

HERITAGE FINANCIAL CORP /WA/  
Form DEF 14A  
March 23, 2017

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

SCHEDULE 14A INFORMATION  
Proxy Statement Pursuant to Section 14(a) of the  
Securities Exchange Act of 1934  
(Amendment No. )

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 under 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)

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No fee required.

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

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(1) Amount Previously Paid:

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(3) Filing Party:

(4) Date Filed:

March 23, 2017

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 Wednesday, May 3, 2017 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.

We encourage you to attend the meeting in person. Whether or not you plan to attend, please take the time to read the Proxy Statement and vote via the Internet or telephone or by completing and mailing the proxy card (if you received one) 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. We appreciate your confidence and support and look forward to seeing you at the meeting.

Brian S. Charneski      Brian L. Vance  
Chairman of the Board    President and Chief Executive Officer

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Date: Wednesday, May 3, 2017

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 nine 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. An advisory (non-binding) vote on the frequency of future votes to approve the compensation paid to named executive officers.
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, 2017.

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 March 6, 2017 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. For instructions on voting, please refer to the instructions on the Notice of Internet Availability of Proxy Materials you received in the mail. You can request to receive proxy materials by mail or e-mail. Promptly voting your shares via the Internet, by telephone, or by signing, dating, and returning the proxy card, which is solicited by the Board of Directors, will save us the expense and extra work for additional solicitation. The proxy will not be used if you attend and vote at the annual meeting in person. Your vote is very important.

By Order of the Board of Directors,

Kaylene M. Lahn

Senior Vice President and Corporate Secretary

Olympia, Washington

March 23, 2017

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PROXY STATEMENT  
2017 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 (“Board”) is using this Proxy Statement to solicit proxies from our shareholders for use at the annual meeting of shareholders. We first provided access to this Proxy Statement and a form of proxy card on March 23, 2017.

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 mean Heritage Financial Corporation and its consolidated subsidiaries and all references to Heritage Financial Corporation mean Heritage Financial Corporation excluding its subsidiaries, in each case unless otherwise expressly stated or the context requires otherwise.

INFORMATION ABOUT THE ANNUAL MEETING

Time and Place of the Annual Meeting

Our annual meeting will be held as follows:

Date: Wednesday, May 3, 2017

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:

• The election of nine 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.

• An advisory, non-binding, vote on the frequency of future advisory votes on executive compensation.

• 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, 2017.

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 May 3, 2017

Our Proxy Statement, the Notice of Internet Availability of Proxy Materials and our Annual Report to Shareholders are available at [www.hf-wa.com](http://www.hf-wa.com). The following materials are available for review:

• Proxy Statement;

• Notice of Internet Availability of Proxy Materials;

• Proxy Card;

• Annual Report to Shareholders; and

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

We provided access to our proxy materials beginning on March 23, 2017. On that day, we mailed the Notice of Availability of Proxy Materials to our shareholders. The SEC allows us to deliver proxy materials to shareholders over the Internet.



We believe that this offers a convenient way for shareholders to review our information. It also reduces printing expenses and lessens the environmental impact of paper copies.

#### Who is Entitled to Vote?

We have fixed the close of business on March 6, 2017, 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 outstanding 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 March 6, 2017, there were 29,956,344 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 holding an advisory vote on executive compensation every year and FOR ratification of the appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2017. If any other matters are properly presented at the annual meeting for action, the persons named in the form of proxy and acting thereunder will have the discretion to vote on those 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.

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 proposal for the election of directors and the advisory votes on executive compensation 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) Profit Sharing Plan Be Voted?

We maintain a 401(k) profit sharing plan ("401(k) Plan") which owned 321,088 shares or 1.1% of Heritage's common stock as of the record date. Our employees participate in the 401(k) Plan. Each participant may instruct the 401(k) Plan trustee how to vote the shares of Heritage common stock allocated to his or her account under the Plan by





completing a vote authorization form. If a participant properly executes a vote authorization form, the 401(k) Plan trustee will vote the participant's shares in accordance with the participant's instructions. 401(k) Plan 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 401(k) Plan participants by the transfer agent by April 28, 2017.

#### 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.

#### Vote Required to Approve Proposal 1: Election of Directors

On September 28, 2016, the Board of Directors adopted amendments to our Bylaws to provide for the election of directors by the majority of votes cast by shareholders in uncontested elections. The Bylaw amendment provides that in an uncontested election, the number of shares voted "for" a director nominee must exceed the number of shares voted "against" a director nominee, in order for a director nominee to be elected. The following are not considered votes cast: (1) a share whose ballot is marked as withheld; (2) a share otherwise present at the meeting but for which there is an abstention; and (3) a share otherwise present at the meeting as to which a shareholder of record gives no authority or direction. The term of any director, who was a director at the time of the election, but who does not receive a majority of votes cast in an election held under the new majority vote standard will continue to serve as a director until terminated on the earliest to occur of: (1) 90 days after the date election results are determined; (2) the date the Board appoints a new director to fill the position; or (3) the date and time the director's resignation is effective.

The Bylaw amendment provides that an election is considered a "contested election" if there are shareholder nominees for director pursuant to Heritage's advance notice provision and who are not withdrawn by the advance notice deadline set forth in Heritage's Articles of Incorporation. If the Board determines there is a "contested election", the election of directors will be held under a plurality standard. Under the plurality standard, the nominees who receive the highest number of votes for the directorships for which they have been nominated 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 against each nominee, or shareholders may withhold their votes. Votes that are withheld and broker non-votes will have no effect on the outcome of the election. 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) resolution to approve the compensation paid to our named executive officers 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: Advisory Vote on the Frequency of Shareholder Votes on Executive Compensation

The advisory (non-binding) vote regarding the frequency of shareholder votes on executive compensation has three alternatives. Shareholders may vote that shareholder votes on executive compensation be held every year, every two years or every three years, or shareholders may abstain from voting. The alternative receiving the greatest number of votes - every year, every two years or every three years - will be the frequency that shareholders approve. Abstentions and broker non-votes will have no effect on the outcome of the advisory vote because the alternative receiving the

greatest number of votes will be the frequency that shareholders approve. Our Board of Directors unanimously

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recommends that you vote FOR the adoption of an advisory resolution that shareholders should consider an advisory resolution on executive compensation every year.

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, 2017, 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 appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2017.

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 (or if you hold your shares in street name, your broker, bank or other nominee) before the annual meeting that you have revoked your proxy; or
- voting in person at the annual meeting.

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” below (known as “named executive officers”); and
- all current directors and executive officers of Heritage as a group.

On March 6, 2017, there were 29,956,344 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 as 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 the most recent date for which ownership information is available.

| Beneficial Owners of More Than 5%  | Number of Shares<br>Beneficially Owned | Percent of Common<br>Stock Outstanding |
|--|--|--|
| BlackRock Inc. <sup>(1)</sup><br>55 East 52 <sup>nd</sup> Street<br>New York, New York 10055 | 2,101,286                              | 7.0 %                                  |

According to a Schedule 13G filed with the SEC on January 24, 2017 reporting shares owned as of December 31, (1)2016, BlackRock Inc. has sole voting power over 2,009,320 shares and sole dispositive power over 2,101,286 shares.

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

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are currently exercisable or exercisable within 60 days after March 6, 2017 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 March 6, 2017, 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.

| Directors & Officers                                     | Number of Shares<br>Beneficially Owned | Percent of Common<br>Stock Outstanding |
|--|--|--|
| Rhoda L. Altom <sup>(1)</sup>                            | 8,020                                  | *                                      |
| David H. Brown <sup>(2)</sup>                            | 98,068                                 | *                                      |
| Brian S. Charneski <sup>(3)</sup>                        | 41,897                                 | *                                      |
| Gary B. Christensen <sup>(4)</sup>                       | 64,450                                 | *                                      |
| John A. Clees <sup>(5)</sup>                             | 55,592                                 | *                                      |
| Mark D. Crawford   | 12,002                                 | *                                      |
| Kimberly T. Ellwanger <sup>(6)</sup>                     | 18,227                                 | *                                      |
| Deborah J. Gavin   | 9,108                                  | *                                      |
| Jeffrey S. Lyon <sup>(7)</sup>                           | 35,947                                 | *                                      |
| Gragg E. Miller <sup>(8)</sup>                           | 25,715                                 | *                                      |
| Anthony B. Pickering <sup>(9)</sup>                      | 63,147                                 | *                                      |
| Robert T. Severns <sup>(10)</sup>                        | 14,879                                 | *                                      |
| Ann Watson <sup>(11)</sup>                               | 9,014                                  | *                                      |
| Brian L. Vance <sup>(12)</sup>                           | 179,603                                | *                                      |
| Jeffrey J. Deuel <sup>(13)</sup>                         | 33,482                                 | *                                      |
| Donald J. Hinson <sup>(14)</sup>                         | 40,395                                 | *                                      |
| Bryan McDonald <sup>(15)</sup>                           | 28,336                                 | *                                      |
| David A. Spurling <sup>(16)</sup>                        | 36,483                                 | *                                      |
| Directors and Executive Officers as a group (22 persons) | 821,440                                | 2.7%                                   |

\*Less than one percent of shares outstanding

(1) Includes 347 shares held in her son's individual retirement account ("IRA") and 333 shares held in her daughter's IRA.

(2) Held jointly with his spouse.

(3) Includes 25,013 shares held jointly with his spouse, 10,675 shares owned by an entity controlled by Mr. Charneski and 420 shares held in trust.

(4) Includes 36,773 shares held jointly with his spouse and 22,400 shares owned by entities controlled by Mr. Christensen.

(5) Includes 50,621 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 16,806 shares held jointly with her spouse.

(7) Includes 3,235 shares held as custodian for a minor and 2,850 shares held by his daughter.

(8) Includes 18,447 shares held jointly with his spouse, 1,170 shares held solely by his spouse and 4,672 shares in a simplified employee pension plan.

(9) Includes 53,598 shares jointly with his spouse, 4,062 shares held in Mr. Pickering's IRA and 4,062 shares held in Mr. Pickering's spouse's IRA.

(10) Includes 3,485 shares held in an IRA.

(11) Includes 6,365 shares held jointly with her spouse.

(12) Includes 92,363 shares held jointly with his spouse, 28,621 shares held in an IRA, 19,785 vested shares in the 401(k) plan and 24,636 shares of restricted stock, as to which Mr. Vance has voting but not dispositive power.

(13) Includes 12,918 shares of restricted stock, as to which Mr. Deuel has voting but not dispositive power.

- (14) Includes 4,330 shares issuable upon exercise of options and 12,056 shares of restricted stock, as to which Mr. Hinson has voting but not dispositive power.
- (15) Includes 8,022 shares held jointly with his spouse, 9,339 vested shares in the 401(k) plan and 7,022 shares of restricted stock, as to which Mr. McDonald has voting but not dispositive power.
- (16) Includes 4,587 shares issuable upon exercise of options, 15,920 shares held jointly with his spouse, 546 vested shares in the 401(k) plan and 14,720 shares of restricted stock, as to which Mr. Spurling has voting but not dispositive power.

**PROPOSAL 1—ELECTION OF DIRECTORS**

Since our merger with Washington Banking Company ("Washington Banking") effective May 1, 2014, our Board of Directors has consisted of fourteen members who stand for election annually. In an effort to continually provide effective corporate governance, it is the Board's recommendation to reduce the size of the board from fourteen members to nine members. The nine directors below have been nominated to serve a one-year term ending at the 2018 annual meeting, or when their respective successors have been duly elected and qualified.

The table below sets forth information regarding each director of Heritage standing for re-election, 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.

The Board of Directors recommends you vote FOR the election of each of the nominees in the table below.

| Name                  | Age <sup>(1)</sup> | Position(s) Held with Heritage | Director Since | Term to Expire <sup>(2)</sup> |
|-----------------------|--------------------|--------------------------------|----------------|-------------------------------|
| Brian S. Charneski    | 55                 | Chairman                       | 2000           | 2018                          |
| John A. Clees         | 69                 | Director                       | 2005           | 2018                          |
| Kimberly T. Ellwanger | 57                 | Director                       | 2006           | 2018                          |
| Deborah J. Gavin      | 60                 | Director                       | 2013           | * 2018                        |
| Jeffrey S. Lyon       | 64                 | Director                       | 2001           | 2018                          |
| Gragg E. Miller       | 65                 | Director                       | 2009           | * 2018                        |
| Anthony B. Pickering  | 69                 | Director                       | 1996           | * 2018                        |
| Brian L. Vance        | 62                 | Director, President & CEO      | 2002           | 2018                          |
| Ann Watson            | 55                 | Director                       | 2012           | 2018                          |

\*Reflects year appointed to the Washington Banking Board of Directors

(1) As of December 31, 2016.

(2) Assuming re-election.

