HERITAGE COMMERCE CORP
Form 10-Q
November 06, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 Q

(MARK ONE)

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

For the quarterly period ended September 30, 2018

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 000 23877

Heritage Commerce Corp

(Exact name of Registrant as Specified in its Charter)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

The Registrant had 43,279,185 shares of Common Stock outstanding on October 30, 2018.

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HERITAGE COMMERCE CORP

QUARTERLY REPORT ON FORM 10 Q

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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, Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, Rule 3b 6 promulgated thereunder 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 “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:

- current and future economic and market conditions in the United States generally or in the communities we serve, including the effects of declines in property values, high unemployment rates and overall slowdowns in economic growth should these events occur;
- 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;
- changes in inflation, interest rates, and market liquidity which may impact interest margins and impact funding sources;
- volatility in credit and equity markets and its effect on the global economy;
- changes in the competitive environment among financial or bank holding companies and other financial service providers;
- changes in consumer and business spending and saving habits and the related effect on our ability to increase assets and to attract deposits;
- our ability to develop and promote customer acceptance of new products and services in a timely manner;
- risks associated with concentrations in real estate related loans;

other than temporary impairment charges to our securities portfolio;

changes in the level of nonperforming assets and charge offs and other credit quality measures, and their impact on the adequacy of the Heritage Commerce Corp's (the "Company") allowance for loan losses and the Company's provision for loan losses;

· increased capital requirements for our continual growth or as imposed by banking regulators, which may require us to raise capital at a time when capital is not available or favorable terms or at all;

regulatory limits on Heritage Bank of Commerce's ability to pay dividends to the Company;

changes in our capital management policies, including those regarding business combinations, dividends, and share repurchases, among others;

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- our inability to attract, recruit, and retain qualified officers and other personnel could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, results of operations and growth prospects;
- the potential increase in reserves and allowance for loan loss as a result of the transition to the current expected credit loss standard ("CECL") established by the Financial Accounting Standards Board to account for expected credit losses;

operational issues stemming from, and/or capital spending necessitated by, the potential need to adapt to industry changes in information technology systems, on which we are highly dependent;

our ability to keep pace with technological changes, including our ability to identify and address cyber-security risks such as data security breaches, "denial of service" attacks, "hacking" and identity theft;

inability of our framework to manage risks associated with our business, including operational risk and credit risk;

risks of loss of funding of Small Business Administration or SBA loan programs, or changes in those programs;

compliance with governmental and regulatory requirements, including the Dodd-Frank Act and others relating to banking, consumer protection, securities , accounting and tax matters;

significant changes in applicable laws and regulations, including those concerning taxes, banking and securities;

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;

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;

availability of and competition for acquisition opportunities;

risks resulting from domestic terrorism;

risks of natural disasters (including earthquakes) and other events beyond our control;

- fully realizing cost savings and other benefits, and/or business disruption following the mergers of Tri-Valley Bank and United American Bank; and

our success in managing the risks involved in the foregoing factors.

Forward-looking statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events. You should consider any forward looking statements in light of this explanation, and we caution you about relying on forward-looking statements.

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Part I—FINANCIAL INFORMATION

ITEM 1—CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

HERITAGE COMMERCE CORP

CONSOLIDATED BALANCE SHEETS (Unaudited)

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Assets		
Cash and due from banks	$ 40,831	$ 31,681
Other investments and interest-bearing deposits in other financial institutions	340,198	284,541
Total cash and cash equivalents	381,029	316,222
Securities available-for-sale, at fair value	319,071	391,852
Securities held-to-maturity, at amortized cost (fair value of $359,698 at September 30, 2018 and $394,292 at December 31, 2017)	375,732	398,341
Loans held-for-sale - SBA, at lower of cost or fair value, including deferred costs	6,344	3,419
Loans, net of deferred fees	1,899,387	1,582,667
Allowance for loan losses	(27,426)	(19,658)
Loans, net	1,871,961	1,563,009
Federal Home Loan Bank and Federal Reserve Bank stock and other investments, at cost	25,210	17,911
Company-owned life insurance	61,630	60,814
Premises and equipment, net	7,246	7,353
Goodwill	83,752	45,664
Other intangible assets	12,614	5,589
Accrued interest receivable and other assets	48,321	33,278
Total assets	$ 3,192,910	$ 2,843,452
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand, noninterest-bearing	$ 1,081,846	$ 989,753
Demand, interest-bearing	670,624	601,929
Savings and money market	828,297	684,131
Time deposits - under $250	68,194	51,710
Time deposits - $250 and over	84,763	138,634
CDARS - interest-bearing demand, money market and time deposits	11,575	16,832

Total deposits	2,745,299	2,482,989
Subordinated debt, net of issuance costs	39,322	39,183
Accrued interest payable and other liabilities	54,723	50,041
Total liabilities	2,839,344	2,572,213
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; none issued and outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock, no par value; 60,000,000 shares authorized; 43,271,676 shares issued and outstanding at September 30, 2018 and 38,200,883 shares issued and outstanding at December 31, 2017	300,208	218,355
Retained earnings	70,531	62,136
Accumulated other comprehensive loss	(17,173)	(9,252)
Total shareholders' equity	353,566	271,239
Total liabilities and shareholders' equity	$ 3,192,910	$ 2,843,452

See notes to unaudited consolidated financial statements

HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands, except per share amounts)			
Interest income:				
Loans, including fees	$ 28,632	$ 22,507	$ 77,271	$ 64,112
Securities, taxable	3,483	3,596	11,112	9,916
Securities, exempt from Federal tax	555	563	1,675	1,694
Other investments, interest-bearing deposits in other financial institutions and Federal funds sold	1,940	1,289	4,409	3,037
Total interest income	34,610	27,955	94,467	78,759
Interest expense:				
Deposits	1,575	1,051	3,772	2,867
Subordinated debt	583	583	1,731	811
Short-term borrowings	1	—	1	1
Total interest expense	2,159	1,634	5,504	3,679
Net interest income before provision for loan losses	32,451	26,321	88,963	75,080
Provision (credit) for loan losses	(425)	115	7,279	390
Net interest income after provision for loan losses	32,876	26,206	81,684	74,690
Noninterest income:				
Service charges and fees on deposit accounts	1,107	869	2,981	2,410
Gain on sales of SBA loans	236	147	551	635
Increase in cash surrender value of life insurance	216	417	816	1,259
Servicing income	163	246	533	736
Gain (loss) on sales of securities	—	—	266	(6)
Other	484	781	2,034	2,014
Total noninterest income	2,206	2,460	7,181	7,048
Noninterest expense:				
Salaries and employee benefits	10,719	9,071	35,302	27,766
Occupancy and equipment	1,559	1,142	3,927	3,426
Professional fees	721	695	1,116	2,439
Other	4,729	3,926	18,235	11,785
Total noninterest expense	17,728	14,834	58,580	45,416
Income before income taxes	17,354	13,832	30,285	36,322
Income tax expense	4,979	5,249	8,186	13,752
Net income	$ 12,375	$ 8,583	$ 22,099	$ 22,570

Earnings per common share:				
Basic	$ 0.29	$ 0.22	$ 0.54	$ 0.59
Diluted	$ 0.28	$ 0.22	$ 0.53	$ 0.59

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Net income	$ 12,375	$ 8,583	$ 22,099	$ 22,570
Other comprehensive income:				
Change in net unrealized holding (losses) gains on available-for-sale securities and I/O strips	(1,880)	539	(11,009)	2,975
Deferred income taxes	545	(227)	3,192	(1,250)
Change in net unamortized unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	(11)	(12)	(33)	(38)
Deferred income taxes	3	5	9	16
Reclassification adjustment for losses (gains) realized in income	—	—	(266)	6
Deferred income taxes	—	—	79	(2)
Change in unrealized (losses) gains on securities and I/O strips, net of deferred income taxes	(1,343)	305	(8,028)	1,707
Change in net pension and other benefit plan liability adjustment	51	39	152	116
Deferred income taxes	(15)	(17)	(45)	(49)
Change in pension and other benefit plan liability, net of deferred income taxes	36	22	107	67
Other comprehensive (loss) income	(1,307)	327	(7,921)	1,774
Total comprehensive income	$ 11,068	$ 8,910	$ 14,178	$ 24,344

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

	Nine Months Ended September 30, 2018 and 2017				
	Common Stock		Retained	Accumulated Other Comprehensive	Total Shareholders'
	Shares	Amount	Earnings	Loss	Equity
	(Dollars in thousands)				
Balance, January 1, 2017	37,941,007	$ 215,237	$ 52,527	$ (7,914)	$ 259,850
Net income	—	—	22,570	—	22,570
Other comprehensive income	—	—	—	1,774	1,774
Issuance of restricted stock awards, net	64,136	—	—	—	—
Amortization of restricted stock awards, net of forfeitures and taxes	—	678	—	—	678
Cash dividend declared $0.30 per share	—	—	(11,418)	—	(11,418)
Stock option expense, net of forfeitures and taxes	—	639	—	—	639
Stock options exercised	193,863	1,352	—	—	1,352
Balance, September 30, 2017	38,199,006	$ 217,906	$ 63,679	$ (6,140)	$ 275,445
Balance, January 1, 2018	38,200,883	$ 218,355	$ 62,136	$ (9,252)	$ 271,239
Net income	—	—	22,099	—	22,099
Other comprehensive loss	—	—	—	(7,921)	(7,921)
Issuance of common shares to acquire Tri-Valley Bank	1,889,613	30,725	—	—	30,725
Issuance of common shares to acquire United American Bank	2,826,032	47,280	—	—	47,280
Issuance of restricted stock awards, net	95,378	—	—	—	—
Amortization of restricted stock awards, net of forfeitures and taxes	—	814	—	—	814
Cash dividend declared $0.33 per share	—	—	(13,704)	—	(13,704)
Stock option expense, net of forfeitures and taxes	—	535	—	—	535
Stock options exercised	259,770	2,499	—	—	2,499

