

Bank of Commerce Holdings
Form 10-Q
May 02, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2008

OR

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

For the transition period from _____ to _____

Commission file number 0-25135

California
(State or other jurisdiction of incorporation or
organization)

1901 Churn Creek Road Redding, California

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

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

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

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

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

Common Stock, no par value per share

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller Reporting Company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

Outstanding shares of Common Stock, no par value, as of March 31, 2008: 8,707,745

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

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

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

<i>Dollars in thousands</i>	March 31, 2008	Dec. 31,2007	March 31,2007
ASSETS			
Cash and due from banks	\$ 12,737	\$ 13,839	\$ 12,597
Federal funds sold and securities purchased under agreements to resell	25,995	8,395	21,195
Cash and cash equivalents	38,732	22,234	33,792
Securities available-for-sale (including pledged collateral of \$57,274 at March 31, 2008, \$61,329 at December 31, 2007 and \$68,261 at March 31, 2007)	62,090	67,906	93,769
Securities held-to-maturity, at cost (estimated fair value of \$10,646 at March 31, 2008, \$10,632 at December 31, 2007 and \$10,693 at March 31, 2007)	10,421	10,559	10,673
Loans, net of the allowance for loan losses of \$5,815 at March 31, 2008, \$8,233 at December 31, 2007 and \$4,933 at March 31, 2007	506,374	486,283	411,357
Bank premises and equipment, net	11,370	10,964	9,992
Other assets	22,248	20,381	18,513
TOTAL ASSETS	\$ 651,235	\$ 618,327	\$ 578,096
LIABILITIES AND STOCKHOLDERS' EQUITY			
Demand noninterest bearing	\$ 71,722	\$ 75,718	\$ 70,035
Demand interest bearing	140,624	142,821	112,550
Savings accounts	42,946	41,376	41,537
Certificates of deposit	229,006	213,716	211,422
Total deposits	484,298	473,631	435,544
Securities sold under agreements to repurchase	12,455	15,513	35,053
Federal Home Loan Bank borrowings	85,000	60,000	40,000
Other liabilities	7,633	7,554	6,646
	15,465	15,465	15,465

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Junior subordinated debt payable to unconsolidated subsidiary grantor trust

Total Liabilities	604,851	572,163	532,708
Commitments and contingencies			
Stockholders' Equity:			
Preferred stock, no par value, 2,000,000 authorized no shares issued and outstanding in 2008 and 2007			
Common stock, no par value, 50,000,000 shares authorized; 8,707,745 shares issued and outstanding at March 31, 2008, 8,757,445 at December 31, 2007 and 8,907,680 at March 31, 2007	9,550	9,996	11,940
Retained earnings	37,135	36,605	34,110
Accumulated other comprehensive loss, net of tax	(301)	(437)	(662)
Total stockholders' equity	46,384	46,164	45,388
 TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	 \$ 651,235	 \$ 618,327	 \$ 578,096

See accompanying notes to condensed consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Condensed Consolidated Statements of Income (Unaudited)
Three months ended March 31, 2008 and 2007

	Three Months Ended	
	March 31, 2008	March 31, 2007
<i>Dollars in thousands, except for per share data</i>		
Interest income:		
Interest and fees on loans	\$ 9,131	\$ 8,464
Interest on tax-exempt securities	274	278
Interest on U.S. government securities	481	832
Interest on federal funds sold and securities purchased under agreements to resell	58	200
Interest on other securities	22	36
Total interest income	9,966	9,810
Interest expense:		
Interest on demand deposits	750	557
Interest on savings deposits	290	171
Interest on certificates of deposit	2,376	2,605
Securities sold under repurchase agreements	84	342
Interest on FHLB and other borrowings	731	539
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	315	269
Total interest expense	4,546	4,483
Net interest income	5,420	5,327
Provision for loan and lease losses	600	6
Net interest income after provision for loan and lease losses	4,820	5,321
Noninterest income:		
Service charges on deposit accounts	62	69
Payroll and benefit processing fees	129	108
Earnings on cash surrender value - Bank owned life insurance	83	95
Net gain on sale of securities available-for-sale	242	46
Net loss on sale of derivative swap transaction	(225)	0
Merchant credit card service income, net	83	92
Mortgage brokerage fee income	10	6
Other income	181	82
Total noninterest income	565	498
Noninterest expense:		
Salaries and related benefits	1,949	2,097
Occupancy and equipment expense	644	458
FDIC insurance premium	58	13

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Data processing fees	78		55
Professional service fees	118		195
Payroll processing fees	33		31
Deferred compensation expense	111		97
Stationery and supplies	62		61
Postage	34		33
Directors' expense	48		45
Other expenses	430		403
Total noninterest expense	3,565		3,488
Income before provision for income taxes	1,820		2,331
Provision for income taxes	591		844
Net income	\$ 1,229	\$	1,487
Basic earnings per share	\$ 0.14	\$	0.17
Weighted average shares basic	8,719		8,864
Diluted earnings per share	\$ 0.14	\$	0.17
Weighted average shares diluted	8,748		8,976
Cash dividends per share	\$ 0.08	\$	0.08

See accompanying notes to condensed consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)
Three months ended March 31, 2008 and 2007

<i>Dollars in thousands</i>	March 31, 2008	March 31, 2007
Cash flows from operating activities:		
Net income	\$ 1,229	\$ 1,487
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	600	6
Provision for depreciation and amortization	302	207
Compensation expense associated with stock options	28	36
Tax benefits from the exercise of stock options	0	(118)
(Gain) Loss on sale of securities available-for-sale	(242)	(46)
Amortization of investment premiums and accretion of discounts, net	7	8
Loss on sale of derivative swap transaction	225	0
Gain on sale of fixed assets	(6)	(2)
Deferred income taxes	(698)	349
(Increase) in cash surrender value of bank owned life policies	(83)	(95)
Effect of changes in:		
Other assets	(1,308)	567
Deferred compensation	111	97
Deferred loan fees	(53)	(31)
Other liabilities	92	(791)
Net cash from operating activities	204	1,674
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale securities	765	1,627
Proceeds from sales of available-for-sale securities	16,682	20,372
Proceeds from maturities of held-to-maturity securities	138	136
Purchases of available-for-sale securities	(11,383)	(19,102)
Loan origination, net of principal repayments	(20,638)	(2,342)
Purchases of Bank premises and equipment, net	(829)	(1,608)
Proceeds on sale of fixed assets	127	7
Net cash from investing activities	(15,140)	(910)
Cash flows from financing activities:		
Net (decrease) in demand and savings accounts	(4,623)	(2,843)
Net increase (decrease) in certificates of deposit	15,290	(1,020)
Net (decrease) in securities sold under agreement to repurchase	(3,058)	(2,064)
Proceeds from Federal Home Loan Bank advances	80,000	0
Repayments of Federal Home Loan Bank advances	(55,000)	(0)
Cash dividends paid on common stock	(700)	(713)
Proceeds from stock options exercised	29	284
Common Stock repurchase	(504)	0

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Tax benefits from the exercise of stock options	0	118
Net cash from financing activities	31,434	(6,238)
Net increase (decrease) in cash and cash equivalents	16,498	(5,474)
Cash and cash equivalents, beginning of period	22,234	39,266
Cash and cash equivalents, end of period	\$ 38,732	\$ 33,792
Supplemental disclosures:		
Cash paid during the period for:		
Income taxes	\$ 250	\$ 350
Interest	4,445	4,639

See accompanying notes to condensed consolidated financial statements.