**Business Experience of Nominees for 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.

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 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. Through his involvement, Mr. Charneski has extensive experience in the consumer products industry from product development, sales and marketing to manufacturing and logistics. Mr. Charneski is a past director of the Washington Center for Performing Arts, The Community Foundation of the South Sound and St. Martin's University. Mr. Charneski is a 1985 graduate of Seattle University with a Bachelor of Arts in Economics. Mr. Charneski serves as 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.





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 nine years with 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 served on Heritage's Board of Directors from 1990 until 2000 and served as a non-voting consultant to Heritage's Board of Directors and Audit Committee from 2000 until June 2005, when he was reappointed to the Board. 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.

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 Boards of the Northwest Chapter of the 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 Director Conferences, NACD programs and the DirectWomen Board Institute, and she recently completed NACD's comprehensive program of study to become an NACD Leadership Fellow. Ms. Ellwanger brings significant legal expertise to the Board, which is complemented by her leadership skills and corporate, government and regulatory expertise.

Deborah J. Gavin was employed by the Boeing Company, an aerospace company, for over 20 years and retired from the position of Vice President of Finance and Controller in 2010. Prior to her employment with Boeing, Ms. Gavin held positions as a management consultant for Deloitte (a public accounting firm), and Special Agent with the U.S. Department of Treasury. She also taught undergraduate and graduate adjunct accounting courses at City University, Seattle, Washington. 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 Master of Business Administration in Finance from Seattle University. Other board experiences include private company boards in Malaysia and China, and nonprofit organizations including the Washington Business Alliance and Snoqualmie Summit Central Ski Patrol. Ms. Gavin's extensive financial background, leadership skills, and depth of public company knowledge provide the Board with valuable expertise.

Jeffrey S. Lyon is the Chairman and Chief Executive Officer of Kidder Mathews, headquartered in Seattle, Washington and the President of Kidder Mathews of California. Mr. Lyon serves as a director for Kidder Mathews Segner Inc. Mr. Lyon is a member of the Real Estate Advisory Board at the Runstad School of Real Estate at the University of Washington and is also on the Tacoma-Pierce County Economic Development Board. Mr. Lyon has over 45 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 has served as the Principal Managing Broker of Coldwell Banker Bain realtors in Bellingham, Washington since the firm's sale to Bain in 2011. Prior to that, he held a principal position with Coldwell Banker since 1978. Mr. Miller graduated from the University of Washington in 1973 with a Bachelor's of Arts degree. He holds the GRI and CRB designations from the National Association of Realtors and was honored with the Lifetime Achievement Award from the Whatcom County Board of Realtors in 2006. He has held numerous board positions with the Washington Association of Realtors as well as the Whatcom County Board of Realtors. Mr. Miller's real estate investment experience includes ownership in Meridian Associates, LLC, Garden Street Associates, LLC and Cornwall Center, Inc. Mr. Miller has extensive involvement in civic and business organizations in Bellingham.

Anthony B. Pickering served as Chairman of the Board of Heritage following the merger between Heritage and Washington Banking from May 1, 2014 until May 1, 2016, and served as the Chairman of the Board of Washington Banking and its subsidiary 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 Regional Public Facilities District. Mr. Pickering's business background gives him experience in financial literacy, human resources management and community relations.

Brian L. Vance is the President and Chief Executive Officer of Heritage and is the Chief Executive Officer of Heritage Bank, positions he has held since 2006 and 2003, respectively. 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 a director of the Pacific Bankers Management Institute and the Community Foundation of South Puget Sound. He also serves on the Western Independent Bankers Advisory Committee. He is the past President of the Washington Financial League and formerly served as a trustee for the South Puget Sound Community College. 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 has served as the Chief Operating Officer of Cascadia Capital LLC, a middle market investment bank headquartered in Seattle, Washington, since November 2015. Ms. Watson previously served as the Chief Financial Officer with Moss Adams LLP, a public accounting firm, from 2013 to October 2015. She has also 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 spent seven years 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 a trustee of the Seattle Foundation and is a member of Social Venture Partners. Among her prior community roles, 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.

#### Summary of Director Nominee Qualifications and Experience

| Name                  | Business Banking Expertise | CPA, MBA or Experience | Financial Expertise | Attorney | Community Presence |
|-----------------------|----------------------------|------------------------|---------------------|----------|--------------------|
| Brian S. Charneski    | ü                          | ü                      | ü                   |          | ü                  |
| John A. Clees         | ü                          | ü                      | ü                   | ü        | ü                  |
| Kimberly T. Ellwanger | ü                          | ü                      | ü                   | ü        | ü                  |
| Deborah J. Gavin      | ü                          | ü                      | ü                   |          | ü                  |
| Jeffrey S. Lyon       | ü                          | ü                      |                     |          | ü                  |
| Gragg E. Miller       | ü                          | ü                      |                     |          | ü                  |
| Anthony B. Pickering  | ü                          | ü                      |                     |          | ü                  |
| Brian L. Vance        | ü                          | ü                      | ü                   |          | ü                  |
| Ann Watson            | ü                          | ü                      | ü                   |          | ü                  |

#### Board Diversity

Although Heritage does not have a formal policy specifically governing diversity, diversity is an integral part of the Company's corporate governance practices. The Nominating and Governance Committee actively considers diversity in recruitment and nominations of directors. The current composition of our Board reflects those efforts and the importance of diversity to the Board with three women and diverse skills represented amongst the nominees.

#### Board Tenure and Independence

The Board has an effective mix of experience and fresh perspective as reflected in the illustrations below. The director nominees have an average tenure of 11 years, which includes director service at Washington Banking. In addition, 89% of the Heritage directors standing for re-election are independent.

#### MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS

##### Board of Directors

The Board conducts its business through meetings of the Board and through its committees. The Board typically meets eight times per year, 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 (“CEO”) and management. During the year ended December 31, 2016, the Board held eight regular 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

The Board has standing Audit and Finance, Governance and Nominating, Compensation, Risk, Strategy and Trust Committees and has adopted written charters for each of these committees. You may obtain a copy of the 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. The charters of the Audit and Finance, Governance and Nominating, and Compensation committees are also available on our website at [www.hf-wa.com](http://www.hf-wa.com).

The following table shows the current membership of the Board committees and the number of meetings held by each committee in 2016.

## Committee Membership

| Name                  | Audit and Finance | Compensation | Governance and Nominating | Risk | Strategy | Trust |
|-----------------------|-------------------|--------------|---------------------------|------|----------|-------|
| Rhoda L. Altom        |                   |              | ü                         | ü    |          |       |
| David H. Brown        |                   |              |                           | ü    |          |       |
| Brian S. Charneski    | ü                 |              | ü                         |      | ü        |       |
| Gary B. Christensen   |                   |              | ü                         |      |          | ü     |
| John A. Clees         | ü                 |              |                           | ü*   | ü        | ü     |
| Mark D. Crawford      | ü                 |              |                           |      |          | ü     |
| Kimberly T. Ellwanger |                   | ü*           | ü                         |      | ü        |       |
| Deborah J. Gavin      | ü*                |              |                           |      | ü        |       |
| Jeffrey S. Lyon       |                   | ü            | ü                         |      |          |       |
| Gragg E. Miller       | ü                 |              |                           |      |          | ü*    |
| Anthony B. Pickering  |                   | ü            | ü*                        |      | ü*       |       |
| Robert T. Severns     |                   | ü            |                           | ü    |          |       |
| Brian L. Vance        |                   |              |                           | ü    | ü        | ü     |
| Ann Watson            |                   | ü            |                           |      |          |       |
| # of Meetings         | 8                 | 6            | 5                         | 4    | 4        | 4     |

\*Committee Chair

## Audit and Finance Committee

The Audit and Finance Committee is composed of independent directors, in accordance with the requirements for companies listed on The NASDAQ Stock Market ("NASDAQ") and applicable SEC rules. Director Gavin has been designated by the Board as the "audit committee financial expert," as defined by the SEC. In addition, directors Charneski and Clees both qualify as financially sophisticated, as defined by NASDAQ. 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.

## Compensation Committee

The Compensation Committee is composed of independent directors, in accordance with the requirements for companies listed on NASDAQ and applicable SEC and Internal Revenue Service rules. The Compensation Committee meets quarterly and on an as-needed basis regarding the personnel, compensation and benefits-related matters of Heritage.

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 is composed of independent directors, in accordance with the requirements for companies listed on NASDAQ. 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. Final approval of director nominees is made by the full Board, based on the recommendations of the Committee. The Committee's role includes oversight of our corporate governance program, including the development and administration of Heritage's corporate governance policies, guidelines and practices.

## Risk Committee

The Risk 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. The Company has established an Enterprise Risk Management model to manage the Company's risks.

### Strategy Committee

The Strategy Committee meets quarterly and on an as-needed basis to serve as a resource to executive management in assessing strategies and action plans designed to meet the Company's strategic objectives.

### Trust Committee

The Trust Committee meets quarterly and is responsible for regulatory compliance within the trust department. As a separate function, the Committee also reviews activities and compliance of the Wealth Management department.

## CORPORATE GOVERNANCE

Heritage is committed to effective corporate governance and acts in a manner that it believes 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](http://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 at a Glance

- |                                |   |
|--------------------------------|---|
| Board Independence             | • 13 of 14 of our directors are independent   |
| Board Performance              | • The Board regularly assesses its performance through self-evaluation  |
| Board Committees               | • Independent directors serve on the Audit and Finance, Governance and Nominating, and Compensation Committees  |
| Leadership Structure           | • The positions of Chairman and Chief Executive Officer are separately held   |
| Risk Oversight                 | • The Board is responsible for key risks and oversees management  |
| Open Communication             | • We encourage open communication among our shareholders, directors and management  |
| Stock Ownership                | • Directors and the named executive officers are required to hold and retain Company stock  |
|                                | • Directors are required to own 3 times the annual cash retainer paid   |
|                                | • The Chief Executive Officer is required to own 3 times his annual base salary and the other named executive officers are required to own 1.5 times their annual base salaries |
| Accountability to Shareholders | • We elect all directors annually   |
|                                | • We actively engage with our largest institutional investors through a shareholder outreach process  |
|                                | • Majority voting with plurality voting only in contested elections   |
| Succession Planning            | • The Board actively monitors our director and management succession planning   |

### 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, retirement age of directors, director education, succession planning and other important governance matters.

### Process for Selecting Directors

The Governance and Nominating Committee Charter requires the Committee to consider in its deliberations for selecting candidates for nomination as a director: 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; diversity; 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 begins by soliciting 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, and the Committee may use the services of a search firm. The Committee then considers the potential pool of director candidates, selects the top candidate based on the candidates' qualifications and the Board's needs, and conducts 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 or a search firm, in the same manner in which the Committee would evaluate its nominees for director.

#### Majority Voting

In a continual effort to hear our shareholder's feedback and to incorporate effective corporate governance practices, during 2016 the Board adopted majority voting with plurality voting retained in a contested election. This means that in an uncontested election, the number of shares voted "for" a director nominee must exceed the number of shares voted "against" a director nominee, in order for a director nominee to be elected.

#### Board Leadership

The Board annually elects the 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 positions of Board Chairman and of President and CEO 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.

#### 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 has determined that 13 of our 14 directors are independent. Directors Altom, Brown, Charneski, Christensen, Clees, Crawford, Ellwanger, Gavin, Lyon, Miller, Pickering, Severns and Watson are all independent. Brian L. Vance, who serves as President and CEO of Heritage Financial Corporation and CEO of Heritage Bank is not independent.

#### 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 (or its committees) reviews operational and regulatory reports provided by management to assess credit risk, interest rate risk, liquidity risk, compliance 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 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 while the Internal Auditor and the Loan Review Manager report directly to the Audit and Finance Committee Chair.

#### Code of Ethics

The Board has adopted a written Code of Ethics Policy that applies to our directors, officers and employees. The Code of Ethics Policy sets expectations for conducting our business with integrity, due skill, care and diligence while avoiding conflicts of interest.



### Shareholder Engagement

The Board believes that accountability to the shareholders is representative of good corporate governance. To that end, we engage with our shareholders on a variety of topics throughout the year to ensure we are addressing their questions and concerns, to seek input and to provide perspective on Company policies and practices. In the fourth quarter of 2016, we entered into our third annual targeted shareholder engagement by reaching out to 15 of our largest institutional investors, which represented approximately 40% of our outstanding shares. The Chairman of the Board and the Compensation Committee Chair participated in some of these conversations. We discussed with these shareholders our corporate governance practices, executive compensation programs, internal audit practices and shareholder rights. The investors with whom we spoke were supportive of Heritage's corporate governance practices. See page 18 for additional information about our engagement with shareholders regarding executive compensation.

