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\$810,000, \$652,000 and \$540,000 for the years ended December 31, 2018, 2017 and 2016, respectively. The

112

Table of Contents

Company's contributions totaled \$583,000, \$453,000 and \$521,000 for the years ended December 31, 2018, 2017 and 2016, respectively. As of December 31, 2018 and 2017, the carrying value of the obligation related to the deferred compensation plans was \$3.7 million and \$2.8 million, respectively.

(d) Split-Dollar Life Insurance Benefit Plan

In conjunction with the Washington Banking Merger, the Company assumed the split-dollar life insurance benefit plan previously maintained by Washington Banking. Life insurance policies are maintained for current or former officers of the Bank or former Washington Banking officers that are subject to split-dollar life insurance agreements, which continue after the participant's employment and retirement. All participants are fully vested in their split-dollar life insurance benefits. The accrued benefit liability for the split-dollar life insurance agreements represents the present value of the future death benefits payable to the participants' beneficiaries.

The split-dollar life insurance projected benefit obligation is included in accrued expenses and other liabilities on the Company's Consolidated Statements of Financial Condition. As of December 31, 2018 and 2017, the carrying value of the obligation was \$268,000 and \$250,000, respectively.

(e) Salary Continuation Plan

In conjunction with the Premier Merger, the Company assumed an unfunded deferred compensation plan for select former Premier Commercial executive officers, some of which are current Heritage officers. Under the Salary Continuation Plan, the Company will pay each participant, or their beneficiary, specified benefits over specified periods beginning with the individual's termination of service due to retirement subject to early termination provisions. A liability is accrued for the obligation under this plan. As of December 31, 2018, the carrying value of the obligation was \$4.6 million. The expense incurred for the Salary Continuation Plan was \$184,000 during the year ended December 31, 2018. There was no expense incurred for the Salary Continuation Plan during the years ended December 31, 2017 and 2016.

(14) Commitments and Contingencies**(a) Lease Commitments**

The Bank leases certain premises and equipment under operating leases. Rental expense of leased premises and equipment was \$6.1 million, \$3.8 million and \$4.4 million for the years ended December 31, 2018, 2017 and 2016, respectively, which is included in occupancy and equipment expense on the Company's Consolidated Statements of Income.

The estimated future minimum annual rental commitments under noncancelable leases having an original or remaining term of more than one year are as follows:

	Year Ending December 31, (In thousands)
2019	\$ 4,766
2020	4,251
2021	2,477
2022	1,704
2023	1,568
Thereafter	1,788
	\$ 16,554

The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term.

(b) Commitments to Extend Credit

In the ordinary course of business, the Company may enter into various types of transactions that include commitments to extend credit that are not included in the Consolidated Financial Statements. The Company applies the same credit standards to these commitments as it uses in all its lending activities and has included these

commitments in its lending risk evaluations. The majority of the commitments presented below are variable rate. The Company's exposure to credit and market risk under commitments to extend credit is represented by the amount of these commitments.

113

Table of Contents

The following table presents outstanding commitments to extend credit, including letters of credit, at the dates indicated:

	December 31, 2018	December 31, 2017
	(In thousands)	
Commercial business:		
Commercial and industrial	\$568,215	\$ 363,272
Owner-occupied commercial real estate	13,065	6,815
Non-owner occupied commercial real estate	13,621	13,543
Total commercial business	594,901	383,630
One-to-four family residential	—	—
Real estate construction and land development:		
One-to-four family residential	59,772	38,160
Five or more family residential and commercial properties	95,535	86,787
Total real estate construction and land development	155,307	124,947
Consumer	239,822	204,625
Total outstanding commitments	\$990,030	\$ 713,202

(c) Variable Interests

The Company has two equity investments in Low-Income Housing Tax Credit partnerships ("LIHTCs") which are indirect federal subsidies that finance low-income housing projects. The Company reported the investments in the unconsolidated LIHTCs as prepaid expenses and other assets on the Company's Statements of Financial Condition with carrying values of \$50.9 million and \$54.0 million as of December 31, 2018 and 2017, respectively. As a limited liability investor in these partnerships, the Company receives tax benefits in the form of tax deductions from partnership operating losses and federal income tax credits. The federal income tax credits are earned over a 10-year period as a result of the investment properties meeting certain criteria and are subject to recapture for noncompliance with such criteria over a 15-year period. The Company accounts for the LIHTCs under the proportional amortization method and amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance on the Company's Consolidated Statements of Income as a component of income tax expense. During the years ended December 31, 2018, 2017, and 2016 the Company recognized tax benefits of \$2.4 million, \$2.9 million and \$640,000, respectively. See Note (21) Income Taxes for further information on tax benefits.

The maximum exposure to loss in the LIHTCs is the amount of equity invested and credit extended by the Company. Loans to these entities are underwritten in substantially the same manner as are other loans and are generally secured. The Company has evaluated the variable interests held by the Company in each LIHTC investment and determined that the Company does not have controlling financial interests in such investments, and is not the primary beneficiary. Total unfunded contingent commitments related to the Company's LIHTC investments totaled \$31.5 million and \$39.8 million at December 31, 2018 and 2017, respectively, and is reported as accrued expenses and other liabilities on the Company's Statements of Financial Condition. The Company expects to fund LIHTC commitments of \$26.4 million during the year ended December 31, 2019 and \$523,000 during the year ended December 31, 2020, with the remaining commitments of \$4.5 million paid by December 31, 2034. There were no impairment losses on the Company's LIHTC investments during the years ended December 31, 2018, 2017 or 2016.

The Company also made a total of \$25.0 million of Qualified Equity Investments ("QEIs") into three Certified Development Entities ("CDEs") in May 2014 and is eligible to receive New Markets Tax Credits ("NMTC") on the QEIs. The NMTC program provides federal tax incentives to investors to make investments in distressed communities and promotes economic improvements through the development of successful businesses in these communities. The NMTC is available to investors over a seven-year period and is subject to recapture if certain events occur during such period. Gross tax credits related to the Company's CDEs totaling \$9.8 million are available through 2020. The Company is required to fund 85 percent of a tranche to claim the entire tax credit, and it had until May 15, 2015 to

complete the funding. The tranche was funded in 2015 before the deadline.

114

Table of Contents

The Company accounts for its NMTC on the equity method and reported the investment balance as prepaid expenses and other assets on the Company's Statements of Financial Condition with carrying value of \$25.7 million and \$25.8 million at December 31, 2018 and December 31, 2017, respectively. The Company recorded investment income of \$708,000, \$735,000 and \$740,000 during the years ended December 31, 2018, 2017 and 2016, respectively, in other income on the Company's Statements of Income.