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BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Consolidation and Basis of Presentation

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

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

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in Bank of Commerce Holdings 2007 Annual Report on Form 10-K. The results of operations and cash flows for the 2008 interim periods shown in this report are not necessarily indicative of the results for any future interim period or the entire fiscal year.

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and repurchase agreements. Generally, federal funds are sold for a one-day period and securities purchased under agreements to resell are for no more than a 90-day period.

2. Recent Accounting pronouncements

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

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

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

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

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Basic earnings per share (EPS) excludes dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Stock options are considered to be common stock equivalents. The following table displays the computation of earnings per share for the three months ended March 31, 2008 and 2007. 144,937 shares are excluded due to anti-dilutive values.

	Three Months Ended	
	March 31, 2008	March 31, 2007
(Dollars in thousands, except per share data)		
Basic EPS calculation:		
Numerator (net income)	\$ 1,229	\$ 1,487
Denominator (average common shares outstanding)	8,719	8,864
Basic EPS	\$ 0.14	\$ 0.17
Diluted EPS calculation:		
Numerator (net income)	\$ 1,229	\$ 1,487
Denominator:		
Average common shares outstanding	8,719	8,864
Dilutive effect of stock options	29	112
Adjusted weighted average common shares outstanding	8,748	8,976
Diluted EPS	\$ 0.14	\$ 0.17
Anti- dilutive shares excluded	145	108

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The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment, on January 1, 2006. The scope of FAS 123R includes a wide range of stock-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. FAS 123R requires that the Company measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date. That cost must be recognized in the income statement over the vesting period of the award. Under the modified prospective transition method, awards that are granted, modified or settled beginning at the date of adoption will be measured and accounted for in accordance with FAS 123R. In addition, expense must be recognized in the income statement for unvested awards that were granted prior to the date of adoption. Prior to the adoption of FAS 123R and as permitted by FAS 123 and FAS 148,

Accounting for Stock-Based Compensation Transition and Disclosure, the Company elected to follow APB 25 and related interpretations in accounting for our employee stock options.

For the first quarter of 2008, stock option compensation expense charged against income was \$28,398 compared to \$20,763 at March 31, 2007. At March 31, 2008, there was \$303,595 of total unrecognized compensation costs related to non-vested share based payments which is expected to be recognized over a period of 3.6 years. No options were granted during the first quarter of 2008 or 2007.

During the three months ended March 31, 2008 and 2007 the Company realized income tax benefits of \$0 and \$117,925 respectively, related to the exercise of nonqualified stock options. The income tax benefit is reflected in net cash provided by financing activities in the consolidated statements of cash flow for the same period.

During the three months ended March 31, 2008 and 2007 the Company received cash of \$29,393 and \$284,354 respectively, upon exercise of stock-based compensation arrangements.

5. Comprehensive Income

The Company's total comprehensive income was as follows:

	Three Months Ended	
	March 31, 2008	March 31, 2007
<i>(Dollars in thousands)</i>		
Net income as reported	\$ 1,229	\$ 1,487
Other comprehensive income, net of tax:		
Unrealized holding gain on securities available for sale, net of tax	349	164
Reclassification adjustment for gain on available for sale securities, net of tax	(142)	(27)
Unrealized gains arising during the period on derivative transactions, net	28	157
Total other comprehensive (loss) income	235	294
Total comprehensive income	\$ 1,464	\$ 1,781

6. Junior Subordinated Debt Payable to Unconsolidated Subsidiary Grantor Trust

During 2003, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust I (the grantor trust), which issued \$5.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings junior subordinated debentures (the trust notes) to the public and \$155,000 common securities to the Company.

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These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines. The proceeds from the issuance of the trust notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital. The trust notes accrue and pay distributions on a quarterly basis at 3 month London Interbank Offered Rate (LIBOR) plus 3.30%. The rate at March 31, 2008 was 5.98%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the trust notes is March 18, 2033, and the debt allows for prepayment after five years on the quarterly payment date. During 2005, Bank of Commerce Holdings (the Company) participated in a private placement to an institutional investor of \$10.0 million of fixed rate trust preferred securities (the Trust Preferred Securities); through a newly formed Delaware trust affiliate, Bank of Commerce Holdings Trust II (the Trust). The Trust Preferred Securities mature on September 15, 2035, and are redeemable at the Company's option on any March 15, June 15, September 15 or December 15 on or after September 15, 2010. In addition, the Trust Preferred Securities require quarterly distributions by the Trust to the holder of the Trust Preferred Securities at a rate of 6.12%, until September 10, 2010 after which the rate will reset quarterly to equal LIBOR plus 1.58%. The Trust simultaneously issued \$310,000 of the Trust's common securities of beneficial interest to the Company. The proceeds from the sale of the Trust Preferred Securities were used by the Trust to purchase from the Company the aggregate principal amount of \$10,310,000 of the Company's floating rate junior subordinate notes (the Notes). The net proceeds to the Company from the sale of the Notes to the Trust will be used by the Company for general corporate purposes, including funding the growth of the Company's various financial services. The Notes were issued pursuant to a Junior Subordinated Indenture (the Indenture), dated July 29, 2005, by and between the Company and J.P. Morgan Chase Bank, National Association, as trustee. Like the Trust Preferred Securities, the Notes bear interest at a floating rate, at 6.12% until September 10, 2010, after which the rate will reset on a quarterly basis to equal LIBOR plus 1.58%. The interest payments by the Company will be used to pay the quarterly distributions payable by the Trust to the holder of the Trust Preferred Securities. However, so long as no event of default, as described below, has occurred under the Notes, the Company may, at any time and from time to time, defer interest payments on the Notes (in which case the Trust will be entitled to defer distributions otherwise due on the Trust Preferred Securities) for up to twenty (20) consecutive quarters. The Notes are subordinated to the prior payment of other indebtedness of the Company that, by its terms, is not similarly subordinated. Although the Notes will be recorded as a long term liability on the Company's balance sheet, for regulatory purposes, the Notes are expected to be treated as Tier 1 or Tier 2 capital under rulings of the Federal Reserve Board, the Company's primary federal regulatory agency. The Notes mature on September 15, 2035, but may be redeemed at the Company's option at any time on or after September 15, 2010, or at any time upon certain events, such as a change in the regulatory capital treatment of the Notes, the Trust being deemed to be an investment company or the occurrence of certain adverse tax events. In each case, the Company may redeem the Notes for their aggregate principal amount, plus accrued interest, if any.

