

HERITAGE FINANCIAL CORP /WA/
Form DEF 14A
June 11, 2014
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**Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934**

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2)).**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-12

HERITAGE FINANCIAL CORPORATION

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:
N/A

(2) Aggregate number of securities to which transactions applies:
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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:
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(4) Proposed maximum aggregate value of transaction:
N/A

(5) Total fee paid:
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.. Fee paid previously with preliminary materials: N/A

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

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(2) Form, Schedule or Registration Statement No.:
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(3) Filing Party:
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(4) Date Filed:
N/A

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June 11, 2014

Dear Shareholder:

On behalf of the Board of Directors and management of Heritage Financial Corporation, we cordially invite you to attend the annual meeting of shareholders. The meeting will be held at 10:30 a.m. Pacific time, on Thursday, July 24, 2014 at the DoubleTree by Hilton, 415 Capitol Way N., Olympia, Washington. The matters expected to be acted upon at the meeting are described in the attached Proxy Statement. In addition, we will report on our results of operations during the past year and address your questions and comments.

Effective May 1, 2014, Heritage Financial Corporation completed its previously announced merger with Washington Banking Company. Washington Banking Company merged with and into Heritage Financial Corporation and immediately following this merger, Washington Banking Company's wholly owned subsidiary bank, Whidbey Island Bank, merged with and into Heritage Financial Corporation's wholly owned subsidiary bank, Heritage Bank. The strategic partnership between Heritage Financial Corporation and Washington Banking Company is a transformational and collaborative transaction that will provide enhanced opportunities for the customers, employees and shareholders.

We encourage you to attend the meeting in person. Whether or not you plan to attend, please read the enclosed Proxy Statement and then complete, sign and date the enclosed proxy card and return it in the accompanying postpaid return envelope, or follow the instructions on the proxy card to vote by phone or via the Internet, as promptly as possible. This will save us the additional expense of soliciting proxies and will ensure that your shares are represented at the annual meeting.

Your Board of Directors and management are committed to the continued success of Heritage Financial Corporation and the enhancement of your investment. As President and Chief Executive Officer, I want to express my sincere appreciation for your confidence and support.

We look forward to seeing you at the meeting.

Sincerely,
Brian L. Vance
President and Chief Executive Officer

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Date: Thursday, July 24, 2014

Time: 10:30 a.m. Pacific time

Place: DoubleTree by Hilton, 415 Capitol Way N., Olympia, Washington

Matters to be voted on:

1. The election of fifteen directors to each serve for a one-year term.
2. An advisory (non-binding) resolution to approve the compensation paid to our named executive officers, as disclosed in this Proxy Statement.
3. The approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan.
4. The ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2014.

We will also transact other business that may properly come before the meeting, or any adjournment or postponement thereof.

Shareholders of record at the close of business on May 28, 2014 are entitled to receive notice of and to vote at the annual meeting.

Please vote your shares at your earliest convenience. This will ensure the presence of a quorum at the meeting. Promptly voting your shares via the Internet, by telephone, or by signing, dating, and returning the enclosed proxy card, which is solicited by the Board of Directors, will save us the expense and extra work for additional solicitation. If you wish to vote by mail, we have enclosed an addressed envelope, postage prepaid if mailed in the United States. The proxy will not be used if you attend and vote at the annual meeting in person. Regardless of the number of shares you own, your vote is very important. Please act today.

By Order of the Board of Directors

Kaylene M. Lahn

Senior Vice President and Corporate Secretary

Olympia, Washington

June 11, 2014

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**2014 PROXY STATEMENT
ANNUAL MEETING OF SHAREHOLDERS**

HERITAGE FINANCIAL CORPORATION

201 Fifth Avenue S.W.

Olympia, Washington 98501

(360) 943-1500

The Board of Directors of Heritage Financial Corporation is using this Proxy Statement to solicit proxies from our shareholders for use at the annual meeting of shareholders. We are first mailing this Proxy Statement and the enclosed form of proxy to our shareholders on or about June 11, 2014.

The information provided in this Proxy Statement relates to Heritage Financial Corporation and its wholly-owned bank subsidiary, Heritage Bank. Heritage Financial Corporation may also be referred to as Heritage or the Company. All references in this Proxy Statement to Heritage, we, us and our or similar references means Heritage Financial Corporation and its consolidated subsidiaries and all references to Heritage Financial Corporation means Heritage Financial Corporation excluding its subsidiaries, in each case unless otherwise expressly stated or the context requires otherwise.

MERGER WITH WASHINGTON BANKING COMPANY

Effective May 1, 2014, Heritage completed its previously announced merger with Washington Banking Company (Washington Banking). Washington Banking merged with and into Heritage and immediately following this merger, Washington Banking 's wholly owned subsidiary bank, Whidbey Island Bank, merged with and into Heritage Bank. As of the date of the merger, seven members of Washington Banking 's Board were appointed to Heritage 's Board and various Board committees. This Proxy Statement identifies the new Board; however, except where specifically stated otherwise, the disclosure herein is as of December 31, 2013 and relates to the prior Board.

INFORMATION ABOUT THE ANNUAL MEETING

Time and Place of the Annual Meeting

Our annual meeting will be held as follows:

Date: Thursday, July 24, 2014
Time: 10:30 a.m., Pacific time
Place: DoubleTree by Hilton, 415 Capitol Way N., Olympia, Washington

Matters to Be Considered at the Annual Meeting

At the meeting, you will be asked to consider and vote on:

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The election of fifteen directors to each serve for a one-year term.

An advisory, non-binding, resolution to approve the compensation paid to our named executive officers, as disclosed in this Proxy Statement.

The approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan.

The ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2014.

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We will also transact any other business that may properly come before the annual meeting. As of the date of this Proxy Statement, we are not aware of any business to be presented for consideration at the annual meeting other than the matters described in this Proxy Statement.

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on July 24, 2014

Our Proxy Statement and Annual Report to Shareholders are available at www.hf-wa.com. The following materials are available for review:

Proxy Statement;

Proxy Card;

Annual Report to Shareholders; and

Directions to attend the annual meeting, where you may vote in person.

Who is Entitled to Vote?

We have fixed the close of business on May 28, 2014, as the record date for shareholders entitled to notice of and to vote at our annual meeting. Only holders of record of Heritage's common stock on that date are entitled to notice of and to vote at the annual meeting. You are entitled to one vote for each share of Heritage common stock you own, unless you acquired more than 10% of Heritage's common stock without prior Board approval. As provided in our Articles of Incorporation, for each vote in excess of 10% of the voting power of the outstanding shares of Heritage's voting stock, the record holders in the aggregate will be entitled to cast one-hundredth of a vote, and the aggregate power of these record holders will be allocated proportionately among these record holders. On May 28, 2014, there were 30,200,590 shares of Heritage common stock outstanding and entitled to vote at the annual meeting.

How Do I Vote at the Annual Meeting?

Proxies are solicited to provide all shareholders on the voting record date an opportunity to vote on matters scheduled for the annual meeting and described in these materials. This answer provides voting instructions for shareholders of record. You are a shareholder of record if your shares of Heritage common stock are held in your name. If you are a beneficial owner of Heritage common stock held by a broker, bank or other nominee (i.e., in street name), please see the instructions in the following question.

Shares of Heritage common stock can only be voted if the shareholder is present in person or by proxy at the annual meeting. To ensure your representation at the annual meeting, we recommend you vote by proxy even if you plan to attend the annual meeting. You can always change your vote at the meeting if you are a shareholder of record.

Voting instructions are included on your proxy card. Shares of Heritage common stock represented by properly executed proxies will be voted by the individuals named on the proxy card in accordance with the shareholder's instructions. Where properly executed proxies are returned to us with no specific instruction as to how to vote at the annual meeting, the persons named in the proxy will vote the shares FOR the election of each of our director nominees, FOR advisory approval of the compensation of our named executive officers as disclosed in this Proxy Statement, FOR the approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan and FOR ratification of the appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2014. If any other matters are properly presented at the annual meeting for action, the persons named in the enclosed proxy and acting thereunder will have the discretion to vote on these matters in accordance with their best judgment. We do not currently expect that any other matters will be properly presented for action at the annual meeting.

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You may receive more than one proxy card depending on how your shares are held. For example, you may hold some of your shares individually, some jointly with your spouse and some in trust for your children. In this case, you will receive three separate proxy cards to vote.

What if My Shares Are Held in Street Name by a Broker?

If you are the beneficial owner of shares held in street name by a broker, your broker, as the record holder of the shares, is required to vote the shares in accordance with your instructions. If you do not give instructions to your broker, your broker may nevertheless vote the shares with respect to discretionary items, but will not be permitted to vote your shares with respect to non-discretionary items, pursuant to current industry practice. In the case of non-discretionary items, the shares not voted will be treated as broker non-votes. The proposals for the election of directors, the advisory vote on executive compensation and the approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan are considered non-discretionary items; therefore, you must provide instructions to your broker in order to have your shares voted on these proposals.

If your shares are held in street name, you will need proof of ownership to be admitted to the annual meeting. A recent brokerage statement or letter from the record holder of your shares are examples of proof of ownership. If you want to vote your shares of common stock held in street name in person at the annual meeting, you will have to get a written proxy in your name from the broker, bank or other nominee who holds your shares.

How Will My Shares of Common Stock Held in the 401(k) Employee Stock Ownership Plan Be Voted?

We maintain a 401(k) employee stock ownership plan (KSOP) which owned 372,566 shares or 1.2% of Heritage's common stock as of the record date. Our employees participate in the KSOP. Each KSOP participant may instruct the trustee of the plan how to vote the shares of Heritage common stock allocated to his or her account under the KSOP by completing a vote authorization form. If a KSOP participant properly executes a vote authorization form, the KSOP trustee will vote the participant's shares in accordance with the participant's instructions. KSOP shares for which proper voting instructions are not received will not be voted. In order to give the trustee sufficient time to vote, all vote authorization forms, which are in the form of a proxy card, must be received from KSOP participants by the transfer agent on or before July 18, 2014.

How Many Shares Must Be Present to Hold the Meeting?

A quorum must be present at the meeting for any business to be conducted. The presence at the meeting, in person or by proxy, of at least a majority of the shares of Heritage common stock entitled to vote at the annual meeting as of the record date will constitute a quorum. Proxies received but marked as abstentions or broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting.

What if a Quorum Is Not Present at the Meeting?

If a quorum is not present at the scheduled time of the meeting, a majority of the shareholders present or represented by proxy may adjourn the meeting until a quorum is present. The time and place of the adjourned meeting will be announced at the time the adjournment is taken, and no other notice will be given unless a new record date for the meeting is set. An adjournment will have no effect on the business that may be conducted at the meeting.

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Vote Required to Approve Proposal 1: Election of Directors

Directors are elected by a plurality of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Accordingly, the 15 nominees for election as directors who receive the highest number of votes actually cast will be elected. Pursuant to our Articles of Incorporation, shareholders are not permitted to cumulate their votes for the election of directors. Votes may be cast for or withheld from each nominee. Votes that are withheld and broker non-votes will have no effect on the outcome of the election because the 15 nominees receiving the greatest number of votes will be elected. **Our Board of Directors unanimously recommends that you vote FOR the election of each of its director nominees.**

Vote Required to Approve Proposal 2: Advisory Vote on Executive Compensation

Approval of the advisory (non-binding) vote on executive compensation requires the affirmative vote of the majority of the shares of Heritage common stock present, in person or by proxy, and entitled to vote at the annual meeting. Abstentions are not affirmative votes and, therefore, will have the same effect as a vote against the proposal. Broker non-votes are not entitled to vote and therefore will have no effect on the approval of the proposal. **Our Board of Directors unanimously recommends that you vote FOR the adoption of an advisory resolution to approve our executive compensation as disclosed in this Proxy Statement.**

Vote Required to Approve Proposal 3: Approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan

Approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan requires the affirmative vote of the majority of the shares of Heritage common stock present, in person or by proxy, and entitled to vote at the annual meeting. Abstentions are not affirmative votes and, therefore, will have the same effect as a vote against the proposal. Broker non-votes are not entitled to vote and therefore will have no effect on the approval of the proposal. **Our Board of Directors unanimously recommends that you vote FOR the approval of the Heritage Financial Corporation 2014 Omnibus Equity Plan as discussed in this Proxy Statement.**

Vote Required to Approve Proposal 4: Ratification of the Appointment of Our Independent Registered Public Accounting Firm

Ratification of the Audit and Finance Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2014, requires the affirmative vote of the majority of the shares of Heritage common stock present, in person or by proxy, and entitled to vote at the annual meeting by holders of Heritage common stock. Abstentions are not affirmative votes and, therefore, will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote FOR the proposal to ratify the selection of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2014.**

May I Revoke My Proxy?