(15) Derivative Financial Instruments

The Company has entered into certain interest rate swap contracts that are not designated as hedging instruments. The purpose of these derivative contracts is primarily to provide commercial business loan customers the ability to convert their loans from variable to fixed interest rates. Upon the origination of a derivative contract with a customer, the Company simultaneously enters into an offsetting derivative contract with a third party in order to offset its exposure on the variable and fixed rate components of the customer agreement. The Company recognizes immediate income based upon the difference in the bid/ask spread of the underlying transactions with its customers and the third party, which is recorded in interest rate swap fees on the Consolidated Statements of Income. Because the Company acts only as an intermediary for its customer, subsequent changes in the fair value of the underlying derivative contracts offset each other and do not significantly impact the Company's results of operations.

The notional amounts and estimated fair values of interest rate derivative contracts outstanding at December 31, 2018 and December 31, 2017 are presented in the following table:

December 31, 2018		December 31, 2017	
Notional Amounts	Estimated Fair Value	Notional Amounts	Estimated Fair Value

(In thousands)

Non-hedging interest rate derivatives

Interest rate swaps with customer ⁽¹⁾ \$171,798 \$(1,643) \$146,537 \$(882)

Interest rate swap with third party ⁽¹⁾ 171,798 1,643 146,537 882

⁽¹⁾ The estimated fair value of the derivative included in prepaid and other assets on the Consolidated Statements of Financial Condition was \$5.1 million and \$3.4 million as of December 31, 2018 and 2017, respectively. The estimated fair value of the derivative included in accrued expenses and other liabilities on the Consolidated Statements of Financial Condition was \$5.1 million and \$3.4 million as of December 31, 2018 and 2017, respectively.

(16) Stockholders' Equity**(a) Earnings Per Common Share**

The following table illustrates the reconciliation of weighted average shares used for earnings per common share computations for the years ended December 31, 2018, 2017 and 2016:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Net income:			
Net income	\$53,057	\$41,791	\$38,918
Dividends and undistributed earnings allocated to participating securities	(321)	(293)	(358)
Net income allocated to common shareholders	\$52,736	\$41,498	\$38,560
Basic:			
Weighted average common shares outstanding	35,281,400	29,937,400	29,963,365
Restricted stock awards	(87,405)	(179,581)	(285,063)
Total basic weighted average common shares outstanding	35,194,000	29,757,819	29,678,302
Diluted:			
Basic weighted average common shares outstanding	35,194,000	29,757,819	29,678,302

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Effect of potentially dilutive common shares ⁽¹⁾	177,587	91,512	13,851
Total diluted weighted average common shares outstanding	35,371,590	29,849,331	29,692,153

⁽¹⁾ Represents the effect of the assumed exercise of stock options and vesting of restricted stock awards and units.

Table of Contents

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the years ended December 31, 2018 and December 31, 2017, there were no anti-dilutive shares outstanding related to options to acquire common stock. For the year ended December 31, 2016, anti-dilutive shares outstanding related to options to acquire common stock totaled 436. Anti-dilution occurs when the exercise price of a stock option or the unrecognized compensation cost per share of a restricted stock award exceeds the market price of the Company's stock.

(b) Dividends

The timing and amount of cash dividends paid on the Company's common stock depends on the Company's earnings, capital requirements, financial condition and other relevant factors. Dividends on common stock from the Company depend substantially upon receipt of dividends from the Bank, which is the Company's predominant source of income. The following table summarizes the dividend activity for the years ended December 31, 2018, 2017 and 2016:

Declared	Cash Dividend per Share	Record Date	Paid Date
January 27, 2016	\$0.11	February 10, 2016	February 24, 2016
April 20, 2016	\$0.12	May 5, 2016	May 19, 2016
July 20, 2016	\$0.12	August 4, 2016	August 18, 2016
October 26, 2016	\$0.12	November 8, 2016	November 22, 2016
October 26, 2016	\$0.25	November 8, 2016	November 22, 2016 *
January 25, 2017	\$0.12	February 9, 2017	February 23, 2017
April 25, 2017	\$0.13	May 10, 2017	May 24, 2017
July 25, 2017	\$0.13	August 10, 2017	August 24, 2017
October 25, 2017	\$0.13	November 8, 2017	November 22, 2017
October 25, 2017	\$0.10	November 8, 2017	November 22, 2017 *
January 24, 2018	\$0.15	February 7, 2018	February 21, 2018
April 25, 2018	\$0.15	May 10, 2018	May 24, 2018
July 24, 2018	\$0.15	August 9, 2018	August 23, 2018
October 24, 2018	\$0.17	November 7, 2018	November 21, 2018
October 24, 2018	\$0.10	November 7, 2018	November 21, 2018 *

* Denotes a special dividend.

The FDIC and the Washington State Department of Financial Institutions, Division of Banks have the authority under their supervisory powers to prohibit the payment of dividends by the Bank to the Company. Additionally, current guidance from the Board of Governors of the Federal Reserve System ("Federal Reserve") provides, among other things, that dividends per share on the Company's common stock generally should not exceed earnings per share, measured over the previous four fiscal quarters. Current regulations allow the Company and the Bank to pay dividends on their common stock if the Company's or the Bank's regulatory capital would not be reduced below the statutory capital requirements set by the Federal Reserve and the FDIC.

Table of Contents

(c) Stock Repurchase Program

The Company has had various stock repurchase programs since March 1999. On October 23, 2014, the Company's Board of Directors authorized the repurchase of up to 5% of the Company's outstanding common shares, or approximately 1,513,000 shares, under the eleventh stock repurchase plan. The number, timing and price of shares repurchased will depend on business and market conditions, and other factors, including opportunities to deploy the Company's capital.

Since the inception of the eleventh plan, the Company has repurchased 579,996 shares at an average share prices of \$16.67. No shares were repurchased under this plan during the years ended December 31, 2018 and 2017. During the year ended December 31, 2016, 138,000 shares were repurchased with an average share price of \$17.16.

In addition to the stock repurchases under a plan, the Company repurchases shares to pay withholding taxes on the vesting of restricted stock awards and units. The following table provides total repurchased shares for the periods indicated:

	Year Ended December		
	31,		
	2018	2017	2016
Repurchased shares to pay withholding taxes ⁽¹⁾	53,256	29,429	29,512
Stock repurchase to pay withholding taxes average share price	\$31.99	\$25.01	\$17.82

⁽¹⁾ During the year ended December 31, 2018, the Company repurchased 26,741 shares related to the withholding taxes due on the accelerated vesting of the restricted stock units of Puget Sound which were converted to Heritage common stock shares with a share price of \$31.80 under the terms of the Puget Sound Merger. See Note (2) Business Combinations. There were no shares repurchased as a result of the accelerated vesting of the restricted stock awards related to the Premier Merger.

(d) Issuance of Common Stock

In conjunction with the Premier Merger effective on July 2, 2018 and the Puget Sound Merger effective on January 16, 2018, Heritage issued 2,848,579 and 4,112,258 shares, respectively, of the Company's common stock at the merger date share price of \$34.85 and \$31.80, respectively, for a fair value of \$99.3 million and \$130.8 million, respectively.

In addition, common stock was issued during the years ended December 31, 2018, 2017 and 2016 related to the exercise of stock options and issuance of restricted stock awards as further described in Note (19) Stock-Based Compensation.