7. Commitments and Contingent Liabilities

Lease Commitments The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under all non-cancelable operating leases as of March 31, 2008 are below:

(Dollars in thousands)

2008	\$ 453
2009	\$ 558
2010	\$ 524
2011	\$ 454
2012	\$ 279
Thereafter	\$ 761
Total	\$ 3,029

Minimum rental due in the future Under noncancellable subleases	\$	4
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Legal Proceedings The Company is involved in various pending and threatened legal actions arising in the ordinary course of business. The Company maintains reserves for losses from legal actions, which are both probable and estimable. In the opinion of management, the disposition of claims, currently pending will not have a material adverse affect on the Company's financial position or results of operations.

FHLB Advances Borrowings are advances from the Federal Home Loan Bank of San Francisco (FHLB) totaling \$85,000,000 as March 31, 2008, \$60,000,000 at December 31, 2007 and \$40,000,000 as of March 31, 2007. The FHLB advances bear fixed and floating rates of interest ranging from 2.82% to 5.23%. Interest is payable either monthly or quarterly.

The following table illustrates borrowings outstanding at the end of the period:

Amount	Interest Rate	Maturity
\$ 15,000,000	3.20%	01/26/2009
\$ 15,000,000	2.82%	01/22/2010
\$ 15,000,000	2.89%	01/22/2009
\$ 35,000,000	3.97%	11/23/2009
\$ 5,000,000	5.23%	04/28/2008

\$ 85,000,000

These borrowings are secured by an investment in FHLB stock and certain real estate mortgage loans which have been specifically pledged to the FHLB pursuant to their collateral requirements. Based upon the level of FHLB advances, the Bank was required to hold a minimum investment of \$4,267,400 in FHLB stock and pledge collateral of \$74,533,568 in real estate mortgage loans as of March 31, 2008. At March 31, 2008, the Bank had available borrowing lines at the FHLB of \$25,201,255 and additional federal fund borrowing lines at two correspondent banks totaling \$25,000,000.

Off-Balance Sheet Financial Instruments - In the ordinary course of business, the Company enters various types of transactions, which involve financial instruments with off-balance sheet risk. These instruments include commitments to extend credit and standby letter of credits, which are not reflected in the accompanying consolidated balance sheets. These transactions may involve, to varying degrees, credit and interest rate risk more than the amount, if any recognized in the consolidated balance sheets. Commitments to extend credit are agreements to lend to customers.

These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Company if certain conditions of the contract are violated. Although currently subject to draw down, many of the commitments do not necessarily represent future cash requirements. Collateral held relating to these commitments varies, but generally includes real estate, securities and cash. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Credit risk arises in these transactions from the possibility that a customer may not be able to repay the Bank upon default of performance. Collateral held for standby letters of credit is based on an individual evaluation of each customer's creditworthiness, but may include cash and securities. Commitments to extend credit and standby letters of credit bear similar credit risk characteristics as outstanding loans.

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Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(Unaudited)

8. Accounting for Income Tax Uncertainties (FIN 48)

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

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

Table of Contents**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Unaudited)****9. Fair Value Measurement**

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

In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of March 31, 2008, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

		Fair Value Measurements at March 31, 2008, Using		
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(Dollars in thousands)	Fair Value March 31, 2008	(Level 1)	(Level 2)	(Level 3)
Description				
Available-for-sale securities	\$62,090	\$62,090		
To Total assets measured at fair value	\$62,090	\$62,090	\$	\$
Derivative Liabilities	\$ 200		200	
Total liabilities measured at fair value	\$ 200	\$	\$ 200	\$

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

Securities available-for-sale - Securities classified as available-for-sale are reported at fair value utilizing Level 1 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit

information and the bond's terms and conditions among other things.

Derivatives Derivatives are valued using internal models, most of which are primarily based on market observable input including interest rate curves and both forward Derivatives are reported at fair value utilizing Level 2 inputs, and are provided to the Company by an independent pricing source. The fair market value of the derivative is based on the present value of the expected cash flows over the life of the instrument. Expected cash flows are determined by evaluating transactions with a pricing model using a specific market environment. The fair values disclosed were estimated using the closing mid-market market/price environment as of March 31, 2008. These values do not take into account liquidity, hedging cost, bid/offer, credit or other considerations that are specific to each counterparty and transaction, and that vary over time.

Table of Contents**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Unaudited)****Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

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

(Dollars in thousands)

March 31, 2008	Total	Level 1	Level 2	Level 3
Impaired Loans	\$ 15,958	\$	\$	\$ 15,958
Total assets at fair value	\$ 15,958	\$	\$	\$ 15,958
Total liabilities at fair value	\$	\$	\$	\$

Impaired loans When available, we use observable market data, including pricing on recent closed market transactions, to value loans. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3. The Company had outstanding balances of \$16.0 and \$12.4 million in impaired loans as of March 31, 2008 and December 31, 2007, respectively.

The fair value measurements recorded during the period

We recognized a \$2.9 million write-down related to non-recurring fair value measurements of impaired loans during the period. Reserves were previously allocated in anticipation of this impairment review. Interest reversed from income during the period due to impaired loans was \$84,525.

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

Forward Looking Statements and Risk Factors

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

For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007 under the heading

Risk factors that may affect results. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following sections discuss significant changes and trends in the financial condition, capital resources and liquidity of the Company from December 31, 2007 to March 31, 2008. Also discussed are significant trends and changes in the Company's results of operations for the three months ended March 31, 2008, compared to the same period in 2007. The consolidated financial statements and related notes appearing elsewhere in this report are condensed and unaudited. The following discussion and analysis is intended to provide greater detail of the Company's financial condition and results.

Company Overview

Bank of Commerce Holdings (the "Holding Company") is a corporation organized under the laws of California and a financial holding company ("FHC") registered under the Bank Holding Company Act of 1956, as amended ("BHC Act"). The Holding Company's principal business is to serve as a holding company for Redding Bank of Commerce, Roseville Bank of Commerce, Sutter Bank of Commerce and Bank of Commerce Mortgage, and for other banking or banking-related subsidiaries which the Holding Company may establish or acquire (collectively the "Company"). The Holding Company also has two unconsolidated subsidiaries, Bank of Commerce Holdings Trust and Bank of Commerce Holdings Trust II. The Company is listed on the NASDAQ National Market under the trading symbol BOCH (Bank of Commerce Holdings).