### Communication with the Board of Directors

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

### Annual Meeting Attendance

Directors are encouraged, but not required, to attend the annual meeting of shareholders and 12 of 14 directors attended the 2016 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 non-director and non-employee 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 meeting minutes. There were \$19.9 million in loans outstanding to directors and executive officers as of December 31, 2016, all of which were performing in accordance with their terms.

### Corporate Community Engagement

At Heritage, we are fully committed to diversified and meaningful giving within the communities we serve. We actively encourage and empower our employees to volunteer and serve as community leaders. During 2016, Heritage invested over \$1 million in a diverse group of non-profits within our market area and our employees donated a significant number of volunteer hours. We believe that our community engagement focus not only strengthens our communities, but supports our strong culture, drives employee engagement, reinforces our brand and results in greater Company performance.

## DIRECTOR COMPENSATION

The following table shows the compensation paid to Heritage's directors for their service to Heritage for the year ended December 31, 2016, with the exception of Brian L. Vance, who is the President and CEO of Heritage, and whose compensation is included in the section below entitled "Executive Compensation."

| Name                  | Fees Earned or<br>Paid In Cash (\$) | Stock<br>Awards (\$) <sup>(1)</sup> | Total (\$) |
|-----------------------|-------------------------------------|-------------------------------------|------------|
| Rhoda L. Altom        | 34,500                              | 24,995                              | 59,495     |
| David H. Brown        | 32,000                              | 24,995                              | 56,995     |
| Brian S. Charneski    | 52,000                              | 24,995                              | 76,995     |
| Gary B. Christensen   | 34,500                              | 24,995                              | 59,495     |
| John A. Clees         | 46,500                              | 24,995                              | 71,495     |
| Mark D. Crawford      | 35,000                              | 24,995                              | 59,995     |
| Kimberly T. Ellwanger | 47,000                              | 24,995                              | 71,995     |
| Deborah J. Gavin      | 45,000                              | 24,995                              | 69,995     |
| Jeffrey S. Lyon       | 34,500                              | 24,995                              | 59,495     |
| Gragg E. Miller       | 38,000                              | 24,995                              | 62,995     |
| Anthony B. Pickering  | 49,750                              | 24,995                              | 74,745     |
| Robert T. Severns     | 34,000                              | 24,995                              | 58,995     |
| Ann Watson            | 33,500                              | 24,995                              | 58,495     |

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 (1) Topic 718"). For a discussion of valuation assumptions, please see footnotes to the financial statements in Heritage's Annual Report on Form 10-K for the year ended December 31, 2016. Outstanding awards are discussed below under "Equity Compensation."

## 2016 Director Compensation Highlights

Director fees remained unchanged during 2016 and the value of equity compensation increased by approximately \$5,000 per director.

## Cash Compensation

For 2016, each non-employee director was paid an annual cash retainer of \$30,000 plus committee fees for service as a director. The Chairman of the Board also received an additional annual cash retainer of \$24,000 in lieu of committee fees. The Vice Chairman of the Board was paid an annual cash retainer of \$2,500; however, the Vice Chairman position was eliminated effective May 1, 2016. The Chairs of the Audit and Finance and Compensation Committees were each paid an additional annual cash retainer of \$10,000. The Chairs of the Governance and Nominating Committee and Risk Committee were paid an additional annual cash retainer of \$7,500. The Chairs of the Strategy and Trust Committees were paid an additional annual cash retainer of \$3,000. Members and Chairs of all committees received an additional per meeting attendance fee of \$500.

Mr. Vance did not receive any compensation for service as a director or Board committee member.

## Equity Compensation

On June 21, 2016, each non-employee director received an award of 1,421 restricted shares of Heritage common stock, which vest on May 1, 2017. As of December 31, 2016, Directors Altom, Brown, Charneski, Christensen, Clees, Crawford, Ellwanger, Gavin, Lyon, Miller, Pickering, Severns and Watson each had 1,421 shares of restricted stock outstanding.

As of December 31, 2016, the non-employee directors did not have any remaining unexercised nonqualified stock options.

### Stock Ownership Guidelines

Under our stock ownership guidelines for non-employee directors, each director is expected to have equity ownership with a value equal to three times their annual cash retainer. The guidelines require directors to retain not less than 50% of shares received (on a net after tax basis) until the director satisfies the ownership requirements. If the director fails to satisfy the ownership requirement, 25% of their annual cash director fees will instead be paid in Heritage shares. The guidelines provide the directors three years to comply. As of December 31, 2016, all directors were in compliance with the guidelines. Information about ownership guidelines for our named executive officers can be found in the “Compensation Discussion and Analysis” section of this proxy statement.

### PROPOSAL 2—ADVISORY (NON-BINDING) VOTE ON EXECUTIVE COMPENSATION

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), we are required to include in this Proxy Statement and present at the annual meeting of shareholders a non-binding proposal to approve the compensation of our named executive officers, as disclosed in this Proxy Statement pursuant to the compensation disclosure rules of the SEC. This proposal, commonly known as a “say-on-pay” proposal, gives shareholders the opportunity to endorse or not endorse the compensation of Heritage’s executives as disclosed in this Proxy Statement. We currently hold our say-on-pay vote every year. The proposal will be presented at the annual meeting in the form of the following resolution:

RESOLVED, that the shareholders approve the compensation of Heritage Financial Corporation’s named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables and related material in Heritage’s Proxy Statement for the 2017 annual meeting of shareholders.

This vote will not be binding on our Board of Directors or Compensation Committee and may not be construed as overruling a decision by the Board or create or imply any additional fiduciary duty on the Board. The Compensation Committee and the Board will consider the outcome of the vote when determining future executive compensation arrangements.

The purpose of our compensation policies and procedures is to attract and retain experienced, highly qualified executives critical to our long-term success and enhancement of shareholder value. We believe that our compensation policies and procedures are strongly aligned with the long-term interests of our shareholders. As discussed in the Compensation Discussion and Analysis, the Compensation Committee believes that the executive compensation for 2016 is reasonable and appropriate, is justified by Heritage’s performance and is the result of a carefully considered approach.

The Committee regularly reviews our officer compensation strategies, policies and programs in an effort to ensure the program continues to meet these overall objectives. In considering how to vote on this proposal, the Board requests that you consider the following factors:

- Pay for Performance—A significant portion of our named executive officers’ compensation is tied to performance with clearly articulated financial goals.
- Annual Compensation Risk Assessment—A process has been established whereby we regularly analyze risks related to our compensation programs and conduct a broad risk assessment annually.
- Key Performance Metrics—Objective performance metrics are established to determine annual incentive compensation.
- Clawback Policy—Our policy requires recovery of performance-based cash and equity incentive compensation following a financial restatement.
- Performance-based Equity Grants—Awards were determined based on objective performance metrics including a longer term performance metric.

Stock Ownership Policy—Directors and officers are required to own Heritage common stock having a value of at least the following amounts: 3 times annual cash retainer for directors, 3 times annual base salary for the CEO and 1.5 times annual base salary for the remaining named executive officers.

Independent Compensation Consultant—The Compensation Committee retains an independent consultant to obtain advice on executive compensation matters.

Each of the above factors is discussed more fully in the Compensation Discussion and Analysis below.



The Board of Directors recommends that you vote FOR approval of the compensation of our named executive officers as disclosed in this Proxy Statement.

**PROPOSAL 3—ADVISORY (NON-BINDING) VOTE ON FREQUENCY OF VOTE ON EXECUTIVE COMPENSATION**

Under the Dodd-Frank Act, we are required to include in this Proxy Statement and present at the meeting a non-binding shareholder vote to determine the timing of future shareholder votes on executive compensation. We must include such a proposal at least every six years. This proposal gives shareholders the opportunity to vote on whether a resolution to approve the compensation of our named executive officers should be presented to shareholders every one, two or three years, or to abstain from voting.

The Board of Directors believes that a resolution to approve the compensation of our executives should be presented to shareholders every year because the Board is committed to strong corporate governance and an annual cycle provides for the greatest accountability to our shareholders. We have held an annual vote to approve the compensation of our executives since 2011.

This vote will not be binding on our Board of Directors or Compensation Committee and may not be construed as overruling a decision by the Board or create or imply any additional fiduciary duty on the Board. It also will not affect when the shareholders will be asked to vote on executive compensation in future years. The Compensation Committee and the Board will, however, take into account the outcome of the vote when considering when to present shareholders with a resolution to approve executive compensation.

The Board of Directors recommends that you vote for conducting an advisory vote on executive compensation every year.

**COMPENSATION DISCUSSION AND ANALYSIS**

In this section, we discuss our executive compensation philosophy and programs. The “Committee” refers to the Compensation Committee in this Compensation Discussion and Analysis. Following this discussion, we disclose compensation of our named executive officers (“NEOs”) in the Summary Compensation Table and other compensation tables. The following individuals are our NEOs for 2016:

| NEO               | Title   |
|-------------------|---|
| Brian L. Vance    | Chief Executive Officer of Heritage Bank & President & Chief Executive Officer of Heritage Financial Corporation  |
| Jeffrey J. Deuel  | President & Chief Operating Officer of Heritage Bank & Executive Vice President of Heritage Financial Corporation |
| Donald J. Hinson  | Executive Vice President & Chief Financial Officer of Heritage Bank and Heritage Financial Corporation            |
| Bryan D. McDonald | Executive Vice President & Chief Lending Officer of Heritage Bank and Heritage Financial Corporation              |
| David A. Spurling | Executive Vice President & Chief Credit Officer of Heritage Bank and Heritage Financial Corporation               |

**Executive Summary  
Our Business**

Heritage is the parent company of a wholly-owned subsidiary bank, Heritage Bank, headquartered in Olympia, Washington, with a branch network of 63 locations from Portland, Oregon to Bellingham, Washington. Heritage Bank is committed to being the leading community bank in the Pacific Northwest by continuously improving customer satisfaction, employee empowerment, community investment and shareholder value.

**2016 Business Highlights**

Heritage embarked on several key initiatives during 2016, which included a retail optimization, the continued expansion in our Seattle metropolitan market, a focus on exceptional customer service, and the optimization of technology to leverage data and reporting. These key initiatives have required a disciplined management team to integrate multiple initiatives while continually focusing on credit quality and capital and balance sheet management.

In 2016, we continued to focus on the business fundamentals and achieved solid financial and operating results, as demonstrated below:

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| Performance Metric                   | At or For the Year Ended<br>December 31, 2016 | At or For the Year Ended<br>December 31, 2015 | % Change |
|--------------------------------------|---|---|----------|
| Total Assets                         | \$3.88 billion                                | \$3.65 billion                                | 6.3%     |
| Net Income                           | \$38.9 million                                | \$37.5 million                                | 3.7%     |
| Return on Average Assets             | 1.04%   | 1.06%   | (1.9)%   |
| Total Loans, Net                     | \$2.61 billion                                | \$2.37 billion                                | 10.1%    |
| Total Deposits                       | \$3.23 billion                                | \$3.11 billion                                | 3.9%     |
| Return on Average Equity             | 8.01%   | 8.08%   | (0.9)%   |
| Dividends Paid (special and regular) | \$0.72  | \$0.53  | 35.8%    |

#### 2016 Executive Compensation Highlights

During 2016, the Committee acted in accordance with Heritage's compensation philosophy and provided our executives compensation aligned with Heritage's financial performance and each executive's individual performance. Compensation was commensurate with market comparisons and the Committee continued to consider shareholder value and prudent risk management.

**Base Salary:** NEOs received base salary increases ranging from 3.1% to 12.4% to remain market competitive and align them with their peers.

**Annual Incentive Compensation:** Annual cash incentives ranged from \$75,940 to \$202,828, or 15% to 19% of total compensation, based on a cash incentive plan whereby two of the three predetermined performance metrics were achieved at or above target.

#### **Long-term Incentive Compensation:**

Equity incentive awards ranged from \$54,544 to \$130,047, or 11% to 12% of total compensation, based on 2015 performance results, which vest ratably over four years.

Deferred compensation contributions ranged from \$70,626 to \$215,420, or 14% to 20% of total compensation.

Deferred compensation contributions are generally performance-based with a 16.66% fixed portion for the CEO.

For 2017, 50% of the performance-based awards will be granted with a three-year cliff performance vesting and 50% will have a three-year ratable vesting provision.

#### 2016 Say-on-Pay Results and Shareholder Outreach

At the 2016 shareholders' meeting, approximately 90% of the shares present and entitled to vote supported the executive compensation program. Management, 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' affirmation of our compensation philosophy and the manner in which we compensate our executives. We value our shareholders' feedback and, as a result, entered into our third shareholder outreach program during 2016. We requested feedback from 15 of our institutional shareholders to further understand what, if any, concerns they may have with our compensation programs. The feedback we obtained from our shareholders during this outreach was very positive and supported our overall compensation practices. The Committee did not make any substantive changes to the executive compensation programs for 2016.