(17) Accumulated Other Comprehensive Loss

The changes in accumulated other comprehensive (loss) income ("AOCI"), all of which are due to changes in the fair value of available for sale securities and are net of tax, during the years ended December 31, 2018, 2017 and 2016 are as follows:

	December	December	December
	31, 2018	31, 2017	31, 2016
	(In thousands)		
Balance of AOCI at the beginning of the year	\$(1,298)	\$(2,606)	\$2,559
Other comprehensive (loss) income before reclassification	(5,956)	1,530	(4,311)
Amounts reclassified from AOCI for gain on sale of investment securities included in net income	(108)	(4)	(854)
Net current period other comprehensive (loss) income	(6,064)	1,526	(5,165)
ASU 2016-01 and 2018-02 Implementations	(93)	(218)	—
Balance of AOCI at the end of the year	\$(7,455)	\$(1,298)	\$(2,606)

Table of Contents

(18) Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Valuations for assets and liabilities traded in active exchange markets, or interest in open-end mutual funds that allow the Company to sell its ownership interest back to the fund at net asset value on a daily basis. Valuations are obtained from readily available pricing sources for market transactions involving identical assets, liabilities, or funds.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or valuations using methodologies with observable inputs.

Level 3: Valuations for assets and liabilities that are derived from other valuation methodologies, such as option pricing models, discounted cash flow models and similar techniques using unobservable inputs, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

(a) Recurring and Nonrecurring Basis

The Company used the following methods and significant assumptions to measure the fair value of certain assets on a recurring and nonrecurring basis:

Investment Securities Available for Sale:

The fair values of all investment securities are based upon the assumptions that market participants would use in pricing the security. If available, fair values of investment securities are determined by quoted market prices (Level 1). For investment securities where quoted market prices are not available, fair values are calculated based on market prices on similar securities (Level 2). For investment securities where quoted prices or market prices of similar securities are not available, fair values are calculated by using observable and unobservable inputs such as discounted cash flows or other market indicators (Level 3). Security valuations are obtained from third party pricing services for comparable assets or liabilities.

Impaired Loans:

At the time a loan is considered impaired, its impairment is measured based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the observable market price, or the fair market value of the collateral (less costs to sell) if the loan is collateral-dependent. Impaired loans for which impairment is measured using the discounted cash flow approach are not considered to be measured at fair value because the loan's effective interest rate is generally not a fair value input, and for the purposes of fair value disclosures, the fair value of these loans are measured commensurate with non-impaired loans. If the Company utilizes the fair market value of the collateral method, the fair value used to measure impairment is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value based on the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation and management's expertise and knowledge of the client and client's business (Level 3). Impaired loans are evaluated on a quarterly basis and impairment is adjusted accordingly.

Other Real Estate Owned:

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable

sales and income data available. Such adjustments are usually significant and typically result in Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers for commercial properties or certified residential appraisers for residential properties whose qualifications and licenses have been reviewed and verified by the Company. Once received, the Company reviews

Table of Contents

the assumptions and approaches utilized in the appraisal as well as the resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On a quarterly basis, the Company compares the actual selling price of collateral that has been liquidated to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Derivative Financial Instruments:

The Company obtains broker or dealer quotes to value its interest rate derivative contracts, which use valuation models using observable market data as of the measurement date (Level 2).

Recurring Basis

The following tables summarize the balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 and December 31, 2017:

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets				
Investment securities available for sale:				
U.S. Treasury and U.S. Government-sponsored agencies	\$101,603	\$15,936	\$85,667	\$ —
Municipal securities	158,864	—	158,864	—
Mortgage backed securities and collateralized mortgage obligations:				
Residential	331,602	—	331,602	—
Commercial	333,761	—	333,761	—
Corporate obligations	25,563	—	25,563	—
Other asset-backed securities	24,702	—	24,702	—
Total investment securities available for sale	976,095	15,936	960,159	—
Derivative assets - interest rate swaps	5,095	—	5,095	—
Liabilities				
Derivative liabilities - interest rate swaps	\$5,095	\$—	\$5,095	\$ —

Table of Contents

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets				
Investment securities available for sale:				
U.S. Treasury and U.S. Government-sponsored agencies	\$13,442	\$	—\$13,442	\$
Municipal securities	250,015	—	250,015	—
Mortgage backed securities and collateralized mortgage obligations:				
Residential	280,211	—	280,211	—
Commercial	217,079	—	217,079	—
Collateralized loan obligations	4,580	—	4,580	—
Corporate obligations	16,770	—	16,770	—
Other securities	28,433	146	28,287	—
Total investment securities available for sale	810,530	146	810,384	—
Derivative assets - interest rate swaps	3,418	—	3,418	—
Liabilities				
Derivative liabilities - interest rate swaps	\$3,418	\$	—\$3,418	\$

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2018 and 2017.

Nonrecurring Basis

The Company may be required to measure certain financial assets and liabilities at fair value on a nonrecurring basis. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets.

The tables below represent assets measured at fair value on a nonrecurring basis at December 31, 2018 and December 31, 2017 and the net losses recorded in earnings during years ended December 31, 2018 and 2017:

	Fair Value at December 31, 2018				Net Losses Recorded in Earnings During the Year Ended December 31, 2018	
Basis ⁽¹⁾	Total	Level 1	Level 2	Level 3		
(In thousands)						
Impaired loans:						
Commercial business:						
Commercial and industrial	\$117	\$107	\$	—\$	—\$107	\$ 10
Non-owner occupied commercial real estate	1,378	1,102	—	—	1,102	150
Total commercial business	1,495	1,209	—	—	1,209	160
Consumer	9	7	—	—	7	8
Total assets measured at fair value on a nonrecurring basis	\$1,504	\$1,216	\$	—\$	—\$1,216	\$ 168

⁽¹⁾ Basis represents the unpaid principal balance of impaired loans.

Table of Contents

	Fair Value at December 31, 2017				Net Losses (Gains) Recorded in Earnings During the Year Ended December 31, 2017
	Basis ⁽¹⁾	Total	Level 1	Level 2	Level 3
(In thousands)					
Impaired loans:					
Real estate construction and land development:					
One-to-four family residential	\$976	\$307	\$	—\$	—\$307 \$ (558)
Total assets measured at fair value on a nonrecurring basis	\$976	\$307	\$	—\$	—\$307 \$ (558)

⁽¹⁾ Basis represents the unpaid principal balance of impaired loans.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2018 and December 31, 2017:

		December 31, 2018		Range of Inputs; Weighted Average
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	
(Dollars in thousands)				
Impaired loans	\$1,216	Market approach	Adjustment for differences between the comparable sales	10.4% - (37.3%); (10.9%)
		December 31, 2017		
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range of Inputs; Weighted Average
(Dollars in thousands)				
Impaired loans	\$307	Market approach	Adjustment for differences between the comparable sales	(91.5%) - (14.4%); (44.0%)

(b) Fair Value of Financial Instruments

Because broadly traded markets do not exist for most of the Company's financial instruments, the fair value calculations attempt to incorporate the effect of current market conditions at a specific time. These determinations are subjective in nature, involve uncertainties and matters of significant judgment and do not include tax ramifications; therefore, the results cannot be determined with precision, substantiated by comparison to independent markets and may not be realized in an actual sale or immediate settlement of the instruments. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results. For all of these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Company.