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

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

gross premiums earned to BWC Mortgage Services.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risk Factors

Economic Conditions and Geographic Concentration

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

The Company's primary lending focus has historically been commercial real estate, commercial lending and, to a lesser extent, construction lending. At March 31, 2008, all of the Company's real estate mortgage, real estate construction loans, and commercial real estate loans, were secured fully or in part by deeds of trust on underlying real estate. The Company's dependence on real estate increases the risk of loss in the loan portfolio of the Company and its holdings of other real estate owned if economic conditions in California deteriorate in the future. Deterioration of the real estate market in California has had a material adverse effect on the Company's business, financial condition and results of operations during the first quarter 2008.

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

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

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

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

The Company assesses interest rate risk by estimating the effect on earnings in various scenarios that differ based on assumptions about the direction, magnitude and speed of interest rate changes and the slope of the yield curve. The Company may hedge some interest rate risk with interest rate derivatives. The Company does not hedge all of its interest rate risk. There is risk that changes in interest rates could reduce our net interest income and earnings in material amounts, especially if actual conditions turn out to be materially different than the assumptions used in the model. One example: If interest rates rise or fall faster than assumed or the slope of the yield curve changes, the Company may incur losses on debt securities held as investments. To reduce the interest rate risk, the Company may choose to rebalance the investment and loan portfolio, refinance debt outstanding or take other strategic actions. The Company may incur losses or expenses when taking such actions.

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

Lending Risks Associated with Commercial Real Estate and Construction Activities

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

Adequacy of Allowance for Loan and Lease Losses (ALLL)

Higher credit losses could require the Company to increase the allowance for loan and lease losses through a charge to earnings. When the Company loans money or commits to loan money it incurs credit risk or the risk of losses if our borrowers do not repay their loans. The Company provides a reserve for credit risk by establishing an allowance through a charge to earnings. The amount of the allowance is based on an assessment of credit losses inherent in the loan portfolio (including unfunded credit commitments). The process for determining the amount of the allowance is critical to our financial results and condition. It requires difficult, subjective and complex judgments about the future, including forecasts of economic or market conditions that might impair our borrower's ability to repay their loans. The Company might increase the allowance because of changing economic conditions or unexpected events. The Company's allowance for loan and lease losses was approximately \$5.8 million, or 1.14% of total loans at March 31, 2008.

Potential Volatility of Deposits

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

At March 31, 2008, time certificates of deposit in excess of \$100,000 represented approximately 27% of the dollar value of the total deposits of the Company. As such, these deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits could adversely affect the liquidity of the Company, profitability, business prospects, results of operations and cash flows. The Company monitors activity of volatile liability deposits on a quarterly basis.

Dividends

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

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

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

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

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

Government Regulation and Legislation

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

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

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

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

Certain Ownership Restrictions under California and Federal Law

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

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

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

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

Negative Publicity could Damage our Reputation

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

Environmental Risks

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

Shares Eligible for Future Sale

As of March 31, 2008, the Company had 8,707,745 shares of Common Stock outstanding, of which 6,008,873 shares are eligible for sale in the public market without restriction and 2,698,872 shares are eligible for sale in the public market pursuant to Rule 144 under the Securities Act of 1933, as amended (the *Securities Act*). Future sales of substantial amounts of the Company's common stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the common stock. In addition, options to acquire 213,235 shares of the issued and outstanding shares of common stock at exercise prices ranging from \$3.23 to \$11.59 have been issued to directors and certain employees of the Company under the Company's 1998 Stock Option Plan. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company's common stock.

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

Technology and Computer Systems

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

Company Stock Price may be volatile due to Other Factors

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

General business and economic conditions;

Recommendations by securities analysts;

New technologies introduced or services offered by our competitors;

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

Natural disasters; and

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

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

Executive Overview

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

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

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

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

Our management processes, structures and policies help to ensure compliance with laws and regulations and provide clear lines for decision-making and accountability. Results are important, but equally important is how we achieve those results. Our core values and commitment to high ethical standards is material to sustaining public trust and confidence in our Company. For additional information concerning risks and uncertainties related to the Company and its operations please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007, under the heading "Risk Management".

Sources of Income

The Company derives its income from two principal sources: (i) net interest income, which is the difference between the interest income it receives on debt securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest expense it pays for deposits and long-term and short-term debt, and (ii) fee income, which includes fees earned on deposit services, electronic-based cash management services, mortgage brokerage fee income and merchant credit card processing services. The net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and other sources of funding.

The income of the Company depends to a great extent on net interest income. These interest rate factors are highly sensitive to many factors, which are beyond the Company's control, including general economic conditions, inflation, recession, and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Because of the Company's predisposition to variable rate pricing and non-interest bearing demand deposit accounts, the Company is considered asset sensitive. As a result, the Company is adversely affected by declining interest rates.

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

	March 31, 2008	March 31, 2007
Profitability Ratios		
Net Interest Income to Average Assets	3.49%	3.77%
Net Income to Average Equity	10.54%	13.37%

Efficiency Ratio¹	59.57%	59.88%
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Capital Ratios

Leverage Ratio	9.15%	9.75%
Risk Based Capital	\$63,081,047	\$56,050,000
Tier 1 Capital	9.90%	11.23%
Total Capital	10.98%	12.29%

Per Common Share Data

Dividend Payout Ratio	56.92%	47.94%
Book Value	\$ 5.33	\$ 5.10
Market Price	\$ 8.00	\$ 11.75
High	\$ 8.59	\$ 12.29
Low	\$ 6.00	\$ 10.98

Financial Highlights Results of Operations

Net income for the first quarter of 2008 totaled \$1,229,000 a decrease of 17.4% from the \$1,487,000 reported for the same quarterly period of 2007. On the same basis, diluted earnings per common share for the first quarter of 2008 were \$0.14, compared to \$0.17 for the same period of 2007. Return on average assets (ROA) and return on average equity (ROE) for the first quarter of 2008 were 0.79% and 10.54%, respectively, compared with 1.05% and 13.37%, respectively, for the first quarter of 2007. The drop in net income is directly related to higher provisions for loan and lease losses during the first quarter.

Net Interest Income and Net Interest Margin

Net interest income is the primary source of the Company's income. Net interest income represents the excess of interest and fees earned on interest-earning assets (loans, securities and federal funds sold) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets. Net interest income for the quarter ended March 31, 2008 was \$5,420,000 compared with \$5,327,000 for the same period in 2007, an increase of 1.7%.