You may revoke your proxy before it is voted by:

submitting a new proxy with a later date;

notifying the Corporate Secretary of Heritage in writing before the annual meeting that you have revoked your proxy; or

voting in person at the annual meeting.

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If you plan to attend the annual meeting and wish to vote in person, we will give you a ballot at the annual meeting. However, if your shares are held in street name, you must bring a validly executed proxy from the nominee indicating that you have the right to vote the shares.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following tables set forth, as of the record date or the most currently reported date, information regarding share ownership of:

those persons or entities (or groups of affiliated persons or entities) known by management to beneficially own more than five percent of Heritage's common stock other than directors and executive officers;

each director of Heritage;

each executive officer of Heritage named in the Summary Compensation Table appearing under Executive Compensation above (known as named executive officers); and

all current directors and executive officers of Heritage as a group.

On May 28, 2014, there were 30,200,590 shares of Heritage common stock outstanding.

Persons and groups who beneficially own in excess of five percent of Heritage's common stock are required to file with the Securities and Exchange Commission (SEC), and provide a copy to Heritage, reports disclosing their ownership pursuant to the Securities Exchange Act of 1934, as amended (Securities Exchange Act). To our knowledge, no other person or entity, other than the ones set forth below, beneficially owned more than five percent of the outstanding shares of Heritage's common stock as of the close of business on December 31, 2013, the most recent date for which ownership information is available.

	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
Beneficial Owners of More Than 5%		
Forest Hill Capital, L.L.C. and Mark Lee ⁽¹⁾ 100 Morgan Keegan Drive, Suite 430 Little Rock, Arkansas 72202	1,123,682	6.9%
Investment Counselors of Maryland, LLC ⁽²⁾ 803 Cathedral Street Baltimore, Maryland 21201	1,073,193	6.6%
BlackRock Inc. ⁽³⁾ 40 East 52 nd Street New York, New York 10022	979,323	6.0%
Woodmen of the World Life Insurance Society and/or Omaha Woodmen Life Insurance Company ⁽⁴⁾ 1700 Farnam Street Omaha, Nebraska 68102	926,842	5.7%

(1) According to a Schedule 13G filed with the SEC on February 14, 2014, Forest Hill Capital, L.L.C. and Mark Lee as principal have shared voting power over 391,899 shares and shared dispositive power over 1,123,682 shares.

(2) According to a Schedule 13G filed with the SEC on February 12, 2014, Investment Counselors of Maryland, LLC has sole voting power over 706,388 shares, shared voting power over 366,805 shares and sole dispositive power over 1,073,193 shares.

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- (3) According to a Schedule 13G filed with the SEC on January 17, 2014, BlackRock Inc. has sole voting power over 947,569 shares and sole dispositive power over 979,323 shares.
- (4) According to a Schedule 13G filed with the SEC on February 11, 2014, Woodmen of the World Life Insurance Society and/or Omaha Woodmen Life Insurance Company have sole voting and dispositive power over the shares reported.

Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In accordance with Rule 13d-3 of the Securities Exchange Act, a person is deemed to be the beneficial owner of any shares of common stock if he or she has voting and/or investment power with respect to those shares. Therefore, the table below includes shares owned by spouses, other immediate family members in trust, shares held in retirement accounts or funds for the benefit of our named individuals, and other forms of ownership, over which shares the persons named in the table may possess voting and/or investment power. In addition, in computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to outstanding options that are currently exercisable or exercisable within 60 days after May 28, 2014 are included in the number of shares beneficially owned by the person and are deemed outstanding for the purpose of calculating the person's percentage ownership. These shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person.

The following table shows, as of May 28, 2014, the amount of Heritage common stock owned (unless otherwise indicated) by each director, named executive officers and all of our directors and executive officers as a group. In connection with the merger, seven directors from Washington Banking were added to the Heritage Board of Directors.

	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
Directors & Officers		
Rhoda L. Altom ⁽¹⁾	2,002	*
David H. Brown ⁽²⁾	94,282	*
Brian S. Charneski ⁽³⁾	38,111	*
Gary B. Christensen ⁽⁴⁾	60,012	*
John A. Clees ⁽⁵⁾	75,834	*
Mark D. Crawford	7,216	*
Deborah J. Gavin	1,322	*
Kimberly T. Ellwanger ⁽⁶⁾	16,441	*
Jay T. Lien ⁽⁷⁾	71,126	*
Jeffrey S. Lyon ⁽⁸⁾	37,009	*
Gragg E. Miller ⁽⁹⁾	20,484	*
Anthony B. Pickering ⁽¹⁰⁾	59,361	*
Robert T. Severns ⁽¹¹⁾	11,093	*
Ann Watson ⁽¹²⁾	5,228	*
Brian L. Vance ⁽¹³⁾	152,031	*
Jeffrey J. Deuel ⁽¹⁴⁾	45,170	*
Donald J. Hinson ⁽¹⁵⁾	32,481	*
D. Michael Broadhead ⁽¹⁶⁾	56,417	*
David A. Spurling ⁽¹⁷⁾	36,173	*
Directors and Executive Officers as a group (21 persons)	866,661	2.87%

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- * Less than one percent of shares outstanding
- (1) Includes 347 shares held in her son's IRA and 333 shares held in her daughter's IRA.
 - (2) All shares are owned jointly with his spouse.
 - (3) Includes 2,000 shares issuable upon exercise of options, 22,533 shares held jointly with his spouse, 8,675 shares owned by an entity controlled by Mr. Charneski and 420 shares held in trust.
 - (4) Includes 4,550 shares issuable upon exercise of options, 30,157 shares held jointly with his spouse and 21,400 shares owned by entities controlled by Mr. Christensen.
 - (5) Includes 3,500 shares issuable upon exercise of options, 70,850 shares held jointly with his spouse, 1,050 shares owned solely by his spouse and 2,500 shares owned by an entity controlled by Mr. Clees.
 - (6) Includes 2,000 shares issuable upon exercise of options and 13,213 held jointly with her spouse.
 - (7) Includes 3,092 shares issuable upon exercise of options and 623 shares held in a profit sharing plan trust.
 - (8) Includes 3,500 shares issuable upon exercise of options and 3,150 shares held as custodian for a minor.
 - (9) Includes 4,672 shares within a SEP.
 - (10) Includes 3,092 shares issuable upon exercise of options, 48,144 shares held jointly with his spouse, 4,062 shares in an IRA solely owned by Mr. Pickering and 4,062 shares in an IRA solely owned by his spouse.
 - (11) Includes 3,485 shares held in an IRA.
 - (12) Includes 2,000 shares held jointly with her spouse.
 - (13) Mr. Vance is also a director. Includes 85,016 shares held jointly with his spouse and 18,564 vested shares in the retirement plan.
 - (14) Includes 20,000 shares issuable upon exercise of options and 402 vested shares in the retirement plan.
 - (15) Includes 6,880 shares issuable upon exercise of options and 1,722 vested shares in the retirement plan.
 - (16) Includes 10,296 shares issuable upon exercise of options, 20,414 shares owned jointly with his spouse and 2,672 vested shares in the retirement plan.
 - (17) Includes 6,987 shares issuable upon exercise of options, 10,875 shares held jointly with his spouse and 1,777 vested shares in the retirement plan.

PROPOSAL 1 ELECTION OF DIRECTORS

Our Board of Directors consists of 15 members and the terms of all current members expire at the 2014 annual meeting. Upon recommendation of the Governance and Nominating Committee, each of these incumbent directors has been nominated by the Board to serve a one-year term ending at the 2015 annual meeting, or when their respective successors have been duly elected and qualified.

On April 29, 2014, and in connection with the merger with Washington Banking, the Board of Directors amended the Bylaws to provide for the current composition of the Board of Directors, including the appointment of the Chairman and the Vice-Chairman of the Board of Heritage. In connection with the Bylaw amendment, Directors Donald V. Rhodes and Daryl D. Jensen resigned from the Boards of Heritage and Heritage Bank effective April 30, 2014.

The table below sets forth information regarding each director of Heritage and each nominee for director, including his or her age, position and term of office. Each nominee has consented to being named in this Proxy Statement and has agreed to serve if elected. If a nominee is unable to stand for election, the Board of Directors may either reduce the number of directors to be elected or select a substitute nominee. If a substitute nominee is selected, the proxy holders will vote your shares for the substitute nominee, unless you have withheld authority. At this time, we are not aware of any reason why a nominee might be unable to serve if elected.

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The Board of Directors recommends you vote FOR the election of Rhoda L. Altom, David H. Brown, Brian S. Charneski, Gary B. Christensen, John A. Clees, Mark D. Crawford, Deborah J. Gavin, Kimberly T. Ellwanger, Jay T. Lien, Jeffrey S. Lyon, Gragg E. Miller, Anthony B. Pickering, Robert T. Severns, Brian L. Vance and Ann Watson.

Name	Age ⁽¹⁾	Position(s) Held with Heritage	Director Since	Term to Expire ⁽²⁾
Nominees				
Rhoda L. Altom	56	Director	2013*	2015
David H. Brown	68	Director	2013	2015
Brian S. Charneski	52	Vice Chairman	2000	2015
Gary B. Christensen	65	Director	2005	2015
John A. Clees	66	Director	2005	2015
Mark D. Crawford	53	Director	2011*	2015
Kimberly T. Ellwanger	54	Director	2006	2015
Deborah J. Gavin	57	Director	2013*	2015
Jay T. Lien	69	Director	1987*	2015
Jeffrey S. Lyon	61	Director	2001	2015
Gragg E. Miller	62	Director	2009*	2015
Anthony B. Pickering	66	Chairman	1996*	2015
Robert T. Severns	63	Director	2010*	2015
Brian L. Vance	59	Director, President & CEO	2002	2015
Ann Watson	52	Director	2012	2015

* Reflects year appointed to the Washington Banking Board of Directors

(1) As of December 31, 2013.

(2) Assuming election or re-election.

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Business Experience of Nominees for Election or Re-Election

The business experience of each nominee of Heritage for at least the past five years and the experience, qualifications, attributes, skills and areas of expertise of each director that led to the conclusion that the person should serve as a director of Heritage is set forth below. All nominees have held their present positions for at least five years unless otherwise indicated.

Rhoda L. Altom is a real estate investor and manager and has been the President and Managing Member of Milestone Properties and Milestone Managers since 1984. Her company specializes in the acquisition and property management of commercial, retail, apartment, and land projects which are held in partnerships to own and operate properties in the Puget Sound area. A resident of Seattle, Ms. Altom holds a Bachelor of Science degree in Engineering Construction Management from Washington State University and an Executive Masters in Business Administration from the University of Washington. She is a founder and trustee of several philanthropic associations, including the YWCA Endowment Guild, Washington Women's Foundation, and Pediatric Brain Tumor Research Fund & PBTRF Guild at Children's Hospital. Ms. Altom received an Alumni Achievement Award from Washington State University in 2009. Ms. Altom's business acumen and strategic management skills, together with her broad experience serving on various boards and committees, bring strong operational and financial experience to the Board.

