

EAGLE BANCORP INC  
Form 10-K  
March 01, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2018

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: 0-25923

Eagle Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland

52-2061461

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

7830 Old Georgetown Road, Third Floor, Bethesda, Maryland 20814

(Address of principal executive offices) (Zip Code)

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Registrant's telephone number, including area code: (301) 986-1800

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$0.01 par value	The Nasdaq Capital Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Section 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports; and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by checkmark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the outstanding Common Stock held by nonaffiliates as of June 30, 2018 was approximately \$1.94 billion.

As of February 8, 2019, the number of outstanding shares of the Common Stock, \$0.01 par value, of Eagle Bancorp, Inc. was 34,417,186.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 16, 2019 are incorporated by reference in Part III hereof.

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**EAGLE BANCORP, INC.**

**ANNUAL REPORT ON FORM 10-K**

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**PART I**

**ITEM 1. BUSINESS**

In this report, unless otherwise expressly stated or the context otherwise requires, the terms “we,” “us,” the “Company,” “Eagle,” and “our” refer to Eagle Bancorp, Inc. and our subsidiaries on a combined basis, except in the description of any of our securities, in which case these terms refer solely to Eagle Bancorp, Inc. and not to any of our subsidiaries. References to “EagleBank” or “Bank” refer to EagleBank, which is our principal subsidiary.

Eagle Bancorp, Inc. (the “Company”), headquartered in Bethesda, Maryland, was incorporated under the laws of the State of Maryland on October 28, 1997, to serve as the bank holding company for EagleBank (the “Bank”). The Company was formed by a group of local businessmen and professionals with significant prior experience in community banking in the Company’s market area, together with an experienced community bank senior management team.

The Bank, a Maryland chartered commercial bank, which is a member of the Federal Reserve System, is the Company’s principal operating subsidiary. It commenced banking operations on July 20, 1998. The Bank currently operates twenty banking offices: six in Suburban Maryland; five located in the District of Columbia; and nine in Northern Virginia. Refer to Properties on page 36 for a listing of banking offices. The Bank may seek additional banking offices consistent with its strategic plan, although there can be no assurance that the Bank will establish any additional offices, or that any branch office will prove to be profitable.

The Bank has two active direct subsidiaries: Bethesda Leasing, LLC and Eagle Insurance Services, LLC. Bethesda Leasing, LLC holds title to and operates real estate owned and acquired through foreclosure. Eagle Insurance Services, LLC a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker.

The Bank operates as a community bank alternative to the super-regional financial institutions, which dominate its primary market area. The cornerstone of the Bank’s philosophy is to provide superior, personalized service to its clients. The Bank focuses on relationship banking, providing each client with a number of services, familiarizing itself with, and addressing itself to, client needs in a proactive, personalized fashion. Management believes that the Bank’s target market segments, small and medium-sized for profit and non-profit businesses and the consumer base working or living in and near the Bank’s market area, demand the convenience and personal service that an independent locally based financial institution such as the Bank can offer. These themes of convenience and proactive personal service form the basis for the Bank’s business development strategies.

The Company has grown primarily through organic growth over its twenty year history. Two acquisitions have been completed (one in 2008 and one in 2014). On August 31, 2008, the Company completed the acquisition of Fidelity & Trust Financial Corporation (“Fidelity”) which increased loans and deposits by approximately \$361 million and \$385 million, respectively. The acquisition of Virginia Heritage Bank (“Virginia Heritage”) completed on October 31, 2014, added approximately \$800 million in loans, and \$645 million in deposits. Refer to Note 6 to the Consolidated Financial Statements for additional disclosure regarding intangible assets established incident to mergers and acquisitions.

*Description of Services.* The Bank offers a broad range of commercial banking services to its business and professional clients, as well as full service consumer banking services to individuals living and/or working primarily in the Bank’s market area. The Bank emphasizes providing commercial banking services to sole proprietors, small and medium-sized businesses, partnerships, corporations, non-profit organizations and associations, and investors living and working in and near the Bank’s primary service area. A full range of retail banking services are offered to accommodate the individual needs of both corporate customers as well as the community the Bank serves. The Bank also offers online banking, mobile banking and a remote deposit service, which allows clients to facilitate and expedite deposit transactions through the use of electronic devices. A suite of Treasury Management services is also offered to business clients. The Bank’s deposits are insured by the Federal Deposit Insurance Corporation, or FDIC, to the fullest extent provided by law.

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The Bank provides a variety of commercial and consumer lending products to small, medium and large-sized businesses and to individuals for various business and personal purposes, including (i) commercial loans for a variety of business purposes such as for working capital, equipment purchases, real estate lines of credit, and government contract financing; (ii) asset based lending and accounts receivable financing (on a limited basis); (iii) construction and commercial real estate loans; (iv) business equipment financing; (v) consumer home equity lines of credit, personal lines of credit and term loans; (vi) consumer installment loans such as auto and personal loans; (vii) personal credit cards offered through an outside vendor; and (viii) residential mortgage loans.

The Bank's loan portfolio consists primarily of traditional business and real estate secured loans. Commercial and industrial loans are made, with a substantial portion having variable and adjustable rates, and where the cash flow of the borrower/borrower's operating business is the principal source of debt service with a secondary emphasis on collateral. Real estate loans are made generally for commercial purposes and are structured using both variable and fixed rates and renegotiable rates which adjust in three to five years, with maturities of generally five to ten years. Commercial real estate loans, which comprise the largest portion of the loan portfolio, are secured by both owner occupied and non-owner occupied real property and include a significant component of acquisition, development and construction, or ADC lending.

The Bank's consumer loan portfolio is a smaller portion of the loan portfolio and is comprised generally of two loan types: (i) home equity loans and lines of credit that are structured with an interest only draw period followed either by a balloon maturity or a fully amortized repayment schedule; and (ii) first lien residential mortgage loans, although the Bank's general practice is to sell conforming first trust loans on a servicing released basis to third party investors. In certain limited instances, residential mortgage first deed of trust loans are packaged along with a line of credit to the same borrower for sale in the secondary market by the Bank.

The Bank has also developed significant expertise and commitment as a Small Business Administration ("SBA") lender and has been recognized as a top originator of such loans in our market area. The Bank is a preferred lender under the SBA's Preferred Lender Program. As a preferred lender, the Bank can originate certain SBA loans in-house without prior SBA approval. SBA loans are made through programs designed by the federal government to assist the small business community in obtaining financing from financial institutions that are given government guarantees as an incentive to make the loans. Under certain circumstances, the Bank attempts to further mitigate commercial term loan losses by using loan guarantee programs offered by the SBA. SBA lending is subject to federal legislation that can affect the availability and funding of the program. From time to time, this dependence on legislative funding causes limitations and uncertainties with regard to the continued funding of such programs, which could potentially have an adverse financial impact on our business.

The Company originates multifamily FHA loans through the Department of Housing and Urban Development's, or HUD's, Multifamily Accelerated Program, or MAP. The Company securitizes these loans through the Government National Mortgage Association, or Ginnie Mae, MBS I program and sells the resulting securities in the open market to authorized dealers in the normal course of business and generally retains the mortgage servicing rights, or MSRs, for a

period of time before the MSR's are packaged into a portfolio and sold.

The lending activities in which the Bank engages carry the risk that the borrowers will be unable to perform on their obligations. As such, interest rate policies of the Board of Governors of the Federal Reserve System, which we refer to as the Federal Reserve Board or the Federal Reserve, and general economic conditions, nationally and in the Bank's primary market area, could have a significant impact on the Bank's and the Company's results of operations. To the extent that economic conditions deteriorate, business and individual borrowers may be less able to meet their obligations to the Bank in full, in a timely manner, resulting in decreased earnings or losses to the Bank. Economic conditions may also adversely affect the value of property pledged as security for loans.

The Bank's goal is to mitigate risks in the event of unforeseen threats to the loan portfolio as a result of economic downturn or other negative influences. Plans for mitigating inherent risks in managing loan assets include: carefully enforcing loan policies and procedures, evaluating each borrower's business plan during the underwriting process and throughout the loan term, identifying and monitoring primary and alternative sources for loan repayment, and obtaining collateral to mitigate economic loss in the event of liquidation. Specific loan reserves are established based upon credit and/or collateral risks on an individual loan basis. A risk rating system is employed to proactively estimate loss exposure and provide a measuring system for setting general and specific reserve allocations.



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The composition of the Company's loan portfolio is heavily weighted toward commercial real estate, both owner occupied and income producing real estate. At December 31, 2018, owner occupied commercial real estate and construction - C&I (owner occupied) represent approximately 14% of the loan portfolio. At December 31, 2018, non-owner occupied commercial real estate and real estate construction represented approximately 61% of the loan portfolio. The combined owner occupied and commercial real estate loans represented approximately 75% of the loan portfolio. Real estate also serves as collateral for loans made for other purposes, resulting in 85% of all loans being secured by real estate. These loans are underwritten to mitigate lending risks typical of this type of loan such as declines in real estate values, changes in borrower cash flow and general economic conditions. The Bank typically requires a maximum loan to value of 80% and minimum cash flow debt service coverage of 1.15 to 1.0. Personal guarantees may be required, but may be limited. In making real estate commercial mortgage loans, the Bank generally requires that interest rates adjust not less frequently than five years.

