FIRST MARINER BANCORP
Form 10-Q
May 16, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011.

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from to

Commission file number: 0-21815

FIRST MARINER BANCORP

(Exact name of registrant as specified in its charter)

Maryland (State of Incorporation)		**52-1834860** (I.R.S. Employer Identification Number)
1501 South Clinton Street, Baltimore, MD (Address of principal executive offices)	**21224** (Zip Code)	**410-342-2600** (Telephone Number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such report, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o (Not Applicable)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes o No x

The number of shares of common stock outstanding as of April 30, 2011 is 18,532,929 shares.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of our statements contained in, or incorporated by reference into, this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and are including this statement for purposes of invoking these safe harbor provisions. Forward-looking statements are not guarantees of performance or results. When we use words like may, plan, contemplate, anticipate, believe, intend, con expect, project, predict, estimate, target, could, is likely, should, would, will, and similar expressions, you should consider the forward-looking statements, although we may use other phrasing. These forward-looking statements involve risks and uncertainties and are based on our beliefs and assumptions and on the information available to us at the time that these disclosures were prepared. These forward-looking statements involve risks and uncertainties and may not be realized due to a variety of factors, including, but not limited to, the following:

- the unfavorable effects of future economic conditions, including inflation, recession or a continuing decrease in real estate values;
- the failure of assumptions underlying the establishment of our allowance for loan losses, that may prove to be materially incorrect or may not be borne out by subsequent events;
- the success and timing of our business strategies and our ability to effectively carry out our business plan;
- our inability to realize the benefits from our cost saving initiatives;
- our ability to continue to operate as a going concern;
- increased loan delinquencies;
- an escalation in problem assets and foreclosures;
- a decline in demand for our products and services;

- a reduction in the value of the collateral for loans made by us, especially real estate, which, in turn would likely reduce our customers borrowing power and the value of assets and collateral associated with our existing loans;

- a reduction in the value of certain assets held by us;

- an inability to meet our liquidity needs;

- an inability to raise sufficient capital to comply with the requirements of our regulators and for continued support of operations;

- adverse changes in the securities markets;

- the effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission, the Financial Accounting Standards Board, or other accounting standards setters;

- the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve Board, inflation, interest rate, market, and monetary fluctuations;

- the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities, and interest sensitive assets and liabilities;

- the imposition of additional enforcement actions by bank regulatory authorities upon First Mariner Bank or First Mariner Bancorp;

- unanticipated regulatory or judicial proceedings;

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- changes in consumer spending and savings habits;

- our ability to effectively manage market risk, credit risk, and operational risk;

- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market, and other mutual funds, and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally, and internationally, together with competitors offering banking products and services by mail, telephone, and the Internet;

- our ability to successfully implement our capital plan;

- our ability to successfully implement our plan to reduce First Mariner Bank s risk exposure on each asset classified as Substandard or below;

- our ability to successfully implement our liquidity contingency plan;

- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;

- geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts, which could impact business and economic conditions in the United States and abroad;

- the timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;

- the effect of any mergers, acquisitions, or other transactions to which we or our subsidiaries may from time to time be a party, including our ability to successfully integrate any businesses that we acquire; and

- the risks described in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K as of and for the year ended December 31, 2010.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks, and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, please read the Risk Factors in Item 1A in Part II of this Quarterly Report on Form 10-Q and in Item 1A in Part I of our Annual Report on Form 10-K as of and for the year ended December 31, 2010. Any forward-looking statement speaks only as of the date which such statement was made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

First Mariner Bancorp and Subsidiary

Consolidated Statements of Financial Condition

(dollars in thousands, except per share data)

	March 31, 2011 (unaudited)	December 31, 2010
ASSETS		
Cash and due from banks	$ 233,914	$ 169,557
Federal funds sold and interest-bearing deposits	39,437	48,404
Securities available for sale, at fair value	59,388	27,826
Loans held for sale, at fair value	47,354	140,343
Loans receivable	767,396	811,687
Allowance for loan losses	(14,097)	(14,115)
Loans, net	753,299	797,572
Real estate acquired through foreclosure	28,317	21,185
Restricted stock investments	7,095	7,095
Premises and equipment, net	40,360	41,068
Accrued interest receivable	3,886	3,844
Bank-owned life insurance	36,522	36,188
Prepaid expenses and other assets	16,408	16,555
Total assets	$ 1,265,980	$ 1,309,637
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 107,173	$ 103,450
Interest-bearing	978,202	1,018,439
Total deposits	1,085,375	1,121,889
Short-term borrowings	69,127	84,399
Long-term borrowings	48,854	33,888
Junior subordinated deferrable interest debentures	52,068	52,068
Accrued expenses and other liabilities ($266 and $137 at fair value, respectively)	13,904	13,647
Total liabilities	1,269,328	1,305,891
Stockholders equity:		
Common stock, $.05 par value; 75,000,000 shares authorized; 18,532,929 and 18,050,117 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	923	902
Additional paid-in capital	79,753	79,667
Accumulated deficit	(80,519)	(73,210)
Accumulated other comprehensive loss	(3,505)	(3,613)
Total stockholders equity	(3,348)	3,746
Total liabilities and stockholders equity	$ 1,265,980	$ 1,309,637

