

BOCH 10-Q 9/30/2008

Section 1: 10-Q (FORM 10-Q)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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

Bank of Commerce Holdings

California

94-2823865

(State or jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

1901 Churn Creek Road Redding, California

96002

(Address of principal executive offices)

(Zip Code)

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

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

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 definition of "accelerated filer, large accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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 September 30, 2008: 8,711,495

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Index to Form 10-Q

	PAGE NUMBER
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1 Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets September 30, 2008, December 31, 2007 and September 30, 2007</u>	4
<u>Condensed Consolidated Statements of Income Three and Nine months ended September 30, 2008 and 2007</u>	5
<u>Consolidated Statement of Stockholders' Equity</u>	6
<u>Condensed Consolidated Statements of Cash Flows Nine months ended September 30, 2008 and 2007</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2 Management's Discussion and Analysis Of Financial Condition and Results of Operations</u>	18
<u>Company Overview</u>	18
<u>Risk Factors</u>	21
<u>Economic Conditions and Geographic Concentration</u>	21
<u>Changes in interest rates could reduce the Company's Net interest Income and Earnings</u>	21
<u>Lending Risks Associated with Commercial Banking and Construction Activities</u>	22
<u>Adequacy of Allowance for Loan and Lease Losses (ALLL)</u>	22
<u>Potential Volatility of Deposits</u>	22
<u>Dividends</u>	23
<u>Government Regulation and Legislation</u>	23
<u>Certain Ownership Restrictions under California and Federal Law</u>	24
<u>Negative publicity could Damage our Reputation</u>	24
<u>Environmental Risks</u>	24
<u>Shares Eligible for Future Sale</u>	25
<u>Technology and Computer Systems</u>	25
<u>Company Stock Price may be volatile due to Other Factors</u>	25
<u>Executive Overview</u>	26
<u>Sources of Income</u>	26
<u>Financial Highlights — Results of Operations</u>	27
<u>Net Interest Income and Net Interest Margin</u>	27
<u>Liquidity</u>	28
<u>Capital Management</u>	28
<u>Short term borrowings</u>	29
<u>Provision for loan and lease losses</u>	29
<u>Factors that may affect future results</u>	30
<u>Critical accounting policies</u>	30
<u>Average balances, Interest Income/Expense and Yields/Rates paid</u>	33
<u>Analysis of changes in net interest income and interest expense</u>	34
<u>Noninterest Income</u>	35
<u>Noninterest Expense</u>	35
<u>Income taxes</u>	36
<u>Asset quality</u>	37
<u>Allowance for loan and lease losses (ALLL)</u>	39
<u>Quarterly Income Statement</u>	41
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	

Table of Contents

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES

Index

	PAGE NUMBER
<u>Item 3 Quantitative and Qualitative Disclosure about Market Risk</u>	42
<u>Item 4 Controls and Procedures</u>	44
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1 Legal Proceedings</u>	44
<u>Item 1a Risk Factors</u>	44
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 3 Defaults Upon Senior Securities</u>	44
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	44
<u>Item 5 Other Information</u>	44
<u>Item 6 Exhibits</u>	44
<u>SIGNATURES</u>	45

[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>	September 30, 2008	December 31, 2007	September 30, 2007
ASSETS			
Cash and due from banks	\$ 12,617	\$ 13,839	\$ 12,366
Federal funds sold and securities purchased under agreements to resell	20,135	8,395	7,980
Cash and cash equivalents	32,752	22,234	20,346
Securities available-for-sale (including pledged collateral of \$58,939 at September 30, 2008, \$61,329 at December 31, 2007 and \$85,574 at September 30, 2007)	74,863	67,906	93,423
Securities held-to-maturity, at cost (\$10,632 at December 31, 2007 and \$10,538 at September 30, 2007)	0	10,559	10,592
Loans, net of the allowance for loan losses of \$6,128 at September 30, 2008, \$8,233 at December 31, 2007 and \$5,061 at September 30, 2007	503,348	486,283	461,171
Bank premises and equipment, net	10,893	10,964	10,464
Other assets	28,688	20,381	19,979
TOTAL ASSETS	\$ 650,544	\$ 618,327	\$ 615,975
LIABILITIES AND STOCKHOLDERS' EQUITY			
Demand — noninterest bearing	\$ 80,168	\$ 75,718	\$ 70,809
Demand — interest bearing	138,319	142,821	136,219
Savings accounts	69,469	41,376	44,406
Certificates of deposit	215,095	213,716	220,803
Total deposits	503,051	473,631	472,237
Securities sold under agreements to repurchase	13,580	15,513	26,755
Federal Home Loan Bank borrowings	65,000	60,000	50,000
Other liabilities	7,863	7,554	6,734
Junior subordinated debt payable to unconsolidated subsidiary grantor trust	15,465	15,465	15,465
Total Liabilities	604,959	572,163	571,191
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; 8,711,495 at September 30, 2008, 8,757,445 at December 31, 2007 and 8,784,359 at September 30, 2007	9,619	9,996	10,252
Retained earnings	37,364	36,605	35,617
Accumulated other comprehensive loss, net of tax	(1,398)	(437)	(1,085)
Total stockholders' equity	45,585	46,164	44,784
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 650,544	\$ 618,327	\$ 615,975

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**
Condensed Consolidated Statements of Income (Unaudited)
Three and nine months ended September 30, 2008 and 2007

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2008	Sept. 30, 2007	Sept. 30, 2008	Sept. 30, 2007
<i>Amounts in thousands, except for per share data</i>				
Interest income:				
Interest and fees on loans	\$ 8,252	\$ 9,350	\$ 25,554	\$ 26,779
Interest on tax exempt securities	308	324	884	936
Interest on U.S. government securities	582	798	1,596	2,446
Interest on federal funds sold and securities purchased under agreements to resell	116	190	264	580
Interest on other securities	13	22	58	67
Total interest income	9,271	10,684	28,356	30,808
Interest expense:				
Interest on demand deposits	514	791	1,762	1,935
Interest on savings deposits	543	359	1,193	885
Interest on time deposits	1,963	2,702	6,577	7,934
Securities sold under agreements to repurchase	32	289	151	1,012
Interest on FHLB and other borrowing expense	662	628	2,174	1,799
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	317	274	793	814
Total interest expense	4,031	5,043	12,650	14,379
Net interest income	5,240	5,641	15,706	16,429
Provision for loan and lease losses	1,300	115	2,900	121
Net interest income after provision for loan losses	3,940	5,526	12,806	16,308
Noninterest income:				
Service charges on deposit accounts	91	70	203	215
Payroll and benefit processing fees	107	90	335	287
Earnings on cash surrender value — bank owned life insurance	86	100	254	294
Net gain on sale of securities available-for-sale	159	0	595	46
Net loss on sale of derivative swap transaction	0	0	(225)	0
Merchant credit card service income, net	99	109	279	297
Mortgage brokerage fee income	2	21	17	56
Other income	207	136	575	447
Total non-interest income	751	526	2,033	1,642
Noninterest expense:				
Salaries and related benefits	1,909	2,402	5,750	6,458
Occupancy and equipment expense	613	635	1,897	1,636
FDIC insurance premium	113	13	284	39
Data processing fees	81	82	224	227
Professional service fees	146	216	397	663
Payroll and benefit fees	26	25	86	81
Deferred compensation expense	118	105	342	303
Stationery and supplies	50	34	192	141
Postage	32	39	104	106
Directors' expense	81	86	223	207
Other expenses	443	391	1,290	1,356
Total non-interest expense	3,612	4,028	10,789	11,217
Income before provision for income taxes	1,079	2,024	4,050	6,733
Provision for income taxes	362	693	1,197	2,315
Net Income	\$ 717	\$ 1,331	\$ 2,853	\$ 4,418
Basic earnings per share				
Basic earnings per share	\$ 0.08	\$ 0.15	\$ 0.33	\$ 0.50
Weighted average shares — basic	8,711	8,904	8,713	8,893
Diluted earnings per share				
Diluted earnings per share	\$ 0.08	\$ 0.15	\$ 0.33	\$ 0.49
Weighted average shares — diluted	8,713	8,929	8,729	8,983