Table of Contents

The tables below present the carrying value amount of the Company's financial instruments and their corresponding estimated fair values at the dates indicated:

	December 31, 2018		Fair Value Measurements		
	Carrying Value	Fair Value	Using: Level 1	Level 2	Level 3
	(In thousands)				
Financial Assets:					
Cash and cash equivalents	\$161,910	\$161,910	\$161,910	\$ —	—
Investment securities available for sale	976,095	976,095	15,936	960,159	—
Federal Home Loan Bank stock	6,076	N/A	N/A	N/A	N/A
Loans held for sale	1,555	1,605	—	1,605	—
Total loans receivable, net	3,619,118	3,614,348	—	—	3,614,348
Accrued interest receivable	15,403	15,403	68	4,091	11,244
Derivative assets - interest rate swaps	5,095	5,095	—	5,095	—
Equity security	114	114	114	—	—
Financial Liabilities:					
Noninterest deposits, interest bearing demand deposits, money market accounts and savings accounts	\$3,965,510	\$3,965,510	\$3,965,510	\$ —	—
Certificate of deposit accounts	466,892	470,222	—	470,222	—
Securities sold under agreement to repurchase	31,487	31,487	31,487	—	—
Junior subordinated debentures	20,302	20,500	—	—	20,500
Accrued interest payable	191	191	63	81	47
Derivative liabilities - interest rate swaps	5,095	5,095	—	5,095	—

Table of Contents

	December 31, 2017		Fair Value Measurements			
	Carrying Value	Fair Value	Using:	Level 1	Level 2	Level 3
(In thousands)						
Financial Assets:						
Cash and cash equivalents	\$103,015	\$103,015	\$103,015	\$	—	—
Investment securities available for sale	810,530	810,530	146	810,384	—	—
Federal Home Loan Bank stock	8,347	N/A	N/A	N/A	N/A	N/A
Loans held for sale	2,288	2,364	—	2,364	—	—
Total loans receivable, net	2,816,985	2,810,401	—	—	—	2,810,401
Accrued interest receivable	12,244	12,244	23	3,772	8,449	—
Derivative assets - interest rate swaps	3,418	3,418	—	3,418	—	—
Financial Liabilities:						
Noninterest deposits, interest bearing demand deposits, money market accounts and savings accounts	\$2,994,662	\$2,994,662	\$2,994,662	\$	—	—
Certificate of deposit accounts	398,398	397,039	—	397,039	—	—
Federal Home Loan Bank advances	92,500	92,500	—	92,500	—	—
Securities sold under agreement to repurchase	31,821	31,821	31,821	—	—	—
Junior subordinated debentures	20,009	18,500	—	—	—	18,500
Accrued interest payable	162	162	45	79	38	—
Derivative liabilities - interest rate swaps	3,418	3,418	—	3,418	—	—

(19) Stock-Based Compensation

On July 24, 2014, the Company's shareholders approved the Heritage Financial Corporation 2014 Omnibus Equity Plan ("Equity Plan") that provides for the issuance of 1,500,000 shares of the Company's common stock in the form of stock options, stock appreciation rights, stock awards (which includes restricted stock units, restricted stock awards, performance units, performance shares or bonus shares) and cash incentive awards. The Company issues new shares of common stock to satisfy share option exercises and restricted stock awards. As of December 31, 2018, shares remain available for future issuance under the Equity Plan totaled 955,282.

(a) Stock Option Awards

Stock options generally vest ratably over three years and expire five years after they become exercisable or vest ratably over four years and expire ten years from date of grant. For the years ended December 31, 2018, 2017 and 2016, the Company did not recognize any compensation expense or related tax benefit related to stock options as all of the compensation expense related to the outstanding stock options had been previously recognized. The intrinsic value from options exercised during the years ended December 31, 2018, 2017 and 2016 was \$202,000, \$161,000 and \$177,000, respectively. The cash proceeds from options exercised during the years ended December 31, 2018, 2017 and 2016 were \$132,000, \$164,000 and \$540,000, respectively.

Table of Contents

The following table summarizes the stock option activity for the years ended December 31, 2018, 2017 and 2016:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2015	79,408	\$ 14.19		
Exercised	(37,713)	14.31		
Forfeited or expired	(4,200)	16.80		
Outstanding at December 31, 2016	37,495	13.77		
Exercised	(12,662)	12.97		
Forfeited or expired	(1,602)	13.76		
Outstanding at December 31, 2017	23,231	14.21		
Exercised	(9,842)	13.45		
Forfeited or expired	(831)	14.77		
Outstanding, vested and expected to vest and exercisable at December 31, 2018	12,558	\$ 14.77	1.39	\$ 188

(b) Restricted Stock Awards

Restricted stock awards granted generally have a four-year cliff vesting or four-year ratable vesting schedule. For the years ended December 31, 2018, 2017 and 2016 the Company recognized compensation expense related to restricted stock awards of \$907,000, \$1.4 million and \$1.8 million, respectively, and a related tax benefit of \$191,000, \$488,000 and \$644,000, respectively. As of December 31, 2018, the total unrecognized compensation expense related to non-vested restricted stock awards was \$556,000 and the related weighted average period over which the compensation expense is expected to be recognized is approximately 0.88 years. The vesting date fair value of the restricted stock awards that vested during the years ended December 31, 2018, 2017 and 2016 was \$2.2 million, \$2.9 million and \$2.0 million, respectively.

The following table summarizes the restricted stock award activity for the years ended December 31, 2018, 2017 and 2016:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2015	264,521	\$ 15.92
Granted	121,039	17.60
Vested	(112,516)	15.62
Forfeited	(11,748)	16.62
Nonvested at December 31, 2016	261,296	16.80
Vested	(113,479)	16.55
Forfeited	(10,418)	16.80
Nonvested at December 31, 2017	137,399	17.00
Vested	(67,877)	16.74
Forfeited	(3,489)	16.92
Nonvested at December 31, 2018	66,033	\$ 17.28

(c) Restricted Stock Units

During 2017, the Company began issuing stock-settled restricted stock unit awards ("RSU") and performance-based stock-settled restricted stock unit awards ("PRSU"), collectively called "units". RSUs granted vest ratably over three years. PRSUs granted generally have a three-year cliff vesting schedule. Additionally, PRSU grants may be subject to performance-based vesting as well as other approved vesting conditions. The number of shares of actually delivered pursuant to the PRSUs depends on the performance of the Company's Total Shareholder Return and Return on Average Assets over the performance period in relation to the performance of the common stock of a predetermined

peer group. The conditions of the grants allow for an actual payout ranging between no payout and 150% of target.