See accompanying notes to the consolidated financial statements

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First Mariner Bancorp and Subsidiary

Consolidated Statements of Operations

(dollars in thousands except per share data)

	Three Months Ended March 31, 2011	2010
	(unaudited)	
Interest income:		
Loans	$ 11,698	$ 13,444
Investments and other earning assets	490	761
Total interest income	12,188	14,205
Interest expense:		
Deposits	4,503	5,610
Short-term borrowings	103	47
Long-term borrowings	778	1,647
Total interest expense	5,384	7,304
Net interest income	6,804	6,901
Provision for loan losses	800	2,190
Net interest income after provision for loan losses	6,004	4,711
Noninterest income:		
Total other-than-temporary impairment (OTTI) charges		(130)
Less: Portion included in other comprehensive income (pre-tax)		7
Net OTTI charges on securities available for sale		(123)
Mortgage-banking revenue	935	2,507
ATM fees	771	735
Service fees on deposits	735	1,060
Gain on financial instruments carried at fair value		847
Gain on sale of premises and equipment		152
Commissions on sales of nondeposit investment products	118	145
Income from bank-owned life insurance	335	353
Other	168	166
Total noninterest income	3,062	5,842
Noninterest expense:		
Salaries and employee benefits	6,270	6,596
Occupancy	2,176	2,371
Furniture, fixtures, and equipment	485	612
Professional services	1,164	720
Advertising	136	178
Data processing	455	402
ATM servicing expenses	208	204
Write-downs, losses, and costs of real estate acquired through foreclosure	1,759	1,685
FDIC insurance premiums	973	934
Service and maintenance	652	683
Other	2,097	1,904
Total noninterest expense	16,375	16,289
Net loss from continuing operations before income taxes and discontinued operations	(7,309)	(5,736)
Income tax benefit - continuing operations		(2,497)
Net loss from continuing operations	(7,309)	(3,239)
Loss from discontinued operations		(200)
Net loss	$ (7,309)	$ (3,439)

Net loss per common share from continuing operations:				
Basic	$	(0.40)	$	(0.50)
Diluted	$	(0.40)	$	(0.50)
Net loss per common share from discontinued operations:				
Basic	$		$	(0.03)
Diluted	$		$	(0.03)
Net loss per common share:				
Basic	$	(0.40)	$	(0.53)
Diluted	$	(0.40)	$	(0.53)

See accompanying notes to the consolidated financial statements.

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First Mariner Bancorp and Subsidiary

Consolidated Statements of Changes in Stockholders Equity

(dollars in thousands except per share data)

For the Three Months Ended March, 31, 2011

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity	Comprehensive Loss
Balance at December 31, 2010	18,050,117	$ 902	$ 79,667	$ (73,210)	$ (3,613)	$ 3,746	$
Net loss				(7,309)		(7,309)	(7,309)
Common stock issued, net of costs	482,812	21	81			102	
Stock-based compensation expense			5			5	
Changes in unrealized losses on securities, net of taxes					108	108	108
Comprehensive loss							$ (7,201)
Balance at March 31, 2011	18,532,929	$ 923	$ 79,753	$ (80,519)	$ (3,505)	$ (3,348)	

For the Three Months Ended March 31, 2010

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity	Comprehensive Loss
Balance at December 31, 2009	6,452,631	$ 323	$ 56,771	$ (26,621)	$ (3,486)	$ 26,987	$
Net loss				(3,439)		(3,439)	(3,439)
Common stock issued, net of costs	1,626,016	81	12,535			12,616	
Stock-based compensation expense			7			7	
Changes in unrealized losses on securities, net of taxes					561	561	561
Comprehensive loss							$ (2,878)
Balance at March 31, 2010	8,078,647	$ 404	$ 69,313	$ (30,060)	$ (2,925)	$ 36,732	

See accompanying notes to the consolidated financial statements.