David H. Brown was appointed to the Board of Directors in October 2013. Mr. Brown is a graduate of Washington State University in pre-law. Mr. Brown was the President and Chief Executive Officer of Valley Community Bancshares, Inc. and its subsidiary, Valley Bank, for 24 years prior to its acquisition by Heritage Bank in 2013. Mr. Brown's banking career began in 1970 progressing through branch management, retail and commercial lending. Mr. Brown served on the Washington Bankers Association Board of Directors for a number of years including service as Chairman. His Washington Bankers Association service also included three years of service as Chairman of the Employee Benefit Trust. Mr. Brown's experience in banking, his leadership and credit quality skills attribute to his extensive knowledge of the financial services industry.

Brian S. Charneski is the President of L&E Bottling Company based in Olympia, Washington and is Chairman of Pepsi Northwest Beverages, LLC, a regional beverage manufacturing joint venture with PepsiCo, Inc. headquartered in Tumwater, Washington. Mr. Charneski is a director of Spyglass Capital Partners, LLC, a private equity investment company and chairs its operating committee. Mr. Charneski is a director of the American Beverage Association and is also a member of the Board of Directors of the Pepsi-Cola Bottlers Association, having chaired the Association from 2005 to 2007. Mr. Charneski serves on the Board of Trustees of Saint Martin's University and is a past director of the Washington Center for Performing Arts and The Community Foundation of the South Sound. Mr. Charneski is a 1985 graduate of Seattle University with a Bachelor of Arts in Economics. Mr. Charneski serves as Vice Chairman of the Board and provides a depth of knowledge in corporate and regulatory matters as he is a strong advocate for the beverage industry. He brings significant financial, economic and merger and acquisition expertise to the Board.

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Gary B. Christensen is the President, Chief Executive Officer and Chairman of the Board of Powell Christensen Inc., a fuel, lubricant and propane distributorship headquartered in Grandview, Washington. Mr. Christensen is also the Chief Executive Officer and Chairman of the Board of MidValley Chrysler, Jeep, Dodge Inc., the Chief Executive Officer of Christensen West LLC and the Chief Executive Officer of Seaport Petroleum. In 2004, R.E. Powell Distributing (a subsidiary of Powell Christensen Inc.) was named one of five inductees into the University of Washington sponsored Leadership Circle at the Annual University of Washington Minority Business of the Year Awards dinner. Mr. Christensen is a current member of the Chevron Oil Company National Wholesale Council, serves on the Board of Ambassadors for the University of Washington Business and Economic Development Program, is a member of the Foster School Advisory Board for the Foster School of Business at the University of Washington and is a founding director and a former President of the Central Washington Chapter of Safari Club International. Mr. Christensen served as a director for Central Valley Bank from 1999 through June 2013. He also previously served as the Chairman of the Board of Directors for Yakima County Development Association. Mr. Christensen provides significant knowledge in corporate matters with his proven leadership in the success of his multiple companies. He also provides extensive knowledge of the Yakima Valley real estate market, where Central Valley Bank, a division of Heritage Bank, is located.

John A. Clees is an attorney at Worth Law Group with a practice emphasis in estate and business succession planning for closely held companies and their owners. Formerly, Mr. Clees was a Managing Director for 9 years for a national certified public accounting firm, McGladrey, after they acquired the Olympia, Washington firm founded by Mr. Clees. Mr. Clees is a graduate of the University of Washington with a Bachelor of Arts in Economics and a graduate of the University of Washington School of Law. Mr. Clees is licensed as a Certified Public Accountant, an attorney and mediator in the State of Washington. Mr. Clees has served on Heritage's Board of Directors since 1990 and served as a non-voting consultant to Heritage's Board of Directors and Audit Committee from 2000 until June 2005. Mr. Clees provides important tax and accounting expertise to the Board. He also brings a legal perspective to the Board, with a solid understanding of corporate governance matters.

Mark D. Crawford is the Vice-President and General Manager of Smokey Point Concrete/Skagit Ready Mix unit of CPC Materials, Inc. He previously served as the President of Smokey Point Concrete, Inc., from 1986 until September 2013, when the company was purchased by CPC Materials, Inc. He served on the Washington Aggregate & Concrete Association Board and is an Advisory Board member for Youth Dynamics - Arlington WA. Mr. Crawford has additional experience in board and committee service for other local entities and he holds a Bachelor of Arts Degree in Business Management from Portland State University. Mr. Crawford contributes to the Board by drawing on his knowledge of business practices, familiarity with the Snohomish County market, and previous experience as a director.

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Kimberly T. Ellwanger was Senior Director of Corporate Affairs and Associate General Counsel at Microsoft Corporation of Redmond, Washington from 1991 until her retirement in October 1999. She led Microsoft in developing a corporate presence in government, industry and community affairs, including opening a Washington, D.C. office and developing a network of state and local government affairs representation. Prior to joining Microsoft, Ms. Ellwanger was a Partner at Perkins Coie in Seattle, Washington from 1985 to 1991, where her practice included state and local tax planning, tax litigation, bankruptcy, general business and corporate advice and transactions. She has been involved in numerous civic and professional activities including currently serving on the Board of the South Sound YMCA, the Northwest Chapter of National Association of Corporate Directors and the Providence St. Peter Foundation. She is past Chair of the Washington Council on International Trade, past Vice President of the Business Software Alliance and past Board member of the American Electronics Association. Ms. Ellwanger graduated with high honors from the University of Washington School of Law and graduated Phi Beta Kappa from Vassar College with an honors degree in economics. She has participated in and presented at a number of director education programs, including the Bank Directors Executive and Director Compensation Conference and the DirectWomen Board Institute. Ms. Ellwanger brings significant legal expertise, which is complemented with her knowledge and experience in corporate and government matters.

Deborah J. Gavin was employed by the Boeing Company for over 20 years and retired from the position of Vice President of Finance and Controller in 2010. Ms. Gavin served as an Undergraduate and Graduate Adjunct Accounting Faculty with City University, Seattle and was a Management Consultant for Deloitte. Prior to her employment with Boeing, Ms. Gavin was a Special Agent with the US Department of Treasury. Ms. Gavin is a Certified Public Accountant in the State of Washington. She holds a Bachelor of Science degree in Business from the State University of New York College at Buffalo and a Masters Business Administration in Finance from Seattle University. Ms. Gavin is currently a board member of the Washington Business Alliance. Her extensive financial background, leadership skills, and depth of public company knowledge provide the Board and Audit Committee with valuable expertise.

Jay T. Lien is currently the owner of Saratoga Passage LLC, a real estate and business consulting company that was established in 2004. Mr. Lien was also the president of Dan Garrison Inc. Real Estate, a land development company in Camano Island from 1986 to when he sold the company in 1996. He also owned and operated two Windermere Real Estate offices on Camano Island from 1986 until 1998. Mr. Lien has been very active in the real estate business since 1977 and served on the Board of Island Title Co. of Island County and the Board of Terminal Freezers in Oxford, California. He has also served on numerous non-profit organizations in Stanwood and Camano Island, Washington. Mr. Lien served as Chairman of the Board of Washington Banking Company and Whidbey Island Bank from September 1998 until April 2001. Mr. Lien started his career with National Bank of Commerce of Seattle in 1966 and attended Western Washington University. Mr. Lien brings significant knowledge of the real estate market, 27 years of board experience and a solid understanding of the financial services industry.

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Jeffrey S. Lyon is the Chairman and Chief Executive Officer of Kidder Mathews, headquartered in Seattle, Washington. Mr. Lyon serves as a director for Kidder Mathews Segner Inc. Mr. Lyon is a member of the Real Estate Advisory Board of Washington State University, the Business Advisory Board for the Milgard School of Business at the University of Washington, Tacoma and is also on the Tacoma-Pierce County Economic Development Board. Mr. Lyon has over 35 years of experience in the commercial real estate industry in the Puget Sound area. Mr. Lyon provides expertise in the commercial real estate industry and has excellent entrepreneurial and leadership skills, which are beneficial to the Board.

Gragg E. Miller is the Principal Managing Broker of Coldwell Banker Bain realtors in Bellingham and has held a principal position at the same realty firm since 1978. Mr. Miller holds a Bachelor's Degree from the University of Washington. He has attended numerous professional institutes in the real estate field and was honored with the Lifetime Achievement Award from the Whatcom County Board of Realtors in 2006. Mr. Miller has extensive community relations experience, with involvement in civic and business organizations in Bellingham.

Anthony B. Pickering is Chairman of the Board of Heritage as a result of the merger between Heritage and Washington Banking effective May 1, 2014 and served as the Chairman of the Board of Washington Banking and Whidbey Island Bank from 2005 to 2014. Mr. Pickering owned Max Dale's Restaurant and Stanwood Grill from 1983 and 2001, respectively, until 2008. He holds a Bachelor's Degree in Mathematics from Washington State University. He is a past-President of the Skagit Valley Hospital Foundation and previously served as a Trustee for the Washington State University Foundation Board of Trustees and on the board of the Economic Development Association of Skagit County. Mr. Pickering serves on the Board of Directors of the Skagit Preschool and Resource Center and the Skagit Regional Public Facilities District. Mr. Pickering's business background gives him experience in financial literacy, human resources management and community relations.

Robert T. Severns has been in the title insurance business for over 40 years. From 1999, he was the President of Chicago Title Insurance Company/ Island Division, Oak Harbor until retiring to part-time status in 2011. He served on the Island Title Company Board of Directors for 15 years and served on the Board for Land Title of Kitsap and Mason Counties for four years. Mr. Severns currently serves as an Oak Harbor City Council member. He holds a Bachelor of Arts Degree in Administrative Management from Central Washington University, and has varied experience in board and committee memberships at local and state levels. Mr. Severns brings to the Board a specialized knowledge of the title insurance industry, extensive community involvement, and a considerable amount of experience as a director.

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Brian L. Vance is the President and Chief Executive Officer of Heritage, positions he has held since 2006. He is also Chief Executive Officer of Heritage Bank, a position he has held since 2003. Mr. Vance served as President and Chief Executive Officer of Heritage Bank from 2003 until September 2012, when Jeffrey J. Deuel was promoted to President. Mr. Vance served as President and Chief Operating Officer of Heritage Bank from 1998 until 2003. Mr. Vance joined Heritage Bank in 1996 as its Executive Vice President and Chief Credit Officer. Prior to joining Heritage Bank, Mr. Vance was employed for 24 years with West One Bank, a bank with offices in Idaho, Utah, Oregon and Washington. Prior to leaving West One, he was Senior Vice President and Regional Manager of Banking Operations for the south Puget Sound region. Mr. Vance serves as trustee of the South Puget Sound Community College and as a director of the University of Washington Tacoma Milgard School of Business Foundation and the Community Foundation. He is also the past President of the Washington Financial League. Mr. Vance's experience with the financial services industry, which includes credit administration, management and strategic forecasting, brings valuable management and financial analysis skills to the Board.

Ann Watson is the Chief Financial Officer of Moss Adams LLP, headquartered in Seattle, Washington. Ms. Watson previously served in executive leadership roles at Russell Investments where she played an integral part in the company's successful expansion spanning a 15 year period. In these leadership roles, she served as Chief Human Resources Officer, as a Management Committee Member, a Russell Mellon Board Member overseeing the Russell Indexes and as a Director in the Corporate Finance Group. Prior to joining Russell Investments she had a seven year career with Chemical Bank/Manufacturers Hanover in New York and abroad where she held multiple global roles including strategic planning, loan workouts, client relationship management and credit analysis. Ms. Watson is a graduate of Whitman College with a Bachelor of Arts in Economics and a graduate of Columbia University with a Masters of Business Administration. Ms. Watson is an active community leader in the Seattle area. She currently serves as the Board Vice-Chair of the Seattle Foundation and is active in Social Venture Partners. Previously she served on the Board of the Washington Economic Development Finance Authority and on the Executive Committee of the Washington State China Relations Council. Ms. Watson brings extensive financial services industry and corporate financial knowledge to the Board, including merger and acquisition experience. Her significant leadership, compensation and human resources experience add to the Board's perspective.