### Best-Practice Features

Embedded in our overall compensation program are additional features that align the interests of our shareholders with those of our executives.

#### WHAT WE DO

Strong emphasis on variable pay

Adhere to stock ownership guidelines

Enforce clawback provisions

Annually assess incentive compensation risks

Engage independent compensation consultants

Actively reach out to our shareholders

The annual cash incentive plan is not paid if the Tier I

Leverage ratio drops below 8%

#### 2016 Key Performance Metrics

The graphs below capture the key performance metrics used to determine 2016 incentives for our NEOs. The 2015 and 2014 performance metrics are provided to demonstrate trends and were not used in measuring the 2016 performance for the NEOs.

\* Total shareholder return is for a trailing 36-month period. Metric utilized relative to peers for long term incentives.

#### WHAT WE DO NOT DO

No excessive perquisites; all perquisites have a specific business rationale

No stock option repricing, reloads, or exchanges without shareholder approval

No tax gross-ups

No hedging of Heritage common stock

No single trigger for accelerated vesting

Fixed compensation is not heavily weighted

\*\* Non-interest expense divided by average assets.



### Philosophy and Objectives of Our Executive Compensation Program

Heritage's compensation philosophy provides clear guidelines for establishing and managing all elements of compensation. The philosophy is to target total executive compensation at market competitive levels 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:

**Pay Aligned with Performance**—We strive to provide a competitive salary combined with incentive opportunities that reward outstanding individual and Company performance that contributes to creating shareholder value.

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

**Prudent Management of Risk**—We evaluate, design and manage compensation programs to ensure that we are properly and prudently managing any risks created by these 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 Compensation 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 CEO and other NEOs;
- review and approve the corporate goals and objectives for the NEOs annually;
- review and recommend to the full Board for approval the director fees, benefits and equity compensation grants;
- review the results of any shareholder advisory vote regarding executive compensation and consider whether to implement any changes as a result of such advisory vote;
- review and evaluate risks posed to Heritage by the design and implementation of various compensation programs and ensure 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;
- 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 provides it the authority and adequate funding to retain and terminate any third party advisors for the purpose of evaluating the compensation programs for, and performance of, Heritage's directors, CEO and senior executive officers.



### Role of Management in Compensation Committee Deliberations

The Committee frequently requests that Mr. Vance and other members of senior management be present at Committee meetings to discuss executive compensation. Executive officers in attendance may provide their insights and suggestions, but only Committee members may vote on decisions regarding executive compensation. The Committee may discuss 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 input from the independent compensation consultant and/or legal counsel when making decisions regarding the compensation of Mr. Vance and the other NEOs.

### Compensation Consultants and Advisors

We utilize Pearl Meyer & Partners ("Pearl Meyer"), an independent compensation consulting firm. Pearl Meyer was engaged to review our peer group and perform an executive and director compensation review for 2016. In addition, Pearl Meyer provides assistance and advice related to a variety of Committee responsibilities on an as-needed basis, such as review of incentive plans, review of compensation philosophy and strategy, evaluation of compensation-related proposals from management, and ongoing Committee education on compensation topics. Pearl Meyer does not perform any services for the Company other than those directed by the Committee. After the Committee's review of applicable rules for independence, the Committee determined that there are no known conflicts of interest between Pearl Meyer and its affiliates and the Company and its affiliates. Pearl Meyer reports directly to the Committee.

The Committee 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

A peer group benchmarking study was performed by Pearl Meyer during 2016. A peer group was identified based, generally, on the following criteria:

- publicly-traded financial institutions;
- geographic priority given to western United States with a small group outside of the western region which appeared to be a particularly good size and business model fit;
- asset size and operating revenue range of 0.5 to 2.5 times Heritage as of December 31, 2015;
- market capitalization range of 0.33 to 3.0 times Heritage; and
- comparable business model.

The resulting peer group consisted of the following 20 companies:

|                              |                             |                                 |
|------------------------------|-----------------------------|---------------------------------|
| Banner Corporation           | CVB Financial Corp.         | Mercantile Bank Corporation     |
| Bank of Marin Bancorp        | First Interstate BancSystem | Pacific Continental Corporation |
| Cascade Bancorp              | Glacier Bancorp, Inc.       | Pacific Premier Bancorp         |
| CenterState Banks, Inc.      | Guaranty Bancorp            | State Bank Financial Corp.      |
| CoBiz Financial Inc.         | Heritage Commerce Corp      | TriCo Bancshares                |
| Columbia Banking System Inc. | HomeStreet, Inc.            | Westamerica Bancorp             |
| CU Bancorp                   | Lakeland Bancorp, Inc.      |                                 |

### Peer Group Data

The following summary data for the peer group was obtained from SNL Financial's database as of December 31, 2016.

| Percentile                                  | Market Capitalization<br>(\$ in millions) | Total Assets<br>(\$ in thousands) |
|---|---|-----------------------------------|
| 25 <sup>th</sup> Percentile                 | \$631.64                                  | \$3,081,693                       |
| 50 <sup>th</sup> Percentile                 | \$883.87                                  | \$4,371,414                       |
| 75 <sup>th</sup> Percentile                 | \$1,685.88                                | \$6,701,202                       |
| Heritage Financial Corporation              | \$771.34                                  | \$3,875,077                       |
| Heritage Financial Corporation Percent Rank | 41%                                       | 39%                               |



In addition to analyzing the pay practices and performance of our peer group, the 2016 Pearl Meyer executive compensation study was considered by the Committee in making pay decisions for 2016.

### Components of Compensation

The following table lists some of the major components of the compensation program.

| Component                    | Key Characteristics   | Purpose   |
|------------------------------|---|---|
| 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.   |
| Cash Incentives              | Annual incentives, variable compensation component  | Intended to motivate and reward executives for achieving annual goals. The annual incentives are performance-based and reflect the actual performance results compared to established goals.                    |
| Equity-based Compensation    | Long-term incentives, variable compensation component—performance-based award opportunity, typically granted annually. Beginning in 2017, equity will be awarded with 50% performance vesting and 50% time vesting. | Intended to motivate executives to achieve our business objectives by tying incentives to long-term performance. The stock ownership aligns executive and shareholder interests and serves as a retention tool. |
| Deferred Compensation        | Long-term incentives, variable compensation component—performance-based award opportunity, typically granted annually   | Intended to provide a retirement planning mechanism while motivating executives to achieve our business objectives by tying incentives to long-term performance.  |
| Post-employment Compensation | Fixed compensation component  | Intended to provide temporary income following an executive's involuntary termination of employment and to retain senior executives in a competitive marketplace.   |

### Target Pay Mix

Target pay mix represents the relative value of each of the primary compensation components as a percentage of total compensation. We seek to compensate our executives through an appropriate balance of fixed and performance-based pay, as well as short and long-term pay. The graphs below represent the target pay mix for 2016. Our CEO and other NEOs have significant pay at-risk, with 100% of their 2016 equity award and a meaningful portion of deferred compensation opportunity subject to pre-established performance goals (50% of the target deferred compensation contribution for our CEO is performance-based; 100% for the other NEOs). In total, performance-based pay represents 43% of target total compensation for the CEO and other NEOs.

### Base Salary

Salary levels are designed to be competitive within the banking industry and are based on the experience, tenure, performance and responsibility of each executive. We utilize various compensation surveys and peer group comparisons to ensure that executive compensation is not significantly out of line with competitors of a similar size or within our market areas. The 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 NEO's performance and the prior year performance of Heritage and its subsidiaries, as well as the availability of current proxy information for members of our peer group.

### Salary Adjustments Made in 2016

Salary adjustments were made during 2016 to provide for moderate increase as well as move the NEOs' base salaries closer to the median level of similarly-positioned executives within our updated peer group. Messrs. Deuel and Spurling received larger salary increases than the other NEOs due to an effort to align them with the median level of the peer group. The base salaries for 2015 and 2016 were as follows:

| Name              | 2016 Base Salary (\$)<br>(effective July 1, 2016) | 2015 Base Salary (\$)<br>(effective July 1, 2015) | %<br>Increase |
|-------------------|---|---|---------------|
| Brian L. Vance    | 517,100   | 501,624   | 3.1%          |
| Jeffrey J. Deuel  | 332,400   | 295,824   | 12.4%         |
| Donald J. Hinson  | 266,800   | 258,864   | 3.1%          |
| Bryan D. McDonald | 275,600   | 265,248   | 3.9%          |
| David A. Spurling | 265,700   | 246,480   | 7.8%          |

### Annual Cash Incentives

We use annual cash incentives to focus attention on annual 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 rewarded if Heritage achieves or exceeds pre-determined annual performance criteria. The Management Incentive Plan's design incorporates annual incentive awards that are linked to the achievement of pre-defined performance goals with targets and maximum percentages determined by roles and responsibilities. The incentive ranges (as a percentage of salary) are designed to provide market competitive payouts for the achievement of threshold, target and maximum levels of performance. The annual awards are determined by previously approved goals, calculated based on actual financial and individual performance results and then recommended by the CEO 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 a proration of the annual cash incentive payout. Each NEO has a scorecard with performance results. The 2016 Management Incentive Plan provided that no bonus payments will be paid from the plan should the corporate Tier 1 Leverage Ratio drop below 8% at December 31, 2016. The Committee reserves the right, in its sole discretion, to not award any incentive payouts when extraordinary circumstances occur that may negatively impact Heritage.

### 2016 Annual Cash Incentive Award Determinations

The opportunities for 2016 cash incentive awards for our NEOs are as follows:

| Name              | Target Opportunity<br>as % of Base Salary | Maximum Opportunity<br>as % of Base Salary | Actual Annual Cash<br>Incentive Received as<br>% of January 1, 2016<br>Base Salary | Earned Annual<br>Cash Incentive (\$) |
|-------------------|---|--|--|--------------------------------------|
| Brian L. Vance    | 40%                                       | 60%  | 40.4%  | \$202,828                            |
| Jeffrey J. Deuel  | 30%                                       | 45%  | 30.3%  | \$89,711                             |
| Donald J. Hinson  | 30%                                       | 45%  | 30.3%  | \$78,502                             |
| Bryan D. McDonald | 30%                                       | 45%  | 30.3%  | \$80,438                             |
| David A. Spurling | 30%                                       | 45%  | 30.8%  | \$75,940                             |

#### Annual Cash Incentive Performance Goals

For 2016, the Committee approved the following corporate performance goals for our NEOs:

| Corporate Goal                | Weighting          | Threshold | Target | Maximum | Actual 2016<br>Performance |
|-------------------------------|--------------------|-----------|--------|---------|----------------------------|
| Earnings per Share            | 40%                | \$1.13    | \$1.26 | \$1.39  | \$1.30                     |
| Net Charge Offs/Average Loans | 35% <sup>(1)</sup> | 0.25%     | 0.15%  | 0.05%   | 0.14%                      |
| Overhead Ratio                | 25% <sup>(2)</sup> | 2.92%     | 2.81%  | 2.70%   | 2.84%                      |

(1) Mr. Spurling, 40%.

(2) Mr. Spurling, 20%.

#### 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 threshold, target and maximum of base salary dependent on roles and responsibilities, with equity awards linked to the achievement of the pre-defined performance goals. The incentive ranges (as a percentage of salary) are designed to provide market-competitive payouts for the achievement of threshold, 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. The Committee reviews and approves or disapproves the equity-based compensation recommendations from management. Officers are required to receive a satisfactory annual performance evaluation rating to obtain an equity award, and the equity-based compensation awards are ultimately discretionary.

The Heritage Financial Corporation 2014 Omnibus Equity Plan 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.

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

#### 2016 Equity Award Determinations

In February 2016, our NEOs received grants of restricted stock based on 2015 calendar year performance. These restricted stock grants vest ratably over four years from the date of grant. Heritage applied target award opportunities expressed as a percentage of salary, as described in the table below. Each NEO target opportunity is based upon factors such as role and scope of responsibilities. If a NEO did not meet the performance goals under the Management Incentive Plan for the prior year, they may not receive an award, or the award may be reduced. Additionally, the NEO is required to maintain a satisfactory performance rating to receive 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 and development of new officers.

Beginning in 2017, the Committee approved grants of restricted stock units rather than restricted stock. For our NEOs, 50% of the restricted stock unit awards will have three-year ratable service-based vesting and 50% of the award will



have three-year cliff performance-based vesting. The performance metrics are return on average assets and total shareholder return relative to an established bank peer group to provide for a stronger emphasis on performance aligned with our peers' performance. The Committee chose this mix to increase the pay for performance feature while preserving the retention benefit of the awards.