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**
Condensed Consolidated Statements of Stockholders' Equity
Nine months ended September 30, 2008

Stockholders Equity (Dollars in thousands)	Comprehensive Income	Common Shares	Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net of tax	Total
Balance at December 31, 2007		8,757	\$ 9,996	\$ 36,605	\$ (437)	\$ 46,164
Comprehensive Income:						
Net Income	1,229			1,229		1,229
Other Comprehensive Income:						
Unrealized gains on securities	381					
Net of reclassification adjustment for gains included in net income, net of tax	(245)					
Other Comprehensive Income	136				136	136
Total Comprehensive Income	\$ 1,365					
Cash dividends (\$0.08 per share)				(699)		(699)
Compensation expense associated with stock options			29			29
Share Repurchase		(59)	(504)			(504)
Stock options exercised		9	29			29
Balance at March 31, 2008		8,707	\$ 9,550	\$ 37,135	\$ (301)	\$ 46,384
Comprehensive Income:						
Net Income	906			906		906
Other Comprehensive Income:						
Other Comprehensive Income net of tax						
Unrealized losses on securities	(538)					
Net of reclassification adjustment for gains included in net income, net of tax	(66)					
Other Comprehensive Income	(604)				(604)	(604)
Total Comprehensive Income	\$ 302					
Cash dividends (\$0.08 per share)				(697)		(697)
Compensation expense associated with stock options			28			28
Stock options exercised		4	12			12
Balance at June 30, 2008		8,711	\$ 9,590	\$ 37,344	\$ (905)	\$ 46,029
Comprehensive Income:						
Net Income	717			717		717
Other Comprehensive Income:						
Unrealized losses on securities	(434)					
Net of reclassification adjustment for gains included in net income, net of tax	(59)					
Other Comprehensive Income	(493)				(493)	(493)
Total Comprehensive Income	\$ 224					
Cash dividends (\$0.08 per share)				(697)		(697)
Compensation expense associated with stock options			29			29
Balance at September 30, 2008		8,711	\$ 9,619	\$ 37,364	\$ (1,398)	\$ 45,585

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**
Condensed Consolidated Statements of Cash Flows (Unaudited)
Nine months ended September 30, 2008 and 2007*Dollars in thousands*

	September 30, 2008	September 30, 2007
Cash flows from operating activities:		
Net Income	\$ 2,853	\$ 4,418
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	2,900	121
Provision for depreciation and amortization	872	759
Compensation expense associated with stock options	86	23
Tax benefits from the exercise of stock options	0	(118)
Gain on sale of securities available for sale	(595)	46
Loss on sale of derivative	225	0
Amortization of investment premiums and accretion of discounts, net	45	4
Gain on sale of fixed assets	3	(31)
Proceeds from sales of loans	0	0
Deferred income taxes	560	27
Changes in operating assets and liabilities:		
Increase in Cash Surrender Value	(254)	(294)
(Increase) Decrease in Other Assets	(8,460)	278
Changes in Deferred Compensation	325	218
Decrease in Deferred loan fees	(299)	(66)
Decrease in Other liabilities	(16)	(685)
Net cash (used) provided by operating activities	(1,755)	4,700
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale securities	7,428	5,210
Proceeds from sales of available-for-sale securities	42,901	20,236
Proceeds from maturities of held-to-maturity securities	208	220
Purchases of available-for-sale securities	(47,725)	(23,495)
Loan originations, net of principal repayments	(19,666)	(52,236)
Purchases of premises and equipment	(807)	(2,597)
Proceeds from sale of equipment	3	0
Net cash used by investing activities	(17,658)	(52,662)
Cash flows from financing activities:		
Net (decrease) increase in deposits	29,420	32,831
Net (decrease) increase in securities sold under agreement to repurchase	(1,933)	(10,362)
Proceeds from Federal Home Loan Bank advances	65,000	10,000
Repayments of Federal Home Loan Bank advances	(60,000)	0
Cash dividends paid on common stock	(2,093)	(2,138)
Proceeds from stock options exercised	41	498
Common Stock Repurchased	(504)	(1,930)
Excess tax benefits from the exercise of stock options	0	143
Net cash provided by financing activities	29,931	29,042
Net increase (decrease) in cash and cash equivalents	10,518	(18,920)
Cash and cash equivalents, beginning of period	22,234	39,266
Cash and cash equivalents, end of period	\$ 32,752	\$ 20,346
Supplemental disclosures:		
Cash paid during the period for:		
Income taxes	\$ 0	\$ 2,533
Interest	12,155	14,461

See accompanying notes to condensed consolidated financial statements.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements

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.

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 October 10, 2008, the FASB issued FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active." FAS 157-3 is a FASB Staff Position that clarifies the application of FASB Statement No. 157, "Fair Value Measurements," for a non-active market and provides an illustrative example of key considerations in determining the fair value of financial assets under such conditions. FAS 157-3 is currently under management review with the impact on the Company yet to be determined.

The FASB has decided to amend SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement of FASB Statement No. 125" (SFAS 140), impacting the accounting for qualifying special-purpose entities ("QSPS"), and make certain changes to FASB Interpretation (FIN) No. 46 (revised December 2003) "Consolidation of Variable Interest Entities — an interpretation of ARB No. 51" (FIN 46R). Exposure drafts of the proposed requirements are expected in the third quarter of 2008. The impact on the Company and the timing of adoption cannot be determined until the FASB issues the final amendments to SFAS 140 and FIN 46R.

On March 19, 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB No. 133" (SFAS 161). SFAS 161 requires expanded qualitative, quantitative and credit-risk disclosures about derivatives and hedging activities and their effects on the Companies financial position, financial performance and cash flows. SFAS 161 also clarifies that derivatives are subject to credit risk disclosures as required by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments." SFAS 161 is effective for the Companies financial statements for the year beginning on January 1, 2009.