Table of Contents**MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS****Board of Directors**

The Board of Directors of Heritage conducts its business through meetings of the Board and through its committees. The Board meets on a monthly basis with the exception of the month of August, holding special meetings as necessary. After each regular Board meeting, the directors meet in executive session, outside of the presence of the Chief Executive Officer. In addition, the outside directors hold separate meetings on a regular basis. During the year ended December 31, 2013, the Board of Directors held 11 regular and nine special meetings. No director attended fewer than 75% of the total meetings of the Board and committees on which the director served during this period.

Committees and Committee Charters

Our Board of Directors has standing Audit and Finance, Governance and Nominating, Compensation and Risk Committees and has adopted written charters for each of these committees. You may obtain a copy of the Audit and Finance, Governance and Nominating, and Compensation Committee charters, free of charge, by writing to: Kaylene M. Lahn, Corporate Secretary, Heritage Financial Corporation, 201 Fifth Avenue S.W., Olympia, Washington, 98501, or by calling (360) 943-1500. These charters are also available on our website at www.hf-wa.com.

The following table shows the membership of the various committees and the number of meetings held by each committee in 2013.

Committee Membership 2013

Name	Audit and Finance	Compensation	Governance and Nominating	Risk
David H. Brown				ü
Brian S. Charneski		ü	ü *	
Gary B. Christensen	ü	ü	ü	
John A. Clees	ü			ü *
Kimberly T. Ellwanger		ü *	ü	
Daryl D. Jensen	ü *			ü
Jeffrey S. Lyon	ü	ü	ü	
Donald V. Rhodes	ü		ü	ü
Brian L. Vance				ü
Ann Watson	ü	ü	ü	
Total Meetings in 2013	6	5	4	4

* Committee Chair

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The following table shows the membership of the various committees as of May 1, 2014, the effective date of the merger with Washington Banking.

Committee Membership May 1, 2014

Name	Audit and Finance	Compensation	Governance and Nominating	Risk
Rhoda L. Altom			ü	ü
David H. Brown				ü
Brian S. Charneski	ü		ü *	
Gary B. Christensen			ü	
John A. Clees	ü			ü *
Mark D. Crawford	ü			
Kimberly T. Ellwanger		ü *	ü	
Deborah J. Gavin	ü *			
Jay T. Lien				ü
Jeffrey S. Lyon		ü		
Gragg E. Miller	ü			
Anthony B. Pickering		ü	ü	
Robert T. Severns		ü		ü
Brian L. Vance				ü
Ann Watson		ü		

* Committee Chair

Audit and Finance Committee

The Audit and Finance Committee was composed of six members for the year ended December 31, 2013, each of whom is independent in accordance with the requirements for companies listed on The NASDAQ Stock Market and applicable SEC rules. Director Jensen had been designated by the Board of Directors as the audit committee financial expert, as defined by the SEC. The Committee meets quarterly and on an as-needed basis to evaluate the effectiveness of Heritage's internal controls for safeguarding its assets and ensuring the integrity of the financial reporting. The Committee also appoints the independent registered public accounting firm and reviews the audit reports prepared by the independent registered public accounting firm.

Effective May 1, 2014, the Audit and Finance Committee consisted of five members, each of whom is independent in accordance with the requirements for companies listed on The NASDAQ Stock market and applicable SEC rules. Director Gavin has been designated by the Board of Directors as the audit committee expert.

Compensation Committee

The Compensation Committee was composed of five members for the year ended December 31, 2013, each of whom is an independent director as defined by NASDAQ listing standards and applicable SEC and Internal Revenue Service rules. The Compensation Committee meets on an as-needed basis regarding the personnel, compensation and benefits related matters of Heritage.

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Effective May 1, 2014, the Compensation Committee consisted of five members, each of whom is an independent director as defined by NASDAQ listing standards and applicable SEC and Internal Revenue Service rules.

For more information on the responsibilities and activities of the Compensation Committee, including the Committee's processes for determining executive compensation, see the Compensation Discussion and Analysis section below.

Governance and Nominating Committee

The Governance and Nominating Committee was composed of six members for the year ended December 31, 2013, each of whom is an independent director as defined by NASDAQ listing standards. The Governance and Nominating Committee and its Chair are appointed annually by the Board of Directors. The Committee meets annually and on an as-needed basis, and is responsible for selecting qualified individuals to fill expiring directors' terms and vacancies on the Board of Directors. Final approval of director nominees is determined by the full Board, based on the recommendations of the Committee. The Committee's role includes oversight of our corporate governance program. The Committee's duties include the development and administration of Heritage's corporate governance standards.

Effective May 1, 2014, the Governance and Nominating Committee consisted of five members, each of whom is an independent director as defined by NASDAQ listing standards.

Risk Committee

The Risk Committee was composed of five members for the year ended December 31, 2013. The Committee meets quarterly and on an as needed basis to review risks inherent in our business such as credit risk, market and liquidity risk, operational risk and the regulatory component of compliance risk. During the year, the Company developed an Enterprise Risk Management model for the Committee and full Board to utilize in managing risks of the Company.

Effective May 1, 2014, the Risk Committee consisted of six members.

CORPORATE GOVERNANCE

Heritage is committed to good corporate governance and acts in a manner that best serves the interests of the Company and its shareholders. The Board reviews Heritage's policies and business strategies and advises executive management who manage and implement Heritage's business model and operations. The Board has adopted Corporate Governance Guidelines, Committee Charters, Stock Ownership Guidelines and various policies including the Code of Ethics Policy and Whistleblower Policy to provide a framework for effective governance practices. The full text of these documents can be found at www.hf-wa.com. Governance is a continuing focus at Heritage and in this section we describe our key governance policies, guidelines and practices.

Corporate Governance Guidelines

The Corporate Governance Guidelines outline Heritage's governance framework by addressing such items as responsibilities of directors, adherence to conflict of interest rules, the selection process for director candidates, required meeting attendance, stock ownership guidelines, the annual completion of Board performance assessments, director compensation, retirement age of directors, director education, succession planning and other important governance matters.

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Process for Selecting Directors

In its deliberations for selecting candidates for nomination as director, the Governance and Nominating Committee Charter requires the Committee to consider: each candidate's business and occupational background and experience; integrity and reputation; education; knowledge of and contacts in our market area and ties to the community; ability to commit adequate time and attention to serve as a director in light of other commitments; ability to work effectively in a group; independence and potential conflicts of interest; tenure on the Board; specialized knowledge or skills; and any other factors that the Committee deems appropriate. In selecting nominees, the Committee must consider these criteria, and any other criteria established by the Board, in the context of an assessment of the operation and needs of the Board as a whole and the Board's goal of maintaining a diversity of backgrounds among its members. In searching for qualified director candidates to fill vacancies on the Board, the Committee solicits its current Board for names of potentially qualified candidates. Additionally, the Committee may request that members of the Board pursue their own business contacts for the names of potentially qualified candidates, or the Committee may use the services of a search firm. The Committee would then consider the potential pool of director candidates, select the top candidate based on the candidate's qualifications and the Board's needs, and conduct an investigation of the proposed candidate's background to ensure there is no past history that would cause the candidate not to be qualified to serve as a director of Heritage. The Committee will consider director candidates recommended by Heritage's shareholders. If a shareholder has submitted a proposed nominee, the Committee would consider the proposed nominee, along with any other proposed nominees recommended by members of the Board of Directors, in the same manner in which the Committee would evaluate its nominees for director.

Pursuant to the merger with Washington Banking, Heritage's Board of Directors adopted amendments to its Bylaws which, among other things, govern vacancies, nomination of directors and reduction of the size of the Board. The actions to be taken depend on whether a director was a continuing Heritage director or a continuing Washington Banking director. The continuing Heritage directors are the eight members of Heritage's Board of Directors immediately prior to the effective time of the merger, as designated by Heritage's Board, and their replacements, if any. The continuing Heritage directors are Directors Brown, Charneski, Christensen, Clees, Ellwanger, Lyon, Vance and Watson. The continuing Washington Banking directors are the seven members of Washington Banking's Board of Directors immediately prior to the effective time of the merger, as designated by Washington Banking's Board, (including each of the persons designated for specified Board or office), and their replacements, if any. The continuing Washington Banking directors are Directors Altom, Crawford, Gavin, Lien, Miller, Pickering and Severns.

The Corporate Governance and Nominating Committee will recommend to the Board that each continuing Heritage director and each continuing Washington Banking director be nominated, and the Board will nominate each such director so recommended, for election at each annual meeting of shareholders that is held during the period from May 1, 2014 until May 1, 2016 or such shorter period as determined by the Board (the integration period), provided that each director continues to satisfy the eligibility criteria for serving as a Heritage director. If any continuing Heritage director no longer satisfies the eligibility criteria, a replacement nominee will be selected by a majority of the remaining continuing Heritage directors, and if any continuing Washington Banking director no longer satisfies the eligibility criteria, a replacement nominee will be selected by a majority of the remaining continuing Washington Banking directors.

All vacancies on the Board created by the cessation of service by any continuing Heritage director will be filled by a nominee proposed to the Corporate Governance and Nominating Committee by a majority of the remaining continuing Heritage directors and approved by at least two-thirds of the directors then in office in accordance with the Articles of Incorporation. All vacancies on the Board

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created by the cessation of service by any continuing Washington Banking director will be filled by a nominee proposed to the Corporate Governance and Nominating Committee by a majority of the remaining continuing Washington Banking directors and approved by at least two-thirds of the directors then in office in accordance with the Articles of Incorporation. If the Committee does not recommend any such proposed nominee, or if at least two-thirds of the directors then in office do not approve any such proposed nominee, a majority of the remaining continuing Heritage directors or a majority of the remaining continuing Washington Banking directors, as the case may be, shall propose a substitute nominee to the Committee. This process shall be repeated if necessary until the applicable vacancy has been filled.

After May 1, 2015, at least two-thirds of the directors then in office may determine to reduce the size of the Board in accordance with Article 2, Section 2.2 of the Bylaws, provided that as a result of any such reduction, the continuing Heritage directors and continuing Washington Banking directors shall have pro rata representation on the Board based upon the number of continuing Heritage directors (eight of fifteen, or 53.3%) and continuing Washington Banking directors (seven of fifteen, or 46.7%) as of the effective time of the merger, rounded to the nearest whole number.

Board Leadership

The Board annually elects the Chairman and Vice Chairman of the Board. The Chairman leads the Board and presides at all Board meetings, and is responsible for delivery of information to enable the Board to make informed decisions. The Vice Chairman leads the Board meetings in the absence of the Chairman of the Board. The positions of Board Chairman and of President and Chief Executive Officer have been separately held since 2006. The Board believes this structure is appropriate for Heritage because it provides segregation of duties between managing Heritage and leadership of the Board.

Pursuant to the merger with Washington Banking, Heritage's Board of Directors adopted amendments to its Bylaws which, among other things, govern selection of the Chairman and Vice Chairman of the Board. Effective as of May 1, 2014, the effective date of the merger, Anthony B. Pickering was appointed as Chairman of the Board and Brian S. Charneski was appointed as Vice Chairman of the Board, each to serve until May 1, 2016. If Mr. Pickering ceases to serve as Chairman of the Board for any reason prior to May 1, 2016, his successor as Chairman will be selected by the affirmative vote of at least a majority of the continuing Washington Banking directors, and approved by at least two-thirds of the directors then in office in accordance with the Articles of Incorporation. Any such successor will serve as Chairman of the Board until May 1, 2016. Similarly, if Brian S. Charneski ceases to serve as Vice Chairman of the Board for any reason prior to May 1, 2016, his successor as Vice Chairman of the Board will be selected by the affirmative vote of at least a majority of the continuing Heritage directors, and approved by at least two-thirds of the directors then in office in accordance with the Articles of Incorporation. Any such successor will serve as Vice Chairman of the Board until May 1, 2016.

