



**HERITAGE
FINANCIAL
CORPORATION**

7505515

CONTINUOUSLY IMPROVING

BALANCE



Filings Services

MAR 19 2008

SNL Financial, LC
1-800-969-4121

2007 ANNUAL REPORT

BALANCE

Creating a balanced company requires the integration of all its people and strategies. This results in a stable foundation that is rock solid.

Heritage Financial Corporation, a bank holding company with headquarters in Olympia, Washington, operates two independent community banks, Heritage Bank and Central Valley Bank.



www.HF-WA.com

Celebrating our 10th year with NASDAQ

Heritage Financial Corporation celebrated 10 years as a publicly traded company on the NASDAQ Exchange. This important milestone in our history was recognized with an invitation to ring the opening bell in New York City on January 8, 2008. President and Chief Executive Officer, Brian Vance officially opened market trading for the day. He was joined by Ed Cameron, SVP, Corporate Secretary and Don Hinson, SVP, Chief Financial Officer.

Looking back on the past 10 years, our progress is clear. Heritage Financial has tripled in assets, increased the loan portfolio four-fold and has 20 branches serving customers in both Western and Central Washington State.

Dear Fellow Shareholders:

As you have noticed, the theme we have chosen for our annual report to you this year is *balance*. We have always held to the belief that a community bank should stay focused on being balanced in all areas but especially growth, asset mix and risk.

As we managed through the year, we could see certain market risks developing and consequently began to strategically limit growth in certain markets such as residential construction. In doing so, we believe we have continued to build a solid and balanced company by focusing on fundamental community banking concepts such as meeting the needs of our customers and shareholders to the best of our ability without compromising asset quality.

We are pleased with the balance we have achieved and for our overall results for 2007.

Here are some of the highlights:

- Increased total loans \$29 million while decreasing the ratio of non-performing assets to total assets to a low 0.13% at December 31, 2007 from 0.36% at December 31, 2006.
- Limited and reduced our single-family residential construction loans to 10.6% of total loans as compared to 11.4% as of December 31, 2006.
- Net income for 2007 increased to \$10.7 million from \$10.5 million in 2006.
- Non-interest income for 2007 increased 8% from the prior year.
- Diluted earnings per share for the fourth quarter of 2007 increased 11% from the prior year fourth quarter.

We are also pleased to report, consistent with our overall asset quality objectives, we have no exposure to the sub prime mortgage issues that negatively impact many financial institutions today.

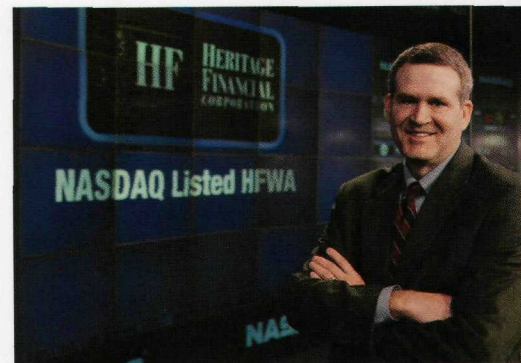
The reasons for our successes are many, but none more important than our employees. We have assembled the best community banking team in our region and their efforts have built the solid foundation that we stand on today and that will serve us well as we focus on continuously improving.

Sincerely,



Brian L. Vance

President and Chief Executive Officer



BOTH PHOTOS: © 2008, The Nasdaq Stock Market, Inc. Reprinted with permission.

Top: pictured from left to right: Ed Cameron, Brian Vance and Don Hinson

Bottom: Brian Vance, President and Chief Executive Officer

strength and stability



Brian L. Vance, President and CEO

In 2007, Heritage Bank celebrated 80 years of strength and stability.

The Bank has been creating financial solutions for our Puget Sound neighbors since 1927. We are known as the "quality bank" because we combine a heritage of excellence in relationship banking with 21st century technology, products and services.

We have a tradition of supporting commercial banking activities that strengthen the core of our community and help improve the vitality of small businesses in the Pacific Northwest. We partner with our customers to help them succeed. Many of our customers took advantage of our new products, including Business Deposit Manager,[™] which helps streamline the check-deposit process and improves cash flow and another new addition, our business invoice printing service, which saves them time and money.