On December 4, 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS 141R). SFAS 141R modifies the accounting for business combinations and requires, with limited exceptions, the acquirer in a business combination to recognize 100 percent of the assets acquired, liabilities assumed, and any non-controlling interest in the acquiree at the acquisition-date fair value. In addition, SFAS 141R requires the expensing of acquisition-related transaction and restructuring costs, and certain contingent assets and liabilities acquired, as well as contingent consideration, to be recognized at fair value. SFAS 141R also modifies the accounting for certain acquired income tax assets and liabilities. SFAS 141R is effective for new acquisitions consummated on or after January 1, 2009 and earlier adoption is not permitted.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Continued) (Unaudited)

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 will be effective beginning January 1, 2008. The adoption of FAS 159 did not have a material impact on our consolidated financial statements.

3. Earnings per Share

Basic earnings per share exclude dilution and is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that subsequently shared in the earnings of the entity. The following table displays the computation of earnings per share for the three and nine months ended September 30, 2008 and 2007.

(Amounts in thousands, except per share data)

Earnings Per Share	Three Months Ended		Nine Months Ended	
	Sept. 30, 2008	Sept. 30, 2007	Sept. 30, 2008	Sept. 30, 2007
Basic EPS Calculation:				
Numerator (net income)	\$ 717	\$ 1,331	\$ 2,853	\$ 4,418
Denominator (average common shares outstanding)	8,711	8,904	8,713	8,893
Basic earnings per Share	\$ 0.08	\$ 0.15	\$ 0.33	\$ 0.50
Diluted EPS Calculation:				
Numerator (net income)	\$ 717	\$ 1,331	\$ 2,853	\$ 4,418
Denominator:				
Average common shares outstanding	8,711	8,904	8,713	8,893
Options	2	25	16	90
	8,713	8,929	8,729	8,983
Diluted earnings per Share	\$ 0.08	\$ 0.15	\$ 0.33	\$ 0.49
Anti-dilutive options not included in EPS Calculation	49,434	74,217	146,167	133,575

Stock options totaling 284,430 were outstanding at September 30, 2008 at an average exercise price of \$5.46.

4. Stock Option Plans

For the first nine months of 2008, stock option compensation expense charged against income was \$85,331 compared to \$22,578 at September 30, 2007. At September 30, 2008, there was \$246,800 of total unrecognized compensation costs related to non-vested share based payments which is expected to be recognized over a period of 2.3 years. No options were granted during the first nine months of 2008.

During the nine months ended September 30, 2008 and 2007 the Company realized income tax benefits of \$0 and \$144,630 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 nine months ended September 30, 2008 and 2007 the Company received cash of \$41,506 and \$498,421 respectively, upon exercise of stock-based compensation arrangements.

[Table of Contents](#)

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

5. Comprehensive Income

The Company's total comprehensive income was as follows:

Comprehensive Income	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Net income as reported	\$ 717	\$ 1,331	\$ 2,853	\$ 4,418
Components of other comprehensive income:				
Holding (loss) gain arising during period on AFS securities, net of tax	(434)	783	(591)	(148)
Reclassification adjustment on AFS securities, net of tax	(59)	(0)	(370)	(27)
Holding gain (loss) arising during period on derivative transactions, net of tax	0	0	0	51
Reclassification adjustment on derivative transactions, net of tax	0	0	0	(24)
Total comprehensive income	\$ 224	\$ 2,114	\$ 1,892	\$ 4,270

6. 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 \$249,000 or 0.36% at September 30, 2008 compared to December 31, 2007. As of September 30, 2008, the Company has pledged a total of \$67.7 million of securities for treasury, tax and loan accounts; public funds collateral; collateralized repurchase agreements and 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.

Available for sale securities	As of September 30, 2008			
	Amortized Costs	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. government & agencies	\$ 10,023	\$ 3	\$ (301)	\$ 9,725
Obligations of state and political subdivisions	30,911	108	(1,590)	29,429
Mortgage backed securities	36,266	66	(623)	35,709
Other securities	0	0	0	0
Total	\$ 77,200	\$ 177	\$ (2,514)	\$ 74,863

[Table of Contents](#)

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

As of December 31, 2007

(Dollars in thousands)				Estimated
Available for sale securities	Amortized Costs	Unrealized Gains	Unrealized 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

Economic factors may affect market pricing over the stated maturity of the security. The unrealized losses associated with securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. Security income is accrued when earned and included in interest income.

With the recent Government take-over of the government sponsored entities ('GSE') Freddie Mac and Fannie Mae you will be reading of many regional and community banks that have had to take a charge against income for *other-than-temporary-impairment* ('OTTI') to investments of preferred stock in these companies. OTTI, is an accounting principal which requires, in part, that the lost market value of securities be charged to income if a loss has persisted for at least six months. Bank of Commerce does not hold any Freddie Mac or Fannie Mae preferred stock investments in our portfolio.

During the third quarter 2008, the Company reclassified the remaining \$8.9 million in held-to-maturity securities to available-for-sale. The Company feels that it is prudent to have all investment securities available to provide liquidity in these current economic times. The reclassification resulted in an increase the accumulated other comprehensive loss, net of tax of approximately \$40,000. All new purchase of securities will be classified as available-for-sale.

The following table presents the current fair value and associated unrealized losses on available-for-sale and held-to-maturity investments with unrealized losses at September 30, 2008. The table also discloses whether these securities have had unrealized losses for less than 12 months or for 12 months or longer.

Securities Portfolio	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities and Obligations of U. S. Agencies	\$ 6,694,925	\$ (301,497)	\$ 0	\$ 0	\$ 6,694,925	\$ (301,497)
Obligations of state and political subdivisions	\$23,918,787	\$(1,453,933)	\$ 868,992	\$(136,957)	\$23,918,787	\$(1,590,891)
Mortgage-backed securities	\$30,772,855	\$ (152,787)	\$6,983,924	\$(468,997)	\$30,722,855	\$ (621,783)
Corporate Bonds	\$ 0	\$ 0	\$ 0	\$ (0)	\$ 0	\$ (0)
Total temporarily impaired securities	\$61,386,567	\$(1,908,217)	\$7,852,916	\$(605,954)	\$61,336,567	\$(2,514,171)

Economic factors may affect market pricing over the stated maturity of the security. The unrealized losses associated with securities are not considered to be other-than-temporary because their unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. Security income is accrued when earned and included in interest income. The Company requires a credit rating of A or higher on its initial acquisition of investments and maintains an average rating of AA on the overall securities portfolio.

Management has evaluated each security in an unrealized loss position to determine if the impairment is other-than-temporary. Management has determined that no security is other than temporarily impaired. The unrealized losses are due to interest rate changes and the Company has the ability and intent to hold all securities with identified impairments to the earlier of the forecasted recovery or the maturity of the underlying security.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Continued) (Unaudited)

7. Junior Subordinated Debt Payable to Unconsolidated Subsidiary Grantor Trust

During the first quarter 2003, Bank of Commerce Holdings formed a wholly-owned Delaware statutory business trust, Bank of Commerce Holdings Trust (the "grantor trust"), which issued \$5.0 million of guaranteed preferred beneficial interests in Bank of Commerce Holdings' junior subordinated debentures (the "trust notes") to the public and \$155,000 common securities to the Company. These debentures qualify as Tier 1 capital under Federal Reserve Board guidelines.

