397
Intangible assets	2,884	3,014
Accrued interest receivable and other assets	44,857	45,905
Total assets	$ 1,255,410	$ 1,246,369
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	$ 325,058	$ 280,258
Demand, interest-bearing	135,903	153,917
Savings and money market	262,763	272,399
Time deposits under $100	32,592	33,499
Time deposits $100 and over	128,156	137,514
Time deposits CDARS	21,025	17,864
Time deposits brokered	97,826	98,467
Total deposits	1,003,323	993,918
Securities sold under agreement to repurchase		5,000
Subordinated debt	23,702	23,702
Short-term borrowings	2,174	2,445
Accrued interest payable and other liabilities	42,979	39,152
Total liabilities	1,072,178	1,064,217
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized		
Series A fixed rate cumulative preferred stock, 40,000 shares issued and outstanding (liquidation preference of $43,310 at March 31, 2011 and	39,846	39,846

$42,810 at December 31, 2010)		
Discount on Series A preferred stock	(1,131)	(1,227)
Series C convertible perpetual preferred stock, 21,004 shares issued and outstanding at March 31, 2011 and December 31, 2010 (liquidation preference of $21,004 at March 31, 2011 and December 31, 2010)	19,519	19,519
Common stock, no par value; 60,000,000 shares authorized; 26,233,001 shares issued and outstanding at March 31, 2011 and December 31, 2010	130,682	130,531
Accumulated deficit	(881)	(1,866)
Accumulated other comprehensive loss	(4,803)	(4,651)
Total shareholders' equity	183,232	182,152
Total liabilities and shareholders' equity	$ 1,255,410	$ 1,246,369

See notes to consolidated financial statements

Table of Contents

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands, except per share data)	
Interest income:		
Loans, including fees	$ 10,989	$ 13,174
Securities, taxable	1,963	1,162
Interest-bearing deposits in other financial institutions	34	10
Total interest income	12,986	14,346
Interest expense:		
Deposits	1,271	2,364
Subordinated debt	466	466
Repurchase agreements	24	131
Short-term borrowings	29	16
Total interest expense	1,790	2,977
Net interest income before provision for loan losses	11,196	11,369
Provision for loan losses	770	5,095
Net interest income after provision for loan losses	10,426	6,274
Noninterest income:		
Service charges and fees on deposit accounts	567	548
Increase in cash surrender value of life insurance	425	409
Servicing income	411	421
Gain on sales of SBA loans	379	114
Other	135	192
Total noninterest income	1,917	1,684
Noninterest expense:		
Salaries and employee benefits	5,393	5,881
Occupancy and equipment	1,038	959
Professional fees	839	1,278
FDIC deposit insurance premiums	524	1,191
Software subscriptions	255	234
Insurance expense	241	256
Data processing	220	212
Low income housing investment losses	162	225
Other real estate owned expense	21	418
Other	1,738	1,544
Total noninterest expense	10,431	12,198
Income (loss) before income taxes	1,912	(4,240)
Income tax expense (benefit)	331	(120)
Net income (loss)	1,581	(4,120)

Dividends and discount accretion on preferred stock		(596)		(591)
Net income (loss) allocable to common shareholders	$	985	$	(4,711)
Earnings (loss) per common share:				
Basic	$	0.03	$	(0.40)
Diluted	$	0.03	$	(0.40)

See notes to consolidated financial statements

Table of Contents

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

Three Months Ended March 31, 2011 and 2010

	Preferred Stock			Common Stock		Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Comprehensive Income (Loss)
	Shares	Amount	Discount	Shares	Amount				
	(Dollars in thousands, except share data)								
Balance, January 1, 2010	40,000	$ 39,846	$ (1,598)	11,820,509	$ 80,222	$ 56,389	$ (2,554)	$ 172,305	
Net loss						(4,120)		(4,120)	$ (4,120)
Net change in unrealized gain/loss on securities available-for-sale and interest-only strips, net of reclassification adjustment and deferred income taxes							127	127	127
Net change in pension and other postretirement obligations, net of deferred income taxes							15	15	15
Total comprehensive loss									$ (3,978)
Amortization of restricted stock award, net of forfeitures and taxes					(36)			(36)	
Cash dividends accrued on preferred stock						(500)		(500)	
Accretion of discount on preferred stock			91			(91)			
Stock option expense, net of forfeitures and taxes					298			298	
Balance, March 31, 2010	40,000	$ 39,846	$ (1,507)	11,820,509	$ 80,484	$ 51,678	$ (2,412)	$ 168,089	
Balance, January 1, 2011	61,004	$ 59,365	$ (1,227)	26,233,001	$ 130,531	$ (1,866)	$ (4,651)	$ 182,152	
Net income						1,581		1,581	$ 1,581
Net change in unrealized gain/(loss) on securities available-for-sale and interest-only strips, net of reclassification adjustment and deferred income taxes							(213)	(213)	(213)
Net change in pension and other postretirement obligations, net of							61	61	61

deferred income taxes									
Total comprehensive income									$ 1,429
Amortization of restricted stock awards, net of forfeitures and taxes					(36)			(36)	
Cash dividends accrued on Series A preferred stock						(500)		(500)	
Accretion of discount on Series A preferred stock			96			(96)			
Stock option expense, net of forfeitures and taxes					187			187	
Balance, March 31, 2011	61,004	$ 59,365	$ (1,131)	26,233,001	$ 130,682	$ (881)	$ (4,803)	$ 183,232	

See notes to consolidated financial statements

Table of Contents

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 1,581	$ (4,120)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization (accretion) of discounts and premiums on securities	271	(224)
Gain on sale of SBA loans	(379)	(114)
Proceeds from sale of SBA loans originated for sale	4,710	2,414
Net change in SBA loans originated for sale	(2,830)	(4,354)
Writedowns on other loans held-for-sale	29	
Provision for loan losses	770	5,095
Increase in cash surrender value of life insurance	(425)	(409)
Depreciation and amortization	197	202
Amortization of other intangible assets	130	144
Writedowns and (gains)/losses on sale of foreclosed assets, net	(10)	406
Stock option expense, net	187	298
Amortization of restricted stock awards, net	(36)	(36)
Effect of changes in:		
Accrued interest receivable and other assets	874	2,994
Accrued interest payable and other liabilities	(4,799)	(3,055)
Net cash provided by (used in) operating activities	270	(759)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available-for-sale	(18,339)	(25,100)
Maturities/paydowns/calls of securities available-for-sale	7,872	4,351
Net change in SBA loans previously transferred to held-for-sale		(269)
Net change in other loans transferred to held-for-sale	8	
Net change in loans	39,924	58,274
Changes in Federal Home Loan Bank stock and other investments	136	
Purchase of premises and equipment	(19)	(57)
Proceeds from sale of foreclosed assets	1,305	
Purchase of restricted stock and other investments		(9)
Net cash provided by investing activities	30,887	37,190
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in deposits	9,405	(7,590)
Net change in securities sold under agreement to repurchase	(5,000)	(5,000)
Net change in short-term borrowings	(271)	(16,108)
Net cash provided by (used in) financing activities	4,134	(28,698)
Net increase in cash and cash equivalents	35,291	7,733
Cash and cash equivalents, beginning of period	72,177	45,562

