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

FORM 10-K

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

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 Number)

150 Almaden Boulevard
San Jose, California 95113
(Address of Principal Executive Offices including Zip Code)

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

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

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

COMMON STOCK (NO PAR VALUE)

(Title of class)

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [X] No [ ]

The aggregate market value of the stock held by non-affiliates of the Registrant, based upon the closing price of its common stock as of June 30, 2004 ($14.58 per share), as reported on the Nasdaq National Market System, was approximately $149.5 million.

As of March 16, 2005, there were 11,780,425 shares of the Registrant's common stock (no par value) outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENTS INCORPORATED	PARTS OF FORM 10-K INTO WHICH INCORPORATED
Definitive proxy statement for the Company's 2005 Annual Meeting of Shareholders to be filed within 120 days of the end of the fiscal year ended December 31, 2004.	Part III

HERITAGE COMMERCE CORP
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ANNUAL REPORT ON FORM 10-K
FOR YEAR ENDED DECEMBER 31, 2004

PART I

ITEM 1 - BUSINESS

Discussions of certain matters in this Report on Form 10-K may constitute forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words such as "believe", "expect", "intend", "anticipate", "estimate", "project", “assume,” “plan,” “predict,” “forecast” or similar expressions. These forward-looking statements relate to, among other things, expectations of the business environment in which the Company operates, projections of future performance, potential future performance, potential future credit experience, perceived opportunities in the market, and statements regarding the Company's mission and vision. The Company's actual results, performance, and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. The factors include, but are not limited to changes in interest rates, reducing interest margins or increasing interest rate risk, general economic conditions nationally or in the State of California, legislative and regulatory changes adversely affecting the business in which the Company operates, monetary and fiscal policies of the US Government, real estate valuations, the availability of sources of liquidity at a reasonable cost, competition in the financial services industry, the occurrence of events such as the terrorist acts of September 11, 2001, and other risks. All of the Company's operations and most of its customers are located in California. In addition, acts and threats of terrorism or the impact of military conflicts have increased the uncertainty related to the national and California economic outlook and could have an effect on the future operations of the Company or its customers, including borrowers. The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

GENERAL

Heritage Commerce Corp (the "Company") is registered with the Board of Governors of the Federal Reserve System ("FRB") as a Bank Holding Company under the Bank Holding Company Act ("BHCA"). The Company was organized in 1997 to be the holding company for Heritage Bank of Commerce ("HBC"). In 1998 the Company also became the holding company for Heritage Bank East Bay ("HBEB"); in January 2000 the Company became the holding company for Heritage Bank South Valley ("HBSV"); and in October 2000 the Company became the holding company for Bank of Los Altos ("BLA"). On January 1, 2003, HBEB, HBSV, and BLA were merged into HBC. The former HBEB, HBSV, and BLA now operate as branch offices of HBC and continue to serve their local markets.

The Internet address of the Company’s website is “http://www.heritagecommercecorp.com.” In 1998 the Company began making available free of charge through the Company’s website, the Company’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports. The Company makes these reports available on its website on the same day they appear on the SEC’s website.

On February 19, 2004, HBC opened a new Small Business Administration (SBA) loan production office in Irvine. The Irvine office is HBC’s ninth SBA loan production office.

General Banking Services

The Company's customer base consists primarily of small to medium-sized businesses and their owners, managers, and employees residing in Santa Clara, Alameda, and Contra Costa counties. Businesses served include manufacturers, distributors, contractors, professional corporations/partnerships, and service businesses. The Company had approximately 15,000 deposit accounts at December 31, 2004.

The Company offers a range of loans, primarily commercial, including real estate, construction, Small Business Administration (SBA), inventory and accounts receivable, and equipment loans and leases. The Company also accepts checking, savings, and time deposits; NOW and money market deposit accounts; and provides travelers' checks, safe deposit, and other customary non-deposit banking services. The Company does not have a trust department.

The main and executive offices of the Company and the offices of HBC, are located at 150 Almaden Boulevard in San Jose, California 95113, with branch offices located at 15575 Los Gatos Boulevard in Los Gatos, California 95032, 3077 Stevenson Boulevard in Fremont, California 94538, 310 Hartz Road in Danville, California 94526, 18625 Sutter Boulevard in Morgan Hill, California 95037, 737 First Street in Gilroy, California 95020, 4546 El Camino Real in Los Altos, California 94022, 369 South San Antonio Road in Los Altos, California 94022, and at 175 East El Camino Real in Mountain View, California 94040. See Item 2 -"PROPERTIES." The Company's primary market area is Santa Clara, Alameda, and Contra Costa counties. The Company serves a secondary market consisting of the South Bay portion of the San Francisco Bay area and portions of other counties contiguous to its primary market area.

Recent management changes

On March 17, 2004, Phillip R. Boyce resigned as a Director of Heritage Commerce Corp and Heritage Bank of Commerce for personal reasons.

On May 4, 2004, Brad L. Smith resigned as Chief Executive Officer (CEO) and Director of Heritage Commerce Corp and CEO of Heritage Bank of Commerce. William Del Biaggio, Jr., the Chairman of the Board of Directors of Heritage Commerce Corp, was appointed interim CEO.

On June 14, 2004, Ranson W. Webster was appointed to Heritage Commerce Corp's Board of Directors.

On October 4, 2004, Jack W. Conner and Robert Moles joined Heritage Commerce Corp’s Board of Directors.

On November 16, 2004, Executive Vice President and Chief Information Officer Phil Griffin left the Company.

On March 7, 2005, John F. McGrath resigned as President of Heritage Bank of Commerce.

On March 17, 2005, Roy E. Lave resigned from the Board of Directors.

On March 18, 2005, Walt Kaczmarek was named President, Chief Executive Officer and a member of the Board of Directors of Heritage Bank of Commerce and Heritage Commerce Corp.

On March 24, 2005, Anneke Dury and Kirk Rossmann resigned from the Board of Directors.

On March 24, 2005, Richard L. Conniff resigned from the Board of Directors, but he continues as the Company's Chief Operating Officer.

The resignations of Roy E. Lave, Anneke Dury, Kirk Rossmann, and Richard L. Conniff were in connection with the Board decision to reduce its size to 11 persons.

COMPETITION

The banking and financial services business in California generally, and in the Company's market areas specifically, is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the consolidation among financial service providers. The Company competes for loans, deposits and customers for financial services with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other non-bank financial service providers. Many of these competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services than the Company. In order to compete with the other financial service providers, the Company principally relies upon local promotional activities, personal relationships established by officers, directors, and employees with its customers, and specialized services tailored to meet its customers' needs. In those instances where the Company is unable to accommodate a customer's needs, the Company seeks to arrange for such loans on a participation basis with other financial institutions or to have those services provided in whole or in part by its correspondent banks. See Item 1 - "BUSINESS - Supervision and Regulation."

SUPERVISION AND REGULATION

General

Bank holding companies and banks are extensively regulated under both federal and state law. This regulation is intended primarily for the protection of depositors and the deposit insurance fund and not for the benefit of stockholders of the Company. Set forth below is a summary of certain laws that relate to the regulation of the Company and HBC. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

As a registered bank holding company, the Company is subject to the supervision of, and regular inspection by, the Federal Reserve Board (FRB). Historically the activities of bank holding companies, such as the Company, have been limited by the BHCA to banking, managing or controlling banks, furnishing services to or performing services for their subsidiaries, or any other activity which the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making determinations regarding which activities are closely related to banking, the FRB is required to consider whether the performance of such activities by a bank holding company or its subsidiaries can reasonably be expected to produce benefits to the public such as greater convenience, increased competition, or gains in efficiency that outweigh the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. Generally, bank holding companies are required to give notice to or obtain prior approval from FRB to engage in any new activity or to acquire more than 5% of any class of voting stock of any bank. For discussion of the expansion of the powers of bank holding companies, see "Gramm-Leach-Bliley Act" below.

The Company is also a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, the Company and its subsidiary, HBC, are subject to examination by, and may be required to file reports with, the California Department of Financial Institutions (the "Department").

The Company's common stock is registered with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As such, the Company is subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the Exchange Act.

Deposit accounts at HBC are insured by the Federal Deposit Insurance Corporation (FDIC), which currently insures deposits to a maximum of $100,000 per depositor. For this protection, HBC pays a semi-annual assessment and are subject to the rules and regulations of the FDIC pertaining to deposit insurance and other matters.

HBC is a California state-chartered bank and member of the Federal Reserve System. State banks chartered in California that are members of the FRB are subject to regulation, supervision and regular examination by the Department and by the FRB. The regulations of the Department and the FRB continue to govern most aspects of HBC’s business, including reporting requirements, activities, investments, loans, borrowings, certain check-clearing activities, branching, mergers and acquisitions, reserves against deposits, and other areas.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act of 1999 (the "GLB Act") repealed two provisions of the Glass-Steagall Act: Section 20, which restricted the affiliation of Federal Reserve Member Banks with firms "engaged principally" in specified securities activities; and Section 32, which restricts officer, director, or employee interlocks between a member bank and any Company or person "primarily engaged" in specified securities activities. In addition, the GLB Act also contains provisions that expressly pre-empt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the BHCA framework to permit a holding company system to engage in a full range of financial activities through a new entity known as a Financial Holding Company. "Financial Activities" is broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

Generally, the GLB Act:

- Repeals historical restrictions on, and eliminates many federal and state law barriers to, affiliations among banks, securities firms, insurance companies, and other financial service providers;
- Provides a uniform framework for the functional regulation of the activities of banks, savings institutions, and their holding companies;
- Broadens the activities that may be conducted by national banks, banking subsidiaries of bank holding companies, and their financial subsidiaries;
- Provides an enhanced framework for protecting the privacy of consumer information;
- Adopts a number of provisions related to capitalization, membership, corporate governance, and other measures designed to modernize the Federal Home Loan Bank system;
- Modifies the laws governing the implementation of the Community Reinvestment Act ("CRA"); and
- Addresses a variety of other legal and regulatory issues affecting both day-to-day operations and long-term activities of financial institutions.

In order for the Company to take advantage of the ability to affiliate with other financial services providers, the Company must become a "Financial Holding Company" as permitted under an amendment to BHCA. To become a Financial Holding Company, the Company would file a declaration with the FRB, electing to engage in activities permissible for Financial Holding Companies and certifying that it is eligible to do so because its insured depository institution subsidiary is well-capitalized and well-managed. In addition, the FRB must also determine that the insured depository institution subsidiary of the Company has at least a "Satisfactory" CRA rating. The Company currently meets the requirements to make an election to become a Financial Holding Company. The Company's management has not determined at this time whether it will seek an election to become a Financial Holding Company. The Company is examining its strategic business plan to determine whether, based on market conditions, the relative financial conditions of the Company and its subsidiaries, regulatory capital requirements, general economic conditions, and other factors, the Company desires to utilize any of the expanded powers provided in the GLB Act.

The GLB Act also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development, real estate investment, or merchant banking, all of which may only be conducted through a subsidiary of a Financial Holding Company. Financial activities include all activities permitted under new sections of the BHCA or permitted by regulation.

A national bank seeking to have a financial subsidiary, and each of its depository institution affiliates, must be "well-capitalized" and "well-managed." The total assets of all financial subsidiaries may not exceed the lesser of 45% of a bank's total assets, or $50 billion. A national bank must exclude from its assets and equity all equity investments, including retained earnings, in a financial subsidiary. The assets of the subsidiary may not be consolidated with the bank's assets. The bank must also have policies and procedures to assess financial subsidiary risk and protect the bank from such risks and potential liabilities.

The GLB Act provides that designated federal regulatory agencies, including the FDIC, the FRB, the OCC and the SEC, must publish regulations to implement certain provisions of the Act. These agencies have cooperated in the release of rules that establish minimum requirements to be followed by financial institutions for protecting the privacy of financial information provided by consumers. The FDIC's rule requires a financial institution to (i) provide notice to customers about its privacy policies and practices, (ii) describe the conditions under which the institution may disclose nonpublic personal information about consumers to nonaffiliated third parties, and (iii) provide a method for consumers to prevent the financial institution from disclosing information to nonaffiliated third parties by "opting out" of that disclosure.

The GLB Act also includes a new section of the Federal Deposit Insurance Act governing subsidiaries of state banks that engage in "activities as principal that would only be permissible" for a national bank to conduct in a financial subsidiary. It expressly preserves the ability of a state bank to retain all existing subsidiaries. Because California permits commercial banks chartered by the state to engage in any activity permissible for national banks, HBC will be permitted to form subsidiaries to engage in the activities authorized by the GLB Act, to the same extent as a national bank. In order to form a financial subsidiary, the bank must be well-capitalized, and the bank would be subject to the same capital deduction, risk management and affiliate transaction rules are applicable to national banks.

The Company does not believe that the GLB Act has had or will have a material adverse effect on our operations in the near-term. However, to the extent that the GLB Act permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLB Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis. Nevertheless, this act may have the result of increasing the amount of competition that the Company faces from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company and HBC.

The Depository Institution Management Interlocks Act

The Depository Institution Management Interlocks Act (12 U.S.C. § 3201 et seq.) (the "Act") prohibits certain interlocking management relationships between depository institutions. Implementing the Act, the Board of Governors of the Federal Reserve System (the Bank's primary Federal regulator) has promulgated Regulation L with which the Company and the Bank must comply. The Act and Regulation L prohibit directors of the Company holding management positions, including honorary or advisory directorships, in a depository institution having offices in the same geographic area. For a period commencing September 30, 2003 and continuing until January 31, 2004, one of the Company's directors may have served in capacities that violated the Act and Regulation L. Had the Company been aware of the director's honorary directorship, the Company would have been eligible for an exemption from the Act's prohibitions. Once the Company learned of the director’s honorary directorship with another financial institution and spoke to the director, the director resigned his honorary directorship with the other financial institution on January 31, 2004 and the possible violation of law would have ceased at that time.

Limitations on Dividends

The Company's ability to pay cash dividends is dependent on dividends paid to it by HBC. Under California law the holders of common stock of the Company are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available therefor, subject to certain restrictions. A California corporation such as the Company may make a distribution to its shareholders if its retained earnings will equal at least the amount of the proposed distribution. California law further provides that in the event sufficient retained earnings are not available for the proposed distribution a corporation may nevertheless make a distribution to its shareholders if, after giving effect to the distribution, it meets two conditions, which generally stated are as follows: (i) the corporation's assets must equal at least 125% of its liabilities; and (ii) the corporation's current assets must equal at least its current liabilities or, if the average of the corporation's earnings before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the corporation's interest expense for such fiscal years, then the corporation's current assets must equal at least 125% of its current liabilities. Most bank holding companies are unable to meet this test.

The payment of cash dividends by the Company depends on various factors, including the earnings and capital requirements of itself and its subsidiaries, and other financial conditions. The primary source of funds for payment of dividends by the Company to its shareholders will be the receipt of dividends and management fees from HBC. The Company has no present intention of paying cash dividends in the foreseeable future. The legal ability of HBC to pay dividends is subject to restrictions set forth in the California banking law and regulations of the FDIC. No assurance can be given that HBC will pay dividends at any time. For restrictions applicable to HBC, see Item 5 - "MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS - Dividends."

Safety and Soundness Standards

The federal banking agencies have adopted guidelines establishing standards for safety and soundness. The guidelines are designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, earnings, asset quality, asset growth, and compensation, fees and benefits. The guidelines establish the safety and soundness standards that the agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If an institution fails to comply with a safety and soundness standard, the appropriate federal banking agency may require the institution to submit a compliance plan. Failure to submit a compliance plan or to implement an accepted plan may result in enforcement action.

"Source Of Strength" Policy

According to FRB policy, bank holding companies are expected to act as a source of financial and managerial strength to each subsidiary bank and to commit resources to support each such subsidiary.

Capital Adequacy Guidelines

Federal banking agencies have adopted risk-based capital guidelines for insured banks and bank holding companies. These guidelines require a minimum risk-based capital ratio of 8%, with at least 4% in the form of "Tier 1" capital. Tier 1 capital consists of common equity, non-cumulative perpetual preferred stock, trust preferred securities, and minority interests in the equity accounts of consolidated subsidiaries and excludes goodwill. "Tier 2" capital consists of cumulative perpetual preferred stock, limited-life preferred stock, mandatory convertible securities, subordinated debt and (subject to a limit of 1.25% of risk-weighted assets) general loan loss reserves.

The guidelines make regulatory capital requirements more sensitive to the differences in risk profiles among banking institutions, take off-balance sheet items into account when assessing capital adequacy and minimize disincentives to holding liquid low-risk assets. In addition, the regulations may require some banking institutions to increase the level of their common shareholders' equity. Banking regulators have also instituted minimum leverage ratio guidelines for financial institutions. The leverage ratio guidelines require maintenance of a minimum ratio of 3% Tier 1 capital to total assets for the most highly rated bank holding Company organizations. Institutions that are less highly rated, anticipating significant growth, or subject to other significant risks will be required to maintain capital levels ranging from 1% to 2% above the 3% minimum.

The following table presents the capital ratios of the Company computed in accordance with applicable regulatory guidelines and compared to the standards for minimum capital adequacy requirements under the FDIC's prompt corrective action authority as of December 31, 2004:

	December 31, 2004			
	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
Total risk-based capital/risk-weighted assets	$132,685,000	14.3%	$74,248,000	(greater than or equal to) 8.0%
Tier 1 capital/risk-weighted assets	$121,096,000	13.0%	$37,260,000	(greater than or equal to) 4.0%
Tier 1 capital / average assets	$121,096,000	10.9%	$44,439,000	(greater than or equal to) 4.0%

Federal banking agencies, including the FRB and the FDIC, have adopted regulations implementing a system of prompt corrective action pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). The regulations establish five capital categories for banks based on the capital measures indicated below:

Capital Category	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Tier 1 Leverage Ratio
Well capitalized	10.0%	6.0%	5.0%
Adequately capitalized	8.0%	4.0%	4.0%
Undercapitalized	less than 8.0%	less than 4.0%	less than 4.0%
Significantly undercapitalized	less than 6.0%	less than 3.0%	less than 3.0%
Critically undercapitalized (1)	N/A	N/A	N/A

(1) Tangible equity to total assets less than 2.0%

As of December 31, 2004, management believes the Company's capital met all minimum regulatory requirements and that the Company's subsidiary Bank was considered "well capitalized" under the regulatory framework for prompt corrective action.

The regulations establish procedures for classification of financial institutions within the capital categories, filing and reviewing capital restoration plans required under the regulations and procedures for issuance of directives by the appropriate regulatory agency, among other matters. See Item 1 - "BUSINESS - Supervision and Regulation - Prompt Corrective Action."

The appropriate federal banking agency, after notice and an opportunity for a hearing, is authorized to treat a well capitalized, adequately capitalized or undercapitalized insured depository institution as if it had a lower capital-based classification if it is in an unsafe or unsound condition or engaging in an unsafe or unsound practice. Thus, an adequately capitalized institution can be subject to the restrictions on undercapitalized institutions (provided that a capital restoration plan cannot be required of the institution) described below and an undercapitalized institution can be subject to the restrictions applicable to significantly undercapitalized institutions described below. See Item 1 - "BUSINESS - Supervision and Regulation - Prompt Corrective Action."

An insured depository institution cannot make a capital distribution (as broadly defined to include, among other items, dividends, redemption and other repurchases of stock), or pay management fees to any person who controls the institution, if thereafter it would be undercapitalized. The appropriate federal banking agency, however, may (after consultation with the FDIC) permit an insured depository institution to repurchase, redeem, retire or otherwise acquire its shares if such action (i) is taken in connection with the issuance of additional shares or obligations in at least an equivalent amount and (ii) will reduce the institution's financial obligations or otherwise improve its financial condition. An undercapitalized institution is also generally prohibited from increasing its average total assets. An undercapitalized institution is also generally prohibited from making any acquisitions, establishing any branches or engaging in any new line of business except in accordance with an accepted capital restoration plan or with the approval of the FDIC. In addition, the appropriate federal banking agency is given authority with respect to any undercapitalized depository institution to take any of the actions it is required to or may take with respect to a significantly undercapitalized institution as described below if it determines "that those actions are necessary to carry out the purpose" of FDICIA.

The federal banking agencies have adopted a joint agency policy statement to provide guidance on managing interest rate risk. The statement indicated that the adequacy and effectiveness of a bank's interest rate risk management process and the level of its interest rate exposures are critical factors in the agencies' evaluation of the bank's capital adequacy. If a bank has material weaknesses in its risk management process or high levels of exposure relative to its capital, the agencies will direct it to take corrective action. Such directives may include recommendations or directions to raise additional capital, strengthen management expertise, improve management information and measurement systems, reduce level of exposure or some combination of these actions.

The federal banking agencies have issued an interagency policy statement that, among other things, establishes certain benchmark ratios of loan loss reserves to certain classified assets. The benchmark set forth by such policy statement is the sum of (i) 100% of assets classified loss; (ii) 50% of assets classified doubtful; (iii) 15% of assets classified substandard; and (iv) estimated credit losses on other assets over the upcoming 12 months. This amount is neither a "floor" nor a "safe harbor" level for an institution's allowance for loan losses.

Insurance Premiums and Assessments

Pursuant to FDICIA, the FDIC has developed a risk-based assessment system, under which the assessment rate for an insured depository institution will vary according to the level of risk incurred on its activities. An institution's risk category is based upon whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. Each insured depository institution is also to be assigned to one of the following "supervisory subgroups": group A, B or C. Group A institutions are financially sound institutions with few minor weaknesses; Group B institutions are institutions that demonstrate weaknesses which, if not corrected, could result in significant deterioration; and Group C institutions are institutions for which there is a substantial probability that the FDIC will suffer a loss in connection with the institution unless effective action is taken to correct the areas of weakness.

The FDIC assigns each Bank Insurance Fund (BIF) member institution an annual FDIC assessment rate, summarized below (assessment figures are expressed in terms of cents per $100 in deposits):

Capital Category	Group A	Group B	Group C
Well capitalized	0[(1)]	3	17
Adequately capitalized	3	10	24
Undercapitalized	10	24	27

(1) Subject to a statutory minimum assessment of $2,000 per year (which also applies to all other assessment risk classifications).

At December 31, 2004, HBC’s assessment rates were all equivalent to that of a well capitalized, Group A institution.

Pursuant to the Economic Growth and Paperwork Reduction Act of 1996 (the "Paperwork Reduction Act"), at January 1, 1997, HBC began paying, in addition to their normal deposit insurance premium as a member of the BIF, an assessment that is used toward the retirement of the Financing Corporation bonds ("FICO Bonds") issued in the 1980s to assist in the recovery of the savings and loan industry. Members of the Savings Association Insurance Fund ("SAIF"), also pay an assessment, which generally has been calculated at a higher rate than the assessment paid by banks. Under the Paperwork Reduction Act, the FDIC is not permitted to establish SAIF assessment rates that are lower than comparable BIF assessment rates. Effective January 1, 2000, the rate paid to retire the FICO Bonds became equal for members of the BIF and the SAIF. The Paperwork Reduction Act also provided for the merging of the BIF and the SAIF by January 1, 1999 provided there were no financial institutions still chartered as savings associations at that time. However, as of January 1, 2005, there were still financial institutions chartered as savings associations.

In February 2000 the FDIC announced that it was refining the system by which it assesses the risks that are presented to the deposit insurance fund by certain financial institutions. The refinements are intended to identify institutions with typically high-risk profiles from among those institutions in the best-rated premium category, and to determine whether there are unresolved supervisory concerns regarding the risk-management practices of those institutions. The FDIC is concerned about institutions that exhibit characteristics such as rapid asset growth (especially when concentrated in potentially risky, high-yielding lending areas), significant concentrations in high-risk assets, and recent changes in business mix. The FDIC has noted that although such institutions may be well-capitalized and exhibit good earnings when the economy is strong, they often experience deteriorating financial conditions when economic conditions are less favorable. As a result, institutions whose practices are determined to exhibit risky traits under the refined risk assessment system will be assessed higher insurance premiums. These rules are not expected to have a significant impact on HBC.

Prompt Corrective Action

The FDIC has authority: (1) to request that an institution's regulatory agency take enforcement action against it based upon an examination by the FDIC or the agency, (2) if no action is taken within 60 days and the FDIC determines that the institution is in an unsafe or unsound condition or that failure to take the action will result in continuance of unsafe or unsound practices, to order the action against the institution, and (3) to exercise this enforcement authority under "exigent circumstances" merely upon notification to the institution's appropriate regulatory agency. This authority gives the FDIC the same enforcement powers with respect to any institution and its subsidiaries and affiliates as such institution's appropriate regulatory agency has with respect to those entities.

An undercapitalized institution is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. The plan must specify (i) the steps the institution will take to become adequately capitalized, (ii) the capital levels to be attained each year, (iii) how the institution will comply with any regulatory sanctions then in effect against the institution, and (iv) the types and levels of activities in which the institution will engage. The banking agency may not accept a capital restoration plan unless the agency determines, among other things, that the plan "is based on realistic assumptions, and is likely to succeed in restoring the institution's capital" and "would not appreciably increase the risk . . . to which the institution is exposed." A requisite element of an acceptable capital restoration plan for an undercapitalized institution is a guaranty by its parent holding Company that the institution will comply with such capital restoration plan. Liability with respect to this guaranty is limited to the lesser of (i) five percent of the institution's assets at the time when it became undercapitalized and (ii) the amount necessary to bring the institution into capital compliance with "all capital standards applicable to [it]" as of the time when the institution fails to comply with the plan. The guaranty liability is limited to companies controlling the undercapitalized institution and does not affect other affiliates. In the event of a bank holding Company's bankruptcy, any commitment by the bank holding Company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment over the claims of other creditors, including the holders of the Company's long-term debt.

FDICIA provides that the appropriate federal regulatory agency must require an insured depository institution that (i) is significantly undercapitalized or (ii) is undercapitalized and either fails to submit an acceptable capital restoration plan within the time period allowed by regulation or fails in any material respect to implement a capital restoration plan accepted by the appropriate federal banking agency to take one or more of the following actions: (i) sell enough shares, including voting shares, to become adequately capitalized; (ii) merge with (or be sold to) another institution (or holding Company), but only if grounds exist for appointing a conservator or receiver; (iii) restrict certain transactions with banking affiliates as if the "sister bank" exception to the requirements of Section 23A of the Federal Reserve Act did not exist; (iv) otherwise restrict transactions with bank or non-bank affiliates; (v) restrict interest rates that the institution pays on deposits to "prevailing rates" in the institution's "region"; (vi) restrict asset growth or reduce total assets; (vii) alter, reduce or terminate activities; (viii) hold a new election of directors; (ix) dismiss any director or senior executive officer who held office for more than 180 days immediately before the institution became undercapitalized, provided that in requiring dismissal of a director or senior executive officer, the agency must comply with certain procedural requirements, including the opportunity for an appeal in which the director or officer will have the burden of proving his or her value to the institution; (x) employ "qualified" senior executive officers; (xi) cease accepting deposits from correspondent depository institutions; (xii) divest certain non-depository affiliates which pose a danger to the institution; (xiii) be divested by a parent holding Company; and (xiv) take any other action which the agency determines would better carry out the purposes of the prompt corrective action provisions.