Balance, September 30, 2018	43,271,676	$ 300,208	$ 70,531	$ (17,173)	$ 353,566

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended September 30,	
	2018	2017
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 22,099	$ 22,570
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of discounts and premiums on securities	3,093	3,218
(Gain) loss on sale of securities available-for-sale	(266)	6
Gain on sale of SBA loans	(551)	(635)
Proceeds from sale of SBA loans originated for sale	9,315	8,304
SBA loans originated for sale	(11,689)	(8,957)
Provision for loan losses	7,279	390
Increase in cash surrender value of life insurance	(816)	(1,259)
Depreciation and amortization	566	586
Amortization of other intangible assets	1,336	1,083
Stock option expense, net	535	639
Amortization of restricted stock awards, net	814	678
Amortization of subordinated debt issuance costs	139	64
Effect of changes in:		
Accrued interest receivable and other assets	(19)	2,428
Accrued interest payable and other liabilities	1,723	(12)
Net cash provided by operating activities	33,558	29,103
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of securities available-for-sale	(15,193)	(123,561)
Purchase of securities held-to-maturity	(16,906)	(89,470)
Maturities/paydowns/calls of securities available-for-sale	44,832	41,463
Maturities/paydowns/calls of securities held-to-maturity	38,091	32,502
Proceeds from sales of securities available-for-sale	94,291	6,536
Net change in loans	20,215	(60,683)
Changes in Federal Home Loan Bank stock and other investments	(4,478)	(2,709)
Purchase of premises and equipment	(108)	(635)
Cash received in bank acquisition, net of cash paid	36,028	—
Net cash provided (used in) by investing activities	196,772	(196,557)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in deposits	(154,318)	218,464
Issuance of subordinated debt, net of issuance costs	—	39,073
Exercise of stock options	2,499	1,352

Payment of cash dividends	(13,704)	(11,418)
Net cash (used in) provided by financing activities	(165,523)	247,471
Net increase in cash and cash equivalents	64,807	80,017
Cash and cash equivalents, beginning of period	316,222	266,103
Cash and cash equivalents, end of period	$ 381,029	$ 346,120
Supplemental disclosures of cash flow information:		
Interest paid	$ 4,728	$ 2,912
Income taxes paid	8,671	11,731
Supplemental schedule of non-cash investing activity:		
Transfer of loans held-for-sale to loan portfolio	—	2,391
Summary of assets acquired and liabilities assumed through acquisitions:		
Cash and cash equivalents, net of cash paid	$ 36,028	$ —
Securities avaiable-for-sale	63,723	—
Net loans	336,446	—
Premises and equipment, net	350	—
Goodwill	38,088	—
Other intangible assets	8,361	
Other assets, net	14,736	—
Deposits	(416,628)	—
Other borrowings	(62)	—
Other liabilities	(3,037)	—
Common stock issued to acquire Tri-Valley and United American Bank	78,005	—

See notes to unaudited consolidated financial statements

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HERITAGE COMMERCE CORP

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(Unaudited)

1) Basis of Presentation

The unaudited consolidated financial statements of Heritage Commerce Corp (the "Company" or "HCC") and its wholly owned subsidiary, Heritage Bank of Commerce ("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, 2017.

HBC is a commercial bank serving customers primarily located in Santa Clara, Alameda, Contra Costa, San Benito, and San Mateo counties of California. CSNK Working Capital Finance Corp. a California corporation, dba Bay View Funding ("Bay View Funding") is a wholly owned subsidiary of HBC, and provides business-essential working capital factoring financing to various industries throughout the United States. No customer accounts for more than 10% of revenue for HBC or the Company. The Company reports its results for two segments: banking and factoring. The Company's management uses segment results in its operating and strategic planning.

In management'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 and nine months ended September 30, 2018 are not necessarily indicative of the results expected for any subsequent period or for the entire year ending December 31, 2018.

Business Combinations

The Company accounts for acquisitions of businesses using the acquisition method of accounting. Under the acquisition method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes various valuation techniques including discounted cash flow analyses to determine these fair values. Any excess of the purchase price over amounts allocated to the acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill.

Goodwill and Other Intangible Assets

Goodwill resulted from the acquisition of Tri-Valley Bank ("Tri-Valley") on April 6, 2018 and United American Bank ("United American") on May 4, 2018, and from acquisitions in prior years. Goodwill represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment is recognized in the period identified.

Other intangible assets consist of core deposit intangible assets and a below market value lease intangible asset, arising from the United American and Tri-Valley acquisitions. They are initially measured at fair value and then are amortized over their estimated useful lives. The core deposit intangible assets from the acquisitions of United American and Tri-Valley are being amortized on an accelerated method over ten years. The below market value lease intangible assets are being amortized on the straight line method over three years for United American and eleven years for Tri-Valley.

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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 May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers", which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The standard replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of the standard did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of the standard. The Company's revenue recognition pattern for revenue streams within the scope of the standard, including but not limited to service charges on deposit accounts and gains/losses on the sale of other real estate owned ("OREO"), did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of the standard to uncompleted contracts at the date of adoption however, periods prior to the date of adoption were not retrospectively revised as the impact of the standard on uncompleted contracts at the date of adoption was not material. See Note 15 – Revenue Recognition for more information.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The guidance affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements of financial instruments. The standard was effective for the Company on January 1, 2018 and resulted in the use of an exit price rather than an entrance price to determine the fair value of financial instruments not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 10 – Fair Value regarding the valuation of the loan portfolio.

In March 2017, the FASB issued ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The standard amended existing guidance to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit costs are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The amendments allow only the service cost component to be eligible for capitalization. The Company adopted the new guidance on January 1, 2018, and there was no material impact to the financial statements.

Newly Issued, but not yet Effective Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02, Leases. The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right of use asset representing its right to use the underlying asset for the lease term. When measuring assets and liabilities arising from a lease, a lessee (and a lessor) should include payments to be made in optional periods only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. Similarly, optional payments to purchase the underlying asset should be included in the measurement of lease assets and lease liabilities only if the lessee is reasonably certain to exercise that purchase option. Reasonably certain is a high threshold that is consistent with and intended to be applied in the same way as the reasonably assured threshold in the previous leases guidance. In addition, also consistent with the previous leases guidance, a lessee (and a lessor) should exclude most variable lease payments in measuring lease assets and lease liabilities, other than those that depend on an index or a rate or are in substance fixed payments. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight line basis over the lease term. The new guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are

currently evaluating the provisions of this ASU and have determined that the provisions of ASU No. 2016-02 will result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase in liabilities; however, we do not expect this to have a material impact to the Company's results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments. The standard is the final guidance on the new current expected credit loss ("CECL") model. The amendments in this update replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to estimate future credit loss estimates. As CECL encompasses all financial assets carried at amortized cost, the requirement that reserves be established based on an organization's reasonable and supportable estimate of expected credit losses extends to held-to-maturity debt securities. The update amends the accounting for credit losses on available for sale securities, whereby credit losses will be presented as an allowance as opposed to a write down. In addition, CECL will modify the accounting for purchased loans with credit deterioration since origination, so that reserves are established at the date of acquisition for purchased loans. Lastly, the amendment requires enhanced disclosures on the significant estimates and judgments used to estimate credit losses, as well as on the credit quality and underwriting standards of an organization's portfolio. These disclosures require organizations to present the currently required credit quality disclosures disaggregated by the year of origination or vintage. The guidance allows for a modified retrospective approach with a cumulative effect adjustment to the balance sheet upon adoption (charge to retained earnings instead of the income statement). The new guidance is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2019, and early adoption is permitted. We have formed a committee that has assessed our data needs and is in the process of implementing a system to comply with the new guidance. The committee has also selected a vendor to assist in generating loan level cash flows and disclosures. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses and a charge to equity as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In January 2017, the FASB issued accounting standards ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The provisions of the update eliminate the existing second step of the goodwill impairment test which provides for the allocation of reporting unit fair value among existing assets and liabilities, with the net remaining amount representing the implied fair value of goodwill. In replacement of the existing goodwill impairment rule, the update will provide that impairment should be recognized as the excess of any of the reporting unit's goodwill over the fair value of the reporting unit. Under the provisions of this update, the amount of the impairment is limited to the carrying value of the reporting unit's goodwill. For public business entities that are SEC filers, the amendments of the update will become effective in fiscal years beginning after December 15, 2019. Management does not expect the requirements of this update to have a material impact on the Company's financial position, results of operations or cash flows.