124

Table of Contents

The payout level is calculated based on actual performance achieved during the performance period compared to a defined peer group. The fair value of such PRSUs was determined using a Monte Carlo simulation and will be recognized over the subsequent three years. The Monte-Carlo simulation model uses the same input assumptions as the Black-Scholes model; however, it also further incorporates into the fair value determination the possibility that the market condition may not be satisfied. Compensation costs related to these awards are recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided.

Expected volatilities in the model were estimated using a historical period consistent with the performance period of approximately three years. The risk-free interest rate was based on the United States Treasury rate for a term commensurate with the expected life of the grant. The Company used the following assumptions to estimate the fair value of PRSUs granted during February 2018 and 2017:

	2018		2017	
Shares issued	5,550		6,089	
Expected Term in Years	2.84		2.85	
Weighted-Average Risk Free Interest Rate	2.39	%	1.40	%
Expected Dividend Yield	—	%	—	%
Weighted-Average Fair Value	27.69		24.39	
Correlation coefficient	ABA NASDAQ Community Bank Index		ABA NASDAQ Community Bank Index	
Range of peer company volatilities	18.99% - 51.42%		17.8% - 63.1%	
Range of peer company correlation coefficients	28.16% - 94.29%		8.24% - 89.79%	
Heritage volatility	22.30	%	21.80	%
Heritage correlation coefficient	76.44	%	75.93	%

For the year ended December 31, 2018 and 2017, the Company recognized compensation expense related to the units of \$1.8 million and \$712,000, respectively, and a related tax benefit of \$387,000 and \$249,000, respectively. As of December 31, 2018, the total unrecognized compensation expense related to non-vested units was \$3.5 million and the related weighted-average period over which the compensation expense is expected to be recognized is approximately 2.17 years. The vesting date fair value of the units that vested during the year ended December 31, 2018 was \$1.0 million. There were no PRSUs that vested during the years end December 31, 2018 and 2017.

The following table summarizes the unit activity for the year ended December 31, 2018 and 2017:

	Units	Weighted-Average Grant Date Fair Value
Nonvested at December 31, 2016	—	\$ —
Granted	92,356	25.31
Forfeited	(1,812)	25.35
Nonvested at December 31, 2017	90,544	25.31
Granted	125,633	30.62
Vested	(32,375)	25.44
Forfeited	(4,617)	27.82
Nonvested at December 31, 2018	179,185	\$ 28.94

(20) Cash Requirement

The Company is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The required reserve balance at December 31, 2018 and December 31, 2017 was \$9.2 million and \$60,000, respectively, and was met by holding cash and maintaining an average balance with the Federal Reserve Bank.

Table of Contents

(21) Income Taxes

Income tax expense is substantially due to Federal income taxes as the provision for the state of Oregon income taxes is insignificant. Income tax expense for the years ended December 31, 2018, 2017 and 2016 consisted of the following:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Current tax expense	\$9,658	\$12,171	\$6,885
Deferred tax expense	1,372	6,185	6,918
Income tax expense	\$11,030	\$18,356	\$13,803

A reconciliation of the Company's effective income tax rate with the Federal statutory income tax rate of 35% for the years 2017 and 2016 and 21% for the year 2018 is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Income tax expense at Federal statutory rate	\$13,502	\$21,051	\$18,452
Tax-exempt instruments	(1,879)	(3,212)	(3,198)
Non-deductible acquisition costs	336	210	—
Federal tax credits and other benefits ⁽¹⁾	(515)	(1,510)	(931)
Effects of BOLI	(330)	(531)	(511)
Revaluation of net deferred tax assets		2,568	—
Other, net	(84)	(220)	(9)
Income tax expense	\$11,030	\$18,356	\$13,803

(1) Federal tax credits are provided for under the NMTC program and LIHTC programs as described in Note (14) Commitments and Contingencies. Tax benefits related to these credits were recognized for financial reporting purposes in the same period that the credits were recognized in the Company's income tax returns. Other benefits include the proportional amortization of the LIHTC of \$3.1 million, \$2.2 million and \$523,000, for the years ended December 31, 2018, 2017 and 2016, respectively.

On December 22, 2017, the U.S. Government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act amended the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. For businesses, the Tax Act reduced the corporate federal tax rate from a maximum of 35% to a flat 21% rate. The corporate tax rate reduction was effective January 1, 2018. The Tax Act required a revaluation the Company's deferred tax assets and liabilities to account for the future impact of lower corporate tax rates and other provisions of the legislation. As a result of the Company's revaluation, the net deferred tax asset was reduced through an increase to the provision for income tax during the year ended December 31, 2017.

Table of Contents

The following table presents major components of the deferred income tax asset (liability) resulting from differences between financial reporting and tax basis:

	December 31, 2018	December 31, 2017	
	(In thousands)		
Deferred tax assets:			
Allowance for loan losses	\$6,941	\$ 6,699	
Accrued compensation	3,379	1,779	
Stock compensation	769	660	
Net unrealized losses charged to other comprehensive income on securities	2,070	347	
Market discount on purchased loans	1,054	539	
Foregone interest on nonaccrual loans	811	471	
Net operating loss carryforward acquired from NCB	336	270	
Other Real Estate Owned	754	—	
Other deferred tax assets	364	763	
Total deferred tax assets	16,478	11,528	
Deferred tax liabilities:			
Deferred loan fees, net	(3,333)	(2,518)	
Premises and equipment	(1,819)	(1,091)	
FHLB stock	(569)	(557)	
Goodwill and other intangible assets	(3,526)	(304)	
Federal tax credits	(1,457)	(1,107)	
Junior subordinated debentures	(1,176)	(1,215)	
Other deferred tax liabilities	(540)	(847)	
Total deferred tax liabilities	(12,420)	(7,639)	
Deferred tax asset, net	\$4,058	\$ 3,889	

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. A valuation allowance is required to be recognized for the portion of the deferred tax asset that will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. As of December 31, 2018, based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management expects to realize the benefits of these deductible differences.

The Company had a net operating loss carryforward of \$1.6 million and \$1.3 million at December 31, 2018 and 2017, respectively, that will begin to expire in 2024. The Company is limited to the amount of the net operating loss carryforward that it can deduct each year. A tax planning strategy has been developed that management believes will enable the Company to deduct all of the net operating loss carryforwards prior to the expiration date. Based on these estimates, management has not recorded a valuation allowance as of December 31, 2018 and 2017.

As of December 31, 2018 and 2017, the Company had an insignificant amount of unrecognized tax benefits, none of which would materially affect its effective tax rate if recognized. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. The amount of interest and penalties accrued as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 were immaterial.

The Company has qualified under provisions of the Internal Revenue Code to compute income taxes after deductions of additions to the bad debt reserves when it was registered as a Savings Bank. At December 31, 2018, the Company had a taxable temporary difference of approximately \$2.8 million that arose before 1988 (base-year amount). In accordance with FASB ASC 740, a deferred tax liability of an estimated \$980,000 has not been recognized for the temporary difference. Management does not expect this temporary difference to reverse in the foreseeable future.