In addition to the foregoing sanctions, without the prior approval of the appropriate federal banking agency, a significantly undercapitalized institution may not pay any bonus to any senior executive officer or increase the rate of compensation for such an officer without regulatory approval. Furthermore, in the case of an undercapitalized institution that has failed to submit or implement an acceptable capital restoration plan, the appropriate federal banking agency cannot approve any such bonus.

Not later than 90 days after an institution becomes critically undercapitalized, the appropriate federal banking agency for the institution must appoint a receiver or a conservator, unless the agency, with the concurrence of the FDIC, determines that the purposes of the prompt corrective action provisions would be better served by another course of action. Any alternative determination must be documented by the agency and reassessed on a periodic basis. Notwithstanding the foregoing, a receiver must be appointed after 270 days unless the FDIC determines that the institution has a positive net worth, is in compliance with a capital plan, is profitable or has a sustainable upward trend in earnings and is reducing its ratio of non-performing loans to total loans and the head of the appropriate federal banking agency and the chairperson of the FDIC certify that the institution is viable and not expected to fail.

The FDIC is required, by regulation or order, to restrict the activities of such critically undercapitalized institutions. The restrictions must include prohibitions on the institution's doing any of the following without prior FDIC approval: entering into any material transactions not in the usual course of business; extending credit for any highly leveraged transaction; engaging in any "covered transaction" (as defined in Section 23A of the Federal Reserve Act) with an affiliate; paying "excessive compensation or bonuses"; and paying interest on "new or renewed liabilities" that would increase the institution's average cost of funds to a level significantly exceeding prevailing rates in the market.

Brokered Deposits

A bank cannot accept brokered deposits (defined to include payment of an interest rate more than 75 basis points above prevailing rates) unless (i) it is well capitalized or (ii) it is adequately capitalized and receives a waiver from the FDIC. A bank that cannot receive brokered deposits also cannot offer "pass-through" insurance on certain employee benefit accounts unless certain specified procedures are followed. In addition, a bank that is "adequately capitalized" may not pay an interest rate on any deposits in excess of 75 basis points over certain prevailing market rates. There are no such restrictions on a bank that is "well capitalized."

Federal Reserve Borrowings

The FRB may not make advances to an undercapitalized institution for more than 60 days in any 120-day period without a viability certification by a federal banking agency or by the Chairman of the FRB after an examination by the FRB. If an institution is deemed critically undercapitalized, an extension of FRB credit cannot continue for more than five days without demand for payment unless the FRB is willing to accept responsibility for any resulting loss to the FDIC. As a practical matter, this provision is likely to mean that FRB credit will not be extended beyond the limitations in this provision.

Potential Enforcement Actions; Supervisory Agreements

Banks and their institution-affiliated parties may be subject to potential enforcement actions by the FRB, the FDIC or the Office of the Comptroller of the Currency (OCC) for unsafe or unsound practices in conducting their businesses, or for violations of any law, rule or regulation or provision, any consent order with any agency, any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, cease-and-desist orders and written agreements, the termination of insurance of deposits, the imposition of civil money penalties and removal and prohibition orders against institution-affiliated parties.

Interstate Banking

Bank holding companies (including bank holding companies that also are financial holding companies) also are required to obtain the prior approval of the FRB before acquiring more than five percent of any class of voting stock of any non-affiliated bank. Pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the “Interstate Banking and Branching Act”), a bank holding company may acquire banks located in states other than its home state without regard to the permissibility of such acquisitions under state law, but subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company, after the proposed acquisition, controls no more than 10 percent of the total amount of deposits of insured depository institutions in the United States and no more than 30 percent or such lesser or greater amount set by state law of such deposits in that state.

Subject to certain restrictions, the Interstate Banking and Branching Act also authorizes banks to merge across state lines to create interstate banks. The Interstate Banking and Branching Act also permits a bank to open new branches in a state in which it does not already have banking operations if such state enacts a law permitting de novo branching.

Tie-in Arrangements and Transactions with Affiliated Persons

A bank is prohibited from certain tie-in arrangements in connection with any extension of credit, sale or lease of property or furnishing of services. For example, with certain exceptions, a bank may not condition an extension of credit on a promise by its customer to obtain other services provided by it, its holding Company or other subsidiaries (if any), or on a promise by its customer not to obtain other services from a competitor.

Directors, officers and principal shareholders of the Company, and the companies with which they are associated, may conduct banking transactions with the Company in the ordinary course of business. Any loans and commitments to loans included in such transactions must be made in accordance with applicable law, on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of similar creditworthiness, and on terms not involving more than the normal risk of collectibility or presenting other unfavorable features.

Community Reinvestment Act

Pursuant to the Community Reinvestment Act of 1977, the federal regulatory agencies that oversee the banking industry are required to use their authority to encourage financial institutions to help meet the credit needs of the local communities in which such institutions are chartered, consistent with safe and sound banking practices.

When conducting an examination of a financial institution such as HBC, the agencies assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods. This record is taken into account in an agency's evaluation of an application for creation or relocation of domestic branches or for merger with another institution. Failure to address the credit needs of a bank's community may also result in the imposition of certain other regulatory sanctions, including a requirement that corrective action be taken.

The federal banking agencies determine a bank's CRA rating by evaluating its performance on lending, service, and investment tests, with the lending test as the most important. The tests are to be applied in an "assessment context" that is developed by the agency for a particular institution. The assessment context takes into account demographic data about the community, the community's characteristics and needs, the institution's capacities and constraints, the institution's product offerings and business strategy, the institution's prior performance, and data on similarly situated lenders. Since the assessment context is developed by the regulatory agencies, a particular bank will not know until it is examined whether its CRA programs and efforts have been sufficient.

Larger institutions are required to compile and report certain data on their lending activities in order to measure performance. Some of this data is also required under other laws, such as the Equal Credit Opportunity Act. Small institutions (those institutions with less than $250 million in assets) are now being examined on a "streamlined assessment method." The streamlined method focuses on the institution's loan to deposit ratio, degree of local lending, record of lending to borrowers and neighborhoods of differing income levels, and record of responding to complaints. Large and small institutions have the option of being evaluated for CRA purposes in relation to their own pre-approved strategic plan. Such a strategic plan must be submitted to the institution's regulator three months before its effective date and be published for public comment.

Environmental Regulation

Federal, state, and local regulations regarding the discharge of materials into the environment may have an impact on the Company. Under federal law, liability for environmental damage and the cost of cleanup may be imposed on any person or entity who is an owner or operator of contaminated property. State law provisions impose substantially similar requirements. Both federal and state laws provide generally that a lender who is not actively involved in contaminating a property will not be liable to clean up the property, even if the lender has a security interest in the property or becomes an owner of the property through foreclosure, provided certain conditions are observed.

The Economic Growth Act includes protection for lenders from liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. The Economic Growth Act specifies the actions a lender may take with respect to lending and foreclosure activities without incurring environmental cleanup liability or responsibility. Typical contractual provisions regarding environmental issues in the loan documentation and due diligence inspections will not lead to lender liability for cleanup, and a lender may foreclose on contaminated property, so long as it merely maintains the property and moves to divest it at the earliest possible time.

Under California law, a lender generally will not be liable to the State for the cost associated with cleaning up contaminated property unless the lender realized some benefit from the property, failed to divest the property promptly, caused or contributed to the release of the hazardous materials, or made the loan primarily for purposes of investing in the property.

The extent of the protection provided by both the federal and state lender protection statutes depends on their interpretation by administrative agencies and courts. The Company cannot predict whether it will be adequately protected for the types of loans made by it. In addition, the Company is still subject to the risks that a borrower's financial position will be impaired by liability under the environmental laws and that property securing a loan made by the Company may be environmentally impaired and not provide adequate security for the Company. The Company attempts to protect its position against environmental risks by performing prudent due diligence. Environmental questionnaires and information on the use of toxic substances are requested as part of its underwriting procedures. The Company lends based on its evaluation of the collateral, net worth of the borrower, and the borrower's capacity for unforeseen business interruptions or risks.

Limitation on Activities

FDICIA prohibits state chartered-banks and their subsidiaries from engaging, as principal, in activities not permissible by national banks and their subsidiaries, unless the bank's primary federal regulator determines the activity poses no significant risk to the BIF and the state bank is and continues to be adequately capitalized. Similarly, state bank subsidiaries may not engage, as principal, in activities impermissible by subsidiaries of national banks. This prohibition extends to acquiring or retaining any investment, including those that would otherwise be permissible under California law.

The State Bank Parity Act, eliminates certain disparities between California state chartered banks and federally chartered national banks by authorizing the Commissioner to address such disparities through a streamlined rulemaking process. The Commissioner has taken action pursuant to the Parity Act to authorize, among other matters, previously impermissible share repurchases by state banks, subject to the prior approval of the Commissioner.

In 1996 the OCC issued regulations permitting national banks to engage in a wider range of activities through subsidiaries. "Eligible institutions" (those national banks that are well-capitalized, have a high overall rating and a satisfactory CRA rating, and are not subject to an enforcement order) may engage in activities related to banking through operating subsidiaries after going through a new expedited application process. In addition, the new regulations include a provision whereby a national bank may apply to the OCC to engage in an activity through a subsidiary in which the bank itself may not engage. In determining whether to permit the subsidiary to engage in the activity, the OCC will evaluate why the bank itself is not permitted to engage in the activity and whether a Congressional purpose will be frustrated if the OCC permits the subsidiary to engage in the activity. The State Bank Parity Act may permit state-licensed banks to engage in similar new activities, subject to the discretion of the Commissioner.

State Bank Sales of Non-Deposit Investment and Insurance Products

Securities activities of state non-member banks, as well as the activities of their subsidiaries and affiliates, are governed by the GLB Act and by guidelines and regulations issued by the securities and financial institution regulatory agencies. These agencies have taken the position that bank sales of alternative investment products, such as mutual funds and annuities, raise substantial bank safety and soundness concerns involving consumer confusion over the nature of the products offered, as well as the potential for mismanagement of sales programs which could expose a bank to liability under the antifraud provisions of federal securities laws.

Accordingly, the agencies have issued guidelines that require, among other things, the establishment of a compliance and audit program to monitor a bank's mutual funds sales activities and its compliance with applicable federal securities laws; the provision of full disclosures to customers about the risks of such investments, including the possible loss of the customer's principal investment; and the conduct of securities activities of bank subsidiaries or affiliates in separate and distinct locations. In addition, the guidelines prohibit bank employees involved in deposit-taking activities from selling investment products or giving investment advice. Banks are also required to establish a qualitative standard for the selection and marketing of the investments offered by the bank, and to maintain appropriate documentation regarding the suitability of investments recommended to bank customers.

California state-licensed banks have authority to engage in the insurance business as an agent or broker, but not as an insurance underwriter.

Change in Senior Executives or Board Members

Certain banks and bank holding companies are required to file a notice with their primary regulator prior to (i) adding or replacing a member of the board of directors, or (ii) the employment of or a change in the responsibilities of a senior executive officer. Notice is required if the bank or holding company is failing to meet its minimum capital standards or is otherwise in a "troubled condition", as defined in FDIC regulations, has undergone a change in control within the past two years, or has received its bank charter within the past two years.

Impact of Economic Conditions and Monetary Policies

The earnings and growth of the Company will be affected by general economic conditions, both domestic and international, and by the monetary and fiscal policies of the United States Government and its agencies, particularly the FRB. One function of the FRB is to regulate the national supply of bank credit in order to mitigate recessionary and inflationary pressures. Among the instruments of monetary policy used to implement those objectives are open market transactions in United States Government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements held by depository institutions. The monetary policies of the FRB have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. However, the effect, if any, of such policies on the future business and earnings of the Company cannot be accurately predicted.

Cross-Institution Assessments

Any insured depository institution owned by the Company can be assessed for losses incurred by the FDIC in connection with assistance provided to, or the failure of, any other depository institution owned by the Company.

Audit Requirements

Like all California state-chartered commercial banks, HBC is required to have an annual independent audit and to prepare all financial statements in accordance with accounting principles generally accepted in the United States of America. HBC is also required to have an independent audit committee comprised entirely of outside directors. Under National Association of Securities Dealers (NASD) on-time certifications, the Company has certified that the audit committee has adopted a formal written charter and meets the requisite number of directors, independence and qualification standards. The Company’s stock is listed on Nasdaq.

Other Consumer Protection Laws and Regulations

The bank regulatory agencies closely monitor an institution’s compliance with consumer protection laws and regulations. The examination and enforcement activities conducted by these agencies are intense, and banks have been advised to focus on compliance with consumer protection laws and their implementing regulations. The federal Interagency Task Force on Fair Lending has issued a policy statement on discrimination in home mortgage lending which describes three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. In addition to CRA and fair lending requirements, HBC is subject to numerous other federal consumer protection statutes and regulations. Due to heightened regulatory concern related to compliance with consumer protection laws and regulations generally, HBC may incur additional compliance costs or be required to expend additional funds for investments in the local communities it serves.

USA PATRIOT Act

On October 26, 2001, President Bush signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA PATRIOT Act").

Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ("IMLAFATA").

IMLAFATA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures may include enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

Among its other provisions, IMLAFATA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign banks; and (iii) avoid establishing, maintaining, administering, or managing correspondent accounts in the United States for, or on behalf of, a foreign bank that does not have a physical presence in any country. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLAFATA also amends the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

Regulations adopted pursuant to IMLAFATA implement minimum standards to verify customer identity, to encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, to prohibit the anonymous use of "concentration accounts," and to require all covered financial institutions to have in place a Bank Secrecy Act compliance program.

Regulation W

In 2002 the FRB adopted Regulation W, the rule that comprehensively implements sections 23A and 23B of the Federal Reserve Act. The rule became effective April 1, 2003.

Sections 23A and 23B and Regulation W limit the risks to a bank from transactions between the bank and its affiliates and limit the ability of a bank to transfer to its affiliates the benefits arising from the bank's access to insured deposits, the payment system and the discount window and other benefits of the FRB. The statute and rule impose quantitative and qualitative limits on the ability of a bank to extend credit to, or engage in certain other transactions with, an affiliate (and a nonaffiliate if an affiliate benefits from the transaction). However, certain transactions that generally do not expose a bank to undue risk or abuse the safety net are exempted from coverage under Regulation W.

Historically, a subsidiary of a bank was not considered an affiliate for purposes of Sections 23A and 23B, since their activities were limited to activities permissible for the bank itself. The GLB Act authorized "financial subsidiaries" that may engage in activities not permissible for a bank. These financial subsidiaries are now considered affiliates. Certain transactions between a financial subsidiary and another affiliate of a bank are also covered by sections 23A and 23B under Regulation W.

Regulation W has certain exemptions, including:

- For state-chartered banks, an exemption for subsidiaries lawfully conducting nonbank activities before issuance of the final rule.

- An exemption for extensions of credit by a bank under a general purpose credit card where the borrower uses the credit to purchase goods or services from an affiliate of the bank, so long as less than 25 percent of the aggregate amount of purchases with the card are purchases from an affiliate of the bank (a bank that does not have nonfinancial affiliates is exempt from the 25 percent test).

- An exemption for loans by a bank to a third party secured by securities issued by a mutual fund affiliate of the bank (subject to a number of conditions).

- An exemption that would permit a banking organization to engage more expeditiously in internal reorganization transactions involving a bank's purchase of assets from an affiliate (subject to a number of conditions).

The rule contains new valuation rules for a bank's investments in, and acquisitions of, affiliates.

The FRB expects examiners and other supervisory staff to review intercompany transactions closely for compliance with the statutes and Regulation W and to resolve any violations or potential violations quickly.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (the "Act") implemented legislative reforms intended to address corporate and accounting fraud. In addition to the establishment of a new accounting oversight board that enforces auditing, quality control and independence standards and is funded by fees from all publicly traded companies, the Act places certain restrictions on the scope of services that are provided by accounting firms to their public company audit clients. All services being provided to a public company audit client require preapproval by the company's audit committee. In addition, the Act makes certain changes to the requirements for partner rotation after a period of time. The Act requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement. In addition, under the Act, counsel is required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Under the Act, longer prison terms apply to corporate executives who violate federal securities laws; the period during which certain types of suits can be brought against a company or its officers is extended; and bonuses issued to top executives prior to restatement of a company's financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan "blackout" periods, and loans to company executives (other than loans by financial institutions permitted by federal rules and regulations) are restricted. In addition, a provision directs that civil penalties levied by the SEC as a result of any judicial or administrative action under the Act be deposited to a fund for the benefit of harmed investors. The legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers must also provide information for most changes in ownership in a company's securities generally within two business days of the change.

The Act also increases responsibilities and codifies certain requirements relating to audit committees of public companies and how they interact with the Company's "registered public accounting firm." Audit Committee members must be independent and are absolutely barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, companies must disclose whether at least one member of the committee is an "audit committee financial expert" (as defined by the SEC) and if not, why not. A company's registered public accounting firm is prohibited from performing audit services for a company if the company's chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by the auditor and participated in the Company's audit during the year preceding the audit initiation date. The Act also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent accountant engaged in the audit of the company's financial statements for the purpose of rendering the financial statements materially misleading. The Act also requires the SEC to prescribe rules requiring inclusion of any internal control report and assessment by management in the annual report to shareholders. The Act requires the company's registered public accounting firm that issues the audit report to attest to and report on management's assessment of the company's internal controls.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect the Company, HBC and the banking industry in general are pending, and additional initiatives may be proposed or introduced, before the United States Congress, the California legislature and other governmental bodies in the future. For example, from time to time consumer legislation has been proposed in Congress which would require banks to offer basic, low-cost financial services to meet minimum client needs. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of the Company and HBC would be affected thereby.

EMPLOYEES

At December 31, 2004, the Company had 198 full-time employees. The Company's employees are not represented by any union or collective bargaining agreement and the Company believes its employee relations are satisfactory.

RISK FACTORS

In addition to the information on the financial condition of the Company contained in this report, the following risks may affect the Company. If any of these risks occurs, our business, financial condition or operating results could be adversely affected.

Changes in market interest rates may adversely affect the Company's performance

The Company's earnings are impacted by changing interest rates. Changes in interest rates impact the demand for new loans, the credit profile of existing loans, the prepayment characteristics of loans sold to the secondary market, the rates received on loans and securities and rates paid on deposits and securities and borrowings. The Board of Governors of the Federal Reserve System increased short-term interest rates 125 basis points during 2004 and 50 basis points through March 30, 2005. Any further increases will continue to have a positive effect on the Company's net interest margin and net interest income.

Business focus and economic and competitive conditions in the San Francisco Bay Area could adversely affect the Company's operations

All of the Company's operations and a vast majority of its customers are located in the Bay Area of California. A continued deterioration in economic and business conditions in the Bay Area, particularly in the technology and real estate industries on which this area depends, could have a material adverse impact on the quality of the Company's loan portfolio and the demand for the Company's products and services, which in turn may have a material adverse effect on the Company's results of operations. A downturn in the national economy might further exacerbate local economic conditions.

The banking and financial services business in California generally, and in the Company's market areas specifically, is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the consolidation among financial service providers. The Company competes for loans, deposits and customers for financial services with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other non-bank financial service providers. Many of these competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services than the Company. In order to compete with the other financial service providers, the Company principally relies upon local promotional activities, personal relationships established by officers, directors, and employees with its customers, and specialized services tailored to meet its customers' needs. In those instances where the Company is unable to accommodate a customer's needs, the Company seeks to arrange for such loans on a participation basis with other financial institutions or to have those services provided in whole or in part by its correspondent banks.

Both residential and commercial real estate in the Bay Area will continue to be under pressure because of the region's heavy dependence on the technology industry. Job and spending cuts have been extensive in the Bay Area's high-tech industries. Many of the Bay Area's service industries are also severely affected by the tech sector. The drop in job and income growth has had an impact on the real estate market. Further deterioration in the Bay Area job market will tend to adversely affect the quality of the Company's loan portfolio.

ITEM 2 – *PROPERTIES*

The main and executive offices of the Company and HBC are located at 150 Almaden Boulevard in San Jose, California 95113, with branch offices located at 15575 Los Gatos Boulevard in Los Gatos, California 95032, at 3077 Stevenson Boulevard in Fremont, California 94538, at 310 Hartz Road in Danville, California 94526, at 18625 Sutter Boulevard in Morgan Hill, California 95037, at 737 First Street in Gilroy, California 95020, at 4546 El Camino Real in Los Altos, California 94022, at 369 S. San Antonio Road in Los Altos, California 94022, and at 175 E. El Camino Real in Mountain View, California 94040.

Bank Branchs

The main offices of Heritage Bank of Commerce are located at 150 Almaden Boulevard in San Jose, California in a fifteen-story Class-A type office building. The primary operating area, which consists of approximately 13,511 square feet, was subleased from a non-affiliated third party under a non-cancelable operating lease dated February 12, 1996. The current monthly rent payment for this space is $25,535 and is subject to change in 2006 based on fair rental value at that time. The sublease expires on February 28, 2010; however, the Company has reserved the right to terminate the sublease in 2006, subject to the terms and conditions established for early termination.

In January of 1997, the Company leased approximately 1,255 square feet of office space (referred to as the "Kiosk") located next to the primary operating area at 150 Almaden Boulevard in San Jose, California to be used for meetings, staff training and marketing events. The current monthly rent payment for this space is $3,328 and is subject to annual increases of 3% until the lease expires on February 28, 2010.

In August of 1997, the Company subleased approximately 2,175 square feet of office space located on the second floor at 150 Almaden Boulevard in San Jose, California. The current monthly rent payment for this space is $4,785 and is subject to change in 2006 based on fair rental value at that time. The sublease expires on February 28, 2010; however, the Company has reserved the right to terminate the sublease in 2006, subject to the terms and conditions established for early termination.

In April of 2000, the Company leased approximately 12,824 square feet of office space located on the third floor at 150 Almaden Boulevard in San Jose, California. The current monthly rent payment for this space is $47,630 and is subject to annual increases of 3% until the lease expires on February 28, 2010.

In May of 2002, the Company subleased approximately 6,731 square feet of office space located on the second floor at 150 Almaden Boulevard in San Jose, California. The current monthly rent payment for this space is $14,808 and is subject to change in 2006 based fair rental value at that time. The sublease expires on February 28, 2010; however, the Company has reserved the right to terminate the sublease in 2006, subject to the terms and conditions established for early termination.

In December of 2003, the Company leased approximately 1,920 square feet of office space located at 15575 Los Gatos Boulevard in Los Gatos, California. The currently monthly rent payment for this space is $4,647 and is subject to annual increases of 3% until the lease expires on November 30, 2008.

In November of 1997, the Company leased approximately 6,590 square feet of space for a branch office in a stand alone office building located at 3077 Stevenson Boulevard in Fremont, California. The current monthly rent payment for this space is $17,002 and is subject to annual increases of 4% until the lease expires on January 31, 2008. The Company has reserved the right to extend the term of the lease for (2) two additional periods of (5) five years each.

In September of 1999, the Company subleased an additional 2,700 square feet of space for a branch office in a one-story multi-tenant building located at 310 Hartz Avenue in Danville, California. The current monthly rent payment for this space is $8,547 and is subject to annual increases of 4% until the lease expires on December 31, 2007.

In March of 1999, the Company leased approximately 7,260 square feet of space for a branch office in a one-story multi-tenant office building located at 18625 Sutter Boulevard in Morgan Hill, California. The current monthly rent payment for this space is $11,676 and is subject to adjustment every 36 months, based on the Consumer Price Index of the Labor of Statistics as defined in the lease agreement, until the lease expires on October 31, 2014.

In January of 2001, the Company leased an additional 2,200 square feet of space for a branch office in a one-story multi-tenant shopping center located at 737 First Street in Gilroy, California. The current monthly rent payment for this space is $3,406 and is subject to change annually based on the Consumer Price Index of the Bureau of Labor Statistics as defined in the lease agreement. The lease expires on February 28, 2006; however, the Company has reserved the right to extend the term of the lease for (1) one additional period of (5) five years.

In February of 1995, the Company leased approximately 7,889 square feet of space for a branch office in a two-story multi-tenant shopping center located at 4546 El Camino Real in Los Altos, California. In October of 2001, the lease was amended to return 795 square feet to the Landlord, leaving 7,094 square feet remaining under the lease. The current monthly rent payment for this space is $14,290 and is subject to annual increases, based on the Consumer Price Index of the Bureau of Labor Statistics as defined in the lease agreement, until the lease expires on April 30, 2005.

In January of 1998, the Company leased an additional 4,840 square feet of space for a branch office in a multi-tenant shopping center located at 175 E. El Camino Real in Mountain View, California. The current monthly rent payment for this space is $12,774 and is subject to annual increases based on the Consumer Price Index of the Bureau of Labor Statistics as defined in the lease agreement. The lease expires on May 30, 2008; however, the Company has reserved the right to extend the term of the lease for (2) two additional periods of (5) five years each.

In September of 1998, the Company leased an additional 3,471 square feet of space for a branch office in a one-story stand-alone office building located at 369 S. San Antonio Road in Los Altos, California. The current monthly rent payment for this space is $15,371 and is subject to annual increases of 4% until the lease expires on September 30, 2008. The Company has reserved the right to extend the term of the lease for (2) two additional periods of (5) five years each.

Loan Production Offices

In August of 2000, the Company leased space for a loan production office located at 740 Front Street in Santa Cruz, California 95060. The lease covers approximately 2,176 square feet of office space and expires on July 31, 2005. The current monthly rent payment for this space is $4,538 and is subject to annual increases based on the Consumer Price Index of the Bureau of Labor Statistics as defined in the lease agreement.

In February of 2004, the Company leased space for a loan production office located at 19200 Von Karman Avenue, in Irvine, California 92612. The lease covers approximately 144 square feet of office space and expires on January 31, 2006. The current monthly rent payment for this space is $875.

In March of 2004, the Company renewed its lease for a loan production office located at 23 E. Beach Street in Watsonville, California 95076. The lease covers approximately 287 square feet of office space and expires on March 31, 2005. The current monthly rent payment for this space is $330.

In March of 2004, the Company leased space for a loan production office located at 264 Clovis Avenue in Clovis, California 93612. The lease covers approximately 140 square feet of office space and expires on March 31, 2005. The current monthly rent payment for this space is $500.

In June of 2004, the Company leased space for a loan production office located at 3120 Cohasset Road in Chico, California 95973. The lease covers approximately 220 square feet of office space and expires on May 31, 2005. The current monthly rent payment for this space is $169. The Company has reserved the right to extend the term of the lease for (2) two additional periods of (1) one year each.

In July of 2004, the Company renewed its leases for (2) loan production offices located at 450 North Brand Boulevard in Glendale, California 91203. Each office is leased under a separate lease agreement, each consisting of approximately 132 square feet of office space. Both leases expire on June 30, 2005; however, the Company has reserved the right to extend each lease for multiple additional periods of (1) one year each. The current monthly rent payment for each office is $1,563.

In December of 2004, the Company renewed its lease for a loan production office located at 8788 Elk Grove Boulevard in Elk Grove, California 95624. The lease consists of approximately 224 square feet of office space and expires on December 1, 2005; however, the Company has reserved the right to extend the term of the lease for a single additional period of (1) one year. The current monthly rent payment for this space is $612.