Cash and cash equivalents, end of period	$ 107,468	$ 53,295
Supplemental disclosures of cash flow information:		
Interest paid	$ 1,425	$ 2,551
Supplemental schedule of non-cash investing activity:		
Due to broker for securities purchased	$ 8,231	$ 8,201
Transfer of loans held-for-sale to loan portfolio		1,942
Loans transferred to foreclosed assets	918	
Cash dividend accrued on Series A preferred stock	500	500

See notes to consolidated financial statements

8

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2011

(Unaudited)

1) Basis of Presentation

The unaudited consolidated financial statements of Heritage Commerce Corp (the "Company") and its wholly owned subsidiary, Heritage Bank of Commerce (sometimes referred to as "HBC"), have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and notes required by accounting principles generally accepted in the United States of America ("GAAP") for annual financial statements are not included herein. The interim statements should be read in conjunction with the consolidated financial statements and notes that were included in the Company's Form 10-K for the year ended December 31, 2010. The Company has also established the following unconsolidated subsidiary grantor trusts: Heritage Capital Trust I; Heritage Statutory Trust I; Heritage Statutory Trust II; and Heritage Commerce Corp Statutory Trust III which are Delaware Statutory business trusts formed for the exclusive purpose of issuing and selling trust preferred securities.

HBC is a commercial bank serving customers located in Santa Clara, Alameda, and Contra Costa counties of California. No customer accounts for more than 10 percent of revenue for HBC or the Company. Management evaluates the Company's performance as a whole and does not allocate resources based on the performance of different lending or transaction activities. Accordingly, the Company and its subsidiary operate as one business segment.

In the Company's opinion, all adjustments necessary for a fair presentation of these consolidated financial statements have been included and are of a normal and recurring nature. All intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from these estimates.

The results for the three months ended March 31, 2011 are not necessarily indicative of the results expected for any subsequent period or for the entire year ending December 31, 2011.

Reclassifications

Certain reclassifications of prior year balances have been made to conform to the current year presentation. These reclassifications had no impact on the Company's consolidated financial position, results of operations or net change in cash and cash equivalents.

Adoption of New Accounting Standards

In July 2010, the FASB updated disclosure requirements with respect to the credit quality of financing receivables and the allowance for credit losses. According to the guidance there are two levels of detail at which credit information will be presented the portfolio segment and class levels. The portfolio segment level is defined as the level where financing receivables are aggregated in developing a Company's systematic method for calculating its allowance for credit losses. The class level is the second level at which credit information will be presented and represents the categorization of

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

1) Basis of Presentation (Continued)

financing related receivables at a slightly less aggregated level than the portfolio segment level. Companies will now be required to provide the following disclosures as a result of this update: a rollforward of the allowance for credit losses at the portfolio segment level with the ending balances further categorized according to impairment method along with the balance reported in the related financing receivables at period end; additional disclosure of nonaccrual and impaired financing receivables by class as of period end; credit quality and past due/aging information by class as of period end; information surrounding the nature and extent of loan modifications and troubled-debt restructurings and their effect on the allowance for credit losses during the period; and detail of any significant purchases or sales of financing receivables during the period. The increased period-end disclosure requirements became effective for periods ending on or after December 15, 2010, with the exception of additional disclosures surrounding troubled-debt restructurings, which were deferred in December 2010 and become effective for periods ending on or after June 15, 2011. The increased disclosures for activity within a reporting period became effective for periods beginning on or after December 15, 2010. The provisions of this update expanded the Company's current disclosures with respect to the allowance for loan losses.

Newly Issued But Not Yet Effective Accounting Standards:

In April 2011, the FASB issued an accounting standard updated to amend previous guidance with respect to troubled debt restructurings. This updated guidance is designed to assist creditors with determining whether or not a restructuring constitutes a troubled debt restructuring. In particular, additional guidance has been added to help creditors determine whether a concession has been granted and whether a debtor is experiencing financial difficulties. Both of these conditions are required to be met for a restructuring to constitute a troubled debt restructuring. The amendments in the update are effective for the first interim period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The provisions of this update are not expected to have a material impact on the Company's financial position, results or operations or cash flows.

2) Earnings Per Share

Basic earnings (loss) per common share is computed by dividing net income (loss), less dividends and discount accretion on preferred stock, by the weighted average common shares outstanding. The 21,004 shares of Series C Preferred Stock are convertible into 5,601,000 shares of common stock. The Series C Preferred Stock participates in the earnings of the Company and, therefore, the shares issued on the conversion of the Series C Preferred Stock would be considered outstanding under the two-class method of computing basic earnings per common share during periods of earnings. Diluted earnings (loss) per share reflect potential dilution from outstanding stock options and common stock warrants, using the treasury stock method. Due to the Company's net loss allocable to common shareholders for the three months ended March 31, 2010, all stock options and common stock warrants were excluded

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

2) Earnings Per Share (Continued)

from the computation of diluted loss per average common share. A reconciliation of the weighted average shares used in computing basic and diluted earnings (loss) per common share is as follows:

	For the Three Months Ended March 31,	
	2011	**2010**
Weighted average common shares outstanding	26,233,001	11,820,509
Effect of convertible preferred stock	5,601,000	
Shares used in computing basic earnings (loss) per common share	31,834,001	11,820,509
Dilutive effect of stock options oustanding, using the treasury stock method	7,161	N/A
Shares used in computing diluted earnings (loss) per common share	31,841,162	11,820,509

3) Securities

The amortized cost and estimated fair value of securities at March 31, 2011 and December 31, 2010 were as follows:

March 31, 2011	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
	(Dollars in thousands)			
Securities available-for-sale:				
Agency Mortgage-Backed Securities	$ 253,527	$ 1,230	$ (4,625)	$ 250,132

December 31, 2010	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
	(Dollars in thousands)			
Securities available-for-sale:				
Agency Mortgage-Backed Securities	$ 235,099	$ 1,079	$ (4,013)	$ 232,165

At March 31, 2011 and December 31, 2010, all agency mortgage backed securities were issued by Fannie Mae, Freddie Mac, or the Government National Mortgage Association ("Ginnie Mae"), and there were no holdings of securities of any one issuer, other than the U.S. Government and its sponsored entities, in an amount greater than 10% of shareholders' equity.