Average earning assets for the three-months ended March 31, 2008 increased \$55.4 million or 10.4% compared with the same period in the prior year. Average net loans, the largest component of earning assets, increased \$96.3 million or 23.6% compared with the prior year period. Average securities decreased \$26.9 million or 24.7% over the prior year period. Securities were sold during the period to cover loan growth. The yield on earning assets decreased to 6.80% for the three-month period ended March 31, 2008 compared to 7.39% for the same three-month period in the prior year, specifically due to interest rate drops in the current economic environment.

The overall cost of interest-bearing liabilities (funding costs) for the first three months of 2008 was \$4,546,000 compared with \$4,483,000 for the first three months of 2007, a 1.41% increase. The increase in funding costs was primarily a result of increases in the volume on core deposit accounts. The net effect of the changes discussed above resulted in an increase of \$93,000 or 1.7% in net interest income for the three-month period ended March 31, 2008 from the same period in 2007. Net interest margin decreased 31 basis points to 3.70% from 4.01% for the same period a year ago.

¹ The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income)

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

Liquidity

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

The Asset Liability Management Committee (ALCO) establishes and monitors liquidity guidelines that require sufficient asset-based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. In addition to the immediately liquid resources of cash and due from banks, federal funds sold and securities purchased under agreements to resell, asset liquidity is supported by debt securities in the available-for-sale securities portfolio and wholesale lines of credit with the Federal Home Loan Bank and other financial institutions. Customer core deposits have historically provided the Company with a source of relatively stable and low-cost funds. Management monitors the sources and uses of funds on a daily basis to maintain an acceptable liquidity position. In addition to liquidity from core deposits and repayments and maturities of loans and securities, the Company has the ability to sell securities under agreements to repurchase, obtain Federal Home Loan Bank advances or purchase overnight Federal Funds.

The Company's consolidated liquidity position remains adequate to meet short-term and long-term future contingencies. At March 31, 2008, the Company had overnight cash in investments of \$38.7 million and available lines of credit at the Federal Home Loan bank of approximately \$25.2 million, and a Federal Funds borrowing line with two correspondent financial institutions of \$25.0 million.

To accommodate future growth and business needs, the Company develops an annual capital expenditure budget during strategic planning sessions. The Company expects that the earnings of the Bank, acquisition of core deposits and wholesale borrowing arrangements are sufficient to support liquidity needs in 2008.

Capital Management

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

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

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

The Company and Bank are subject to various regulatory capital adequacy requirements as prescribed by the Federal Reserve Bank. Risk-based capital guidelines establish a risk-adjusted ratio relating capital to difference categories of assets and off-balance sheet exposures. At March 31, 2008, the Company and Bank were well capitalized under applicable regulatory capital adequacy guidelines.

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

As of March 31, 2008	Capital	Actual Ratio	Well Capitalized Requirement	Minimum Capital Requirement
The Company Leverage	\$56,050,000	8.94%	n/a	4.0%
Tier 1 Risk-Based	56,050,000	9.75%	n/a	4.0%
Total Risk-Based	62,247,791	10.83%	n/a	8.0%
Bank of Commerce Redding Leverage	\$56,883,257	9.15%	5.0%	4.0%
Tier 1 Risk-Based	56,883,257	9.90%	6.0%	4.0%
Total Risk-Based	63,081,047	10.98%	10.00%	8.0%

Short and Long Term Borrowings

The Company actively uses Federal Home Loan Bank (FHLB) advances as a source of wholesale funding to support growth strategies as well as to provide liquidity. At March 31, 2008, all of the Company's FHLB advances were a combination of fixed term and variable borrowings without call or put option features.

During the three months ended March 31, 2008, the average balance of FHLB advances was \$80.5 million and the average interest rates during the period was 3.60%. The maximum outstanding at any month-end during the three months ended March 31, 2008 was \$85.0 million. The FHLB advances are collateralized by loans and securities pledged to the FHLB.

Allowance for Loan and Lease Losses

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

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

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

Provision for loan and lease losses of \$600,000 were provided for the three-months ended March 31, 2008 compared with \$6,000 for the same period of 2007. The Company's allowance for loan and lease losses was 1.14% of total loans at March 31, 2008, 1.66% at December 31, 2007 and 1.18% at March 31, 2007, while its ratio of non-performing assets to total assets was 2.45% at March 31, 2008, compared to 2.01% at December 31, 2007 and 0.00% at March 31, 2007. Management has taken aggressive action by placing two real estate development related loans into nonaccrual status. In addition, an impairment review of one Sacramento development loan has resulted in a \$2.9 million write-down. Reserves were previously allocated in anticipation of this impairment review. Interest reversed from income during the period due to nonaccrual loans was \$84,525.

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

Factors that may affect future results

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

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

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

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

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

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

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

Critical Accounting Policies

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

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

Preparation of financial statements

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

Use of estimates

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

Accounting Principles Generally Accepted in the United States of America

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

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

Allowance for Loan and Lease Losses (ALLL)

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

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

The Company's allowance for loan and lease losses is the accumulation of various components that are calculated based upon independent methodologies.

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

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

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

Revenue recognition

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

Stock-based Compensation

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

Income Taxes

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

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

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

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

	Three Months Ended March 31, 2008			Three Months Ended March 31, 2007		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Earning Assets						
Portfolio Loans ²	\$ 504,091	\$ 9,131	7.25%	\$ 407,758	\$ 8,464	8.30%
Tax-exempt Securities ³	27,901	274	3.93%	29,712	278	3.74%
US Government Securities	15,272	142	3.72%	33,722	356	4.22%
Mortgage backed Securities	29,055	339	4.67%	41,919	476	4.54%
Federal Funds Sold	8,014	58	2.89%	15,540	200	5.15%
Other Securities	2,000	22	4.40%	2,302	36	6.26%
Average Earning Assets	\$ 586,333	\$ 9,966	6.80%	\$ 530,953	\$ 9,810	7.39%
Cash & Due From Banks	\$ 12,708			\$ 12,939		
Bank Premises	11,303			9,288		
Allowance for Loan Losses	(8,441)			(4,892)		
Other Assets	20,116			17,226		
Average Total Assets	\$ 622,019			\$ 565,514		
Interest Bearing Liabilities						
Demand Interest Bearing	\$ 141,709	\$ 750	2.12%	\$ 112,910	\$ 557	1.97%
Savings Deposits	41,195	290	2.82%	28,864	171	2.37%
Certificates of Deposit	216,051	2,376	4.40%	214,094	2,605	4.87%
Repurchase Agreements	13,052	84	2.57%	34,860	342	3.92%
FHLB Borrowings	80,569	731	3.63%	40,000	539	5.39%
Trust Preferred Borrowings	15,000	315	8.40%	15,000	269	7.17%
	507,576	\$ 4,546	3.58%	445,728	\$ 4,483	4.02%
Noninterest bearing demand	66,825			73,977		
Other Liabilities	995			1,333		
Stockholders' Equity	46,623			44,476		
Average Liabilities and Stockholders' Equity	\$ 622,019			\$ 565,514		
		\$ 5,420	3.70%		\$ 5,327	4.01%

Net Interest Income and Net
Interest Margin

² Average
non-performing
loans of
\$14.9 million
are included

³ The yield on
tax-exempt
securities has
not been
adjusted to a
tax-equivalent
yield basis.