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2) Shareholders' Equity and Earnings Per Share

Basic earnings per common share is computed by dividing net income by the weighted average common shares outstanding. Diluted earnings per share reflect potential dilution from outstanding stock options using the treasury stock method. There were 512,261 and 227,409 stock options for the three months ended September 30, 2018 and 2017, and 505,686 and 140,659 for the nine months ended September 30, 2018 and 2017, respectively, considered to be antidilutive and excluded from the computation of diluted earnings per share. A reconciliation of these factors used in computing basic and diluted earnings per common share is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands, except per share amounts)			
Net income	$ 12,375	$ 8,583	$ 22,099	$ 22,570
Weighted average common shares outstanding for basic earnings per common share	43,230,016	38,152,633	41,132,043	38,060,224
Dilutive effect of stock options outstanding, using the treasury stock method	501,354	428,665	551,001	504,910
Shares used in computing diluted earnings per common share	43,731,370	38,581,298	41,683,044	38,565,134
Basic earnings per share	$ 0.29	$ 0.22	$ 0.54	$ 0.59
Diluted earnings per share	$ 0.28	$ 0.22	$ 0.53	$ 0.59

3) Accumulated Other Comprehensive Income (Loss) ("AOCI")

The following table reflects the changes in AOCI by component for the periods indicated:

	Three Months Ended September 30, 2018 and 2017
	Unamortized
	Unrealized

	Unrealized Gains (Losses) on Available-for-Sale Securities and I/O Strips(1)	Gain on Available-for-Sale Securities Reclassified to Held-to-Maturity	Defined Benefit Pension Plan Items	Total
	(Dollars in thousands)			
Beginning balance July 1, 2018, net of taxes	$ (7,031)	$ 359	$ (9,194)	$ (15,866)
Other comprehensive income (loss) before reclassification, net of taxes	(1,335)	—	(4)	(1,339)
Amounts reclassified from other comprehensive income (loss), net of taxes	—	(8)	40	32
Net current period other comprehensive income (loss), net of taxes	(1,335)	(8)	36	(1,307)
Ending balance September 30, 2018, net of taxes	$ (8,366)	$ 351	$ (9,158)	$ (17,173)
Beginning balance July 1, 2017, net of taxes	$ 877	$ 321	$ (7,665)	$ (6,467)
Other comprehensive income (loss) before reclassification, net of taxes	312	—	(7)	305
Amounts reclassified from other comprehensive income (loss), net of taxes	—	(7)	29	22
Net current period other comprehensive income (loss), net of taxes	312	(7)	22	327
Ending balance September 30, 2017, net of taxes	$ 1,189	$ 314	$ (7,643)	$ (6,140)

Nine Months Ended
September 30, 2018 and 2017
Unamortized
Unrealized

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	Unrealized Gains (Losses) on Available-for-Sale Securities and I/O Strips	Gain on Available-for-Sale Securities Reclassified to Held-to-Maturity	Defined Benefit Pension Plan Items	Total
	(Dollars in thousands)			
Beginning balance January 1, 2018, net of taxes	$ (362)	$ 375	$ (9,265)	$ (9,252)
Other comprehensive (loss) before reclassification, net of taxes	(7,817)	—	(13)	(7,830)
Amounts reclassified from other comprehensive (loss) income, net of taxes	(187)	(24)	120	(91)
Net current period other comprehensive (loss) income, net of taxes	(8,004)	(24)	107	(7,921)
Ending balance September 30, 2018, net of taxes	$ (8,366)	$ 351	$ (9,158)	$ (17,173)
Beginning balance January 1, 2017, net of taxes	$ (540)	$ 336	$ (7,710)	$ (7,914)
Other comprehensive income (loss) before reclassification, net of taxes	1,725	—	(22)	1,703
Amounts reclassified from other comprehensive income (loss), net of taxes	4	(22)	89	71
Net current period other comprehensive income (loss), net of taxes	1,729	(22)	67	1,774
Ending balance September 30, 2017, net of taxes	$ 1,189	$ 314	$ (7,643)	$ (6,140)

Details About AOCI Components	Amounts Reclassified from AOCI(1) Three Months Ended September 30, 2018	2017	Affected Line Item Where Net Income is Presented
	(Dollars in thousands)		
Unrealized gains on available-for-sale securities and I/O strips	$ —	$ —	Gain (loss) on sales of securities
	—	—	Income tax expense
	—	—	Net of tax
Amortization of unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	11	12	Interest income on taxable securities
	(3)	(5)	Income tax expense
	8	7	Net of tax

Amortization of defined benefit pension plan items (1)			
Prior transition obligation	16	18	
Actuarial losses	(73)	(69)	
	(57)	(51)	Salaries and employee benefits
	17	22	Income tax benefit
	(40)	(29)	Net of tax
Total reclassification for the year	$ (32)	$ (22)	

(1) This AOCI component is included in the computation of net periodic benefit cost (see Note 9—Benefit Plans) and includes split-dollar life insurance benefit plan.

Amounts Reclassified from AOCI(1)

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Details About AOCI Components	Nine Months Ended 2018	2017	Net Income is Presented
	(Dollars in thousands)		
Unrealized gains on available-for-sale securities and I/O strips	$ 266	$ (6)	Gain (loss) on sales of securities
	(79)	2	Income tax expense
	187	(4)	Net of tax
Amortization of unrealized gain on securities available-for-sale that were reclassified to securities held-to-maturity	33	38	Interest income on taxable securities
	(9)	(16)	Income tax expense
	24	22	Net of tax
Amortization of defined benefit pension plan items (1)			
Prior transition obligation	48	53	
Actuarial losses	(219)	(207)	
	(171)	(154)	Salaries and employee benefits
	51	65	Income tax benefit
	(120)	(89)	Net of tax
Total reclassification from AOCI for the year	$ 91	$ (71)	

(1) This AOCI component is included in the computation of net periodic benefit cost (see Note 9—Benefit Plans) and includes split-dollar life insurance benefit plan.

4) Securities

The amortized cost and estimated fair value of securities at September 30, 2018 and December 31, 2017 were as follows:

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
Agency mortgage-backed securities	$ 324,309	$ 18	$ (12,662)	$ 311,665
U.S. Government sponsored entities	7,419	—	(13)	7,406
Total	$ 331,728	$ 18	$ (12,675)	$ 319,071
Securities held-to-maturity:				
Agency mortgage-backed securities	$ 288,594	$ —	$ (12,778)	$ 275,816

Municipals - exempt from Federal tax	87,138	242	(3,498)	83,882
Total	$ 375,732	$ 242	$ (16,276)	$ 359,698

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(Dollars in thousands)			
Securities available-for-sale:				
Agency mortgage-backed securities	$ 378,339	$ 786	$ (4,392)	$ 374,733
Trust preferred securities	15,000	2,119	—	17,119
Total	$ 393,339	$ 2,905	$ (4,392)	$ 391,852
Securities held-to-maturity:				
Agency mortgage-backed securities	$ 309,616	$ 6	$ (4,394)	$ 305,228
Municipals - exempt from Federal tax	88,725	946	(607)	89,064
Total	$ 398,341	$ 952	$ (5,001)	$ 394,292

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Securities with unrealized losses at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are as follows:

	Less Than 12 Months		12 Months or More		Total	
September 30, 2018	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
	(Dollars in thousands)					
Securities available-for-sale:						
Agency mortgage-backed securities	$ 76,522	$ (2,290)	$ 231,110	$ (10,372)	$ 307,632	$ (12,662)
U.S. Government sponsored entities	7,405	(13)	—	—	7,405	(13)
Total	$ 83,927	$ (2,303)	$ 231,110	$ (10,372)	$ 315,037	$ (12,675)
Securities held-to-maturity:						
Agency mortgage-backed securities	$ 71,766	$ (2,639)	$ 203,293	$ (10,139)	$ 275,059	$ (12,778)
Municipals - exempt from Federal tax	33,027	(996)	33,211	(2,502)	66,238	(3,498)
Total	$ 104,793	$ (3,635)	$ 236,504	$ (12,641)	$ 341,297	$ (16,276)

	Less Than 12 Months		12 Months or More		Total	
December 31, 2017	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
	(Dollars in thousands)					
Securities available-for-sale:						
Agency mortgage-backed securities	$ 185,824	$ (1,623)	$ 146,670	$ (2,769)	$ 332,494	$ (4,392)
Total	$ 185,824	$ (1,623)	$ 146,670	$ (2,769)	$ 332,494	$ (4,392)
Securities held-to-maturity:						
Agency mortgage-backed securities	$ 168,439	$ (1,368)	$ 130,759	$ (3,026)	$ 299,198	$ (4,394)
Municipals - exempt from Federal tax	18,159	(182)	19,240	(425)	37,399	(607)
Total	$ 186,598	$ (1,550)	$ 149,999	$ (3,451)	$ 336,597	$ (5,001)

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 September 30, 2018, the Company held 495 securities

(172 available-for-sale and 323 held to maturity), of which 428 had fair values below amortized cost. At September 30, 2018, there were $231,110,000 of agency mortgage-back securities available-for-sale, $203,293,000 of agency mortgage-backed securities held-to-maturity, and $33,211,000 of municipal bonds held-to-maturity, carried with an unrealized loss for 12 months or more. The total unrealized loss for securities 12 months or more was $23,013,000 at September 30, 2018. The 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 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 September 30, 2018.

The proceeds from sales of securities and the resulting gains and losses were as follows for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)		(Dollars in thousands)	
Proceeds	$ —	$ —	$ 94,291	$ 6,536
Gross gains	—	—	1,243	—
Gross losses	—	—	(977)	(6)

The amortized cost and estimated fair values of securities as of September 30, 2018 are shown by contractual maturity below. The expected maturities will differ from contractual maturities if borrowers have the right to call or

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pre pay obligations with or without call or pre payment penalties. Securities not due at a single maturity date are shown separately.

	Available-for-sale	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due after one through five years	$ 7,419	$ 7,406
Agency mortgage-backed securities	324,309	311,665
Total	$ 331,728	$ 319,071

	Held-to-maturity	
	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)	
Due 3 months or less	$ 503	$ 503
Due after 3 months through one year	286	286
Due after one through five years	4,558	4,587
Due after five through ten years	23,713	23,417
Due after ten years	58,078	55,089
Agency mortgage-backed securities	288,594	275,816
Total	$ 375,732	$ 359,698

Securities with amortized cost of $44,595,000 and $110,874,000 as of September 30, 2018 and December 31, 2017 were pledged to secure public deposits and for other purposes as required or permitted by law or contract.

5) Loans

Loans were as follows for the periods indicated:

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Loans held-for-investment:		
Commercial	$ 600,594	$ 573,296
Real estate:		

CRE	988,491	772,867
Land and construction	131,548	100,882
Home equity	116,657	79,176
Residential mortgages	52,441	44,561
Consumer	9,932	12,395
Loans	1,899,663	1,583,177
Deferred loan fees, net	(276)	(510)
Loans, net of deferred fees	1,899,387	1,582,667
Allowance for loan losses	(27,426)	(19,658)
Loans, net	$ 1,871,961	$ 1,563,009

At September 30, 2018, total net loans included in the table above include $43,311,000, $115,158,000 and $193,787,000, of the loans acquired in the Focus Business Bank ("Focus"), Tri-Valley, and United American acquisitions that were not purchased credit impaired loans, respectively. At December 31, 2017, total net loans included in the table above include $58,551,000, of the loans acquired in the Focus transaction that were not purchased credit impaired loans.