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First Mariner Bancorp and Subsidiary

Consolidated Statements of Cash Flows

(dollars in thousands)

	Three Months Ended March 31, 2011	2010
	(unaudited)	
Cash flows from operating activities:		
Net loss	$ (7,309)	$ (3,439)
Adjustments to reconcile net loss to net cash from operating activities:		
Loss from discontinued operations		200
Stock-based compensation	5	7
Depreciation and amortization	852	1,020
Amortization of unearned loan fees and costs, net	87	12
Amortization (accretion) of premiums and discounts on mortgage-backed securities, net	1	(12)
Gain on financial instruments carried at fair value		(847)
Origination fees and gain on sale of mortgage loans	(745)	(2,050)
Net OTTI charges on securities available for sale		123
(Increase) decrease in accrued interest receivable	(42)	226
Provision for loan losses	800	2,190
Write-downs and losses on sale of real estate acquired through foreclosure	1,669	1,336
Gain on sale of premises and equipment		(152)
Increase in cash surrender value of bank-owned life insurance	(335)	(353)
Originations of mortgage loans held for sale	(118,872)	(183,885)
Proceeds from mortgage loans held for sale	212,605	252,660
Net increase (decrease) in accrued expenses and other liabilities	399	(2,682)
Net decrease in prepaids and other assets	37	4,214
Net cash provided by operating activities	89,152	68,568
Cash flows from investing activities:		
Loan principal repayments, net	34,174	14,524
Repurchase of loans previously sold	(400)	(593)
Purchases of premises and equipment	(148)	(679)
Proceeds from disposals of premises and equipment	3	759
Maturities/calls/repayments of trading securities		561
Activity in securities available for sale:		
Maturities/calls/repayments of securities available for sale	2,644	1,709
Purchase of securities available for sale	(34,026)	
Proceeds from sales of real estate acquired through foreclosure	810	3,177
Net cash provided investing activities	3,057	19,458
Cash flows from financing activities:		
Net (decrease) increase in deposits	(36,513)	36,314
Net decrease in other borrowed funds	(306)	(2,178)
Net cash (used in) provided by financing activities	(36,819)	34,136
Increase in cash and cash equivalents	55,390	122,162
Cash and cash equivalents at beginning of period	217,961	173,703
Cash and cash equivalents at end of period	$ 273,351	$ 295,865
Supplemental information:		
Interest paid on deposits and borrowed funds	$ 5,052	$ 8,409
Income taxes paid	$	$
Real estate acquired in satisfaction of loans	$ 9,611	$ 2,798
Exchange transaction reducting junior subordinated deferrable interest debentures	$	$ 20,000

See accompanying notes to the consolidated financial statements

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First Mariner Bancorp and Subsidiaries

Notes to Consolidated Financial Statements

(Information as of and for the three months

ended March 31, 2011 and 2010 is unaudited)

(1) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements for First Mariner Bancorp have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a full presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (U.S.). The consolidated financial statements should be read in conjunction with the audited financial statements included in First Mariner Bancorp s Annual Report on Form 10-K for the year ended December 31, 2010. When used in these notes, the terms the Company, we, us, and our refer to First Mariner Bancorp and, unless the context requires otherwise, its consolidated subsidiary.

The consolidated financial statements include the accounts of First Mariner and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation. Events occurring after the date of the financial statements were considered in the preparation of the financial statements. Certain reclassifications have been made to amounts previously reported to conform to classifications made in 2011.

The consolidated financial statements as of March 31, 2011 and for the three months ended March 31, 2011 and 2010 are unaudited but include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of financial position and results of operations for those periods. The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results that will be achieved for the entire year or any future interim period.

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses (the allowance), loan repurchases and related valuations, real estate acquired through foreclosure, impairment of securities available for sale (AFS), valuations of financial instruments, and deferred income taxes. In connection with these determinations, management evaluates historical trends and ratios and, where appropriate, obtains independent appraisals for significant properties and prepares fair value analyses. Actual results could differ significantly from those estimates.

(2) Going Concern Consideration

Due to the conditions and events discussed later in Note 6, we believe substantial doubt exists as to our ability to continue as a going concern. Management is taking various steps designed to improve the Bank s capital position. The Bank has developed a written alternative capital plan designed to improve the Bank s capital ratios. Such plan is dependent upon a capital infusion to meet the capital requirements of the various regulatory agreements (see Note 6 for more information on the agreements). The Company continues to work with its advisors in an attempt to improve capital ratios. The Company has entered into a definitive agreement regarding the raising of additional capital (see Note 13), however, no assurances can be made that the Company will ultimately meet the provisions and deadlines of the agreement.

The consolidated financial statements presented above and the accompanying Notes have been prepared on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future, and does not include any adjustment to reflect the possible future effects on the recoverability and classification of assets, or the amounts and classification of liabilities that may result from the outcome of any extraordinary regulatory action, which would affect our ability to continue as a going concern.