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

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

Table 2. Analysis of Changes in Net Interest Income and Interest Expense

(Dollars in thousands)	March 31, 2008 Volume	over Rate	March 31, 2007 Total
Increase (Decrease) In Interest Income			
Portfolio Loans	\$ 1,745	\$ (1,078)	\$ 667
Tax-exempt Securities	(18)	14	(4)
US Government Securities	(172)	(42)	(214)
Mortgage back Securities	(150)	13	(137)
Federal Funds Sold	(54)	(88)	(142)
Other Securities	(3)	(11)	(14)
Total Increase (Decrease)	\$ 1,348	\$ (1,192)	\$ 156
Increase (Decrease) In Interest Expense			
Interest Bearing Demand	\$ 152	\$ 41	\$ 193
Savings Deposits	87	32	119
Certificates of Deposit	22	(251)	(229)
Repurchase Agreements	(140)	(118)	(258)
FHLB Borrowings	368	(176)	192
Trust Preferred Borrowings	0	46	46
Total Increase (Decrease)	\$ 489	\$ (426)	\$ 63
Net Increase	\$ 859	\$ (766)	\$ 93

Net interest income was \$5.4 million for the first three-months of 2008 compared with \$5.3 million for the same period in 2007, a 1.7% increase (Tables 1 and 2). The increase in net interest income is primarily attributed to the increased volume of earning assets during the period. Average earning assets for the first three-months of 2008 were \$586.3 million compared with \$530.9 million for the same period in 2007, an increase of \$55.4 million or 10.4%. The single largest component of increased earning assets was in the loan portfolio. Average loans increased \$96.3 million or 23.6% over the same three-month period in 2007. Coupled with the asset growth, yields on earning assets decreased to 6.80% compared with 7.39% over the same three-month period in 2007, a loss of 59 basis points.

Average interest bearing liabilities also increased by \$61.9 million or 13.9% for the first three-months of 2008 to \$507.6 million in 2008 compared with \$445.7 million for the same period in 2007. The cost of interest bearing liabilities or funding decreased to 3.58% in 2008 compared to 4.02% in 2007, a decrease in interest expense of \$62,000 or 1.4%. The increase in interest expense is primarily due to increased volume in core deposit relationships. As a result of these changes, the interest spread (the difference between the yield on earning assets and the cost of interest bearing liabilities) decreased 31 basis points to 3.70% for the three-months ended March 31, 2008 compared with 4.01% for the same three-month period in the prior year.

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

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

(Dollars in thousands)	Three Months Ended	
	March 31, 2008	March 31, 2007
Noninterest income		
Service charges on deposit accounts	\$ 62	\$ 69
Payroll and benefit processing fees	129	108
Earnings on cash surrender value - Bank owned life insurance	83	95
Net gain on sale of securities available-for-sale	242	46
Net loss on sale of derivative swap	(225)	0
Merchant credit card service income, net	83	92
Mortgage brokerage fee income	10	6
Other income	181	82
Total noninterest income	\$ 565	\$ 498

Noninterest income increased \$67,000 or 13.5% for the quarter ended March 31, 2008 over March 31, 2007. During the first quarter, net gains on sale of securities totaled \$242,000. The securities available-for-sale portfolio was repositioned to take advantage of higher yielding investments in the loan portfolio. A derivative swap transaction was unwound in the first quarter 2008 resulting in a one time loss of \$225,000. Other income, consisting of fees, is up 120.7% due to the increase in core deposit relationships.

Noninterest Expense

(Dollars in thousands)	Three Months Ended	
	March 31, 2008	March 31, 2007
Noninterest expense		
Salaries and related benefits	\$ 1,949	\$ 2,097
Occupancy and equipment expense	644	458
FDIC insurance premium	58	13
Data processing fees	78	55
Professional service fees	118	195
Payroll processing fees	33	31
Deferred compensation expense	111	97
Stationery and supplies	62	61
Postage	34	33
Directors' expense	48	45
Other expenses	430	403
Total noninterest expense	\$ 3,565	\$ 3,488

Noninterest expense for the quarter ended March 31, 2008 was \$3.6 million, an increase of \$77,000 or 2.2% over the same period a year ago. The increase is housed in occupancy and equipment expense and is reflective of the new West

Side office opening in January 2008.

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

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

The Company's effective tax rate varies with changes in the relative amounts of its non-taxable income and non-deductible expenses. The increase in the Company's tax provision is attributable to decreases in non-taxable income related to a reduction in the municipal security portfolio and reclassification of enterprise zone qualified credits.

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

(Dollars in thousands)	Three Months Ended	
	March 31, 2008	March 31, 2007
Income Taxes		
Tax provision	\$ 591	\$ 844
Effective tax rate	32.5%	36.2%

The Company's provision for income taxes includes both federal and state income taxes and reflects the application of federal and state statutory rates to the Company's net income before taxes. The principal difference between statutory tax rates and the Company's effective tax rate is the benefit derived from investing in tax-exempt securities and enterprise zone qualifying loans. Increases and decreases in the provision for taxes reflect changes in the Company's net income before tax, and takes into consideration strategies to increase tax exempt income and tax credits.

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

The Company has a deferred tax asset of \$5.2 million which did not change significantly during the three months ended March 31, 2008. The Company does not reasonably estimate that the unrecognized tax benefit will change significantly within the next twelve months. Deferred tax assets are recognized subject to management judgment that realization is more likely than not. The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense.

The Company files a consolidated federal and state income tax return. The Company determines deferred income tax assets and liabilities using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between book and tax basis of assets and liabilities, and recognizes enacted changes in tax rates and laws.