The Company is also an active traditional commercial lender providing loans for a variety of purposes, including working capital, equipment, and account receivable financing. This loan category represents approximately 22% of the loan portfolio at December 31, 2018 and was generally variable or adjustable rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral, and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited. SBA loans represent approximately 2% of the commercial loan category. In originating SBA loans, the Company assumes the risk of non-payment on the unguaranteed portion of the credit. The Company generally sells the guaranteed portion of the loan generating noninterest income from the gains on sale, as well as servicing income on the portion participated. SBA loans are subject to the same cash flow analyses as other commercial loans. SBA loans are subject to a maximum loan size established by the SBA as well as internal loan size guidelines.

Approximately 1% of the loan portfolio at December 31, 2018 consists of home equity loans and lines of credit and other consumer loans. These credits, while making up a small portion of the loan portfolio, demand the same emphasis on underwriting and credit evaluation as other types of loans advanced by the Bank.

Approximately 2% of the loan portfolio consists of residential mortgage loans. At December 31, 2018, the repricing duration of these loans was 21 months. These credits represent first liens on residential property loans originated by the Bank. While the Bank's general practice is to originate and sell (servicing released) loans made by its Residential Lending department, from time to time certain loan characteristics do not meet the requirements of third party investors and these loans are instead maintained in the Bank's portfolio until they are resold to another investor at a later date or mature.

Our lending activities are subject to a variety of lending limits imposed by state and federal law. These limits will increase or decrease in response to increases or decreases in the Bank's level of capital. At January 31, 2019, the Bank had a legal lending limit of \$185 million. At December 31, 2018, the average loan size outstanding for Commercial Real Estate, or CRE, and Commercial and Industrial, or C&I, loans was \$3.5 million and \$788 thousand, respectively. In accordance with internal lending policies, the Bank may sell participations in its loans to other banks, which allows

the Bank to manage risk involved in these loans and to meet the lending needs of its clients.

The risk of nonpayment (or deferred payment) of loans is inherent in all lending. The Bank's marketing focus on small to medium-sized businesses may result in the assumption by the Bank of certain lending risks that are different from those associated with loans to larger companies. Management and/or committees of the Bank carefully evaluate loan applications and attempt to minimize credit risk exposure by use of extensive loan application data, due diligence, and approval and monitoring procedures; however, there can be no assurance that such procedures can significantly reduce such lending risks.

The Bank originates residential mortgage loans primarily as a correspondent lender. Activity in the residential mortgage loan market is highly sensitive to changes in interest rates and product availability. While the Bank does have delegated underwriting authority from most of its investors, it also employs the services of the investor to underwrite the loans. Because the loans are originated within investor guidelines and designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. Most contracts with investors contain recourse periods. In general, the Bank may be required to repurchase a previously sold mortgage loan or indemnify the investor if there is non-compliance with defined loan origination or documentation standards, including fraud, negligence or material misstatement in the loan documents. In addition, the Bank may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term or may be required to return profits made should the loan prepay within a short period. The potential repurchase period varies by investor but can be up to approximately twelve months after sale of the loan to the investor. Mortgages subject to recourse are collateralized by single-family residential properties, have loan-to-value ratios of 80% or less, or have private mortgage insurance. In certain instances, the Bank may provide equity loans (second position financing) in combination with residential first mortgage lending for purchase money and refinancing purposes.

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The Bank enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. To protect against the price risk inherent in residential mortgage loan commitments, the Bank utilizes both “best efforts” and “mandatory delivery” forward loan sale commitments to mitigate the risk of potential decrease in the values of loans that would result from the exercise of the derivative loan commitments. Under a “best efforts” contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Bank if the loan to the underlying borrower closes. The Bank protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the investor commits to purchase a loan at a price representing a premium on the day the borrower commits to an interest rate with the intent that the buyer/investor has assumed the interest rate risk on the loan. As a result, the Bank is not generally exposed to losses on loans sold utilizing best efforts, nor will it realize gains related to rate lock commitments due to changes in interest rates. The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, no gain or loss should occur on the rate lock commitments. Under a “mandatory delivery” contract, the Bank commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Bank fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a “pair-off” fee, based on then-current market prices, to compensate the investor for the shortfall. The rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The Bank manages the interest rate risk on rate lock commitments by entering into forward sale contracts of mortgage backed securities, whereby the Bank obtains the right to deliver securities to investors in the future at a specified price. Such contracts are accounted for as derivatives and are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in other income. The period of time between issuance of a loan commitment to the customer and closing and sale of the loan to an investor generally ranges from 30 to 90 days under current market conditions.

Loans are secured primarily by duly recorded first deeds of trust or mortgages. In some cases, the Bank may accept a recorded junior trust position. In general, borrowers will have a proven ability to build, lease, manage and/or sell a commercial or residential project and demonstrate satisfactory financial condition. Additionally, an equity contribution toward the project is generally required whether associated with acquisition or construction of a property.

The general terms and underwriting standards for each type of commercial real estate and construction loan are incorporated into the Bank’s lending policies. These policies are analyzed periodically by management, and the policies are reviewed and re-approved annually by the Board. The Bank’s loan policies and practices described in this report are subject to periodic change, and each guideline or standard is subject to waiver or exception in the case of any particular loan, by the appropriate officer or committee, in accordance with the Bank’s loan policies. Policy standards are often stated in mandatory terms, such as “shall” or “must”, but these provisions are subject to exceptions. Policy requires that loan value not exceed a percentage of “market value” or “fair value” based upon appraisals or evaluations obtained in the ordinary course of the Bank’s underwriting practices.

Construction loans require that the financial condition and experience of the general contractor and major subcontractors be satisfactory to the Bank. Guaranteed, fixed price contracts are required whenever appropriate, along with payment and performance bonds or completion bonds for larger scale projects.

Loans intended for residential land acquisition, lot development and construction are made on the premise that the land: (1) is or will be developed for building sites for residential structures; and (2) will ultimately be utilized for construction or improvement of residential zoned real properties, including the creation of housing. Residential development and construction loans will finance projects such as single family subdivisions, planned unit developments, townhouses, and condominiums. Residential land acquisition, development and construction loans generally are underwritten with a maximum term of 36 months, including extensions approved at origination.

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Commercial land acquisition and construction loans are secured by real property where loan funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner user commercial properties. Borrowers are generally required to put equity into each project at levels determined by the appropriate Loan Committee. Commercial land acquisition and construction loans generally are underwritten with a maximum term of 24 months.

Loan-to-value, or LTV, ratios, with few exceptions, are maintained consistent with or below supervisory guidelines.

Substantially all construction draw requests must be presented in writing on American Institute of Architects documents and certified either by the contractor, the borrower and/or the borrower's architect. Each draw request shall also include the borrower's soft cost breakdown certified by the borrower or their Chief Financial Officer. Prior to an advance, the Bank or its contractor inspects the project to determine that the work has been completed, to justify the draw requisition.

Commercial permanent loans are generally secured by improved real property, which is generating income in the normal course of operation. Debt service coverage, assuming stabilized occupancy, must be satisfactory to support a permanent loan. The debt service coverage ratio is ordinarily at least 1.15 to 1.0. As part of the underwriting process, debt service coverage ratios are stress tested assuming a 200 basis point increase in interest rates from their current levels.

Commercial permanent loans generally are underwritten with a term not greater than 10 years or the remaining useful life of the property, whichever is lower. The preferred term is between 5 to 7 years, with amortization to a maximum of 25 years.

Personal guarantees are generally received from the principals on commercial real estate loans, and only in instances where the loan-to-value is sufficiently low and the debt service coverage is sufficiently high is consideration given to either limiting or not requiring personal recourse.

Updated appraisals for real estate secured loans are obtained as necessary and appropriate to borrower financial condition, project status, loan terms, and market conditions.