(3) Securities

The composition of our securities portfolio (all AFS) is as follows:

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(dollars in thousands)	March 31, 2011 Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 11,742	$ 125	$ 14	$ 11,853
Trust preferred securities	14,267	80	3,675	10,672
U.S. government agency notes	33,970	15	149	33,836
U.S. Treasury securities	1,037			1,037
Corporate obligations	922	110		1,032
Equity securities - banks	215	11	24	202
Equity securities - mutual funds	750	6		756
	$ 62,903	$ 347	$ 3,862	$ 59,388

(dollars in thousands)	December 31, 2010 Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 2,216	$ 109	$	$ 2,325
Trust preferred securities	14,269	101	3,906	10,464
U.S. government agency notes	12,075	12	16	12,071
U.S. Treasury securities	1,000	1		1,001
Corporate obligations	913	97		1,010
Equity securities - banks	215	11	29	197
Equity securities - mutual funds	750	8		758
	$ 31,438	$ 339	$ 3,951	$ 27,826

The amount of OTTI recorded as accumulated other comprehensive loss as of March 31, 2010 was $7,000 on trust preferred securities. We did not record any such OTTI for the three months ended March 31, 2011.

Contractual maturities of debt securities at March 31, 2011 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

(dollars in thousands)	Amortized Cost	Estimated Fair Value
Due after one year through five years	$ 36,431	$ 36,430
Due after five years through ten years	1,026	1,018
Due after ten years	12,739	9,129
Mortgage-backed securities	11,742	11,853
	$ 61,938	$ 58,430

The following table shows the level of our gross unrealized losses and the fair value of the associated securities by type and maturity for securities AFS at March 31, 2011 and December 31, 2010:

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	March 31, 2011					
	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Mortgage-backed securities	$ 5,110	$ 14	$	$	$ 5,110	$ 14
Trust preferred securities			5,935	3,675	5,935	3,675
U.S. government agency notes	25,757	149			25,757	149
U.S. Treasury securities	1,037				1,037	
Equity securities - banks			109	24	109	24
	$ 31,904	$ 163	$ 6,044	$ 3,699	$ 37,948	$ 3,862

	December 31, 2010					
	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Trust preferred securities	$ 340	$ 14	$ 5,722	$ 3,892	$ 6,062	$ 3,906
U.S. government agency notes	4,984	16			4,984	16
Equity securities - banks			105	29	105	29
	$ 5,324	$ 30	$ 5,827	$ 3,921	$ 11,151	$ 3,951

The trust preferred securities that we hold in our securities portfolio are issued by other banks, bank holding companies, and insurance companies. Certain of these securities have experienced declines in value since acquisition. These declines have occurred due to changes in the market which has limited the demand for these securities and reduced their liquidity. We recorded net OTTI charges of $123,000 on positions in pooled trust preferred collateralized debt obligations during the three months ended March 31, 2010. We did not record any OTTI charges during the three months ended March 31, 2011.

The following shows the activity in OTTI related to credit losses for the three months ended March 31:

(dollars in thousands)	2011	2010
Balance at beginning of year	$ 7,892	$ 6,643
Additional OTTI taken for credit losses		123
Balance at end of period	$ 7,892	$ 6,766

All of the remaining securities that are temporarily impaired are impaired due to declines in fair values resulting from changes in interest rates or increased credit/liquidity spreads since the time they were purchased. We have the intent to hold these debt securities to maturity, and, for debt and equity securities in a loss position, for the foreseeable future and do not intend, nor do we believe it is more likely than not, that we will be required to sell the securities before anticipated recovery. We expect these securities will be repaid in full, with no losses realized. As such, management considers the impairments to be temporary.

We purchased securities of $34.0 million during the three months ended March 31, 2011. We did not purchase any securities during the same period in 2010. We did not sell any securities during the three months ended March 31, 2011 or 2010.

At March 31, 2011, we held securities with an aggregate carrying value (fair value) of $51.4 million that we have pledged as collateral for certain hedging activities, borrowings, government deposits, and customer deposits.

(4) Loans Receivable and Allowance for Loan Losses

Loans receivable are summarized as follows:

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(dollars in thousands)		March 31, 2011		December 31, 2010
Commercial	$	65,238	$	78,607
Commercial mortgage		342,407		349,691
Commercial construction		56,940		58,742
Consumer construction		36,684		31,107
Residential mortgage		122,184		144,194
Consumer		142,932		148,166
Total loans		766,385		810,507
Unearned loan fees, net		1,011		1,180
	$	767,396	$	811,687

Included in consumer loan totals in the above table are overdrawn commercial and retail checking accounts totaling $198,000 as of March 31, 2011 and $186,000 as of December 31, 2010.

Transferred Loans

In accordance with the Financial Accounting Standards Board (FASB) guidance on mortgage-banking activities, any loans which are originally originated for sale into the secondary market and which we subsequently elect to transfer into the Company s loan portfolio are valued at fair value at the time of the transfer with any decline in value recorded as a charge against earnings.