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

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2008 consist of the following:

March 31, 2008

Deferred Tax Assets

State Franchise taxes	186,193
Deferred compensation	1,962,157
Loan loss reserves	3,585,204
Net unrealized losses on securities available-for-sale	124,016
Other	398,793

Total Deferred Tax Assets	6,256,363
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Deferred Tax Liabilities

Depreciation	(180,882)
Deferred loan origination costs	(452,281)
Deferred state taxes	(413,227)
Other	(0)

Total Deferred Tax Liabilities	(1,046,390)
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Total Net Deferred Tax Asset	\$ 5,209,973
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Asset Quality

The Company concentrates its lending activities primarily within El Dorado, Placer, Sacramento, Shasta, Tehama, Sutter and Yuba counties, California, and the location of the Bank's five full services branches, specifically identified as Upstate California. The Company manages its credit risk through diversification of its loan portfolio and the application of underwriting policies and procedures and credit monitoring practices. Although The Company has a diversified loan portfolio, a significant portion of its borrowers' ability to repay the loans is dependent upon the professional services, commercial real estate market and the residential real estate development industry sectors. Generally, the loans are secured by real estate or other assets located in California and are expected to be repaid from cash flows of the borrower or proceeds from the sale of collateral.

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

(Dollars in thousands)	March 31, 2008	December 31, 2007
Portfolio Loans		
Commercial and financial loans	\$ 170,570	\$ 173,704
Real estate-construction loans	103,217	106,977
Real estate-commercial	180,013	175,013
Real estate- mortgage	21,867	10,787
Real estate- other	34,925	26,818
Installment	196	226
Other loans	1,581	1,223

Less:

Net deferred loan fees	(180)	(232)
Allowance for loan losses	(5,815)	(8,233)

Total net loans	\$ 506,374	\$ 486,283
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The Company's practice is to place an asset on nonaccrual status when one of the following events occur: (i) any installment of principal or interest is 90 days or more past due (unless in management's opinion the loan is well secured and in the process of collection). (ii) Management determines the ultimate collection of principal or interest to be unlikely or (iii) the terms of the loan have been renegotiated due to a serious weakening of the borrower's financial condition. Nonperforming loans are loans that are on nonaccrual, are 90 days past due and still accruing or have been restructured.

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

Net portfolio loans increased \$20.1 million or 4.1% at March 31, 2008 over December 31, 2007. The balance of the portfolio remains relatively consistent with the mix at December 31, 2007, with commercial and financial loans of approximately 34%, real estate construction of approximately 20% and commercial real estate of approximately 35%. Impaired loans are loans for which it is probable that the Company will not be able to collect all amounts due and payable. The Company had outstanding balances of \$16.0 and \$12.4 million in impaired loans as of March 31, 2008 and December 31, 2007, respectively. Impairment is based on SFAS No. 114, 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 following table sets forth a summary of the Company's nonperforming assets as of the dates indicated:

(Dollars in thousands)	March 31, 2008	December 31, 2007
Non performing assets		
Nonaccrual loans	\$ 15,958	\$ 12,409
90 days past due and still accruing interest	0	0
Total nonaccrual loans	15,958	12,409
Other Real Estate Owned	0	0
Total non performing assets	\$ 15,958	\$ 12,409

Allowance for Loan and Lease Losses (ALLL)

The allowance for loan and lease losses is management's estimate of the amount of probable loan losses in the loan portfolio. The Company determines the allowance for loan losses based on an ongoing evaluation. The evaluation is inherently subjective because it requires material estimates, including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The Company makes provisions to the ALLL on a regular basis through charges to operations that are reflected in the Company's statements of income as a provision for loan losses. When a loan is deemed uncollectible, it is charged against the allowance. Any recoveries of previously charged-off loans are credited back to the allowance. There is no precise method of predicting specific losses or amounts that ultimately may be charged-off on particular categories of the loan portfolio. The Company's allowance for loan losses is the accumulation of various components that are calculated based upon independent methodologies. All components of the allowance for loan losses represent an estimation performed pursuant to SFAS No. 5, Accounting for Contingencies or SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Management's estimate of each SFAS No. 5 Accounting for Contingencies component is based on certain observable data that management believes is the most reflective of the underlying loan losses being estimated. Changes in the amount of each component of the allowance for loan losses are directionally consistent with changes in the observable data, taking into account the interaction of the SFAS No. 5 components over time.

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

The ALLL is a general reserve available against the total loan portfolio. It is maintained without any inter-allocation to the categories of the loan portfolio, and the entire allowance is available to cover loan losses. While management

uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination. Accordingly, it is not possible to predict the effect future economic trends may have on the level of the provision for loan losses in future periods. In addition to the ALLL, an allowance for unfunded loan commitments and letters of loan is determined using estimates of the probability of funding. This reserve is carried as a liability on the condensed consolidated balance sheet.

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

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

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

(Dollars in thousands)	March 31, 2008	March 31, 2007
Allowance for Loan and Lease Losses		
Beginning balance for Loan and Lease Losses	\$ 8,233	\$ 4,904
Provision for Loan and Lease Losses	600	6
Charge offs:		
Commercial	(0)	(0)
Real Estate	(3,020)	(0)
Other	(0)	(0)
Total Charge offs	(3,020)	(0)
Recoveries:		
Commercial	0	19
Real Estate	0	0
Other	2	4
Total Recoveries	2	23
Ending Balance	\$ 5,815	\$ 4,933
ALLL to total loans	1.14%	1.18%
Net Charge offs to average loans	0.60%	0.00%

During the first quarter 2008, as part of management's ongoing credit practices, management has performed a thorough review of the loan portfolio, with special emphasis on construction and development projects. The recent slowdown in residential development and construction markets has led to an increase in nonperforming loans which makes it prudent to strengthen our reserve position at this time. Management has taken aggressive action by placing two real estate development related loans into nonaccrual status. In addition, an impairment review of one Sacramento development loan has resulted in a \$2.9 million write-down due to a significant drop in appraised values of the underlying collateral. Reserves were previously allocated in anticipation of this impairment review. Non-performing loans and leases were 3.12% of total loans as of March 31, 2008 compared to 2.55% at December 31, 2007 and 0% one year ago. Interest reversed from income during the period due to nonaccrual loans was \$84,525.

Management expects that the amount of nonaccrual loans will change due to portfolio growth, portfolio seasoning, routine problem loan recognition and resolution through collections, sales or charge-offs. The performance of any one loan can be affected by external factors, such as economic or market conditions, or factors particular to a borrower, such as actions of a borrower's management.

Managing credit risk is a company-wide process. The Company has policies for all banking operations incurring risk with customers or counterparties that provide a prudent approach to credit risk management. Management uses detailed tracking and analysis to measure credit performance and exception rates and we routinely review and modify credit policies as appropriate.

Management assumes that our allowance for credit losses as a percentage of charge-offs and nonaccrual loans will change at different points in time based on credit performance, loan mix and collateral values. Any loan with past due principal or interest that is not both well-secured and in the process of collection generally is charged off (to the extent

that it exceeds the fair value of any related collateral) based on loan category after a defined period of time.

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

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

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

The Company does not include federal funds sold as securities. These investments are included in cash and cash equivalents.