Board Risk Oversight

The Board has the ultimate responsibility and authority for overseeing risk management at Heritage. The Board assesses risks facing Heritage and Heritage Bank. On a regular basis, the Board reviews operational and regulatory reports provided by management to assess credit risk, liquidity risk, and operational risk.

The Board also delegates the oversight of risk to various committees. The Audit and Finance Committee oversees the financial, accounting and internal control risk management. The Compensation Committee oversees the management of risks that may be posed by our compensation practices and programs. The Compensation Committee is responsible for reviewing compensation policies and practices for all employees to ensure that they do not create or encourage risks that are reasonably likely to have a

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material adverse effect on Heritage. The Risk Committee oversees the risks inherent in our businesses in the following categories: credit risk, market and liquidity risk, operational risk and the regulatory component of compliance risk. The Audit and Finance Committee and Risk Committee hold a joint meeting annually to review the annual audit plan and risk assessment. The Compensation Committee Chair also attends the joint Audit and Finance and Risk Committee meeting to ensure that compensation risks are also reviewed as part of the annual risk assessment process. The Senior Risk Officer reports directly to the Risk Committee Chair and Audit and Finance Committee Chair.

Code of Ethics

The Board of Directors has adopted a written Code of Ethics Policy that applies to our directors, officers and employees.

Shareholder Communication with the Board of Directors

The Board of Directors maintains a process for shareholders to communicate with the Board of Directors. Shareholders wishing to communicate with the Board of Directors should send any communication to Kaylene M. Lahn, Corporate Secretary, Heritage Financial Corporation, 201 Fifth Avenue S.W., Olympia, Washington 98501. Any such communication should state the number of shares beneficially owned by the shareholder making the communication.

Annual Meeting Attendance

Directors are encouraged to attend the annual meeting of shareholders and nine directors attended the 2013 annual meeting of shareholders.

Related Party Transactions

We have followed a policy of granting loans to our executive officers and directors, which fully complies with all applicable federal regulations, including those governing loans and other transactions with affiliated persons of Heritage. Loans to our directors and executive officers are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with all customers, and do not involve more than the normal risk of collectability or present other unfavorable features.

All loans and aggregate loans to individual directors and executive officers, without regard to loan amount, are completely documented and underwritten using the same underwriting policies, procedures, guidelines and documentation requirements as are used for non-director and non-employee customers of Heritage. Following the normal underwriting approvals by underwriting personnel, all such loans are then presented for review and approval by the Board of Directors of Heritage Bank pursuant to Regulation O of the Federal Reserve Board, and the requirements of the Federal Deposit Insurance Corporation and the Washington State Department of Financial Institutions, Division of Banks. There are no exceptions to these procedures and all approvals are documented in the Board meeting minutes. There was \$9.3 million in loans outstanding to directors and executive officers as of April 30, 2014, which includes loans to newly-added directors and executive officers as a result of the merger with Washington Banking, effective May 1, 2014.

Director Independence

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. The Board of Directors has determined that as of May 28, 2014, 13 of our 15 directors are independent. Directors Altom, Brown,

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Charneski, Christensen, Clees, Crawford, Ellwanger, Gavin, Lyon, Miller, Picker, Severns and Watson are all independent. Brian L. Vance, who serves as President and Chief Executive Officer of Heritage Financial Corporation and Chief Executive Officer of Heritage Bank, and David H. Brown, former Chief Executive Officer of Valley Community Bancshares and Valley Bank, are not independent.

DIRECTOR COMPENSATION

The following table shows the compensation paid to Heritage's directors for their service to Heritage for the year ended December 31, 2013, with the exception of Brian L. Vance, who is the President and Chief Executive Officer of Heritage, and whose compensation is included in the section below entitled Executive Compensation.

Name	Fees Earned or Paid In Cash (\$)	Stock Awards (\$) ⁽¹⁾	Total (\$)
David H. Brown ⁽²⁾	9,750	-	9,750
Brian S. Charneski	48,550	17,499	66,049
Gary B. Christensen	42,700 ⁽³⁾	27,306	70,006
John A. Clees	42,730	17,499	60,229
Kimberly T. Ellwanger	50,700	17,499	68,199
Daryl D. Jensen ⁽⁴⁾	51,700 ⁽³⁾	27,474	79,174
Jeffrey S. Lyon	41,300	17,499	58,799
Donald V. Rhodes ⁽⁴⁾	60,000	27,474	87,474
Ann Watson	40,000	17,499	57,499

- (1) Reflects the aggregate grant date fair value of awards, computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation Stock Compensation (FASB ASC Topic 718). For a discussion of valuation assumptions, please see footnotes to the financial statements of Heritage's Annual Report on Form 10-K for the year ended December 31, 2013. The stock awards include grants for service at Central Valley Bank as well. Outstanding awards are discussed below under Equity Compensation.
- (2) Mr. Brown was appointed to the Board in October 2013.
- (3) Includes \$2,700 for service on the Board of Central Valley Bank.
- (4) Messrs. Jensen and Rhodes retired effective April 30, 2014 in conjunction with the merger between Washington Banking and Heritage which was effective May 1, 2014.

2013 Director Compensation Highlights

During 2013, there were no changes to the structure of, or fees paid for, director compensation. The Compensation Committee typically retains McLagan, an independent compensation consultant, every other year to review total director compensation and assist with updating Heritage's compensation peer group (see Compensation Discussion and Analysis below for additional discussion about the peer group). This analysis was last performed during 2012. As a result of McLagan's review in 2012, the Compensation Committee and the full Board determined that Board fees and equity as a percentage of total compensation should each be increased to more closely align the directors with the 50th percentile of the peer group. Additionally, equity compensation became a larger percentage of total compensation to encourage long-term ownership in Heritage as well as to more closely align our Board compensation program with the programs of our peer group.

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Cash Compensation

In 2013, each non-employee director, other than the Chairman of the Board, was paid an annual cash retainer of \$24,000 plus committees fees for service as a director. The Chairman of the Board received an annual cash retainer of \$60,000 in lieu of the standard annual retainer and committee fees. The Chairs of the Audit and Finance, Compensation, and Governance and Nominating Committees were paid a quarterly cash retainer of \$2,500 and the Chair of the Risk Committee was paid a quarterly cash retainer of \$1,250, to serve as Chairs of the respective committees. Members and Chairs of the Audit and Finance, Compensation, and Governance and Nominating Committees received an additional per meeting attendance fee of \$500. Members and the Chair of the Risk Committee received an additional per meeting fee of \$400. Mr. Vance did not receive any compensation for service as a director or Board committee member.

Equity Compensation

In June 2013, each non-employee director with the exception of Mr. Brown, who was not yet appointed to the Board, received an award of 1,228 restricted shares of Heritage common stock, which vested on April 30, 2014. Directors Christensen, Jensen and Rhodes each received an additional award of 700 shares for their service as directors of Central Valley Bank. Due to the merger of Central Valley Bank into Heritage Bank, the Central Valley Bank equity awards were larger than prior years due to the severance shares provided based on years served as a director with Central Valley Bank. As of December 31, 2013, Directors Charneski, Christensen, Clees, Ellwanger, Jensen, Lyon, Rhodes and Watson each had 1,228 shares of restricted stock outstanding.

Prior to 2010, non-employee directors historically received annual grants of non-qualified stock options. As of December 31, 2013, the non-employee directors had unexercised nonqualified stock options in the following amounts: Mr. Charneski, 3,000 shares; Mr. Christensen, 5,850 shares; Mr. Clees, 4,500 shares; Ms. Ellwanger, 3,000 shares; Mr. Jensen, 5,850 shares; Mr. Lyon, 4,500 shares; and Mr. Rhodes, 5,850 shares.

COMPENSATION DISCUSSION AND ANALYSIS

In this section we discuss our executive compensation philosophy and programs at Heritage. The Committee refers to the Compensation Committee. Following this discussion, we disclose compensation for our named executive officers for SEC reporting purposes (which we refer to as our NEOs) in the Summary Compensation Table and other compensation tables. The following individuals are our NEOs for 2013:

Brian L. Vance Chief Executive Officer of Heritage Bank and Central Valley Bank and President and Chief Executive Officer of Heritage Financial Corporation

Jeffrey J. Deuel President and Chief Operating Officer of Heritage Bank and Executive Vice President of Heritage Financial Corporation

Donald J. Hinson Executive Vice President and Chief Financial Officer of Heritage Bank and Heritage Financial Corporation

D. Michael Broadhead President of Central Valley Bank, a division of Heritage Bank

David A. Spurling Executive Vice President and Chief Credit Officer of Heritage Bank and Heritage Financial Corporation

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Executive Summary

Our Business

Heritage is the parent company of a wholly-owned subsidiary bank, Heritage Bank, located in Olympia, Washington. Heritage's total assets as of December 31, 2013 were \$1.66 billion. Heritage Bank has 36 branches located from Portland, Oregon to Seattle, Washington and six branches in the Yakima and Kittitas Valleys of Washington State that do business as Central Valley Bank, a division of Heritage Bank. Heritage's vision is to contribute to the success of our clients through our innovative team, providing quality financial services. We are committed to continuously improving customer satisfaction, employee empowerment and shareholder value.

2013 Business Highlights

Heritage embarked on several key initiatives during 2013, which included growth strategies, efficiency improvements, credit quality improvements and balance sheet management. These key initiatives have required a disciplined management team to integrate multiple initiatives while continually focusing on the improvement of key performance metrics. Our performance in 2013 reflected an improvement in credit quality, deposit mix and three-year shareholder return metrics, effective management of efficiency initiatives and continued efforts to maintain our core business operations while integrating and implementing acquisitions and seeking further growth opportunities. During 2013, we had the following significant accomplishments:

Total Shareholder Return Heritage's one-year shareholder return was 19.7%, with a three-year return of 38.0%. Although Heritage's shareholder returns are below our peer group's returns, we had significant expenses as a result of our continued organic and acquisition-related growth initiatives during 2013.

Growth Initiatives Heritage completed the acquisition of Northwest Commercial Bank on January 9, 2013 and Valley Community Bancshares, Inc. and its subsidiary, Valley Bank, on July 15, 2013, and announced a strategic alliance with Washington Banking on October 23, 2013. The completion of the Washington Banking merger occurred on May 1, 2014 and was a transformational transaction resulting in a combined branch footprint of 67 branches spanning from Portland, Oregon to Bellingham, Washington, and combined total assets of approximately \$3.4 billion. We continue a disciplined approach to seeking organic and strategic growth opportunities that will benefit our shareholders and customers.

Efficiency Initiatives Heritage completed the merger of Central Valley Bank into Heritage Bank during June 2013, which consolidated the two bank subsidiaries and eliminated a bank charter, resulting in significant annual cost savings. During 2013, Heritage also closed three Heritage Bank branches that were acquired in 2010 as part of the Cowlitz Bank acquisition, consolidated four of eight Valley Bank branches and closed the mortgage and item processing divisions of Heritage Bank. Additionally, Heritage had a core system conversion that provided efficiencies for Heritage Bank and enhanced features for our customers. Heritage management measures assets per employee (ApE) as a measure of efficiency and realized an improvement in this metric during 2013, with ApE of \$4.4 million at December 31, 2013, compared to \$3.7 million at December 31, 2012.

Credit Quality Heritage significantly improved its credit quality during 2013, with nonperforming originated assets to total originated assets, excluding portions guaranteed by government agencies, decreasing to 0.68% at December 31, 2013, compared to 1.39% at December 31, 2012. As of December 31, 2013, our allowance for loan losses to total originated loans was 1.76%, representing 329.4% of nonperforming loans, net of governmental guarantees.