Information on the activity in transferred loans and related accretable yield is as follows for the three months ended March 31:

	Loan Balance				Accretable Yield				Total			
(dollars in thousands)		2011		2010		2011		2010		2011		2010
Beginning balance	$	26,219	$	24,575	$	178	$	423	$	26,041	$	24,152
Loans moved to real estate acquired through foreclosure		(83)		(281)				(8)		(83)		(273)
Charge-offs				(146)				(15)				(131)
Payments/amortization		(17)		(2,454)		(32)		(67)		15		(2,387)
Ending balance	$	26,119	$	21,694	$	146	$	333	$	25,973	$	21,361

As of March 31, 2011 and December 31, 2010, we maintained servicing on mortgage loans sold to the Federal National Mortgage Association (FNMA) of approximately $326.4 million and $323.3 million, respectively.

At March 31, 2011, we have pledged loans with a carrying value of $93.2 million as collateral for Federal Home Loan Bank (FHLB) advances.

Credit Quality

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, we have segmented our loan portfolio by product type. Our portfolio loan segments are commercial, commercial mortgage, commercial construction, consumer construction, residential mortgage, and consumer. We have looked at all segments to determine if subcategorization into classes is warranted based upon our credit review methodology. We have divided consumer loans into two classes, (1) home equity and second mortgage loans and (2) other consumer loans.

To establish the allowance for loan losses, loans are pooled by portfolio class and an historical loss percentage is applied to each class. The historical loss percentage is based upon a rolling 24 month history. That calculation determines the required allowance for loan loss level. We then apply additional loss multipliers to the different classes of loans to reflect various environmental factors. This amount is considered our unallocated reserve. For individually evaluated loans (impaired loans), we do additional analyses to determine the impairment. In general, this impairment is included as part of the allowance for loan losses (specific reserve) for modified loans and is charged-off for all other impaired loans. These loss estimates are performed under multiple economic scenarios to establish a range of potential outcomes for each criterion. Management applies judgment to develop its own view of loss probability within that range, using external and internal parameters with the objective of establishing an allowance for loss inherent within these portfolios as of the reporting date.

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The following table presents by portfolio segment, the changes in the allowance for loan losses, and the recorded investment in loans.

As of and for the three months ended March 31, 2011:

(dollars in thousands)	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
Beginning Balance	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Charge-offs:		(40)		(24)	(350)	(470)		(884)
Recoveries:					7	59		66
Net charge-offs		(40)		(24)	(343)	(411)		(818)
(Reversal of) provision for loan losses	(128)	98	(281)	(315)	477	618	331	800
Ending Balance	$ 163	$ 2,600	$ 1,772	$ 478	$ 3,166	$ 2,624	$ 3,294	$ 14,097
Ending balance - individually evaluated for impairment	$	$ 103	$ 13	$	$ 423	$	$	$ 539
Ending balance - collectively evaluated for impairment	$ 163	$ 2,497	$ 1,759	$ 478	$ 2,743	$ 2,624	$ 3,294	$ 13,558
Ending loan balance - individually evaluated for impairment	$ 1,486	$ 23,647	$ 13,183	$ 1,533	$ 24,888	$ 596		$ 65,333
Ending loan balance - collectively evaluated for impairment	63,921	318,469	43,726	34,828	97,332	143,787		702,063
	$ 65,407	$ 342,116	$ 56,909	$ 36,361	$ 122,220	$ 144,383		$ 767,396

As of and for the three months ended March 31, 2010:

(dollars in thousands)	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
Beginning Balance	$ 817	$ 3,336	$ 1,647	$ 293	$ 2,062	$ 882	$ 2,602	$ 11,639
Charge-offs:		(270)	(193)	(121)	(804)	(550)		(1,938)
Recoveries:					63	49		112
Net charge-offs		(270)	(193)	(121)	(741)	(501)		(1,826)
Provision for loan losses	59	159	374	56	621	559	362	2,190
Ending Balance	$ 876	$ 3,225	$ 1,828	$ 228	$ 1,942	$ 940	$ 2,964	$ 12,003
Ending balance - individually evaluated for impairment	$	$ 55	$ 257	$	$ 248	$ 236	$	$ 796
Ending balance - collectively evaluated for impairment	$ 876	$ 3,170	$ 1,571	$ 228	$ 1,694	$ 704	2,964	$ 11,207
Ending loan balance - individually evaluated for impairment	$ 499	$ 12,483	$ 19,835	$ 2,232	$ 18,595	$ 1,337		$ 54,981
Ending loan balance - collectively evaluated for impairment	78,891	318,584	75,986	42,695	149,987	151,261		817,404

	$ 79,390	$ 331,067	$ 95,821	$ 44,927	$ 168,582	$ 152,598	$ 872,385

We use creditworthiness categories to grade commercial loans. Our internal grading system is based on experiences with

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similarly graded loans. Category ratings are reviewed each quarter. Our internal risk ratings are as follows:

Superior Credit Quality (RR1)   This category includes credits that are secured by up to 95% advance against cash balances, municipal or corporate bonds carrying an A rating or better (subject to maturity), U.S. Government securities (subject to maturity), and fully marketable securities of companies with an A or better debt rating. In addition, the borrower must have a reasonable financial condition evidenced by complete financial statements.