There was a ($425,000) credit to the provision for loan losses for the third quarter of 2018, compared to a provision for loan losses of $115,000 for the third quarter of 2017. The credit to the provision for loan losses for the third quarter of 2018 was primarily due to net recoveries of $1,187,000. For the nine months ended September 30, 2018, there was a $7,279,000 provision for loan losses compared to a $390,000 provision for loan losses for the nine months ended September 30, 2017. The increase in the provision for loan losses for the first nine months of 2018 compared to the first nine months of 2017 was primarily due to a single large lending relationship that was placed on nonaccrual during the second quarter of 2018. At September 30, 2018, the recorded investment of this lending relationship was $21,764,000,

and the Company had a $7,000,000 specific loan loss reserve allocated for this lending relationship. Additionally, subsequent to the end of the third quarter of 2018, the recorded investment of this lending relationship was reduced to $17,384,000. Net recoveries totaled $1,187,000 for the third quarter of 2018, and $489,000 for the first nine months of 2018, compared to net recoveries of $236,000 for the third quarter of 2017, and net recoveries of $269,000 for the first nine months of 2017.

Changes in the allowance for loan losses were as follows for the periods indicated:

	Three Months Ended September 30, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 17,522	$ 9,020	$ 122	$ 26,664
Charge-offs	(719)	—	(25)	(744)
Recoveries	1,897	34	—	1,931
Net (charge-offs) recoveries	1,178	34	(25)	1,187
Provision (credit) for loan losses	(1,427)	1,022	(20)	(425)
End of period balance	$ 17,273	$ 10,076	$ 77	$ 27,426

	Three Months Ended September 30, 2017			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 11,259	$ 7,982	$ 156	$ 19,397
Charge-offs	(111)	—	—	(111)
Recoveries	281	66	—	347
Net recoveries	170	66	—	236
Provision (credit) for loan losses	(441)	592	(36)	115
End of period balance	$ 10,988	$ 8,640	$ 120	$ 19,748

	Nine Months Ended September 30, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 10,608	$ 8,950	$ 100	$ 19,658
Charge-offs	(1,835)	—	(25)	(1,860)
Recoveries	2,229	120	—	2,349
Net (charge-offs) recoveries	394	120	(25)	489
Provision for loan losses	6,271	1,006	2	7,279
End of period balance	$ 17,273	$ 10,076	$ 77	$ 27,426

	Nine Months Ended September 30, 2017			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Beginning of period balance	$ 10,656	$ 8,327	$ 106	$ 19,089
Charge-offs	(2,179)	—	—	(2,179)
Recoveries	1,453	995	—	2,448
Net (charge-offs) recoveries	(726)	995	—	269
Provision (credit) for loan losses	1,058	(682)	14	390
End of period balance	$ 10,988	$ 8,640	$ 120	$ 19,748

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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 at the following period ends:

	September 30, 2018			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 7,089	$ —	$ —	$ 7,089
Collectively evaluated for impairment	10,184	10,076	77	20,337
Acquired with deteriorated credit quality	—	—	—	—
Total allowance balance	$ 17,273	$ 10,076	$ 77	$ 27,426
Loans:			—	
Individually evaluated for impairment	$ 18,843	$ 6,206	$ —	$ 25,049
Collectively evaluated for impairment	581,751	1,282,931	9,932	1,874,614
Acquired with deteriorated credit quality	—	—	—	—
Total loan balance	$ 600,594	$ 1,289,137	$ 9,932	$ 1,899,663

	December 31, 2017			
	Commercial	Real Estate	Consumer	Total
	(Dollars in thousands)			
Allowance for loan losses:				
Ending allowance balance attributable to loans:				
Individually evaluated for impairment	$ 290	$ —	$ —	$ 290
Collectively evaluated for impairment	10,318	8,950	100	19,368
Acquired with deteriorated credit quality	—	—	—	—
Total allowance balance	$ 10,608	$ 8,950	$ 100	$ 19,658
Loans:				
Individually evaluated for impairment	$ 1,775	$ 998	$ 1	$ 2,774
Collectively evaluated for impairment	571,521	996,488	12,394	1,580,403
Acquired with deteriorated credit quality	—	—	—	—
Total loan balance	$ 573,296	$ 997,486	$ 12,395	$ 1,583,177

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The following table presents loans held-for-investment individually evaluated for impairment by class of loans as of September 30, 2018 and December 31, 2017. 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. The recorded investment in consumer loans collateralized by residential real estate property that are in process of foreclosure according to local requirements of the applicable jurisdiction are not material as of the periods indicated:

	September 30, 2018			December 31, 2017		
	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	$ 6,246	$ 6,246	$ —	$ 1,243	$ 1,243	$ —
Real estate:						
CRE	5,639	5,639	—	500	500	—
Land and construction	—	—	—	138	119	—
Home Equity	567	567	—	379	379	—
Consumer	—	—	—	1	1	—
Total with no related allowance recorded	12,452	12,452	—	2,261	2,242	—
With an allowance recorded:						
Commercial	12,597	12,597	7,089	589	532	290
Total with an allowance recorded	12,597	12,597	7,089	589	532	290
Total	$ 25,049	$ 25,049	$ 7,089	$ 2,850	$ 2,774	$ 290

The following tables present interest recognized and cash basis interest earned on impaired loans for the periods indicated:

	Three Months Ended September 30, 2018					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 19,638	$ 5,720	$ —	$ 572	$ —	$ 25,930
Interest income during impairment	$ —	$ —	$ —	$ —	$ —	$ —
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

	Three Months Ended September 30, 2017					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 2,010	$ 501	$ 641	$ 394	$ 1	$ 3,547
Interest income during impairment	$ —	$ —	$ 3	$ —	$ —	$ 3
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

	Nine Months Ended September 30, 2018					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 11,056	$ 3,110	$ 30	$ 472	$ —	$ 14,668
Interest income during impairment	$ —	$ —	$	$ —	$ —	$ —
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

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	Nine Months Ended September 30, 2017					
		Real Estate				
	Commercial	CRE	Land and Construction	Home Equity	Consumer	Total
	(Dollars in thousands)					
Average of impaired loans during the period	$ 2,625	$ 583	$ 419	$ 326	$ 2	$ 3,955
Interest income during impairment	$ —	$ —	$ 3	$ —	$ —	$ 3
Cash-basis interest recognized	$ —	$ —	$ —	$ —	$ —	$ —

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:

	September 30,		December 31,
	2018	2017	2017
	(Dollars in thousands)		
Nonaccrual loans - held-for-investment	$ 23,342	$ 2,560	$ 2,250
Restructured and loans over 90 days past due and still accruing	1,373	931	235
Total nonperforming loans	24,715	3,491	2,485
Other restructured loans	334	325	289
Total impaired loans	$ 25,049	$ 3,816	$ 2,774

The following table presents the nonperforming loans by class for the periods indicated:

	September 30, 2018			December 31, 2017		
	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	$ 17,361	$ 1,148	$ 18,509	$ 1,250	$ 235	$ 1,485
Real estate:						
CRE	5,639	—	5,639	501	—	501
Land and construction	—	—	—	119	—	119
Home equity	342	225	567	379	—	379
Consumer	—	—	—	1	—	1

Total	$ 23,342	$ 1,373	$ 24,715	$ 2,250	$ 235	$ 2,485

The following tables present the aging of past due loans by class for the periods indicated:

	September 30, 2018					
	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	$ 6,430	$ 2,098	$ 1,456	$ 9,984	$ 590,610	$ 600,594
Real estate:						
CRE	—	—	—	—	988,491	988,491
Land and construction	—	—	—	—	131,548	131,548
Home equity	967	—	—	967	115,690	116,657
Residential mortgages	—	—	—	—	52,441	52,441
Consumer	—	—	—	—	9,932	9,932
Total	$ 7,397	$ 2,098	$ 1,456	$ 10,951	$ 1,888,712	$ 1,899,663

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	December 31, 2017					
	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	$ 4,288	$ 1,224	$ 589	$ 6,101	$ 567,195	$ 573,296
Real estate:						
CRE	—	—	500	500	772,367	772,867
Land and construction	—	—	119	119	100,763	100,882
Home equity	223	—	—	223	78,953	79,176
Residential mortgages	—	—	—	—	44,561	44,561
Consumer	—	—	—	—	12,395	12,395
Total	$ 4,511	$ 1,224	$ 1,208	$ 6,943	$ 1,576,234	$ 1,583,177

Past due loans 30 days or greater totaled $10,951,000 and $6,943,000 at September 30, 2018 and December 31, 2017, respectively, of which $617,000 and $1,410,000 were on nonaccrual, respectively. At September 30, 2018, there were also $22,725,000 of loans less than 30 days past due included in nonaccrual loans held-for-investment, which included $21,764,000 of loans related to a single lending relationship. At December 31, 2017, there were also $840,000 of loans less than 30 days past due included in nonaccrual loans held-for-investment. 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 being pursued.

Credit Quality Indicators

Concentrations of credit risk arise when a number of customers 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 remaining 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 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, and it is probable that the Company will not receive payment of the full contractual principal and interest. 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. In addition, the Company no longer accrues interest on the loan because of the underlying weaknesses.

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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.

Loss. Loans classified as loss are considered uncollectable or of so little value that their continuance as assets is not warranted. This classification does not necessarily mean that a loan has no recovery or salvage value; but rather, there is much doubt about whether, how much, or when the recovery would occur. Loans classified as loss are immediately charged off against the allowance for loan losses. Therefore, there is no balance to report as of September 30, 2018 and December 31, 2017.