The following table contains the target opportunity for each of our NEOs, as well as their potential and actual 2016 awards, expressed as a percentage of base salary.

| Name              | Target Opportunity as % of Base Salary | Maximum Opportunity as % of Base Salary | 2016 Actual Award as % of January 1, 2016 Base Salary | Equity Awards Granted (\$ Value) |
|-------------------|--|---|---|----------------------------------|
| Brian L. Vance    | 30%                                    | 45.0%                                   | 26%   | \$130,047                        |
| Jeffrey J. Deuel  | 25%                                    | 37.5%                                   | 22%   | \$63,912                         |
| Donald J. Hinson  | 25%                                    | 37.5%                                   | 22%   | \$55,927                         |
| Bryan D. McDonald | 25%                                    | 37.5%                                   | 22%   | \$57,310                         |
| David A. Spurling | 25%                                    | 37.5%                                   | 22%   | \$54,544                         |

To determine the 2016 equity awards, Heritage took into consideration whether our NEOs met their individual performance goals under the Management Incentive Plan for 2015. In March 2015, the Committee approved all such goals for the NEOs, which were related to Heritage's 2015 performance. These goals are set forth in the table below.

| Corporate Goal                  | Weighting | Threshold       | Target          | Maximum         | Actual 2015 Performance |
|---------------------------------|-----------|-----------------|-----------------|-----------------|-------------------------|
| Net Charge Offs/Average Loans   | 35%       | 0.30            | 0.20            | 0.15            | 0.10                    |
| 3-Year Total Shareholder Return | 30%       | 25th percentile | 50th percentile | 75th percentile | 31.2 percentile         |
| Earnings per Share              | 20%       | \$ 1.10         | \$ 1.23         | \$ 1.36         | \$ 1.25                 |
| Overhead Ratio                  | 15%       | 3.00            | 2.90            | 2.80            | 3.01                    |

#### Stock Ownership Guidelines

Heritage maintains stock ownership guidelines for our NEOs. These guidelines were established to promote a long-term perspective in managing Heritage and to align the interests of our shareholders and NEOs. The stock ownership goal for each of these individuals is a multiple of salary as follows—three times base salary for the CEO and one and one half times base salary for the other NEOs. The guidelines require NEOs to retain not less than 50% of shares received (on a net after tax basis) until the NEO satisfies the ownership requirements. If the NEO fails to satisfy the ownership requirement, 25% of their annual cash incentive bonus will be paid in Heritage shares. The guidelines provide the NEOs five years to comply. As of December 31, 2016, all NEOs were in compliance with the stock ownership guidelines. Information about ownership guidelines for our non-employee directors can be found in "Director Compensation" of this proxy statement.

#### Risk Assessment Analysis

Each year, Heritage performs a robust risk assessment of each of the Company's compensation programs. This report is presented to the Committee for review and discussion. If warranted, the Committee will recommend changes to address concerns or considerations raised in this risk review process. Changes may be recommended for the program design or its oversight and administration in order to mitigate unreasonable risk, if any is determined to exist. The Committee has concluded that the Company's compensation arrangements do not encourage employees to take unnecessary and excessive risks. We do not believe that any risks arising from our compensation policies and practices are reasonably likely to have a material adverse effect on Heritage.

#### Clawback Policy

Heritage maintains a clawback policy which provides the Board the authority to recover certain bonus or other incentive compensation paid to any NEO in appropriate circumstances where there has been a restatement of Heritage's financial statements filed with the SEC. While the Committee believes its risk assessment procedures are effective, it is prepared to implement any additional steps that may be deemed necessary to fully comply with the rules required to be issued under the Dodd-Frank Act.

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## Retirement Benefits

401(k) Plan: We maintain the Heritage Financial Corporation 401(k) Plan Profit Sharing Plan and Trust as a retirement plan. The Plan is a defined contribution plan and is designed to provide employees (including our NEOs) with savings opportunities and financial security during retirement. There are two possible Company 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; and

• A profit-sharing contribution that includes a discretionary contribution based on a percentage of an employee's eligible compensation based on Heritage's financial performance and management's recommendation, as may be approved by the Board. For 2016, the Company did not make a discretionary contribution to the Plan.

Deferred Compensation Plan: 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 is 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.

Each of the NEOs 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 the named executive officers are described in more detail following the Nonqualified Deferred Compensation table below.

During 2016, the Committee extended the Deferred Compensation Plan participation agreements for Messrs. Deuel, Hinson, Spurling and McDonald through December 31, 2019.

The Committee approved the following performance goals for the 2015 performance period:

| Corporate Goal                 | Weighting | Threshold | Target | Maximum | Actual 2015 Performance |
|--------------------------------|-----------|-----------|--------|---------|-------------------------|
| Net Charge Offs <sup>(1)</sup> | 50%       | 0.30%     | 0.20%  | 0.15%   | 0.10%                   |
| Earnings per Share             | 50%       | \$1.10    | \$1.23 | \$1.36  | \$1.25                  |

(1) This metric is the ratio of net charge offs to average loans.

The following table reflects the 2016 deferred compensation contributions based on 2015 performance results:

| Name              | Earned Deferred Compensation Incentives (\$) | Earned Deferred Compensation Incentive as Percentage of Total Compensation (%) |
|-------------------|--|--|
| Brian L. Vance    | \$215,420                                    | 19.8%  |
| Jeffrey J. Deuel  | \$84,765                                     | 14.9%  |
| Donald J. Hinson  | \$74,174                                     | 15.3%  |
| Bryan D. McDonald | \$76,004                                     | 13.9%  |
| David A. Spurling | \$70,626                                     | 15.1%  |

The Committee approved the following performance goals for the 2016 performance period:

| Corporate Goal                 | Weighting | Threshold | Target | Maximum | Actual 2016 Performance |
|--------------------------------|-----------|-----------|--------|---------|-------------------------|
| Net Charge Offs <sup>(1)</sup> | 50%       | 0.25%     | 0.15%  | 0.05%   | 0.14%                   |

Earnings per Share 50%      \$1.13      \$1.26      \$1.39      \$1.30

(1) This metric is the ratio of net charge offs to average loans.

In February 2017, the Compensation Committee approved Company contributions to the Deferred Compensation Plan of \$189,916, \$76,644, \$61,518, \$63,547 and \$61,264 on behalf of Messrs. Vance, Deuel, Hinson, McDonald and Spurling, respectively, based on 2016 performance results.

#### Perquisites and Other Benefits

Heritage NEOs participate in all Heritage 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. Messrs. Vance and Deuel additionally receive perquisites in the form of club memberships and Messrs. Vance, Deuel and McDonald receive perquisites for the use of automobiles. These perquisites are considered a priority for these individuals because of their community involvement and business development activities. In addition, each of our NEOs have entered into a split dollar agreement that provides additional life insurance in an amount equal to 100% of their base salary. In connection with the Washington Banking merger, Mr. McDonald is also entitled to certain relocation benefits and other reimbursements as explained in the description of his employment agreement below.

#### 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 Committee reviews the projected expense amounts and expense timing associated with alternative types of awards. In selecting appropriate incentive devices, the Committee reviews extensive financial scenarios and 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 2016 to its NEOs is expected to be deductible under Section 162(m). The Committee retains the discretion, however, to pay non-deductible compensation if it believes doing so would be in Heritage's 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, 2016 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 Compensation Committee's discussion with management, the Committee recommended that the Board of Directors approve and include the Compensation Discussion and Analysis in this Proxy Statement.

Respectfully submitted by:

Kimberly T. Ellwanger, Chair

Jeffrey S. Lyon

Anthony B. Pickering

Robert T. Severns

Ann Watson

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.

## EXECUTIVE COMPENSATION

## Summary Compensation Table

The following table shows the aggregate compensation for services rendered to Heritage or its subsidiaries by our NEOs paid or accrued for the years ended December 31, 2016, 2015 and 2014.

| Name and Principal Position   | Year | Salary (\$) | Bonus (\$) | Stock Awards (\$) <sup>(1)</sup> | Non-Equity Incentive Plan Compensation (\$) <sup>(2)</sup> | Change in Pension Value & Nonqualified Deferred Compensation Earnings (\$) <sup>(3)</sup> | All Other Compensation (\$) |
|---|------|-------------|------------|----------------------------------|--|---|-----------------------------|
| Brian L. Vance<br>President & Chief Executive Officer of Heritage Bank  | 2016 | 509,362     | —          | 130,047                          | 202,828  | 11,321  | 234,230                     |
|   | 2015 | 494,316     | —          | 159,886                          | 229,232  | 3,653   | 181,280                     |
|   | 2014 | 449,508     | —          | 243,479                          | 157,813  | 2,399   | 212,508                     |
| Jeffrey J. Deuel<br>Executive Vice President of Heritage and President & Chief Operating Officer of Heritage Bank | 2016 | 314,112     | —          | 63,912                           | 89,711   | 3,481   | 96,920                      |
|   | 2015 | 291,516     | —          | 78,584                           | 101,390  | 1,018   | 63,135                      |
|   | 2014 | 271,608     | —          | 136,336                          | 70,043   | 257   | 119,613                     |
| Donald J. Hinson<br>Executive Vice President, Chief Financial Officer of Heritage and Heritage Bank               | 2016 | 262,832     | —          | 55,927                           | 78,502   | 3,176   | 83,043                      |
|   | 2015 | 255,084     | —          | 73,472                           | 88,716   | 947   | 52,771                      |
|   | 2014 | 247,656     | —          | 132,966                          | 71,335   | 245   | 109,241                     |
| Bryan D. McDonald <sup>(5)</sup><br>Executive Vice President, Chief Lending Officer of Heritage Bank              | 2016 | 270,424     | 41,667     | <sup>(6)</sup> 57,310            | 80,438   | 1,003   | 94,061                      |
|   | 2015 | 261,374     | 125,000    | <sup>(6)</sup> 47,293            | 90,903   | —   | 33,917                      |
|   | 2014 | 171,667     | 83,333     | <sup>(6)</sup> 50,005            | 56,747   | —   | 24,286                      |
| David A. Spurling<br>Executive Vice President, Chief Credit Officer of Heritage Bank                              | 2016 | 256,090     | —          | 54,544                           | 75,940   | 2,447   | 79,481                      |
|   | 2015 | 237,342     | —          | 50,159                           | 82,670   | 653   | 48,921                      |
|   | 2014 | 221,730     | —          | 174,259                          | 47,306   | 74  | 101,848                     |

Reflects the aggregate grant date fair value of awards, computed in accordance with FASB ASC Topic 718. For a (1) discussion of valuation assumptions, please see Note 20 to the Consolidated Financial Statements in the Form 10-K for the year ended December 31, 2016.

Reflects amounts earned under the Management Incentive Plan. The material terms of the Management Incentive (2) Plan for 2016 are described in the Compensation Discussion and Analysis under “2016 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 2016:

| Name           | Employer 401(k) Match (\$) | Cell Phone Plan (\$) | Deferred Compensation Contributions (\$) | Club Membership (\$) | Automobile Provision (\$) | Housing Allowance (\$) | Executive Life Insurance (\$) | Total (\$) |
|----------------|----------------------------|----------------------|--|----------------------|---------------------------|------------------------|-------------------------------|------------|
| Brian L. Vance | 7,950                      | 1,780                | 215,420                                  | 6,518                | 1,817                     | —                      | 745                           | 234,230    |

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|                   |       |     |        |       |       |       |     |        |
|-------------------|-------|-----|--------|-------|-------|-------|-----|--------|
| Jeffrey J. Deuel  | 7,950 | 495 | 84,765 | 2,208 | 1,123 | —     | 379 | 96,920 |
| Donald J. Hinson  | 7,950 | 660 | 74,174 | —     | —     | —     | 259 | 83,043 |
| Bryan D. McDonald | 7,950 | 303 | 76,004 | —     | 1,666 | 8,000 | 138 | 94,061 |
| David A. Spurling | 7,950 | 485 | 70,626 | —     | —     | —     | 420 | 79,481 |

(5) Mr. McDonald joined Heritage on May 1, 2014 as part of the Washington Banking merger.

(6) Paid pursuant to the Washington Banking merger employment agreement.