At March 31, 2011, the Company held 119 securities, of which 58 had fair values below amortized cost. No securities had been carried with an unrealized loss for over 12 months. Unrealized losses were due to higher interest rates. The issuers are of high credit quality and all principal amounts are expected to be paid when securities mature. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline. The Company does not intend to sell any

11

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

3) Securities (Continued)

securities with an unrealized loss and does not believe that it is more likely than not that the Company will be required to sell a security in an unrealized loss position prior to recovery in value. The Company does not consider these securities to be other-than-temporarily impaired at March 31, 2011.

At December 31, 2010, the Company held 106 securities, of which 54 had fair values below amortized cost. No securities have been carried with an unrealized loss for over 12 months. The Company did not consider these securities to be other-than-temporarily impaired at December 31, 2010.

The amortized cost and estimated fair values of securities as of March 31, 2011, by weighted average life, are shown below. The weighted average life will differ from contractual maturities because borrowers may have the right to call or pre-pay obligations with or without call or pre-payment penalties.

	Available-for-sale	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due within one year	$	$
Due after one through five years	104,749	105,482
Due after five through ten years	105,730	103,025
Due after ten years	43,048	41,625
Total	$ 253,527	$ 250,132

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans

Loans were as follows:

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Loans held-for-sale:		
Loans held-for-sale SBA	$ 7,141	$ 8,750
Loans held-for-sale other	2,223	2,260
Total loans held-for-sale	$ 9,364	$ 11,010
Loans held-for-investment:		
Commercial	$ 365,748	$ 378,412
Real estate:		
Commercial and residential	320,950	337,457
Land and construction	50,496	62,356
Home equity	52,129	53,697
Consumer	13,174	13,244
Loans	802,497	845,166
Deferred loan origination costs and fees, net	853	883
Loans, including deferred costs	803,350	846,049
Allowance for loan losses	(24,009)	(25,204)
Loans, net	$ 779,341	$ 820,845

At March 31, 2011, the balance of loans held-for-sale included $2,174,000 of SBA loans that were transferred to third parties. Prior to February 15, 2011 these loans were subject to an SBA warranty for a period of 90 days. In accordance with generally accepted accounting principles, the Company treats these loans as secured borrowings during the warranty period. The secured borrowings are classified as "short-term borrowings" on the unaudited consolidated balance sheets. The warranty period for these loans expires in the following quarter. Provided the loans remain current through the end of the warranty period all elements necessary to record the sale will have been met. The Company has deferred gains of $192,000 associated with these loans at March 31, 2011, which are included in other liabilities on the unaudited consolidated balance sheets. Effective February 15, 2011, the SBA no longer requires a warranty period in loan sales agreements. Therefore, gains on loan sales completed after February 15, 2011 are recognized upon completion of the transaction. At December 31, 2010, there were $2,445,000 of SBA loans that were transferred to third parties, with associated deferred gains of $194,000.

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

Changes in the allowance for loan losses were as follows:

	Three Months Ended March 31, 2011				Three Months Ended March 31, 2010
	Commercial	Real Estate	Consumer	Total	Total
	(Dollars in thousands)				
Balance, beginning of period	$ 13,952	$ 10,363	$ 889	$ 25,204	$ 28,768
Charge-offs	(1,119)	(995)		(2,114)	(7,702)
Recoveries	139	10		149	366
Net charge-offs	(980)	(985)		(1,965)	(7,336)
Provision for loan losses	622	161	(13)	770	5,095
Balance, end of period	$ 13,594	$ 9,539	$ 876	$ 24,009	$ 26,527

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment, based on the impairment method as of March 31, 2011 and December 31, 2010:

	March 31, 2011			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 3,385	$ 668	$ 748	$ 4,801
Collectively evaluated for impairment	10,209	8,871	128	19,208
Total ending allowance balance	$ 13,594	$ 9,539	$ 876	$ 24,009
Loans:				
Individually evaluated for impairment	$ 13,254	$ 10,420	$ 893	$ 24,567
Collectively evaluated for impairment	352,494	413,155	12,281	777,930
Total ending loan balance	$ 365,748	$ 423,575	$ 13,174	$ 802,497

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

	December 31, 2010			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 3,427	$ 1,855	$ 778	$ 6,060
Collectively evaluated for impairment	10,525	8,508	111	19,144
Total ending allowance balance	$ 13,952	$ 10,363	$ 889	$ 25,204
Loans:				
Individually evaluated for impairment	$ 14,374	$ 16,041	$ 898	$ 31,313
Collectively evaluated for impairment	364,038	437,469	12,346	813,853
Total ending loan balance	$ 378,412	$ 453,510	$ 13,244	$ 845,166

The following table presents loans held-for-investment individually evaluated for impairment by class of loans as of March 31, 2011 and December 31, 2010. The recorded investment included in the following table represents loan principal net of any partial charge-offs recognized on the loans. The unpaid principal balance represents the recorded balance prior to any partial charge-offs.

	March 31, 2011			December 31, 2010		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
	(Dollars in thousands)					
With no related allowance recorded:						
Commercial	$ 3,400	$ 3,400	$	$ 5,557	$ 5,125	$
Real estate:						
Commercial and residential	3,513	2,873		4,392	2,431	
Land and construction	2,171	2,171		6,138	3,429	
Consumer	15	15				
Total with no related allowance recorded	9,099	8,459		16,087	10,985	
With an allowance recorded:						
Commercial	10,561	9,854	3,385	9,695	9,249	3,427
Real estate:						
Commercial and residential	93	93	54	4,753	4,753	1,002
Land and construction	5,356	5,001	601	6,862	5,428	853
Home Equity	282	282	13			
Consumer	878	878	748	898	898	778

Total with an allowance recorded	17,170	16,108	4,801	22,208	20,328	6,060
Total	$ 26,269	$ 24,567	$ 4,801	$ 38,295	$ 31,313	$ 6,060

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

The following table presents interest recognized and cash-basis interest earned on impaired loans:

	Three Months Ended March 31, 2011						Three Months Ended March 31, 2010
		Real Estate					
	Commercial	Commercial and Residential	Land and Construction	Home Equity	Consumer	Total	Total
	(Dollars in thousands)						
Average of impaired loans during the period	$ 13,814	$ 5,076	$ 8,015	$ 141	$ 895	$ 27,941	$ 64,789
Interest income during impairment	$ 1	$	$	$ 1	$	$ 2	$ 17
Cash-basis interest earned	$ 1	$	$	$	$	$ 1	$ 1