The Company's loan portfolio includes loans made for real estate ADC purposes, including both income producing and owner occupied projects. ADC loans amounted to \$1.62 billion at December 31, 2018. A portion of the ADC

portfolio, both speculative and non-speculative, includes loan funded interest reserves at origination. ADC loans that provide for the use of interest reserves represent approximately 70% of the outstanding ADC loan portfolio at December 31, 2018. The decision to establish a loan funded interest reserve is made upon origination of the ADC loan and is based upon a number of factors considered during underwriting of the credit including: (i) the feasibility of the project; (ii) the experience of the sponsor; (iii) the creditworthiness of the borrower and guarantors; (iv) borrower equity contribution; and (v) the level of collateral protection. When appropriate, an interest reserve provides an effective means of addressing the cash flow characteristics of a properly underwritten ADC loan. The Company does not significantly utilize interest reserves in other loan products. The Company recognizes that one of the risks inherent in the use of interest reserves is the potential masking of underlying problems with the project and/or the borrower's ability to repay the loan. In order to mitigate this inherent risk, the Company employs a series of reporting and monitoring mechanisms on all ADC loans, whether or not an interest reserve is provided, including: (i) construction and development timelines which are monitored on an ongoing basis and which track the progress of a given project to the timeline projected at origination; (ii) a construction loan administration department independent of the lending function; (iii) third party independent construction loan inspection reports; (iv) monthly interest reserve monitoring reports detailing the balance of the interest reserves approved at origination and the days of interest carry represented by the reserve balances as compared to the then current anticipated time to completion and/or sale of speculative projects; and (v) quarterly commercial real estate construction meetings among senior Company management which includes monitoring of current and projected real estate market conditions. If a project has not performed as expected, it is not the customary practice of the Company to increase loan funded interest reserves.

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The Company has not experienced any significant issues with increased vacancy rates or lower rents for income producing properties financed. The construction loan portfolio has remained solid, particularly in areas of well-located residential and multifamily projects, as the housing market has continued to improve and stabilize. The Washington, D.C. metropolitan area real estate market has been relatively stable; however, certain segments, including suburban offices, have exhibited higher than normal vacancy and experienced concessions in specific submarkets. The impact of disruptions in government spending patterns, (i.e. government shutdowns, sequestration, program cuts or terminations, leasing activity, and changes in geographic distribution of government spending) while within manageable levels to date, remain of concern. As a result, the Company has continued to maintain somewhat higher environmental allocation factors for the allowance for loan and lease losses, or ALLL, associated with the real estate loan portfolio. As part of its overall risk assessments, management carefully reviews the Bank's loan portfolio and general economic and market conditions on a regular basis and will continue to adjust both the specific and environmental reserve factors as necessary.

Deposit services include business and personal checking accounts, NOW accounts, tiered savings and money market account and time deposits with varying maturity structures and customer options. A complete individual retirement account program is available. The Bank also participates in the Promontory Interfinancial Network, LLC ("Promontory") Certificate of Deposit Account Registry Service ("CDARS") and its Insured Cash Sweep ("ICS") program, both of which networks function to assure full FDIC insurance for participating Bank customers. In cooperation with Goldman Sachs Asset Management, the Bank offers a Goldman Sachs Investment Sweep Account, a check writing cash management account that sweeps funds to one of several non-FDIC insured off-balance sheet investment accounts managed by Goldman Sachs.

The Bank offers a full range of on-line banking services for both personal and business accounts and has a Mobile Banking application for both businesses and individuals. Other services include cash management services, business sweep accounts, lock box, remote deposit capture, account reconciliation services, merchant card services, safety deposit boxes and Automated Clearing House origination. After-hours depositories and ATM service are also available.

The Company and Bank maintain portfolios of short term investments and investment securities consisting primarily of U.S. agency bonds and government sponsored enterprise mortgage backed securities, municipal bonds, and corporate bonds. The Bank also owns equity investments related to membership in the Federal Reserve System and the Federal Home Loan Bank of Atlanta, or the FHLB. The Company's securities portfolio also consists of equity investments in the form of common stock of two local banking companies. These portfolios provide the following objectives: capital preservation, liquidity management, additional income to the Company and Bank in the form of interest and gain on sale opportunities, collateral to facilitate borrowing arrangements and assistance with meeting interest rate risk management objectives. The current Investment Policy limits the Bank to investments of high quality, U.S. Treasury securities, U.S. agency securities and high grade municipal and corporate securities, including subordinated debentures of U.S. regulated banks. High risk investments and non-traditional investments are prohibited. Investment maturities are generally limited to ten to fifteen years, except as specifically approved by the Asset Liability Committee, or ALCO, and mortgage backed pass through securities, which may have final stated maturities of 30 years, with average lives generally not to exceed eight years.

The Company and Bank have formalized an asset and liability management process and have a standing ALCO consisting both of outside and inside directors and senior management. The ALCO operates under established policies and practices and a Committee Charter, which practices are updated and re-approved annually. A typical ALCO meeting includes discussion of current economic conditions and balance sheet and other strategies, including interest rate trends and, the current balance sheet and earnings position, comparisons to budget, cash flow estimates, liquidity positions, liquidity stress tests (quarterly), and funding alternatives as necessary, interest rate risk position (monthly), including derivative positions, capital positions of the Company and Bank, reviews (including independent reviews) of the investment portfolio of the Bank and the Company, and the approval of investment transactions. Additionally, monthly ALCO meetings may include reports and analysis of outside firms to enhance the Committee's knowledge and understanding of various financial matters. Various other bank employees attend monthly committee meetings to build their understanding of all financial matters. A weekly conference call is scheduled to bring added attention primarily to shorter term cash flow estimates and interest rate matters.



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The development of the Company's customer base has benefited from the extensive business and personal contacts of its directors and executive officers. Full relationships have been fostered including deposit balances, loan balances and non interest revenue sources. The Bank has placed enhanced reliance on proactively designed officer calling programs and lender teams, active participation in business organizations, and enhanced referral programs.

*Internet Access to Company Documents.* The Company provides access to its Securities and Exchange Commission ("SEC") filings through its web site at [www.eaglebankcorp.com](http://www.eaglebankcorp.com). After accessing the web site, the filings are available upon selecting "Investor Relations/SEC Filings/Documents." Reports available include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after the reports are electronically filed with or furnished to the SEC. Further, the SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

## **MARKET AREA AND COMPETITION**

The primary service area of the Bank is the Washington, D.C. metropolitan area. With a population of nearly 6.2 million, the region is the 6<sup>th</sup> largest metropolitan area in the US (US Census Bureau 2017). Total employment in the region is approximately 3,353,400 (Bureau of Labor Statistics report October 2018). The region has the 7<sup>th</sup> highest rate of job creation records of any market in the country with reported new job creation of 60,700 new jobs created in 2018. The Washington D.C. metropolitan area contains a substantial federal workforce, as well as a variety of support industries that employ professionals such as attorneys, lobbyists, government contractors, real estate developers and investors, non-profit organizations, and consultants. The Gross Regional Product ("GRP") for the metropolitan area in 2017 was reported at \$529 billion. Of this amount, approximately 30% is associated with spending by the government. Other significant sectors include professional and business services, education, health, leisure, and hospitality. The region also has a very active non-profit sector including trade associations, colleges, universities, and major hospitals. Transportation congestion and federal government spending levels remain threats to future economic development and quality of life in the area.

Montgomery County, Maryland, with a total population estimated at 1,058,810 as of 2017 and occupying an area of about 500 square miles, borders Washington, D.C. to the north and is roughly 30 miles southwest of Baltimore. Montgomery County represents a diverse and healthy segment of Maryland's economy. Montgomery County is a thriving business center and is Maryland's most populous jurisdiction. Population in the county is expected to grow 6.7% between 2017 and 2025. The State of Maryland boasts a demographic profile superior to the U.S. economy at large, and the economy in and around Montgomery County is among the best in Maryland. The number of jobs in Montgomery County has been relatively stable in the recent past with the public sector contributing about 20% of the employment. The unemployment rate in Montgomery County is among the lowest in the state at 2.6% in December of 2018, based on Bureau of Labor Statistics', or BLS, Local Area Unemployment preliminary dataset. A highly educated population has contributed to favorable median household income of \$103,178 with the number of households totaling 369,242. According to the U.S. census update, approximately 58% of the County's residents in 2017 hold college or

advanced degrees, placing the population of Montgomery County among the most educated in the nation. The area boasts a diverse business climate of over 27,000 businesses with over 424,372 private and public sector jobs. Major areas of employment include a substantial technology sector, biotechnology, software development, a housing construction and renovation sector, and legal, financial services, health care, and professional services sectors. Major private employers include Adventist Healthcare, Lockheed Martin, Giant Food, and Marriott International. The county is also an incubator for firms engaged in biotechnology and the area has traditionally attracted significant amounts of venture capital. Montgomery County is home to many major federal and private sector research and development and regulatory agencies, including the National Institute of Standards and Technology, the National Institutes of Health, National Oceanic and Atmospheric Administration, Naval Research and Development Center, Naval Surface Warfare Center, Nuclear Regulatory Commission, the Food and Drug Administration and the Walter Reed National Military Medical Center in Bethesda.

Prince George's County, Maryland, covering just under 500 square miles, has a total estimated population of 912,756 as of July 2017 and is located just east of Washington, D.C. The county supports 306,694 households as of 2017 with median incomes of \$78,607. The unemployment rate in the county was 3.7% in December of 2018 according BLS. Prince George's County continues to promote a business friendly environment and is home to major employers such as the University of Maryland, Joint Base Andrews Naval Air Facility Washington, U.S. Internal Revenue Service and United Parcel Service.