The proceeds from the issuance of the trust notes were transferred from the grantor trust to the Holding Company and from the Holding Company to the Bank as surplus capital. The trust notes accrue and pay distributions on a quarterly basis at 3 month London Interbank Offered Rate ("LIBOR") plus 3.30%. The rate at September 30, 2008 was 6.09%. The rate increase is capped at 2.75% annually and the lifetime cap is 12.5%. The final maturity on the trust note is March 18, 2033, and the debt allows for prepayment after five years on the quarterly payment date.

On July 29, 2005, Bank of Commerce Holdings (the "Company") participated in a private placement to an institutional investor of \$10 million of fixed rate trust preferred securities (the "Trust Preferred Securities"); through a newly formed Delaware trust affiliate, Bank of Commerce Holdings Trust II (the "Trust"). The Trust 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 3-Month 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. During September 2008, \$1,200,000 in proceeds from the issuance of the trust notes were transferred from the Holding Company to the Bank as surplus capital.

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 3-Month LIBOR plus 1.58%. The interest payments by the Company will be used to pay the quarterly distributions payable by the Trust to the holder of the Trust Preferred Securities.

However, so long as no event of default, as described below, has occurred under the Notes, the Company may, 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.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

8. 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 September 30, 2008 are below:

(Dollars in thousands)

Operating Leases	
2008	\$ 131
2009	\$ 515
2010	\$ 524
2011	\$ 454
2012	\$ 279
Thereafter	\$ 761
Total	\$ 2,664

Minimum rental due in the future Under non-cancelable subleases \$ 12

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.

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

FHLB Advances — The Company has advances from the Federal Home Loan Bank of San Francisco ("FHLB") totaling \$65,000,000 as of September 30, 2008 and \$50,000,000 as of September 30, 2007. The FHLB advances bear fixed interest rates ranging from 2.89% to 3.97%. Interest is payable monthly and semiannually. The following table illustrates borrowings outstanding at the end of the period:

Advance Amount	Interest Rate	Maturity
\$15,000,000	2.89%	01/22/2009
\$35,000,000	3.97%	11/23/2009
\$15,000,000	3.41%	04/29/2011

\$65,000,000

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 Company was required to hold a minimum investment in FHLB stock of \$4,826,200 and to pledge \$93,205,880 of its real estate mortgage loans to the FHLB as collateral as of September 30, 2008. At September 30, 2008, the Bank had available borrowing lines at the FHLB of \$61,128,042 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.

The Company's commitments to extend credit are illustrated below:

	September 30, 2008	September 30, 2007
Credit Commitments		
Unfunded loan commitments	\$ 150,616,771	\$ 184,065,127
Standby letters of credit	8,674,216	6,600,143
Guaranteed commitments outstanding	1,350,399	1,375,998
	<u>\$ 160,641,386</u>	<u>\$ 192,041,268</u>

BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

9. 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.

10. 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 September 30, 2008, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

[Table of Contents](#)**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)

(Dollars in thousands)

Recurring Basis

Description	Fair Value September 30, 2008	Quoted Prices in Active Markets For Identical Assets Level (1)	Fair Value Measurements At September 30, 2008	
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities	\$ 74,863	\$ 0	\$ 74,863	\$ 0
Total Assets Measured at fair value	\$ 74,863	\$ 0	\$ 74,863	\$ 0
Derivative Liabilities	\$ 57		\$ 57	
Total Liabilities Measured at fair value	\$ 57		\$ 57	

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 2 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 inputs 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 September 30, 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.

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.

[Table of Contents](#)**BANK OF COMMERCE HOLDINGS & SUBSIDIARIES**
Notes to Unaudited Condensed Consolidated Financial Statements (Continued)
(Unaudited)**Non Recurring Basis**

Description	Fair Value September 30, 2008	Quoted Prices in Active Markets For Identical Assets Level (1)	Fair Value Measurements At September 30, 2008	
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans	\$ 11,058	\$ 0	\$ 0	\$ 11,058
Total Assets Measured at fair value	\$ 11,058	\$ 0	\$ 0	\$ 11,058
Liabilities	\$ 0	\$ 0	\$ 0	\$ 0
Total Liabilities Measured at fair value	\$ 0	\$ 0	\$ 0	\$ 0

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 September 30, 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 \$11.1 and \$12.4 million in impaired loans as of September 30, 2008 and December 31, 2007, respectively. Impairment allowances totaled \$1.1 million and \$3.2 million at September 30, 2008 and December 31, 2007, respectively.

The fair value measurements recorded during the period

The Company recognized a \$4.8 million write-down related to non-recurring fair value measurements of impaired loans during the nine months of 2008. Interest reversed from income during this nine month period due to impaired loans was \$148,534.

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 September 30, 2008. Also discussed are significant trends and changes in the Company's results of operations for the three and nine months ended September 30, 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| *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.

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.bankofcommcercemortgage.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 ("DFI") 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 is an affiliate of LPL Financial and offers wealth management services through the affiliation.

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. It is important to note that Redding Bank of Commerce does not originate or hold sub-prime loans, nor do we hold collateralized debt obligations or asset backed securities backed by sub-prime loans in our securities portfolio.

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.

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.

Early in October 2008, the Treasury Department announced a Capital Purchase Program under which the Treasury will purchase up to \$250.0 billion of senior preferred shares from qualifying U.S. controlled banks and financial institutions. The program is aimed at healthy banks and provides attractive terms to encourage lending. The minimum subscription amount is one percent of risk weighted assets. The maximum subscription amount is the lesser of \$25 billion or three percent of risk weighted assets. The Treasury intends to fund the senior preferred shares purchased under the program by the end of 2008.

Our Company's capital position is solid. After careful consideration, management has concluded that the capital available through the Capital Purchase Program would increase our capacity to engage in increased lending activities and to invest for future growth. Bank of Commerce Holdings received preliminary approval for participation of \$17.0 million through the Capital Purchase Program on Friday, October 24, 2008. This is the least expensive capital available. The preferred stock issuance will carry a dividend rate of 5% for the first five years, callable at par at year three, and increase to 9% after the fifth year anniversary. The preferred stock issuance contains no voting rights. Coupled with the preferred stock is a warrant issuance of 15% of the investment (approximately 510,000 shares) and minimally dilutes current shareholders. Participation in the program is granted to 'qualified' financial institutions and is intended to increase growth, expansion and acquisition opportunities of well run institutions. The Company has thirty days to complete due diligence and Board approval on the transaction and the final agreement and authorization of payments. The agreements are currently under review with the Company's legal counsel.

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 ability 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 September 30, 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 an adverse effect on the Company's business, financial condition and results of operations.

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 less 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 deposits 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, thereby affecting 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.

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

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.