Nonperforming loans include both smaller dollar balance homogenous loans that are collectively evaluated for impairment and individually classified loans. Nonperforming loans were as follows at period-end:

	March 31, 2011	March 31, 2010	December 31, 2010
	(Dollars in thousands)		
Nonaccrual loans held-for-sale	$ 1,989	$	$ 2,026
Nonaccrual loans held-for-investment	22,896	65,026	28,821
Restructured and loans over 90 days past due and still accruing	1,671	2,176	2,492
Total	$ 26,556	$ 67,202	$ 33,339

The following table presents the nonperforming loans by class as of March 31, 2011 and December 31, 2010:

	March 31, 2011			December 31, 2010		
	Nonaccrual	Restructured and Loans Over 90 Days Past Due and Still Accruing	Total	Nonaccrual	Restructured and Loans Over 90 Days Past Due and Still Accruing	Total
	(Dollars in thousands)					
Commercial	$ 11,865	$ 1,389	$ 13,254	$ 13,545	$ 829	$ 14,374
Real estate:						
Commercial and residential	3,866		3,866	6,450	1,663	8,113
Land and construction	8,261		8,261	9,954		9,954

Home equity		282	282			
Consumer	893		893	898		898
Total	$ 24,885	$ 1,671	$ 26,556	$ 30,847	$ 2,492	$ 33,339

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

The following table presents the aging of past due loans as of March 31, 2011 by class of loans:

	March 31, 2011					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
	(Dollars in thousands)					
Commercial	$ 1,927	$ 2,206	$ 5,645	$ 9,778	$ 355,970	$ 365,748
Real estate:						
Commercial and residential	1,208		1,467	2,675	318,275	320,950
Land and construction			7,172	7,172	43,324	50,496
Home equity			282	282	51,847	52,129
Consumer			893	893	12,281	13,174
Total	$ 3,135	$ 2,206	$ 15,459	$ 20,800	$ 781,697	$ 802,497

The following table presents the aging of past due loans as of December 31, 2010 by class of loans:

	December 31, 2010					
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
	(Dollars in thousands)					
Commercial	$ 3,176	$ 807	$ 14,374	$ 18,357	$ 360,055	$ 378,412
Real estate:						
Commercial and residential	1,078	1,595	7,184	9,857	327,600	337,457
Land and construction			8,857	8,857	53,499	62,356
Home equity	80			80	53,617	53,697
Consumer			898	898	12,346	13,244
Total	$ 4,334	$ 2,402	$ 31,313	$ 38,049	$ 807,117	$ 845,166

Past due loans totaled $20,800,000 and $38,049,000 at March 31, 2011 and December 31, 2010, respectively, of which $16,520,000 and $28,821,000 were on nonaccrual. At March 31, 2011, there were also $6,376,000 current loans included in nonaccrual loans held-for-investment. There were no current loans included in nonaccrual loans held-for-investment at December 31, 2010. Management's classification of a loan as "nonaccrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Company stops accruing interest income, and reverses any uncollected interest that had been accrued as income. The Company begins recognizing interest income only as cash interest payments are received and it has been determined the collection of all outstanding principal is not in doubt. The loans may or may not be collateralized, and collection efforts are pursued.

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

Credit Quality Indicators

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The Company's loan portfolio is concentrated in commercial (primarily manufacturing, wholesale, and service) and real estate lending, with the balance in consumer loans. While no specific industry concentration is considered significant, the Company's lending operations are located in the Company's market areas that are dependent on the technology and real estate industries and their supporting companies. Thus, the Company's borrowers could be adversely impacted by a continued downturn in these sectors of the economy which could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans.

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. Nonclassified loans generally include those loans that are expected to be repaid in accordance with contractual loans terms. Classified loans are those loans that are assigned a substandard, substandard-nonaccrual, or doubtful risk rating using the following definitions:

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Substandard-Nonaccrual. Loans classified as substandard-nonaccrual are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as 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.

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

4) Loans (Continued)

The following table provides a summary of the loan portfolio by loan type and credit quality classification at March 31, 2011 and December 31, 2010:

	March 31, 2011			December 31, 2010		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
	(Dollars in thousands)					
Commercial	$ 328,500	$ 37,248	$ 365,748	$ 340,319	$ 38,093	$ 378,412
Real estate:						
Commercial and residential	307,389	13,561	320,950	320,867	16,590	337,457
Land and construction	24,846	25,650	50,496	32,664	29,692	62,356
Home equity	51,198	931	52,129	50,757	2,940	53,697
Consumer	12,281	893	13,174	12,346	898	13,244
Total	$ 724,214	$ 78,283	$ 802,497	$ 756,953	$ 88,213	$ 845,166

5) Preferred Stock

Series A Preferred Stock

On November 21, 2008, the Company issued 40,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock ("Series A Preferred Stock") to the U.S. Treasury under the terms of the U.S. Treasury Capital Purchase Program for $40,000,000 with a liquidation preference of $1,000 per share. The Series A Preferred Stock carries a coupon of 5% for five years and 9% thereafter. On February 15, 2011, the Company suspended payment of dividends on its Series A Preferred Stock for the sixth consecutive quarter, and therefore, the U.S. Treasury has the right to appoint two members to the Company's Board of Directors. If the U.S. Treasury exercises its rights, these directors would serve on the Company's Board of Directors until such time as the Company has paid in full all dividends not previously paid. So long as payment of dividends on the Series A Preferred Stock remain suspended, we may not, among other things and with limited exceptions, pay cash dividends on or repurchase our common stock or preferred stock. As of the date of this filing, the Company has not been advised whether the U.S. Treasury will exercise its rights to elect two members to the Board of Directors. Effective during the first quarter of 2011, the Company has permitted the U.S. Treasury to allow an observer employed by the U. S. Treasury to attend meetings of the Company's Board of Directors.

Private Placement

On June 21, 2010, the Company issued to various institutional investors 53,996 shares of Series B Mandatory Convertible Perpetual Preferred Stock ("Series B Preferred Stock") and 21,004 shares of Series C Convertible Perpetual Preferred Stock ("Series C Preferred Stock") for an aggregate purchase price of $75,000,000. The Series B Preferred Stock was mandatorily convertible into common stock, upon approval by the shareholders, at a conversion price of $3.75 per share. The Series C Preferred Stock is mandatorily convertible into common stock at a conversion price of $3.75 per share upon both approval by the shareholders and thereafter, a subsequent transfer of the Series C Preferred Stock to third parties not affiliated with the holder in a widely dispersed offering. The Series B Preferred Stock

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

5) Preferred Stock (Continued)

and the Series C Preferred Stock did not include a beneficial conversion feature, as the conversion price of $3.75 per share was not below the fair market value of the Company's common stock on the commitment date.