High Credit Quality (RR2)   This category includes credits that are secured by up to 70% advance against municipal or corporate bonds carrying an A rating or better, U.S. Government securities, and marketable securities of companies with an A or better debt rating. For individual credits, the credit must be secured by any of the aforementioned items or first deed of trust (DOT) on residential owner-occupied property with a loan-to-value (LTV) ratio of 80% or less and adequate cash flow to service the debt. Permanent real estate loans on fully leased properties with A-rated tenants and a 70% or less LTV with income coverage of 1.25 times or higher may qualify for this rating, with confirmation of tenants   financial condition. No commercial construction loans may carry this rating at inception. At March 31, 2011 and December 31, 2010, none of our loans carried this risk rating.

Above Average Credit Quality (RR3)   This category includes business loans to publicly traded companies with a B rating or better, commercial construction loans with a contingent-free take-out or substantial pre-leasing (75% or more of leasable space) with a LTV of 70% or less, residential construction loans with pre-sold units and a LTV of 70% or less as long as sales are on a noncontingent basis and the overall project is progressing on schedule as originally determined, loans to individuals with liquid assets and strong net worth and the additional ability to service the debt from sources unrelated to the purpose of the credit extension, and monitored credits to borrowers of sound financial condition with approved advance rates providing adequate margin so that collateral can be easily liquidated within 90 days or less.

Average/Satisfactory Credit Quality (RR4)   In general, this category includes small-to-medium sized companies with satisfactory financial condition, cash flow, profitability, and balance sheet and income statement ratios, term loans and revolving credits with annual clean-up requirements, the majority of retail commercial credits, loans to partnerships or small businesses, most wholesale sales finance lines, wholesale distributors whose capital position and profitability are at Robert Morris and Associates averages, and loans to individuals with acceptable financial condition and sufficient net cash flow to service the debt as long as the source of repayment is identifiable and sufficient to liquidate the debt within an acceptable period of time and a secondary source of repayment is evident.

Acceptable With Care (RR5)   This category includes secured loans to small or medium sized companies which have suffered a financial setback where a convincing plan for correction demonstrates the deficiency is temporary in nature, loans with debt service coverage ratios below or LTV ratios above policy guidelines, most construction and development loans, permanent loans underwritten based on pro forma rents as opposed to historical or actual rents, real estate loans where the project is moderately off the original projections as to cost estimates or absorption, and loans where the interest reserve is no longer adequate, but the customer or guarantor has a proven ability to carry the interest expense out of pocket for an extended time period without undue financial strain. These credits require additional attention by the account officer and/or loan administration.

Watch Credits (RR6)   This category includes loans to borrowers who have experienced a temporary setback or deterioration in financial condition that should correct itself during the next twelve months, companies whose financial condition has been marginally acceptable for a period of time and prospects for significant improvement are limited, loans to individuals with marginal financial condition, and most credits for start-up operations. Also included in this category are real estate loans where the project is moderately off original projections, interest reserve may be depleted, with the borrower or guarantor having a questionable or unproved ability to pay interest out of pocket. Such loans may have modest cost overruns that will cause a shortage in the budget, raising question as to how the project will be completed. These loans may have a good collateral position, additional collateral, or strong guarantors to mitigate the risk. These credits are considered marginally acceptable, and greater than usual attention is warranted by the account officer and/or loan operations.

Special Mention (RR7) special mention credits are characterized as adequately covered by collateral (if any) and/or the paying capacity of the borrower, but are subject to one or more deteriorating trends. These credits constitute an undue and unwarranted credit risk, but not to the point of justifying a classification of substandard. These credits have potential weaknesses which, if not examined and corrected, may weaken the asset or inadequately protect the Bank s credit position at some future date. This category should not be used to list assets that bear risks usually associated with the particular type of financing. Assets with this rating may have the potential for significant weakness. Loans where weaknesses are evident and significant must be considered for more serious criticism. Examples of credits carried in special mention may include the following:

- Loans which are fully covered by collateral and cash flow, but where margins are inadequate;

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- Loans to borrowers with a strong capital base, who are experiencing modest losses;

- Loans to borrowers with very strong cash flows, but experiencing modest losses;

- Credits that are subject to manageable, but excessive, leverage;

- Credits with material collateral documentation exceptions, but which appear to be strong credits. If the documentation exception results in an unperfected/under secured collateral position, the credit may be risk rated as if it were under secured until such time as the exception is corrected;

- Credits to customers who have not provided the Bank with current or satisfactory financial data (unless the credit is secured by liquid marketable collateral or guaranteed by financially sound parties);

- Credits that the account officer may be unable to supervise properly because of a lack of expertise or lack of control over the collateral and/or its condition;

- Loans with deficient documentation or other deviations from prudent lending practices; and

- Loans with strong guarantors and/or secondary sources of cash flow are the support for repayment.