For additional information on operating leases and rent expense, refer to Note 10 to the Consolidated Financial Statements following "Item 15 – Exhibits and Financial Statement Schedules".

ITEM 3 - *LEGAL PROCEEDINGS*

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.

ITEM 4 - *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

There was no submission of matters to a vote of security holders during the fourth quarter of the year ended December 31, 2004.

PART II

ITEM 5 - *MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS*

In June 2004, the Company's Board of Director authorized the purchase of up to $10 million of its common stock, which represents approximately 700,000 share, or 6%, of its outstanding shares at current market price. The share repurchase authorization is valid through June 1, 2005.

The Company intends to finance the purchase using its available cash. Shares may be repurchased by the Company in open market purchases or in privately negotiated transactions as permitted under applicable rules and regulations. The repurchase program may be modified, suspended or terminated by the Board of Directors at any time without notice. The extent to which the Company repurchases its shares and the timing of such repurchases will depend upon market conditions and other corporate considerations.

As of December 31, 2004, the Company has repurchased 263,728 shares at an average price of $15.98. Shares were purchased on the open market using available cash.

Repurchases of equity securities during the three months period ended December 31, 2004 are presented in the table below:

Settlement Date	Total Number of Shares Purchased		Price Paid Per Shares	Total Number of Shares Purchased as Part of Publicly Announced Plans		Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans
November 8, 2004	1,900	$	17.66	1,900	$	7,385,717
November 9, 2004	2,900	$	17.80	2,900	$	7,334,097
November 10, 2004	1,900	$	17.70	1,900	$	7,300,467
November 15, 2004	2,900	$	17.70	2,900	$	7,249,137
November 16, 2004	1,500	$	17.71	1,500	$	7,222,572
November 16, 2004	1,000	$	17.75	1,000	$	7,204,822
November 17, 2004	2,800	$	17.98	2,800	$	7,154,478
November 18, 2004	1,000	$	17.87	1,000	$	7,136,608
November 19, 2004	1,000	$	17.90	1,000	$	7,118,708
November 22, 2004	3,300	$	18.07	3,300	$	7,059,077
November 23, 2004	3,800	$	18.41	3,800	$	6,989,119
November 24, 2004	1,000	$	18.49	1,000	$	6,970,629
November 26, 2004	3,000	$	18.83	3,000	$	6,914,139
November 29, 2004	4,200	$	18.90	4,200	$	6,834,759
December 2, 2004	11,700	$	19.17	11,700	$	6,610,470
December 3, 2004	4,200	$	19.37	4,200	$	6,529,116
December 6, 2004	4,300	$	19.51	4,300	$	6,445,223
December 7, 2004	4,500	$	19.44	4,500	$	6,357,743
December 8, 2004	4,700	$	19.48	4,700	$	6,266,187
December 10, 2004	4,800	$	19.00	4,800	$	6,174,987
December 13, 2004	4,700	$	18.65	4,700	$	6,087,332
December 14, 2004	4,800	$	18.55	4,800	$	5,998,292
December 15, 2004	2,000	$	18.83	2,000	$	5,960,632
December 16, 2004	4,800	$	18.78	4,800	$	5,870,488
December 17, 2004	4,500	$	18.78	4,500	$	5,785,978
Total	87,200			87,200		

The Company's Common Stock is listed on the Nasdaq National Market under the symbol "HTBK." BrokerageAmerica, LLC, Citigroup Global Markets Holdings Inc., FIG Partners, LLC, FTN Midwest Research Securities Corp., Hill Thompson Magid, L.P., Hoefer & Arnett Incorporated, Keefe, Bruyette & Woods, Inc., Knight Equity Markets, L.P., Merrill Lynch, Pierce, Fenner & Smith, Inc., Morgan Stanley & Company, Inc., RBC Dain Rauscher Inc., Sandler O'Neill & Partners, LP, Schwab Capital Markets L.P., Shemano Group, Inc. and Susquehanna Capital Group have acted as market makers for the Common Stock. These market makers have committed to make a market for the Company's Common Stock, although they may discontinue making a market at any time. No assurance can be given that an active trading market will be sustained for the Common Stock at any time in the future.

The information in the following table for 2004 and 2003 indicates the high and low closing prices for the Common Stock, based upon information provided by the Nasdaq Stock Market.

Quarter	High	Low
Year ended December 31, 2004:		
Fourth quarter	$ 19.56	$ 16.20
Third quarter	$ 16.50	$ 14.27
Second quarter	$ 15.00	$ 12.74
First quarter	$ 13.00	$ 12.12
Year ended December 31, 2003:		
Fourth quarter	$ 12.63	$ 11.21
Third quarter	$ 12.53	$ 10.51
Second quarter	$ 12.05	$ 9.11
First quarter	$ 9.30	$ 8.56

As of March 16, 2005, there were approximately 1,200 holders of record of Common Stock. There are no other classes of common equity outstanding.

DIVIDENDS

Under California law, the holders of common stock of a bank are entitled to receive dividends when and as declared by the Board of Directors, out of funds legally available therefor. The California Banking Law 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 Department 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. In the event that the Department 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 Department may order a bank to refrain from making such a proposed distribution.

The FDIC and the Department have authority to prohibit a bank from engaging in business practices that are considered to be unsafe or unsound. Depending upon the financial condition of a bank and upon other factors, the FDIC or the Department could assert that payments of dividends or other payments by a bank might be such an unsafe or unsound practice. The FRB has similar authority with respect to a bank holding company.

For regulatory restrictions on payment of dividends by the Company, see Item 1- "BUSINESS - Regulation and Supervision - Limitations on Dividends."

To date, the Company has not paid cash dividends. It is the current policy of the Company to retain earnings to increase its capital to support growth. Payment of cash dividends in the future will depend upon the Company's earnings and financial condition and other factors deemed relevant by management. Accordingly, it is likely that no cash dividends from the Company will be paid in the foreseeable future.

MANDATORILY REDEEMABLE CUMULATIVE TRUST PREFERRED SECURITIES OF SUBSIDIARY GRANTOR TRUST

To enhance regulatory capital and to provide liquidity the Company, through unconsolidated subsidiary grantor trusts, issued the following mandatorily redeemable cumulative trust preferred securities of subsidiary grantor trusts: In the first quarter of 2000, the Company issued $7,000,000 aggregate principal amount of 10.875% subordinated debentures due on March 8, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2000, the Company issued $7,000,000 aggregate principal amount of 10.60% subordinated debentures due on September 7, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2001, the Company issued $5,000,000 aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on July 31, 2031 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2002, the Company issued $4,000,000 aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on September 26, 2032 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. Under applicable regulatory guidelines, the Trust Preferred securities currently qualify as Tier I capital. These subsidiary trusts are not consolidated in the Company's consolidated financial statements and the subordinated debt payable to subsidiary grantor trusts is recorded as debt of the Company to the related trusts. See "Footnote 7 to the Consolidated Financial Statements following "Item 15 – Exhibits and Financial Statement Schedules".

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities. The purpose of this interpretation is to provide guidance on how to identify a variable interest entity (VIE) and to determine when the assets, liabilities, noncontrolling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. A company that holds variable interests in an entity will need to consolidate that entity if the company's interest in the VIE is such that the company will absorb a majority of the VIE's expected losses and/or receive a majority of the VIE's expected residual returns, if they occur. New disclosure requirements are also prescribed by FIN 46. In December 2003, the FASB issued FIN 46R, a revision of FIN 46. FIN 46R was effective for all VIE's created after January 31, 2003 in the reporting period ending after March 15, 2004, and became effective for VIE's that existed before February 1, 2003 for the first period ending after December 15, 2003. Under FIN 46R, the Company's subsidiaries, which issued mandatorily redeemable trust preferred securities, were required to be deconsolidated. The Company applied the provisions of FIN 46R to the VIE and deconsolidated its assets and liabilities. Deconsolidation of these entities resulted in total assets and total liabilities increasing by $702,000 and did not have any impact on the Company's results of operations. The adoption of FIN 46R did not have any other material impact on the Company's financial position or result of operations.

ITEM 6 - *SELECTED FINANCIAL DATA*

The following table presents a summary of selected financial information that should be read in conjunction with the Company's consolidated financial statements and notes thereto included under Item 8 - "FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA."

SELECTED FINANCIAL DATA

(Dollars in thousands, except per share amounts and ratios)	AT AND FOR YEAR ENDED DECEMBER 31, 2004	2003 As Restated (7)	2002 As Restated (7)	2001 As Restated (7)	2000 As Restated (7)
INCOME STATEMENT DATA:					
Interest income	$ 52,417	$ 48,096	$ 52,756	$ 65,005	$ 67,921
Interest expense	9,648	10,003	15,237	24,366	25,101
Net interest income before provision for probable loan losses	42,769	38,093	37,519	40,639	42,820
Provision for probable loan losses	666	2,900	2,663	1,910	3,159
Net interest income after provision for probable loan losses	42,103	35,193	34,856	38,729	39,661
Noninterest income	10,234	10,429	9,030	6,297	2,877
Noninterest expenses	40,660	34,350	33,248	33,435	34,417
Income before income taxes	11,677	11,272	10,638	11,591	8,121
Provision for income taxes	3,199	3,496	3,484	4,374	2,899
Net income	$ 8,478	$ 7,776	$ 7,154	$ 7,217	$ 5,222
PER SHARE DATA:					
Basic net income(1)	$ 0.73	$ 0.69	$ 0.65	$ 0.66	$ 0.49
Diluted net income(2)	$ 0.71	$ 0.67	$ 0.63	$ 0.64	$ 0.47
Book value(3)	$ 8.45	$ 7.86	$ 7.30	$ 6.60	$ 5.98
Weighted average number of shares outstanding - basic	11,559,155	11,221,232	11,063,965	10,960,157	10,607,584
Weighted average number of shares outstanding - diluted	11,986,856	11,572,588	11,324,650	11,257,721	11,108,329
Shares outstanding at period end	11,669,837	11,381,037	11,214,414	11,114,967	10,939,124
BALANCE SHEET DATA:					
Investment securities	$ 232,809	$ 153,473	$ 126,443	$ 106,810	$ 110,802
Net loans	$ 713,033	$ 648,706	$ 660,680	$ 621,763	$ 601,130
Allowance for probable loan losses	$ 12,497	$ 13,451	$ 13,227	$ 11,154	$ 9,651
Total assets	$ 1,108,173	$ 1,005,982	$ 960,066	$ 912,362	$ 846,072
Total deposits	$ 918,535	$ 835,410	$ 841,936	$ 807,908	$ 738,186
Other borrowed funds	$ 47,800	$ 43,600	$ --	$ --	$ 18,000
Notes payable to subsidiary grantor trusts	$ 23,702	$ 23,702	$ 23,000	$ 19,000	$ 14,000
Total shareholders' equity	$ 98,579	$ 89,485	$ 81,862	$ 73,341	$ 65,450
SELECTED PERFORMANCE RATIOS:					
Return on average assets(4)	0.80 %	0.81 %	0.77 %	0.83 %	0.67 %
Return on average equity	9.04 %	9.04 %	9.15 %	10.20 %	8.74 %
Net interest margin	4.40 %	4.34 %	4.39 %	5.00 %	5.95 %
Efficiency	76.71 %	70.79 %	71.34 %	71.24 %	75.32 %
Average net loans as a percentage of average deposits	77.11 %	77.21 %	76.49 %	76.88 %	71.24 %
Average total shareholders' equity as a percentage of average total assets	8.80 %	8.95 %	8.41 %	8.15 %	7.67 %
SELECTED ASSET QUALITY RATIOS(5):					
Net loan charge-offs (recoveries)to average loan:	(0.29)%	0.41 %	0.09 %	0.07 %	-- %
Allowance for loan losses to total loans	1.72 %	2.03 %	1.96 %	1.76 %	1.58 %
CAPITAL RATIOS(6):					
Tier 1 risk-based	13.0 %	13.3 %	12.1 %	11.7 %	10.4 %
Total risk-based	14.3 %	14.5 %	13.3 %	13.0 %	11.7 %

Notes:

1) Represents net income divided by the average number of shares of common stock outstanding for the respective period.

2) Represents net income divided by the average number of shares of common stock and common stock-equivalents outstanding for the respective period.

3) Represents shareholders' equity divided by the number of shares of common stock outstanding at the end of the period indicated.

4) Average balances used in this table and throughout this Annual Report are based on daily averages.

5) Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and still accruing, restructured loans, foreclosed assets, and other real estate owned (OREO). As of December 31, 2004, the Company had $1,330,000 in nonperforming assets. As of December 31, 2003, the Company had $4,580,000 in nonperforming assets. As of December 31, 2002, the Company had $4,571,000 in nonperforming assets. As of December 31, 2001 and 2000, the Company had no nonperforming assets.

6) The Risk-Based and Leverage Capital ratios are defined in Item 1 - "BUSINESS - Supervision And Regulation - Capital Adequacy Guidelines."

7) See Note 2 to the consolidated financial statements for description of the restatements.

ITEM 7 - *MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

The following management discussion and analysis gives effect to the restatement in Note 2 to the consolidated financial statements.

Executive Summary

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

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

Lending

Loan growth is a key metric used by management to measure market share. Over the previous five years ending December 31, 2004, the Company has continued its growth trend in commercial loans. This growth reflects the Company's focus on closely held businesses and success in penetrating this market even in a period of economic stress. Construction lending has declined since 2000, but with evidence of some improvement in market conditions in 2004. Given the slowdown in construction activity, the Company increased its commercial real estate mortgage activity by focusing on financing properties for customers with whom we already had a primary banking relationship. The majority of the Company's commercial real estate mortgages are located in its primary service area and properties financed are often owner occupied.

Deposits

Growth in deposits is another important metric management uses to measure market share. The Company's depositors are primarily located in its primary market area. Depending on loan demand and other funding requirements, the Company will occasionally obtain deposits from wholesale sources including deposit brokers. During 2002, the Company began to reduce its reliance on brokered deposits from $68 million on December 31, 2001 to $20 million at December 31, 2004. The Company also seeks deposits from title insurance companies and real estate exchange facilitators. The Company has a policy to monitor all deposits that may be sensitive to interest rate changes to assure that liquidity risk does not become excessive due to concentrations.

Net Interest Income

The management of interest income and interest expense is fundamental to the performance of the Company. Net interest income, the difference between interest income and interest expense, is the largest component of the Company's total revenue. Management closely monitors both total net interest income and the net interest margin (net interest income divided by average earning assets). Net interest income for the Company has been significantly impacted by market rates of interest. Although assets have grown from $846 million at December 31, 2000 to $1.108 billion at December 31, 2004, net interest income for the years ended December 31, 2000 and December 31, 2004 are virtually the same. This reflects a significant decline in the Company's net interest margin. Approximately 85% of the Company's loan portfolio is indexed to the prime rate. As the Federal Open Market Committee (FOMC) reduced short term interest rates from 2000 to 2003, the prime rate dropped sharply from 9.50% at December 31, 2000 to 4.00% in June 2003. The FOMC began to increase short term rates in July 2004 and the prime rate at December 31, 2004 was 5.25%. The improvement in net interest margin in 2004 is attributable to the FOMC action in the last two quarters of 2004. Because of its focus on commercial lending to closely held businesses, the Company will continue to have a high percentage of floating rate loans and other assets. Management believes that the Company's assets will tend to reprice faster than liabilities when market rates of interest change. This characteristic makes the Company "asset sensitive." Asset sensitive balance sheets tend to perform better, i.e., generate higher net interest income and have higher net interest margins, in a rising rate environment. In a falling rate environment an asset sensitive balance sheet does not tend to perform as well.

The Company, through its asset and liability policies and practices, seeks to maximize net interest income without exposing the Company to an excessive level of interest rate risk. Interest rate risk is managed by monitoring the pricing, maturity and repricing options of all classes of interest bearing assets and liabilities. This is discussed in more detail in *Item 7 - Liquidity and Asset/Liability Management.*

Management of Credit Risk

Because of its focus on business banking, loans to single borrowing entities are often larger than would be found in a more consumer oriented bank with many smaller, more homogenous loans. The average size of its relationships makes the Company more susceptible to larger losses. As a result of this concentration of larger risks, the Company has maintained an allowance for loan and lease losses which is substantially higher than would be indicated by its actual historic loss experience. A complete discussion of the management of credit risk appears in *Item 7 - Provision for Loan and Lease Losses* and *Allowance for Loan and Lease Losses.*

The significantly lower provision for loan and lease losses in 2004 was primarily attributable to commercial loan recoveries of $1.562 million.

Noninterest Income

While net interest income remains the largest single component of total revenues, noninterest income has become a growing component. A significant percentage of the Company's noninterest income is associated with its SBA lending activity, either as gains on the sale of loans sold in the secondary market or servicing income related to loans sold in the secondary market on which the Company retains servicing.

Noninterest income associated with SBA activity has increased each year from 2003 through 2004. Risks associated with the continuation of this level of noninterest income from SBA lending include the possibility that the federal government will eliminate or change SBA programs in a manner that becomes less attractive to the Company or to SBA borrowers. Further, change in the secondary market for SBA loans could reduce gains on sale. Higher than expected prepayments of SBA loans on which the Company has retained servicing could reduce the carrying value of the associated servicing asset and interest only strip. Loan servicing is discussed in *Item 7 - Critical Accounting Policies* and in the *Notes to Consolidated Financial Statements*.

In mid-2004, the Company closed its residential mortgage department because of concerns about its long term profitability in changing market conditions. As a result of the closure, mortgage brokerage fees dropped significantly in 2004 and are not expected to be significant in future periods. The closure of the mortgage brokerage department also eliminated costs, including salary and commissions, related to that activity.

During 2003 and 2004, the Company recognized $1.195 million and $871,000, respectively, in income related to the short term leasing of electronic test equipment. In the fourth quarter of 2004, the Company significantly reduced the carrying value of the electronic test equipment through a charge to operating expenses. The Company does not expect to recognize any significant income from this activity in the future.

Noninterest expense

Management considers the control of operating expenses to be a critical element of the Company's performance. Beginning in the second quarter of 2004, the Company undertook several initiatives to reduce its noninterest expense and improve its efficiency. These initiatives included a reduction in staff and the consolidation of its operations under a common brand, Heritage Bank of Commerce. Prior to the third quarter of 2004, the Company had operated with four different bank identities. The implementation of these changes created one time, non-recurring expenses in 2004 totaling approximately $1.283 million which are included in the Company's noninterest expenses for the year.

In addition to the nonrecurring expenses the Company reduced the carrying value of electronic test equipment which is subject to or available for short term leases. The reduction in carrying value resulted in a charge of $2.236 million to operating expenses during 2004.

Key Performance Measures

Through its asset and liability management process, the Company monitors a number of ratios to analyze the Company's performance over time and also to compare the Company against similarly sized and situated companies in the banking industry. Management considers the following ratios to be important benchmarks for the Company's performance and financial conditions:

- Return on average assets: Net income as a percentage of average assets. Measures the earning power of the balance sheet.

- Return on average equity: Net income as a percentage of average shareholders' equity. Measures the return on invested capital.

- Net interest margin: Net interest income as a percentage of average interest earning assets. Measures the earning power of interest earning assets funded by interest bearing liabilities.

- Efficiency ratio: Net interest income plus noninterest income divided by non-interest expense. Measures the cost of producing revenue as a percentage of total revenue.

There is no single ratio or metric that summarizes the performance of the Company. The ratios above each take an element of the Company's performance and quantify it so that it can be compared over time and benchmarked against other peer companies. Management uses these and other ratios and metrics in assessing and planning the Company's performance.

The Company believes that the initiatives it undertook in 2004, coupled with increases in short term interest rates including the target federal funds rate and the prime rate, will cause its performance to more closely match the performance of peer banks in the future..

Capital Management and Share Repurchases

Heritage Commerce Corp and Heritage Bank of Commerce meet the regulatory definition of "well capitalized." As part of its asset and liability process, the Company continually assesses its capital position to take into consideration growth, expected earnings, risk profile and potential corporate activities that it may chose to pursue. As a part of this process, the Company determined in the second quarter of 2004 that its capital levels were higher than necessary. To adjust capital to levels consistent with its view of current market conditions, the Company commenced a stock repurchase plan in June 2004.

Critical Accounting Policies

General

HCC's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial information contained within our consolidated financial statements is, to a significant extent, based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. In certain instances, we use a discount factor and prepayment assumptions to determine the present value of assets and liabilities. A change in the discount factor or prepayment spreads could increase or decrease the values of those assets and liabilities which would result in either a beneficial or adverse impact to our financial results. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. The Company applies Accounting Principles Board ("APB") No. 25, "Accounting for Stock Issued to Employees" and related interpretations to account for its stock option plan awards. Other estimates that we use are related to the expected useful lives of our depreciable assets. In addition GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

Allowance for Probable Loan Losses

The allowance for probable loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting. (1) Statement of Financial Accounting Standards (SFAS) No. 5 "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and estimable and (2) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued based on the differences between that value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The Company's allowance for probable loan losses has three basic components: the formula allowance, the specific allowance and the unallocated allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. The formula allowance uses an historical loss view as an indicator of future losses and, as a result formula losses could differ from the loss incurred in the future. The specific allowance uses various techniques to arrive at an estimate of loss. Historical loss information and fair market value of collateral are used to estimate those losses. The use of these values is inherently subjective and our actual losses could differ from the estimates. The unallocated allowance captures losses that are attributable to various economic events, industry or geographic sectors whose impact on the portfolio have occurred but have yet to be recognized in either the formula or specific allowances. For further information regarding our allowance for credit losses, see Allowance for Probable Loan Losses on page 43.

Loan Sales and Servicing

The amounts of gains recorded on sales of loans and the initial recording of servicing assets and interest only strips is based on the estimated fair values of the respective components. In recording the initial value of the servicing assets and the fair value of the I/O strips receivable, the Company uses estimates which are made based on management's expectations of future prepayment and discount rates. In evaluating the servicing assets, management used discounted cash flow modeling techniques, which require estimates regarding the amount and times of future cash flows, including assumptions about loan repayment rates, costs to service, as well as interest rate assumptions that contemplate the risks involved. For the year ended December 31, 2004, management's estimate of constant prepayment rate ("CPR") was 14% and the weighted average discount rate assumption was 9%. These prepayment and discount rates were based on current market conditions and historical performance of the various pools. If actual prepayments with respect to sold loans occur more quickly than projected the carrying value of the servicing assets may have to be adjusted through a charge to earnings. A corresponding decrease in the value of the I/O strip receivable would also be expected.

Stock Based Compensation

Under APB No. 25, compensation cost for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of the grant over the amount required to be paid to the Company by the optionee upon exercising the option. Because the Company's stock option plan provides for the issuance of options at a price of no less than the fair market value at the date of the grant, no compensation cost is required to be recognized for the stock option plan on the date of grant. For further information see Note 1 to the Consolidated Financial Statements .

RESULTS OF OPERATIONS

OVERVIEW

In 2004, consolidated net income was $8,478,000, or $0.71 per diluted share, compared to $7,776,000, or $0.67 per diluted share in 2003, and $7,154,000, or $0.63 per diluted share, in 2002. The increase in 2004 from 2003 was primarily due to the increase in average earning assets and increases in key market interest rates in 2004. The increase in 2003 from 2002 was primarily due to the increase in the level of average earning assets, the continuing impact of the decreasing interest rate environment on interest bearing liabilities, and the change in mix of the deposit liabilities with a slight decrease in average interest bearing deposits and an increase in average noninterest bearing deposits. Also contributing to the increase in net income in 2003 was the growth in noninterest income that outpaced the growth in noninterest expenses.

Average interest earning assets increased 11% in 2004 from 2003 and increased 3% in 2003 from 2002. The increase in 2004 was primarily attributable to growth in average loans and investments. The average rate on interest earning assets decreased to 5.39% in 2004 from 5.47% in 2003, and 6.17% in 2002 reflective of the continuing low interest rate environment during the first half of 2004. Average interest bearing liabilities increased 9% in 2004 from 2003, with the increase primarily attributable to growth in interest bearing demand deposits, savings and money-market accounts and other borrowing offset by a decrease in time deposits and brokered deposits. Over the same period average noninterest bearing demand deposits increased 15%. Average interest bearing liabilities decreased 1% for 2003 from 2002. Average time and brokered deposits decreased 33% in 2003 from 2002 more than offsetting the 19% increase in interest bearing demand deposits and the 16% increase in average savings and money-market accounts. Over the same period average noninterest bearing demand deposits increased 13%. The Company's average rate paid on interest bearing liabilities decreased to 1.42% in 2004 from 1.61% in 2003 and 2.43% in 2002, reflective of the continuing low interest rate environment in 2004 and 2003. As a result, the net interest margin increased 6 basis points to 4.40% in 2004 from 4.34% in 2003. In 2003, the net interest margin decreased 5 basis points from 4.39% in 2002.

Net interest income increased $4,676,000, or 12%, for 2004 to $42,769,000 from $38,093,000 for 2003 primarily due to the increase in interest rates. Net interest income increased $574,000, or 2%, to $38,093,000 for 2003 from $37,519,000 for 2002 as the increase in average earning assets and the decrease in average interest bearing liabilities offset the effect of the decline in market interest rates.

Total noninterest income was $10,234,000 in 2004, compared to $10,429,000 in 2003 and $9,030,000 in 2002. Noninterest income in 2004 included $3,052,000 in gains on sales of SBA loans, an increase of $824,000, or 37%, from 2003, and $2,325,000 in servicing income, an increase of $506,000, or 28%, from 2003. Partially offsetting these increases in noninterst income was a decrease in mortgage brokerage fees of $844,000 resulting from the close of the Company's residential mortgage department in June 2004. The primary components of noninterest income in 2003 included $2,228,000 in gain on sales of SBA loans, $1,819,000 in servicing income, $1,810,000 in service charges and other fees, $1,151,000 in appreciation of Corporate Owned Life Insurance, $1,012,000 in brokered fees, and $735,000 in gain on sales of securities. The increase in other income from 2002 to 2003 was primarily due to an increase in rental income from electronic test equipment subject to operating leases of $1,092,000. The primary components of noninterest income in 2002 included $2,262,000 in gains on sales of SBA loans, $1,036,000 in gain on sales of securities, $1,113,000 in appreciation of Corporate Owned Life Insurance, $1,317,000 in servicing income, $1,085,000 in brokered fees, and $1,425,000 in service charges and other fees.

Total noninterest expense was $40,660,000 in 2004, an increase from $34,350,000 in 2003, and $33,248,000 in 2002. Salaries and employee benefits, the single largest component of operating expenses, were $18,754,000 in 2004, an increase from $17,975,000 in 2003, and $18,067,000 in 2002. The increase in noninterest expenses for 2004 was primarily due to a write down in the carrying value of electronic test equipment subject to operating leases of $2,200,000 and increases in retirement plan expense of $1,000,000 primarily related to the resignation of two executive officers, professional fees of $1,108,000 and data processing expense of $635,000 which included costs of outsourcing core data processing operations.