The following table provides a summary of the loan portfolio by loan type and credit quality classification at period end:

	September 30, 2018			December 31, 2017		
	Nonclassified	Classified	Total	Nonclassified	Classified	Total
Commercial	$ 577,325	$ 23,269	$ 600,594	$ 554,913	$ 18,383	$ 573,296
Real estate:						
CRE	982,852	5,639	988,491	766,988	5,879	772,867
Land and construction	131,548	—	131,548	100,763	119	100,882
Home equity	115,019	1,638	116,657	78,486	690	79,176
Residential mortgages	52,441	—	52,441	44,561	—	44,561
Consumer	9,932	—	9,932	12,394	1	12,395
Total	$ 1,869,117	$ 30,546	$ 1,899,663	$ 1,558,105	$ 25,072	$ 1,583,177

The increase in classified assets at September 30, 2018 was primarily due to seasonal advances on a line of credit associated with a single large lending relationship that was moved to classified loans in the fourth quarter of 2017, which totaled $21,764,000 at September 30, 2018, compared to $12,500,000 at December 31, 2017. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed in accordance with the Company’s underwriting policy.

The balance of troubled debt restructurings at September 30, 2018 was $676,000, which are all accrual loans. The balance of troubled debt restructurings at December 31, 2017 was $325,000, which included $16,000 of nonaccrual loans and $309,000 of accruing loans. Approximately $46,000 and $1,000 of specific reserves were established with respect to these loans as of September 30, 2018 and December 31, 2017.

The following table presents loans by class modified as troubled debt restructurings:

	During the Nine Months Ended September 30, 2018		
Troubled Debt Restructurings:	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
	(Dollars in thousands)		
Commercial	2	$ 159	$ 159
Home equity	1	225	225
Total	3	$ 384	$ 384

The following table presents loans by class modified as troubled debt restructurings:

	During the Three and Nine Months Ended September 30, 2017		
Troubled Debt Restructurings:	Number of Contracts	Pre-modification Outstanding Recorded Investment	Post-modification Outstanding Recorded Investment
	(Dollars in thousands)		
Commercial	3	$ 318	$ 318
Total	3	$ 318	$ 318

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During the three months ended September 30, 2018, there were no new loans modified as troubled debt restructurings in which the amount of principal or accrued interest owed from the borrower was forgiven or which resulted in a charge-off or change to the allowance for loan losses. The Company has committed to lend no additional amounts to customers with outstanding loans that are classified as troubled debt restructurings as of September 30, 2018.

A loan is considered to be in payment default when it is 30 days contractually past due under the modified terms. There were no defaults on troubled debt restructurings, within twelve months following the modification, during the three and nine months ended September 30, 2018 and 2017.

A loan that is a troubled debt restructuring on nonaccrual status may return to accruing status after a period of at least six months of consecutive payments in accordance with the modified terms.

6) Business Combinations

On April 6, 2018, the Company completed its acquisition of Tri-Valley for a transaction value of $32,320,000. At closing the Company issued 1,889,613 shares of the Company's common stock with an aggregate market value of $30,725,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 0.0489 of a share of the Company's common stock for each outstanding share of Tri-Valley common stock. In addition, at closing the Company paid cash to the holder of a stock warrant and holders of outstanding stock options and related fees and fractional shares totaling $1,595,000. The following table summarizes the consideration paid for Tri-Valley:

	(Dollars in thousands)	
Cash paid for:		
Warrant	$	889
Options		615
Other		91
Total cash paid		1,595
Issuance of 1,889,613 shares of common stock to Tri-Valley shareholders at $16.26 per share		30,725
Total consideration	$	32,320

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

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	As Recorded by Tri-Valley	Fair Value Adjustments		As Recorded at Acquisition
	(Dollars in thousands)			
Assets acquired:				
Cash and cash equivalents	$ 21,757	$ 1,153	(a)	$ 22,910
Loans	123,532	(2,563)	(b)	120,969
Allowance for loan losses	(1,969)	1,969	(c)	—
Other intangible assets	—	1,978	(d)	1,978
Other assets, net	9,939	(2,894)	(e)	7,045
Total assets acquired	$ 153,259	$ (357)		152,902
Liabililities assumed:				
Deposits	$ 135,351	$ 37	(f)	135,388
Other liabilities	608	—		608
Total liabilities assumed	$ 135,959	$ 37		135,996
Net assets acquired				16,906
Purchase price				30,725
Goodwill recorded in the merger				$ 13,819

Explanation of certain fair value related adjustments for the Tri-Valley acquisition:

(a)Represents the cash acquired in the merger, the disposition of other real estate owned of $1,132,000, a gain on the sale of securities of $53,000, partially offset by invoices paid after closing for services prior to closing of $29,000, and cash paid for fractional shares in the transaction of $3,000. The remaining $1,592,000 of cash paid for the transaction is an adjustment to prepaid assets included in other assets, net.

(b)Represents the fair value adjustment to the net book value of loans, which includes an interest rate mark and credit mark adjustment.

(c)Represents the elimination of Tri-Valley's allowance for loan losses.

(d)Represents intangible assets recorded to reflect the fair value of core deposits and a below market lease. The core deposit asset was recorded as an identifiable intangible asset and is amortized on an accelerated basis over the estimated average life of the deposit base. The below market lease intangible assets will be amortized on the straight line method over eleven years.

(e)Represents an adjustment to net deferred tax assets resulting from the fair value adjustments related to the acquired assets, liabilities assumed and identifiable intangible assets recorded,and the disposition of other real estate owned.

(f)Represents the fair value adjustment on time deposits, which was be accreted as a reduction of interest expense.

Tri-Valley's results of operations have been included in the Company's results of operations beginning April 7, 2018.

On May 4, 2018, the Company completed its acquisition of United American for a transaction value of $56,417,000. At closing the Company issued 2,826,032 shares of the Company's common stock with an aggregate market value of $47,280,000 on the date of closing. The number of shares issued was based on a fixed exchange ratio of 2.1644 of a share of the Company's common stock for each outstanding share of United American common stock and each common stock equivalent underlying the United American Series D Preferred Stock and Series E Preferred Stock. The shareholders of the United American Series A Preferred Stock and Series B Preferred Stock received $1,000 cash for each share totaling $8,700,000 and $435,000, respectively. In addition, the Company paid $2,000 in cash for fractional shares, for total cash consideration of $9,137,000. The following table summarizes the consideration paid for United American:

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		(Dollars in thousands)
Consideration paid:		
Cash paid for:		
Series A Preferred Stock	$	8,700
Series B Preferred Stock		435
Other		2
Total cash paid		9,137
Issuance of 2,826,032 shares of common stock to United American shareholders at $16.73 per share		47,280
Total consideration	$	56,417

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

		As Recorded by United American		Fair Value Adjustments			As Recorded at Acquisition
		(Dollars in thousands)					
Assets acquired:							
Cash and cash equivalents	$	45,638	$	(32,520)	(a)	$	13,118
Securities avaiable-for-sale		64,144		(421)	(b)		63,723
Loans		196,694		18,783	(c)		215,477
Allowance for loan lossess		(2,952)		2,952	(d)		—
Other intangible assets		—		6,383	(e)		6,383
Other assets, net		9,119		(1,078)	(f)		8,041
Total assets acquired	$	312,643	$	(5,901)			306,742
Liabililities assumed:							
Deposits	$	281,189	$	51	(g)		281,240
Other borrowings		62		—			62
Other liabilities		2,617		(188)	(h)		2,429
Total liabilities	$	283,868	$	(137)			283,731
Net assets acquired							23,011
Purchase price							47,280
Goodwill recorded in the merger						$	24,269

Explanation of certain fair value related adjustments for the United American acquisition:

(a)Represents the cash acquired in the merger, net of cash paid for the transaction of $9,137,000, the repurchase of $23,732,000 loan participations from ATBancorp, and $51,000 for invoices paid after closing for services prior to closing, partially offset by a tax refund of $400,000.

(b)Represents the fair value adjustment on investment securities available-for-sale.

(c)Represents the repurchase of $23,732,000 loan participations from ATBancorp, partially ofsset by the fair value adjustment to the net book value of loans of $4,680,000, which includes an interest rate mark and credit mark adjustment, and net charge-offs of $269,000 subsequent to closing.

(d)Represents the elimination of United American's allowance for loan losses.

(e)Represents intangible assets recorded to reflect the fair value of core deposits and a below market lease. The core deposit asset was recorded as an identifiable intangible asset and is amortized on an accelerated basis over the estimated average life of the deposit base. The below market lease intangible assets will be amortized on the straight line method over three years.

(f)Represents an adjustment to net deferred tax assets resulting from the fair value adjustments related to the acquired assets, liabilities assumed and identifiable intangible assets recorded.

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(g)Represents the fair value adjustment on time deposits, which was be accreted as a reduction of interest expense.

(h)Represents the reversal of over accrued accounts payable.

United American's results of operations have been included in the Company's results of operations beginning May 5, 2018.

The Company believes the merger provides the opportunity to combine three independent business banking franchises with similar philosophies and cultures into a combined $3.2 billion business bank based in San Jose, California. The pooling of the three banks' resources and knowledge enhance our capabilities, operational efficiencies, and community outreach. The Company also believes the combined bank will be much better positioned to meet the needs of our customers, shareholders and the community. The one-time pre-tax acquisition and integration costs of $16,000 and $5,452,000 for the three months and nine months ended September 30, 2018, respectively, were included in other noninterest expense. In addition, salaries and employee benefits included severance and retention expense of $183,000 and $3,576,000 for the three months and nine months ended September 30, 2018, respectively, related to the Tri-Valley and United American acquisitions. Total severance, retention, acquisition and integration costs were $199,000 and $9,028,000 for the three months and nine months ended September 30, 2018, respectively.

The fair value of net assets acquired includes fair value adjustments to certain receivables of which some were considered impaired and some were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows, adjusted for expected losses and prepayments, where appropriate. The receivables that were not considered impaired at the acquisition date were not subject to the guidance relating to purchased credit impaired loans, which have shown evidence of credit deterioration since origination.