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Capital Management Strategies Heritage repurchased 544,000 shares of its common stock with a weighted average price of \$15.88 during 2013 through its stock repurchase program. We declared regular and special cash dividends for a total of \$0.42 per share for 2013, and also declared first quarter 2014 cash dividends of \$0.16 per share. Despite our multiple acquisitions during 2013, tangible common equity to tangible assets was 11.3% at year-end and we continue to maintain capital levels in excess of regulatory requirements.

Net Income Heritage's net income was \$9.6 million, or \$0.61 per diluted common share, for the year ended December 31, 2013, compared to \$13.3 million, or \$0.87 per diluted common share, for the year ended December 31, 2012. During 2013, various growth and restructuring initiatives had a significant impact on net income with additional pre-tax expenses of approximately \$5.1 million.

Solid Balance Sheet Heritage increased total assets by \$313.5 million during 2013 to \$1.66 billion as of December 31, 2013, compared to \$1.35 billion as of December 31, 2012. Originated loans increased by approximately \$102.8 million, or 11.8%, during 2013 and we improved our deposit mix with non-maturity deposits to total deposits increasing to 77.9% at December 31, 2013, compared to 74.2% at December 31, 2012.

2013 Executive Compensation Highlights

Heritage continually strives to align pay with performance for all officers. During 2013, the Committee acted in accordance with Heritage's compensation philosophy and provided our executives with compensation aligned with Heritage's financial performance and each executive's individual performance, and commensurate with market comparisons, while continuing to consider shareholder value.

Base Salary: Only one NEO received an increase in base salary in 2013 to better align him with our peer group. Based upon a peer group analysis done by an independent compensation consultant in 2012, executive salaries were moved up closer to the peer median in 2012. During 2013, an internal review of peer compensation was performed, and executive base salary increases ranged from 0% to 5% as management and the Committee continued to consider and evaluate shareholder say on pay votes and market conditions.

Incentive Compensation: Annual cash incentives were awarded in 2014 based on Heritage's successful 2013 performance and equity incentives were granted in 2013 as a result of our strong 2012 financial performance. Since 2011, the Board has imposed a cap on annual cash incentives of 15% of net income to limit the amount of Heritage's net income that can be paid out of the Management Incentive Plan, which reduced the cash incentive payouts otherwise earned under our annual incentive compensation plan by 29% in 2013, 5% in 2012 and 12% in 2011.

Stock Ownership Guidelines: The Committee updated Heritage's Stock Ownership Guidelines, which are intended to encourage additional corporate ownership by the NEOs and members of the Board.

Employment Agreements: Heritage entered into a transitional employment and retirement agreement with Mr. Broadhead in connection with his retirement transition in 2014, and a new employment agreement with Mr. Spurling (which became effective January 2, 2014) in connection with his promotion to Executive Vice President and Chief Credit Officer of Heritage and Heritage Bank.

Philosophy and Objectives of Our Executive Compensation Program

Heritage's compensation philosophy provides overarching guidelines for establishing and managing all elements of compensation. The philosophy targets total overall executive compensation at market

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competitive levels, which we define as between the 50th and 75th percentile of peer banks, in order to manage base salary levels, allow for meaningful performance-based compensation and recruit and retain key talent. Our compensation philosophy takes into account factors such as internal consistency of executive pay, and the experience, tenure and scope of responsibility for each of our NEOs. Officer compensation is weighted toward Heritage's achievement of stated annual and long-term performance objectives.

Our compensation programs are designed to link compensation with performance, taking into account competitive compensation levels at peer group institutions and in the markets where we compete for talent. The policies and underlying philosophy governing our compensation programs include the following:

Employer of Choice We view compensation as a key factor in being an employer of choice in our markets. We believe that competitive compensation packages allow us to attract and retain well-qualified, key employees critical to our long-term success.

Pay Aligned with Performance We strive to provide a competitive salary combined with incentive opportunities that reward outstanding individual and Company performance.

Prudent Management of Risk We evaluate, design and manage compensation programs to ensure that we are properly and prudently managing the risks that may be created by such programs. The Committee has the authority and responsibility to mitigate such risks, where necessary, through procedural oversight or program modification.

Flexibility We recognize that the market for key talent requires flexibility in compensation in order to attract qualified individuals. Salary ranges and individual compensation decisions take into account local competitive pressures and changing market conditions, as well as regulatory restrictions. Furthermore, the targeted position relative to market may vary depending on the type and level of position, recognizing the different recruiting conditions and relative importance of various qualifications.

This compensation philosophy is reviewed periodically by the Committee and is modified, as appropriate, to reflect market trends and industry best practices.

Role of the Compensation Committee

The Committee, composed entirely of independent directors, establishes and monitors compensation programs for employees of Heritage and its subsidiaries. The Committee's responsibilities are to:

review the goals, policies and objectives of the compensation plans of Heritage and Heritage Bank;

review and administer our compensation plans in light of the goals and objectives of these plans, and adopt and recommend new compensation plans or amendments to existing plans;

review and approve actions affecting salaries, annual cash incentives, benefits, equity compensation grants and other compensation arrangements for the Chief Executive Officer and other NEOs;

review and approve the corporate goals and objectives for the Chief Executive Officer annually;

review and recommend to the full Board for approval the director compensation and fees, benefits and equity compensation grants;

review the results of any shareholder advisory vote regarding compensation plans or programs of Heritage and consider whether to implement any changes as a result of such advisory vote;

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review and evaluate risks posed to Heritage by the design and implementation of various compensation programs and appropriate risk management and controls to avoid or mitigate any excessive or unreasonable risk to Heritage;

approve and recommend to the Board for adoption any programs or policies regarding the recovery of previously paid or earned compensation later determined to have been based on inaccurate financial information as may be required by statutory or regulatory authority or as may be deemed in the best interest of Heritage and its shareholders;

review and discuss the Compensation Discussion and Analysis with management; and

review our policies regarding the tax deductibility of compensation paid to executive officers for purposes of Section 162(m) of the Internal Revenue Code.

In order to fulfill these responsibilities, the Committee's charter grants it the authority and adequate funding to retain and terminate any third party for the purpose of evaluation of the compensation and performance of Heritage's directors, senior executive officers and Chief Executive Officer.

Role of Executives in Compensation Committee Deliberations

The Committee frequently requests that Mr. Vance and other executives be present at Committee meetings to discuss executive compensation. Executive officers in attendance may provide their insights and suggestions, but only Compensation Committee members may vote on decisions regarding executive compensation. The Compensation Committee discusses Mr. Vance's compensation with him, but final deliberations and all votes regarding all compensation are made in executive session with independent directors and without management present. The Committee also reviews Mr. Vance's recommendations and input from the independent compensation consultant or legal counsel when making decisions regarding the compensation of Mr. Vance and the other NEOs.

Compensation Consultants and Advisors

The Committee typically retains McLagan, an independent compensation consultant, every other year to assist with updating Heritage's compensation peer group. This analysis was last performed during 2012. During 2013, McLagan was not engaged by the Committee to perform any specific consulting services and McLagan was not paid for any services. Representatives of McLagan were generally available during 2013 to counsel the Committee as needed. The Committee may replace McLagan or hire additional consultants at any time. As an independent consulting firm, McLagan does not provide other non-executive services such as retirement or welfare plan administration to Heritage. The Committee does not believe that McLagan has any conflicts of interest that would impair its independence in advising the Committee. The Committee has engaged McLagan to perform consulting services during 2014 to include a review of the compensation peer group, an executive and director compensation benchmarking survey, an equity overhang analysis for the Heritage Financial Corporation 2014 Omnibus Equity Plan and other compensation projects undertaken in connection with the Washington Banking merger completed on May 1, 2014.

The Committee also has the authority to retain, at Heritage's expense, legal counsel and other advisors on an as needed basis, and has and will evaluate the independence of such advisors as the Committee deems appropriate and as may be required by the NASDAQ listing standards.

Use of Competitive Data

During 2013, a peer group benchmarking study was not performed by a third party consultant; however, management did compile proxy data from the previously established peer group to present to

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the Compensation Committee to assist in its review of annual compensation for the executives. In 2012, the Committee engaged McLagan to conduct a review of the compensation of Heritage's executives and directors. A peer group was identified based, generally, on the following criteria:

publicly-traded financial institutions with return on average assets greater than negative 1% and non-performing assets less than 9%;

locations in the states of Idaho, Montana, Oregon, Utah, Washington, Alaska and Northern and Central California;

asset size of \$925 million to \$5 billion; and

comparable business model and performance results.

Our peer group of 15 comparable commercial bank holding companies comprises the following:

Columbia Banking System, Inc.	Bank of Commerce Holdings	Pacific Continental Corporation
Banner Corporation	Guaranty Bancorp	Bridge Capital Holdings
TriCo Bancshares	Washington Banking Company	Northrim Bancorp Inc.
Farmers & Merchants Bancorp	Bank of Marin Bancorp	Heritage Oaks Bancorp
CoBiz Financial Inc.	Sierra Bancorp	Heritage Commerce Corp.

In addition to analyzing the pay practices and performance of our peer group, the 2012 McLagan study included executive compensation information from published banking industry surveys including the American Bankers Association Survey and surveys published by McLagan.

Table of Contents**Components of Compensation**

The following table lists some of the major components of compensation that we may use as part of the compensation program.

Component	Key Characteristics	Purpose	Principal 2013 Actions
Base Salary	Fixed compensation component reviewed annually and adjusted, if and when appropriate	Intended to compensate an executive officer fairly for the responsibility level of the position held as well as be competitive within the banking industry.	Only one NEO had an increase in salary, of approximately 5%.
Cash Incentives	Annual incentives, variable compensation component	Intended to motivate and reward executive officers for achieving annual goals. The annual incentives are performance-based and reflect the actual performance results compared to established goals.	Annual incentives for our NEOs ranged from \$58,736 to \$161,329, or 16% to 20% of total compensation.
Equity-Based Compensation	Long-term incentives, variable compensation component performance-based award opportunity, typically granted annually	Intended to motivate executive officers to achieve our business objectives by tying incentives to long-term performance. The increased stock ownership aligns employee and shareholder interests and serves as a retention tool.	Our NEOs received long-term incentives in the form of restricted stock awards ranging in value from \$61,503 to \$126,697, or 16% to 18% of total compensation.
Post-Employment Compensation	Fixed compensation component	Intended to provide temporary income following an executive officer's involuntary termination of employment and to retain senior executives in a competitive marketplace.	A transitional employment and retirement agreement was entered into with Mr. Broadhead effective April 8, 2013; an employment agreement was entered into with Mr. Spurling (effective January 2, 2014); and deferred compensation contributions were made for Messrs. Vance, Deuel and Hinson.

Prior Year's Say-on-Pay Vote

Heritage received 86% of votes cast in support of executive compensation during the 2013 annual shareholders' meeting. Heritage, the Board and the Committee pay careful attention to communications received from shareholders regarding executive compensation, including the results of these non-binding advisory votes. The Committee believes that these votes reflect our shareholders' agreement with our compensation philosophy and the manner in which we compensate our NEOs. Although shareholder support at the 2013 shareholder meeting was not at the level we strive to

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achieve, the Committee recognizes that one-time decisions that were made during 2012 may have led to the decrease in support. The Committee was cognizant of the 2013 decline in votes and carefully considered executive compensation decisions as a result of these votes. The Committee continually strives to provide shareholder value while retaining key executives and will closely monitor the results of all future advisory votes on executive compensation. The Committee continued during 2013 to adhere to and monitor the requirements within the Dodd-Frank Wall Street Reform and Consumer Protection Act impacting compensation programs, which generally focus on deferred incentives, claw back policies and performance-based compensation.