Total assets as of December 31, 2004 were $1,108,173,000, an increase of $102,191,000, or 10%, from $1,005,982,000 as of December 31, 2003. Total deposits as of December 31, 2004 were $918,535,000, an increase of $83,125,000, or 10%, from $835,410,000 as of December 31, 2003.

Total loans at December 31, 2004 were $725,530,000, an increase of $63,373,000, or 10%, compared to $662,157,000 for 2003. The Company's allowance for probable loan losses was $12,497,000, or 1.72%, of total loans for 2004, compared to $13,451,000, or 2.03%, of total loans for 2003.

Nonperforming assets include nonaccrual loans, loans past due 90 days or more and still accruing, restructured loans foreclosed assets and other real estate owned (OREO). Nonperforming assets for 2004 were $1,330,000, compared to $4,580,000 for 2003 and $4,571,000 for 2002.

The Company's shareholders' equity at December 31, 2004 was $98,579,000 compared with $89,485,000 as of December 31, 2003, a 10% increase, which reflects net earnings of $8,478,000 in 2004, the proceeds from exercise of stock options, the change in unallocated ESOP shares, and the effect of the unrealized losses on securities available-for-sale and on a projected benefit obligation. Book value per share increased 8% to $8.45 as of December 31, 2004, compared to $7.86 as of December 31, 2003 and $7.30 as of December 31, 2002. The Company's leverage capital ratio was 10.8% at December 31, 2004, compared to 11.2% at December 31, 2003 and 10.7% at December 31, 2002.

Return on average equity for 2004 was 9.04%, compared to 9.04% for 2003 and 9.15% for 2002. Return on average assets for 2004 was 0.80%, compared to 0.81% for 2003 and 0.77% for 2002.

NET INTEREST INCOME AND NET INTEREST MARGIN

Net interest income is the largest component of the Company's total revenue. Net interest income is the difference between the interest and fees earned on loans and investments and the interest paid on deposits and other liabilities. Net interest income depends on two factors: (1) the volume or balance of earning assets compared to the volume or balance of interest bearing deposits and liabilities, and (2) the interest rate earned on those interest earning assets compared with the interest rate paid on those interest bearing assets and liabilities. Net interest margin is net interest income expressed as a percentage of average earning assets. To maintain its net interest margin, the Company must manage the relationship between interest earned and paid.

The following table presents the average amounts outstanding for the major categories of the Company's balance sheet, the average interest rates earned or paid thereon, and the resulting net yield on average interest earning assets for the periods indicated. Average balances are based on daily averages.

	Year Ended December 31,								
	2004			2003			2002		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
ASSETS:									
Loans, gross(1)	$ 725,921	$ 45,325	6.24%	$ 681,174	$ 42,934	6.30%	$ 675,295	$ 46,609	6.90%
Investment securities(2)	216,012	6,715	3.11%	143,529	4,609	3.21%	111,428	5,076	4.56%
Interest bearing deposits in other institutions	1,336	14	1.05%	5,207	44	0.85%	6,758	88	1.30%
Federal funds sold	28,964	363	1.25%	48,604	509	1.05%	61,191	983	1.61%
Total interest earning assets	972,233	52,417	5.39%	878,514	48,096	5.47%	854,672	52,756	6.17%
Cash and due from banks	47,911			40,233			37,522		
Premises and equipment, net	3,728			4,846			5,596		
Other assets	41,923			36,894			31,739		
Total assets	$ 1,065,795			$ 960,487			$ 929,529		
LIABILITIES AND SHAREHOLDERS' EQ UITY:									
Deposits:									
Demand, interest bearing	$ 112,439	$ 536	0.48%	$ 96,772	$ 496	0.51%	$ 81,011	$ 719	0.89%
Savings and money-market	350,922	3,658	1.04%	318,774	3,705	1.16%	275,217	4,778	1.74%
Time deposits, under $100	38,717	575	1.49%	43,060	798	1.85%	56,097	1,762	3.14%
Time deposits, $100 and over	100,309	1,556	1.55%	101,406	1,812	1.79%	129,702	3,572	2.75%
Brokered deposits	11,460	473	4.13%	24,559	995	4.05%	65,183	2,522	3.87%
Other borrowings	66,842	2,850	4.26%	38,387	2,197	5.72%	20,784	1,884	9.06%
Total interest bearing liabilities	680,689	9,648	1.42%	622,958	10,003	1.61%	627,994	15,237	2.43%
Demand deposits, noninterest bearing	275,192			238,467			211,195		
Other liabilities	16,139			13,058			12,164		
Total liabilities	972,020			874,483			851,353		
Shareholders' equity	93,775			86,004			78,176		
Total liabilities and shareholders' equity	$ 1,065,795			$ 960,487			$ 929,529		
Net interest income / margin		$ 42,769	4.40%		$ 38,093	4.34%		$ 37,519	4.39%

(1) Yields and amounts earned on loans include loan fees of $4,057,000, $4,036,000, and $4,544,000 for the years ended December 31, 2004, 2003, and 2002. Nonaccrual loans of $1,028,000, $3,972,000, and $4,571,000 for the

years ended December 31, 2004, 2003, and 2002 are included in the average balance calculations above.

(2) Interest income is reflected on an actual basis, not a fully taxable equivalent basis and does not include a fair value adjustment.

Net interest income for 2004 increased 12% from 2003. Net interest income for 2003 increased 2% from 2002. The increase in 2004 was due to the increase in average earning assets and increases in key market interest rates in 2004. The increase in average interest earnings assets was primarily attributable to growth in average loans and investments. Average earning assets increased by $93,719,000 in 2004 from 2003. Average loans outstanding, including loans held for sale, increased $44,747,000 during 2004 over the average during 2003. Average securities in 2004 increased $72,483,000 from 2003. The change in the average loans outstanding in 2004 was primarily due to the increase in the commercial and real estate mortgage loan portfolios and real estate land and construction loan portfolio. The increase in net interest income in 2003 from 2002 was primarily due to an increase in the level of the average earning assets, partially affected by the continuing impact of the decreasing interest rate environment on interest bearing liabilities, and the change in mix of the deposit liabilities with a slight decrease in average interest bearing liabilities.

In 2004, changes in volume of earning assets contributed $3,780,000 to net interest income while the effect of the changes in rates contributed $896,000 resulting in the overall increase from 2003 of $4,676,000. The Company's average interest earning assets increased $93,719,000, or 11%, for 2004 to $972,233,000 from $878,514,000 for 2003. The yield on interest earning assets in 2004 was 5.39%, compared to 5.47% in 2003, and 6.17% in 2002. The Company's average interest bearing liabilities increased $57,731,000, or 9%, in 2004 to $680,689,000, compared to $622,958,000 for 2003. The rate paid on interest bearing liabilities in 2004 was 1.42%, compared to 1.61% in 2003, and 2.43% in 2002.

The following tables show the changes in interest income resulting from changes in the volume of interest earning assets and interest-bearing liabilities and changes in the average rates earned and paid. The total change is shown in the column designated "Net Change" and is allocated in the columns to the left, for the portions attributable to volume changes and rate changes that occurred during the period indicated. Changes due to both volume and rate have been allocated to the change in volume.

	2004 versus 2003 Increase (Decrease) Due to Change In:			2003 versus 2002 Increase (Decrease) Due to Change In:		
(Dollars in thousands)	Average Volume	Average Rate	Net Change	Average Volume	Average Rate	Net Change
INTEREST EARNING ASSETS:						
Loans, gross	$ 2,820	$ (429)	$ 2,391	$ 371	$ (4,046)	$ (3,675)
Investment securities	2,251	(145)	2,106	1,031	(1,498)	(467)
Interest bearing deposits in other institutions	(41)	11	(30)	(13)	(31)	(44)
Federal funds sold	(245)	99	(146)	(132)	(342)	(474)
Total interest earning assets	$ 4,785	$ (464)	$ 4,321	$ 1,257	$ (5,917)	$ (4,660)
INTEREST BEARING LIABILITIES:						
Demand, interest bearing	$ 71	$ (31)	$ 40	$ 81	$ (304)	$ (223)
Savings and money-market	343	(390)	(47)	506	(1,579)	(1,073)
Time deposits, under $100	(67)	(156)	(223)	(242)	(722)	(964)
Time deposits, $100 and over	(16)	(240)	(256)	(506)	(1,254)	(1,760)
Brokered deposits	(541)	19	(522)	(1,646)	119	(1,527)
Other borrowings	1,215	(562)	653	1,008	(695)	313
Total interest bearing liabilities	$ 1,005	$ (1,360)	$ (355)	$ (799)	$ (4,435)	$ (5,234)
Net interest income	$ 3,780	$ 896	$ 4,676	$ 2,056	$ (1,482)	$ 574

PROVISION FOR PROBABLE LOAN LOSSES

The provision for probable loan losses represents the current period expense associated with maintaining an appropriate allowance for credit losses. The loan loss provision and level of allowance for each period is dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in the Company's market area. Periodic fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for probable loan losses; however, actual loan losses may vary from current estimates.

For 2004, the provision for probable loan losses was $666,000, compared to $2,900,000 for 2003 and $2,663,000 for 2002. The allowance for probable loan losses represented 1.72%, 2.03%, and 1.96% of total loans at December 31, 2004, 2003, and 2002, respectively. See "Allowance for Probable Loan Losses" on page 43 for additional information.

NONINTEREST INCOME

The following table sets forth the various components of the Company's noninterest income:

	Years Ended December 31,			2004 versus 2003		2003 versus 2002	
(Dollars in thousands)	2004	2003	2002	Amount	Percent	Amount	Percent
Gain on sale of loans	$ 3,052	$ 2,228	$ 2,262	$ 824	37 %	$ (34)	(2)%
Servicing income	2,325	1,819	1,317	506	28 %	502	38 %
Service charges and other fees on deposit accounts	1,799	1,810	1,425	(11)	(1)%	385	27 %
Appreciation of company owned life insurance	1,031	1,151	1,113	(120)	(10)%	38	3 %
Equipment leasing	871	1,195	103	(324)	(27)%	1,092	1,060 %
Gain on sale of securities available-for-sale	476	735	1,036	(259)	(35)%	(301)	(29)%
Mortgage brokerage fees	168	1,012	1,085	(844)	(83)%	(73)	(7)%
Other	512	479	689	33	7 %	(210)	(30)%
Total	$ 10,234	$ 10,429	$ 9,030	$ (195)	(2)%	$ 1,399	15 %

Noninterest income for 2004 was $10,234,000, compared to $10,429,000 for 2003 and $9,030,000 for 2002. In 2004, gain on sale of Small Business Administration (SBA) loans increased 37%, and loan-servicing income increased 28%. The Company has an ongoing program of originating SBA loans and selling the government guaranteed portion in the secondary market, while retaining the servicing of the whole loans. The increased noninterest income from SBA lending in 2004 was offset by a decrease in mortgage brokerage fees resulting from the close of the Company’s residential mortgage department in June 2004, and declines in equipment leasing income. The decline in the appreciation of company owned life insurance was primarily the result of a lower interest rate environment in early 2004 compared to 2003. The decline in gain on sales of securities in 2004 was related to market conditions.

The increase in noninterest income in 2003 compared to the same period in 2002 was primarily due to increased servicing income, service charges and other fees, and rental income from electronic test equipment subject to operating leases. The overall increase in servicing income was primarily the result of expansion of the SBA lending operation and the overall increase in the level of loans serviced. The increase in service charges and other fees was primarily from an increase in demand deposit accounts resulting in customers paying additional fees for services.

The above increases were offset by the decrease in gain on sale of securities available-for-sale of $301,000 due to market conditions and the decrease on sale of the credit card portfolio of $172,000 sold in 2002.

NONINTEREST EXPENSES

The following table sets forth the various components of the Company's noninterest expenses:

	Years Ended December 31,			2004 versus 2003		2003 versus 2002	
(Dollars in thousands)	2004	2003	2002	Amount	Percent	Amount	Percent
Salaries and employee benefits	$ 18,754	$ 17,975	$ 18,067	$ 779	4 %	$ (92)	(1)%
Occupancy	3,670	3,541	3,207	129	4 %	334	10 %
Professional fees	2,656	1,548	1,563	1,108	72 %	(15)	(1)%
Operational Losses	2,219	(1)	88	2,220	222,000 %	(89)	(101)%
Retirement plan expense	1,741	741	897	1,000	135 %	(156)	(17)%
Loan origination costs	1,628	1,439	1,277	189	13 %	162	13 %
Advertising and promotion	1,090	747	737	343	46 %	10	1 %
Client services	1,044	1,018	1,100	26	3 %	(82)	(7)%
Amortization of leased equipment	1,016	985	83	31	3 %	902	1,087 %
Furniture and equipment	921	1,588	1,503	(667)	(42)%	85	6 %
Amortization of low income housing projects	878	398	341	480	121 %	57	17 %
Data processing expense	722	87	86	635	730 %	1	1 %
Other	4,321	4,284	4,299	37	1 %	(15)	0 %
Total	$ 40,660	$ 34,350	$ 33,248	$ 6,310	18 %	$ 1,102	3 %

The following table indicates the percentage of noninterest expenses in each category:

	2004		2003		2002	
(Dollars in thousands)	Amount	% of Total	Amount	% of Total	Amount	% of Total
Salaries and employee benefits	$ 18,754	46%	$ 17,975	52%	$ 18,067	54%
Occupancy	3,670	9%	3,541	10%	3,207	10%
Professional fees	2,656	7%	1,548	5%	1,563	5%
Operational Losses	2,219	5%	(1)	0%	88	0%
Retirement plan expense	1,741	4%	741	2%	897	3%
Loan origination costs	1,628	4%	1,439	4%	1,277	4%
Advertising and promotion	1,090	3%	747	2%	737	2%
Client services	1,044	3%	1,018	3%	1,100	3%
Amortization of leased equipment	1,016	2%	985	3%	83	0%
Furniture and equipment	921	2%	1,588	5%	1,503	5%
Amortization of low income housing projects	878	2%	398	1%	341	1%
Data processing expense	722	2%	87	0%	86	0%
Other	4,321	11%	4,284	13%	4,299	13%
Total	$ 40,660	100%	$ 34,350	100%	$ 33,248	100%

Noninterest expenses for 2004 increased $6,310,000, or 18%, from 2003. In 2003 noninterest expense increased $1,102,000, or 3%, from 2002. The efficiency ratio was 76.71% for 2004, compared to 70.79% and 71.34%, respectively, for 2003 and 2002.

Salaries and employee benefits, the single largest component of noninterest expenses increased $779,000 in 2004 from 2003. In 2003, salaries and employee benefits decreased $92,000 from 2002. The increase in 2004 was primarily related to severance payments of $1,283,000 incurred as the result of the elimination of certain full time positions and $521,000 associated with the resignation of the former CEO, partially offset by a decrease of $428,000 in loan officer commissions related to closure of the residential mortgage brokerage department. Salaries and employee benefit, as a percentage of total noninterest expenses decreased to 46% in 2004 from 52% in 2003 and 54% in 2002, respectively. Salaries and employee benefits in 2005 will reflect the addition of a new Chief Executive Officer hired in March 2005.

Occupancy increased by $129,000, or 4%, for 2004 compared to 2003. Occupancy costs increased 10% in 2003 from 2002. The increase in 2004 from 2003 was primarily attributable to increased rental costs related to the opening of a new branch office in Los Gatos in December 2003, depreciation on leasehold improvements and write-offs associated with the outsourcing of the data processing function. Occupancy cost as a percentage of total noninterest expenses decreased to 9% for 2004 from 10% for 2003 and 2002.

Professional fees increased $1,108,000, or 72%, in 2004, compared to 2003. Professional fees decreased 1% in 2003 from 2002. The increase in 2004 from 2003 was primarily due to increased audit and consulting expenses related to compliance with Sarbanes-Oxley, legal expenses related to the proxy solicitation for the 2004 annual meeting and other corporate governance matters. Professional fees as a percentage of total noninterest expenses increased to 7% for 2004 from 5% for 2003 and 2002.

Operational losses increased $2,220,000 in 2004, compared to 2003. Operational losses decreased $89,000 in 2003 from 2002. The increase in 2004 from 2003 was primarily due to the write-off of electronic test equipment subject to operating leases.

Retirement plan expense increased $1,000,000, or 135%, for 2004, compared to 2003. Retirement plan expense decreased 17% in 2003 from 2002. The increase in 2004 from 2003 was primarily due to the elimination of certain full time positions and the resignation of the former CEO. Retirement plan expense as a percentage of total noninterest expenses increased to 4% for 2004 from 2% in 2003 and 3% in 2002.

Loan origination costs increased $189,000, or 13%, for 2004, compared to 2003. Loan origination costs increased 13% from 2002. The increase in 2004 from 2003 was primarily due to continued growth in the loan portfolio. Loan origination costs as a percentage of total noninterest expenses remained fairly constant for 2004, 2003 and 2002.

Advertising and promotion costs increased $343,000, or 46%, for 2004, compared to 2003. Advertising and promotion increased 1% from 2002. The increase in 2004 from 2003 was primarily due to several new promotions and sponsorships in 2004 as well as expenses associated with the consolidation of the Company's operations under the common brand Heritage Bank of Commerce during 2004. Prior to the third quarter of 2004, the Company had operated under 4 different trade names; Heritage Bank of Commerce, Heritage Bank East Bay, Heritage Bank South Valley, and Bank of Los Altos. Advertising and promotion as a percentage of total expenses increased to 3% for 2004 from 2% for 2003 and 2002.

Furniture and equipment decreased $667,000, or 42%, for 2004, compared to 2003. Furniture and equipment increased 6% from 2002 to 2003. The decrease in 2004 from 2003 was primarily due to the decrease in the level of purchase of small equipment, fewer equipment repairs, and lower depreciation on furniture and equipment in 2004. Furniture and equipment as a percentage of total noninterest expenses decrease to 2% for 2004 from 5% for 2003 and 2002.

Data processing expense increased $635,000, or 730%, for 2004, compared to 2003 and 2002. The increase in 2004 from 2003 was primarily due to outsourcing of the core data and item processing functions in the first quarter of 2004. As a result of the outsourcing arrangement, contracted data processing costs are shown as data processing expenses in 2004. When the data processing function was internal, prior to the first quarter of 2004, staffing and depreciation costs, the two major expenses associated with this function, were included in salaries and employee benefits and furniture and equipment expense, respectively. The Company estimates that the outsourcing of core data and item processing has reduced costs by an approximately $50,000 pre-tax per quarter, beginning with the second quarter of 2004.

Other noninterest expenses increased $37,000, or 1%, for 2004, compared to 2003. Other noninterest expenses in remained fairly constant for 2003 and 2002. Other noninterest expenses as a percentage of total noninterest expenses decreased to 11% for 2004 from 13% for 2003 and 2002.

PROVISION FOR INCOME TAXES

The Company files consolidated federal and combined state income tax returns. Amounts provided for income tax expense are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable under tax laws.

The provision for income taxes was $3,199,000 for 2004 and $3,496,000 for 2003 and $3,484,000 for 2002. The Company's effective tax rates were 27.4%, 31.0%, and 32.8% for 2004, 2003, and 2002, respectively. The difference in the effective tax rate compared to the statutory tax rate of 42% is primarily the result of the Company's investment in life insurance policies whose earnings are not subject to taxes, tax credits related to investments in low income housing, jobs creation in an enterprise zone, and investments in tax-free municipal securities.

FINANCIAL CONDITION

As of December 31, 2004, total assets were $1,108,173,000, an increase of 10% from $1,005,982,000 for 2003. Total securities available-for-sale was $232,809,000, an increase of 52% from $153,473,000 for 2003. The total loan portfolio was $725,530,000, an increase of 10% from $662,157,000 for 2003. Total deposits were $918,535,000, an increase of 10% from $835,410,000 for 2003. Other borrowings increased $4,200,000, or 10%, to $47,800,000 for 2004, from $43,600,000 for 2003.

SECURITIES PORTFOLIO

A major component of the Company's earning asset base is its securities portfolio. The following table sets forth the carrying value of investment securities at the dates indicated:

	Years Ended December 31,		
(Dollars in thousands)	2004	2003	2002
Securities available-for-sale (at fair value)			
U.S. Treasury	$ 5,942	$ 7,015	$ 4,740
U.S. Government Agencies	90,308	36,115	48,029
Municipals - Tax Exempt	9,206	15,704	12,134
Mortgage-Backed Securities	107,735	79,615	44,774
CMOs	19,618	15,024	14,134
Corporate Bonds	--	--	2,632
Total securities available-for-sale	$ 232,809	$ 153,473	$ 126,443

The following table summarizes the amounts and distribution of the Company's investment securities and the weighted average yields as of December 31, 2004:

	Within One Year		After One Year and Within Five Years		After Five Years and Within Ten Years		After Ten Years		Total	
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale:										
U.S. Treasury	$ 4,956	1.67 %	$ 986	1.64 %	$ --	-- %	$ --	-- %	$ 5,942	1.67 %
U.S. Government Agencies	19,961	2.09 %	70,347	2.37 %	--	-- %	--	-- %	90,308	2.31 %
Municipals - tax exempt	709	4.61 %	8,497	2.24 %	--	-- %	--	-- %	9,206	2.42 %
Mortgage-Backed Securities	--	-- %	212	5.05 %	11,400	3.88 %	96,123	4.04 %	107,735	4.03 %
CMOs	--	-- %	--	-- %	--	-- %	19,618	3.03 %	19,618	3.03 %
Total available-for-sale	$ 25,626	2.06 %	$ 80,042	2.35 %	$ 11,400	3.88 %	$ 115,741	3.87 %	$ 232,809	3.15 %

Note: Yields on tax exempt municipal securities are not presented on a fully tax equivalent basis.

Securities that are classified as available of sale are carried at their fair value. This means that the carrying amount of same securities will increase or decrease based on changes in interest rates and very rarely to changes in their credit quality. In 2002, the Company recognized that the flexibility to sell any of its securities prior to maturity in order to manage interest rate risk or to provide liquidity was more desirable than the avoidance of the balance sheet volatility and consequently reclassified all of its securities as available for sale. The amortized cost of the transferred securities was $12,778,000 and the related unrealized holding gain was $841,000.

As of December 31, 2004, the only securities held by the Company where the aggregate book value of the Company's investment in securities of a single issuer exceeded 10% of the Company's shareholders' equity were direct obligations of the U.S. government or U.S. government agencies.

The securities portfolio of the Company is also used as collateral to meet requirements imposed as a condition of deposit by some depositors and other contractual obligations, such as political subdivisions (public funds) or of other funds such as bankruptcy trustee deposits. Securities with amortized cost of $85,883,000 and $49,474,000 as of December 31, 2004 and 2003 were pledged to secure public and certain other deposits as required by law or contract. A portion of these deposits can only be secured by U.S. treasury. The Company has not used interest rate swaps or other derivative instruments to hedge fixed rate loans or to otherwise mitigate interest rate risk.

LOANS

Total loans (exclusive of loans held for sale) were $725,530,000 at December 31, 2004, an increase of 10% from $662,157,000 at December 31, 2003, and an increase of 8% from $673,907,000 at December 31, 2002. The Company's allowance for loan losses was $12,497,000, or 1.72% of total loans, for 2004, as compared to $13,451,000, or 2.02% of total loans, for 2003, and $13,227,000, or 1.96% of total loans, for 2002. As of December 31, 2004, 2003, and 2002, the Company had $1,330,000, $4,580,000, and $4,571,000, respectively, in nonperforming assets.

The loan portfolio is primarily composed of commercial loans to companies principally engaged in manufacturing, wholesale and service businesses and real estate lending, with the balance in direct finance leases and consumer loans.

The following table presents the Company's loans outstanding at year-end by loan type:

	December 31,									
(Dollars in thousands)	2004	% of Total	2003	% of Total	2002	% of Total	2001	% of Total	2000	% of Total
Commercial........................	$ 300,452	41%	$ 281,561	43%	$ 263,144	39%	$ 208,713	33%	$ 200,846	33%
Real estate - mortgage........	303,154	42%	276,908	42%	259,974	38%	246,119	39%	230,468	38%
Real estate - land and construction......................	118,290	16%	101,082	15%	147,822	22%	174,077	27%	171,325	28%
Consumer...........................	2,908	1%	1,743	0%	2,850	1%	3,833	1%	8,172	1%
Total loans.........................	724,804	100%	661,294	100%	673,790	100%	632,742	100%	610,811	100%
Deferred loan costs (fees)...	726		863		117		175		(30)	
Allowance for loan losses....	(12,497)		(13,451)		(13,227)		(11,154)		(9,651)	
Loans, net..........................	$ 713,033		$ 648,706		$ 660,680		$ 621,763		$ 601,130	

The change in the Company's loan portfolio is primarily due to the increase in the commercial and real estate mortgage loan portfolios and real estate land and construction loan portfolio. The increase in the commercial loans, commercial real estate mortgages and land and construction loans is due to the Company's continued expansion and focus on originating these types of loans.

The Company's commercial loans are made for working capital, financing the purchase of equipment or for other business purposes. Such loans include loans with maturities ranging from thirty days to one year and "term loans," with maturities normally ranging from one to five years. Short-term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest.

The Company is an active participant in the Small Business Administration (SBA) and California guaranteed lending programs, and has been approved by the SBA as a lender under the Preferred Lender Program. The Company regularly makes SBA-guaranteed loans and considers such loans to be investment loans; however, the guaranteed portion of these loans may be sold in the secondary market depending on market conditions and, once it is determined they will be sold, are classified as held for sale and carried at the lower of cost or market. In the event of the sale of the guaranteed portion of an SBA loan, the Company retains the servicing rights for the sold portion. As of December 31, 2004, 2003, and 2002, $146.1 million, $117.8 million and $83.0 million, respectively, in SBA loans were serviced by the Company for others.

As of December 31, 2004, real estate mortgage loans consists of adjustable and fixed rate loans secured by commercial property of $248,736,000, loans secured by first mortgages on 1-4 family residential properties of $2,249,000, and home equity lines of credit secured by junior deeds of trust on 1-4 family residential properties of $52,170,000. Properties securing the real estate mortgage loans are primarily located in the Company’s trade area. 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. Real estate values in portions of Santa Clara County and neighboring San Mateo County are among the highest in the country at present. 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' abilities to repay their loans.

The Company's real estate term loans consist primarily of loans made based on the borrower's cash flow and are secured by deeds of trust on commercial and residential property to provide a secondary source of repayment. It is the Company's policy to restrict real estate term loans to no more than 80% of the lower of the property's appraised value or the purchase price of the property, depending on the type of property and its utilization. The Company offers both fixed and floating rate loans. Maturities on such loans are generally restricted to between five and ten years (on an amortization ranging from fifteen to twenty-five years with a balloon payment due at maturity); however, SBA and certain other real estate loans easily sold in the secondary market may be granted for longer maturities.

The Company's real estate land and construction loans are primarily interim loans made by the Company to finance the construction of commercial and single family residential properties. These loans are typically short term. The Company utilizes underwriting guidelines to assess the likelihood of repayment from sources such as sale of the property or permanent mortgage financing prior to making the construction loan.