At the Company's Special Meeting of shareholders held on September 15, 2010, the Company's shareholders approved the issuance of common stock upon the conversion of the Series B Preferred Stock and upon the conversion of the Series C Preferred Stock, as required by the NASDAQ Stock Market and California corporate law. As a result, on September 16, 2010, the Series B Preferred Stock was converted into 14,398,992 shares of common stock of the Company and the shares of Series B Preferred Stock ceased to be outstanding.

The Series C Preferred Stock remains outstanding until it has been converted into common stock in accordance with its terms. The Series C Preferred Stock is non-voting except in the case of certain transactions that would affect the rights of the holders of the Series C Preferred Stock or applicable law. Holders of Series C Preferred Stock will receive dividends if and only to the extent dividends are paid to holders of common stock. The Series C Preferred Stock is not redeemable by the Company or by the holders and has a liquidation preference of $1,000 per share. The Series C Preferred Stock ranks senior to the Company's common stock and ranks on parity with the Company's Series A Preferred Stock.

6) Income Taxes

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles, leading to timing differences between the Company's actual tax liability and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Company's tax expense or benefit, which is accumulated on the Company's books as a deferred tax asset or deferred tax liability until such time as they reverse. At March 31, 2011, the Company had a net deferred tax asset of approximately $26,913,000, compared to $27,361,000 at December 31, 2010. The deferred tax asset at March 31, 2011 and December 31, 2010 is net of a $3,700,000 partial valuation allowance.

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

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

7) Supplemental Retirement Plan

The Company has a supplemental retirement plan (the "Plan") covering current and former key executives and directors. The Plan is a nonqualified defined benefit plan. Benefits are unsecured as there are no Plan assets. The following table presents the amount of periodic cost recognized for the periods indicated:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
	(Dollars in thousands)	
Components of net periodic benefit cost:		
Service cost	$ 236	$ 244
Interest cost	206	209
Amortization of prior service cost	9	9
Amortization of net actuarial loss	31	17
Net periodic benefit cost	$ 482	$ 479

8) Fair Value

Accounting guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data (for example, interest rates and yield curves observable at commonly quoted intervals, prepayment speeds, credit risks, and default rates).

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Financial Assets and Liabilities Measured on a Recurring Basis

The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

8) Fair Value (Continued)

The fair value of interest-only ("I/O") strip receivable assets is based on a valuation model used by a third party. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2 inputs).

		Fair Value Measurements Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obeservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets at March 31, 2011:				
Available-for-sale securities:				
Agency Mortgage-Backed Securities	$ 250,132		$ 250,132	
I/O strip receivables	2,193		2,193	
Assets at December 31, 2010:				
Available-for-sale securities:				
Agency Mortgage-Backed Securities	$ 232,165		$ 232,165	
I/O strip receivables	2,140		2,140	

There were no transfers between Level 1 and Level 2 during the period for assets measured at fair value on a recurring basis.

Assets and Liabilities Measured on a Non-Recurring Basis

The fair value of loans held-for-sale is generally based on obtaining bids and broker indications on the estimated value of these loans held-for-sale, resulting in a Level 2 classification.

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. The appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Nonrecurring adjustments to certain commercial and residential estate properties classified as other real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

8) Fair Value (Continued)

classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

		Fair Value Measurements Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obeservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
Assets at March 31, 2011:				
Impaired loans held-for-sale other:				
Real estate:				
Commercial and residential	$ 900		$ 900	
Land and construction	1,089		1,089	
	$ 1,989		$ 1,989	
Impaired loans held-for-investment:				
Commercial	$ 8,124			$ 8,124
Real estate:				
Commercial and residential	1,902			1,902
Land and construction	4,685			4,685
Consumer	145			145
	$ 14,856			$ 14,856
Other real estate owned	$ 918			$ 918
Assets at December 31, 2010:				
Loans held-for-sale other:				
Real estate:				
Commercial and residential	$ 929		$ 929	
Land and construction	1,097		1,097	
	$ 2,026		$ 2,026	
Impaired loans held-for-investment:				
Commercial	$ 6,725			$ 6,725
Real estate:				
Commercial and residential	5,982			5,982
Land and construction	8,005			8,005
Consumer	120			120

	$ 20,832	$ 20,832
Other real estate owned	$ 1,296	$ 1,296

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

8) Fair Value (Continued)

The following table shows the detail of the impaired loans held-for-investment and the impaired loans held-for-investment carried at fair value for the periods indicated:

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Impaired loans held-for-investment:		
Book value of impaired loans held-for-investment carried at fair value	$ 19,657	$ 26,892
Book value of impaired loans held-for-investment carried at cost	4,910	4,421
Total impaired loans held-for-investment	$ 24,567	$ 31,313
Impaired loans held-for-investment carried at fair value:		
Book value of impaired loans held-for-investment carried at fair value	$ 19,657	$ 26,892
Specific valuation allowance	(4,801)	(6,060)
Impaired loans held-for-investment carried at fair value, net	$ 14,856	$ 20,832

Impaired loans held-for-investment which are measured primarily for impairment using the fair value of the collateral were $24,567,000 at March 31, 2011, after partial charge-offs of $1,702,000 in the first three months of 2011. In addition, these loans had a specific valuation allowance of $4,801,000 at March 31, 2011. Impaired loans held-for-investment totaling $19,657,000 at March 31, 2011 were carried at fair value as a result of the aforementioned partial charge-offs and specific valuation allowances at period-end. The remaining $4,910,000 of impaired loans were carried at cost at March 31, 2011, as the fair value of the collateral exceeded the cost basis of each respective loan. Partial charge-offs and changes in specific valuation allowances during the first three months of 2011 on impaired loans held-for-investment carried at fair value at March 31, 2011 resulted in an additional provision for loan losses of $676,000.

Total other real estate owned, consisting of two properties, had a fair value of $918,000 at March 31, 2011.