Substandard (RR8) Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses, which jeopardize the orderly liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. The borrower s financial condition indicates an inability to repay, even if restructured. Prospects for improvement in the borrower s financial condition are poor. Primary repayment source appears to be shifting from cash flow to liquidation of collateral. Examples of Substandard credits may include the following:

- Credits adequately covered by collateral value, where repayment is dependent upon the sale of nonliquid collateral, nontrading assets, or from guarantors;

- Loans secured by collateral greater than the amount of the credit, but where cash flow is inadequate to amortize the debt over a reasonable period of time;

- Credits with negative financial trends coupled with material collateral documentation deficiencies or where there is a high potential for loss of principal;

- Unsecured loans to borrowers whose financial condition does not warrant unsecured advances;

- Credits where the borrower is in bankruptcy or the work out effort is proceeding toward legal remedies including foreclosure; and

- All nonaccrual loans.

Doubtful (RR9) Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently known facts, conditions, and values highly questionable and improbable. A doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific, reasonable, and pending factors which may strengthen and work to the advantage of the credit in the near term. Account officers attempt to identify any principal loss in the credit, where possible, thereby limiting the excessive use of the doubtful classification. The classification is a deferral of the estimated loss until its more exact status may be determined. Pending factors include proposed mergers, acquisition or liquidation procedures, new capital injection, perfecting liens on additional collateral, and refinancing plans. At March 31, 2011 and December 31, 2010, none of our loans carried this risk rating.

Loss (RR10) Losses must be taken as soon as they are realized. In some instances and on a temporary basis, a portion of a loan may receive this rating (split rating) when the actual loss cannot be currently identified. In these instances, additional facts or information is necessary to determine the final amount to be charged against the loan loss reserve. When applied for these purposes, this risk rating may be used for a period not to exceed six months. Subsequent to the identification of this split rating, the remaining balance will be risk rated Substandard. This category includes advances in excess of calculated current fair value which are considered uncollectible and do not warrant continuance as bankable assets. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer

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writing off this basically worthless asset even though partial recovery may occur in the future. Credits to distressed borrowers lacking an identifiable and realistic source of repayment are generally charged-off. Loans where repayment is dependent upon events that are not predictable in terms of result or timing (such as protracted litigation) are generally charged-off. At March 31, 2011 and December 31, 2010, none of our loans carried this risk rating.

The following table shows the credit quality breakdown of our commercial loan portfolio by class as of March 31, 2011 and December 31, 2010:

	Commercial		Commercial Mortgage		Commercial Construction		Consumer Construction		Total	
	(dollars in thousands)									
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
RR8	$ 1,920	$ 1,939	$ 33,285	$ 33,492	$ 13,855	$ 14,677	$ 1,133	$ 1,150	$ 50,193	$ 51,258
RR7	13,802	7,241	12,661	10,921	11,276	6,686	136	136	37,875	24,984
RR6	10,037	9,174	22,710	23,097	11,254	15,081	99	98	44,100	47,450
RR5	13,315	22,417	121,952	126,297	14,584	13,811			149,851	162,525
RR4	24,566	36,257	151,242	155,336	5,940	8,509	34,993	29,408	216,741	229,510
RR3	1,000	1,000	266	268					1,266	1,268
RR1	767	773							767	773
	$ 65,407	$ 78,801	$ 342,116	$ 349,411	$ 56,909	$ 58,764	$ 36,361	$ 30,792	$ 500,793	$ 517,768

We do not individually grade residential mortgage or consumer loans. Such loans are classified as performing or nonperforming. Loan performance is reviewed each quarter. The following table shows performing and nonperforming (nonaccrual) residential mortgage and consumer loans by class as of March 31, 2011 and December 31, 2010:

	Residential Mortgage		Home Equity & 2nd Mortgage		Other Consumer		Total	
(dollars in thousands)	2011	2010	2011	2010	2011	2010	2011	2010
Nonaccruing loans	$ 12,925	$ 11,877	$ 474	$ 946	$	$	$ 13,399	$ 12,823
Performing loans	109,295	132,332	117,551	119,874	26,358	28,890	253,204	281,096
	$ 122,220	$ 144,209	$ 118,025	$ 120,820	$ 26,358	$ 28,890	$ 266,603	$ 293,919

The following tables show the aging of our loans receivable by class. Also included are loans that are 90 days or more past due as to interest and principal and still accruing because they are (1) well-secured and in the process of collection or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual.