The Company makes consumer loans for the purpose of financing automobiles, various types of consumer goods, and other personal purposes. Additionally, the Company makes equity lines of credit and equity loans available to its clientele. Consumer loans generally provide for the monthly payment of principal and interest. Most of the Company's consumer loans are secured by the personal property being purchased, or, in the instances of equity loans or lines, real property.

With certain exceptions, state chartered banks are permitted to make extensions of its credit to any one borrowing entity up to 15% of the banks’ capital and reserves for unsecured loans and up to 25% of the banks’ capital and reserves for secured loans. For HBC these lending limits were $19.0 million and $31.7 million at December 31, 2004.

The Company does not have any concentrations by industry or group of industries in its loan portfolio, however, 59% and 58% of its net loans were secured by real property as of December 31, 2004 and 2003. 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.

The following table presents the maturity distribution of the Company's loans as of December 31, 2004. The table shows the distribution of such loans between those loans with predetermined (fixed) interest rates and those with variable (floating) interest rates. Floating rates generally fluctuate with changes in the prime rate as reflected in the western edition of The Wall Street Journal. As of December 31, 2004, approximately 84% of the Company's loan portfolio consisted of floating interest rate loans.

(Dollars in thousands)	Due in One Year or Less	Over One Year But Less Than Five Years	Over Five Years	Total
Commercial	$ 282,355	$ 11,412	$ 6,685	$ 300,452
Real estate - mortgage	197,020	58,282	47,852	303,154
Real estate - land and construction	118,241	49	--	118,290
Consumer	2,703	205	--	2,908
Total loans	$ 600,319	$ 69,948	$ 54,537	$ 724,804
Loans with variable interest rates	$ 582,330	$ 25,284	$ 17	$ 607,631
Loans with fixed interest rates	17,989	44,664	54,520	117,173
Total loans	$ 600,319	$ 69,948	$ 54,537	$ 724,804

In the normal course of business, HBC is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk, in excess of the amounts recognized in the balance sheet.

HBC uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Credit risk is the possibility that a loss may occur because a party to a transaction failed to perform according to the terms of the contract. HBC controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures. The Company established an allowance for credit losses on off-balance sheet exposures of $281,000 as of December 31, 2004. Management does not anticipate any significant losses as a result of these transactions.

Commitments to extend credit as of December 31, were as follows:

(Dollars in thousands)	2004	2003
Commitments to extend credit	$ 313,036	$ 269,504
Standby letters of credit	5,256	4,449
	$ 318,292	$ 273,953

Commitments to extend credit are agreements to lend to a client as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. HBC evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by HBC upon extension of credit, is based on management's evaluation of the borrower. Collateral held varies but may include cash, marketable securities, accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and/or residential properties.

Standby letters of credit are written conditional commitments issued by HBC to guaranty the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients.

NONPERFORMING ASSETS

Nonperforming assets consist of nonaccrual loans, loans past due 90 days and still accruing, troubled debt restructurings and other real estate owned. Management generally places loans on nonaccrual status when they become 90 days past due, unless they are well secured and in the process of collection. When a loan is placed on nonaccrual status, the accrual of interest is discontinued, and any accrued and unpaid interest is reversed, and the amortization of the deferred loan fees and costs is discontinued. Any interest or principal payments received on the nonaccrual loans are applied to principal. Loans are charged off when management determines that collection has become unlikely. Restructured loans are those where HBC has granted a concession on the interest paid or original repayment terms due to financial difficulties of the borrower. Other real estate owned ("OREO") consists of real property acquired through foreclosure on the related underlying defaulted loans. The following table shows nonperforming assets at the dates indicated:

	December 31,				
(Dollars in thousands)	**2004**	**2003**	**2002**	**2001**	**2000**
Nonaccrual loans	$ 1,028	$ 3,972	$ 4,571	$ --	$ --
Loans 90 days past due and still accruing	302	608	--	--	--
Restructured loans	--	--	--	--	--
Total nonperforming loans	1,330	4,580	4,571	--	--
Other real estate owned	--	--	--	--	--
Total nonperforming assets	$ 1,330	$ 4,580	$ 4,571	$ --	$ --
Nonperforming assets as a percentage of period end loans plus foreclosed assets	0.18%	0.69%	0.68%	--	--

As of December 31, 2004, the Company had $1,028,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $250,000 as of December 31, 2004. The Company had $302,000 in loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2004. As of December 31, 2003, the Company had $3,972,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $464,000 as of December 31, 2003. The Company had $608,000 in loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2003. As of December 31, 2002, the Company had $4,571,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $356,000 as of December 31, 2002. The Company had no loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2002.

ALLOWANCE FOR PROBABLE LOAN LOSSES

The Company assigns to all of its loans a risk grade consistent with the system recommended by regulatory agencies. Grades range from "Pass" to "Loss" depending on credit quality, with "Pass" representing loans that involve an acceptable degree of risk. Management conducts a critical evaluation of the loan portfolio monthly. This evaluation includes periodic loan by loan review for certain loans to evaluate the level of impairment as well as detailed reviews of other loans (either individually or in pools) based on an assessment of the following factors: past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, collateral value, loan volumes and concentrations, size and complexity of the loans, recent loss experience in particular segments of the portfolio, bank regulatory examination results, and current economic conditions in the Company's marketplace, in particular the state of the technology industry and the real estate market.

This process attempts to assess the risk of loss inherent in the portfolio by segregating loans into four components for purposes of determining an appropriate level of the allowance: "watch," "special mention," "substandard" and "doubtful." Additionally, the Company maintains a program for regularly scheduled reviews of certain new and renewed loans by an outside loan review consultant. Any loans identified during an external review process that expose the Company to increased risk are appropriately downgraded and an increase in the allowance for loan losses is established for such loans. Further, the Company is examined periodically by the FDIC, FRB, and the Department, at which time a further review of loan quality is conducted.

Loans that demonstrate a weakness, for which there is a possibility of loss if the weakness is not corrected, are categorized as "classified." Classified loans include all loans considered as substandard, doubtful, and loss and may result from problems specific to a borrower's business or from economic downturns that affect the borrower's ability to repay or that cause a decline in the value of the underlying collateral (particularly real estate).

At December 31, 2004, the principal balance of classified loans, which include all loans internally graded as substandard, doubtful, and loss, was $35,646,000. These loans constituted 5% of total loans and 32% of capital and reserves at that date. As of December 31, 2003, the principal balance of classified loans was $48,257,000. These loans constituted 7% of total loans and 47% of capital and reserves as of that date. As of December 31, 2002, the principal balance of classified loans was $27,915,000. These loans constituted 4% of total loans and 29% of capital and reserves as of that date. During the first quarter of 2004, the Company identified a $4,000,000 unsecured commercial line of credit with risks identified that create doubt about the full repayment under the original terms of the agreement. The loan was placed on nonaccrual a specific reserve was established. Subsequent to placement on nonaccrual, the Company was advised that the borrower had filed for bankruptcy protection and $2,000,000 was charged-off in the first quarter of 2004. The Company continued to negotiate with the borrower within the framework of the bankruptcy and the remaining $2,000,000 of the loan was paid during the second quarter of 2004. An additional $250,000 of the $2,000,000 loss was recovered in the fourth quarter of 2004. Other than this loan and the loans already classified at December 31, 2004, the Company has not identified any potential problem loans. The decrease in the allowance related to the charged-offs in 2004.

It is the policy of management to maintain the allowance for probable loan losses at a level adequate for risks inherent in the loan portfolio. Based on information currently available to analyze loan loss delinquency and a history of actual charge-offs, management believes that the loan loss allowance is adequate. However, the loan portfolio can be adversely affected if California economic conditions and the real estate market in the Company's market area were to weaken. Also any weakness of a prolonged nature in the technology industry would have a negative impact on the local market. The effect of such events although uncertain at this time, could result in an increase in the level of nonperforming loans and increased loan losses, which could adversely affect the Company's future growth and profitability. No assurance of the ultimate level of credit losses can be given with any certainty. Loans are charged against the allowance when management believes that the collectibility of the principal is unlikely. See "Provision for probable loan losses" on page 35.

The following table summarizes the Company's loan loss experience as well as provisions and charges to the allowance for loan losses and certain pertinent ratios for the periods indicated:

(Dollars in thousands)	2004	2003	2002	2001	2000
Balance, beginning of period	$ 13,451	$ 13,227	$ 11,154	$ 9,651	$ 6,511
Charge-offs:					
Commercial	(2,901)	(2,906)	(936)	(708)	(52)
Real estate - mortgage	--	--	--	--	--
Real estate - land and construction	--	--	--	--	--
Direct financing lease	--	--	--	--	--
Consumer	--	--	--	(1)	--
Total charge-offs	(2,901)	(2,906)	(936)	(709)	(52)
Recoveries:					
Commercial	1,562	230	346	301	33
Real estate - mortgage	--	--	--	--	--
Real estate - land and construction	--	--	--	--	--
Real estate - land and construction	--	--	--	--	--
Direct financing lease	--	--	--	--	--
Consumer	--	--	--	1	--
Total recoveries	1,562	230	346	302	33
Net charge-offs	(1,339)	(2,676)	(590)	(407)	(19)
Provision for loan losses	666	2,900	2,663	1,910	3,159
Reclassification to other liabilities	(281) (1)	--	--	--	--
Balance, end of period	$ 12,497	$ 13,451	$ 13,227	$ 11,154	$ 9,651
RATIOS:					
Net charge-offs to average loans outstanding	0.19 %	0.41 %	0.09 %	0.07 %	-- %
Allowance for loan losses to average loans	1.80 %	2.07 %	2.07 %	1.84 %	1.80 %
Allowance for loan losses to total loans at end of period	1.72 %	2.03 %	1.96 %	1.76 %	1.58 %
Allowance for loan losses to nonperforming loans	940 %	294 %	289 %	-- %	-- %

(1) The Company reclassified the allowance for probable loan losses on unused commitments of $281,000 to other liabilities as of December 31, 2004.

Charge-offs reflect the realization of losses in the portfolio that were recognized previously though provisions for loan losses. The net charge-offs in 2004 were $1,339,000, compared to $2,676,000 in 2003, $590,000 in 2002, $407,000 in 2001, and $19,000 in 2000. The decrease in net charge-offs in 2004 was primarily due to a $1.56 million in the recovery of commercial loans which had been previously charge-off.

The increase in net charge-offs in 2003 was primarily a result of a $2,000,000 write-off taken in third quarter of 2003 related to a single commercial loan. Historical net charge-offs are not necessarily indicative of the amount of net charge-offs that the Company will realize in the future.

The following table summarizes the allocation of the allowance for loan losses (ALL) by loan type and the allocation as a percent of loans outstanding in each loan category at the dates indicated:

	December 31,									
	2004		2003		2002		2001		2000	
(Dollars in thousands)	Allowance	Percent of ALL in each category to total loans	Allowance	Percent of ALL in each category to total loans	Allowance	Percent of ALL in each category to total loans	Allowance	Percent of ALL in each category to total loans	Allowance	Percent of ALL in each category to total loans
Commercial	$ 8,691	2.89 %	$ 9,667	3.42 %	$ 6,349	2.41 %	$ 5,489	2.63 %	$ 4,244	2.11 %
Real estate - mortgage	1,671	0.55 %	2,003	0.72 %	2,411	0.93 %	1,420	0.58 %	1,509	0.65 %
Real estate - land and construction	1,711	1.45 %	1,714	1.70 %	3,574	2.42 %	3,066	1.76 %	2,084	1.22 %
Consumer	38	1.31 %	37	2.12 %	47	1.63 %	102	2.66 %	158	1.93 %
Unallocated	386	-- %	30	-- %	846	-- %	1,077	-- %	1,656	-- %
Total	$ 12,497	1.72 %	$ 13,451	2.03 %	$ 13,227	1.96 %	$ 11,154	1.76 %	$ 9,651	1.58 %

Loans are charged against the allowance when management believes that the collectibility of the principal is doubtful. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include specific allowances, the formula allowance and the unallocated allowance.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss may be incurred in excess of the amount determined by the application of the formula allowance. As of December 31, 2004, 2003 and 2002, nonperforming loans had a related specific valuation allowance of $270,000, 474,000 and $356,000, respectively.

The formula allowance is calculated by applying loss factors to outstanding loans. Loss factors are based on management's experience and may be adjusted for significant factors that, in management's judgment, may affect the collectibility of the portfolio as of the evaluation date. Due to the Company's limited historical loss experience, management also considers peer bank loan loss experience to determine the loss factor for each loan category. The formula allowance on December 31, 2004 was $11,841,000, compared to $12,947,000 on December 31, 2003.

The unallocated allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. As of December 31, 2004, the Company's unallocated allowance was $386,000, compared to $30,000 on December 31, 2003. In evaluating the appropriateness of the unallocated allowance, management considered the following factors:

- Bank's Lending Policies and Procedures – Changes in lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.

- Economic Conditions – Changes in national and local economic and business conditions, trends, and developments, including the condition of various market segments.

- Changes in the Bank's Lending Management and Staff – Changes in the experience, ability and depth of lending management and other relevant staff.

- Changes in Trend and Volume of Past Due and Classified Loans – Changes in the trend of the volume and severity of past due and classified loans; and trends in the volume of nonaccrual loans, troubled debt restructurings and other loan modifications.

- Quality of the Bank's Loan Review System – Changes in the quality of the Bank's loan review system and the degree of oversight by the Bank's Board of Directors.

- Credit Concentrations – The existence and effect of any concentrations of credit and changes in the level of such concentrations.

There can be no assurance that the adverse impact of any of these conditions on the Bank will not be in excess of the current level of unallocated reserves. The current business, economic, and real estate markets along with the seasoning of the portfolio and the nature and duration of the current business cycle will affect the amount of unallocated reserve.

In an effort to improve its analysis of risk factors associated with its loan portfolio, the Company continues to monitor and to make appropriate changes to its internal loan policies. These efforts better enable the Company to assess risk factors prior to granting new loans and to assess the sufficiency of the allowance for loan losses.

Management believes that it has adequately provided an allowance for estimated probable losses in the credit portfolio. Significant deterioration in Northern California real property values or economic downturns could impact future operating results, liquidity or capital resources and require additional provisions to the allowance or cause losses in excess of the allowance.

DEPOSITS

Total deposits were $918,535,000 at December 31, 2004, an increase of $83,125,000, or 10%, compared to $835,410,000 at December 31, 2003. Demand, savings, and money market deposits increased $66,090,000, or 10%, to $755,659,000 at December 31, 2004 from $689,569,000 at December 31, 2003. During 2004, time deposits increased $17,035,000, or 12%, from $145,841,000 in 2003 to $162,876,000. The overall change in the deposit portfolio had a positive impact on the net interest margin as the average cost of interest bearing liabilities was reduced.

The following table summarizes the distribution of average deposits and the average rates paid for the periods indicated:

	Years ended December 31,					
	2004		2003		2002	
(Dollars in thousands)	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
Demand, noninterest bearing	$ 275,192	-- %	$ 238,467	-- %	$ 211,195	-- %
Demand, interest bearing	112,439	0.48 %	96,772	0.51 %	81,011	0.89 %
Savings and money market	350,922	1.04 %	318,774	1.16 %	275,217	1.74 %
Time deposits, under $100	38,717	1.49 %	43,060	1.85 %	56,097	3.14 %
Time deposits, $100 and over	100,309	1.55 %	101,406	1.79 %	129,702	2.75 %
Time deposits, brokered deposits	11,460	4.13 %	24,559	4.05 %	65,183	3.87 %
Total average deposits	$ 889,039	0.76 %	$ 823,038	0.95 %	$ 818,405	1.63 %

As of December 31, 2004, the Company had a deposit mix of 39% in savings and money market accounts, 18% in time deposits, 13% in interest bearing demand accounts, and 30% in noninterest bearing demand deposits. On December 31, 2004, approximately $6,568,000, or less than 1%, of deposits were from public sources, and approximately $70,743,000, or 8%, of deposits were from title and escrow companies. As of December 31, 2003, the Company had a deposit mix of 41% in savings and money market accounts, 17% in time deposits, 13% in interest bearing demand accounts, and 29% in noninterest bearing demand deposits. On December 31, 2003, approximately $5,006,000, or less than 1%, of deposits were from public sources, and approximately $69,640,000, or 8%, of deposits were from title and escrow companies.

The Company obtains deposits from a cross-section of the communities it serves. The Company's business is not seasonal in nature. The Company had brokered deposits totaling approximately $19,862,000 and $11,970,000 at December 31, 2004 and 2003, respectively. These brokered deposits generally mature within one to three years. The Company is not dependent upon funds from sources outside the United States.

The following table indicates the maturity schedule of the Company's time deposits of $100,000 or more as of December 31, 2004:

(Dollars in thousands)	Balance	% of Total
Three months or less	$ 46,082	37 %
Over three months through six months	19,017	15 %
Over six months through twelve months	32,192	26 %
Over twelve months	27,290	22 %
Total	$ 124,581	100 %

The Company focuses primarily on providing and servicing business deposit accounts that are frequently over $100,000 in average balance per account. As a result certain types of business clients whom the Company caters to and serves typically carry average deposits in excess of $100,000. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Company to ensure its ability to fund deposit withdrawals.

OFF-BALANCE SHEET ARRANGEMENTS AND AGGREGATE CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The contractual obligations of the Company, summarized by type of obligation and contractual maturity, at December 31, 2004, are as follows:

(Dollars in thousands)	Less Than One Year	One to Three Years	Four to Five Years	After Five Years	Total
Long-term borrowings	$ 15,100	$ 21,800	$ 10,900	$ –	$ 47,800
Notes payable to subsidiary grantor trusts	–	–	–	23,702	23,702
Operating leases	2,186	4,211	3,064	910	10,371
Time deposits	130,080	24,881	7,915	–	162,876
Total debt and operating leases	$ 147,366	$ 50,892	$ 21,879	$ 24,612	$ 244,749

In addition to those obligations listed above, in the normal course of business, the Company will make cash distributions for the payment of interest on interest bearing deposit accounts and debt obligations, payments for quarterly tax estimates and contributions to certain employee benefit plans.

The following table presents the Company's commitments to fund as of December 31, 2004 and 2003.

(Dollars in thousands)	2004	2003
Commitments to extend credit	$ 313,036	$ 269,504
Standby letters of credit	5,256	4,449
	$ 318,292	$ 273,953

LIQUIDITY AND ASSET/LIABILITY MANAGEMENT

To meet liquidity needs, the Company maintains a portion of its funds in cash deposits in other banks, in Federal funds sold and in investment securities. As of December 31, 2004, the Company's primary liquidity ratio was 16.35%, comprised of $105,700,000 in investment securities available-for-sale of maturities (or probable calls) of up to five years, less $15,800,000 of securities that were pledged to secure public and certain other deposits as required by law and contract, Federal funds sold of $24,100,000, and $33,600,000 in cash and due from banks, as a percentage of total unsecured deposits of $902,735,000. As of December 31, 2003, the Company's primary liquidity ratio was 18.51%, comprised of $53,200,000 in investment securities available-for-sale of maturities (or probable calls) of up to five years, less $15,900,000 million securities that were pledged to secure public and certain other deposits as required by law and contract, Federal funds sold of $72,200,000, and $42,000,000 in cash and due from banks, as a percentage of total unsecured deposits of $819,510,000. As of December 31, 2002, the Company's primary liquidity ratio was 16.47%, comprised of $64,600,000 in investment securities available-for-sale of maturities (or probable calls) of up to five years, less $15,000,000 of securities that were pledged to secure public and certain other deposits as required by law and contract, Federal funds sold of $44,000,000, and $42,600,000 in cash and due from banks, as a percentage of total unsecured deposits of $827,000,000.

The following table summarizes the Company's borrowings under its Federal funds purchased, security repurchase arrangements and lines of credit for the periods indicated:

(Dollars in thousands)	2004	2003
Average balance during the year	$ 43,109	$ 15,387
Average interest rate during the year	2.07%	1.71%
Maximum month-end balance during the year	$ 48,600	$ 43,600
Average rate at December 31	2.21%	1.68%

The Company has Federal funds purchase lines and lines of credit of totaling $56,000,000 from correspondent banks. As of December 31, 2004, the Company had borrowing capacity of approximately $105,000,000 under a borrowing line with the Federal Home Loan Bank secured by certain loans and investment securities.

CAPITAL RESOURCES

The following table summarizes risk-based capital, risk-weighted assets, and risk-based capital ratios of the Company:

	December 31,			
(Dollars in thousands)	2004	2003	2002	
Capital components:				
Tier 1 Capital	$ 121,096	$ 110,891	$ 101,966	
Tier 2 Capital	11,623	10,403	10,563	
Total risk-based capital	$ 132,719	$ 121,294	$ 112,529	
Risk-weighted assets	$ 929,241	$ 830,537	$ 842,399	
Quarterly average assets	$ 1,112,526	$ 992,608	$ 950,091	
				MINIMUM REGULATORY REQUIREMENTS
Capital ratios:				
Total risk-based capital	14.3%	14.6%	13.4%	8.0%
Tier 1 risk-based capital	13.0%	13.4%	12.1%	4.0%
Leverage ratio(1)	10.9%	11.2%	10.7%	4.0%

(1) Tier 1 capital divided by average assets (excluding goodwill).

The table above presents the capital ratios of the Company computed in accordance with applicable regulatory guidelines and compared to the standards for minimum capital adequacy requirements under the FDIC's prompt corrective action authority as of December 31, 2004. The risk-based and leverage capital ratios are defined in Item 1 -

"Business - Supervision and Regulation - Capital Adequacy Guidelines" on page 9.

At December 31, 2004, 2003 and 2002, the Company's capital met all minimum regulatory requirements. As of December 31, 2004, 2003 and 2002, management believes that HBC, and its former subsidiary banks, were considered "well capitalized" under the regulatory framework for prompt corrective action.

To enhance regulatory capital and to provide liquidity the Company, through unconsolidated subsidiary grantor trusts, issued the following mandatorily redeemable cumulative trust preferred securities of subsidiary grantor trusts: In the first quarter of 2000, the Company issued $7,000,000 aggregate principal amount of 10.875% subordinated debentures due on March 8, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2000, the Company issued $7,000,000 aggregate principal amount of 10.60% subordinated debentures due on September 7, 2030 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2001, the Company issued $5,000,000 aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on July 31, 2031 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. In the third quarter of 2002, the Company issued $4,000,000 aggregate principal amount of Floating Rate Junior Subordinated Deferrable Interest Debentures due on September 26, 2032 to a subsidiary trust, which in turn issued a similar amount of trust preferred securities. Under applicable regulatory guidelines, the Trust Preferred securities currently qualify as Tier I capital. No assurance can be given that the banking regulators will continue Tier 1 capital treatment for trust preferred securities in light of the recent accounting change. The subsidiary trusts are not consolidated in the Company's consolidated financial statements and the subordinated debt payable to the subsidiary grantor trusts is recorded as debt of the Company to the related trusts.

MARKET RISK

Market risk is the risk of loss to future earnings, to fair values, or to future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is attributed to all market risk sensitive financial instruments, including securities, loans, deposits, borrowings, its trading activities for its own account, and its role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the Company's earnings and equity to loss and to reduce the volatility inherent in certain financial instruments.

INTEREST RATE SENSITIVITY

The planning of asset and liability maturities is an integral part of the management of an institution's net yield. To the extent maturities of assets and liabilities do not match in a changing interest rate environment, net yields may change over time. Even with perfectly matched repricing of assets and liabilities, risks remain in the form of prepayment of loans or investments or in the form of delays in the adjustment of rates of interest applying to either earning assets with floating rates or to interest bearing liabilities. The Company has generally been able to control its exposure to changing interest rates by maintaining primarily floating interest rate loans and a majority of its time certificates with relatively short maturities.

The table below sets forth the interest rate sensitivity of the Company's interest earning assets and interest bearing liabilities as of December 31, 2004, using the rate sensitivity GAP ratio. For purposes of the following table, an asset or liability is considered rate-sensitive within a specified period when it can be repriced or when it is scheduled to mature within the specified time frame:

(Dollars in thousands)	Due Within Three Months	Due in Three to Twelve Months	Due After One to Five Years	Due After Five Years	Not Rate-Sensitive	Total
INTEREST EARNING ASSETS:						
Federal funds sold	$ 24,100	$ --	$ --	$ --	$ --	$ 24,100
Interest bearing deposits in other institutions	2,210	--	--	--	--	2,210
Securities	140	25,486	80,042	127,141	--	232,809
Total loans, including loans held-for-sale, net of deferred costs	558,683	79,540	69,948	54,537	--	762,708
Total interest earning assets	585,133	105,026	149,990	181,678	--	1,021,827
Cash and due from banks	--	--	--	--	31,436	31,436
Other assets	--	26,303	--	--	28,607	54,910
Total assets	$ 585,133	$ 131,329	$ 149,990	$ 181,678	$ 60,043	$ 1,108,173
INTEREST BEARING LIABILITIES:						
Demand, interest bearing	$ 120,890	$ --	$ --	$ --	$ --	$ 120,890
Savings and money market	357,318	--	--	--	--	357,318
Time deposits	61,407	68,674	32,795	--	--	162,876
Other borrowings	--	15,100	32,700	--	--	47,800
Notes payable to subsidiary grantor trusts	9,279	--	--	14,423	--	23,702
Total interest bearing liabilities	548,894	83,774	65,495	14,423	--	712,586
Demand noninterest bearing	70,743	--	--	--	206,708	277,451
Accrued interest payable and other liabilities	--	--	--	--	19,557	19,557
Shareholders' equity	--	--	--	--	98,579	98,579
Total liabilities and shareholders' equity	$ 619,637	$ 83,774	$ 65,495	$ 14,423	$ 324,844	$ 1,108,173
Interest rate sensitivity GAP	$ (34,504)	$ 47,555	$ 84,495	$ 167,255	$ (264,801)	$ --
Cumulative interest rate sensitivity GAP	$ (34,504)	$ 13,051	$ 97,546	$ 264,801	$ --	$ --
Cumulative interest rate sensitivity GAP ratio	(3.11)%	1.18 %	8.80 %	23.90 %	-- %	-- %

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates. To supplement traditional GAP analysis, the Company performs simulation modeling to estimate the potential effects of changing interest rate environments.

The process allows the Company to explore the complex relationships within the GAP over time and various interest rate environments. For additional information on the Company's simulation model and the methodology used to estimate the potential effects of changing interest rates, see Item 7A - "Quantitative and qualitative disclosures about market risk" below.

Liquidity risk represents the potential for loss as a result of limitations on the Company's ability to adjust for future cash flows, to meet the needs of depositors and borrowers, and to fund operations on a timely and cost-effective basis. The liquidity policy approved by the board requires annual review of the Company's liquidity by the asset/liability committee, which is composed of senior executives, and the finance and investment committee of the board of directors.

The Company's internal asset/liability committee and the finance and investment committee of the board each meet monthly to monitor the Company's investments, liquidity needs and to oversee its asset/liability management. The Company evaluates the rates offered on its deposit products on a weekly basis.