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The District of Columbia, in addition to being the seat of the federal government, is a vibrant city with a well-educated, diverse population. According to survey data from the latest U.S. Census, the estimated July 2018 population of the District of Columbia is approximately 702,455, up from 601,766 in 2010. Median household income, at \$77,649 as of 2017, is above the national median level of \$57,652. The growth of residents in the city is due partially to improvements in the city's services and to the many housing options available, ranging from grand old apartment buildings to Federal era town homes to the most modern condominiums. As of July 2017, the housing market has grown to 314,805 units. While the federal government and its employees are a major factor in the economy, over 100 million square feet of commercial office space support a dynamic business community of more than 23,000 companies. These include law and accounting firms, trade and professional associations, information technology companies, international financial institutions, health and education organizations and research and management companies. Unemployment was 4.8% at December 2018 according to BLS. The disparity between the higher level of unemployment among District of Columbia residents and the strong employment trends reflects the high level of jobs in the District held by residents of the surrounding suburban jurisdictions. The District of Columbia has a well-educated and highly paid work force. The federal government accounts for approximately 27% of the employment and private firms provide an additional 68% with local government making up the other 5%. Other large employers include the many local universities and hospitals. Another significant factor in the economy is the leisure and hospitality industry, as Washington, D.C. remains a popular tourist destination for both national and international travelers.

Fairfax County, Virginia, which is just across the Potomac River and west from Washington, D.C., is a large, affluent jurisdiction with an estimated population of 1,148,433 as of July 2017 including Fairfax City. This county covers about 395 square miles. Fairfax County is one of the leading technology centers in the US. Eight Fortune 500 companies are headquartered in the county and 31 of the largest 100 technology federal contractors in the Washington D.C. metropolitan area are located in Fairfax County. The county has over 116.4 million square feet of office space and is one of the largest suburban office markets in the US. It is a thriving residential as well as business center with 393,380 households. The county is among the most affluent in the country with average annual household income of \$117,515 as of 2017. Unemployment was 2.1% in December of 2018 according to BLS. Major companies headquartered in the county, which are also major employers, include Capital One Financial, CSC, Gannett, General Dynamics, Hilton Hotels, Leidos, Sallie Mae, and Inova Health Systems. In 2018, global construction firm Bechtel moved their corporate headquarters from San Francisco to Fairfax County. The county is also home to several federal entities including the CIA, Fort Belvoir and a major facility of the Smithsonian Institution.

Arlington County, Virginia, has an estimated population of over 234,965 as of July 2017. The county is made up of 26 square miles and is situated just west of Washington, D.C., directly across the Potomac River. There are approximately 102,310 households with a median household income of \$112,138 as of July 2017. Significant private sector employers include Deloitte, Lockheed Martin, Virginia Hospital Center and Marriott International, Inc. The unemployment rate was just 1.7% at the end of 2018. This is the lowest unemployment rate in the state of Virginia and compares very favorably to the U.S rate of 3.9%. The population is highly educated, with about 74.1% of residents over 25 years of age holding at least a bachelor's degree as of 2017. In 2017, Nestle moved their US headquarters to the County. In 2018, Amazon announced that they would be establishing a major corporate presence in Arlington as well.

Alexandria, Virginia is a city with an estimated population of 160,035 as of July 2017. The city is made up of just over 15 square miles and sits on the west bank of the Potomac River just south of Arlington, Virginia. There are approximately 68,663 households with a median household income of \$93,370 as of July 2017. Alexandria has almost 4,711 employer establishments, located in the more than 22 million square feet of office space existing in the city as of December 2016. The unemployment rate was just 1.9% at the end of 2018 according to BLS. The population is highly educated, with over 61.8% of residents over 25 years of age holding at least a bachelor's degree as of 2017.

Loudoun County, Virginia covers about 520 square miles of land 25 miles northwest of Washington, D.C. and boasts a population of 398,080 as of July 2017. Median income, according to July 2017 Census Bureau data, is \$129,588 which is more than twice the national median household income of \$57,652. The Virginia Employment Commission expects to see employment growth of 1.2% annually through 2024. The major private employers in the county include United Airlines, Inc., Raytheon Company, Loudoun Hospital Center and Swissport U.S.A., Inc. The county is also home to public sector employees such as the Loudoun County Schools, County of Loudoun, U.S. Department of Homeland Security and the Postal Service.

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Throughout the Washington, D.C. metropolitan area, competition is significant from large banking institutions headquartered in and outside of the area. Although some consolidation has occurred in the market in the past few years, the Bank continues to compete with other community banks, savings and loan associations, credit unions, mortgage companies and finance companies, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, private lenders and nontraditional competitors such as fintech companies and internet-based lenders, depositories and payment systems. Among the advantages that many of these large institutions have over the Bank are their abilities to finance extensive advertising campaigns, maintain extensive branch networks and make larger technology investments, and to directly offer certain services, such as international banking and trust services, which are not offered directly by the Bank. Further, the greater capitalization of the larger institutions headquartered out-of-state allows for higher lending limits than the Bank, although the Bank's current lending limit is quite favorable and able to accommodate the credit needs of most businesses in the Washington D.C. metropolitan area, which distinguishes it from most community banks in the market area. Some of these competitors have other advantages, such as tax exemption in the case of credit unions, and to some extent lesser regulation in the case of mortgage companies, finance companies, and many nontraditional competitors. As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), enacted in July 2010, regulation of all financial firms has been heightened, although new draft legislation in 2018 is expected to diminish bank regulatory pressures. Under current law, unlimited interstate *de novo* branching is available to all state and federally chartered banks. As a result, institutions, which previously were ineligible to establish *de novo* branches in the Bank's market area, may elect to do so.

Effective July 1, 2015, the Bank entered into a multi-faceted support agreement with George Mason University ("George Mason"), the Commonwealth of Virginia's largest public research university. The agreement provides for significant educational support, and a strategic alliance including the Bank obtaining the naming rights to a multi-purpose sports and entertainment venue formerly known as the Patriot Center, now known as "EagleBank Arena" in Fairfax, VA for up to a 20 year term. Under the agreement, the Bank pays George Mason an annual fee to be used for scholarships, internships, overall educational and athletic support and beautification efforts.

Effective March 12, 2018, the Bank entered into a five year sponsorship of the Major League Soccer club D.C. United. EagleBank has been designated the official bank of D.C. United and the "EagleBank Club" at Audi Field, the soccer club's stadium in southwest Washington D.C., provides premium seating for fans and patrons of the Bank. The stadium opened in the summer of 2018 and hosts cultural and community events and concerts as well as Major League Soccer games.

## **EMPLOYEES**

At December 31, 2018 the Bank employed 470 persons on a full time basis (six of whom are executive officers of the Bank), which compares to 466 employees at December 31, 2017. None of the Bank's employees are represented by any collective bargaining group and the Bank believes that its employee relations are good. At December 31, 2018, the Bank provided a benefit program, which included health and dental insurance, a 401(k) plan, life and short and

long-term disability insurance, and company paid fitness facilities in various locations. Additionally, the Company maintains an employee stock purchase plan and a stock-based compensation plan for employees of the Bank who meet certain eligibility requirements. A performance-based stock compensation plan is also maintained for executive officers meeting certain requirements. All employees benefit from robust training programs and tuition assistance. Additionally, leadership development programs are offered to employees who meet certain eligibility requirements.

## **REGULATION**

Our business and operations are subject to extensive federal and state governmental regulation and supervision. The following is a brief summary of certain statutes and rules and regulations that affect or will affect us. This summary is not intended to be an exhaustive description of the statutes or regulations applicable to our business. Supervision, regulation, and examination of the Company by the regulatory agencies are intended primarily for the protection of depositors and the Deposit Insurance Fund, rather than our shareholders.

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*The Company.* The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, (the “Act”) and is subject to regulation and supervision by the Federal Reserve Board. The Act and other federal laws subject bank holding companies to restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations and unsafe and unsound banking practices. As a bank holding company, the Company is required to file with the Federal Reserve Board an annual report and such other additional information as the Federal Reserve Board may require pursuant to the Act. The Federal Reserve Board may also examine the Company and each of its subsidiaries. The Company is subject to risk-based capital requirements adopted by the Federal Reserve Board, which are substantially identical to those applicable to the Bank, and which are described below.

The Act requires approval of the Federal Reserve Board for, among other things, a bank holding company’s direct or indirect acquisition of control of more than five percent (5%) of the voting shares, or substantially all the assets, of any bank or the merger or consolidation by a bank holding company with another bank holding company. The Act also generally permits the acquisition by a bank holding company of control or substantially all the assets of any bank located in a state other than the home state of the bank holding company, except where the bank has not been in existence for the minimum period of time required by state law; but if the bank is at least 5 years old, the Federal Reserve Board may approve the acquisition.