Table of Contents

The Company and its subsidiary file a United States consolidated federal income tax return and an Oregon State income tax return, and the tax years subject to examination by the Internal Revenue Service are the years ended December 31, 2018, 2017, 2016 and 2015.

(22)Regulatory Capital Requirements

The Company is a bank holding company under the supervision of the Federal Reserve Bank. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. Heritage Bank is a federally insured institution and thereby is subject to the capital requirements established by the FDIC. The Federal Reserve capital requirements generally parallel the FDIC requirements. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements and operations. Management believes as of December 31, 2018, the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2018 and December 31, 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's categories.

Table of Contents

	Minimum Requirements		Well-Capitalized Requirements		Actual	
	\$	%	\$	%	\$	%
(Dollars in thousands)						
As of December 31, 2018:						
The Company consolidated						
Common equity Tier 1 capital to risk-weighted assets	\$ 197,189	4.5 %	N/A	N/A	\$ 510,618	11.7 %
Tier 1 leverage capital to average assets	201,920	4.0	N/A	N/A	530,920	10.5
Tier 1 capital to risk-weighted assets	262,918	6.0	N/A	N/A	530,920	12.1
Total capital to risk-weighted assets	350,558	8.0	N/A	N/A	566,268	12.9
Heritage Bank						
Common equity Tier 1 capital to risk-weighted assets	197,004	4.5	284,561	6.5	513,993	11.7
Tier 1 leverage capital to average assets	203,339	4.0	254,174	5.0	513,993	10.1
Tier 1 capital to risk-weighted assets	262,671	6.0	350,229	8.0	513,993	11.7
Total capital to risk-weighted assets	350,229	8.0	437,786	10.0	549,341	12.5
As of December 31, 2017:						
The Company consolidated						
Common equity Tier 1 capital to risk-weighted assets	\$ 154,522	4.5 %	N/A	N/A	\$ 386,689	11.3 %
Tier 1 leverage capital to average assets	159,494	4.0	N/A	N/A	406,687	10.2
Tier 1 capital to risk-weighted assets	206,029	6.0	N/A	N/A	406,687	11.8
Total capital to risk-weighted assets	274,706	8.0	N/A	N/A	439,044	12.8
Heritage Bank						
Common equity Tier 1 capital to risk-weighted assets	154,400	4.5	223,023	6.5	391,092	11.4
Tier 1 leverage capital to average assets	159,300	4.0	199,125	5.0	391,092	9.8
Tier 1 capital to risk-weighted assets	205,867	6.0	274,490	8.0	391,092	11.4
Total capital to risk-weighted assets	274,490	8.0	343,112	10.0	423,348	12.3

The Company is subject to capital adequacy requirements of the Basel Committee on Banking Supervision, commonly called Basel III. Under the capital requirements both the Company and the Bank are required to have a common equity Tier 1 capital ratio of 4.5%. In addition, both the Company and the Bank are required to have a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0% and a total risk-based ratio of 8.0%. Both the Company and the Bank are required to establish a “conservation buffer”, consisting of common equity Tier 1 capital of more than 2.5% above the minimum risk-based capital ratios. The capital conservation buffer is designed to ensure that banks build up capital buffers outside periods of stress which can be drawn down as losses are incurred. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers. The capital conservation buffer requirement began to be phased-in on January 1, 2016 when more than 0.625% of risk-weighted assets was required, and increases by 0.625% on each subsequent January 1, until it is fully phased-in on January 1, 2019. Certain calculations under the

Table of Contents

rules will also have phase-in periods. At December 31, 2018, the capital conservation buffer was 4.92% and 4.55% for the Company and the Bank, respectively.

(23) Heritage Financial Corporation (Parent Company Only)

Following is the condensed financial statements of the Parent Company.

HERITAGE FINANCIAL CORPORATION
(PARENT COMPANY ONLY)
Condensed Statements of Financial Condition

	December 31,	
	2018	2017
	(In thousands)	
ASSETS		
Cash and interest earning deposits	\$14,602	\$ 11,904
Investment in subsidiary bank	764,097	512,655
Other assets	2,520	4,696
Total assets	\$781,219	\$ 529,255
LIABILITIES AND STOCKHOLDERS' EQUITY		
Junior subordinated debentures	\$20,302	\$ 20,009
Other liabilities	194	941
Total stockholders' equity	760,723	508,305
Total liabilities and stockholders' equity	\$781,219	\$ 529,255

Table of Contents

HERITAGE FINANCIAL CORPORATION
(PARENT COMPANY ONLY)
Condensed Statements of Income

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
INTEREST INCOME:			
Interest and dividends on interest earning deposits and other assets	\$7	\$44	\$34
Total interest income	7	44	34
INTEREST EXPENSE:			
Junior subordinated debentures	1,263	1,014	880
Total interest expense	1,263	1,014	880
Net interest expense	(1,256)	(970)	(846)
NONINTEREST INCOME:			
Dividends from subsidiary bank	30,000	23,000	30,000
Equity in undistributed income of subsidiary bank	29,258	21,755	11,848
Other income	22	—	—
Total noninterest income	59,280	44,755	41,848
NONINTEREST EXPENSE:			
Professional services	3,063	768	385
Other expense	3,833	3,726	3,437
Total noninterest expense	6,896	4,494	3,822
Income before income taxes	51,128	39,291	37,180
Income tax benefit	(1,929)	(2,500)	(1,738)
Net income	\$53,057	\$41,791	\$38,918

Table of Contents

HERITAGE FINANCIAL CORPORATION
(PARENT COMPANY ONLY)
Condensed Statements of Cash Flows

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Cash flows from operating activities:			
Net income	\$53,057	\$41,791	\$38,918
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed income of subsidiary bank	(29,258)	(21,755)	(11,848)
Net excess tax benefit from exercise of stock options and vesting of restricted stock	—	—	(123)
Stock-based compensation expense	2,744	2,103	1,840
Net change in other assets and liabilities	1,735	(1,925)	(1,141)
Net cash provided by operating activities	28,278	20,214	27,646
Cash flows from investing activities:			
Net cash received from acquisitions	1,782	—	—
Net cash provided by investing activities	1,782	—	—
Cash flows from financing activities:			
Common stock cash dividends paid	(25,791)	(18,305)	(21,569)
Proceeds from exercise of stock options	133	164	540
Net excess tax benefit from exercise of stock options and vesting of restricted stock	—	—	123
Repurchase of common stock	(1,704)	(737)	(2,894)
Net cash used in financing activities	(27,362)	(18,878)	(23,800)
Net increase in cash and cash equivalents	2,698	1,336	3,846
Cash and cash equivalents at the beginning of year	11,904	10,568	6,722
Cash and cash equivalents at the end of year	\$14,602	\$11,904	\$10,568
Supplemental non-cash disclosures of cash flow information:			
Common stock issued for business combinations	\$230,043	\$—	\$—
Capital contribution of net assets acquired in business combinations to Bank	228,261	—	—