Lending Risks Associated with Commercial Banking and Construction Activities

The business strategy of the Company is to focus on commercial, single family and multi-family real estate loans, construction loans 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 \$6.1 million, or 1.20% of total loans at September 30, 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 September 30, 2008, time certificates of deposit in excess of \$100,000 represented approximately 25% 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.

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

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.

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 shareholders 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.

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

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.

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 "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.

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

Shares Eligible for Future Sale

As of September 30, 2008, the Company had 8,711,495 shares of Common Stock outstanding, of which 6,012,623 shares are eligible for sale in the public market without restriction and 2,819,975 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 209,485 shares of the issued and outstanding shares of common stock at exercise prices ranging from \$5.42 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.

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.

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 interest-earning assets and the interest expense it pays on interest-bearing liabilities, and (ii) fee income, which includes fees earned on deposit services, income from SBA lending, electronic-based cash management services, mortgage brokerage fee income and merchant credit card processing services. The income of the Bank 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 Bank's predisposition to variable rate pricing and non-interest bearing demand deposit accounts, the Bank is considered asset sensitive. As a result, the Company is adversely affected by declining interest rates.

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

	September 30, 2008	September 30, 2007
Profitability Ratios		
Net Interest Income to Average Assets	3.21%	3.76%
Net Income to Average Equity	8.11%	9.76%
Efficiency Ratio¹	60.82%	62.07%
Capital Ratios		
Leverage Ratio	8.77%	9.40%
Risk Based Capital	\$ 63,494,408	\$ 61,318,404
Tier 1 Capital	9.54%	10.19%
Total Capital	10.63%	11.18%
Per Common Share Data		
Dividend Payout Ratio	73.38%	48.38%
Book Value	\$ 5.24	\$ 5.04
Market Price	\$ 6.88	\$ 11.00
High	\$ 8.59	\$ 12.50
Low	\$ 5.50	\$ 9.45

Financial Highlights — Results of Operations

Net income for the third quarter of 2008 totaled \$717,000 a decrease of 46.1% from the \$1,331,000 reported for the same quarterly period of 2007. On the same basis, diluted earnings per common share for the third quarter of 2008 were \$0.08, compared to \$0.15 for the same period of 2007, a decrease of 46.7%. Return on average assets (ROA) and return on average equity (ROE) for the third quarter of 2008 were 0.44% and 6.09%, respectively, compared with 0.93% and 12.03%, respectively, for the third quarter of 2007.

Net income for the nine-month period ended September 30, 2008 totaled \$2,853,000 a decrease of 35.4% over net income of \$4,418,000 reported for the same nine-month period ended September 30, 2007. On the same basis, diluted earnings per common share for the nine-months ended September 30, 2008 was \$0.33, compared to \$0.49 for the same nine-month period in 2007, a 32.7% decrease. ROA was 0.58% and ROE was 8.11% for the first nine-months of 2008 compared with 1.01% and 13.02%, respectively, for the same nine-month period of 2007.

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 September 30, 2008 was \$5.2 million compared with \$5.6 million for the same period in 2007, a decrease of 7.1%. Net interest income for the nine-months ended September 30, 2008 was \$15.7 million compared with \$16.4 million for the same nine-month period in 2007, a decrease of 4.4%.

Average earning assets for the nine-months ended September 30, 2008 increased \$65.6 million or 12.0% compared with the same period in the prior year. Average loans, the largest component of average earning assets, increased \$94.7 million or 22.3% on average compared with the prior year period. Average securities including federal funds sold decreased \$29.0 million or 23.7% over the prior period. Investments were sold to fund loan growth. The yield on earning assets decreased to 6.17% for the nine-month period ended September 30, 2008 compared to 7.51% for the same period in the prior year.

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

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

The decrease is primarily due to multiple interest rate drops during the period.

Average interest-bearing deposits for the nine-months ended September 30, 2008 increased \$45.2 million or 12.2% compared with the prior year period. Average non-interest bearing deposits have decreased by \$3.0 million or 4.1% over the prior year nine-month period. Average borrowings have increased by \$15.6 million or 17.5% when compared with the prior year period; the increase is directly related to the substantial loan growth and increase in FHLB borrowings to support such growth.

The overall cost of interest-bearing liabilities for the first nine-months 2008 was 3.21% compared with 4.13% for the first nine-months of 2007. The decreased cost was primarily a result of the drop in interest rates during the period coupled with refinancing of FHLB borrowings at lower interest rates. The net effect of the changes discussed above resulted in a decrease of \$723,000 or 4.4% in net interest income for the nine-month period ended September 30, 2008 from the same period in 2007. The net interest margin decreased 58 basis points to 3.42% from 4.00% over the same period a year ago.

Liquidity

The objective of liquidity management is to ensure that the Company can efficiently meet the borrowing needs of our customers, withdrawals of our 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 and federal funds sold, asset liquidity is supported by debt securities in the available for sale security portfolio and wholesale lines of credit with the Federal Home Loan Bank and borrowing lines with other financial institutions. Customer core deposits have historically provided the Company with a source of relatively stable and low-cost funds.

The Company's consolidated liquidity position remains adequate to meet short-term and long-term future contingencies. At September 30, 2008, the Company had overnight investments of \$20.1 million, available lines of credit at the Federal Home Loan bank of approximately \$61.3 million, and two federal funds borrowing line with correspondent banks of \$25.0 million.

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.

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

At September 30, 2008, the Company and Bank were "well capitalized" under applicable regulatory capital adequacy guidelines.

September 30, 2008	Capital	Actual Ratio	Well Capitalized Requirement	Minimum Capital Requirement
The Company Leverage	\$56,983,019	8.77%	n/a	4.0%
Tier 1 Risk-Based	56,983,019	9.54%	n/a	4.0%
Total Risk-Based	63,494,408	10.63%	n/a	8.0%
Redding Bank of Commerce Leverage	\$59,582,565	9.21%	5.0%	4.0%
Tier 1 Risk-Based	59,582,565	9.98%	6.0%	4.0%
Total Risk-Based	66,093,955	11.07%	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 September 30, 2008, the Company's FHLB advances were a combination of fixed term and variable borrowings without call or put option features.

At September 30, 2008, the Bank had \$65 million in FHLB term advances outstanding at an average rate of 3.60% compared to \$50 million at an average rate of 4.99% at September 30, 2007.

Provision for Loan and Lease Losses

The Allowance for Loan and Lease Losses, which consists of the allowance for loan losses, is 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 probable 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 \$2,900,000 were provided for the nine-months ended September 30, 2008 compared with \$121,000 for the same period of 2007. The Company's allowance for loan and lease losses was 1.20% of total loans at September 30, 2008 and 1.09% at September 30, 2007, while its ratio of non-performing assets to total assets was 1.73% at September 30, 2008, compared to 2.01% at December 31, 2007 and 0.17% at September 30, 2007. Provisions have increased due to weakening economic conditions, the continued downturn in housing, and higher loan charge-offs during the period.

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.

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.

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

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. 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 on impaired loans 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. 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.

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.