ITEM 7A - *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

As a financial institution, the Company's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company's assets and liabilities, and the market value of all interest-earning assets, other than those which have a short term to maturity. Since all of the Company's interest-bearing assets and liabilities are located at HBC, all of the Company's interest rate risk exposure lies at that level, as well. As a result, all interest rate risk management procedures are performed at HBC's level. Based upon the nature of the Company's operations, the Company is not subject to foreign exchange or commodity price risk. The Company has no market risk sensitive instruments held for trading purposes. As of December 31, 2004, the Company does not use interest rate derivatives to hedge its interest rate risk.

The Company's exposure to market risk is reviewed on a regular basis by the Asset/Liability Committee (ALCO). Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximize income. Management realizes certain risks are inherent, and that the goal is to identify and accept the risks. Management uses two methodologies to manage interest rate risk: 1) a standard GAP analysis; and 2) an interest rate shock simulation model.

The detail from the Company's GAP analysis is shown under the caption "Interest Rate Sensitivity", above, and is not discussed here. The Company applies a market value (MV) methodology to gauge its interest rate risk exposure as derived from its simulation model. Generally, MV is the discounted present value of the difference between incoming cash flows on interest earning assets and other investments and outgoing cash flows on interest bearing liabilities and other liabilities. The application of the methodology attempts to quantify interest rate risk as the change in the MV which would result from a theoretical 200 basis point (1 basis point equals 0.01%) change in market interest rates. Both a 200 basis point increase and a 200 basis point decrease in market rates are considered.

At December 31, 2004, it was estimated that the Company's MV would increase 18.09% in the event of a 200 basis point increase in market interest rates. The Company's MV at the same date would decrease 27.73% in the event of a 200 basis point decrease in market interest rates.

Presented below, as of December 31, 2004 and 2003, is an analysis of the Company's interest rate risk as measured by changes in MV for instantaneous and sustained parallel shifts of 200 basis points in market interest rates:

	2004				2003			
(Dollars in thousands)	$ Change in Market	% Change in Market	Market Value as a % of Present Value of Assets		$ Change in Market	% Change in Market	Market Value as a % of Present Value of Assets	
Change in rates	Value	Value	MV Ratio	Change (bp)	Value	Value	MV Ratio	Change (bp)
+ 200 bp.......................	$ 33,886	18.09 %	20.0 %	306	$ 46,986	30.90 %	19.8 %	467
0 bp..........................	$ --	-- %	16.9 %	--	$ --	-- %	15.1 %	--
- 200 bp.......................	$ (51,939)	(27.73)%	12.2 %	(469)	$ (51,713)	(34.02)%	10.0 %	(514)

Management believes that the MV methodology overcomes three shortcomings of the typical maturity gap methodology. First, it does not use arbitrary repricing intervals and accounts for all expected future cash flows. Second, because the MV method projects cash flows of each financial instrument under different interest rate environments, it can incorporate the effect of embedded options on an institutions' interest rate risk exposure. Third, it allows interest rates on different instruments to change by varying amounts in response to a change in market interest rates, resulting in more accurate estimates of cash flows.

However, as with any method of gauging interest rate risk, there are certain shortcomings inherent to the MV methodology. The model assumes interest rate changes are instantaneous parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree may also misstate historic rate patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to repricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag behind the change in general market rates. Additionally, the MV methodology does not reflect the full impact of annual and lifetime restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in monitoring the Company's exposure to interest rate risk.

Liquidity risk represents the potential for loss as a result of limitations on our ability to adjust our future cash flows to meet the needs of depositors and borrowers and to fund operations on a timely and cost-effective basis. The Liquidity Policy approved by the Board requires annual review of the Company's liquidity by the Asset/Liability Committee, which is composed of senior executives, and the Finance and Investment Committee of the Board of Directors.

ITEM 8 - ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

The financial statements and report of Independent Registered Public Accounting Firm are set forth on pages 62 through 91, which follows Item 15 - "Exhibits and Financial Statement Schedules"

The following table discloses the Company's selected unaudited quarterly financial data. See Note 2 to the consolidated financial statements for description of the restatements.

	For the Quarter Ended						
	12/31/2004	As Previously Reported 09/30/2004	As Restated 09/30/2004	As Previously Reported 06/30/2004	As Restated 06/30/2004	As Previously Reported 03/31/2004	As Restated 03/31/2004
Interest income	$ 14,330	$ 13,633	$ 13,563	$ 12,690	$ 12,617	$ 11,984	$ 11,907
Interest expense	2,677	2,484	2,484	2,298	2,298	2,189	2,189
Net interest income	11,653	11,149	11,079	10,392	10,319	9,795	9,718
(Reversal of)Provision for loan losses	(726)	600	254	600	575	600	563
Net interest income after (Reversal of) provision for loan losses	12,379	10,549	10,825	9,792	9,744	9,195	9,155
Noninterest income	2,358	2,363	2,608	2,304	2,549	2,474	2,719
Noninterest expense	11,401	8,889	9,131	10,916	11,158	8,712	8,970
Net income before taxes	3,336	4,023	4,302	1,180	1,135	2,957	2,904
Provision for income taxes	690	1,135	1,210	380	366	950	933
Net income	$ 2,646	$ 2,888	$ 3,092	$ 800	$ 769	$ 2,007	$ 1,971
Net income per share basic	$ 0.23	$ 0.25	$ 0.26	$ 0.07	$ 0.07	$ 0.18	$ 0.17
Net income per share diluted	$ 0.23	$ 0.24	$ 0.26	$ 0.07	$ 0.06	$ 0.17	$ 0.16

	For the Quarter Ended							
	As Previously Reported 12/31/2003	As Restated 12/31/2003	As Previously Reported 09/30/2003	As Restated 09/30/2003	As Previously Reported 06/30/2003	As Restated 06/30/2003	As Previously Reported 03/31/2003	As Restated 03/31/2003
Interest income	$ 12,219	$ 12,219	$ 11,556	$ 11,556	$ 11,873	$ 11,873	$ 12,448	$ 12,448
Interest expense	2,309	2,309	2,369	2,369	2,552	2,552	2,773	2,773
Net interest income	9,910	9,910	9,187	9,187	9,321	9,321	9,675	9,675
(Reversal of)Provision for loan losses	400	400	600	600	600	600	1,300	1,300
Net interest income after (Reversal of) provision for loan losses	9,510	9,510	8,587	8,587	8,721	8,721	8,375	8,375
Noninterest income	2,486	2,486	2,463	2,463	2,516	2,516	2,964	2,964
Noninterest expense	9,044	9,047	8,310	8,313	8,486	8,488	8,500	8,502
Net income before taxes	2,952	2,949	2,740	2,737	2,751	2,749	2,839	2,837
Provision for income taxes	910	909	800	799	880	879	910	909
Net income	$ 2,042	$ 2,040	$ 1,940	$ 1,938	$ 1,871	$ 1,870	$ 1,929	$ 1,928
Net income per share basic	$ 0.18	$ 0.18	$ 0.17	$ 0.17	$ 0.17	$ 0.17	$ 0.17	$ 0.17
Net income per share diluted	$ 0.17	$ 0.17	$ 0.17	$ 0.17	$ 0.16	$ 0.16	$ 0.17	$ 0.17

ITEM 9 - *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

ITEM 9A – *CONTROLS AND PROCEDURES*

Disclosure Control and Procedures

The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2004. As defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported on a timely basis. Based upon that evaluation and as result of the material weakness described below, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of December 31, 2004.

Material Weakness in Internal Control Over Financial Reporting

Management has concluded that, as of December 31, 2004, the Company did not design and implement controls over the selection and application of accounting policies for complex, non-routine transactions. This is a material weakness that caused the restatement of previously issued financial statements. It is considered a material weakness due to the actual misstatements identified, the potential for additional misstatements, and the lack of other mitigating controls to detect the misstatements.

Management has determined that this control deficiency constituted a material weakness in the Company's internal control over financial reporting as of December 31, 2004. A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

This material weakness resulted in restatements of the Company's financial statements for the years ended December 31, 2002 and 2003, and the first three quarters in 2004. The material weakness resulted in accounting errors related to an asset subject to a lease, delayed equity contributions to low income housing partnerships, and leased facilities.

Remediation of Material Weakness

The Company is in the process of creating a formal process related to the design and implementation of control over the selection and application of accounting policies for complex, non-routine transactions. This process will include the early identification of complex, non-routine transactions. These transactions will be initially documented by the Company's internal accounting staff. A regular meeting with accounting staff and executive level officers involved and familiar with accounting issues related to complex, non-routine transactions, will be held to review the initial documentation of complex, non-routine transactions. As required, outside legal or accounting advice will be obtained.

Through these steps, the Company believes it is addressing the deficiencies that affected its internal control over financial reporting as of December 31, 2004. However, the effectiveness of any system of internal controls is subject to inherent limitations and there can be no assurance that the Company's internal control over financial reporting will prevent or detect all errors. The Company intends to continue to evaluate and strengthen its internal control over financial reporting system.

Reports of Management and Independent Registered Public Accounting Firm

Management has assessed of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 and their report is at page 59.

Deloitte & Touche LLP, independent registered public accounting firm has audited the consolidated financial statements of the Company for the year ended December 31, 2004 and has issued their reports on the financial statements and management's assessment of the effectiveness of the Company's internal control over financial reporting.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2004, there were no changes in our internal controls over financial reporting that materially affected, or are reasonably likely to affect, our internal controls over financial reporting. However, the Company is in the process of creating a formal process related to the design and implementation of controls over the selection and application of accounting policies for complex, non-routine transactions as noted above. The Company believes that this change in internal controls over financial reporting will improve its financial reporting system but there is no assurance that this change will materially affect the Company's internal control over financial reporting.

ITEM 9B – *OTHER INFORMATION*

None

PART III

ITEM 10 - *DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT*

Reference is made to the Company's Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders for incorporation of information concerning directors and persons nominated to become directors of the Company. Information concerning executive officers of the Company also included in the Company's Proxy Statement.

ITEM 11 - *EXECUTIVE COMPENSATION*

Information concerning executive compensation is incorporated by reference from the text under the caption "Executive Compensation" in the Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders.

ITEM 12 - *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Information concerning ownership of the equity stock of the Company by certain beneficial owners and management is incorporated by reference from the text under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders.

Information concerning the Company's stock option plans is incorporated by reference from the text under the caption "Equity Compensation Plan Information" in the Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders.

ITEM 13 - *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS*

Information concerning certain relationships and related transactions with officers, directors, and the Company, and equity compensation plan information, is incorporated by reference from the text under the caption "Transactions with Management and Others" in the Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders.

ITEM 14 – PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information concerning principal accounting fees and services is incorporated by reference from the text under the caption "Principal Accounting Firm Fees" in the Proxy Statement for the May 26, 2005 Annual Meeting of Shareholders.

PART IV

ITEM 15 - ***EXHIBITS AND FINANCIAL STATEMENT SCHEDULES***

(a)(1) ***FINANCIAL STATEMENTS***

The Financial Statements of the Company and the independent auditors' report are set forth on pages 62 through 91.

(a)(2) ***FINANCIAL STATEMENT SCHEDULES***

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(a)(3) EXHIBITS

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

Heritage Commerce Corp

BY: /s/ William Del Biaggio, Jr.
DATE: March 31, 2005
William Del Biaggio, Jr.
Interim Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report on Form 10-K has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

Signature	Title	Date
/s/ FRANK BISCEGLIA Frank Bisceglia	Director	March 31, 2005
/s/ JAMES BLAIR James Blair	Director	March 31, 2005
/s/ JACK CONNER Jack Conner	Director	March 31, 2005
/s/ WILLIAM DEL BIAGGIO, JR. William Del Biaggio, Jr.	Director and Chairman of the Board and Interim Chief Executive Officer	March 31, 2005
/s/ LAWRENCE D. MCGOVERN Lawrence D. McGovern	Executive Vice President and Chief Financial Officer, Principal Financial and Accounting Officer	March 31, 2005
/s/ ROBERT MOLES Robert Moles	Director	March 31, 2005
/s/ LON NORMANDIN Lon Normandin	Director	March 31, 2005
/s/ JACK PECKHAM Jack Peckham	Director	March 31, 2005
/s/ HUMPHREY POLANEN Humphrey Polanen	Director	March 31, 2005
/s/ CHARLES TOENISKOETTER Charles Toeniskoetter	Director	March 31, 2005
/s/ RANSON WEBSTER Ranson Webster	Director	March 31, 2005

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Management's Annual Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Rule 13a-15(f) under the Exchange Act, internal control over financial reporting is a process designed by, or under the supervision of, a company's principal executive and principal financial officers and effected by a company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. It includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of a company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of a company are being made only in accordance with authorizations of management and the board of directors of the company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a company's assets that could have a material effect on its financial statements.

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

Management is also responsible for ensuring compliance with federal laws and regulations relating to safety and soundness.

The Company's management has used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the effectiveness of the Company's internal control over financial reporting. Management has selected the COSO framework for its evaluation as it is a control framework recognized by the SEC and the Public Company Accounting Oversight Board, that is free from bias, permits reasonably consistent qualitative and quantitative measurement of the Company's internal controls, is sufficiently complete so that relevant controls are not omitted and is relevant to an evaluation of internal controls over financial reporting.

Management of the Company assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, and identified a material weakness in the design of its internal controls. The Company did not design and implement controls over the selection and application of accounting policies for complex, non-routine transactions.

Because of this material weakness, management has concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2004, based on the criteria described in the COSO Internal Control - Integrated Framework.

The Company's independent registered public accounting firm has issued an attestation report on the management's assessment of the Company's internal controls over financial reporting.

Date: March 30, 2005

/s/ William Del Biaggio, Jr.	/s/ Lawrence D. McGovern
William Del Biaggio, Jr.	Lawrence D. McGovern
Interim Chief Executive Officer	Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Heritage Commerce Corp:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Heritage Commerce Corp and subsidiary (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weakness identified in management's assessment based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in a more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment: The Company did not design and implement controls over the selection and application of accounting policies for complex, non-routine transactions. This material weakness resulted in restatements of the Company's previously issued interim and annual consolidated financial statements as described in Note 2 to the consolidated financial statements. Additionally, certain audit adjustments to the 2004 consolidated financial statements, which were not material individually, but which affected various financial statement line items, were necessary to present the financial statements in accordance with generally accepted accounting principles. This deficiency was concluded to be a material weakness due to the actual misstatements identified, the potential for additional misstatements, and the lack of other mitigating controls to detect the misstatements. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the December 31, 2004 consolidated financial statements and this report does not affect our report on such consolidated financial statements.

In our opinion, management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have not examined and, accordingly, we do not express an opinion or any other form of assurance on management's statement referring to compliance with laws and regulations.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2004 of the Company and our report dated March 30, 2005 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

San Francisco, California
March 30, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Heritage Commerce Corp:

We have audited the accompanying consolidated balance sheets of Heritage Commerce Corp and subsidiary (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Heritage Commerce Corp and subsidiary as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 30, 2005 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of a material weakness.

/s/ Deloitte & Touche LLP

San Francisco, California
March 30, 2005

HERITAGE COMMERCE CORP
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	December 31, 2004	December 31, 2003 (As Restated, see Note 2)
ASSETS		
Cash and due from banks	$ 33,646	$ 42,017
Federal funds sold	24,100	72,200
Total cash and cash equivalents	57,746	114,217
Securities available-for-sale, at fair value	232,809	153,473
Loans held for sale, at lower of cost or market	37,178	30,638
Loans, net of deferred costs of $726 and $863 for 2004 and 2003	725,530	662,157
Allowance for probable loan losses	(12,497)	(13,451)
Loans, net	713,033	648,706
Premises and equipment, net	3,183	4,034
Accrued interest receivable and other assets	33,226	27,137
Company owned life insurance	26,303	25,273
Other investments	4,695	2,504
TOTAL	$ 1,108,173	$ 1,005,982
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits		
Demand, noninterest bearing	$ 277,451	$ 238,423
Demand, interest bearing	120,890	105,260
Savings and money market	357,318	345,886
Time deposits, under $100	38,295	39,869
Time deposits, $100 and over	104,719	94,002
Brokered deposits	19,862	11,970
Total deposits	918,535	835,410
Accrued interest payable and other liabilities	19,557	13,785
Other borrowings	47,800	43,600
Notes payable to subsidiary grantor trusts	23,702	23,702
Total liabilities	1,009,594	916,497
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized: none outstanding	--	--
Common stock, no par value; 30,000,000 shares authorized; shares outstanding: 11,669,837 in 2004 and 11,381,037 in 2003	67,409	65,234
Unallocated ESOP shares	(193)	(443)
Accumulated other comprehensive income (loss), net of taxes	(1,730)	79
Retained earnings	33,093	24,615
Total shareholders' equity	98,579	89,485
TOTAL	$ 1,108,173	$ 1,005,982

See notes to consolidated financial statements.

HERITAGE COMMERCE CORP
CONSOLIDATED INCOME STATEMENTS

(Dollars in thousands, except per share data)	2004	2003 (As Restated, see Note 2)	2002 (As Restated, see Note 2)
	Year ended December 31,		
Interest income:			
Loans, including fees	$ 45,325	$ 42,934	$ 46,609
Securities, taxable	6,418	4,198	4,576
Securities, non-taxable	297	411	500
Interest bearing deposits in other financial institutions	14	44	88
Federal funds sold	363	509	983
Total interest income	52,417	48,096	52,756
Interest expense:			
Deposits	6,798	7,806	13,353
Subsidiary grantor trusts	1,958	1,935	1,871
Other	892	262	13
Total interest expense	9,648	10,003	15,237
Net interest income before provision for probable loan losses	42,769	38,093	37,519
Provision for probable loan losses	666	2,900	2,663
Net interest income after provision for probable loan losses	42,103	35,193	34,856
Noninterest income:			
Gain on sale of loans	3,052	2,228	2,262
Servicing income	2,325	1,819	1,317
Service charges and other fees on deposit accounts	1,799	1,810	1,425
Appreciation of company owned life insurance	1,031	1,151	1,113
Equipment leasing	871	1,195	103
Gain on sales of securities available-for-sale	476	735	1,036
Mortgage brokerage fees	168	1,012	1,085
Other	512	479	689
Total noninterest income	10,234	10,429	9,030
Noninterest expenses:			
Salaries and employee benefits	18,754	17,975	18,067
Occupancy	3,670	3,541	3,207
Professional fees	2,656	1,548	1,563
Operational losses	2,219	(1)	88
Retirement plan expense	1,741	741	897
Loan origination costs	1,628	1,439	1,277
Advertising and promotion	1,090	747	737
Client services	1,044	1,018	1,100
Amortization of leased equipment	1,016	985	83
Furniture and equipment	921	1,588	1,503
Amortization of low income housing projects	878	398	341
Data processing expense	722	87	86
Other	4,321	4,284	4,299
Total noninterest expenses	40,660	34,350	33,248
Income before provision for income taxes	11,677	11,272	10,638
Provision for income taxes	3,199	3,496	3,484
Net income	$ 8,478	$ 7,776	$ 7,154
Earnings per share:			
Basic	$ 0.73	$ 0.69	$ 0.65
Diluted	$ 0.71	$ 0.67	$ 0.63

See notes to consolidated financial statements.

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2004, 2003, AND 2002

(Dollars in thousands)	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Unallocated ESOP Shares	Retained Earnings	Total Shareholders' Equity	Comprehensive Income
BALANCES, JANUARY 1, 2002 (1)	11,114,967	$ 63,536	$ 1,021	$ (901)	$ 9,685	$ 73,341	
Net income (1)	--	--	--	--	7,154	7,154	$ 7,154
Net change in unrealized loss on securities available-for-sale, net of reclassification adjustment and taxes	--	--	693	--	--	693	693
Total comprehensive income (1)	--	--	--	--	--	--	$ 7,847
Amortization of stock compensation	--	--	--	250	--	250	
Additional unallocated ESOP shares	--	--	--	(42)	--	(42)	
Additional paid-in-capital in ESOP	--	45	--	--	--	45	
Stock options exercised	99,447	421	--	--	--	421	
BALANCES, DECEMBER 31, 2002 (1)	11,214,414	64,002	1,714	(693)	16,839	81,862	
Net income (1)	--	--	--	--	7,776	7,776	$ 7,776
Net change in unrealized gain on securities available-for-sale, net of reclassification adjustment and taxes	--	--	(1,635)	--	--	(1,635)	(1,635)
Total comprehensive income (1)							$ 6,141
Amortization of stock compensation	--	--	--	250	--	250	
Additional paid-in-capital in ESOP	--	59	--	--	--	59	
Stock options exercised	166,623	1,173	--	--	--	1,173	
BALANCES, DECEMBER 31, 2003 (1)	11,381,037	65,234	79	(443)	24,615	89,485	
Net income	--	--	--	--	8,478	8,478	$ 8,478
Net change in unrealized loss on securities available-for-sale, net of reclassification adjustment and taxes	--	--	(684)	--	--	(684)	(684)
Additional minimum liblility, net of taxes	--	--	(1,125)	--	--	(1,125)	(1,125)
Total comprehensive income							$ 6,669
Amortization of stock compensation	--	--	--	250	--	250	
Additional paid-in-capital in ESOP	--	296	--	--	--	296	
Common stock repurchased	(263,728)	(4,214)	--	--	--	(4,214)	
Stock options exercised	552,528	6,093	--	--	--	6,093	
BALANCES, DECEMBER 31, 2004	11,669,837	$ 67,409	$ (1,730)	$ (193)	$ 33,093	$ 98,579	

(1) As restated, see Note 2.

See notes to consolidated financial statements.

HERITAGE COMMERCE CORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
(Dollars in thousands)	2004	2003 (As Restated, see Note 2)	2002 (As Restated, see Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 8,478	$ 7,776	$ 7,154
Adjustments to reconcile net income to net cash provided by operating activities:			
Net gain / loss on disposals of property and equipment	(17)	(35)	(100)
Depreciation and amortization	1,366	1,995	1,828
Provision for probable loan losses	666	2,900	2,663
Gain on sales of securities available-for-sale (AFS)	(476)	(735)	(1,036)
Provision for deferred income taxes	(1,163)	(911)	(1,466)
Non-cash compensation expense related to ESOP plan	546	309	253
Amortization / accretion of discounts and premiums on securities	1,090	591	230
Gain on sale of loans	(3,052)	(2,228)	(2,262)
Proceeds from sales of loans held for sale	57,647	46,985	52,200
Originations of loans held for sale	(74,898)	(79,927)	(66,108)
Maturities of loans held for sale	13,763	32,616	20,547
Appreciation of company owned life insurance	(1,031)	(1,151)	(1,113)
Effect of changes in:			
Accrued interest receivable and other assets	(3,948)	930	(9,156)
Accrued interest payable and other liabilities	4,540	1,305	417
Net cash provided by operating activities	3,511	10,420	4,051
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net decrease (increase) in loans	(64,712)	9,074	(41,581)
Purchases of securities available-for-sale (AFS)	(127,662)	(152,989)	(84,260)
Maturities/Paydowns/Calls of securities available-for-sale (AFS)	23,270	49,834	24,575
Proceeds from sales of securities available-for-sale (AFS)	22,641	73,256	40,033
Maturities/Paydowns/Calls of securities held-to-maturity (HTM)	--	--	1,776
Purchases of company owned life insurance	--	(225)	(750)
Purchase of premises and equipment	(532)	(800)	(1,452)
Redemption (purchase) of other investments	(2,191)	768	(528)
Net cash used in investing activities	(149,186)	(21,082)	(62,187)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase in deposits	83,125	(6,526)	34,028
Proceeds from issuance of mandatorily redeemable cumulative trust preferred securities of Subsidiary Grantor Trust	--	--	4,000
Net proceeds from issuance of common stock	6,093	1,173	421
Common stock repurchased	(4,214)	--	--
Net change in other borrowings	4,200	43,600	--
Net cash provided by financing activities	89,204	38,247	38,449
Net increase (decrease) in cash and cash equivalents	(56,471)	27,585	(19,687)
Cash and cash equivalents, beginning of year	114,217	86,632	106,319
Cash and cash equivalents, end of year	$ 57,746	$ 114,217	$ 86,632
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 9,493	$ 10,914	$ 17,327
Income taxes	$ 3,080	$ 2,735	$ 4,480
Supplemental schedule of non-cash investing and financing activity:			
Transfer of investment securities from HTM to AFS	$ --	$ --	$ 13,619

See notes to consolidated financial statements.

HERITAGE COMMERCE CORP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Basis of Presentation

Heritage Commerce Corp (the "Company") operates as a bank holding company. Effective January 1, 2003, Heritage Bank East Bay ("HBEB"), Heritage Bank South Valley ("HBSV"), and Bank of Los Altos ("BLA") were merged into Heritage Bank of Commerce ("HBC"). HBC is a California state chartered bank which offers a full range of commercial and personal banking services to residents and the business/professional community in Santa Clara and Alameda counties, California. HBC was incorporated on November 23, 1993 and commenced operations on June 8, 1994.

The accounting and reporting policies of the Company and its subsidiary conform to accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry.

Use of Estimates

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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary bank. All significant intercompany accounts and transactions have been eliminated.

The Company also has four other subsidiaries, Heritage Capital Trust I, and Heritage Statutory Trust I, formed in 2000, Heritage Statutory Trust II, formed in 2001, and Heritage Statutory Trust III, formed in 2002, which are Delaware statutory business trusts formed for the exclusive purpose of issuing and selling trust preferred securities. Starting on December 31, 2003, these subsidiary trusts are not consolidated in the Company's consolidated financial statements and the subordinated debt payable to subsidiary grantor trusts is recorded as debt of the Company to the related trusts.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with remaining terms to maturity of three months or less from the date of acquisition to be cash equivalents. Cash and cash equivalents include cash on hand, amounts due from banks, and Federal funds sold. Generally, Federal funds are sold and purchased for one-day periods.

Securities

The Company classifies its securities into two categories, available-for-sale and held-to-maturity, at the time of purchase and reevaluates such classifications annually. Securities available-for-sale are recorded at fair value with a corresponding recognition of the net unrealized holding gain or loss, net of income taxes, as a net amount within accumulated other comprehensive income (loss), which is a separate component of shareholders' equity, until realized. Securities held-to-maturity are recorded at amortized cost and are based on the Company's positive intent and ability to hold the securities to maturity. As of December 31, 2004 and 2003, all the Company's securities were classified as available-for-sale securities.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security.

Premiums and discounts are amortized, or accreted, over the life of the related investment security as an adjustment to income using a method that approximates the interest method. Interest income is recognized when earned. Realized gains and losses for securities classified as available-for-sale are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Loans Held for Sale

The Company holds for sale the guaranteed portion of certain Small Business Administration (SBA) loans. These loans are carried at the lower of cost or market, based on the aggregate value of the portfolio.

Gains or losses on SBA loans held for sale are recognized upon completion of the sale, and are based on the difference between the net sales proceeds and the relative fair value of the guaranteed portion of the loan sold compared to the relative fair value of the unguaranteed portion.

The servicing assets that result from the sale of SBA loans, sold with servicing rights retained, are amortized over the lives of the loans using a method approximating the interest method.

The Company accounts for the transfer and servicing of financial assets based on the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. Servicing assets are measured at their fair value and are amortized in proportion to and over the period of net servicing income and are assessed for impairment on an ongoing basis. Impairment is determined by stratifying the servicing rights based on interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance. Any servicing assets in excess of the contractually specified servicing fees have been reclassified at fair value as an interest-only (I/O) strip receivable and treated like an available for sale security. The servicing asset, net of any required valuation allowance, and I/O strip receivable are included in other assets.