We balance risk and growth opportunities by financing a diverse array of companies in our market area. Additionally in 2007, we added a seasoned lender focused on the agriculture and aquaculture business opportunities in Western Washington.

We were recently honored with two awards for our 2007 Small Business Administration (SBA) initiatives from the Evergreen Community Development Association: Top Northwest Community Lending Institution and Top Washington Community Lending Institution.

As always, Heritage Bank strives to build successful relationships by exceeding customer expectations.

All banks are not alike. Heritage Bank's friendly and attentive staff work together as a team to provide customers with unparalleled service. Heritage is an independent community bank serving Washington State's dynamic South Puget Sound region with 14 offices in Thurston, Pierce, Mason and South King counties. The Bank offers a complete array of financial tools for both personal and business needs.

 **HERITAGE BANK**
the quality bank



solid accomplishments

In 2007, Central Valley Bank increased net income, assets, loans and deposits. This is the fourth year in a row that the Bank has outperformed the previous year.

- Net Income increased by 6%
- Assets increased by 6%
- Loans increased by 9%
- Deposits increased by 9%

Our guiding principal is to build long-term relationships with our customers. That means we understand who and what we're financing.

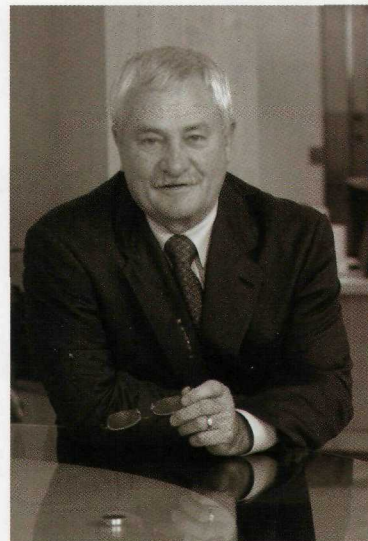
2007 was a great year for Eastern Washington's agriculture region. Commodity prices were above 2006 levels and they are projected to continue this upward trend in 2008. In addition, the Yakima job market is projected to grow in the coming year.

Credit quality is carefully managed and the bank has no exposure to sub prime mortgage problems. The loan portfolio is balanced with construction loans representing just 7% of the total and those loans are all with small contractors with 1-2 unit developments.

Central Valley Bank is dedicated to the long-term success of our customers, employees and the communities we serve. We provide high quality products and services focused on developing long-term relationships.



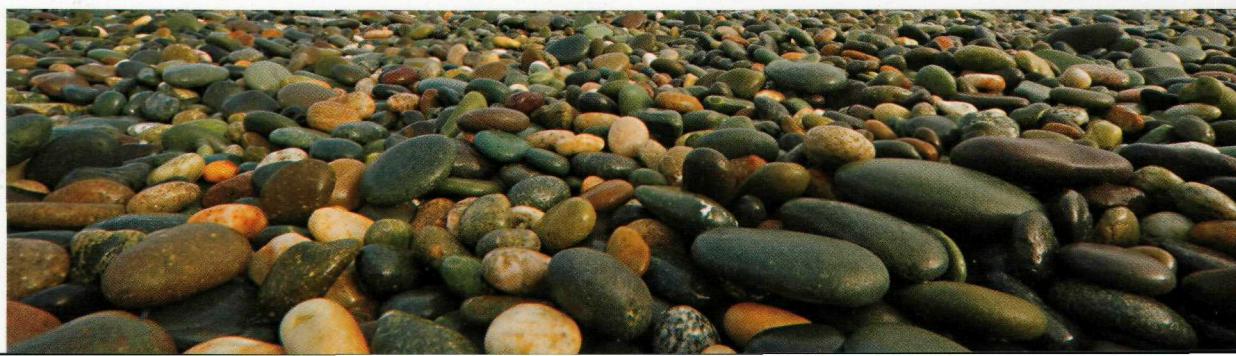
"Large enough to serve, Small enough to care."™