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

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 and/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

Statement of Financial Accounting Standards No. 123 (revised 2004); **Accounting for Stock Based Compensation** was adopted by the Company as of January 1, 2006, using the modified prospective transition method. Under the modified prospective transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards, for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under Statement No. 123 for either recognition or pro forma disclosures.

The amount of the reduction 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.

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 interest-bearing 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)

	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Earning Assets						
Portfolio Loans	\$519,255	\$ 25,554	6.56%	\$424,593	\$ 26,779	8.41%
Tax-exempt Securities	29,754	884	3.96%	31,774	936	3.93%
US Government Securities	45,390	1,596	4.69%	73,810	2,446	4.42%
Federal Funds Sold	16,498	264	2.13%	14,809	580	5.22%
Other Securities	1,730	58	4.47%	2,000	67	4.47%
Average Earning Assets	<u>\$612,627</u>	<u>\$ 28,356</u>	6.17%	<u>\$546,986</u>	<u>\$ 30,808</u>	7.51%
Cash & Due From Banks	\$ 13,287			\$ 14,084		
Bank Premises	11,191			9,938		
Allowance for Loan and Lease Losses	(6,630)			(4,916)		
Other Assets	11,556			16,996		
Average Total Assets	<u>\$642,031</u>			<u>\$583,088</u>		
Interest Bearing Liabilities Demand						
Interest Bearing	\$138,034	\$ 1,762	1.70%	\$115,937	\$ 1,935	2.23%
Savings Deposits	53,244	1,193	2.99%	38,553	885	3.06%
Certificates of Deposit	223,630	6,577	3.92%	215,219	7,934	4.92%
Repurchase Agreements	13,814	151	1.46%	35,427	1,012	3.81%
FHLB Borrowings	81,587	2,174	3.55%	44,396	1,799	5.40%
Trust Preferred Borrowings	15,000	793	7.05%	15,000	814	7.24%
Average Interest Bearing Liabilities	<u>\$525,309</u>	<u>\$ 12,650</u>	3.21%	<u>464,532</u>	<u>\$ 14,379</u>	4.13%
Non interest Demand	68,920			71,880		
Other Liabilities	890			1,419		
Shareholder Equity	<u>46,912</u>			<u>45,257</u>		
Average Liabilities and Stockholders' Equity	<u>\$642,031</u>			<u>\$583,088</u>		
Net Interest Income and Net Interest Margin		<u>\$ 15,706</u>	3.42%		<u>\$ 16,429</u>	4.00%

Interest income on loans includes fee income of approximately \$69,000 and \$188,000 for the period ended September 30, 2008 and 2007, respectively.

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

The following tables set forth changes in interest income and 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 (Unaudited)

(Dollars in thousands)	September 30, 2008 Volume	Over Rate	September 30, 2007 Total
Increase(Decrease) In Interest Income			
Portfolio Loans	\$ 4,658	\$(5,883)	\$ (1,225)
Tax-exempt Securities	(60)	8	(52)
US Government Securities	(999)	149	(850)
Federal Funds Sold	27	(343)	(316)
Other Securities	(9)	0	(9)
Total Increase	\$ 3,617	\$(6,069)	\$ (2,452)
Increase(Decrease) In Interest Expense			
Interest Bearing Demand	\$ 282	\$ (455)	\$ (173)
Savings Deposits	329	(21)	308
Certificates of Deposit	247	(1,604)	(1,357)
Repurchase Agreements	(236)	(625)	(861)
FHLB Borrowings	991	(616)	375
Trust Preferred Borrowings	0	(21)	(21)
Total Increase	\$ 1,613	\$(3,342)	\$ (1,729)
Net Increase	\$ 2,004	\$(2,727)	\$ (723)

Average earning assets for the nine-months ended September 30, 2008 increased \$65.6 million or 12.0% compared with the same period in the prior year. Average loans, the largest component of average earning assets, increased \$94.7 million or 22.3% on average compared with the prior year period. Average securities including federal funds sold decreased \$29.0 million or 23.7% over the prior period. Investments were sold to fund loan growth. The yield on earning assets decreased to 6.17% for the nine-month period ended September 30, 2008 compared to 7.51% for the same period in the prior year.

The decrease is primarily due to multiple interest rate drops during the period.

Average interest-bearing deposits for the nine-months ended September 30, 2008 increased \$45.2 million or 12.2% compared with the prior year period. Average non-interest bearing deposits have decreased by \$3.0 million or 4.1% over the prior year nine-month period. Average borrowings have increased by \$15.6 million or 17.5% when compared with the prior year period; the increase is directly related to the substantial loan growth and increase in FHLB borrowings to support such growth.

The overall cost of interest-bearing liabilities for the first nine-months 2008 was 3.21% compared with 4.13% for the first nine-months of 2007. The decreased cost was primarily a result of the drop in interest rates during the period coupled with refinancing of FHLB borrowings at lower interest rates. The net effect of the changes discussed above resulted in a decrease of \$723,000 or 4.4% in net interest income for the nine-month period ended September 30, 2008 from the same period in 2007. The net interest margin decreased 58 basis points to 3.42% from 4.00% over the same period a year ago.

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

The Company's non-interest 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.

Noninterest income

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Service charges on deposit accounts	\$ 91	\$ 70	\$ 203	\$ 215
Payroll and benefit processing fees	107	90	335	287
Earnings on cash surrender value -bank owned insurance	86	100	254	294
Net gain on sale of securities available-for-sale	159	0	595	46
Net loss on sale of derivative swap transaction	0	0	(225)	0
Merchant credit card service income, net	99	109	279	297
Mortgage brokerage fee income	2	21	17	56
Other Income	207	136	575	447
Total Noninterest income	\$ 751	\$ 526	\$ 2,033	\$ 1,642

Noninterest income increased \$225,000 or 42.8% for the quarter ended September 30, 2008 over September 30, 2007. The increase is primarily related to gains on available-for-sale investment securities that were sold during the period to fund loan growth.

Noninterest income increased \$391,000 or 23.8% for the nine-months ended September 30, 2008 over September 30, 2007. The increase for the nine-month period is related to the aforementioned gains less a loss on the sale of a Swap during the period.

Noninterest Expense

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Noninterest Expense				
Salaries and related benefits	\$ 1,909	\$ 2,402	\$ 5,750	\$ 6,458
Occupancy and equipment expense	613	635	1,897	1,636
FDIC insurance premium	113	13	284	39
Data processing fees	81	82	224	227
Professional service fees	146	216	397	663
Payroll and Benefit fees	26	25	86	81
Deferred compensation expense	118	105	342	303
Stationery and Supplies	50	34	192	141
Postage	32	39	104	106
Directors' expense	81	86	223	207
Other expenses	443	391	1,290	1,356
Total Noninterest expense	\$ 3,612	\$ 4,028	\$ 10,789	\$ 11,217

Noninterest expense for the quarter ended September 30, 2008 was \$3.6 million, a decrease of \$416,000 or 10.33% over the same period a year ago. The decrease is primarily related to the absence of an executive severance package from the quarter ended September 30, 2007; salaries and benefits were lower as a result in the current period.