Loans

Loans are stated at the principal amount outstanding net of deferred loan origination fees and costs. The majority of the Company's loans are at variable interest rates. Interest on loans is credited to income using the effective yield interest method.

Generally, if a loan is classified as non-accrual, the accrual of interest is discontinued, any accrued and unpaid interest is reversed, and the amortization of deferred loan fees and costs is discontinued. Loans are classified as non-accrual when the payment of principal or interest is 90 days past due, unless the amount is well secured and in the process of collection. Any interest or principal payments received on nonaccrual loans are applied toward reduction of principal. Nonaccrual loans generally are not returned to performing status until the obligation is brought current, the loan has performed in accordance with the contract terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Renegotiated loans are those in which the Company has formally restructured a significant portion of the loan. The remaining portion is charged off, with a concession either in the form of below market rate financing, or debt forgiveness on the charged off portion. Loans that have been renegotiated and have not met specific performance standards for payment are classified as renegotiated loans within the classification of nonperforming assets. Upon payment performance, such loans may be transferred from nonperforming status to accrual status. At December 31, 2004 and 2003 the Company did not have any renegotiated loans outstanding.

Non-refundable loan fees and direct origination costs are deferred and recognized over the expected lives of the related loans using the effective yield interest method.

Allowance for Probable Loan Losses

The Company maintains an allowance for probable loan losses to absorb probable losses inherent in the loan portfolio. The allowance is based on ongoing, monthly assessments of the probable estimated losses. Loans are charged against the allowance when management believes that the collectibility of the principal is doubtful. The allowance is increased by the provision for loan losses, which is charged against current period operating results and decreased by the amount of charge-offs, net of recoveries. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances and the unallocated allowance.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unused commitments. Loss factors are based on the Company's historical loss experience and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a credit that management believes indicate the probability that a loss has been incurred in excess of the amount determined by the application of the formula allowance. The allowance also incorporates the results of measuring impaired loans. Management considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the original contractual terms of the note agreement. When a loan is considered to be impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the note's effective interest rate, or the fair value of the collateral if the loan is collateral dependent.

The unallocated allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The conditions evaluated in connection with the unallocated allowance may include existing general economic and business conditions affecting the key lending areas of the Company, in particular the technology industry and the real estate market, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle, and bank regulatory examination results.

Premises and Equipment

Premises and equipment are stated at cost. Depreciation and amortization are computed on a straight-line basis over the lesser of the lease terms or estimated useful lives of five to fifteen years, if appropriate. The Company evaluates the recoverability of long-lived assets on an on-going basis.

Other Investments

Other investments consist of FRB and FHLB stock which are carried at cost.

Equipment Under Operating Leases to Others

Equipment under operating leases where the Company is the lessor is carried at cost less accumulated depreciation based on the terms of the leases and is included in other assets. This equipment represents a pool of electronic testing equipment available for short-term rentals purchased in 2002 from a third party, who also services the leases. At December 31, 2004, the Company has $2,807,000 in equipment and $2,085,000 in accumulated depreciation related to these leases. For the year ended December 31, 2004, depreciation expense was $1,016,000 and rental revenue on the lease was $871,000. The Company regularly evaluates this equipment for impairment. In 2004, the Company recorded a write-off on the electronic test equipment of $2,193,000 recorded in operating losses due to an impairment identified.

Termination Benefits

In 2004, the Company recorded certain termination benefits related to the elimination of certain full time positions and the resignation of the former CEO. The Company recorded severance expense of $1,283,000 recognized in salaries and employee benefits and special termination benefit expense of $765,000 recorded in retirement plan expense related to this activity. The Company has a remaining accrual of $431,000 recorded in accrued interest payable and other liabilities at December 31, 2004 related to remaining cash payments to be made under the termination benefits.

Income Taxes

The Company files consolidated federal and combined state income tax returns. Amounts provided for income tax expense are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable under tax laws. Deferred taxes, which arise principally from temporary differences between the period in which certain income and expenses are recognized for financial accounting purposes and the period in which they affect taxable income, are included in the amounts provided for income taxes. Under this method, the computation of the net deferred tax liability or asset gives current recognition to changes in the tax laws.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average common shares outstanding. Diluted earnings per share reflects potential dilution from outstanding stock options, using the treasury stock method. There were 14,336, 253,805 and 884,474 stock options for 2004, 2003, and 2002 that were considered to be antidilutive and excluded from the computation of diluted earnings per share. For each of the years presented, net income is the same for basic and diluted earnings per share. Reconciliation of weighted average shares used in computing basic and diluted earnings per share is as follows:

	Year ended December 31,		
	2004	**2003**	**2002**
Weighted average common shares outstanding - used in computing basic earnings per share	11,559,155	11,221,232	11,063,965
Dilutive effect of stock options outstanding, using the treasury stock method	427,701	351,356	260,685
Shares used in computing diluted earnings per share	11,986,856	11,572,588	11,324,650

Stock-Based Compensation

The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. No compensation expense has been recognized in the financial statements for employee stock option arrangements, as the Company's stock option plan provides for the issuance of options at a price of no less than the fair market value at the date of the grant.

Statement of Financial Accounting Standard ("SFAS") No. 123, Accounting for Stock-Based Compensation, requires the disclosure of pro forma net income and earnings per share had the Company adopted the fair value method at the grant date of all stock options. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from the Company's stock option awards. Those models also require subjective assumptions, which greatly affect the calculated values. The Company's calculations were made using the Black-Scholes option pricing model with the following weighted average assumptions: expected life, 84 months; risk-free interest rate, 4.10% for 2004, 3.61% for 2003, and 4.34% for 2002; stock volatility of 22% in 2004, 29% in 2003, and 23% in 2002; and no dividends during the expected term. The Company's calculations are based on a multiple option valuation approach, and forfeitures are recognized as they occur.

Subsequent to the issuance of the 2003 consolidated financial statements, management determined that compensation expense for amortization of fair value of stock awards, net of taxes for 2003 and 2002 had been calculated incorrectly. Accordingly, such pro forma amounts presented in the table below have been restated. The effect was to decrease compensation expense for amortization of fair value of stock awards, net of taxes $160,000 in 2003 and to increase compensation expense for amortization of fair value of stock awards, net of taxes $41,000 in 2002. Pro forma net income per common share increased $0.02 per share basic and $0.02 per share diluted in 2003. Pro forma net income per common share decreased $0.01 per share basic but remained the same per share diluted in 2002. This correction did not impact the Company's consolidated financial position, results of operations, or cash flows for any period presented.

Had compensation expense for the Company's stock option plan been determined under the requirements of SFAS No. 123 the Company's pro forma net income and earnings per common share would have been as follows:

	Year ended December 31,		
(Dollars in thousands, except per share data)	2004	2003	2002
Net income			
As reported	$ 8,478	$ 7,776	$ 7,154
Less: Compensation expense for amortization of fair value of stock awards, net of taxes	(445)	(521)	(719)
Pro forma	$ 8,033	$ 7,255	$ 6,435
Net income per common share - basic			
As reported	$ 0.73	$ 0.69	$ 0.65
Pro forma	$ 0.69	$ 0.65	$ 0.58
Net income per common share - diluted			
As reported	$ 0.71	$ 0.67	$ 0.63
Pro forma	$ 0.67	$ 0.63	$ 0.57

Comprehensive Income

Comprehensive income includes net income and other comprehensive income, which represents the changes in its net assets during the period from non-owner sources. The Company's sources of other comprehensive income are unrealized gains and losses on securities available-for-sale, I/O strips, which are treated like available-for-sale securities, and the additional minimum liability related to the Company's supplemented retirement plan. The items in other comprehensive income are presented net of tax. Reclassification adjustments result from gains or losses on investment securities that were realized and included in net income of the current period that also had been included in other comprehensive incomes as unrealized holding gains and losses in the period in which they are excluded from comprehensive income of the current period. The following is a summary of the components of other comprehensive income:

	Year ended December 31,		
(Dollars in thousands)	2004	2003	2002
Net income	$ 8,478	$ 7,776	$ 7,154
Other comprehensive income, net of tax:			
Net unrealized holding gains (losses) on available-for-sale securities during the year, net of tax of $245, $817, and $(1,006) for 2004, 2003 and 2002	(338)	(1,128)	1,389
Additional minimum liability, net of tax of $815 for 2004	(1,125)	--	--
Less: reclassification adjustment for net realized gains, net of tax of $130, $228, and $340 for 2004, 2003 and 2002, on available-for-sale securities included in net income during the year	(346)	(507)	(696)
Other comprehensive income (loss)	(1,809)	(1,635)	693
Comprehensive income	$ 6,669	$ 6,141	$ 7,847

Segment Reporting

HBC is an independent community business bank with eight branch offices, which offer similar products to customers located in Santa Clara, Alameda, and Contra Costa counties of California. No customer accounts for more than 10 percent of revenue for HBC or the Company. Management evaluates the Company's performance as a whole and does not allocate resources based on the performance of different lending or transaction activities. Accordingly, the Company and its subsidiary bank all operate as one business segment.

Reclassifications

Certain amounts in the 2003 and 2002 financial statements have been reclassified to conform to the 2004 presentation.

Costs Associated with Exit or Disposal Activities

Effective January 1, 2003, the Company adopted SFAS No. 146, "*Accounting for Costs Associated with Exit or Disposal Activities*", which addresses accounting for restructuring and similar costs for restructuring activities initiated after December 31, 2002. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue No. 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The adoption of SFAS No. 146 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." The Statement establishes standards for how the Company should classify and measure certain financial instruments with characteristics of both liabilities and equity. This Statement was effective for financial instruments entered into or modified after May 31, 2003, and to other instruments effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of this Statement did not have a material impact on the Company's financial position or results of operations.

Employers' Disclosures about Pensions and Other Postretirement Benefits

In December 2003, the FASB issued SFAS No. 132R, a revision of SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statement No. 87, 88, and 106." The Statement expands the disclosure requirements of SFAS No. 132 to include information describing measurement date(s), plan obligations, cash flows, and components of net periodic benefit costs of defined pension plans and other defined benefit postretirement plans. The Statement was effective for financial statements with fiscal years ending after December 15, 2003, with additional disclosure of expected benefits to be paid in each of the next five years and in the aggregate for the five years thereafter required for fiscal years ending after June 15, 2004. The disclosures required under SFAS No. 132R are contained in Note 11 of these consolidated financial statements.

Accounting for Share-Based Payments

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment". This Statement requires that compensation costs related to share-based payment transactions be recognized in the financial statements. Measurement of the cost of employee service will be based on the grant-date fair value of the equity or liability instruments issued. That cost will recognized over the period during which an employee is required to provide service in exchange for the award. Additionally, liability awards will be remeasured each reporting period. Statement 123R replaces SFAS No. 123, "Accounting for Stock-Based Compensation" and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". This Statement is effective for interim periods beginning after June 15, 2005 and requires adoption using a modified prospective application or a modified retrospective application. The Company has not yet concluded on the method of adoption allowed by the Statement and is currently evaluating the impact of this accounting guidance on its financial condition and results of operations. Disclosure required under SFAS No. 123 is shown in Note 1 of these consolidated financial statements.

Accounting for Guarantors and Disclosure Requirements for Guarantees

In November 2002, the FASB issued FASB Interpretation No. ("FIN") 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including indirect Guarantees of Indebtedness of Others." FIN 45 expands on the accounting guidance of Statements No. 5, 57, and 107 and incorporates without change the provisions of FIN 34, which is superceded. FIN 45 elaborates on the existing disclosure requirements for most guarantees and requires that guarantors recognize a liability for the fair value of guarantees at inception. The disclosure requirements of FIN 45 were effective for financial statement periods ending after December 15, 2002. The initial recognition and measurement provisions of FIN 45 are applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of the measurement provisions of FIN 45 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Consolidation of Variable Interest Entities

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities. The purpose of this interpretation is to provide guidance on how to identify a variable interest entity (VIE) and to determine when the assets, liabilities, noncontrolling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. A company that holds variable interests in an entity will need to consolidate that entity if the company's interest in the VIE is such that the company will absorb a majority of the VIE's expected losses and/or receive a majority of the VIE's expected residual returns, if they occur. New disclosure requirements are also prescribed by FIN 46. In December 2003, the FASB issued FIN 46R, a revision of FIN 46. FIN 46R was effective for all VIE's created after January 31, 2003 in the reporting period ending after March 15, 2004, and became effective for VIE's that existed before February 1, 2003 for the first period ending after December 15, 2003. Under FIN 46R, the Company's subsidiaries, which issued mandatorily redeemable trust preferred securities, were required to be deconsolidated. The Company applied the provisions of FIN 46R to the VIE and deconsolidated its assets and liabilities. Deconsolidation of these entities resulted in total assets and total liabilities increasing by $702,000 and did not have any impact on the Company's results of operations. The adoption of FIN 46R did not have any other material impact on the Company's financial position or result of operations.

(2) RESTATEMENT

Subsequent to the issuance of the Company's consolidated financial statements for the year ended December 31, 2003, management determined that the 2003 and 2002 financial statements should be restated as a result of the following three accounting errors.

- An asset which the Company had accounted for as a direct financing lease and classified as a part of the loan portfolio as of December 31, 2003 should have been accounted for as equipment subject to an operating lease and classified as an other asset. The book value of the equipment subject to an operating lease related to this error is approximately $3,931,000 at December 31, 2003.

- The Company determined that it needed order to increase other assets and other liabilities $2,515,000 as of December 31, 2003, from the amounts previously reported to record unconditional, legally binding delayed equity contributions to low income housing partnerships in accordance with Emerging Issues Task Force (EITF) Issue No. 94-1, "Accounting for Tax Benefits Resulting From Investments in Affordable Housing Projects".

- The Company determined that its previous method of accounting for rent holidays and step-up rents in its facilities lease agreements was not appropriate and that it should have accounted for rent holidays and step-up rents on a straight-line basis. The after-tax income statement effect for years ended December 31, 2003 and 2002 was to reduce income by $6,000 and $23,000, respectively.

The following is a summary of the significant effects of the restatements on the consolidated balance sheet as of December 31, 2003:

December 31, 2003 (Dollars in thousands)		As Previously Reported		Adjustments		As Restated
Loans, net of deferred costs of $726 and $863 for 2004 and 2003	$	666,088	$	(3,931)	$	662,157
Loans, net	$	652,637	$	(3,931)	$	648,706
Accrued interest receivable and other assets	$	20,425	$	6,712	$	27,137
Total assets	$	1,003,201	$	2,781	$	1,005,982
Accrued interest payable and other liabilities	$	10,643	$	3,142	$	13,785
Total liabilities	$	913,355	$	3,142	$	916,497
Retained earnings	$	24,976	$	(361)	$	24,615
Total shareholders' equity	$	89,846	$	(361)	$	89,485
Total liabilities and shareholders' equity	$	1,003,201	$	2,781	$	1,005,982

The following is a summary of the effects of the restatements on the consolidated income statements for the fiscal years ended December 31, 2003 and 2002:

December 31, 2003 (Dollars in thousands)		As Previously Reported		Adjustments		As Restated
Occupancy	$	3,531	$	10	$	3,541
Total noninterest expenses	$	34,340	$	10	$	34,350
Income before provision for income taxes	$	11,282	$	(10)	$	11,272
Provision for income taxes	$	3,500	$	(4)	$	3,496
Net income	$	7,782	$	(6)	$	7,776

December 31, 2002 (Dollars in thousands)		As Previously Reported		Adjustments		As Restated
Occupancy	$	3,168	$	39	$	3,207
Total noninterest expenses	$	33,209	$	39	$	33,248
Income before provision for income taxes	$	10,677	$	(39)	$	10,638
Provision for income taxes	$	3,500	$	(16)	$	3,484
Net income	$	7,177	$	(23)	$	7,154

(3) SECURITIES

The amortized cost and estimated fair value of securities as of December 31, 2004 were as follows:

(Dollars in thousands)		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
Securities available-for-sale:								
U.S. Treasury	$	5,998	$	--	$	56	$	5,942
U.S. Government Agencies		91,245		2		939		90,308
Municipals - Tax Exempt		9,211		26		31		9,206
FHLMC and FNMA Mortgage-Backed Securities		108,642		278		1,734		107,186
GNMA Mortgage-Backed Securities		520		29		--		549
CMOs		19,843		1		226		19,618
Total securities available-for-sale	$	235,459	$	336	$	2,986	$	232,809

The amortized cost and estimated fair value of securities as of December 31, 2003 were as follows:

(Dollars in thousands)		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
Securities available-for-sale:								
U.S. Treasury	$	6,989	$	26	$	--	$	7,015
U.S. Government Agencies		36,138		105		128		36,115
Municipals - Tax Exempt		15,247		500		43		15,704
FHLMC and FNMA Mortgage-Backed Securities		79,996		263		1,490		78,769
GNMA Mortgage-Backed Securities		799		47		--		846
CMOs		15,154		10		140		15,024
Total securities available-for-sale	$	154,323	$	951	$	1,801	$	153,473

At the March 17-18, 2004 Emerging Issues Task Force meeting, the Task Force reached a consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." Issue 03-1 provides guidance for the determination of when an investment is other-than-temporarily impaired. The guidance for evaluating whether an investment is other-than-temporarily impaired should be applied in other-than-temporary impairment evaluations made in reporting periods beginning after June 15, 2004. On September 30, 2004, the FASB deferred the effective date of paragraphs 10 through 20 of EITF Issue No. 03-1. Application of those paragraphs is deferred pending issuance of a final FASB Staff Position. Management is in the process of evaluating the impacts of EITF 03-1 guidance. Other-than-temporary impairment that may need to be recognized upon adoption of Issue 03-1 will be dependant on market conditions and management's intent and ability at the time of the impairment evaluation to hold investments with market values below amortized cost until a forecasted recovery in fair value up to (or beyond) amortized cost.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2004:

		Less Than 12 Months				12 Months or More				Total		
(Dollars in thousands)		Market Value		Unrealized Losses		Market Value		Unrealized Losses		Market Value		Unrealized Losses
U.S. Treasury	$	5,942	$	56	$	--	$	--	$	5,942	$	56
U.S. Government Agencies		84,955		842		2,903		97		87,858		939
Municipals		6,400		31		--		--		6,400		31
FHLMC and FNMA Mortgage-Backed Securities		34,455		497		41,430		1,237		75,885		1,734
CMOs		12,117		226		--		--		12,117		226
Total securities available-for-sale	$	143,869	$	1,652	$	44,333	$	1,334	$	188,202	$	2,986

At December 31, 2004, the Company held 101 securities, of which 64 had market values below amortized cost. Six securities have been carried with an unrealized loss for over 12 months. Higher interest rates at December 31, 2004 resulted in lower market values for the period. Other than temporary loss was primarily due to interest rates. There was no security which sustained downgrades in credit ratings. All principal amounts are expected to be paid when securities mature. Because the Company has the ability and intent to hold these securities until a recovery of fair value, which may be maturity, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2004.

The amortized cost and estimated fair values of securities as of December 31, 2004 by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or pre-pay obligations with or without call or pre-payment penalties.

	Available-for-sale	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Due within one year	$ 25,781	$ 25,626
Due after one through five years	80,880	80,042
Due after five through ten years	11,438	11,400
Due after ten years	117,360	115,741
Total	$ 235,459	$ 232,809

Sales of securities available-for-sale resulted in gross realized gains of $477,000, $816,000, and $1,036,000 during the years ended December 31, 2004, 2003, and 2002, respectively.

Sales of securities available-for-sale resulted in gross realized losses of $1,000, $81,000, and $0 during the years ended December 31, 2004, 2003, and 2002, respectively.

Securities with amortized cost of $85,883,000 and $49,474,000 as of December 31, 2004 and 2003 were pledged to secure public and certain other deposits as required by law or contract.

(4) LOANS

Loans as of December 31, 2004 and 2003 were as follows:

(Dollars in thousands)	2004	2003
Loans held for sale	$ 37,178	$ 30,638
Loans held for investment		
Commercial	$ 300,452	$ 281,561
Real estate - mortgage	303,154	276,908
Real estate - land and construction	118,290	101,082
Consumer	2,908	1,743
Total loans	724,804	661,294
Deferred loan costs	726	863
Allowance for probable loan losses	(12,497)	(13,451)
Loans, net	$ 713,033	$ 648,706

Included in commercial loans at December 31, 2004 and 2003 were overdrafts from various deposit accounts of approximately $1,411,000 and $804,000, respectively.

Changes in the allowance for probable loan losses were as follows:

	Year ended December 31,		
(Dollars in thousands)	2004	2003	2002
Balance, beginning of year	$ 13,451	$ 13,227	$ 11,154
Loans charged-off	(2,901)	(2,906)	(936)
Recoveries	1,562	230	346
Net loans charged-off	(1,339)	(2,676)	(590)
Provision for probable loan losses	666	2,900	2,663
Reclassification to other liabilities	(281) (1)	--	--
Balance, end of year	$ 12,497	$ 13,451	$ 13,227

(1) The Company reclassified the allowance for probable loan losses on unused commitments of $281,000 to other liabilities as of December 31, 2004.

As of December 31, 2004, the Company had $1,028,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $250,000 as of December 31, 2004. For the year ended December 31, 2004, the average recorded investment in loans for which impairment has been recognized was approximately $1,111,000. The Company had $302,000 in loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2004.

As of December 31, 2003, the Company had $3,972,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $464,000 as of December 31, 2003. For the year ended December 31, 2003, the average recorded investment in loans for which impairment has been recognized was approximately $3,933,000. The Company had $608,000 in loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2003.

As of December 31, 2002, the Company had $4,571,000 in loans on nonaccrual status, which were considered impaired loans. The impaired loans had a related valuation allowance of $356,000 as of December 31, 2002. For the year ended December 31, 2002, the average recorded investment in loans for which impairment has been recognized was approximately $2,235,000. The Company had no loans past due 90 days or more and still accruing interest and no restructured loans as of December 31, 2002.

For the year ended December 31, 2004, the Company had $369,000 in foregone interest income on nonaccrual loans and the Company recognized $36,000 in interest income for cash payments received on nonaccrual loans. For the year ended December 31, 2003 the Company had $167,000 in foregone interest income on nonaccrual loans and the Company recognized $3,000 in interest income for cash payments received on nonaccrual loans. For the year ended December 31, 2002 the Company had $70,000 in foregone interest income on nonaccrual loans and the Company recognized $134,000 in interest income for cash payments received on nonaccrual loans.

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

HBC makes loans to executive officers, directors, and their affiliates in the ordinary course of business. These transactions were on substantially the same terms as those prevailing at the time for comparable transactions with unrelated parties and do not involve more than normal risk or unfavorable terms for the Bank.

The following table presents the loans outstanding to related parties, with interest rates at December 31, 2004, ranging from 5.5% to 7.25%, for the years ended December 31, 2004 and 2003:

(Dollars in thousands)	2004	2003
Beginning balance	$ 5,250	$ 11,155
Advances on loans during the year	1,252	1,817
Repayment on loans during the year	(1,873)	(7,722)
Ending balance	$ 4,629	$ 5,250

Loan Servicing

At December 31, 2004 and 2003, the Company serviced loans guaranteed by the Small Business Administration which it had sold to the secondary market of approximately $146,071,000 and $117,770,000.

At December 31, 2004 and 2003, the balance of the servicing assets was $2,213,000 and $1,876,000, respectively. There was no valuation allowance as of December 31, 2004 and 2003 as the fair market value of the assets was greater than the carrying value. At December 31, 2004 and 2003, the carrying amount of Interest-Only (I/O) strip receivable was $3,954,000, net of an unrealized gain of $1,536,000, and $2,803,000, net of an unrealized gain of $925,000, respectively. These assets represent the servicing spread generated from the sold guaranteed portions of SBA loans. Servicing income from these loans was $2,325,000 and $1,819,000 in 2004 and 2003. Amortization of the related assets for 2004 and 2003 was $1,609,000 and $1,346,000, respectively. In recording the initial value of the servicing assets and the fair value of the I/O strip receivable, the Company uses estimates which are made based on management's expectations of future prepayment and discount rates. Management's estimate of constant prepayment rate ("CPR") was 14% for the year ended December 31, 2004 and 2003. The weighted average discount rate assumption was 9% and 10%, respectively, for the year ended December 31, 2004 and 2003. These prepayment and discount rates were based on current market conditions and historical performance of the various loan pools. If actual prepayments with respect to sold loans occur more quickly than projected the carrying value of the servicing assets may have to be adjusted through a charge to earnings. A corresponding decrease in the value of the I/O strip receivable would also be expected.

At December 31, 2004, key economic assumptions and the sensitivity of the current fair value of residual cash flows on the Interest-Only (I/O) strip to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows:

(Dollars in thousands)		
Carrying amount/fair value of interest-only (I/O strip)	$	3,954
Weighted average life (in years)		4.6
Prepayment speed assumption (annual rate)		14%
Impact on fair value of 10% adverse change in prepayment speed (CPR 15%)	$	(151)
Impact on fair value of 20% adverse change in prepayment speed (CPR 17%)	$	(426)
Residual cash flow discount rate assumption (annual)		9%
Impact on fair value of 10% adverse change in discount rate (10% discount rate)	$	(132)
Impact on fair value of 20% adverse change in discount rate (11% discount rate)	$	(256)

It is the policy of management to review key economic assumptions used in FAS 140 accounting model to establish the value of the I/O strip on a quarterly basis. The bank has completed a sensitivity analysis to determine the impact on the value of the asset in the event of a 10% and 20% adverse change, independently from any change in another key assumption. This test involved the "Prepayment speed assumption (CPR)" and the "Residual cash flow discount rate". The value of the asset can be adversely impacted by a significant increase in either the "prepayment speed" of the portfolio or a significant increase in the "discount rate".

(5) PREMISES AND EQUIPMENT

Premises and equipment as of December 31, 2004 and 2003 were as follows:

(Dollars in thousands)	2004	2003
Furniture and equipment	$ 4,404	$ 4,145
Leasehold improvements	4,285	4,339
	8,689	8,484
Accumulated depreciation and amortization	(5,506)	(4,450)
Premises and equipment, net	$ 3,183	$ 4,034

Depreciation expense was $1,366,000, $1,995,000, and $1,828,000 for the year ended December 31, 2004, 2003, and 2002, respectively.

(6) DEPOSITS

At December 31, 2004, the Company had $32,796,000 in interest bearing time deposits with a remaining term of greater than one year, of which $27,290,000 exceeded $100,000. Maturity information of all interest bearing time deposits with a remaining term of greater than one year is summarized below.