Impaired loans held-for-investment which are measured primarily for impairment using the fair value of the collateral totaled $31,313,000 at December 31, 2010, after partial charge-offs of $6,982,000 in 2010. In addition, these loans had a specific valuation allowance of $6,060,000 at December 31, 2010. Impaired loans held-for-investment totaling $26,892,000 at December 31, 2010 were carried at fair value as a result of the aforementioned partial charge-offs and specific valuation allowances at year-end. The remaining $4,421,000 of impaired loans were carried at cost at December 31, 2010, as the fair value of the collateral exceeded the cost basis of each respective loan. Partial charge-offs and changes in specific valuation allowances during 2010 on impaired loans held-for-investment carried at fair value at December 31, 2010 resulted in an additional provision for loan losses of $9,791,000.

Total other real estate owned, consisting of one property, had a fair value of $1,296,000 at December 31, 2010.

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

8) Fair Value (Continued)

The carrying amounts and estimated fair values of the Company's financial instruments for the periods indicated were as follows:

	March 31, 2011		December 31, 2010	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
	(Dollars in thousands)			
Assets:				
Cash and cash equivalents	$ 107,468	$ 107,468	$ 72,177	$ 72,177
Securities available-for-sale	250,132	250,132	232,165	232,165
Loans (including loans held-for-sale), net	788,705	817,275	831,855	855,327
FHLB and FRB stock	9,038	N/A	9,174	N/A
Accrued interest receivable	3,205	3,205	3,215	3,215
Loan servicing rights and I/O strips receivables	3,062	5,493	3,055	5,340
Liabilities:				
Time deposits	$ 279,599	$ 280,360	$ 287,344	$ 288,798
Other deposits	723,724	723,724	706,574	706,574
Securities sold under agreement to repurchase			5,000	5,018
Short-term borrowings	2,174	2,174	2,445	2,445
Subordinated debt	23,702	14,665	23,702	14,445
Accrued interest payable	3,175	3,175	2,810	2,810

The methods and assumptions, not previously discussed, used to estimate the fair value are described as follows:

Cash and Cash Equivalents and Accrued Interest Receivable and Payable

The carrying amount approximates fair value because of the short maturities of these instruments.

Loans

Loans with similar financial characteristics are grouped together for purposes of estimating their fair value. Loans are segregated by type such as commercial, term real estate, construction and land development, and consumer. Each loan category is further segmented into fixed and adjustable rate interest terms.

The fair value of performing, fixed rate loans is calculated by discounting scheduled future cash flows using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The fair value of variable rate loans approximates the carrying amount as these loans generally reprice within 90 days.

The fair value of loans held-for-sale is based on estimated market values from third party investors.

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

8) Fair Value (Continued)

FHLB and FRB Stock

It was not practical to determine the fair value of FHLB and FRB stock due to the restrictions placed on transferability.

Deposits

The fair value of deposits with no stated maturity, such as demand deposits, savings, and money market accounts, approximates the amount payable on demand. The carrying amount approximates the fair value of time deposits with a remaining maturity of less than 90 days. The fair value of all other time deposits is calculated based on discounting the future cash flows using rates currently offered for time deposits with similar remaining maturities.

Subordinated debt and Securities Sold Under Agreement to Purchase

The fair values of subordinated debt and securities sold under agreement to repurchase were determined based on the current market value for like kind instruments of a similar maturity and structure.

Short-term Borrowings and Note Payable

The carrying amount approximates the fair value of short-term borrowings and the note payable that reprice frequently and fully.

Off-Balance Sheet Items

The fair value of off-balance sheet items, such as commitments to extend credit, is not considered material and therefore is not included in the table above.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. 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 and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

9) Regulatory Matters

On February 17, 2010 HCC and HBC entered into a Written Agreement with the Federal Reserve Bank of San Francisco, and the California Department of Financial Institutions ("DFI"). Under the terms of the Written Agreement, the Company must obtain the prior written approval of the Federal Reserve and DFI before it may (i) declare or pay any dividends on common stock or preferred stock; (ii) make any distributions of principal or interest on HCC's outstanding trust preferred securities and

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

9) Regulatory Matters (Continued)

related subordinated debt; (iii) incur, increase or guarantee any debt; (iv) redeem any outstanding stocks, or; (v) take dividends or any other form of payment that represents a reduction in capital from HBC. The Written Agreement required the Company to submit written plans within certain timeframes to the Federal Reserve and the DFI that addresses the following items (i) strengthening credit risk management practices; (ii) improving HBC's position with respect to problem loans in excess of $2 million; (iii) maintaining adequate reserves for loan and lease losses; (iv) maintaining sufficient capital at HCC and HBC; (v) improving the management of HBC's liquidity position and funds management practices; and (vi) improving the Company's earnings and overall condition through a business plan and budget. All plans were submitted to the appropriate regulatory agencies, and all plans requiring approval by such agencies were approved.

In addition, the Agreement (i) required HBC's Board of Directors or a designated committee thereof to approve any extension, renewal or restructuring of any credit to any borrower whose loans have been "criticized"; (ii) requires HBC to charge off loans classified as "loss" by the Federal Reserve and/or DFI; (iii) requires the Company to notify the Federal Reserve and DFI no more than 30 days after the end of any quarter in which the capital ratios of HCC or HBC fall below the approved capital plan' minimum levels; (iv) requires HCC and HBC to comply with the notice provisions of Section 32 of the Federal Deposit Insurance Act and Subpart H of Regulation Y of the Board of Governors of the Federal Reserve System in connection with appointing any new director or senior executive officer or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position; (v) requires HCC and HBC to comply with the restrictions on indemnification and severance payments of Section 18(k) of the Federal Deposit Insurance Act and Part 359 of the FDIC's regulations; and (vi) requires the Company to provide quarterly progress reports to the Federal Reserve and the DFI.

The Board of Directors and management of the Company are committed to addressing and resolving the matters raised in the Written Agreement on a timely basis and actions have been undertaken to comply with the various items addressed by the Written Agreement. A new joint compliance committee was formed by the Board of Directors to oversee HCC's and HBC's response to the Written Agreement. The committee reports monthly to the Board of Directors.

Prior to entering into the Written Agreement in February 2010, HCC had already ceased paying dividends on its common stock (in the second quarter of 2009), suspended interest payments on its trust preferred securities and related subordinated debt (in the fourth quarter of 2009), and suspended dividend payments on its Series A Preferred Stock (also in the fourth quarter of 2009). As a result, the Company has accrued but has not paid approximately $2.9 million in interest on its subordinated debt, and approximately $3.3 million in dividends on its Series A Preferred Stock as of March 31, 2011.