Table of Contents

(24) Selected Quarterly Financial Data (Unaudited)

Results of operations on a quarterly basis were as follows:

	Year Ended December 31, 2018			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in thousands, except per share amounts)			
Interest income	\$43,247	\$46,671	\$54,576	\$54,865
Interest expense	2,410	2,928	3,480	3,595
Net interest income	40,837	43,743	51,096	51,270
Provision for loan losses	1,152	1,750	1,065	1,162
Net interest income after provision for loan losses	39,685	41,993	50,031	50,108
Noninterest income	7,548	7,573	8,080	8,464
Noninterest expense	36,747	35,706	39,597	37,345
Income before provision for income taxes	10,486	13,860	18,514	21,227
Income tax expense	1,399	2,003	3,010	4,618
Net income	\$9,087	\$11,857	\$15,504	\$16,609
Basic earnings per common share	\$0.27	\$0.35	\$0.42	\$0.45
Diluted earnings per common share	0.27	0.35	0.42	0.45
Cash dividends declared on common stock	0.15	0.15	0.15	0.27

	Year Ended December 31, 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in thousands, except per share amounts)			
Interest income	\$34,849	\$36,041	\$37,275	\$39,544
Interest expense	1,717	1,907	2,333	2,389
Net interest income	33,132	34,134	34,942	37,155
Provision for loan losses	867	1,131	884	1,338
Net interest income after provision for loan losses	32,265	33,003	34,058	35,817
Noninterest income	7,363	10,709	8,443	9,064
Noninterest expense	27,223	27,809	27,955	27,588
Income before provision for income taxes	12,405	15,903	14,546	17,293
Income tax expense	3,089	4,075	3,922	7,270
Net income	\$9,316	\$11,828	\$10,624	\$10,023
Basic earnings per common share	\$0.31	\$0.40	\$0.35	\$0.33
Diluted earnings per common share	0.31	0.40	0.35	0.33
Cash dividends declared on common stock	0.12	0.13	0.13	0.23

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

None

Table of Contents

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to ensure that information the Company must disclose in its reports filed or submitted under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized, and reported on a timely basis. Our management has evaluated, with the participation and under the supervision of our chief executive officer (“CEO”) and chief financial officer (“CFO”), the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our CEO and CFO have concluded that, as of such date, the Company’s disclosure controls and procedures are effective in ensuring that information relating to the Company, including its consolidated subsidiaries, required to be disclosed in reports that it files under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting

(a) Management’s report on internal control over financial reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company’s internal control system is designed to provide reasonable assurance to our management and the board of directors regarding the preparation and fair presentation of published financial statements. Nonetheless, all internal control systems, no matter how well designed, have inherent limitations. Even systems determined to be effective as of a particular date can provide only reasonable assurance with respect to financial statement preparation and presentation and may not eliminate the need for restatements.

The Company’s management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 Internal Control—Integrated Framework. Based on our assessment, we believe that, as of December 31, 2018, the Company’s internal control over financial reporting is effective based on these criteria.

As permitted, the Company excluded from its assessment the internal control over financial reporting the operations of Puget Sound Bancorp, Inc. and Premier Commercial Bancorp, which were acquired on January 16, 2018 and July 2, 2018, respectively.

Crowe LLP, an independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2018, and their report is included in Item 8. Financial Statements And Supplementary Data.

(b) Attestation report of the registered public accounting firm.

See Item 8. Financial Statements And Supplementary Data.

(c) Changes in internal control over financial reporting.

There were no significant changes in the Company’s internal control over financial reporting during the fourth quarter of the period covered by this Annual Report on Form 10-K that materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information concerning directors of the registrant is incorporated by reference to the section entitled “Proposal 1 - Election of Directors” of our definitive proxy statement for the annual meeting of shareholders to be held on May 1, 2019 (“Proxy Statement”).

For information regarding the executive officers of the Company, see Item 1. Business—Executive Officers.”

134

Table of Contents

The required information with respect to compliance with Section 16(a) of the Exchange Act is incorporated by reference to the sections entitled “Security Ownership of Certain Beneficial Owners and Management” and "Section 16(a) Beneficial Ownership Reporting Compliance" of the Proxy Statement.

The Company has adopted a written Code of Ethics that applies to our directors, officers and employees. The Code of Ethics can be accessed electronically by visiting the Company’s website at www.hf-wa.com.

The Audit and Finance Committee of our Board of Directors retains our independent auditors, reviews and approves the scope and results of the audits with the auditors and management, monitors the adequacy of our system of internal controls and reviews the annual report, auditors’ fees and non-audit services to be provided by the independent auditors. The members of our Audit Committee are Deborah J. Gavin, chair of the committee, Brian S. Charneski, John A. Clees and Gragg E. Miller, all of whom are considered “independent” as defined by the SEC. Our Board of Directors has determined that Mrs. Gavin meets the definition of an audit committee financial expert, as determined by the requirements of the SEC.

ITEM 11. EXECUTIVE COMPENSATION

Information concerning executive and director compensation and certain matters regarding participation in the Company’s Compensation Committee required by this item is incorporated by reference to the headings “Executive Compensation,” “Director Compensation,” “Report of the Compensation Committee,” and "CEO Pay Ratio" of the Proxy Statement.

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

Information concerning security ownership of certain beneficial owners and management is incorporated by reference to the section entitled “Security Ownership of Certain Beneficial Owners and Management” of the Proxy Statement. The following table summarizes the consolidated activity within the Company’s stock-based compensation plans as of December 31, 2018, all of which were approved by shareholders.

Plan Category	Number of securities to be issued upon vesting of restricted stock awards	Number of securities to be issued upon vesting of restricted stock units	Number of securities to be issued upon exercise of outstanding options	Weighted-average price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans, all of which are approved by security holders	66,033	179,185	12,558	\$14.77	955,282

ITEM 13. CERTAIN RELATIONSHIP AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information concerning certain relationships and related transactions is incorporated by reference to the sections entitled “Meetings and Committees of the Board of Directors" and "Corporate Governance” of the Proxy Statement. Our common stock is listed on the NASDAQ Global Select Market. In accordance with NASDAQ requirements, at least a majority of our directors must be independent directors. The Board of Directors has determined that 9 of our 10 directors are independent. Only Brian L. Vance, who serves as Chief Executive Officer of Heritage Financial Corporation, is not independent.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accounting fees and services is incorporated by reference to the section entitled “Proposal 3 - Ratification of the Appointment of Independent Registered Public Accounting Firm” in the Proxy Statement.

PART IV

135

Table of Contents

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as a part of this report:

(1) Financial Statements: The Consolidated Financial Statements are included in Part II. Item 8. Financial Statements And Supplementary Data.

(2) Financial Statements Schedules: All schedules are omitted because they are not required or applicable, or the required information is shown in the Consolidated Financial Statements or Notes.

(3) Exhibits: Included in schedule below.