## Grants of Plan-Based Awards Table

The following table discloses each plan-based award made to our NEOs during the year ended December 31, 2016.

| Name              | Grant Date     | Estimated Possible Payouts Under Non-Equity Incentive Plan Awards <sup>(1)</sup> |             |              | All Other Stock Awards: Number of Shares of Stock or Units (#) <sup>(2)</sup> | Grant Date Fair Value of Stock and Option Awards (\$) |
|-------------------|----------------|--|-------------|--------------|---|---|
|                   |                | Threshold (\$)   | Target (\$) | Maximum (\$) |   |   |
| Brian L. Vance    | —<br>2/25/2016 | —  | 200,650     | 300,974      | —<br>7,427  | —<br>130,047  |
| Jeffrey J. Deuel  | —<br>2/25/2016 | —  | 88,747      | 133,121      | —<br>3,650  | —<br>63,912   |
| Donald J. Hinson  | —<br>2/25/2016 | —  | 77,659      | 116,489      | —<br>3,194  | —<br>55,927   |
| Bryan D. McDonald | —<br>2/25/2016 | —  | 79,574      | 119,362      | —<br>3,273  | —<br>57,310   |
| David A. Spurling | —<br>2/25/2016 | —  | 73,944      | 110,916      | —<br>3,115  | —<br>54,544   |

Reflects the target and maximum award opportunities under the Management Incentive Plan for 2016. The actual awards for 2016 are presented in the Summary Compensation Table. There were no threshold opportunity levels under the Management Incentive Plan for 2016; 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 2016 are described in the Compensation Discussion and Analysis under “2016 Annual Cash Incentive Award Determinations.”

Reflects restricted stock awards granted in 2016 based upon 2015 Company performance. The material terms of these awards are described in the Compensation Discussion and Analysis under “2016 Equity Award Determinations.”

## Outstanding Equity Awards Table

The following table shows the outstanding option awards and unvested stock awards held by our NEOs as of December 31, 2016.

| Name              | Grant Date | Option Awards   |   |                            |                        | Stock Awards  |   |
|-------------------|------------|---|---|----------------------------|------------------------|---|---|
|                   |            | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price (\$) | Option Expiration Date | Number of Shares or Units of Stock That Have Not Vested (#) | Market Value of Shares or Units of Stock That Have Not Vested (\$) <sup>(1)</sup> |
| Brian L. Vance    | —          | —   | —   | —                          | —                      | 24,636  | <sup>(2)</sup> 634,377  |
| Jeffrey J. Deuel  | —          | —   | —   | —                          | —                      | 12,918  | <sup>(3)</sup> 332,639  |
| Donald J. Hinson  | 5/25/2010  | 4,330   | —   | \$14.77                    | 5/25/2020              | —   | —   |
| Bryan D. McDonald | —          | —   | —   | —                          | —                      | 12,056  | <sup>(4)</sup> 310,442  |
| David A. Spurling | 5/25/2010  | 4,587   | —   | \$14.77                    | 5/25/2020              | 7,022   | <sup>(5)</sup> 180,817  |
|                   | —          | —   | —   | —                          | —                      | 14,720  | <sup>(6)</sup> 379,040  |

Represent grants of restricted shares of Heritage common stock. The market value of these awards is the number of shares that had not vested as of December 31, 2016 multiplied by the December 31, 2016 closing price of Heritage common stock of \$25.75.



Reflects 2,222 shares granted on June 26, 2013, 7,622 shares granted on July 24, 2014, 7,365 shares granted on (2)February 25, 2015 and 7,427 shares granted on February 25, 2016, which each vest ratably over the four years from the date of grant.

Reflects 1,381 shares granted on June 26, 2013, 4,267 shares granted on July 24, 2014, 3,620 shares granted on (3)February 25, 2015 and 3,650 shares granted on February 25, 2016, which each vest ratably over the four years from the date of grant.

Reflects 1,316 shares granted on June 26, 2013, 4,162 shares granted on July 24, 2014, 3,384 shares granted on (4)February 25, 2015 and 3,194 shares granted on February 25, 2016, which each vest ratably over the four years from the date of grant.

Reflects 1,571 shares granted on May 1, 2014, 2,178 shares granted on February 25, 2015 and 3,273 shares granted (5) on February 25, 2016, which each vest ratably over four years from the date of grant.

Reflects 1,106 shares granted on June 26, 2013, 2,324 shares granted on July 24, 2014, 2,310 shares granted on (6)February 25, 2015 and 3,115 shares granted on February 25, 2016, which each vest ratably over the four years from the date of grant; and 5,865 shares granted on January 2, 2014, which vest on December 10, 2017.

## Option Exercises and Stock Vested

The following table shows the value realized upon the exercise of stock options and the vesting of stock awards for the NEOs during the year ended December 31, 2016.

| Name              | Option Awards                             |                                 | Stock Awards                             |                                |
|-------------------|---|---------------------------------|--|--------------------------------|
|                   | Number of Shares Acquired on Exercise (#) | Value Realized on Exercise (\$) | Number of Shares Acquired on Vesting (#) | Value Realized on Vesting (\$) |
| Brian L. Vance    | —   | —                               | 10,211                                   | 179,044                        |
| Jeffrey J. Deuel  | 13,334                                    | 44,536                          | 12,862                                   | 233,590                        |
| Donald J. Hinson  | 1,000                                     | 7,050                           | 12,502                                   | 227,341                        |
| Bryan D. McDonald | 1,262                                     | 7,471                           | 1,513                                    | 26,720                         |
| David A. Spurling | —   | —                               | 3,834                                    | 67,132                         |

## Nonqualified Deferred Compensation

The following table provides information for the NEOs regarding participation in plans that provide for the deferral of compensation on a non-tax qualified basis during the year ended December 31, 2016.

| Name              | Executive Contributions (\$) | Registrant Contributions (\$) <sup>(1)</sup> | Aggregate Earnings (\$) | Aggregate Withdrawals/ Distributions (\$) | Aggregate Balance at December 31, 2016 (\$) <sup>(2)</sup> |
|-------------------|------------------------------|--|-------------------------|---|--|
| Brian L. Vance    | —                            | 215,420                                      | 34,650                  | —   | 892,319  |
| Jeffrey J. Deuel  | —                            | 84,765                                       | 10,653                  | —   | 274,333  |
| Donald J. Hinson  | —                            | 74,174                                       | 9,721                   | —   | 250,351  |
| Bryan D. McDonald | —                            | 76,004                                       | 3,071                   | —   | 79,075   |
| David A. Spurling | —                            | 70,626                                       | 7,488                   | —   | 192,842  |

(1) All amounts were reported as compensation for 2016 in the Summary Compensation Table above.

The following amounts were reported as compensation in the Summary Compensation Table in previous years:

(2) Messrs. Vance, Deuel, Hinson and Spurling had prior year contributions and above market earnings of \$593,967, \$167,141, \$155,356 and \$108,252, respectively.

Heritage adopted a deferred compensation plan in 2012. Heritage has since entered into contribution agreements with Messrs. Vance, Deuel, McDonald, Spurling and Hinson that provided for 2016 contributions to each executive's account based on 2015 performance. The potential contributions were based on a percentage of the respective executive's salary, with a pre-determined minimum, target and maximum level, with the amount of the contributions based on the achievement of performance goals under the Deferred Compensation Plan. The performance metrics used to determine the amount of the contributions are described in the "Deferred Compensation Plan" section of the Compensation Discussion and Analysis under "Retirement Benefits".

Under Mr. Vance's Deferred Compensation Plan participation agreement, Heritage's contributions for 2016 were set at 16.66% of salary for minimum achievement of performance goals, 33.33% for target achievement and 50% for maximum achievement. With respect to Mr. Vance, the 16.66% minimum achievement is a fixed amount to be contributed annually, which may be increased based upon performance that is greater than the minimum performance threshold. The Compensation Committee intends for this minimum 16.66% annual contribution to act as a retirement benefit in addition to the performance-based component. Company contributions on behalf of Mr. Vance were 70% vested as of January 2016 and will vest an additional 10% as of each January 1 thereafter. Mr. Vance's participation agreement provides for Company contributions under the Deferred Compensation Plan for the years 2012 through and including 2019.

Under their respective Deferred Compensation Plan participation agreements, Heritage's contributions on behalf of Messrs. Deuel and Hinson for 2016 were set at 10% of salary for minimum achievement of performance goals, 20% for target achievement and 35% for maximum achievement. Company contributions on behalf of Messrs. Deuel and

Hinson under the Deferred Compensation Plan were 40% vested as of January 1, 2016 and will vest an additional 10% as of each January 1 thereafter. Their participation agreements, as amended in 2016, provide for Company contributions under the Deferred Compensation Plan for the years 2012 through and including 2019.

Under Mr. Spurling's Deferred Compensation Plan participation agreement, Heritage's contributions on his behalf for 2016 were set at 10% of salary for minimum achievement of performance goals, 20% for target achievement and 35% for maximum achievement. Company contributions on behalf of Mr. Spurling under the Deferred Compensation Plan were 40% vested as of January 1, 2016 and will vest an additional 20% as of each January 1 thereafter. His participation agreement, as amended in 2015, provides for Company contributions under the Deferred Compensation Plan for the years 2013 through and including 2019.

Under Mr. McDonald's Deferred Compensation Plan participation agreement, Heritage's contributions on his behalf for 2016 were set at 10% of salary for minimum achievement of performance goals, 20% for target achievement and 35% for maximum achievement. Company contributions on behalf of Mr. McDonald under the Deferred Compensation Plan vest 10% as of January 1, 2016 and 10% as of each January 1 thereafter. His participation agreement, as amended in 2016, provides for Company contributions under the Deferred Compensation Plan for the years 2015 through and including 2019.

Under the Deferred Compensation participation agreements, Heritage's contributions fully vest upon a change in control or the participant's death or disability. In the event of the participant's separation from service other than for cause, the participant forfeits all unvested amounts and if the separation from service is for cause, the participant forfeits all vested and unvested amounts.

Distributions of the vested portion begin on the later to occur of the participant's 65<sup>th</sup> birthday, the participant's separation from service or the participant's death or disability.

Distributions that are made as a result of the participant attaining age 65 (age 67 for Mr. Spurling) or separating from service, other than due to death or disability, are made in monthly installments over 24 or 60 months. If, however, the separation from service occurs within 24 months following a change in control or as a result of the participant's death or disability, the payment would be made in a lump sum in the month following such separation from service, death or disability.

In February 2017, the Compensation Committee approved Company contributions to the Deferred Compensation Plan of \$189,916, \$76,644, \$61,518, \$63,547 and \$61,264 on behalf of Messrs. Vance, Deuel, Hinson, McDonald and Spurling, respectively, based on the achievement of 2016 performance goals under their respective Deferred Compensation Plan participation agreements.

#### Potential Payments Upon Termination or Change in Control

The following table reflects the estimated amount of compensation that would be paid to each NEO in the event of various terminations of employment and in the event of a change in control of Heritage. The values assume a termination date of December 31, 2016. The exact values would need to be calculated upon the actual termination of employment. The calculations do not include compensation and benefits the NEOs would receive that are generally available to our salaried employees.

| Name              | Compensation/<br>Benefits Payable<br>upon Termination          | Termination<br>Without<br>Cause by the<br>Employer or<br>Termination for<br>Good Reason by<br>the Employee<br>(\$) | Qualifying<br>Termination<br>in<br>Connection<br>with a<br>Change in<br>Control<br>(\$) | Termination<br>in the Event<br>of<br>Disability<br>(\$) | Termination<br>in the Event<br>of Death<br>(\$) | Change in<br>Control—No<br>Termination<br>(\$) |
|-------------------|--|--|---|---|---|--|
| Brian L. Vance    | Cash Severance   | 1,427,449  | 2,141,173   | —   | —   | —  |
|                   | Accelerated Vesting of<br>Equity Awards <sup>(1)</sup>         | 634,377  | 634,377   | 634,377   | 634,377   | —  |
|                   | Accelerated Vesting of<br>Deferred Compensation <sup>(2)</sup> | —  | 267,696   | 267,696   | 267,696   | 267,696  |
|                   | Continued Medical and<br>Dental Coverage                       | 27,642   | 27,642  | —   | —   | —  |
|                   | Split Dollar Benefit <sup>(3)</sup>                            | —  | —   | —   | 517,100   | —  |
|                   | MIP <sup>(4)</sup>   | —  | —   | 202,828   | 202,828   | —  |
|                   | Total  | 2,089,468  | 3,070,888   | 1,104,901   | 1,622,001                                       | 267,696  |
| Jeffrey J. Deuel  | Cash Severance   | 419,448  | 838,896   | —   | —   | —  |
|                   | Accelerated Vesting of<br>Equity Awards <sup>(1)</sup>         | 332,639  | 332,639   | 332,639   | 332,639   | —  |
|                   | Accelerated Vesting of<br>Deferred Compensation <sup>(2)</sup> | —  | 164,600   | 164,600   | 164,600   | 164,600  |
|                   | Continued Medical and<br>Dental Coverage                       | 24,763   | 37,145  | —   | —   | —  |
|                   | Split Dollar Benefit <sup>(3)</sup>                            | —  | —   | —   | 332,400   | —  |
|                   | MIP <sup>(4)</sup>   | —  | —   | 89,711  | 89,711  | —  |
|                   | Total  | 776,850  | 1,373,280   | 586,950   | 919,350   | 164,600  |
| Donald J. Hinson  | Cash Severance   | 346,318  | 692,635   | —   | —   | —  |
|                   | Accelerated Vesting of<br>Equity Awards <sup>(1)</sup>         | 310,442  | 310,442   | 310,442   | 310,442   | —  |
|                   | Accelerated Vesting of<br>Deferred Compensation <sup>(2)</sup> | —  | 150,211   | 150,211   | 150,211   | 150,211  |
|                   | Continued Medical and<br>Dental Coverage                       | 23,805   | 35,707  | —   | —   | —  |
|                   | Split Dollar Benefit <sup>(3)</sup>                            | —  | —   | —   | 266,800   | —  |
|                   | MIP <sup>(4)</sup>   | —  | —   | 78,502  | 78,502  | —  |
|                   | Total  | 680,565  | 1,188,995   | 539,155   | 805,955   | 150,211  |
| Bryan D. McDonald | Cash Severance   | 351,629  | 703,259   | —   | —   | —  |
|                   | Accelerated Vesting of<br>Equity Awards <sup>(1)</sup>         | 180,817  | 180,817   | 180,817   | 180,817   | —  |
|                   | Accelerated Vesting of<br>Deferred Compensation <sup>(2)</sup> | —  | 71,168  | 71,168  | 71,168  | 71,168   |
|                   | Continued Medical and<br>Dental Coverage                       | 23,805   | 35,707  | —   | —   | —  |
|                   | Split Dollar Benefit <sup>(3)</sup>                            | —  | —   | —   | 275,600   | —  |
|                   | MIP <sup>(4)</sup>   | —  | —   | 80,438  | 80,438  | —  |
|                   | Total  | 556,251  | 990,951   | 332,423   | 608,023   | 71,168   |