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

Non-interest expense for the nine-months ended September 30, 2008 was \$10.8 million compared to \$11.2 million in the same period a year ago, the decrease of \$428,000 or 3.82% is associated with the absence of the aforementioned executive severance package in the current nine-month period.

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 decrease in the Company's tax provision is attributable to increases in non-taxable income related to increases in the municipal security portfolio, classification of enterprise zone qualified credits and California Affordable Housing project which affords federal and state tax credits. The principal difference between statutory tax rates and the Company's effective tax rate is the benefit derived from key life proceeds, investing in tax-exempt securities and preferential state tax treatment for qualified enterprise zone loans.

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		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Income Taxes				
Tax provision	\$ 362	\$ 693	\$ 1,197	\$ 2,315
Effective tax rate	33.55%	34.2%	29.56%	34.4%

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. 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.

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

The Company has a net deferred tax asset of \$5.1 million for the nine months ended September 30, 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.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at September 30, 2008 consist of the following:

	September 30, 2008	September 30, 2007
Deferred Tax Assets		
State Franchise taxes	\$ 8,330	\$ 197,031
Deferred compensation	2,107,697	1,888,885
Loan loss reserves	2,851,650	2,260,163
Other Comprehensive Income	938,477	758,747
Other	174,848	187,857
Total Deferred Tax Assets	\$ 6,081,002	\$ 5,292,683
Deferred Tax Liabilities		
Depreciation	(65,674)	(152,602)
Deferred loan origination costs	(447,283)	(552,014)
Deferred state taxes	(383,406)	(270,315)
Other	0	(158,240)
Total Deferred Tax Liabilities	(896,363)	(1,133,171)
Total Net Deferred Tax Asset	\$ 5,184,639	\$ 4,159,512

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 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 as economic conditions in California continue to deteriorate in the future. Deterioration of the real estate market in California has had an adverse effect on the Company's business, financial condition and results of operations. The recent slowdown in residential development and construction markets has led to an increase in nonperforming loans which has made it prudent to strengthen our reserve position at this time. Management has taken cautious steps to ensure the proper funding of loan reserves. Credit quality, expense control and the bottom line remain top focus. A number of larger institutions have announced significant losses. These losses stemmed from securities collateralized with sub-prime mortgages and other troubled assets. It is important to note that *Redding Bank of Commerce does not originate or hold sub-prime loans, nor do we hold collateralized debt obligations or asset backed securities backed by sub-prime loans in our securities portfolio.* However, as a lending institution, we are not immune to the residential real estate slowdown.

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

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

(Dollars in thousands)	September 30, 2008	December 31, 2007
Portfolio Loans		
Commercial and financial loans	\$ 156,815	\$ 173,704
Real estate-construction loans	90,008	106,977
Real estate-commercial	203,147	175,013
Real estate-mortgage	21,568	10,787
Real estate-other	36,971	26,818
Installment	132	226
Other loans	974	1,223
Less:		
Net deferred loan costs (fees)	(139)	(232)
Allowance for loan losses	(6,128)	(8,233)
Total net loans	<u>\$ 503,348</u>	<u>\$ 486,283</u>

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.

The portfolio mix reflects increases in commercial real estate and the other real estate category. Both the Commercial and financial loans, and Construction and development loans have declined significantly; combined they now represent 49.0% of total loans compared to 57.8% at December 31, 2007.

Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due and payable. The Bank had outstanding balances of \$11.1 and \$12.4 in impaired loans that had impairment allowances of \$1,100,000 and \$3,242,285 as of September 30, 2008 and December 31, 2007, respectively.

The following table sets forth a summary of the Company's nonperforming assets as of the dates indicated:

(Dollars in thousands)	September 30, 2008	December 31, 2007
Non performing assets		
Nonaccrual loans	\$ 11,057	\$ 12,409
90 days past due and still accruing interest	0	0
Total nonaccrual loans	11,057	12,409
Other Real Estate Owned	4,869	0
Total non performing assets	<u>\$ 15,926</u>	<u>\$ 12,409</u>

The Company booked \$4.9 million in OREO in the third quarter of 2008 compared to \$0 in 2007. The OREO is a single parcel of land located in the company's Sacramento, California market. Prior to foreclosure, the project was in the entitlement phase of development; the company in coordination with the other participating banks will continue the entitlement processes in conjunction with establishing a marketing plan to ultimately dispose of the project. A recent valuation of the property fully supports any additional improvement costs until such time the property is sold. The Company's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties.

Management remains aggressive in identifying problem loans and conducting impairment reviews when applicable. Impairment reviews have resulted in \$4.8 million in write-downs during the first nine months of 2008. Material future additions to the allowance for loan losses may be necessary if material adverse economic conditions persist and the performance of the loan portfolio of the Company deteriorates. Future additions to the Company's allowance for loan and lease losses may also be required to reflect market changes and other factors affecting the Company's real estate and real estate related portfolios. Moreover, the FDIC and the DFI, as an integral part of their examination process, review the Company's allowance for loan and lease losses and the carrying value of its assets. The Bank was recently examined by the FDIC in this regard during the second quarter of 2008. No adjustments were made to management's estimates for the allowance for loan and lease losses during the examination.

Non-performing loans were 2.23% of total loans as of September 30, 2008 compared to 2.55% at December 31, 2007 and 0% one year ago.

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

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.

Material future additions to the allowance for loan losses might be necessary if material adverse changes in economic conditions occur and the performance of the loan portfolio of the Company deteriorates. Future additions to the Company's allowance for loan and lease losses may also be required in order to reflect changes in the markets for real estate in which the Company's real estate related portfolios are located and other factors which may result in adjustments which are necessary to ensure that the Company's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties.

Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Company's allowance for loan and lease losses and the carrying value of its assets. The Bank was most recently examined by the FDIC in this regard during the second quarter of 2008. No adjustments were made to management's estimates for the allowance for loan and lease losses during the examination.

The Company's allowance for loan and lease 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 and lease 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 credit is determined using estimates of the probability of funding. This reserve is carried as a liability on the condensed consolidated balance sheet.

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)	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Allowance for Loan and Lease Losses				
Beginning balance for Loan Losses	\$ 5,017	\$ 4,943	\$ 8,233	\$ 4,904
Provision for Loan Losses	1,300	115	2,900	121
Charge offs:				
Commercial	(155)	(0)	(888)	(0)
Real Estate	(35)	(0)	(4,122)	(0)
Other	(0)	(0)	(0)	(0)
Total Charge offs	(190)	(0)	(5,010)	(0)
Recoveries:				
Commercial	0	1	0	26
Real Estate	0	0	0	0
Other	1	2	5	10
Total Recoveries	1	3	5	36
Ending Balance	\$ 6,128	\$ 5,061	\$ 6,128	\$ 5,061
ALLL to total loans	1.20%	1.09%	1.20%	1.09%
Net Charge offs to average loans	0.04%	0.00%	0.96%	0.00%

The allowance for loan and lease losses totaled \$6.1 million at September 30, 2008 compared to \$8.2 million at December 31, 2007 and \$5.1 million at September 30, 2007. The Company's allowance for loan losses was 1.20% of total loans at September 30, 2008 and 1.09% at September 30, 2007. Provisions for loan losses for the quarter ended September 2008 were \$1,300,000 compared to \$115,000 for the same quarter in 2007. Provision for loan and lease losses of \$2,900,000 were provided for the nine-months ended September 30, 2008 compared with \$121,000 for the same nine-month period of 2007.