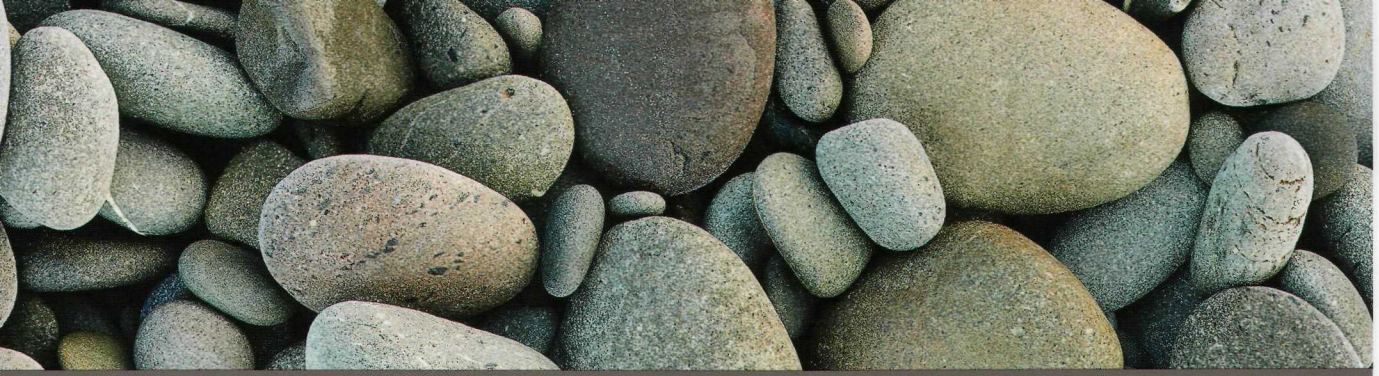


D. Michael Broadhead, President

Established in 1962, Central Valley Bank is a premier community bank serving Washington State's beautiful and vibrant central region.

With six offices in Yakima and Kittitas counties, Central Valley Bank offers a full range of services including checking and savings accounts, home loans, personal loans and business loans.





Our Vision

“We are an Innovative Team
Providing Financial Services
Where Your Success is our Vision”

Balance means having the right people in the right places doing the right things.

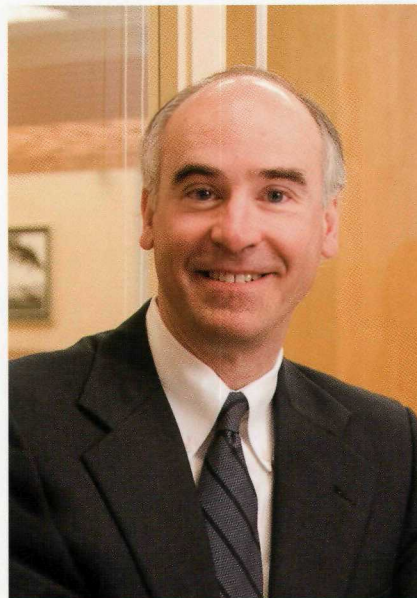
We have established the strongest team of community bankers in our region. Each individual plays a critical role and the synergy created by the team effort is greater than the sum of its parts.

The team members you see pictured here are our 2007 award winners, selected by their peers for their great attitudes, exceptional customer service and dedication to helping others.



Information Technology (IT) Team:

Chuck Fiene, Ann Naccarato, Gene Simms and Heidi Geathers, VP IT Manager



Donald V. Rhodes
Leadership in
Community Banking
Award Recipient:

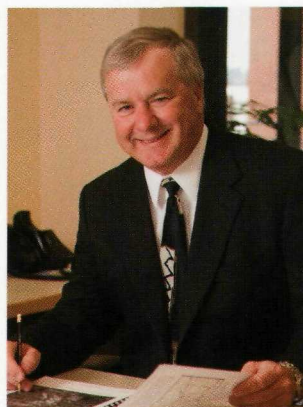
**Blake Lindskog,
SVP Business Banking**

**Blake received this award
for his leadership and
community service. He is
very active in numerous civic
and philanthropic activities
that strengthen the core of
our community.**



Olympia Branch Team:

Back Row: Brandy Deutsch, Chelsea Campbell,
Ashley Martin, Scott Michie
Front Row: Karissa Thompson, Assistant Manager;
Renee Oram, Georgia Lanza, VP Branch Manager



Clockwise from right:

Jim Godfrey, SVP Credit Administrator
Lupe Leach, Union Gap Branch Manager
Jenny VanLaanen, Tumwater Assistant Manager
Mary Kirby, Operations Specialist





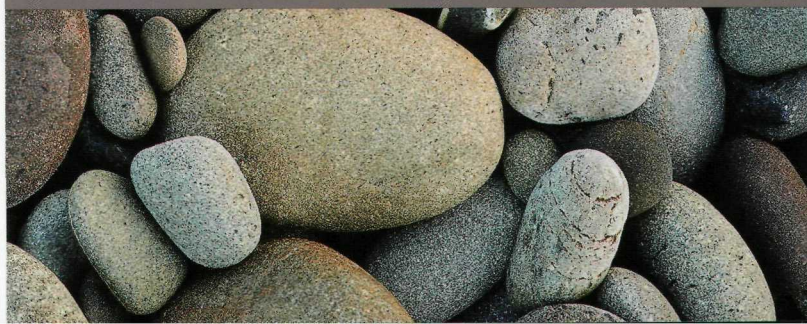
**Top: Debbie Vomacka, VP Project Manager
and Melissa Olivas, Shelton Financial
Services Associate**

**Bottom: Helena Pratt, Senior Mortgage
Processor/Underwriter**

Our Mission

**We are Committed to
Continuously Improving:**

- **Customer Satisfaction**
- **Employee Empowerment**
- **Shareholder Value**



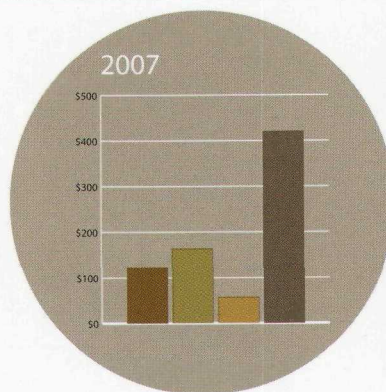
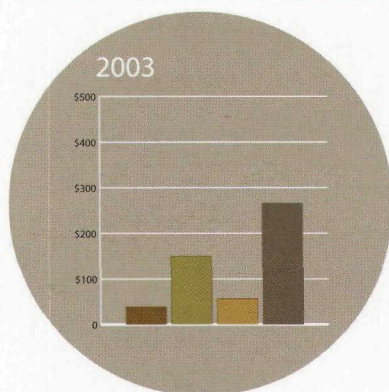
a balanced portfolio

By continuously improving the diversity of our deposit and loan portfolios, we maintain stability even in uncertain economic conditions. Remaining focused on the fundamentals of community banking, we have created a solid company with strong asset quality and steady income growth.

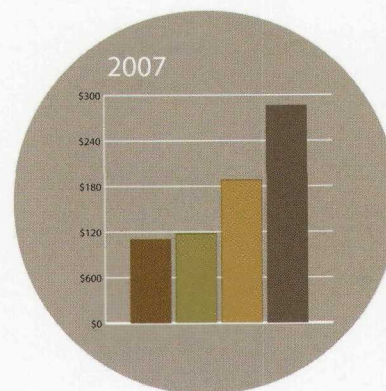
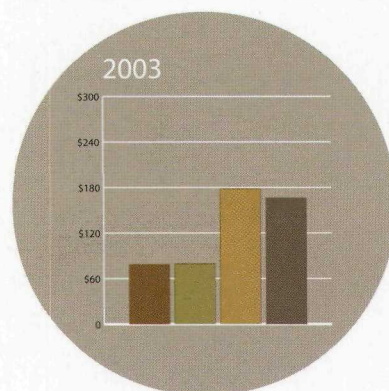


A balanced portfolio means not having all your assets in one basket.