The Company submitted specific plans to the FRB and DFI relating to improving asset quality and credit risk management, improving profitability, liquidity management and its capital plan. All of these plans have been accepted as satisfactory by the FRB and DFI. With respect to credit risk management, management has developed and utilizes risk of loss and loss given default models to evaluate risk exposure limits and potential changes in market conditions and conducts monthly reviews of credit risk management reports with the Boards of Directors of HCC and HBC. With respect to asset

Table of Contents

HERITAGE COMMERCE CORP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2011

(Unaudited)

9) Regulatory Matters (Continued)

improvement, the Company has taken steps to mitigate risk on each real estate loan upon renewal, or sooner based on facts and circumstances, to ensure that HBC has updated appraisals or evaluations which may result in additional collateral or guarantees. If necessary, the loan will be downgraded, placed on nonaccrual status, or foreclosed upon. In addition, the Company has reduced nonperforming loans as evidenced by a 60% decline in nonperforming loans at March 31, 2011 to $26.6 million compared to nonperforming loans at March 31, 2010 of $67.2 million. With respect to allowance for loan and lease losses, the Company's current methodology considers HBC's loan grading system, the volume and severity of criticized loans, concentrations, historical losses, and the impact of overall economic and market conditions on loan and collateral values that could result in probable losses within the portfolio, and the methodology is monitored as events and circumstances change. With respect to capital, HCC issued $75 million of preferred stock on June 21, 2010 and subsequently contributed $40 million of capital to HBC. In addition, the Company has developed a capital stress testing methodology that is updated each quarter and reviewed by the Finance and Investment Committee of the Board of Directors. With respect to liquidity funds management, the Company has a contingent liquidity plan and updates the contingent liquidity plan and its liquidity models each quarter which are reviewed by the Finance and Investment Committee of the Board of Directors. With respect to earnings and overall condition, the Company's Board of Directors has approved a 2011 budget for the Company.

As of this filing date, HCC and HBC believe they are in compliance with the requirements of the Written Agreement. However, compliance with the Written Agreement is determined solely by the Company's regulators. Failure to comply with the Written Agreement may subject the Company and HBC to additional supervisory actions and orders.

Table of Contents

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of Heritage Commerce Corp (the "Company") and its wholly owned subsidiary, Heritage Bank of Commerce (sometimes referred to as "HBC"). This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our consolidated financial statements and the accompanying notes presented elsewhere in this report. Unless we state otherwise or the context indicates otherwise, references to the "Company," "Heritage," "we," "us," and "our," in this Report on Form 10-Q refer to Heritage Commerce Corp and Heritage Bank of Commerce. Reference to "HCC" refers only to Heritage Commerce Corp, the holding company of HBC.

EXECUTIVE SUMMARY

This summary is intended to identify the most important matters on which management focuses when it evaluates the financial condition and performance of the Company. When evaluating financial condition and performance, management looks at certain key metrics and measures. The Company's evaluation includes comparisons with peer group financial institutions and its own performance objectives established in the internal planning process.

The primary activity of the Company is commercial banking. The Company's operations are located entirely in the southern and eastern regions of the general San Francisco Bay Area of California in the counties of Santa Clara, Alameda and Contra Costa. The largest city in this area is San Jose and the Company's market includes the headquarters of a number of technology based companies in the region known commonly as Silicon Valley. The Company's customers are primarily closely held businesses and professionals.

On February 17, 2010 HCC and HBC entered into a Written Agreement with the Federal Reserve Bank of San Francisco, and the California Department of Financial Institutions. The Board of Directors and management of the Company are committed to addressing and resolving the matters raised in the Written Agreement on a timely basis and actions have been undertaken to comply with the various items addressed by the Written Agreement. As of the date of this filing, both HCC and HBC believe they are in compliance with all of the provisions of the Written Agreement. However, compliance with the Written Agreement is determined solely by the Company's regulators. Further discussion of the Written Agreement appears under Note 9 to the unaudited consolidated financial statements located elsewhere herein.

Performance Overview

For the three months ended March 31, 2011, net income was $1.6 million. Net income allocable to common shareholders was $985,000, or $0.03 per diluted common share for the quarter ended March 31, 2011, which included a $770,000 provision for loan losses and $596,000 in dividends and discount accretion on preferred stock. In the quarter ended March 31, 2010, the net loss was ($4.1) million. The net loss allocable to common shareholders was ($4.7) million, or ($0.40) per diluted common share for the quarter ended March 31, 2010, which included a $5.1 million provision for loan losses and $591,000 in dividends and discount accretion on preferred stock. The Company's annualized return on average assets was 0.51% and annualized return on average equity was 3.51% for the first quarter of 2011, compared to -1.23% and -9.61% a year ago.

Table of Contents

The following are major factors that impacted the Company's results of operations:

The net interest margin increased 13 basis points to 3.95% for the first quarter of 2011, compared with 3.82% for the first quarter of 2010, and increased 36 basis points compared with 3.59% for the fourth quarter of 2010. The increase in the net interest margin was primarily due to a lower cost of deposits as a result of maturing higher-cost wholesale funding and growth in noninterest-bearing deposits.

Net interest income decreased to $11.2 million for the first quarter of 2011, from $11.4 million for the first quarter of 2010 primarily due to a decrease in loan balances, which was partially offset by an increase in investment securities.

The provision for loan losses was $770,000 for the first quarter of 2011, compared to $5.1 million for the first quarter of 2010. The decrease in provision for loan losses in the first quarter of 2011 compared to the first quarter of 2010 reflects a lower volume of classified assets and nonperforming loans, a decrease in loan charge-offs, and contraction of the loan portfolio.

Noninterest income increased 14% to $1.9 million for the first quarter of 2011 from $1.7 million for the first quarter of 2010, primarily due to the gain on sale of SBA loans of $379,000 in the first quarter of 2011, compared to $114,000 in gain on sale of SBA loans in the first quarter of 2010.

Noninterest expense decreased 14% to $10.4 million for the first quarter of 2011 from $12.2 million for the first quarter of 2010. The decrease in noninterest expense was primarily due to a decline in salaries and employee benefits expense, professional fees related to problem loans, expenses related to OREO properties, and FDIC insurance premiums in the first quarter of 2011.

The efficiency ratio was 79.55% for the first quarter of 2011, compared to 93.45% for the first quarter of 2010. The improvement was primarily due to lower noninterest expense as management continues to focus on controlling expenses and an increase in gains on sales of SBA loans.

The income tax expense for the first quarter of 2011 was $331,000, as compared to an income tax benefit of $120,000 for the first quarter of 2010. The effective income tax rate was 17% for first quarter of 2011, compared to an effective income tax rate of -3% for the first quarter of 2010. The difference in the effective tax rate compared to the combined Federal and state statutory tax rate of 42% is primarily the result of the Company's investment in life insurance policies whose earnings are not subject to taxes, and tax credits related to investments in low income housing limited partnerships.