With certain limited exceptions, a bank holding company is prohibited from acquiring control of any voting shares of any company which is not a bank or bank holding company and from engaging directly or indirectly in any activity other than banking or managing or controlling banks or furnishing services to or performing service for its authorized subsidiaries. A bank holding company may, however, engage in or acquire an interest in, a company that engages in activities which the Federal Reserve Board has determined by order or regulation to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such a determination, the Federal Reserve Board is required to consider whether the performance of such activities can reasonably be expected to produce benefits to the public, such as convenience, increased competition or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve Board is also empowered to differentiate between activities commenced *de novo* and activities commenced by the acquisition, in whole or in part, of a going concern. Some of the activities that the Federal Reserve Board has determined by regulation to be closely related to banking include making or servicing loans, performing certain data processing services, acting as a fiduciary or investment or financial advisor, and making investments in corporations or projects designed primarily to promote community welfare. The Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company’s continued ownership, activity or control constitutes a serious risk to the financial safety, soundness, or stability of it or any of its bank subsidiaries.

Subsidiary banks of a bank holding company are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or any of its subsidiaries, or investments in the stock or other securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. Further, a bank holding company and any subsidiary bank are prohibited from engaging in certain tie-in arrangements in connection

with the extension of credit. A subsidiary bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer obtain or provide some additional credit, property or services from or to such bank other than a loan, discount, deposit or trust service; (ii) the customer obtain or provide some additional credit, property or service from or to the Company or any other subsidiary of the Company; or (iii) the customer not obtain some other credit, property or service from competitors, except for reasonable requirements to assure the soundness of credit extended.

The Gramm Leach-Bliley Act of 1999, or GLB Act, allows a bank holding company or other company to certify status as a financial holding company, which would allow such company to engage in activities that are financial in nature, that are incidental to such activities, or are complementary to such activities. The GLB Act enumerates certain activities that are deemed financial in nature, such as underwriting insurance or acting as an insurance principal, agent or broker, underwriting, dealing in or making markets in securities, and engaging in merchant banking under certain restrictions. It also authorizes the Federal Reserve Board to determine by regulation what other activities are financial in nature, or incidental or complementary thereto. The Company has not elected financial holding company status.



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The Federal Deposit Insurance Act, or FDIA, and Federal Reserve policy require a bank holding company to serve as a source of financial and managerial strength to its bank subsidiaries. In addition, where a bank holding company has more than one FDIC insured bank or thrift subsidiary, each of the bank holding company's subsidiary FDIC-insured depository institutions is responsible for losses to the FDIC as a result of an affiliated depository institution's failure. As a result of a bank holding company's source of strength obligation, a bank holding company may be required to provide funds to a bank subsidiary in the form of subordinated capital or other instruments which qualify as capital under bank regulatory rules. Any loans from the holding company to such subsidiary banks likely would be unsecured and subordinated to such bank's depositors and perhaps to other creditors of the Bank.

A bank holding company is generally required to give the Federal Reserve prior written notice of any purchase or redemption of its own then outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve order or directive, or any condition imposed by, or written agreement with, the Federal Reserve. The Federal Reserve has adopted an exception to this approval requirement for well-capitalized bank holding companies that meet certain conditions.

As a Maryland corporation, the Company is subject to additional limitations and restrictions. For example, state law restrictions include limitations and restrictions relating to indemnification of directors, distributions to shareholders, transactions involving directors, officers or interested shareholders, maintenance of books, records, minutes, borrowing and the observance of corporate formalities.

*The Bank.* The Bank is a Maryland chartered commercial bank and a member of the Federal Reserve System (a "state member bank") whose accounts are insured by the Deposit Insurance Fund of the FDIC up to the maximum legal limits of the FDIC. The Bank is subject to regulation, supervision and regular examination by the State of Maryland Office of Financial Regulation and the Federal Reserve Board. The regulations of these various agencies govern most aspects of the Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends and location and number of branch offices.

The laws and regulations governing the Bank generally have been promulgated to protect depositors and the Deposit Insurance Fund, and not for the purpose of protecting shareholders.

Competition among commercial banks, savings and loan associations, and credit unions has increased following enactment of legislation, which greatly expanded the ability of banks and bank holding companies to engage in interstate banking or acquisition activities. As a result of federal and state legislation, banks in the Washington, D.C. Metropolitan area can, subject to limited restrictions, acquire or merge with a bank in another jurisdiction, and can

branch *de novo* in any jurisdiction.

Banking is a business, which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of the bank's earnings. Thus, the earnings and growth of the Bank will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve Board, which regulates the supply of money through various means including open market dealings in United States government securities. The nature and timing of changes in such policies and their impact on the Bank cannot be predicted.

*Branching and Interstate Banking.* The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act. Washington, D.C., Maryland and Virginia have each enacted laws, which permit interstate acquisitions of banks and bank branches. The Dodd-Frank Act authorizes national and state banks to establish *de novo* branches in other states to the same extent as a bank chartered by that state would be permitted to branch.

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The GLB Act made substantial changes in the historic restrictions on non-bank activities of bank holding companies, and allows affiliations between types of companies that were previously prohibited. The GLB Act also allows banks to engage in a wider array of nonbanking activities through “financial subsidiaries.”

*Brokered Deposits.* A “brokered deposit” is any deposit that is obtained from or through the mediation or assistance of a deposit broker. These deposit brokers attract deposits from individuals and companies throughout the country and internationally whose deposit decisions are based almost exclusively on obtaining the highest interest rates. Recently enacted legislation excludes reciprocal deposits of up to the lesser of \$5 billion or 20% of an institution’s deposits from the definition of brokered deposits, where the institution is “well-capitalized” and has a composite rating of 1 or 2. We have used brokered deposits in the past, and we intend to continue to use brokered deposits as one of our funding sources to support future growth. As of December 31, 2018, brokered deposits, represented approximately 19% of our total deposits. There are risks associated with using brokered deposits. In order to continue to maintain our level of brokered deposits, we may be forced to pay higher interest rates than those contemplated by our asset-liability pricing strategy. In addition, banks that become less than “well-capitalized” under applicable regulatory capital requirements may be restricted in their ability to accept or renew, or prohibited from accepting or renewing, brokered deposits. If this funding source becomes more difficult to access, we will have to seek alternative funding sources in order to continue to fund our growth. This may include increasing our reliance on FHLB borrowing, attempting to attract additional non-brokered deposits, and selling loans. There can be no assurance that brokered deposits will be available, or if available, sufficient to support our continued growth. The unavailability of a sufficient volume of brokered deposits could have a material adverse effect on our business, financial condition and results of operations.

*USA Patriot Act.* Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the “USA Patriot Act” or the “Patriot Act,” financial institutions are subject to prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to detect, and prevent, the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires financial institutions, including banks, to establish anti-money laundering programs, including employee training and independent audit requirements, meet minimum standards specified by the act, follow minimum standards for customer identification and maintenance of customer identification records, and regularly compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers. The costs or other effects of the compliance burdens imposed by the Patriot Act or future anti-terrorist, homeland security or anti-money laundering legislation or regulation cannot be predicted with certainty.

*Office of Foreign Assets Control.* The United States has imposed economic sanctions that affect transactions with designated foreign countries, foreign nationals and others, which are administered by the U.S. Treasury Department’s Office of Foreign Assets Control, or OFAC. The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on a “U.S. person” engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of a sanctioned country have an interest by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S.

persons). Blocked assets (e.g. property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

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*Capital Adequacy.* The Federal Reserve Board and the FDIC have adopted risk-based and leverage capital adequacy requirements, pursuant to which they assess the adequacy of capital in examining and supervising banks and bank holding companies and in analyzing bank regulatory applications. Risk-based capital requirements determine the adequacy of capital based on the risk inherent in various classes of assets and off-balance sheet items. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

The federal banking agencies have adopted rules, referred to as the Basel III Rules, to implement the framework for strengthening international capital and liquidity regulation adopted by the Basel Committee on Banking Supervision, or Basel III. The Basel III framework, among other things, (i) introduced common equity tier one capital, or CET1, (ii) specified that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) defined CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expanded the scope of the adjustments as compared to existing regulations.

Basel III requires banks to maintain: (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a “capital conservation buffer” of 2.5%, or 7.0%; (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer, or 8.5%; (iii) a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0% plus the capital conservation buffer, or 10.5%; and (iv) a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Basel III also provides for a “countercyclical capital buffer,” generally to be imposed when federal banking agencies determine that excess aggregate credit growth becomes associated with a buildup of systemic risk that would be a CET1 add-on to the capital conservation buffer of 2.5% when fully implemented. The capital conservation buffer is designed to absorb losses during periods of economic stress.

Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) may face constraints on its ability to pay dividends, effect equity repurchases and pay discretionary bonuses to executive officers, which constraints vary based on the amount of the shortfall.

Under the Basel III Rules, mortgage-servicing assets and deferred tax assets are subject to stricter limitations than those previously applicable under capital rules. More specifically, certain deferred tax assets arising from temporary differences, mortgage-servicing assets, and significant investments in the capital of unconsolidated financial institutions in the form of common stock are each subject to an individual limit of 10% of common equity Tier 1

capital elements and are subject to an aggregate limit of 15% of common equity Tier 1 capital elements. The amount of these items in excess of the 10% and 15% thresholds are to be deducted from common equity Tier 1 capital. Amounts of mortgage servicing assets, deferred tax assets, and significant investments in unconsolidated financial institutions that are not deducted due to the aforementioned 10% and 15% thresholds must be assigned a 250% risk weight. Finally, the rule increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors. A recent rule proposal would revise the treatment of deferred tax assets and mortgage servicing rights to increase the amounts of such assets includable in capital.

The Basel III Rules also include, as part of the definition of CET1 capital, a requirement that banking institutions include the amount of additional other comprehensive income, or AOCI, which primarily consists of unrealized gains and losses on available-for-sale securities, which are not required to be treated as other-than-temporary impairment, net of tax) in calculating regulatory capital, unless the institution makes a one-time opt-out election from this provision in connection with the filing of its first regulatory reports after applicability of the Basel III Rules to that institution. The Company opted-out of this requirement and, as such, does not include AOCI in its regulatory capital calculation. The Basel III Rules also require a 4% minimum leverage ratio, and a 5% leverage ratio to be considered well capitalized.

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The Basel III Rules also made changes to the manner of calculating risk weighted assets. New methodologies for determining risk weighted assets in the general capital rules are included, including revisions to recognition of credit risk mitigation, including a greater recognition of financial collateral and a wider range of eligible guarantors. They also include risk weighting of equity exposures and past due loans; and higher (greater than 100%) risk weighting for certain commercial real estate exposures that have higher credit risk profiles, including higher loan to value and equity components. In particular, loans categorized as “high-volatility commercial real estate,” or HVCRE, loans are required to be assigned a 150% risk weighting, and require additional capital support. HVCRE loans are defined to include any credit facility that finances or has financed the acquisition, development or construction of real property, unless it finances: 1-4 family residential properties; certain community development investments; agricultural land used or usable for, and whose value is based on, agricultural use; or commercial real estate projects in which: (i) the LTV is less than the applicable maximum supervisory LTV ratio established by the bank regulatory agencies; (ii) the borrower has contributed cash or unencumbered readily marketable assets, or has paid development expenses out of pocket, equal to at least 15% of the appraised “as completed” value; (iii) the borrower contributes its 15% before the bank advances any funds; and (iv) the capital contributed by the borrower, and any funds internally generated by the project, is contractually required to remain in the project until the facility is converted to permanent financing, sold or paid in full. The “Economic Growth, Regulatory Relief, and Consumer Protection Act,” or the 2018 Act, expanded the exclusion from HVCRE loans to include credit facilities financing the acquisition or refinance of, or improvements to, existing income producing property, secured by the property, if the cash flow being generated by the property is sufficient to support the debt service and expenses of the property in accordance with the institution’s loan criteria for permanent financing. The 2018 Act also provides that the value of contributed property will be its appraised value, rather than its cost. The 2018 Act permits an institution to reclassify an HVCRE loan as a non-HVCRE loan upon substantial completion of the project, where the cash flow from the property is sufficient to support debt service and expenses, in accordance with the institution’s underwriting criteria for permanent financing. Basel III subjected the higher risk loans that were made by ECV to higher risk weightings, and as such those loans required additional capital, or substantial restructuring in order to avoid such higher risk weights.

As discussed below, the Basel III Rules also integrate the new capital requirements into the prompt corrective action provisions under Section 38 of the FDIA.

The capital ratios described above are the minimum levels that the federal banking agencies expect. Our state and federal regulators have the discretion to require us to maintain higher capital levels based upon our concentrations of loans, the risk of our lending or other activities, the performance of our loan and investment portfolios and other factors. Failure to maintain such higher capital expectations could result in a lower composite regulatory rating, which would impact our deposit insurance premiums and could affect our ability to borrow and costs of borrowing, and could result in additional or more severe enforcement actions. In respect of institutions with high concentrations of loans in areas deemed to be higher risk, or during periods of significant economic stress, regulators may require an institution to maintain a higher level of capital, and/or to maintain more stringent risk management measures, than those required by these regulations.

In December 2017, the Basel Committee on Banking Supervision published the last version of the Basel III accord, generally referred to as “Basel IV.” The Basel Committee stated that a key objective of the revisions incorporated into

the framework is to reduce excessive variability of risk-weighted assets, or RWA, which will be accomplished by enhancing the robustness and risk sensitivity of the standardized approaches for credit risk and operational risk, which will facilitate the comparability of banks' capital ratios; constraining the use of internally modeled approaches; and complementing the risk-weighted capital ratio with a finalized leverage ratio and a revised and robust capital floor. Leadership of the federal banking agencies who are tasked with implementing Basel IV supported the revisions. Although it is uncertain at this time, it is anticipated that some, if not all, of the Basel IV accord may be incorporated into the capital requirements framework applicable to the Bank.

The 2018 Act also directs the federal bank regulatory agencies to develop a "Community Bank Leverage Ratio," calculated by dividing tangible equity capital by average consolidated total assets, of not less than 8% and not more than 10%. In November 2018, the federal banking agencies proposed a Community Bank Leverage Ratio of 9%. If a "qualified community bank," generally a depository institution or depository institution holding company with consolidated assets of less than \$10 billion, has a leverage ratio which exceeds the Community Bank Leverage Ratio, then such bank will be considered to have met all generally applicable leverage and risk based capital requirements; the capital ratio requirements for "well capitalized" status under Section 38 of the FDIA, and any other leverage or capital requirements to which it is subject. A bank or holding company may be excluded from qualifying community bank status based on its risk profile, including consideration of its off-balance sheet exposures; trading assets and liabilities; total notional derivatives exposures and such other facts as the appropriate federal banking agencies determine to be appropriate. If the Company and Bank qualify for this simplified capital regime, there can be no assurance that satisfaction of the Community Bank Leverage Ratio will provide adequate capital for their operations and growth, or an adequate cushion against increased levels of nonperforming assets or weakened economic conditions.



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*Prompt Corrective Action.* Under Section 38 of the FDIA, each federal banking agency is required to implement a system of prompt corrective action for institutions, which it regulates. The federal banking agencies have promulgated substantially similar regulations to implement the system of prompt corrective action established by Section 38 of the FDIA. The following capital requirements currently apply to the Bank for purposes of Section 38.

<b>Capital Category</b>	<b>Total Risk-Based Capital Ratio</b>	<b>Tier 1 Risk-Based Capital Ratio</b>	<b>Common Equity Tier 1 Capital Ratio</b>	<b>Leverage Ratio</b>	<b>Tangible Equity to Assets</b>	<b>Supplemental Leverage Ratio</b>
Well Capitalized	10% or greater	8% or greater	6.5% or greater	5% or greater	n/a	n/a
Adequately Capitalized	8% or greater	6% or greater	4.5% or greater	4% or greater	n/a	3% or greater
Undercapitalized	Less than 8%	Less than 6%	Less than 4.5%	Less than 4%	n/a	Less than 3%
Significantly Undercapitalized	Less than 6%	Less than 4%	Less than 3%	Less than 3%	n/a	n/a
Critically Undercapitalized	n/a	n/a	n/a	n/a	Less than 2%	n/a

An institution generally must file a written capital restoration plan which meets specified requirements with an appropriate federal banking agency within 45 days of the date the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. A federal banking agency must provide the institution with written notice of approval or disapproval within 60 days after receiving a capital restoration plan, subject to extensions by the applicable agency.

An institution which is required to submit a capital restoration plan must concurrently submit a performance guaranty by each company that controls the institution. Such guaranty shall be limited to the lesser of (i) an amount equal to 5.0% of the institution's total assets at the time the institution was notified or deemed to have notice that it was undercapitalized or (ii) the amount necessary at such time to restore the relevant capital measures of the institution to the levels required for the institution to be classified as adequately capitalized. Such a guaranty shall expire after the federal banking agency notifies the institution that it has remained adequately capitalized for each of four consecutive calendar quarters. An institution which fails to submit a written capital restoration plan within the requisite period, including any required performance guaranty, or fails in any material respect to implement a capital restoration plan, shall be subject to the restrictions in Section 38 of the FDIA which are applicable to significantly undercapitalized institutions.