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|                   |  |         |           |         |         |         |
|-------------------|--|---------|-----------|---------|---------|---------|
|                   | Cash Severance   | 334,339 | 668,677   | —       | —       | —       |
|                   | Accelerated Vesting of<br>Equity Awards <sup>(1)</sup>         | 379,040 | 379,040   | 379,040 | 379,040 | —       |
| David A. Spurling | Accelerated Vesting of<br>Deferred Compensation <sup>(2)</sup> | —       | 115,705   | 115,705 | 115,705 | 115,705 |
|                   | Continued Medical and<br>Dental Coverage                       | 17,537  | 26,306    | —       | —       | —       |
|                   | Split Dollar Benefit <sup>(3)</sup>                            | —       | —         | —       | 265,700 | —       |
|                   | MIP <sup>(4)</sup>   | —       | —         | 75,940  | 75,940  | —       |
|                   | Total  | 730,916 | 1,189,728 | 570,685 | 836,385 | 115,705 |

(1) Amounts are based on Heritage's common stock closing price of \$25.75 on December 31, 2016.

(2) The incremental cost or unvested portion of deferred compensation is reflected in this table.

(3) Death benefit to be paid to the beneficiary designated by the NEO under split dollar agreement.

(4) Management Incentive Plan ("MIP") allows for a prorated payment upon death or disability.

#### Employment Agreements and Severance/Change in Control Benefits

The rationale for having employment and severance/change in control agreements in place is to retain the employment of our NEOs, and the talent, skills, experience and expertise that they provide to Heritage. Retention of the current leadership team is a critical goal of the Board as it protects Heritage and the shareholders and provides stability and the type of skilled leadership needed in the current environment. Employment agreements also provide critical protection to Heritage by subjecting the executives to non-competition, non-solicitation and other restrictions following their employment.

**Employment Agreements—Messrs. Vance, Deuel and Hinson:** On September 7, 2012, Heritage entered into employment agreements with Messrs. Vance, Deuel, and Hinson. The agreements have initial terms through June 30, 2015 for Mr. Vance and through June 30, 2014 for Messrs. Deuel and Hinson. The terms of the agreements automatically extend for an additional year beginning on July 1, 2014 for Mr. Vance and July 1, 2013 for Messrs. Deuel and Hinson, and on each July 1 thereafter, unless either party gives at least 90 days' prior notice of non-renewal. The employment agreements provide for annual base salaries which were \$517,100, \$332,400 and \$266,800 as of December 31, 2016 for Messrs. Vance, Deuel and Hinson, respectively. The base salaries are reviewed annually and may be increased at the discretion of the Board. The agreements provide that the executives are eligible to receive performance-based annual incentive bonuses, in accordance with Heritage's annual incentive plan, and also to receive employee benefits on as favorable a basis as other similarly situated and performing senior executives of Heritage. Messrs. Vance and Deuel are each provided an automobile for business use or a car allowance, at Heritage's prerogative.

The agreements for Messrs. Vance, Deuel and Hinson provide for severance benefits in the event the executive's employment is terminated by Heritage other than for cause and other than as a result of the executive's death or disability, or if the employment is terminated by the executive for good reason ("Termination"). For a Termination during the term of the employment agreement that does not occur within six months before or within 24 months after a change in control of Heritage ("Covered Period"), Mr. Vance would be entitled to receive an amount equal to 200% of his base salary plus three-year average annual bonus ("Base Compensation") and Messrs. Deuel and Hinson would each be entitled to receive an amount equal to 100% of their Base Compensation, all payable in monthly installments over a 24-month period. For a Termination that occurs during a Covered Period, Mr. Vance would be entitled to receive a lump sum equal to 300% of his Base Compensation and Messrs. Deuel and Hinson would each be entitled to receive a lump sum equal to 200% of their Base Compensation. The executives and their eligible dependents would also be entitled to continued coverage under the medical and dental plans of Heritage at active employee rates (18 months' coverage for Mr. Vance for any Termination; for Messrs. Deuel and Hinson, 12 months' coverage for a Termination that does not occur during a Covered Period and 18 months' coverage for a Termination during a Covered Period). The employment agreements also provide for accelerated vesting of outstanding equity awards in the event of a Termination.

All severance benefits under the employment agreements for Messrs. Vance, Deuel and Hinson are contingent upon the executive's execution and non-revocation of a general release and waiver of claims against Heritage. The agreements are subject to certain banking regulatory provisions and include a clawback provision should any severance payment require recapture under any applicable statute, law, regulation or regulatory interpretation or guidance. Further, the agreements provide for an automatic reduction of severance payments if the reduction would result in a better net-after-tax result for the respective executive after taking into account the impact of the golden parachute payment restrictions of Section 280G of the Internal Revenue Code.

The employment agreements for all the executives contain restrictive covenants prohibiting the unauthorized disclosure of confidential information of Heritage by the executives during and after their employment with the Heritage, and prohibiting the executives from competing with Heritage and from soliciting its employees or customers during employment and after termination of employment for any reason. The non-solicitation and non-competition provisions apply to Mr. Vance for a period of 24 months following any termination not in connection with a change in control. For Messrs. Deuel and Hinson, the non-competition provisions apply for a period of 12 months following any termination not in connection with a change in control and the non-solicitation provisions apply for a period for 24

months following any termination not in connection with a change in control. The non-competition and non-solicitation provisions apply to Messrs. Vance, Deuel and Hinson for a period of 12 months following any termination in connection with a change in control.



Employment Agreement—Mr. McDonald: Effective as of May 1, 2014, in connection with the Washington Banking merger, Heritage entered into an employment agreement with Mr. McDonald pursuant to which he serves as Executive Vice President and Chief Lending Officer of Heritage Bank. Mr. McDonald's employment agreement has an initial term from May 1, 2014 through June 30, 2016, with the agreement automatically extending for an additional year beginning on July 1, 2015 and on each July 1 thereafter, unless either party gives at least 90 days' prior notice of non-renewal. Mr. McDonald is provided an automobile for business use or a car allowance, at Heritage's prerogative. The employment agreement provides for an annual base salary which was \$275,600 as of December 31, 2016. In connection with the Washington Banking merger, the agreement also provides for a one-time grant of restricted stock, a special bonus and housing allowance to be paid over the two years following the effective time of the merger, reimbursement of relocation expenses following the effective time of the merger, and reimbursement of certain legal fees for negotiation of the employment agreement in connection with the merger. Mr. McDonald's employment agreement contains other benefits and terms and conditions that are substantially similar to the employment agreements with Messrs. Deuel and Hinson that are described above.

Employment Agreement—Mr. Spurling: On January 2, 2014, Heritage entered into an employment agreement with Mr. Spurling pursuant to which he serves as Executive Vice President and Chief Credit Officer of Heritage and Heritage Bank. Mr. Spurling's employment agreement has an initial term from January 1, 2014 through June 30, 2016, with the agreement automatically extending for an additional year beginning on July 1, 2015 and on each July 1 thereafter, unless either party gives at least 90 days' prior notice of non-renewal. The employment agreement provides for an annual base salary which was \$265,700 as of December 31, 2016. Mr. Spurling's employment agreement contains other benefits and terms and conditions that are substantially similar to the employment agreements with Messrs. Deuel and Hinson that are described above.

#### Equity Plans

The Heritage Financial Corporation 2010 Omnibus Equity Plan provides for accelerated vesting of awards upon disability, death or retirement eligibility (at or after age 65 and 10 years of service). The 2010 Omnibus Equity Plan further provides that in the event of a change in control, if Heritage is not the surviving corporation and the acquirer does not assume outstanding awards or provide substitute equivalent awards, or if the award recipient is terminated without cause or if the award recipient terminates his or her own employment for good reason within 24 months following a change in control, then all outstanding awards will become immediately exercisable or vested.

Heritage currently maintains the Heritage Financial Corporation 2014 Omnibus Equity Plan. This Plan provides for accelerated vesting of awards upon disability or death. The 2014 Omnibus Equity Plan contains a "double trigger" vesting provision that provides that in the event of a change in control, if Heritage is not the surviving corporation and the acquirer does not assume outstanding awards or provide substitute equivalent awards, or if the award recipient is terminated without cause or if the award recipient terminates his or her own employment for good reason within 24 months following a change in control, then all outstanding awards will become immediately exercisable or vested.

#### Split Dollar Agreements

Each of our NEOs is a party to a split dollar agreement that provides for the payment of a death benefit to a beneficiary designated by the NEO in an amount equal to 100% of their base salary upon the death of the NEO prior to a separation from service.

#### Management Incentive Plan

In the case of a death or disability, the Management Incentive Plan allows for prorated payments for time worked during the performance period. Once the plan year concludes, the incentive award will be calculated based on established performance goals.

#### Compensation Committee Interlocks and Insider Participation

The members of the Compensation Committee are Directors Ellwanger, Lyon, Pickering, Severns and Watson. No members of this Committee were officers or employees of Heritage or its subsidiaries during the year ended December 31, 2016 or at March 6, 2017, nor were they formerly officers or had any relationships otherwise requiring disclosure.



#### REPORT OF THE AUDIT AND FINANCE COMMITTEE

The following Report of the Audit and Finance Committee of the Board of Directors for the year ended December 31, 2016 shall not be deemed to be soliciting material or 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, except to the extent Heritage specifically incorporates this report therein, and shall not otherwise be deemed filed under these Acts.

Management is responsible for: (1) preparing Heritage's financial statements so that they comply with generally accepted accounting principles and fairly present Heritage's financial condition, results of operations and cash flows; (2) issuing financial reports that comply with the requirements of the SEC; and (3) establishing and maintaining adequate internal control structures and procedures for financial reporting. The Audit and Finance Committee's responsibility is to monitor and oversee these processes. In furtherance of its role, the Audit and Finance Committee undertakes periodic reviews of Heritage's internal controls and areas of potential exposure, such as litigation matters. The Committee meets at least quarterly and reviews the interim financial results and earnings releases prior to their publication.

The Audit and Finance Committee reports as follows with respect to Heritage's audited financial statements for the year ended December 31, 2016:

The Audit and Finance Committee has reviewed and discussed the audited financial statements with management; The Audit and Finance Committee has discussed with the independent registered public accounting firm, Crowe Horwath LLP, the matters required to be discussed by Auditing Standard No. 16, Communications with Audit Committees, as amended, as adopted by the Public Company Accounting Oversight Board;

The Audit and Finance Committee has received the written disclosures and the letter from Crowe Horwath LLP required by applicable requirements of the Public Company Accounting Oversight Board regarding Crowe Horwath LLP's communications with the Audit and Finance Committee concerning its independence, and has discussed the same with Crowe Horwath LLP; and

The Audit and Finance Committee has, based on its review and discussions with management of the 2016 audited financial statements and discussions with the independent registered public accounting firm, recommended to the Board of Directors that Heritage's audited financial statements for the year ended December 31, 2016 be included in its Annual Report on Form 10-K.