The following are important factors in understanding our current financial condition and liquidity position:

Cash, Federal funds sold, interest-bearing deposits in other financial institutions and securities available-for-sale increased 86% to $357.6 million at March 31, 2011, from $192.7 million at March 31, 2010, and increased 17% from $304.3 million at December 31, 2010. The substantial increase in liquid assets from March 31, 2010 is primarily due to proceeds from the June 2010 private placement, proceeds from loan sales, and loan paydowns.

Total loans, excluding loans held-for-sale, decreased $203.1 million, or 20%, to $803.4 million at March 31, 2011, compared to $1.01 billion at March 31, 2010, and decreased $42.7 million, or 5%, from December 31, 2010. Land and construction loans decreased $103.3 million, or 67%, to $50.5 million at March 31, 2011, compared to $153.8 million at March 31, 2010, and decreased $11.9 million, or 19%, from $62.4 million at December 31, 2010.

Table of Contents

Classified assets decreased to $81.4 million at March 31, 2011, compared to $171.2 million at March 31, 2010, and $91.8 million at December 31, 2010.

The allowance for loan losses was $24.0 million, or 2.99% of total loans at March 31, 2011, compared to $26.5 million or 2.64% of total loans at March 31, 2010, and $25.2 million, or 2.98% of total loans at December 31, 2010.

The allowance for loan losses to total nonperforming loans, or coverage ratio, increased to 90.41% at March 31, 2011, compared to 39.47% at March 31, 2010, and 80.49% at December 31, 2010.

Nonperforming assets were $27.5 million, or 2.19% of total assets at March 31, 2011, compared to $69.0 million or 5.17% of total assets at March 31, 2010 and $34.6 million, or 2.78% of total assets at December 31, 2010.

Net loan charge-offs were $2.0 million for the first quarter of 2011, compared to $7.3 million for the first quarter of 2010, and $1.1 million for the fourth quarter of 2010.

Noninterest-bearing demand deposits increased 25% to $325.1 million at March 31, 2011, from $261.0 million at March 31, 2010, and increased 16% from $280.3 million at December 31, 2010.

Brokered deposits decreased 44% to $97.8 million at March 31, 2011, from $174.5 million at March 31, 2010, and decreased 1% from $98.5 million at December 31, 2010.

The ratio of noncore funding (which consists of time deposits $100,000 and over, CDARS deposits, brokered deposits, securities under agreement to repurchase and short-term borrowings) to total assets was 19.85% at March 31, 2011, compared to 26.04% at March 31, 2010, and 20.96% at December 31, 2010.

The liquidity position improved with a loan to deposit ratio of 80.07% at March 31, 2011, compared to 93.04% at March 31, 2010, and 85.12% at December 31, 2010.

Capital ratios substantially exceed regulatory requirements for a well-capitalized financial institution, both on a consolidated basis and at the bank level at March 31, 2011. The leverage ratio at the holding company was 15.3%, with a Tier 1 risk-based capital ratio of 19.9%, and a total risk-based capital ratio of 21.2% at March 31, 2011. The leverage ratio for HBC was 13.3%, with a Tier 1 risk-based capital ratio of 17.3%, and a total risk-based capital ratio of 18.5% at March 31, 2011. The regulatory well-capitalized guidelines are a minimum of a 5% leverage ratio, a 6% Tier 1 risk-based capital ratio, and a 10% total risk-based capital ratio.

Deposits

The composition and cost of the Company's deposit base are important in analyzing the Company's net interest margin and balance sheet liquidity characteristics. Except for brokered time deposits, the Company's depositors are generally located in its primary market area. Depending on loan demand and other funding requirements, the Company also obtains deposits from wholesale sources including deposit brokers. The Company had $97.8 million in brokered deposits at March 31, 2011, compared to $174.5 million at March 31, 2010, and $98.5 million at December 31, 2010. Deposits from title insurance companies, escrow accounts and real estate exchange facilitators increased to $34.7 million at March 31, 2011, compared to $21.6 million at March 31, 2010, and decreased from $39.0 million at December 31, 2010. The Company has a policy to monitor all deposits that may be sensitive to interest rate changes to help assure that liquidity risk does not become excessive due to concentrations. Deposits at March 31, 2011 were $1.00 billion, compared to $1.08 billion at March 31, 2010, and $993.9 million at December 31, 2010.

Table of Contents

HBC is a member of the Certificate of Deposit Account Registry Service ("CDARS") program. The CDARS program allows customers with deposits in excess of FDIC insured limits to obtain coverage on time deposits through a network of banks within the CDARS program. Deposits gathered through this program are considered brokered deposits under regulatory guidelines. Deposits in the CDARS program totaled $21.0 million at March 31, 2011, compared to $18.5 million at March 31, 2010, and $17.9 million at December 31, 2010.

Liquidity

Our liquidity position refers to our ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely fashion. At March 31, 2011, we had $107.5 million in cash and cash equivalents and approximately $269.6 million in available borrowing capacity from various sources including the Federal Home Loan Bank ("FHLB"), the Federal Reserve Bank of San Francisco ("FRB"), and Federal funds facilities with several financial institutions. The Company also had $215.7 million in unpledged securities available at March 31, 2011. Our loan to deposit ratio decreased to 80.07% at March 31, 2010, compared to 93.04% at March 31, 2010, and 85.12% at December 31, 2010, primarily due to a reduction in the loan portfolio.

Lending

Our lending business originates primarily through our branch offices located in our primary market. The Company also has an additional SBA loan production office in Santa Rosa, California. The total loan portfolio remains well diversified with commercial loans accounting for 46% of the portfolio at March 31, 2011. Commercial and residential real estate loans accounted for 40% of the total loan portfolio at March 31, 2011, of which 53% were owner-occupied by businesses. We have actively lowered our exposure to land and construction loans and our overall credit risk on these portfolios has been reduced. Land and construction loans decreased $103.3 million to $50.5 million at March 31, 2011, compared to $153.8 million at March 31, 2010, and accounted for 6% of our total loan portfolio. Consumer and home equity loans accounted for the remaining 8% of total loans at March 31, 2011. The yield on the loan portfolio was 5.28% in the first quarter of 2011, compared to 5.02% in the first quarter of 2010. The decline in gross loans in the first quarter of 2011 was primarily due to diminished loan demand, loan payoffs exceeding draw downs of loan commitments and the result of efforts to reduce classified loans. Lower volume of loan originations can be attributed in part to lower demand for certain types of credit as well as more selectivity with respect to the types of loans the Company chooses to originate.