Goodwill of $13,819,000 arising from the Tri-Valley acquisition and $24,269,000 from the United American acquisition is largely attributable to synergies and cost savings resulting from combining the operations of the companies. As these transactions were structured as a tax-free exchange, the goodwill will not be deductible for tax purposes. Management's preliminary valuation of the tangible and intangible assets acquired and liabilities assumed, which are based on assumptions that are subject to change, and the resulting allocation of the consideration paid for the allocation is reflected in the tables above. Prior to the end of the one-year measurement period for finalizing the consideration paid allocation, if information becomes available which would indicate adjustments are required to the allocation, such adjustments will be included in the allocation in the reporting period in which the adjustment amounts are determined. Loan valuations may be adjusted based on new information obtained by the Company in future periods that may reflect conditions or events that existed on the acquisition date. Deferred tax assets may be adjusted for purchase accounting adjustments on open areas such as loans or upon filing final "stub" period tax returns for April 6, 2018 for Tri-Valley, and May 4, 2018 for United American. The closing equity balance for Tri-Valley and United American are also subject to adjustments for invoices received after the close of the transaction that were attributable to their operations through closing.

7) Goodwill and Other Intangible Assets

Goodwill

At September 30, 2018, the carrying value of goodwill was $83,752,000, which included $13,045,000 of goodwill related to its acquisition of Bay View Funding, $32,619,000 from its acquisition of Focus, $13,819,000 from its acquisition of Tri-Valley and $24,269,000 from its acquisition of United American.

Goodwill impairment exists when a reporting unit's carrying value exceeds its fair value, which is determined through a qualitative assessment whether it is more likely than not that the fair value of equity of the reporting unit exceeds the carrying value ("Step Zero"). If the qualitative assessment indicates it is more likely than not that the fair value of equity of a reporting unit is less than book value, then a quantitative two-step impairment test is required. Step 1 includes the determination of the carrying value of the Company's single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, the Company is required to perform a second step to the impairment test. Step 2 requires that the implied fair value of the reporting unit goodwill be compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

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The Company completed its annual goodwill impairment analysis as of November 30, 2017 with the assistance of an independent valuation firm. No events or circumstances since the November 30, 2017 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists.

Other Intangible Assets

Other intangible assets acquired in the acquisition of United American in May 2018 included a core deposit intangible asset of $5,723,000, amortized on an accelerated method over its estimated useful life of 10 years, and a below market value lease intangible asset of $660,000, amortized over its estimated useful life of 3 years. Accumulated amortization of the core deposit intangible and below market lease was $469,000 at September 30, 2018.

Other intangible assets acquired in the acquisition of Tri-Valley in April 2018 include a core deposit intangible asset of $1,768,000, amortized on an accelerated method over its estimated useful life of 10 years, and a below market value lease intangible asset of $210,000, amortized over its estimated useful life of 11 years. Accumulated amortization of the core deposit intangible and below market lease was $143,000 at September 30, 2018.

The core deposit intangible asset acquired in the acquisition of Focus in August 2015 was $6,285,000. This asset is amortized on an accelerated method over its estimated useful life of 10 years. Accumulated amortization of this intangible asset was $2,576,000 and $1,995,000 at September 30, 2018 and December 31, 2017, respectively.

Other intangible assets acquired in the acquisition of Bay View Funding in November 2014 included: a below market value lease intangible asset of $109,000 (amortized over 3 years), customer relationship and brokered relationship intangible assets of $1,900,000, (amortized over the 10 year estimated useful lives), and a non-compete agreement intangible asset of $250,000 (amortized over 3 years). Accumulated amortization of the customer relationship and brokered relationship intangible assets was $743,000 and $601,000 at September 30, 2018 and December 31, 2017, respectively. The below market lease and non-compete agreement intangible assets were fully amortized at December 31, 2017.

Estimated amortization expense for 2018, the next five years and thereafter is as follows:

	United	United			Bay View Funding

Year	American Core Deposit Intangible	American Below Market Lease	Tri-Valley Core Deposit Intangible	Tri-Valley Below Market Lease	Focus Core Deposit Intangible	Customer & Brokered Relationship Intangible	Total Amortization Expense
	(Dollars in thousands)						
2018	$ 585	$ 170	$ 208	$ 14	$ 775	$ 190	$ 1,942
2019	777	255	240	18	734	190	2,214
2020	665	235	208	18	716	190	2,032
2021	602	—	184	18	596	190	1,590
2022	553	—	167	18	502	190	1,430
2023	521	—	158	18	420	190	1,307
Thereafter	2,020	—	603	106	549	159	3,437
	$ 5,723	$ 660	$ 1,768	$ 210	$ 4,292	$ 1,299	$ 13,952

Impairment testing of the intangible assets is performed at the individual asset level. Impairment exists if the carrying amount of the asset is not recoverable and exceeds its fair value at the date of the impairment test. For intangible assets, estimates of expected future cash flows (cash inflows less cash outflows) that are directly associated with an intangible asset are used to determine the fair value of that asset. Management makes certain estimates and assumptions in determining the expected future cash flows from core deposit and customer relationship intangibles including account attrition, expected lives, discount rates, interest rates, servicing costs and other factors. Significant changes in these estimates and assumptions could adversely impact the valuation of these intangible assets. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is then amortized over the remaining useful life of the asset. Based on its assessment, management concluded that there was no impairment of intangible assets at September 30, 2018 and December 31, 2017.

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8) 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 current 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.

Under generally accepted accounting principles, a valuation allowance is required 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.

On December 22, 2017, the Tax Cuts and Jobs Act (the “Tax Act”), was signed into law, which among other items reduces the federal corporate tax rate to 21% from 35%, effective January 1, 2018.

The Company had net deferred tax assets of $28,143,000, and $16,247,000, at September 30, 2018, and December 31, 2017, respectively. After consideration of the matters in the preceding paragraph, the Company determined that it is more likely than not that the net deferred tax assets at September 30, 2018 and December 31, 2017 will be fully realized in future years.

The following table reflects the carry amounts of the low income housing investments included in accrued interest receivable and other assets, and the future commitments included in accrued interest payable and other liabilities for the periods indicated:

	September 30, 2018	Decemebr 31, 2017
	(Dollars in thousands)	
Low income housing investments	$ 3,139	$ 3,411
Future commitments	$ 287	$ 302

The Company expects future commitments of $15,000 to be paid in 2018, and $272,000 in 2019 through 2023.

For tax purposes, the Company had low income housing tax credits of $106,000 and $110,000 for the three months ended September 30, 2018 and September 30, 2017, respectively, and low income housing investment losses of $117,000 and $115,000, respectively. For tax purposes, the Company had low income housing tax credits of $319,000 and $329,000 for the nine months ended September 30, 2018 and September 30, 2017, respectively, and low income housing investment losses of $351,000 and $345,000, respectively. The Company recognized low income housing investment expense as a component of income tax expense.

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9) Benefit Plans

Supplemental Retirement Plan

The Company has a supplemental retirement plan (the "Plan") covering some current and some former key employees 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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Components of net periodic benefit cost:				
Service cost	$ 62	$ 81	$ 186	$ 243
Interest cost	237	259	711	777
Amortization of net actuarial loss	73	69	219	207
Net periodic benefit cost	$ 372	$ 409	$ 1,116	$ 1,227

Split Dollar Life Insurance Benefit Plan

The Company maintains life insurance policies for some current and some former directors and officers that are subject to split dollar life insurance agreements. The following table sets forth the funded status of the split dollar life insurance benefits for the periods indicated:

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	$ 6,711	$ 6,301
Interest cost	170	243
Actuarial loss	—	167
Projected benefit obligation at end of period	$ 6,881	$ 6,711

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Net actuarial loss	$ 2,569	$ 2,453
Prior transition obligation	1,171	1,238
Accumulated other comprehensive loss	$ 3,740	$ 3,691

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in thousands)			
Amortization of prior transition obligation	$ (16)	$ (18)	$ (48)	$ (53)
Interest cost	56	61	170	182
Net periodic benefit cost	$ 40	$ 43	$ 122	$ 129

10) 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.

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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).

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 Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Assets at September 30, 2018				
Available-for-sale securities:				
Agency mortgage-backed securities	$ 311,665	—	$ 311,665	—
U.S. Government sponsored entities	7,406	—	7,406	—
I/O strip receivables	863	—	863	—
Assets at December 31, 2017				
Available-for-sale securities:				
Agency mortgage-backed securities	$ 374,733	—	$ 374,733	—
Trust preferred securities	17,119	—	17,119	—
I/O strip receivables	968	—	968	—

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 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.

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Foreclosed assets are valued at the time the loan is foreclosed upon and the asset is transferred to foreclosed assets. The fair value is based primarily on third party appraisals, less costs to sell. The appraisals may utilize a single valuation approach or a combination of approaches including the comparable sales and 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 typically significant and result in a Level 3 classification of the inputs for determining fair value.

		Fair Value Measurements Using		
	Balance	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
Assets at September 30, 2018				
Impaired loans - held-for-investment:				
Commercial	$ 5,508	—	—	$ 5,508
	$ 5,508	—	—	$ 5,508
Assets at December 31, 2017				
Impaired loans - held-for-investment:				
Commercial	$ 242	—	—	$ 242
Real estate:				
Land and construction	119	—	—	119
	$ 361	—	—	$ 361

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:

	September 30, 2018	December 31, 2017
	(Dollars in thousands)	
Impaired loans held-for-investment:		
Book value of impaired loans held-for-investment carried at fair value	$ 12,597	$ 651
Book value of impaired loans held-for-investment carried at cost	12,452	2,123
Total impaired loans held-for-investment	$ 25,049	$ 2,774
Impaired loans held-for-investment carried at fair value:		
Book value of impaired loans held-for-investment carried at fair value	$ 12,597	$ 651
Specific valuation allowance	(7,089)	(290)
Impaired loans held-for-investment carried at fair value, net	$ 5,508	$ 361

Impaired loans held for investment which are measured primarily for impairment using the fair value of the collateral were $25,049,000 at September 30, 2018. In addition, these loans had a specific valuation allowance of $7,089,000 at September 30, 2018. Impaired loans held for investment totaling $12,597,000 at September 30, 2018, were carried at fair value as a result of the aforementioned partial charge offs and specific valuation allowances at period end. The remaining $12,452,000 of impaired loans were carried at cost at September 30, 2018, 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 nine months of 2018 on impaired loans held for investment carried at fair value at September 30, 2018 resulted in an additional provision for loan losses of $7,042,000.