The foregoing report is provided by the following directors, who constitute the Audit and Finance Committee for the year ended December 31, 2016:

Respectfully submitted by:

Deborah J. Gavin, Chair

Brian S. Charneski

John A. Clees

Mark D. Crawford

Gragg E. Miller

**PROPOSAL 4—RATIFICATION OF THE APPOINTMENT  
OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**Appointment of Independent Registered Public Accounting Firm**

The Audit and Finance Committee of the Board of Directors has appointed Crowe Horwath LLP as its independent registered public accounting firm for the year ending December 31, 2017. You are asked to ratify the appointment of Crowe Horwath LLP at the annual meeting. Although shareholder ratification of the appointment of Crowe Horwath LLP is not required by our Bylaws or otherwise, our Board of Directors is submitting this appointment to shareholders for their ratification at the annual meeting as a matter of good corporate practice. If the appointment of Crowe Horwath LLP is not ratified by our shareholders, the Audit and Finance Committee may appoint another independent registered public accounting firm or may decide to maintain its appointment of Crowe Horwath LLP. Even if the appointment of Crowe Horwath LLP is ratified by the shareholders at the annual meeting, the Audit and Finance Committee, in its discretion, may select a different independent registered public accounting firm at any time during the year. Crowe Horwath LLP served as Heritage's independent registered public accounting firm since 2012.

The Audit and Finance Committee operates under a written charter adopted by the Board of Directors. In fulfilling its oversight responsibility of reviewing the services performed by Heritage's independent registered public accounting firm, the Committee carefully reviews the policies and procedures for the engagement of the independent registered public accounting firm. The Audit and Finance Committee discussed with Crowe Horwath LLP the overall scope and plans for the audit, and the results of the audit for the year ended December 31, 2016. Heritage also reviewed and discussed its fees with Crowe Horwath LLP, as described below, and determined the fees billed for services were compatible with Crowe Horwath LLP maintaining its independence.

A representative of Crowe Horwath LLP is expected to attend the annual meeting of shareholders to respond to appropriate questions and will have an opportunity to make a statement if he or she so desires.

The Board of Directors unanimously recommends that you vote FOR the ratification of the appointment of Crowe Horwath LLP as the independent registered public accounting firm for Heritage for the year ending December 31, 2017.

**Audit Fees**

The following table sets forth the aggregate fees billed or expected to be billed to Heritage by its principal accountant for or during the years indicated. Crowe Horwath LLP audited Heritage's consolidated financial statements for the years ended December 31, 2016 and 2015.

|                                   | Year Ended<br>December 31, |           |
|-----------------------------------|----------------------------|-----------|
|                                   | 2016                       | 2015      |
| Audit Fees <sup>(1)</sup>         | \$512,000                  | \$494,000 |
| Audit-Related Fees <sup>(2)</sup> | 30,000                     | 28,000    |
| Tax Fees                          | —                          | —         |
| All Other Fees <sup>(3)</sup>     | 318,000                    | 27,000    |
| Total                             | \$860,000                  | \$549,000 |

Audit fees consist of fees paid for the audit of Heritage's consolidated financial statements included in Form 10-Ks, the audit of the Heritage's internal control over financial reporting and the reviews of the interim condensed

(1) consolidated financial statements included in Form 10-Qs, including services normally provided by an accountant in connection with statutory and regulatory filings or engagements, and the review of registration statements filed with the SEC and the issuance of consents.

(2) Audit-related fees consist of fees for the audit of the employee benefit plan sponsored by Heritage.

(3) All other fees consist of fees for regulatory compliance consulting services and the review of the trust department of Heritage Bank.

#### Pre-approval Policy

It is the policy of the Audit and Finance Committee to pre-approve all audit and permissible non-audit services to be provided by the independent registered public accounting firm and the estimated fees for these services. Pre-approval is typically granted by the full Audit and Finance Committee. In considering non-audit services, the Audit and Finance Committee will consider various factors, including but not limited to, whether it would be beneficial to have the service provided by the independent registered public accounting firm and whether the service could compromise the independence of the independent registered public accounting firm. For the year ended December 31, 2016, the Audit and Finance Committee approved all, or 100%, of the services provided by Crowe Horwath LLP that were designated as audit fees, audit-related fees and all other fees as set forth in the table above.

#### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act requires our directors and executive officers, and persons who own more than 10% of Heritage's common stock to report their initial ownership of the common stock and any subsequent changes in that ownership to the SEC. Specific due dates for these reports have been established by the SEC and we are required to disclose in this Proxy Statement any late filings or failures to file. Based solely on our review of the copies of such forms we have received and written representations provided to us by the above-referenced persons, we believe that, during the year ended December 31, 2016, all filing requirements applicable to our reporting officers, directors and greater than 10% shareholders were properly and timely complied with, except for a Form 4 covering one transaction filed late by Ms. Gavin as well as Form 4's filed late by Messrs. Vance, Deuel, Hinson, McDonald and Spurling and Ms. Huntley for shares withheld to cover taxes incurred in connection with the March 10, 2016 vesting of restricted stock awards.

#### SHAREHOLDER PROPOSALS

In order to be eligible for inclusion in the proxy materials for next year's annual meeting of shareholders, any shareholder proposal to take action at such meeting must be received at the executive office at 201 Fifth Avenue S.W., Olympia, Washington 98501, no later than November 23, 2017. Any such proposals shall be subject to the requirements of the proxy rules adopted under the Securities Exchange Act, and as with any shareholder proposal (regardless of whether included in our proxy materials), our Articles of Incorporation and Bylaws.

Our Articles of Incorporation generally provide that shareholders will have the opportunity to nominate Heritage directors if the nominations are made in writing and delivered to our Chairman not less than 14 days nor more than 50 days before such annual meeting of shareholders; provided, however, if less than 21 days' notice of the meeting is given, the shareholder's notice shall be delivered to the Chairman no later than the close of the seventh day following the date on which notice of the meeting was mailed to shareholders. As specified in the Articles of Incorporation, the notice with respect to nominations for election of directors must set forth certain information regarding each nominee for election as a director, including the name and address of each proposed nominee, the principal occupation of each proposed nominee, the total number of shares of Heritage common stock that will be voted for each shareholder proposed nominee, the name and address of the nominating shareholder, and the number of shares of Heritage common stock owned by the nominating shareholder. Heritage's Governance and Nominating Committee, in its discretion, may disregard any nominations that do not comply with the above-listed requirements. Upon the Governance and Nominating Committee's instructions, the vote teller may disregard all votes cast for a nominee if the nomination does not comply with the above-listed requirements.

#### MISCELLANEOUS

The Board of Directors is not aware of any business to come before the annual meeting other than the matters described in this Proxy Statement. However, if any other matters should properly come before the meeting, it is intended that proxies in the accompanying form will be voted in respect thereof in accordance with the judgment of the person or persons voting the proxies.

We will pay the cost of soliciting proxies. In addition to furnishing the proxy materials to our shareholders, our directors, officers and employees may also solicit proxies personally, electronically or by telephone without additional compensation. In addition, we have engaged Advantage Proxy to assist in distributing proxy materials and contacting record and beneficial owners of our common stock. We have agreed to pay a fee of \$3,000, including out-of-pocket expenses, for these services. We will also reimburse brokers and other nominees for their expenses in sending these

materials to you and obtaining your voting instructions.

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Our annual report for the year ended December 31, 2016 (including consolidated financial statements) has been furnished along with this Proxy Statement to all shareholders of record as of March 6, 2017. The annual report is not to be treated as part of the proxy solicitation material or having been incorporated by reference in this Proxy Statement. A copy of Heritage's Form 10-K that was filed with the SEC on March 9, 2017 will be provided to you without charge if you were a shareholder of Heritage as of March 6, 2017. Please make your written request to:

Heritage Financial Corporation

Attention: Kaylene M. Lahn

Corporate Secretary

201 Fifth Avenue S.W.

Olympia, Washington 98501

IMPORTANT ANNUAL MEETING INFORMATION

Electronic Voting Instructions

Available 24 hours a day, 7 days a week!

Instead of mailing your proxy, you may choose one of the voting

methods outlined below to vote your proxy.

VALIDATION DETAILS ARE LOCATED BELOW IN THE TITLE BAR.

Proxies submitted by the Internet or telephone must be received by 1:00 a.m., Pacific time, on May 3, 2017.

Vote by Internet

- Go to [www.envisionreports.com/HFWA](http://www.envisionreports.com/HFWA)
- Or scan the QR code with your smartphone
- Follow the steps outlined on the secure website

Vote by telephone

- Call toll free 1-800-652-VOTE (8683) within the USA, US territories & Canada on a touch tone telephone
- Follow the instructions provided by the recorded message

Using a black ink pen, mark your votes with an X as shown in this example. Please do not write outside the designated areas.

x

IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

Proposals — The Board of Directors recommends a vote FOR all the nominees listed and FOR Proposals 2 and 4, and for ONE YEAR for Proposal 3.

1.



Election as directors of the nominees listed below for a one-year term.

|                           | For  | Against | Abstain |
|---------------------------|------|---------|---------|
| 01 - Brian Charneski      | S. o | o       | o       |
| 02 - John Clees           | A. o | o       | o       |
| 03 - Kimberly Ellwanger   | T. o | o       | o       |
| 04 - Deborah Gavin        | J. o | o       | o       |
| 05 - Jeffrey Lyon         | S. o | o       | o       |
| 06 - Gragg Miller         | E. o | o       | o       |
| 07 - Anthony B. Pickering | o    | o       | o       |
| 08 - Brian Vance          | L. o | o       | o       |
| 09 - Ann Watson           | o    | o       | o       |

|   | For  | Against | Abstain |   | 1 Yr.   | 2 Yrs. | 3 Yrs. | Abstain |
|---|--|---------|---------|---|---|--------|--------|---------|
| 2 | Advisory (non-binding) approval of the compensation paid to named executive officers as disclosed in the Proxy Statement.                                      |         |         | 3 | Advisory (non-binding) vote on how often shareholders shall vote on executive compensation. |        |        |         |
| 4 | o  | o       | o       |   | o   | o      | o      | o       |
|   | Ratification of the appointment of Crowe Horwath LLP as Heritage's independent registered public accounting firm for the fiscal year ending December 31, 2017. |         |         |   |   |        |        |         |

In their discretion, upon such other matters as may properly come before the meeting.

B Non-Voting Items

Change  
of  
Address

— Please  
print your  
new  
address  
below.  
Comments — Please print your comments  
below.

Meeting Attendance

Mark the box to the right if you plan to attend the annual meeting.

o

C Authorized Signatures — This section must be completed for your vote to be counted. — Date and Sign Below  
Please sign exactly as your name appears on the enclosed card. When signing as attorney, executor,  
administrator, trustee or guardian, please give your full title. If shares are held jointly, each holder should sign.

Date  
(mm/dd/yyyy)

— Please  
print Signature 1 — Please keep signature within the box. Signature 2 — Please keep signature within the box.

date  
below.

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02ATTA

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IF YOU HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

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Revocable Proxy — Heritage Financial Corporation

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Annual Meeting of Shareholders — May 3, 2017

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS**

The undersigned hereby appoints Anthony B. Pickering and Brian S. Charneski, and each of them, with full powers of substitution to act as attorneys and proxies for the undersigned, to vote all shares of common stock of Heritage Financial Corporation (the “Company” or “Heritage”) which the undersigned is entitled to vote at the annual meeting of shareholders, to be held at the DoubleTree by Hilton, 415 Capitol Way N., Olympia, Washington, on Wednesday, May 3, 2017, at 10:30 a.m., Pacific time, and at any and all adjournments thereof, as stated on the reverse side.

This proxy also provides voting instructions to the trustees of the Heritage Financial Corporation 401(k) Profit Sharing Plan and Trust for participants with shares allocated to their accounts.

This proxy will be voted as directed, but if no instructions are specified, this proxy will be voted FOR the election of the nominees listed in Proposal 1 and FOR Proposals 2 and 4, and for ONE YEAR for Proposal 3. If any other business is presented at such meeting, this proxy will be voted by the proxies named above in their best judgment. At the present time, the Board of Directors knows of no other business to be presented at the annual meeting. This proxy also confers discretionary authority on the proxies named above to vote with respect to the election of any person as director where the nominees are unable to serve or for good cause will not serve and matters incident to the conduct of the annual meeting.

Should the undersigned be present and elect to vote at the annual meeting or at any adjournment thereof and after notification to the Secretary of the Company at the annual meeting of the shareholder’s decision to terminate this proxy, then the power of said attorneys and proxies shall be deemed terminated and of no further force and effect.

The undersigned acknowledges receipt from the Company prior to the execution of this proxy of the Notice of Annual Meeting of Shareholders, a Proxy Statement dated March 23, 2017, and the 2016 Annual Report to Shareholders. PLEASE COMPLETE, DATE, SIGN AND MAIL THIS PROXY PROMPTLY IN THE ENCLOSED POSTAGE-PREPAID ENVELOPE.

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