(Dollars in thousands)		December 31, 2004
Due after one year through two years	$	16,096
Due after two years through three years		8,785
Due after three years through four years		7,915
Due after four years through five years		--
Due after five years		--
Total time deposits	$	32,796

(7) BORROWING ARRANGEMENTS

FHLB Borrowings & Available Lines of Credit

The Company maintains a collateralized line of credit with the Federal Home Loan Bank (the FHLB) of San Francisco. Under this line, the Company can borrow from the FHLB on a short-term (typically overnight) or long-term (over one year) basis. As of December 31, 2004, the Company had no borrowing outstanding from FHLB. At December 31, 2004, the Company has Federal funds purchase lines and lines of credit available of $56,000,000. The following table represents the Company's total other borrowings for the period indicated:

	December 31,			
(Dollars in thousands)		2004		2003
FHLB short-term borrowings	$	--	$	15,000
Long-term borrowings		47,800		28,600
Total other borrowings	$	47,800	$	43,600

The following table summarizes the Company's borrowings under its Federal funds purchased, security repurchase arrangements and lines of credit for the periods indicated:

(Dollars in thousands)		2004		2003
Average balance during the year	$	43,109	$	15,387
Average interest rate during the year		2.07%		1.71%
Maximum month-end balance during the year	$	48,600	$	43,600
Average rate at December 31		2.21%		1.68%

The maturity of the Company's total other borrowings, at December 31, 2004, are as follows:

(Dollars in thousands)	2005	2006	2007	2008	2009	There After	Total
Long-term borrowings	$ 15,100	$ 10,900	$ 10,900	$ 10,900	$ --	$ --	$ 47,800

Notes Payable to Subsidiary Grantor Trusts

The following is a summary of the notes payable to the Company's subsidiary grantor trusts at December 31:

(Dollars in thousands)	2004	2003
Subordinated debentures due to Heritage Capital Trust I with interest payable semi-anually at 10.875%, redeemable with a premium beginning March 8, 2010 and with no premium beginning March 8, 2020 and due March 8, 2030	$ 7,217	$ 7,217
Subordinated debentures due to Heritage Statutory Trust I with interest payable semi-anually at 10.6%, redeemable with a premium beginning September 7, 2010 and with no premium beginning September 7, 2020 and due September 7, 2030	7,206	7,206
Subordinated debentures due to Heritage Statutory Trust II with interest payable semi-anually based on 3-month Libor plus 3.58% (6.13% at December 31, 2004), redeemable with a premium beginning July 31, 2006 and with no premium beginning July 31, 2011 and due July 31, 2031	5,155	5,155
Subordinated debentures due to Heritage Statutory Trust III with interest payable semi-anually based on 3-month Libor plus 3.40% (5.95% at December 31, 2004), redeemable with a premium beginning September 26, 2007 and with no premium beginning September 26, 2012 and due September 26, 2032	4,124	4,124
Total	$ 23,702	$ 23,702

The Company has guaranteed, on a subordinated basis, distributions and other payments due on the trust preferred securities issued by the subsidiary grantor trusts. The amount of deferred costs at December 31, 2004, 2003 and 2002 was $601,000, $624,000 and $647,000, respectively. Deferred costs amortization for the years ended December 31, 2004, 2003 and 2002 was $23,000, $23,000 and $31,000, respectively.

(8) INCOME TAXES

The provision for income taxes for the years ended December 31, consisted of the following:

(Dollars in thousands)	December 31, 2004	2003	2002
Current:			
Federal	$ 3,439	$ 3,463	$ 3,890
State	923	944	1,060
Total current	4,362	4,407	4,950
Deferred:			
Federal	(844)	(658)	(1,037)
State	(319)	(253)	(429)
Total deferred	(1,163)	(911)	(1,466)
Provision for income taxes	$ 3,199	$ 3,496	$ 3,484

The effective tax rate differs from the federal statutory rate for the years ended December 31, as follows:

	December 31, 2004	2003	2002
Statutory federal income tax rate	35.0 %	35.0 %	35.0 %
State income taxes, net of federal tax benefit	7.9	5.2	4.5
Low income housing credits	(5.3)	(2.6)	--
Non-taxable interest income	(2.6)	(1.2)	(1.6)
Officers' life insurance	(8.8)	(3.6)	(3.5)
Other	1.2	(1.8)	(1.6)
Effective tax rate	27.4 %	31.0 %	32.8 %

Net deferred tax asset as of December 31, consists of the following:

(Dollars in thousands)	December 31, 2004	2003
Deferred tax assets:		
Allowance for loan losses	$ 5,255	$ 5,656
Securities available-for-sale	--	32
Accrued expenses	4,127	1,978
FHLB stock	--	602
State income taxes	323	332
Net operating loss carryforward	103	225
Other	1,408	678
Total deferred tax assets	11,216	9,503
Deferred tax liabilities:		
Securities available-for-sale	(468)	--
Leases	(89)	(455)
Loan fees	(989)	(112)
Other	(278)	(207)
Total deferred tax liabilities	(1,824)	(774)
Net deferred tax assets	$ 9,392	$ 8,729

The Company believes that it is more likely than not that it will realize the above deferred tax assets in future periods; therefore, no valuation allowance has been provided against its deferred tax assets.

The Company has net operating loss carryforwards of $295,000 for federal income tax purposes. These losses related to the entity that was the predecessor of the Bank, and are subject to restrictions as a result of the change of control that limits the maximum annual recovery of the net operating loss to $295,000. The net operations losses of approximately $290,000 expire in 2005, $3,000 expire in 2008 and $2,000 expire in 2009. Management has determined that a valuation allowance is not necessary.

(9) STOCK BASED COMPENSATION

The Company has a stock option plan (the Plan) for directors, officers, and key employees. The Plan provides for the grant of incentive and non-qualified stock options. The Plan provides that the option price for both incentive and non-qualified 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. As of December 31, 2004, there are 276,500 shares available for future grants under the Plan. Option activity under the Plan is as follows:

	Number of Shares		Weighted Average Exercise Price
Options Outstanding at January 1, 2002			
(1,148,381 exercisable at weighted average exercise price of $7.69).....................	1,546,651	$	8.25
Granted (weighted average fair value of $3.13)..	300,500	$	8.63
Exercised..	(99,447)	$	2.80
Cancelled..	(149,692)	$	11.14
Options Outstanding at December 31, 2002			
(1,144,948 exercisable at weighted average exercise price of $8.18).....................	1,598,012	$	8.39
Granted (weighted average fair value of $4.45)..	94,438	$	10.95
Exercised..	(166,623)	$	5.57
Cancelled..	(66,989)	$	9.45
Options Outstanding at December 31, 2003			
(1,134,344 exercisable at weighted average exercise price of $8.69).....................	1,458,838	$	8.82
Granted (weighted average fair value of $5.03)..	184,500	$	14.37
Exercised..	(552,528)	$	7.81
Cancelled..	(103,835)	$	10.68
Options Outstanding at December 31, 2004			
(723,336 exercisable at weighted average exercise price of $9.52).........................	986,975	$	10.23

Additional information regarding options outstanding under the Plan as of December 31, 2004 is as follows:

Range of Exercise Prices	Number Outstanding	Weighted Remaining Contractual Life (Yrs.)		Weighted Average Exercise Price	Number Exercisable		Weighted Average Exercise Price
$ 1.42 - $4.41..............	40,787	1.50	$	2.62	40,787	$	2.62
$ 4.42 - $5.32..............	34,296	2.43	$	5.22	34,296	$	5.22
$ 5.33 - $9.70..............	470,505	5.91	$	8.87	381,265	$	8.91
$ 9.71 - $16.37............	417,887	6.73	$	12.49	266,176	$	11.98
$16.38 - $19.06............	23,500	9.87	$	17.94	812	$	17.68
$ 1.42 - $19.06............	986,975	6.05	$	10.23	723,336	$	9.52

As discussed in Note 1, the Company continues to account for its stock-based awards using the intrinsic value method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretations. Accordingly, no compensation expense has been recognized in the financial statements for employee stock option arrangements.

(10) LEASES

Operating Leases

The Company leases its premises under non-cancelable operating leases with terms, including renewal options, ranging from five to fifteen years. Future minimum payments under the agreements are as follows:

(Dollars in thousands)

Year ending December 31,		
2005	$	2,186
2006		2,084
2007		2,127
2008		1,672
2009		1,392
Thereafter		910
Total	$	10,371

Rent expense under operating leases was $2,610,000, $2,609,000, and $2,506,000, during the years ended December 31, 2004, 2003, and 2002. Rent expense was reduced by deferred rent concessions on one of the Company's locations of $42,000 for the year ended December 31, 2004 and $46,000 for the year ended December 31, 2003 and 2002.

(11) BENEFIT PLANS

The Company offers a 401(k) savings plan. All salaried employees are eligible to contribute up to 20% of their pre-tax compensation (to maximums established by the Internal Revenue Code) to the plan through salary deductions under Section 401(k) of the Internal Revenue Code. The Company has made a discretionary matching contribution of up to $1,500 for each employee's contributions in 2004, 2003 and 2002. Contributions paid were $292,000, $284,000, and $304,000 in 2004, 2003 and 2002.

The Company also sponsors an employee stock ownership plan. The plan allows the Company to purchase shares on the open market and award those shares to certain employees in lieu of paying cash bonuses. To be eligible to receive an award of shares under this plan, an employee must have worked at least 1,000 hours during the year and must be employed by the Company, or its subsidiary, on December 31. Awards under this plan generally vest over four years. During 2004, 2003 and 2002, the Company made contributions of $450,000, $397,000, and $358,000 into the Plan. The amount contributed was recognized as salaries and benefits expense in the Company's financial statements. On September 7, 2001, the ESOP borrowed $1,000,000 from an unaffiliated third party lender in order to fund the purchase of common stock of the Company. This loan is being repaid with annual installments of principal of $250,000 until September 7, 2005, at which time the principal outstanding balance together with accrued interest is due and payable. An annual rate of interest, equal to Prime rate plus 0.50% floating on a daily basis, is due on the first day of each month. The funds for repayment will be primarily coming from the Company's contributions to the ESOP over a similar time period. The loan is collateralized by the 127,000 shares of the Company's common stock held by the ESOP. At December 31, 2004, the ESOP owned approximately 197,900 shares of the Company's stock. At December 31, 2004 and 2003, the unearned compensation related to the ESOP was $193,000 and $443,000. These amounts are shown as a reduction of shareholders equity in the Consolidated Balance Sheets.

The Company also has a nonqualified deferred compensation plan for the directors ("Deferral Plan"). Under the Deferral Plan, a participating director may defer up to 100% of his monthly board fees into the Deferral Plan for up to ten years. Amounts deferred earn interest at the rate of 8% per annum. The director may elect a distribution schedule of up to ten years with interest accruing (at the same 8%) on the declining balance. The Company's deferred compensation obligation of $412,000 and $332,000 as of December 31, 2004 and 2003 is included in "Accrued interest payable and other liabilities".

The Company has purchased life insurance policies on the lives of directors who have agreed to participate in the Deferral Plan. It is expected that the earnings on these policies will offset the cost of the program. In addition, the Company will receive death benefit payments upon the death of the director. The proceeds will permit the Company to "complete" the deferral program as the director originally intended if he dies prior to the completion of the deferral program. The disbursement of deferred fees is accelerated at death and commences one month after the director dies.

In the event of the director's disability prior to attainment of his benefit eligibility date, the director may request that the Board permit him to receive an immediate disability benefit equal to the annualized value of the director's deferral account.

The Company has a supplemental retirement plan covering key executives and directors (Plan). The Plan is a nonqualified defined benefit plan and is unsecured and unfunded and there are no Plan assets. The deferred benefit represents a stated amount for key executives and directors that generally vest over nine years and is reduced for early retirement. The Company has purchased insurance on the lives of the directors and executive officers in the plan and intends to use the cash values of these policies ($26,303,000 and $25,273,000 at December 31, 2004 and 2003, respectively) to pay the retirement and death benefit obligations. If the life insurance contract is terminated by the Company, the Company still has the obligation to pay the retirement and death benefits. The accrued pension obligation was $5,805,000 and $4,129,000 as of December 31, 2004 and 2003, respectively, and is included in "Accrued interest payable and other liabilities". Accordingly, the plan had additional minimum liabilities of $1,940,000 as of December 31, 2004, and $0 as of December 31, 2003 and 2002. Due to these additional minimum liabilities, the plan also had accumulated other comprehensive expense before taxes of $1,940,000 as of December 31, 2004, and $0 as of December 31, 2003 and 2002. The measurement date at the plan is December 31.

The following table sets forth the unqualified supplemental retirement defined benefit plan's status at December 31:

(Dollars in thousands)	2004	2003	2002
Change in projected benefit obligation			
Projected benefit obligation at beginning of year	$ 3,962	$ 3,350	$ 2,399
Service cost	473	457	636
Interest cost	386	198	153
Actuarial (gain)/loss	2,223	(43)	162
Special termination benefits	765	--	--
Benefits paid	(64)	--	--
Projected benefit obligation at end of year	$ 7,745	$ 3,962	$ 3,350

(Dollars in thousands)	2004	2003	2002
Change in Plan assets			
Fair value of Plan assets at beginning of year	$ --	$ --	$ --
Actual return on assets	--	--	--
Employer contribution	64	--	--
Benefits paid	(64)	--	--
Fair value of Plan assets at end of year	$ --	$ --	$ --
Unfunded Status	$ (7,745)	$ (3,962)	$ (3,350)
Unrecognized net actuarial (gain)/loss	1,940	(167)	(125)
Net amount recognized	$ (5,805)	$ (4,129)	$ (3,475)
Accrued benefit liability	$ (7,745)	$ (3,962)	$ (3,350)
Accumulated other comprehensive expense	1,940	--	--
Net amount recognized	$ (5,805)	$ (3,962)	$ (3,350)
Weighted-average assumptions as of December 31			
Discount rate	5.60%	7.00%	7.00%
Rate of compensation increase	N/A	N/A	N/A
Expected return on Plan assets	N/A	N/A	N/A

The following benefit payments, which reflect anticipated future events, as appropriate, are expected to be paid over the following years:

Year	Benefit Payments (Dollars in thousands)
2005	$ 64
2006	126
2007	164
2008	225
2009	241
2010 to 2014	2,909

The elements of pension costs for the unqualified supplemental retirement defined benefit plan at December 31, 2004 were as follows:

(Dollars in thousands)	2004	2003	2002
Components of net periodic benefits cost			
Service cost	$ 473	$ 457	$ 636
Interest cost	386	198	153
Amortization of (gain)/loss	116	(23)	130
Net periodic benefit cost	975	632	919
Expense due to special termination benefits	765	--	--
Total expense	$ 1,740	$ 632	$ 919

The net periodic pension cost was determined using the following assumptions:

	2004	2003	2002
Discount rate in determining expense	6.25%	7.00%	7.00%
Discount rate in determining benefit obligations at year end	5.60%	7.00%	7.00%
Rate of increase in future compensation levels for determining expense	N/A	N/A	N/A
Rate of increase in future compensation levels for determining benefit obligations at year end	N/A	N/A	N/A
Expected return on Plan assets	N/A	N/A	N/A

(12) DISCLOSURES OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation techniques may have a material effect on the estimated fair value amounts.

The carrying amounts and estimated fair values of the Company's financial instruments as of December 31, 2004 and 2003 were as follows:

	2004		2003	
(Dollars in thousands)	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Assets				
Cash and cash equivalents	$ 57,746	$ 57,746	$ 114,217	$ 114,217
Securities	232,809	232,809	153,473	153,473
Loans, including loans held for sale, net	750,212	748,139	683,275	682,120
Other investments, including company owned life insurance	30,998	30,998	27,777	27,777
Liabilities				
Time deposits	$ 162,876	$ 162,436	$ 145,841	$ 146,403
Other deposits	755,659	755,659	689,569	689,569
Other borrowings	47,800	43,800	43,600	44,843
Notes payable subsidiary grantor trusts	23,702	21,702	23,702	21,859

The following methods and assumptions were used to estimate the fair value in the table, above:

Cash and Cash Equivalents

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

Securities

The fair value of securities is estimated based on bid market prices. The fair value of certain municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on such dealer quotations.

Loans, net

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

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

Other Investments

Other investments consist of FRB and FHLB stock and the cash surrender value of the Company Owned Life Insurance policies. The carrying amount represents a reasonable estimate of fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, savings, and money market accounts, approximates the amount payable on demand. The fair value of the demand deposit intangible has not been included in the fair value estimate. The carrying amount approximates the fair value of time deposits with a remaining maturity of less than 90 days. The fair value of all other time deposits is calculated based on discounting the future cash flows using rates currently offered by the Bank for time deposits with similar remaining maturities.

Commitments to Fund Loans/Standby Letters of Credit

The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The amounts of and differences between the carrying value of commitments to fund loans or stand by letters of credit and their fair value is not significant and therefore is not included in the table above.

Other Borrowings

Other borrowings consist of FRB and FHLB short-term borrowings and other long-term borrowings. The fair value of the short-term borrowings was based on their carrying amount. The fair values of the other borrowings were determined based on the current market value for like kind instruments of a similar maturity and structure.

Notes Payable to Subsidiary Grantor Trusts

The fair value of the notes payable to subsidiary grantor trusts was determined based on the current market value for like kind instruments of a similar maturity and structure.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(13) COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance Sheet Risk

HBC is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk, in excess of the amounts recognized in the balance sheets.

HBC's exposure to credit loss in the event of non-performance of the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. HBC uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Credit risk is the possibility that a loss may occur because a party to a transaction failed to perform according to the terms of the contract. HBC controls the credit risk of these transactions through credit approvals, limits, and monitoring procedures. Management does not anticipate any significant losses as a result of these transactions.

Commitments to extend credit as of December 31, were as follows:

(Dollars in thousands)	2004	2003
Commitments to extend credit	$ 313,036	$ 269,504
Standby letters of credit	5,256	4,449
	$ 318,292	$ 273,953

Commitments to extend credit are agreements to lend to a client as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since some of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. HBC evaluates each client's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by HBC upon the extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include cash, marketable securities, accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and/or residential properties. Fair value of these instruments is not material.

Standby letters of credit are written with conditional commitments issued by HBC to guaranty the performance of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. The Company has a deferred liability of $19,000 as of December 31, 2004, which represents the premiums received on outstanding financial standby letters of credit. The Company recognizes these premiums as income as the commitments are used or as they expire.

Claims

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.

(14) REGULATORY MATTERS

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the federal 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. 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 the Company's and HBC's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and HBC's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and HBC to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes that, as of December 31, 2004, the Company and HBC meet all capital adequacy guidelines to which it is subject.

The most recent notification from the FDIC for HBC as of December 31, 2004 categorized HBC as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" HBC must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Company's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes	
(Dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2004				
Total Capital........................ (to risk-weighted assets)	$ 132,719	14.3%	$ 74,248	(greater than or equal to) 8.0%
Tier 1 Capital....................... (to risk-weighted assets)	$ 121,096	13.0%	$ 37,260	(greater than or equal to) 4.0%
Tier 1 Capital....................... (to average assets)	$ 121,096	10.9%	$ 44,439	(greater than or equal to) 4.0%
As of December 31, 2003				
Total Capital........................ (to risk-weighted assets)	$ 120,933	14.6%	$ 66,265	(greater than or equal to) 8.0%
Tier 1 Capital....................... (to risk-weighted assets)	$ 110,530	13.3%	$ 33,242	(greater than or equal to) 4.0%
Tier 1 Capital....................... (to average assets)	$ 110,530	11.1%	$ 39,831	(greater than or equal to) 4.0%

HBC's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2004						
Total Capital (to risk-weighted assets)	$ 127,474	13.7%	$ 74,329	(greater than or equal to) 8.0%	$ 92,911	(greater than or equal to) 10.0%
Tier 1 Capital (to risk-weighted assets)	$ 115,851	12.5%	$ 37,162	(greater than or equal to) 4.0%	$ 55,742	(greater than or equal to) 6.0%
Tier 1 Capital (to average assets)	$ 115,851	10.4%	$ 44,687	(greater than or equal to) 4.0%	$ 55,859	(greater than or equal to) 5.0%
As of December 31, 2003						
Total Capital (to risk-weighted assets)	$ 113,538	13.6%	$ 66,787	(greater than or equal to) 8.0%	$ 83,484	(greater than or equal to) 10.0%
Tier 1 Capital (to risk-weighted assets)	$ 103,135	12.4%	$ 33,269	(greater than or equal to) 4.0%	$ 49,904	(greater than or equal to) 6.0%
Tier 1 Capital (to average assets)	$ 103,135	10.3%	$ 40,052	(greater than or equal to) 4.0%	$ 50,066	(greater than or equal to) 5.0%

The Company is required to maintain reserves with the Federal Reserve Bank of San Francisco. Reserve requirements are based on a percentage of certain deposits. As of December 31, 2004, the Company maintained reserves of $8,800,000 in the form of vault cash and balances at the Federal Reserve Bank of San Francisco, which satisfied the regulatory requirements.

Under California 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 therefor. The California Banking Law 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, 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. 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. At December 31, 2004, the amount available for such dividend without prior written approval was approximately $27,885,000 for HBC. Similar restrictions apply to the amounts and sum of loan advances and other transfers of funds from HBC to the Company.

(15) PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

The condensed financial statements of Heritage Commerce Corp (parent company only) are as follows:

CONDENSED BALANCE SHEETS

(Dollars in thousands)	December 31, 2004	December 31, 2003
Cash and cash equivalents	$ 7,830	$ 8,880
Investment in and advancements to subsidiary	115,044	104,104 (1)
Other assets	1,191	1,300
Total	$ 124,065	$ 114,284
Liabilities	$ 1,784	$ 1,097
Amounts due to subsidiaries	23,702	23,702
Shareholders' equity	98,579	89,485 (1)
Total	$ 124,065	$ 114,284

(1) As restated, see Note 2.

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	For the Year Ended,		
(Dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Interest income	$ 97	$ 122	$ 95
Management and service fees	--	--	10,747
Interest expense	--	(1,965)	(1,920)
Other expenses	(3,124)	(71)	(11,176)
Loss before equity in net income of subsidiary banks	(3,027)	(1,914)	(2,254)
Equity in undistributed net income of subsidiary	10,676	9,090 (1)	8,669 (1)
Income tax benefit	829	600	739
Net income	8,478	7,776 (1)	7,154 (1)
Other comprehensive income (loss)	(1,809)	(1,635)	693
Comprehensive income	$ 6,669	$ 6,141	$ 7,847

(1) As restated, see Note 2.

CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	For the Year Ended, December 31, 2004	December 31, 2003	December 31, 2002
Cash flows from operating activities:			
Net Income	$ 8,478	$ 7,776 (1)	$ 7,154 (1)
Adjustments to reconcile net income to net cash used in operations:			
Provision for deferred income taxes	(829)	(600)	(739)
Equity in undistributed income of subsidiary	(10,676)	(9,090)(1)	(8,669)(1)
Net change in other assets	96	135	(416)
Net change in other liabilities	1,529	796	2,328
Net cash used in by operating activities	(1,402)	(983)	(342)
Cash flows from investing activities:			
Cash distributed to Bank subsidiaries	--	--	--
Net cash used in investing activities	--	--	--
Cash flows from financing activities:			
Proceeds from issuance of common stock	4,316	1,173	421
Proceeds from issuance of long-term debt	--	--	4,000
Other, net	250	(443)	(693)
Net cash provided by financing activities	352	730	3,728
Net increase (decrease) in cash and cash equivalents	(1,050)	(253)	3,386
Cash and cash equivalents, beginning of year	8,880	9,133	5,747
Cash and cash equivalents, end of year	$ 7,830	$ 8,880	$ 9,133

(1) As restated, see Note 2.

EXHIBIT INDEX

		Incorporated by Reference to Form					
		Filed Herewith	Form S-8	8-K or 8-A Dated	10-Q Dated	10-K Dated	Exhibit No.
2.1	Agreement and Plan of Merger and Reorganization dated as of May 9, 2000 between Heritage Commerce Corp and Western Holdings Bancorp (incorporated by reference from Annex A of the registration statement on Form S-4, Registration No. 333- 40384, filed with the Commission on June 29, 2000)						
3.1	Heritage Commerce Corp Restated Articles of Incorporation as Amended effective June 29, 2001				6-30-01		3.1
3.2	Heritage Commerce Corp Bylaws as amended to September 27, 2001				9-30-01		3.2
4.1	The indenture, dated as of March 23, 2000, between Heritage Commerce Corp, as Issuer, and the Bank of New York, as Trustee					4-6-01 (10-K/A Amendment No. 1)	4.1
4.2	Amended and restated Declaration of Trust, Heritage Capital Trust I, dated as of March 23, 2000					4-6-01 (10-K/A Amendment No. 1)	4.2
4.3	The indenture, dated as of September 7, 2000, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company, of Connecticut, National Association, as Trustee					4-6-01 (10-K/A Amendment No. 1)	4.3
4.4	Amended and restated Declaration of Trust, Heritage Commerce Corp Statutory Trust I, dated as of September 7, 2000					4-6-01 (10-K/A Amendment No. 1)	4.4
4.5	The indenture, dated as of July 31, 2001, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company, of Connecticut, National Association, as Trustee					3/28/02	4.5
4.6	Amended and restated Declaration of Trust, Heritage Statutory Trust II, dated as of July 31, 2001					3/28/02	4.6

4.7	The indenture, dated as of September 26, 2002, between Heritage Commerce Corp, as Issuer, and State Street Bank and Trust Company, of Connecticut, National Association, as Trustee				3/28/03	4.7
4.8	Amended and restated Declaration of Trust, Heritage Commerce Corp Statutory Trust III, dated as of September 26, 2002				3/28/03	4.8
10.1	Real Property Leases for properties located at 150 Almaden Blvd., San Jose and 100 Park Center Plaza, San Jose.			3-5-98		10.1
10.2	Employment agreement with Mr. Conniff dated April 30, 1998 *				3-31-99	10.2
10.3	Employment agreement with Mr. McGovern dated July 16, 1998 *				3-31-99	10.3
10.4	Agreement between Fiserv Solutions, Inc. and Heritage Commerce Corp dated October 20, 2003				3-12-04	10.4
10.5	Employment agreement with Mr. Corsello dated May 11, 2001, with an amendment dated May 11, 2004 *	X				10.5
10.6	1994 Stock Option Plan and Form of Agreement		07/17/98			10.6
10.7	2004 Stock Option Plan and Form of Agreement		7/16/04			10.7
10.8	Employment agreement with Mr. Kaczmarek dated March 17, 2005 *			03/22/05		10.8
10.9	Restricted stock agreement with Mr. Kaczmarek dated March 17, 2005			03/22/05		10.9
10.10	2004 stock option agreement with Mr. Kaczmarek dated March 17, 2005			03/22/05		10.10
10.11	Non-qualified Deferred Compensation Plan	X				10.11
10.12	Director Deferred Fee Agreement with James R. Blair dated June 30, 1997	X				10.12
10.13	Director Deferred Fee Agreement with Jack Peckham dated June 30, 1997	X				10.13

21.1	Subsidiaries of the registrant	X
23.1	Consent of Deloitte & Touche LLP	X
31.1	Certification of Registrant's Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
31.2	Certification of Registrant's Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
32.1	Certification of Registrant's Chief Executive Officer Pursuant to 18 U.S.C. Section 1350	X
32.2	Certification of Registrant's Chief Financial Officer Pursuant to 18 U.S.C. Section 1350	X

* Management contract or compensatory plan or arrangement.