The Company continues to be aggressive in identifying non-performing assets. Since the beginning of the fourth quarter 2007, the Company has provided \$6.1 million in provisions for loan and lease losses. Elevated provisions are associated with a reclassification of loans, following completion of a total portfolio review, and management's aggressive stance in recognizing impaired loans.

Impairment reviews have resulted in write-downs of \$4.8 million during the first nine months of 2008. These write-downs are largely related with two non-performing residential tract sub-divisions which have been in non accrual status since year end 2007.

The Company's ratio of non-performing assets to total assets was 1.73% at September 30, 2008, compared to 2.01% at December 31, 2007 and 0.00% at September 30, 2007.

The Company booked \$4.9 million in OREO in the third quarter of 2008 compared to \$0 through the first nine months of 2007 (See page 36 for specific details on OREO). The capital ratios of Redding Bank of Commerce continue to be above the well-capitalized guidelines established by bank regulatory agencies.

[Table of Contents](#)
BANK OF COMMERCE HOLDINGS & SUBSIDIARIES
QUARTERLY INCOME STATEMENT

Dollars in thousands, except for per share data	September 30, 2008	June 30, 2008	March 31, 2008	December 31, 2007	September 30, 2007
Interest income:					
Interest and fees on loans	\$ 8,252	\$ 8,171	\$ 9,131	\$ 9,355	\$ 9,350
Interest on tax-exempt securities	308	302	274	293	324
Interest on U.S. government securities	582	533	481	639	798
Interest on federal funds sold and securities purchased under agreements to resell	116	90	58	101	190
Interest on other securities	13	23	22	23	22
Total interest income	9,271	9,119	9,966	10,411	10,684
Interest expense:					
Interest on demand deposits	514	498	750	800	791
Interest on savings deposits	543	360	290	331	359
Interest on certificates of deposit	1,963	2,238	2,376	2,637	2,702
Securities sold under repurchase agreements	32	35	84	165	289
Interest on FHLB and other borrowings	662	781	731	623	628
Interest on junior subordinated debt payable to unconsolidated subsidiary grantor trust	317	161	315	271	274
Total interest expense	4,031	4,073	4,546	4,827	5,043
Net interest income	5,240	5,046	5,420	5,584	5,641
Provision for loan and lease losses	1,300	1,000	600	3,170	115
Net interest income after provision for loan and lease losses	3,940	4,046	4,820	2,414	5,526
Noninterest income:					
Service charges on deposit accounts	91	50	62	63	70
Payroll and benefit processing fees	107	99	129	212	90
Earnings on cash surrender value — bank owned life insurance	86	85	83	96	100
Life insurance policy benefits	0	0	0	2,437	0
Net gain on sale of securities available-for-sale	159	194	242	0	0
Net loss on sale of derivative swap transaction	0	0	(225)	0	0
Merchant credit card service income, net	99	97	83	91	109
Mortgage brokerage fee income	2	5	10	0	21
Other income	207	187	181	(6)	136
Total noninterest income	751	717	565	2,893	526
Noninterest expense:					
Salaries and related benefits	1,909	1,892	1,949	2,208	2,402
Occupancy and equipment expense	613	640	644	737	635
FDIC insurance premium	113	113	58	12	13
Data processing fees	81	65	78	169	82
Professional service fees	146	133	118	365	216
Payroll processing fees	26	27	33	27	25
Deferred compensation expense	118	113	111	108	105
Stationery and supplies	50	80	62	116	34
Postage	32	38	34	32	39
Directors' expense	81	94	48	105	86
Other expenses	443	418	430	649	391
Total noninterest expense	3,612	3,613	3,565	4,528	4,028
Income before provision for income taxes	1,079	1,150	1,820	779	2,024
Provision for income taxes	362	244	591	(910)	693
Net income	\$ 717	\$ 906	\$ 1,229	\$ 1,689	\$ 1,331
Basic earnings per share	\$ 0.08	\$ 0.10	\$ 0.14	\$ 0.19	\$ 0.15
Weighted average shares — basic	8,711	8,748	8,719	8,755	8,904
Diluted earnings per share	\$ 0.08	\$ 0.10	\$ 0.14	\$ 0.19	\$ 0.15
Weighted average shares — diluted	8,713	8,751	8,748	8,802	8,929
Cash dividends per share	\$ 0.08	\$ 0.08	\$ 0.08	\$ 0.08	\$ 0.08

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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

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. 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 100 or 200 basis points up or down. All changes are measured in dollars and are compared to projected net interest income. Management's most recent calculation estimated an annualized reduction in net interest income attributable to a 50 and 100 basis point decline in the federal funds rate at \$222,812 and \$300,207, respectively. At December 31, 2007, the estimated annualized reduction in net interest income attributable to a 100 and 200 basis point decline in the federal funds rate was \$330,889 and \$675,089, respectively, with a similar and opposite result attributable to a 100 and 200 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.

The Company 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. The Company's use of derivatives is monitored by the Directors ALCO committee.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information required to be disclosed is accumulated and communicated to management in a timely manner. Management has reviewed this system of disclosure controls and procedures as of the end of the period covered by this report and believe that the system is operating effectively to ensure appropriate disclosure.

During the quarter ended September 30, 2008, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

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

None

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

Item 6. Exhibits

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

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

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

SIGNATURES

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

BANK OF COMMERCE HOLDINGS (Registrant)

Date: November 7, 2008

/s/ Linda J. Miles
Linda J. Miles
Executive Vice President and
Chief Financial Officer

45

Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATIONS

I, Patrick J. Moty, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Bank of Commerce Holdings ('the registrant');
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervisions, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Patrick J. Moty

Patrick J. Moty
President and Chief Executive Officer
(Principal Executive Officer)
Dated: November 7, 2008

Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATIONS

I, Linda J. Miles, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Bank of Commerce Holdings ('the registrant');
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervisions, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Linda J. Miles

Linda J. Miles

Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: November 7, 2008

Section 4: EX-32 (EX-32)

Exhibit 32

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
Regarding Quarterly Report on Form 10-Q**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Bank of Commerce Holdings, a California Corporation (the "company"), does certify that:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 fully complies with the requirements of section 13(a) or 15(d) of the Securities and Exchange Act of 1934, as amended, and
2. Information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of the Company.

Dated: November 7, 2008

/s/ Patrick J. Moty

Patrick J. Moty
President and Chief Executive Officer

/s/ Linda J. Miles

Linda J. Miles
Executive Vice President and Chief Financial Officer