Exhibit No.	Description of Exhibit	Incorporated by Reference		
		Form	Exhibit	Filing Date/Period End Date
2.1	<u>Agreement and Plan of Merger with Puget Sound Bancorp, Inc</u>	8-K	2.1	7/27/17
2.2	<u>Agreement and Plan of Merger with Premier Commercial Bancorp, Inc</u>	8-K	2.1	3/9/2018
3.1	<u>Amended and Restated Articles of Incorporation</u>	8-K	3.1(B)	5/18/10
3.2	<u>Amended and Restated Bylaws of the Company</u>	8-K	3.2	10/3/16
4.1	Form of Certificate of Heritage's Common Stock ⁽³⁾	S-1/A	-	10/29/97
10.1	<u>Annual Incentive Compensation Plan</u>	10-K	10.5	3/9/17
10.2	<u>2010 Omnibus Equity Plan</u>	S-8	-	5/27/10
10.3	<u>Amended 2014 Omnibus Equity Plan</u>	8-K	99.2	2/1/17
10.4	<u>2014 Omnibus Equity Plan</u>	DEF 14A	-	6/11/14
10.5	<u>Form of Nonqualified Stock Option Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.6	2/1/17
10.6	<u>Form of Nonqualified Stock Option Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	10-Q	10.8	8/8/14
10.7	<u>Form of Restricted Stock Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.7	2/1/17
10.8	<u>Form of Restricted Stock Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	10-Q	10.9	8/8/14
10.9	<u>Form of Restricted Stock Unit Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.4	2/1/17
10.10	<u>Form of Restricted Stock Unit Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	10-Q	10.10	8/8/14

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10.11	<u>Form of Performance-Based Restricted Stock Unit Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.3	2/1/17
10.12	<u>Form of Cash Incentive Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.8	2/1/17
10.13	<u>Form of Incentive Stock Option Award Agreement under the Heritage Financial Corporation 2014 Omnibus Equity Plan</u>	8-K	99.5	2/1/17

136

Table of Contents

10.14	<u>Deferred Compensation Plan and Participation Agreement - Addendum by and between Heritage and Brian L. Vance</u>	8-K	10.1	12/22/16
10.15	<u>Deferred Compensation Plan and Participation Agreement - Addendum by and between Heritage and Jeffrey J. Deuel</u>	8-K	10.2	12/22/16
10.16	<u>Deferred Compensation Plan and Participation Agreement - Addendum by and between Heritage and Donald J. Hinson</u>	8-K	10.3	12/22/16
10.17	<u>Deferred Compensation Plan and Participation Agreement by and between Heritage and Brian L. Vance</u>	8-K	10.5	9/7/12
10.18	<u>Deferred Compensation Plan and Participation Agreement by and between Heritage and Jeffrey J. Deuel</u>	8-K	10.6	9/7/12
10.19	<u>Deferred Compensation Plan and Participation Agreement by and between Heritage and Donald J. Hinson</u>	8-K	10.7	9/7/12
10.20	<u>Employment Agreement by and between Heritage and Brian L. Vance</u>	8-K	10.1	9/7/12
10.21	<u>Employment Agreement by and between Heritage and Jeffrey J. Deuel</u>	8-K	10.2	9/7/12
10.22	<u>Employment Agreement by and between Heritage and Donald J. Hinson</u>	8-K	10.3	9/7/12
10.23	<u>Deferred Compensation Plan and Participation Agreement - Addendum by and between Heritage and David A. Spurling</u>	8-K	10.5	12/22/16
10.24	<u>Employment Agreement by and between Heritage and David A. Spurling</u>	8-K	10.1	1/6/14
10.25	<u>Deferred Compensation Plan and Participation Agreement by and between Heritage and David A. Spurling</u>	8-K	10.2	1/6/14
10.26	<u>Employment Agreement by and between Heritage and Bryan McDonald</u>	S-4		1/24/14
10.27	<u>Deferred Compensation Plan and Participation Agreement - Addendum by and between Heritage and Bryan D. McDonald</u>	8-K	10.4	12/22/16
10.28	<u>Deferred Compensation Plan and Participation Agreement by and between Heritage and Bryan D. McDonald</u>	10-K	10.16	3/11/15
10.29	<u>Form of Split Dollar Agreements, dated August 3, 2015, by and between Heritage and Brian L. Vance, Jeffrey J. Deuel, Donald J. Hinson, Bryan D. McDonald and David A. Spurling</u>	10-Q	10.17	8/6/15
10.30	<u>Deferred Compensation Plan and Participation Agreement Addendum by and between Heritage and David A. Spurling</u>	8-K	10.1	12/22/15
10.31	<u>Transitional Employment Agreement by and between Heritage and Brian L. Vance</u>	8-K	10.1	7/10/18

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10.32	<u>Employment Agreement by and between Heritage and Jeffery J. Deuel</u>	8-K	10.2	7/10/18
10.33	<u>Employment Agreement by and between Heritage and Bryan McDonald</u>	8-K	10.3	7/10/18
14.0	Code of Ethics and Conduct Policy ⁽²⁾			
21.0	<u>Subsidiaries of the Company</u> ⁽¹⁾			
23.0	<u>Consent of Independent Registered Public Accounting Firm</u> ⁽¹⁾			
24.0	<u>Power of Attorney</u> ⁽¹⁾			
31.1	<u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> ⁽¹⁾			

137

Table of Contents

- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ⁽¹⁾
- 32.1 Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ⁽¹⁾

101.INS XBRL Instance Document ⁽¹⁾

101.SCH XBRL Taxonomy Extension Schema Document ⁽¹⁾

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document ⁽¹⁾

101.DEF XBRL Taxonomy Extension Definition Linkbase Document ⁽¹⁾

101.LAB XBRL Taxonomy Extension Label Linkbase Document ⁽¹⁾

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document ⁽¹⁾

⁽¹⁾ Filed herewith.

⁽²⁾ Registrant elects to satisfy Regulation S-K §229.406(c) by posting its Code of Ethics on its website at www.HF-WA.com in the section titled Overview: Governance Documents.

⁽³⁾ Exhibit not previously filed in electronic format.

ITEM 16. FORM 10-K SUMMARY

None.

138

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on March 1, 2019.

HERITAGE FINANCIAL CORPORATION
(Registrant)

/S/ BRIAN L. VANCE
Brian L. Vance
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 1, 2019.

Principal Executive Officer:
/S/ BRIAN L. VANCE
Brian L. Vance
Chief Executive Officer

Principal Financial Officer:
/S/ DONALD J. HINSON
Donald J. Hinson
Executive Vice President and Chief Financial Officer

Brian L. Vance, pursuant to a power of attorney that is being filed with the Annual Report on Form 10-K, has signed this report as attorney in fact for the following directors who constitute a majority of the Board.

Brian S. Charneski
John A. Clees
Kimberly T. Ellwanger
Deborah J. Gavin
Jeffrey S. Lyon
Gragg E. Miller
Anthony B. Pickering
Ann Watson
Stephen A. Dennis

By
/S/ BRIAN L. VANCE
Brian L. Vance
Attorney-in-Fact
March 1, 2019