Debt securities in the securities available-for-sale portfolio provide asset liquidity, in addition to the immediately liquid resources of cash and due from banks and federal funds sold.

Total available-for-sale securities decreased \$31.7 million or 33.8% at March 31, 2008 compared to March 31, 2007. During the period securities were sold to reinvest into the loan portfolio at higher yields. As of March 31, 2008, the Company has pledged \$1.0 million of securities for treasury, tax and loan accounts, \$15.3 million for deposits of public funds, approximately \$5.8 million for collateralized repurchase agreements and \$35.0 million towards Federal Home Loan Bank borrowings.

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

		as of March 31, 2008		
	Amortized	Unrealized	Unrealized	Estimated
<i>(Dollars in thousands)</i>	Costs	Gains	Losses	Fair Value
U.S. government & agencies	\$ 11,015	\$ 123	\$ (0)	\$ 11,138
Obligations of state and political subdivisions	18,505	36	(511)	18,030
Mortgage backed securities	30,899	219	(171)	30,947
Corporate Bonds	2,000	0	(25)	1,975
Total	\$ 62,419	\$ 378	\$ (707)	\$ 62,090

		as of December 31, 2008		
	Amortized	Unrealized	Unrealized	Estimated
<i>(Dollars in thousands)</i>	Costs	Gains	Losses	Fair Value
U.S. government & agencies	\$ 15,989	\$ 26	\$ (104)	\$ 15,911
Obligations of state and political subdivisions	19,017	28	(263)	18,782
Mortgage backed securities	31,638	10	(354)	31,294
Corporate Bonds	2,000	0	(81)	1,919
Total	\$ 68,644	\$ 64	\$ (802)	\$ 67,906

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

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

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

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

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

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

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

Our overall goal is to manage interest rate sensitivity so that movements in interest rates do not adversely affect net interest income. Interest rates risk is measured as the potential volatility in our net interest income caused by changes in market interest rates. Lending and deposit taking create interest rate sensitive positions on our balance sheet. Interest rate risk from these activities as well as the impact of ever changing market conditions is mitigated using the ALM process. The Company does not operate a trading account and does not hold a position with exposure to foreign currency exchange or commodities. The Company faces market risk through interest rate volatility.

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

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

The formal policies and practices adopted by the Company to monitor and manage interest rate risk exposure measure risk in two ways: (i) repricing opportunities for earning assets and interest-bearing liabilities and (ii) changes in net interest income for declining interest rate shocks of 100 to 200 basis points. Because of the Company's predisposition to variable rate, pricing and noninterest bearing demand deposit accounts the Company is asset sensitive.

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As a result, management anticipates that, in a declining interest rate environment, the Company's net interest income and margin would be expected to decline, and, in an increasing interest rate environment, the Company's net interest income and margin would be expected to increase. However, no assurance can be given that under such circumstances the Company would experience the described relationships to declining or increasing interest rates. Because the Company is asset sensitive, the Company is adversely affected by declining rates rather than rising rates.

To estimate the effect of interest rate shocks on the Company's net interest income, management uses a model to prepare an analysis of interest rate risk exposure. Such analysis calculates the change in net interest income given a change in the federal funds rate of 50 or 100 basis points up or down. All changes are measured in dollars and are compared to projected net interest income. At March 31, 2007, the estimated annualized reduction in net interest income attributable to a 500 and 100 basis point decline in the federal funds rate was \$262,294 and \$431,384, respectively. At March 31, 2008, the estimated annual increase in net interest income attributable to a 100 and 200 basis point increase in the federal funds rate was \$330,889 and \$675,089. At December 31, 2007, the estimated annualized reduction in net interest income attributable to a 50 and 100 basis point decline in the federal funds rate was \$330,889 and \$675,089, respectively, with a similar and opposite result attributable to a 50 and 100 basis point increase in the federal funds rate.

The ALCO has established a policy limitation to interest rate risk of -14% of net interest margin and -20% of the present value of equity.

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

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

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

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ITEM 4. CONTROLS AND PROCEDURES

Under SEC rules 13a-15 and 15d-15, each issuer (Company) must maintain disclosure controls, procedures and internal control over financial reporting. Management is required to evaluate the effectiveness, as of the end of each fiscal year, of the Company's disclosure controls and procedures over financial reporting. Management's evaluation must be based on a suitable and recognized framework. Bank of Commerce Holdings management has adopted the widely accepted COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework for its evaluation.

The SEC defines *internal control over financial reporting* as a process designed by, or under the supervision of, the Company's principal executive and financial officers or persons performing similar functions. The control process is affected 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 (GAAP) in the United States of America. Internal control over financial reporting 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 the issuer;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and the Directors of the Company;

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.

Management evaluates the effectiveness of the Company's internal control over financial reporting primarily through periodic testing of *key controls*. The Institute of Internal Auditors defines a *key control* as follows: A key control is a control that, if it fails, means there is at least a reasonable likelihood that a material error in the financial statements could not be detected on a timely basis. Management identified twenty-two major operational processes of which forty-seven key operational controls were earmarked for testing. Under the information technology umbrella, nine major processes were identified and twenty-two key information systems controls were targeted for testing. Of the total sixty-nine key controls, 40% of the key controls were tested internally.

Bank of Commerce Holdings management is responsible for establishing and maintaining adequate internal control over financial reporting per rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's system of internal control is structured to provide reasonable assurance to our Board of Directors and management regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Given its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, assumptions regarding any effectiveness evaluation to future periods are subject to risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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Management assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2008. In our assessment, we utilized the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on this criteria and our assessment, the CEO and CFO have concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and are operating in an effective manner.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

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PART II. Other Information

Item 1. Legal proceedings

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

Item 1a. Risk Factors

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

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

N/A

Item 3. Defaults upon Senior Securities

N/A.

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

N/A

Item 5. Other Information

N/A

Item 6A. Exhibits

(31.1) Certification of Chief Executive Officer pursuant to Sarbanes-Oxley Act of 2002

(31.2) Certification of Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002

(32) Certification of Chief Executive Officer and Chief Financial Officer pursuant to Sarbanes-Oxley Act of 2002

Item 6B. Reports on Form 8-K

Form 8-K dated 4/30/08 1st Quarter 2008 Earnings release

Form 8-K dated 4/5/08 1st Quarter cash dividend \$0.08

Form 8-K dated 2/26/08 Announcement Dave Bonucelli new director

Form 8-K dated 2/4/08 2007 Earnings release

SIGNATURES

Following the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANK OF COMMERCE HOLDINGS

(Registrant)

Date: May 02, 2008

/s/ Linda J. Miles

Linda J. Miles

Executive Vice President &

Chief Financial Officer