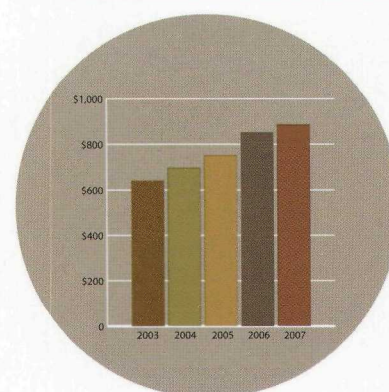
LOANS in millions



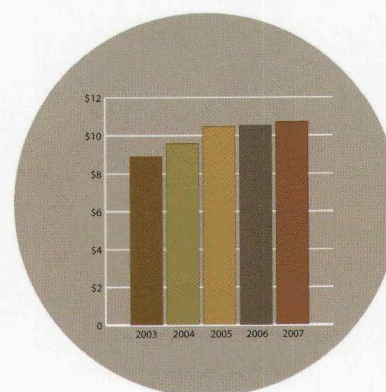
DEPOSITS in millions



TOTAL ASSETS in millions



NET INCOME in millions

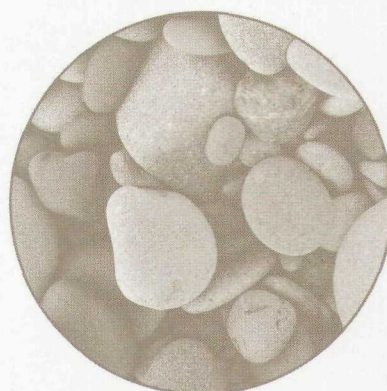
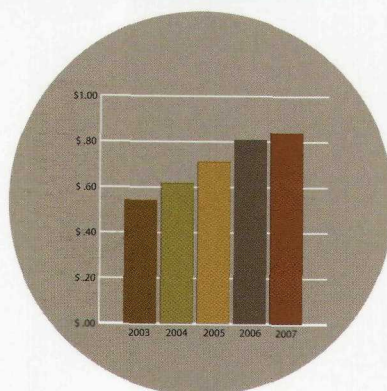


rock solid

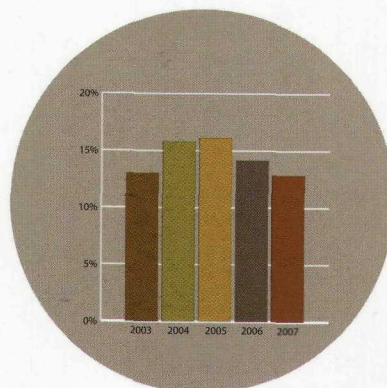
In 2007 we made a conscious effort to better position our balance sheet for a more difficult economic climate we foresee in 2008.

Continuing to diligently manage credit quality remains our primary focus.

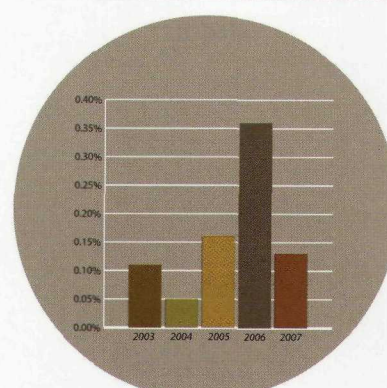
DIVIDEND PAYOUT PER SHARE



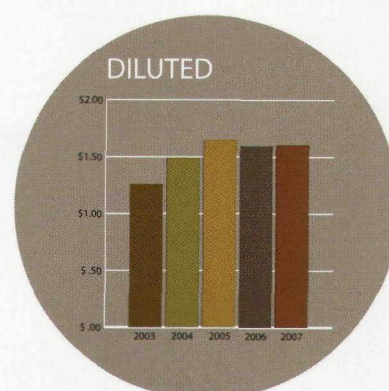
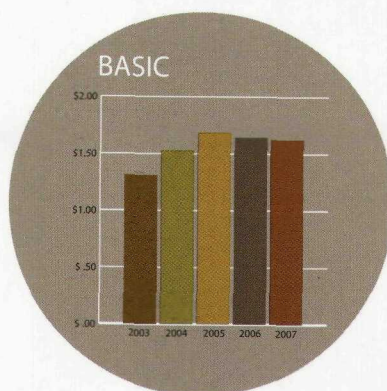
RETURN ON AVERAGE EQUITY



NON-PERFORMING ASSETS TO TOTAL ASSETS



EARNINGS PER SHARE



Providing Direction

The members of our board bring a wealth of experience and expertise to HFWA.

We rely on their advice and counsel to help guide us.