At September 30, 2018, there were no foreclosed assets.

Impaired loans held for investment were $2,774,000 at December 31, 2017. There were no partial charge offs at December 31, 2017. In addition, these loans had a specific valuation allowance of $290,000 at December 31, 2017. Impaired loans held for investment totaling $651,000 at December 31, 2017 were carried at fair value as a result of the aforementioned partial charge offs and specific valuation allowances at year end. The remaining $2,123,000 of impaired loans were carried at cost at December 31, 2017, 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 2017 on impaired loans

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held for investment carried at fair value at December 31, 2017 resulted in an additional provision for loan losses of $254,000.

At December 31, 2017, there were no foreclosed assets

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non recurring basis at the periods indicated:

	September 30, 2018			
	Fair Value	Valuation Techniques	Unobservable Inputs	Range (Weighted Average)
	(Dollars in thousands)			
Impaired loans - held-for-investment:				
Commercial	$ 5,508	Market Approach	Discount adjustment for differences between comparable sales	Less than 1 %

	December 31, 2017			
	Fair Value	Valuation Techniques	Unobservable Inputs	Range (Weighted Average)
	(Dollars in thousands)			
Impaired loans - held-for-investment:				
Commercial	$ 242	Market Approach	Discount adjustment for differences between comparable sales	Less than 1%
Real estate:				
Land and construction	119	Market Approach	Discount adjustment for differences between comparable sales	Less than 1%

The Company obtains third party appraisals on its impaired loans held-for-investment and foreclosed assets to determine fair value. Generally, the third party appraisals apply the “market approach,” which is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (that is, similar) assets, liabilities, or a group of assets and liabilities, such as a business. Adjustments are then made based on the type of property, age of appraisal, current status of property and other related factors to estimate the current value of collateral.

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The carrying amounts and estimated fair values of financial instruments at September 30, 2018 are as follows:

		Estimated Fair Value			
	Carrying Amounts	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)				
Assets:					
Cash and cash equivalents	$ 381,029	$ 381,029	$ —	$ —	$ 381,029
Securities available-for-sale	319,071	—	319,071	—	319,071
Securities held-to-maturity	375,732	—	359,698	—	359,698
Loans (including loans held-for-sale), net	1,878,305	—	6,344	1,840,231	1,846,575
FHLB stock, FRB stock, and other investments	25,210	—	—	—	N/A
Accrued interest receivable	9,213	—	2,327	6,886	9,213
I/O strips receivables	863	—	863	—	863
Liabilities:					
Time deposits	$ 155,879	$ —	$ 156,206	$ —	$ 156,206
Other deposits	2,589,420	—	2,589,420	—	2,589,420
Subordinated debt	39,322	—	39,322	—	39,322
Accrued interest payable	1,026	—	1,026	—	1,026

The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2017:

		Estimated Fair Value			
	Carrying Amounts	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)				
Assets:					
Cash and cash equivalents	$ 316,222	$ 316,222	$ —	$ —	$ 316,222
Securities available-for-sale	391,852	—	391,852	—	391,852
Securities held-to-maturity	398,341	—	394,292	—	394,292
Loans (including loans held-for-sale), net	1,566,428	—	3,419	1,507,967	1,511,386

FHLB stock, FRB stock, and other investments	17,911	—	—	—	N/A
Accrued interest receivable	7,985	—	2,423	5,562	7,985
I/O strips receivables	968	—	968	—	968
Liabilities:					
Time deposits	$ 194,561	$ —	$ 194,844	$ —	$ 194,844
Other deposits	2,288,428	—	2,288,428	—	2,288,428
Subordinated debt	39,183	—	40,384	—	40,384
Accrued interest payable	389	—	389	—	389

The methods and assumptions, not previously discussed, used to estimate the fair value of loans, including loans held-for-sale, are described as follows:

The fair value of loans held for sale is estimated based upon binding contracts and quotes from third parties resulting in a Level 2 classification.

The Company adopted ASU No. 2016-01, effective January 1, 2018. Adoption of the standard resulted in the use of an exit price rather than an entrance price to determine the fair value of loans, excluding loans held-for-sale, using discounted cash flow analyses as of September 30, 2018. The discount rates used to determine fair value use interest rate spreads that reflect factors such as liquidity, credit, and nonperformance risk of the loans, resulting in a level 3 classification.

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Fair values of loans, excluding loans held-for-sale, were estimated as follows as of December 31, 2017: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. The methods utilized to estimate the fair value of loans as of December 31, 2017 do not necessarily represent an exit price.

Impaired loans as of September 30, 2018 and December 31, 2017 are valued at the lower of cost or fair value as described previously.

11) Equity Plan

The Company maintained an Amended and Restated 2004 Equity Plan (the "2004 Plan") for directors, officers, and key employees. The 2004 Plan was terminated on May 23, 2013. On May 23, 2013, the Company's shareholders approved the 2013 Equity Incentive Plan (the "2013 Plan"). On May 25, 2017, the shareholders approved an amendment to the Heritage Commerce Corp 2013 Equity Incentive Plan to increase the number of shares available from 1,750,000 to 3,000,000 shares. The equity plans provide for the grant of incentive and nonqualified stock options and restricted stock. The equity plans provide that the option price for both incentive and nonqualified stock options will be determined by the Board of Directors at no less than the fair value at the date of grant. Options granted vest on a schedule determined by the Board of Directors at the time of grant. Generally options vest over four years. All options expire no later than ten years from the date of grant. Restricted stock is subject to time vesting. For the nine months ended September 30, 2018, the Company granted 305,500 shares of nonqualified stock options and 97,818 shares of restricted stock. There were 1,186,800 shares available for the issuance of equity awards under the 2013 Plan as of September 30, 2018.

Stock option activity under the equity plans is as follows:

Total Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2018	1,602,732	$ 9.54		
Granted	305,500	$ 16.82		
Exercised	(259,770)	$ 9.62		
Forfeited or expired	(84,079)	$ 14.20		
Outstanding at September 30, 2018	1,564,383	$ 10.69	6.64	$ 7,176,631
Vested or expected to vest	1,470,520		6.64	$ 6,746,033

Exercisable at September 30, 2018	1,011,193	5.46	$ 6,475,976

Information related to the equity plans for the periods indicated:

	Nine Months Ended September 30,	
	2018	2017
Intrinsic value of options exercised	$ 1,767,884	$ 1,331,528
Cash received from option exercise	$ 2,499,481	$ 1,352,236
Tax benefit realized from option exercises	$ 513,901	$ 543,654
Weighted average fair value of options granted	$ 3.07	$ 2.66

As of September 30, 2018, there was $1,499,000 of total unrecognized compensation cost related to nonvested stock options granted under the equity plans. That cost is expected to be recognized over a weighted average period of approximately 2.80 years.

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The fair value of each option grant is estimated on the date of grant using the Black Scholes option pricing model that uses the assumptions noted in the following table, including the weighted average assumptions for the option grants for the periods indicated:

	Nine Months Ended September 30,			
	2018		2017	
Expected life in months(1)	72		72	
Volatility(1)	21	%	24	%
Weighted average risk-free interest rate(2)	2.87	%	1.94	%
Expected dividends(3)	2.62	%	2.78	%

(1) The expected life of employee stock options represents the weighted average period the stock options are expected to remain outstanding based on historical experience. Volatility is based on the historical volatility of the stock price over the same period of the expected life of the option.
(2) Based on the U.S. Treasury constant maturity interest rate with a term consistent with the expected life of the option granted.
(3) Each grant’s dividend yield is calculated by annualizing the most recent quarterly cash dividend and dividing that amount by the market price of the Company’s common stock as of the grant date

Restricted stock activity under the equity plans is as follows:

Total Restricted Stock Award	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares at January 1, 2018	181,185	$ 11.66
Granted	97,818	$ 16.83
Vested	(67,015)	$ 16.69
Forfeited or expired	(2,440)	$ 12.65
Nonvested shares at September 30, 2018	209,548	$ 11.04

As of September 30, 2018, there was $2,386,000 of total unrecognized compensation cost related to nonvested restricted stock awards granted under the equity plans. The cost is expected to be recognized over a weighted average period of approximately 2.67 years.

12) Subordinated Debt

On May 26, 2017, the Company completed an underwritten public offering of $40,000,000 aggregate principal amount of its fixed-to-floating rate subordinated notes ("Subordinated Debt") due June 1, 2027. The Subordinated Debt initially bears a fixed interest rate of 5.25% per year. Commencing on June 1, 2022, the interest rate on the Subordinated Debt resets quarterly to the three-month LIBOR rate plus a spread of 336.5 basis points, payable quarterly in arrears. Interest on the Subordinated Debt is payable semi-annually on June 1st and December 1st of each year through June 1, 2022 and quarterly thereafter on March 1st, June 1st, September 1st and December 1st of each year through the maturity date or early redemption date. The Company at its option may redeem the Subordinated Debt, in whole or in part, on any interest payment date on or after June 1, 2022 without a premium.

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13) Capital Requirements

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements and operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and HBC must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. There are no conditions or events since September 30, 2018, that management believes have changed the categorization of the Company or HBC as "well-capitalized."