A "critically undercapitalized institution" is to be placed in conservatorship or receivership within 90 days unless the FDIC formally determines that forbearance from such action would better protect the Deposit Insurance Fund. Unless the FDIC or other appropriate federal banking agency makes specific further findings and certifies that the institution is viable and is not expected to fail, an institution that remains critically undercapitalized on average during the fourth

calendar quarter after the date it becomes critically undercapitalized must be placed in receivership. The general rule is that the FDIC will be appointed as receiver within 90 days after a bank becomes critically undercapitalized unless extremely good cause is shown and an extension is agreed to by the federal regulators. In general, good cause is defined as capital, which has been raised and is imminently available for infusion into the Bank, except for certain technical requirements, which may delay the infusion for a period of time beyond the 90 day time period.

Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA, which (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: requiring the institution to raise additional capital; restricting transactions with affiliates; requiring divestiture of the institution or the sale of the institution to a willing purchaser; and any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

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Additionally, under Section 11(c)(5) of the FDIA, a conservator or receiver may be appointed for an institution where: (i) an institution's obligations exceed its assets; (ii) there is substantial dissipation of the institution's assets or earnings as a result of any violation of law or any unsafe or unsound practice; (iii) the institution is in an unsafe or unsound condition; (iv) there is a willful violation of a cease-and-desist order; (v) the institution is unable to pay its obligations in the ordinary course of business; (vi) losses or threatened losses deplete all or substantially all of an institution's capital, and there is no reasonable prospect of becoming "adequately capitalized" without assistance; (vii) there is any violation of law or unsafe or unsound practice or condition that is likely to cause insolvency or substantial dissipation of assets or earnings, weaken the institution's condition, or otherwise seriously prejudice the interests of depositors or the insurance fund; (viii) an institution ceases to be insured; (ix) the institution is undercapitalized and has no reasonable prospect that it will become adequately capitalized, fails to become adequately capitalized when required to do so, or fails to submit or materially implement a capital restoration plan; or (x) the institution is critically undercapitalized or otherwise has substantially insufficient capital.

*Regulatory Enforcement Authority.* Federal banking law grants substantial enforcement powers to federal banking agencies. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

As a result of the volatility and instability in the financial system in recent years, Congress, the bank regulatory authorities and other government agencies have called for or proposed additional regulation and restrictions on the activities, practices and operations of banks and their holding companies. The Congress and the federal banking agencies have broad authority to require all banks and holding companies to adhere to more rigorous or costly operating procedures, corporate governance procedures, or to engage in activities or practices which they would not otherwise elect. Any such requirement could adversely affect the Company's business and results of operations.

*The Dodd-Frank Act.* The Dodd-Frank Act made significant changes to the current bank regulatory structure, which affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires a number of federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. Although it is not possible to determine the ultimate impact of this statute and regulations, the following provisions are considered to be of greatest significance to the Company:

Expanded the authority of the Federal Reserve Board to examine bank holding companies and their subsidiaries, including insured depository institutions.

Required a bank holding company to be well capitalized and well managed to receive approval of an interstate bank acquisition.

Provided mortgage reform provisions regarding a customer's ability to pay and making more loans subject to provisions for higher-cost loans and new disclosures.

Created the Consumer Financial Protection Bureau, or CFPB, which has rulemaking authority for a wide range of consumer protection laws that apply to all banks, and has broad powers to supervise and enforce consumer protection laws.

Created the Financial Stability Oversight Council with authority to identify institutions and practices that might pose a systemic risk.

Introduced additional corporate governance and executive compensation requirements on companies subject to the Securities Exchange Act of 1934, as amended, or Exchange Act.

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Permitted FDIC-insured banks to pay interest on business demand deposits.

Codified the requirement that holding companies and other companies that directly or indirectly control an insured depository institution to serve as a source of financial strength.

Made permanent the \$250 thousand limit for federal deposit insurance.

Permitted national and state banks to establish interstate branches to the same extent as the branch host state allows establishment of in-state branches.

Recent administration and Congressional actions suggest that certain provisions of the Dodd-Frank Act may be repealed or limited so as to minimize the burden of overall banking regulations, with emphasis on reduced regulatory burden for community banks, but there can be no assurance as to the timing or impact or any such change on the Company, or whether any such changes will be enacted or implemented.

The 2018 Act includes provisions revising Dodd-Frank Act provisions, including provisions that, among other things: (i) exempt banks with less than \$10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans; (ii) exempt certain transactions valued at less than \$400,000 in rural areas from appraisal requirements; (iii) exempt banks and credit unions that originate fewer than 500 open-end and 500 closed-end mortgages from the expanded data disclosures required under the Home Mortgage Disclosure Act, or HMDA (the provision would not apply to nonbanks and would not exempt institutions from HMDA reporting altogether); (iv) amend the SAFE Mortgage Licensing Act by providing registered mortgage loan originators in good standing with 120 days of transitional authority to originate loans when moving from a federal depository institution to a non-depository institution or across state lines; (v) require the CFPB to clarify how TILA-RESPA Integrated Disclosure applies to mortgage assumption transactions and construction-to-permanent home loans as well as outline certain liabilities related to model disclosure use; (vi) revise treatment of HVCRE exposures; and (vii) create the simplified Community Bank Leverage Capital Ratio. The 2018 Act also exempts community banks from Section 13 of the Bank Holding Company Act, commonly referred to as the Volcker Rule, if they have less than \$10 billion in total consolidated assets; and exempts banks with less than \$10 billion in assets, and total trading assets and liabilities not exceeding more than five percent of their total assets from the Volcker Rule restrictions on trading with their own capital. The 2018 Act also adds certain protections for consumers, including veterans and active duty military personnel, expanded credit freezes and creation of an identity theft protection database.

In addition, other new proposals for legislation continue to be introduced in the Congress that could further substantially increase regulation of the bank and non-bank financial services industries and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied. Certain aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads and could expose the Company to additional costs, including increased compliance costs. These changes also may require significant management

attention and resources to make any necessary changes to operations to comply and could have an adverse effect on our business, financial condition and results of operations.

*Consumer Financial Protection Bureau.* The Dodd-Frank Act created the CFPB, a new, independent federal agency within the Federal Reserve System having broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, the consumer financial privacy provisions of the GLB Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with over \$10 billion in assets. Smaller institutions, including the Bank, are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking agencies for compliance with federal consumer protection laws and regulations. The CFPB also has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

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The changes resulting from the Dodd-Frank Act and CFPB rulemakings and enforcement policies may impact the profitability of our business activities, limit our ability to make, or the desirability of making, certain types of loans, including non-qualified mortgage loans, require us to change our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business or profitability. The changes may also require us to dedicate significant management attention and resources to evaluate and make necessary changes to comply with the new statutory and regulatory requirements.

The CFPB has concentrated much of its rulemaking efforts on reforms related to residential mortgage transactions. The CFPB has issued rules related to a borrower's ability to repay and qualified mortgage standards, mortgage servicing standards, loan originator compensation standards, requirements for high-cost mortgages, appraisal and escrow standards and requirements for higher-priced mortgages. The CFPB has also issued rules establishing integrated disclosure requirements for lenders and settlement agents in connection with most closed end, real estate secured consumer loans and rules which, among other things, expand the scope of information lenders must report in connection with mortgage and other housing-related loan applications under HMDA. These rules include significant regulatory and compliance changes and are expected to have a broad impact on the financial services industry.

The rule implementing the Dodd-Frank Act requirement that lenders determine whether a consumer has the ability to repay a mortgage loan, established certain minimum requirements for creditors when making ability to pay determinations, and established certain protections from liability for mortgages meeting the definition of "qualified mortgages." Generally, the rule applies to all consumer-purpose, closed-end loans secured by a dwelling including home-purchase loans, refinances and home equity loans – whether a first or subordinate lien. The rule does not cover, among other things, home equity lines of credit or other open-end credit; temporary or "bridge" loans with a term of 12 months or less, such as a loan to finance the initial construction of a dwelling; a construction phase of 12 months or less of a construction-to-permanent loan; and business-purpose loans, even if secured by a dwelling. The rule afforded greater legal protections for lenders making qualified mortgages that are not "higher priced." Qualified mortgages must generally satisfy detailed requirements related to product features, underwriting standards, and a points and fees requirement whereby the total points and fees on a mortgage loan cannot exceed specified amounts or percentages of the total loan amount. Mandatory features of a qualified mortgage include: (1) a loan term not exceeding 30 years; and (2) regular periodic payments that do not result in negative amortization, deferral of principal repayment, or a balloon payment. Further, the rule clarified that qualified mortgages do not include "no-doc" loans and loans with negative amortization, interest-only payments, or balloon payments. The rule created special categories of qualified mortgages originated by certain smaller creditors. To the extent that we seek to make qualified mortgages, we are required to comply with these rules, subject to available exclusions. Our business strategy, product offerings, and profitability may change as the rule is interpreted by the regulators and courts.