Board of Directors

standing from left to right:

John A. Clees

Owner, RSM McGladrey

Philip S. Weigand

Real Estate Agent

Gary B. Christensen

Owner, RE Powell Distributing

Daryl D. Jensen

Vice President, CFO, Western
Institutional Review Board; Retired
President, Sunset Life Insurance
Company

Kimberly T. Ellwanger

Community Volunteer

Peter N. Fluetsch

CEO, Sunset Air Inc.

seated from left to right:

Jeffrey S. Lyon

Chairman and CEO,
GVA Kidder Matthews

Brian L. Vance

President and CEO

Donald V. Rhodes

Chairman

Brian S. Charneski

President, L&E Bottling Company





Corporate Officers

Heritage Financial Corporation

Donald V. Rhodes
Chairman

Brian L. Vance
President and
Chief Executive Officer

Donald J. Hinson
Senior Vice President
Chief Financial Officer

Edward D. Cameron
Senior Vice President
Corporate Secretary

Lisa L. Welander
Vice President and
Chief Information Officer

Heritage Bank

Donald V. Rhodes
Chairman

Brian L. Vance
President and
Chief Executive Officer

Gregory D. Patjens
Executive Vice President
Community Banking

Edward D. Cameron
Senior Vice President
Corporate Secretary

Donald J. Hinson
Senior Vice President
Chief Financial Officer

Cindy M. Huntley
Senior Vice President
Retail Banking and
Marketing Director

Sabrina Robison
Senior Vice President
Human Resources Manager

David A. Spurling
Senior Vice President
Chief Credit Officer

Lisa L. Welander
Senior Vice President and
Chief Information Officer

Central Valley Bank

Donald V. Rhodes
Chairman

Brian L. Vance
Vice Chairman and
Chief Executive Officer

D. Michael Broadhead
President

Locations

Heritage Bank

Olympia

Main Office
201 5th Ave. SW
Olympia, WA 98501
(360) 943-1500

Shelton

301 E. Wallace Kneeland Blvd., Ste. 115
Shelton, WA 98584
(360) 426-4431

Lacey

4400 Pacific Ave. SE
Lacey, WA 98503
(360) 491-4350

Tumwater

5301 Capitol Blvd. S
Tumwater, WA 98501
(360) 943-5100

Spanaway

15211 Pacific Ave. S
Tacoma, WA 98444
(253) 531-4360

West Olympia

900 Cooper Point Rd. SW
Olympia, WA 98502
(360) 705-3500

Indian Summer

5800 Rainier Loop SE
Lacey, WA 98513
(360) 438-2000

Lakewood

9802 Gravelly Lake Dr. SW
Tacoma, WA 98499
(253) 588-9866

Downtown Tacoma

1119 Pacific Ave.
Tacoma, WA 98402
(253) 572-5772

80th and Pacific

8002 Pacific Ave.
Tacoma, WA 98408
(253) 473-4945

56th and South Tacoma Way

5448 South Tacoma Way
Tacoma, WA 98409
(253) 472-3333

88th and South Tacoma Way

8801 South Tacoma Way
Tacoma, WA 98499
(253) 584-8600

Sumner

612 Harrison St., Ste. 200
Sumner, WA 98390
(253) 826-0944

Federal Way

32303 Pacific Hwy. South
Federal Way, WA 98003
(253) 941-8541

Central Valley Bank

Downtown

301 W Yakima Ave.
Yakima, WA 98907
(509) 453-1172

Ellensburg

100 N Main St.
Ellensburg, WA 98926
(509) 925-5444

Nob Hill

3919 W Nob Hill Blvd.
Yakima, WA 98902
(509) 972-9510

Toppenish

537 West 2nd Ave.
Toppenish, WA 98948
(509) 865-2511

Union Gap

2205 S First St.
Yakima, WA 98903
(509) 576-0424

Wapato

507 West 1st St.
Wapato, WA 98951
(509) 877-6161

Transfer Agent

Computershare Trust Company
1745 Gardena Ave., Glendale, CA 91204
Phone: (818) 254-3163
Corporate Website: www.computershare.com

Stockholder Investor Information

The annual meeting will be held April 24, 2008, at 10:30 a.m. at the Phoenix Inn, 417 Capitol Way N, Olympia, WA. All shareholders are invited to attend.





NASDAQ: HFWA
www.HF-WA.com