Base Salary

Salary levels of executive officers are designed to be competitive within the banking industry and are based on the experience, tenure and responsibility of each officer. We utilize various compensation surveys and peer group comparisons, including the 2012 McLagan study described above, to obtain a general understanding of current base salary, salary range and total cash compensation trends of competitors to ensure that executive compensation is not significantly out of line with competitors of a similar size or within our market areas. Base salaries for our executive officers other than the Chief Executive Officer are based upon recommendations by the Chief Executive Officer, taking into account the subjective and objective factors described above. The Committee reviews and approves or disapproves those recommendations. The base salary for the Chief Executive Officer is recommended to the Board by the Compensation Committee. The Chief Executive Officer is not present during discussions or determinations regarding his compensation. The Compensation Committee generally meets in June of each year in order to approve the base salaries of our NEOs effective July 1 of that year. This timing coincides with the review of the performance of the individual officer and the prior year performance of Heritage and its subsidiaries, as well as the availability of proxy information for our peers.

Salary Adjustments Made in 2013

As a result of the comprehensive review of executive compensation during 2012, and the salary adjustments at that time to align the NEOs' base salaries to the median level of similarly-positioned executives at our peer group institutions, there were minimal salary increases during 2013. Four of the five NEOs for 2013 received no salary increases for 2013. The base salaries for 2012 and 2013 were as follows:

Name	Position	2012 Base	2013 Base
		Salary (\$)	Salary (\$)
		(effective July 1, 2012)	(effective July 1, 2013)
Brian L. Vance	Chief Executive Officer	412,008	412,008
Jeffrey J. Deuel	President, Chief Operating Officer	256,008	256,008
Donald J. Hinson	Executive Vice President, Chief Financial Officer	244,008	244,008
D. Michael Broadhead	President of Central Valley Bank	200,004	200,004
David A. Spurling	Executive Vice President, Chief Credit Officer	205,008	215,256

Annual Cash Incentives

We use annual cash incentives to focus attention on current strategic priorities and encourage achievement of corporate objectives. These incentives are provided under our Management Incentive Plan. The objectives of the plan are to reward and retain high performers, to drive Heritage's long-term financial success, to encourage teamwork and to create an environment where executives are

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rewarded if Heritage achieves or exceeds pre-determined annual performance criteria. The Management Incentive Plan's design incorporates a tiered approach with annual incentive awards that are linked to the achievement of pre-defined performance goals. The incentive ranges (as a percentage of salary) are designed to provide market competitive payouts for the achievement of minimum, target and maximum levels of performance. The annual awards are determined by previously approved goals, calculated based on financial and individual performance and then recommended by the Chief Executive Officer to the Committee. The Committee then reviews and approves or disapproves the annual cash incentive recommendations.

The Committee approves the funding level for the Management Incentive Plan based on meeting or exceeding corporate performance goals. Each performance goal has an established threshold (minimum), target and maximum expectation level; however, no payment will be made for a goal if performance falls below the threshold level. Performance ratings for each specific corporate and individual goal between threshold and target or between target and maximum will result in the annual cash incentive payout being reduced or increased from target on a prorated basis. For the 2011, 2012 and 2013 annual cash incentives, the total pools of incentives paid were limited to an amount not to exceed 15% of Heritage's net income. Each NEO has a scorecard with performance results and the Committee approves the final incentives paid. The Management Incentive Plan includes a provision that would operate to claw back, or require the repayment of, incentives should such incentives be paid based on materially inaccurate performance results. The Compensation Committee reserves the right, in its sole discretion, to not award any incentive payouts when extraordinary circumstances occur that may negatively impact Heritage.

2013 Annual Cash Incentive Award Determinations

In 2013, each of our NEOs was eligible to participate in the Management Incentive Plan, and had an annual cash incentive opportunity based on specified corporate goals and performance. In order for an executive to be eligible to receive any award, corporate performance had to exceed a threshold level and the executive had to achieve a satisfactory individual performance evaluation. The percentage target and maximum opportunities have remained the same since established in 2010. The aggregate incentives paid under the Management Incentive Plan, including those paid to our NEOs, were limited to an amount not to exceed 15% of Heritage's 2013 net income.

The opportunities for 2013 cash incentive awards for our NEOs are as follows:

Name	Target Opportunity as % of Base Salary	Maximum Opportunity as % of Base Salary	Annual Cash Incentive Received as % of January 1, 2013 Base Salary
Brian L. Vance	40%	60%	39%
Jeffrey J. Deuel	30%	45%	29%
Donald J. Hinson	30%	45%	29%
D. Michael Broadhead	30%	45%	29%
David A. Spurling	30%	45%	29%

Table of Contents**Performance Goals**

In March 2013, the Committee approved the following goals for our NEOs that were related to Heritage's performance:

Corporate Goal	Weighting ⁽¹⁾	Threshold	Target	Maximum	Actual Performance
Nonperforming Assets ⁽²⁾	Varies	1.30%	1.10%	0.90%	0.68%
3-Year Total Shareholder Return	Varies	14.0%	17.6%	23.0%	38.0%
Net Interest Margin	Varies	4.50%	4.75%	5.00%	4.80%
Assets per Full Time Equivalent (ApE ⁽³⁾)	Varies	\$ 3,750	\$ 3,950	\$ 4,100	\$ 4,448

- (1) Each NEO received a different weighting. Messrs. Vance, Deuel and Broadhead had the following weightings: 20% nonperforming assets; 15% three-year total shareholder return; 30% net interest margin; and 35% ApE. Mr. Hinson had the following weightings: 15% nonperforming assets; 15% three-year total shareholder return; 35% net interest margin; and 35% ApE. Mr. Spurling had the following weightings: 35% nonperforming assets; 15% three-year total shareholder return; 30% net interest margin; and 20% ApE.
- (2) This metric is the originated nonperforming assets to total originated assets, excluding portions guaranteed by government agencies.
- (3) Amounts reflect dollars in thousands.

As noted above, the aggregate cash incentives pool for 2013 was limited to 15% of Heritage's 2013 net income. As a result of this limitation, the earned cash incentives were limited and, therefore, reduced on a pro-rated basis. Each of our NEO's annual cash incentives was reduced by approximately 29%. In determining the net income limitation, the Committee decided that certain one-time expenses related to recent acquisitions would be reversed prior to applying the limit. Even with this adjustment, the actual bonuses paid were substantially lower than the amounts that would have been paid without the limit. The following table reflects the originally calculated, or earned annual cash incentive, and the actual pro-rata annual cash incentive paid to each NEO for 2013 performance:

Name	Earned Annual Cash Incentive (\$)	Earned Annual Cash Incentive as Percentage of Total Compensation (%)	Annual Cash Incentive Actually Paid (\$)	Annual Cash Incentive Actually Paid as Percentage of Total Compensation (%)
Brian L. Vance	227,428	28.0	161,329	19.8
Jeffrey J. Deuel	105,987	22.6	75,183	16.0
Donald J. Hinson	99,555	22.6	70,621	16.0
D. Michael Broadhead	82,802	24.4	58,736	17.3
David A. Spurling	84,873	24.2	60,206	17.2

Equity-Based Compensation

Equity-based compensation is intended to more closely align the financial interests of our executives with long-term shareholder value, and to assist in the retention of key executives. Our equity-based compensation program is designed to incorporate a tiered approach, with equity awards linked to the achievement of pre-defined performance goals synonymous with the goals under the Management Incentive Plan. The incentive ranges (as a percentage of salary) are designed to provide market-competitive payouts for the achievement of minimum, target and maximum levels of performance. Actual award amounts are determined based on the achievement of previously-approved goals, calculated based on financial and individual performance and then recommended by the Chief Executive Officer to the Committee. The Committee then reviews and approves or disapproves the

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equity-based compensation recommendations. Officers are required to receive a satisfactory annual performance evaluation rating to obtain an equity award and the equity-based compensation is ultimately discretionary.

Historically, we have granted equity-based compensation to officers in the form of incentive stock options and restricted stock awards. We continue to maintain our shareholder approved 2010 Omnibus Equity Plan, which allows us to grant stock options, stock appreciation rights, restricted stock, restricted performance stock, unrestricted stock or performance unit awards to directors, officers and other employees of Heritage and its subsidiaries.

Stock options and restricted stock awards are awarded based on the closing price of Heritage's stock on the date of grant. The date of grant is the date that the options or awards are approved by the Committee.

Stock options granted under the 2010 Omnibus Equity Plan generally vest ratably over four years and expire 10 years after they are granted. The majority of the restricted stock awards granted to date under the 2010 Omnibus Equity Plan vest ratably over four years, while some grants awarded have a three-year, four-year or five-year cliff-vesting schedule. Future awards may be granted with different vesting schedules.

The Chief Executive Officer makes recommendations to the Compensation Committee regarding the amount and terms of equity awards for the other NEOs. Using the recommendations of the Chief Executive Officer, the Committee determines which executives will receive awards and determines the number of shares subject to each award. The Chair of the Compensation Committee, working with the Committee's independent compensation consultant, recommends to the Committee the amount and terms of equity awards for the Chief Executive Officer.

Our Board of Directors has adopted the Heritage Financial Corporation 2014 Omnibus Equity Plan, subject to shareholder approval, which, if so approved, would replace the 2010 Omnibus Equity Plan. We are recommending that our shareholders approve the 2014 Omnibus Equity Plan because we believe the design of the plan and the number of shares to be authorized for issuance are consistent with the interests of our shareholders and good corporate governance practices. A summary of the material provisions of the 2014 Omnibus Equity Plan is set forth below under Proposal 3 Approval of 2014 Omnibus Equity Plan, and a copy of the plan is set forth as Appendix A to this Proxy Statement.

2013 Equity Award Determinations

In June 2013, our NEOs received grants of restricted stock based on 2012 performance. Heritage applied a tiered structure with target award opportunities expressed as a percentage of salary during 2013, as described in the table below. The percentage target and maximum opportunities have remained the same since they were established in 2010. Subjective factors were used to differentiate individual performance. Officers are assigned to one of five different tier levels based upon factors such as title, position and/or responsibilities. The tier level is the primary factor used to determine the equity award each executive officer may earn. The target opportunity is based upon a percentage of salary and placement within the tiered structure. If an officer did not meet his or her performance goals under the Management Incentive Plan for the prior year, the officer may not receive an award, or the award may be reduced. Additionally, the officer is required to maintain a minimum performance rating to achieve an equity award. The Committee may make discretionary grants of stock options or restricted stock, based on factors relating primarily to the responsibilities of individual executives, their expected future contributions to Heritage and the recruitment of new officers.

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The following table below contains the tier level and target opportunity for each of our NEOs, as well as their potential and actual 2013 awards, expressed as a percentage of base salary.

Name	Tier	Target Opportunity as % of Base Salary	Maximum Opportunity as % of Base Salary	2013 Actual Award as % of January 1, 2013 Base Salary
Brian L. Vance	I	30%	45%	31% ⁽¹⁾
Jeffrey J. Deuel	II	25%	37.5%	31%
Donald J. Hinson	II	25%	37.5%	31%
D. Michael Broadhead	II	25%	37.5%	31%
David A. Spurling	II	25%	37.5%	31%

(1) Mr. Vance requested that his equity award target opportunity be decreased from 30% to 25% and that his maximum opportunity be decreased from 45% to 37.5%, which resulted in a 18% reduction of his 2013 equity award or a 31% actual award as a percentage of January 1, 2013 base salary.

To determine the 2013 equity awards, Heritage took into consideration whether our NEOs met their individual performance goals under the Management Incentive Plan for 2012. In March 2012, the Committee approved all such goals for the NEOs, which were related to Heritage's performance. These goals are set forth in the table below.

Corporate Goal	Weighting	Threshold	Target	Maximum	Actual Performance
Nonperforming Assets ⁽¹⁾	25%	1.81%	1.51%	1.21%	1.39%
Net Income ⁽²⁾	30%	\$ 8,817	\$ 11,021	\$ 13,225	\$ 13,261
Net Interest Margin ⁽³⁾	25%	4.80%	5.09%	5.40%	5.17%
Discretionary Strategic Initiatives	20%	1.0	5.0	10.0	⁽⁴⁾

(1) This metric is the originated nonperforming assets to total originated assets, excluding portions guaranteed by government agencies.