As of March 31, 2011:

(dollars in thousands)	31-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
Commercial	$ 1,760	$ 147	$ 2,907	$ 4,814	$ 60,593	$ 65,407	$ 1,583
Commercial mortgage	9,407	3,805	22,045	35,257	306,859	342,116	3,176
Commercial construction	2,113		7,897	10,010	46,899	56,909	
Consumer construction	1,338	123	1,533	2,994	33,367	36,361	

Residential mortgage	11,430	412	12,925	24,767	97,453	122,220	
Home equity and 2nd mortgage	2,769	1,245	593	4,607	113,418	118,025	119
Other consumer	47	6	8	61	26,297	26,358	8
	$ 28,864	$ 5,738	$ 47,908	$ 82,510	$ 684,886	$ 767,396	$ 4,886

As of December 31, 2010:

(dollars in thousands)	31-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
Commercial	$ 1,626	$ 169	$ 1,501	$ 3,296	$ 75,505	$ 78,801	$
Commercial mortgage	4,957	2,706	28,943	36,606	312,805	349,411	1,952
Commercial construction			8,237	8,237	50,527	58,764	250
Consumer construction	2,168	379	1,257	3,804	26,988	30,792	
Residential mortgage	10,919	7,789	12,653	31,361	112,848	144,209	776
Home equity and 2nd mortgage	3,221	390	946	4,557	116,263	120,820	
Other consumer	125	592		717	28,173	28,890	
	$ 23,016	$ 12,025	$ 53,537	$ 88,578	$ 723,109	$ 811,687	$ 2,978

Impaired loans include nonaccrual loans and troubled debt restructures (TDR or TDRs). The following tables show the breakout of impaired loans by class:

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(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Charge-Offs
			March 31, 2011			
With no related allowance:						
Commercial	$ 1,486	$ 1,486	$	$ 1,493	$ 10	$
Commercial mortgage	$ 19,676	$ 19,676	$	$ 23,105	$ 162	$
Commercial construction	$ 12,724	$ 12,724	$	$ 12,769	$ 60	$
Consumer construction	$ 1,533	$ 1,533	$	$ 1,395	$ 23	$
Residential mortgage	$ 12,411	$ 12,411	$	$ 12,052	$ 18	$ 91
Home equity & 2nd mortgage	$ 596	$ 596	$	$ 923	$ 1	$
Other consumer	$	$	$	$	$	$
With a related allowance:						
Commercial						
Commercial mortgage	3,868	3,971	103	3,547	65	40
Commercial construction	446	459	13	445	2	
Consumer construction						24
Residential mortgage	12,054	12,477	423	12,358	148	259
Home equity & 2nd mortgage						471
Other consumer						
Totals:						
Commercial	$ 1,486	$ 1,486	$	$ 1,493	$ 10	$
Commercial mortgage	$ 23,544	$ 23,647	$ 103	$ 26,652	$ 227	$ 40
Commercial construction	$ 13,170	$ 13,183	$ 13	$ 13,214	$ 62	$
Consumer construction	$ 1,533	$ 1,533	$	$ 1,395	$ 23	$ 24
Residential mortgage	$ 24,465	$ 24,888	$ 423	$ 24,410	$ 166	$ 350
Home equity & 2nd mortgage	$ 596	$ 596	$	$ 923	$ 1	$ 471
Consumer	$	$	$	$	$	$

(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Charge-Offs
			December 31, 2010			
With no related allowance:						
Commercial	$ 1,501	$ 1,501	$	$ 2,069	$ 40	$ 1,979
Commercial mortgage	$ 26,534	$ 26,534	$	$ 17,437	$ 811	$ 1,232
Commercial construction	$ 12,814	$ 12,814	$	$ 10,647	$ 310	$ 2,320
Consumer construction	$ 1,257	$ 1,257	$	$ 2,200	$ 35	$ 804
Residential mortgage	$ 11,877	$ 11,877	$	$ 11,973	$ 381	$ 3,757
Home equity & 2nd mortgage	$ 1,067	$ 1,067	$	$ 1,385	$ 15	$ 3,787
Other consumer	$	$	$	$ 13	$	$
With a related allowance:						
Commercial						
Commercial mortgage	3,226	3,314	88	2,864	73	163
Commercial construction	445	459	14	2,567	18	1,932
Consumer construction						
Residential mortgage	12,661	13,147	486	5,339	695	
Home equity & 2nd mortgage				2,065		
Other consumer				1		
Total:						
Commercial	$ 1,501	$ 1,501	$	$ 2,069	$ 40	$ 1,979
Commercial mortgage	$ 29,760	$				