As of January 1, 2015, HCC and HBC along with other community banking organizations became subject to new capital requirements and certain provisions of the new rules will be phased in from 2015 through 2019. The Federal Banking regulators approved the new rules to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of The Dodd Frank Wall Street Reform and Consumer Protection Act of 2010, as amended. The new capital rules establish a "capital conservation buffer," which must consist entirely of common equity Tier 1 capital. The capital conservation buffer is to be phased-in over four years beginning on January 1, 2016. The buffer was 0.625% of risk-weighted assets for 2016, 1.25% for 2017, and is 1.875% for 2018, and will be 2.5% for 2019 and thereafter. The Company and HBC must maintain a capital conservation buffer above the minimum risk-based capital requirements in order to avoid certain limitations on capital distributions, stock repurchases and discretionary bonus payments to executive officers. The Company's consolidated capital ratios and the Bank's capital ratios exceeded the regulatory guidelines for a well-capitalized financial institution under the Basel III regulatory requirements at September 30, 2018.

Quantitative measures established by regulation to help ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios (set forth in the tables below) of total, Tier 1 capital, and common equity Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes that, as of September 30, 2018 and December 31, 2017, the Company and HBC met all capital adequacy guidelines to which they were subject.

The Company's consolidated capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of September 30, 2018, and December 31, 2017.

	Actual	Required For Capital Adequacy Purposes Under Basel III

	Amount	Ratio		Amount	Ratio (1)	
	(Dollars in thousands)					
As of September 30, 2018						
Total Capital (to risk-weighted assets)	$ 334,152	14.4	%	$ 228,973	9.875	%
Tier 1 Capital (to risk-weighted assets)	$ 266,654	11.5	%	$ 182,599	7.875	%
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 266,654	11.5	%	$ 147,818	6.375	%
Tier 1 Capital (to average assets)	$ 266,654	8.6	%	$ 124,005	4.000	%

(1) Includes 1.875% capital conservation buffer, effective January 1, 2018, except the Tier 1 Capital to average assets ratio.

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	Actual Amount	Ratio		Required For Capital Adequacy Purposes Under Basel III Amount	Ratio (1)	
	(Dollars in thousands)					
As of December 31, 2017						
Total Capital (to risk-weighted assets)	$ 288,754	14.4	%	$ 185,338	9.250	%
Tier 1 Capital (to risk-weighted assets)	$ 229,258	11.4	%	$ 145,265	7.250	%
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 229,258	11.4	%	$ 115,210	5.750	%
Tier 1 Capital (to average assets)	$ 229,258	8.0	%	$ 114,959	4.000	%

(1) Includes 1.25% capital conservation buffer, effective January 1, 2017, except the Tier 1 Capital to average assets ratio.

HBC's actual capital amounts and ratios are presented in the following table, together with capital adequacy requirements, under the Basel III regulatory requirements as of September 30, 2018, and December 31, 2017.

	Actual Amount	Ratio		To Be Well-Capitalized Under Basel III Regulatory Requirements Amount	Ratio		Required For Capital Adequacy Purposes Under Basel III Amount	Ratio (1)	
	(Dollars in thousands)								
As of September 30, 2018									
Total Capital (to risk-weighted assets)	$ 310,636	13.4	%	$ 231,696	10.0	%	$ 228,800	9.875	%
Tier 1 Capital (to risk-weighted assets)	$ 282,460	12.2	%	$ 185,357	8.0	%	$ 182,461	7.875	%
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 282,460	12.2	%	$ 150,602	6.5	%	$ 147,706	6.375	%
Tier 1 Capital (to average assets)	$ 282,460	9.1	%	$ 154,920	5.0	%	$ 123,936	4.000	%

(1) Includes 1.875% capital conservation buffer, effective January 1, 2018, except the Tier 1 Capital to average assets ratio.

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	Actual			To Be Well-Capitalized Under Basel III Regulatory Requirements			Required For Capital Adequacy Purposes Under Basel III		
	Amount	Ratio		Amount	Ratio		Amount	Ratio (1)	
	(Dollars in thousands)								
As of December 31, 2017									
Total Capital (to risk-weighted assets)	$ 265,102	13.2	%	$ 200,274	10.0	%	$ 185,253	9.250	%
Tier 1 Capital (to risk-weighted assets)	$ 244,790	12.2	%	$ 160,219	8.0	%	$ 145,198	7.250	%
Common Equity Tier 1 Capital (to risk-weighted assets)	$ 244,790	12.2	%	$ 130,178	6.5	%	$ 115,157	5.750	%
Tier 1 Capital (to average assets)	$ 244,790	8.5	%	$ 143,655	5.0	%	$ 114,924	4.000	%

(1) Includes 1.25% capital conservation buffer, effective January 1, 2017, except the Tier 1 Capital to average assets ratio.

The Subordinated Debt, net of unamortized issuance costs, totaled $39,322,000 at September 30, 2018, and qualifies as Tier 2 capital for the Company under the guidelines established by the Federal Reserve Bank.

Under California General Corporation Law, the holders of common stock are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available. The California Financial Code provides that a state licensed bank may not make a cash distribution to its shareholders in excess of the lesser of the following: (i) the bank's retained earnings; or (ii) the bank's net income for its last three fiscal years, less the amount of any distributions made by the bank to its shareholders during such period. However, a bank, with the prior approval of the Commissioner of the California Department of Business Oversight—Division of Financial Institutions ("DBO") may make a distribution to its shareholders of an amount not to exceed the greater of (i) a bank's retained earnings; (ii) its net income for its last fiscal year; or (iii) its net income for the current fiscal year. Also with the prior approval of the Commissioner of the DBO and the shareholders of the bank, the bank may make a distribution to its shareholders, as a reduction in capital of the bank. In the event that the Commissioner determines that the shareholders' equity of a bank is inadequate or that the making of a distribution by a bank would be unsafe or unsound, the Commissioner may order a bank to refrain from making such a proposed distribution. As of September 30, 2018, HBC would not be required to obtain regulatory approval, and the amount available for cash dividends is $26,057,000. Similar restrictions applied to the amount and sum of loan advances and other transfers of funds from HBC to the parent company. During the third quarter of 2018, HBC distributed dividends of $5,000,000 for a total of $13,000,000 for the first nine months of 2018.

14) Loss Contingencies

The Company is involved in certain legal actions arising from normal business activities. Management, based upon the advice of legal counsel, believes the ultimate resolution of all pending legal actions will not have a material effect on the financial statements of the Company.

15) Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09 (Topic 606) and all subsequent ASUs that modified Topic 606. As stated in Note 1 Basis of Presentation, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 606.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, gain on sale of securities, bank-owned life insurance, gain on sales of SBA loans, and certain credit card fees

are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. The following noninterest income revenue streams are in-scope of Topic 606:

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. We sometimes charge customers fees that are not specifically related to the customer accessing its funds, such as account maintenance or dormancy fees. The amount of deposit fees assessed varies based on a number of factors, such as the type of customer and account, the quantity of transactions, and the size of the deposit balance. We charge, and in some circumstances do not charge, fees to earn additional revenue and influence certain customer behavior. An example would be where we do not charge a monthly service fee, or do not charge for certain transactions, for customers that have a high deposit balance. Deposit fees are considered either transactional in nature (such as wire transfers, nonsufficient fund fees, and stop payment orders) or non-transactional (such as account maintenance and dormancy fees). These fees are recognized as earned or as transactions occur and services are provided. Check orders and other deposit account related fees are largely transactional based and, therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Interchange Revenue

Interchange revenue primarily consists of interchange fees, volume-related incentives and ATM charges. As the card-issuing bank, interchange fees represent our portion of discount fees paid by merchants for credit / debit card transactions processed through the interchange network. The levels and structure of interchange rates are set by the credit card companies and are based on cardholder purchase volumes. The Company earns interchange income as cardholder transactions occur and interchange fees are settled on a daily basis. Since interchange fees are settled on a daily basis, the Company believes the application of Topic 606 to interchange fees would likely not lead to significantly different recognition and measurement outcomes when compared to our current accounting practice. In addition, the Company will continue to consider any constraint on the variability of consideration due to returns, refunds and chargebacks. ATM charges consist of fees received from non-customers using a bank-owned ATM and fees received for customers using a nonbank-owned ATM. These fees are earned when these types of ATM transactions occur.

Merchant Services Revenue

Revenue from the Company's merchant services business consists principally of transaction and account management fees charged to merchants for the electronic processing of transactions. These fees are net of interchange fees paid to the credit card issuing bank, card company assessments, and revenue sharing amounts.

Based on the insignificant level of merchant services revenue, the Company has concluded that the application of Topic 606 to merchant services account management fees would likely not lead to significantly different recognition and measurement outcomes when compared to our current accounting practice. As a result, revenue from account management fees will continue to be recognized by the Company at the end of each month since the end of this measurement period allows us to reliably measure our progress towards completion of our performance obligation.

Other

Noninterest miscellaneous fees consist of charges for various other services including safe deposit box rentals, wire transfers, check cashing, telephone transfers, and online business banking. Given the insignificance of these amounts individually and in total, further consideration of these revenue streams under Topic 606 is not considered necessary.

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The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the periods indicated:

	Three Months Ended September 30,	
	2018	2017
	(Dollars in thousands)	
Noninterest Income In-scope of Topic 606:		
Service charges and fees on deposit accounts	$ 551	$ 510
Interchange fees	83	75
Merchant services revenue	39	44
Other	179	166
Total noninterest income in-scope of Topic 606	852	795
Noninterest Income Out-of-scope of Topic 606	1,354	1,665
Total noninterest income	$ 2,206	$ 2,460

	Nine Months Ended September 30,	
	2018	2017
	(Dollars in thousands)	
Noninterest Income In-scope of Topic 606:		
Service charges and fees on deposit accounts	$ 1,524	$ 1,449
Interchange fees	239	208
Merchant services revenue	122	129
Other	479	498
Total noninterest income in-scope of Topic 606	2,364	2,284
Noninterest Income Out-of-scope of Topic 606	4,817	4,764
Total noninterest income	$ 7,181	$ 7,048

16) Noninterest Expense

The following table sets forth the various components of the Company’s noninterest expense for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017

	(Dollars in thousands)			
Salaries and employee benefits (1)	$ 10,719	$ 9,071	$ 35,302	$ 27,766