(2) Dollars in thousands.

(3) Noninterest expense divided by the sum of net interest income and noninterest income.

(4) Each NEO received a discretionary rating of six. The ratings are defined as a five for meeting expectations and a ten for far exceeding expectations. The strategic initiatives vary between executives and examples would include shareholder relationship management and outreach, ongoing acquisition integration and overall division oversight.

Although, the equity awards were calculated in February 2013, the awards were not granted until the June 2013 Committee meeting to align with the previous year's executive compensation review timing. The 2012 performance results were 123% of target. We anticipate making equity award grants to our NEOs in 2014, taking into consideration 2013 performance results.

Stock Ownership Guidelines

Heritage maintains Stock Ownership Guidelines for our NEOs and directors. These guidelines were established to promote a long-term perspective in managing Heritage and to help align the interests of our shareholders, directors and top executives. The stock ownership goal for each person is determined on an individual basis, first in dollars as a multiple as follows: 2.5 times base salary for the Chief Executive Officer, 1.5 times base salary for the other NEOs and three times annual cash compensation for directors; and then by converting such amount to a fixed number of shares. The guidelines were revised in February 2014 and give directors three years to comply and NEOs five years to comply. As of December 31, 2013 all directors and NEOs were in compliance, or were within the time frame to come into compliance, with the Stock Ownership Guidelines.

Table of Contents**Retirement Benefits**

401(k) Employee Stock Ownership Plan. We maintain a 401(k) Employee Stock Ownership Plan as a retirement plan. During early 2014, the plan name changed to the Heritage Financial Corporation 401(k) Profit Sharing Plan and Trust. The plan is a defined contribution plan and is designed to provide employees (including our NEOs) with savings opportunities and financial security during retirement. Heritage makes three different contributions to the plan:

A matching contribution equal to 50% of an employee's salary deferral contributions up to a maximum of 6% of an employee's eligible compensation;

A profit-sharing contribution that includes a fixed contribution of 2% of an employee's eligible compensation and a discretionary contribution based on a percentage of an employee's eligible compensation based on Heritage's financial performance and management's recommendation and as approved by the Board. For 2013, the discretionary contribution was equal to 1% of employees' eligible compensation; and

A stock contribution as a result of the employee stock ownership plan determined based on the current employee stock ownership plan's loan principal and interest repayments, which is allocated as a percentage of eligible compensation. The loan was fully allocated in December 2012 and therefore during 2013 there were no stock contributions made to participants. The employee stock ownership component of the plan was eliminated in March 2014.

Deferred Compensation Plan. During 2012, Heritage adopted a Deferred Compensation Plan, which provides our directors and select executive officers with the opportunity to defer current compensation. Under the Deferred Compensation Plan, participants are permitted to elect to defer compensation and Heritage has the discretion to make additional contributions to the plan on behalf of any participant based on a number of factors. The notional account balances of participants under the plan earn interest on an annual basis. The applicable interest rate as initially selected by the Committee will be the Moody's Seasoned Aaa Corporate Bond Yield as of January 1 of each year. Generally, a participant's account is payable upon the earliest of the participant's separation from service with Heritage, the participant's death or disability, or a specified date that is elected by the participant in accordance with applicable rules of the Internal Revenue Code. Heritage's obligation to make payments under the Deferred Compensation Plan is a general obligation of the Company and is to be paid from Heritage's general assets. As such, participants are general unsecured creditors of Heritage with respect to their participation under the plan. The Committee believes that the Deferred Compensation Plan provides Heritage with another tool to attract and retain the best qualified individuals to serve in key roles within the organization.

Messrs. Vance, Deuel, Hinson and Spurling have been granted awards pursuant to which Heritage will make contributions to accounts maintained on their behalf under the Deferred Compensation Plan. The terms of the particular awards to Messrs. Vance, Deuel, Hinson and Spurling are described in more detail following the Nonqualified Deferred Compensation table below.

The Committee approved the following performance goals for the 2013 performance period for Messrs. Vance, Deuel, Hinson and Spurling with respect to deferred compensation contributions that were related to Heritage's performance:

Corporate Goal	Weighting	Threshold	Target	Maximum	Actual Performance
Nonperforming Assets ⁽¹⁾	50%	1.30%	1.10%	0.90%	0.68%
Return on Average Assets (ROAA ⁽²⁾)	50%	0.45%	0.60%	0.75%	0.69%

(1) This metric is the originated nonperforming assets to total originated assets, excluding portions guaranteed by government agencies.

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- (2) The net income was adjusted for expenses related to the branch closure initiative and the Washington Banking merger, which resulted in net income of \$10.6 million. The net income adjustment modified the ROAA from 0.62% to 0.69% adjusted.

Perquisites and Other Benefits

Some of the NEOs receive perquisites in the form of golf club memberships and use of automobiles. These perquisites are considered a priority for these individuals because of their community involvement and business development activities. Our NEOs participate in Heritage's other benefit plans on the same terms as other employees. These plans include medical, dental and vision insurance, life insurance, long-term disability insurance and flexible spending accounts.

Tax and Accounting Considerations

Heritage takes into account tax and accounting implications in the design of its compensation programs. For example, in the selection of long-term incentive instruments, the Compensation Committee reviews the projected expense amounts and expense timing associated with alternative types of awards. In selecting appropriate incentive devices, the Compensation Committee reviews extensive modeling analyses and considers the related tax and accounting issues.

Section 162(m) of the Internal Revenue Code places a limit on the tax deduction for compensation in excess of \$1 million paid to the chief executive officer and three other most highly compensated executive officers of a corporation (other than the chief financial officer) in a taxable year. All of the compensation Heritage paid in 2013 to our NEOs is expected to be deductible under Section 162(m). The Compensation Committee retains the discretion, however, to pay non-deductible compensation if it believes doing so would be in our best interests.

REPORT OF THE COMPENSATION COMMITTEE

The Compensation Committee of the Board of Directors of Heritage Financial Corporation for the year ended December 31, 2013 has submitted the following report for inclusion in this Proxy Statement:

The Compensation Committee has reviewed and approved the Compensation Discussion and Analysis contained in this Proxy Statement with management. Based on the Committee's discussion with management, the Compensation Committee recommended that the Board of Directors approve and include the Compensation Discussion and Analysis in this Proxy Statement.

Respectfully submitted by the 2013

Compensation Committee:

Kimberly T. Ellwanger, Chair of the Committee

Brian S. Charneski, Member

Gary B. Christensen, Member

Jeffrey S. Lyon, Member

Ann Watson, Member

This report shall not be deemed to be incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, and shall not otherwise be deemed filed under such acts.

Table of Contents**EXECUTIVE COMPENSATION****Summary Compensation Table**

The following table shows the aggregate compensation for services rendered to Heritage or its subsidiaries by our NEOs in all capacities paid or accrued for the years ended December 31, 2013, 2012 and 2011.

Name and Principal Position	Year	Salary (\$)	Stock Awards (\$) ⁽¹⁾	Non-Equity Incentive Plan Compensation (\$) ⁽²⁾	Change in Pension Value & Nonqualified Deferred Compensation Earnings (\$) ⁽³⁾	All Other Compensation (\$) ⁽⁴⁾	Total (\$)
Brian L. Vance	2013	412,008	126,697	161,329	-	113,047	813,081
President & Chief Executive Officer of Heritage	2012	359,484	95,647	145,796	220	178,727	779,874
	2011	304,722	100,581	109,175	-	26,254	540,732
Jeffrey J. Deuel	2013	256,008	78,717	75,183	-	58,626	468,534
President & Chief Operating Officer of Heritage Bank	2012	236,157	156,177	75,684	-	31,610	499,628
	2011	215,980	59,064	57,705	-	31,118	363,867
Donald J. Hinson	2013	244,008	75,026	70,621	-	51,829	441,484
Executive Vice President, Chief Financial Officer of Heritage and Heritage Bank	2012	212,646	147,079	63,430	-	19,806	442,961
	2011	179,964	49,502	48,359	-	17,765	295,590
D. Michael Broadhead	2013	200,004	61,503	58,736	-	18,801	339,044
President, Central Valley Bank, a division of Heritage	2012	191,004	47,268	63,682	-	22,441	324,395
	2011	180,255	49,220	48,085	-	21,670	299,230
David A. Spurling	2013	210,132	63,042	60,206	-	16,806	350,186
Executive Vice President, Chief Credit Officer of Heritage Bank	2012	187,482	44,129	59,467	-	16,766	307,844
	2011	168,717	46,409	45,336	-	15,997	276,459

Heritage Bank

- (1) Reflects the aggregate grant date fair value of awards, computed in accordance with FASB ASC Topic 718. For a discussion of valuation assumptions, please see Note 15 to the Consolidated Financial Statements in the Form 10-K for the year ended December 31, 2013.
- (2) Reflects amounts earned under the Management Incentive Plan. The material terms of the Management Incentive Plan for 2013 are described in the Compensation Discussion and Analysis under 2013 Annual Cash Incentive Award Determinations.
- (3) Consists of above market interest on deferred compensation under the Deferred Compensation Plan.
- (4) The following table reflects all other compensation to our NEOs for 2013:

Name	Employer 401(k) Match & ESOP Contributions (\$)	Cell Phone (\$)	Deferred Compensation Plan Contributions (\$)	Club Membership & Health Club Dues (\$)	Automobile Provision (\$)	Perquisites (\$) ^(a)	Total (\$)
Brian L. Vance	15,515	1,997	85,867	5,901	2,776	991	113,047
Jeffrey J. Deuel	15,515	1,772	35,222	1,303	1,823	2,991	58,626
Donald J. Hinson	15,515	1,152	33,571	600	-	991	51,829
D. Michael Broadhead	15,515	424	-	-	2,603	259	18,801
David A. Spurling	15,515	600	-	-	-	691	16,806

(a) Includes employer-paid life insurance premiums, perquisites and a housing allowance for Mr. Deuel of \$2,000.

Table of Contents**Grants of Plan-Based Awards Table**

The following table discloses each plan-based award made to our NEOs during the year ended December 31, 2013.

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards ⁽¹⁾			All Other	Grant Date
		Threshold	Target	Maximum	Stock Awards:	Fair Value
		(\$)	(\$)	(\$)	Number of Shares of Stock or Units ⁽²⁾ (#)	of Stock and Option Awards (\$)
Brian L. Vance	-	-	164,803	247,205	-	-
	6/25/2013	-	-	-	8,891	126,697
Jeffrey J. Deuel	-	-	76,802	115,204	-	-
	6/25/2013	-	-	-	5,524	78,717
Donald J. Hinson	-	-	73,202	109,807	-	-
	6/25/2013	-	-	-	5,265	75,026
D. Michael Broadhead	-	-	60,001	90,002	-	-
	6/25/2013	-	-	-	4,316	61,503
David A. Spurling	-	-	61,502	92,254	-	-
	6/25/2013	-	-	-	4,424	63,042

(1) Reflects the target and maximum award opportunities under the Management Incentive Plan for 2013. The actual awards for 2013 are presented in the Summary Compensation Table. There were no threshold opportunity levels under the Management Incentive Plan for 2013; however, in order for a participant to be eligible to receive any award, corporate performance had to exceed a threshold level and the participant had to achieve a satisfactory individual performance evaluation. The material terms of the Management Incentive Plan for 2013 are described in the Compensation Discussion and Analysis under 2013 Annual Cash Incentive Award Determinations.

(2) Reflects restricted stock awards granted in 2013 based upon 2012 Company performance. The material terms of these awards are described in the Compensation Discussion and Analysis under 2013 Equity Award Determinations.

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Outstanding Equity Awards Table

The following table shows the outstanding option awards and unvested stock awards held by our NEOs as of December 31, 2013.

Name	Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable	Option Awards	Stock Awards
			Number of Securities Underlying Unexercised	