*Fair and Responsible Banking.* Banks and other financial institutions are subject to numerous laws and regulations intended to promote fair and responsible banking and prohibit unlawful discrimination and unfair, deceptive or abusive practices in banking. These laws include, among others, the Dodd-Frank Act, Section 5 of the Federal Trade Commission Act, the Equal Credit Opportunity Act, and the Fair Housing Act. Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those listed above. These federal, state and local laws regulate the manner in which financial institutions deal with customers taking deposits, making loans or conducting

other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, and actions by the U.S. Department of Justice and state attorneys general.

*Financial Privacy.* Under the Federal Right to Privacy Act of 1978, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records, financial institutions are required to disclose their policies for collecting and protecting confidential information. Consumers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions' own products and services. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers.

*Community Reinvestment Act.* The CRA requires that, in connection with examinations of financial institutions within their respective jurisdictions, the federal banking agencies will evaluate the record of each financial institution in meeting the needs of its local community, including low- and moderate-income neighborhoods. Our Bank's record of performance under the CRA is publicly available. A bank's CRA performance is also considered in evaluating applications seeking approval for mergers, acquisitions, and new offices or facilities. Failure to adequately meet these criteria could result in additional requirements and limitations being imposed on the Bank. Additionally, we must publicly disclose the terms of certain CRA-related agreements.



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*Concentration and Risk Guidance.* The federal banking regulatory agencies promulgated joint interagency guidance regarding material direct and indirect asset and funding concentrations. The guidance defines a concentration as any of the following: (i) asset concentrations of 25% or more of Total Capital (loan related) or Tier 1 Capital (non-loan related) by individual borrower, small interrelated group of individuals, single repayment source or individual project; (ii) asset concentrations of 100% or more of Total Capital (loan related) or Tier 1 Capital (non-loan related) by industry, product line, type of collateral, or short-term obligations of one financial institution or affiliated group; (iii) funding concentrations from a single source representing 10% or more of Total Assets; or (iv) potentially volatile funding sources that when combined represent 25% or more of Total Assets (these sources may include brokered, large, high-rate, uninsured, internet-listing-service deposits, Federal funds purchased or other potentially volatile deposits or borrowings). If a concentration is present, management must employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, third party review and increasing capital requirements.

Additionally, the federal bank regulatory agencies have issued guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that institutions that have (i) total reported loans for construction, land development, and other land which represent 100% or more of an institution's total risk-based capital; or (ii) total reported commercial real estate loans, excluding loans secured by owner-occupied commercial real estate, representing 300% or more of the institution's total risk-based capital and the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months, are identified as having potential commercial real estate concentration risk. Institutions, which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital.

*FDIC Insurance Premiums.* The FDIC maintains a risk-based assessment system for determining deposit insurance premiums. Through the second quarter of 2016, four risk categories (I-IV), each subject to different premium rates, ranging from a low of 2.5 basis points up to 45 basis points, were established based upon an institution's status as well capitalized, adequately capitalized or undercapitalized, and the institution's supervisory rating. An insured institution was required to pay deposit insurance premiums on its assessment base in accordance with its risk category. In general, a bank's assessment base is determined by subtracting the bank's tangible equity and certain allowable deductions from its consolidated average assets. There were three adjustments that could be made to an institution's initial base assessment rate: (1) a potential decrease for long-term unsecured debt, including senior and subordinated debt and, for small institutions, a portion of Tier 1 capital; (2) a potential increase for secured liabilities above a threshold amount; and (3) for non-Risk Category I institutions, a potential increase for brokered deposits above a threshold amount. Effective for the third quarter of 2016, the risk based system was amended for banks with less than \$10.0 billion in assets that have been FDIC-insured for at least five years, to replace the four risk categories for determining a bank's assessment rate with a financial ratios method based on a statistical model estimating the bank's probability of failure over three years, utilizing seven financial ratios (leverage ratio; net income before taxes/total assets; nonperforming loans and leases/gross assets; other real estate owned/gross assets; brokered deposit ratio; one year asset growth; and loan mix index) and a weighted average of supervisory ratings components. The revised rule provides a new brokered deposit ratio applicable to all small banks, whereby brokered deposits in excess of 10% of total consolidated assets (inclusive of reciprocal deposits if a bank is not well-capitalized or has a composite supervisory rating other than a 1 or 2) may result in increased assessment rates for banks which experience rapid

growth; lowers the range of assessment rates authorized to 1.5 basis points for an institution posing the least risk, to 40 basis points for an institution posing the most risk; and will further lower the range of assessment rates if the reserve ratio of the Deposit Insurance Fund increases to 2% or more. Banks with over \$10.0 billion in total consolidated assets are required to pay a surcharge of 4.5 basis points on their assessment basis, subject to certain adjustments. The FDIC may also impose special assessments from time to time. Under the 2017 Tax Cuts and Jobs Act (the “2017 Tax Act”), FDIC insured institutions with assets in excess of \$10 billion will be subject to a phase out of the deductibility of deposit insurance premiums.

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The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250 thousand per depositor. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on a financial institution's average consolidated total assets less tangible equity capital. The Dodd-Frank Act requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act eliminated the statutory prohibition against the payment of interest on business checking accounts.

*Increased Focus on Lending to Members of the Military.* The federal banking agencies and the Department of Justice have recently increased its focus on financial institution compliance with the Servicemembers Civil Relief Act (SCRA). The SCRA requires a bank to cap the interest rate at 6% for any loan to a member of the military who goes on active duty after taking out the loan. It also limits the actions the bank can take when a servicemember is in foreclosure. The Bank fully complies with this rule.

**ITEM 1A. RISK FACTORS**

*An investment in our common stock involves a high degree of risk. Before making an investment decision, you should carefully read and consider the risk factors described below as well as the other information included in this report and other documents we file with the SEC, as the same may be updated from time to time. Any of these risks, if they actually occur, could materially adversely affect our business, financial condition, and results of operations. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect us. In any such case, you could lose all or a portion of your original investment.*

**The price of our common stock may fluctuate significantly, which may make it difficult for investors to resell shares of common stock at a time or price they find attractive.**

Our stock price may fluctuate significantly as a result of a variety of factors, many of which are beyond our control. In addition to those described in "Caution About Forward Looking Statements," these factors include:

Actual or anticipated quarterly fluctuations in our operating results and financial condition;

Changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to us or other financial institutions;

Reports in the press, internet, or investment community generally or relating to our reputation or the financial services industry, whether or not those reports are based on accurate, complete or transparent information;

Strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;

Fluctuations in the stock price and operating results of our competitors;

Future sales of our equity or equity-related securities;

Proposed or adopted regulatory changes or developments;

Domestic and international economic and political factors unrelated to our performance;

Actions of one or more investors in selling our common stock short; and

General market conditions and, in particular, developments related to market conditions for the financial services industry.

In addition, the stock market in general has experienced price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies, including for reasons unrelated to their operating performance. These broad market fluctuations may adversely affect our stock price, notwithstanding our operating results. We expect that the market price of our common stock will continue to fluctuate and there can be no assurances about the levels of the market prices for our common stock.

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**Shareholders may not be able to readily sell large quantities of common stock at prevailing market prices.**

Although the daily trading volume of our common stock on Nasdaq Capital Market, or Nasdaq, has increased, averaging approximately 204,346 shares per trading day for 2018 and 375,677 shares per the last 90 trading days through February 22, 2019, there can be no assurance that the market for our common stock can accommodate the sale of large quantities of our common stock in a short time frame without adversely impacting the market price for our stock. As a result, shareholders may find it difficult to sell a significant number of shares of our common stock at the prevailing market price.

**Short sellers of our stock may be manipulative and may drive down the market price of our common stock.**

Short selling is the practice of selling securities that the seller does not own but rather has borrowed or intends to borrow from a third party with the intention of buying identical securities at a later date to return to the lender. A short seller hopes to profit from a decline in the value of the securities between the sale of the borrowed securities and the purchase of the replacement shares, as the short seller expects to pay less in that purchase than it received in the sale. As it is in the short seller's interest for the price of the stock to decline, some short sellers publish, or arrange for the publication of, opinions or characterizations regarding the relevant issuer, its business practices and prospects and similar matters calculated to or which may create negative market momentum, which may permit them to obtain profits for themselves as a result of selling the stock short. Issuers whose securities have historically had limited trading volumes and/or have been susceptible to relatively high volatility levels can be particularly vulnerable to such short seller attacks. The publication of any such commentary regarding us in the future may bring about a temporary, or possibly long term, decline in the market price of our common stock. In the past, the publication of commentary regarding us by a self-described short seller has been temporarily associated with the selling of shares of our common stock in the market on a large scale, resulting in a significant decline in the market price per share of our common stock. No assurances can be made that similar declines in the market price of our common stock will not occur in the future, in connection with such commentary by short sellers or otherwise. When the market price of a company's stock drops significantly, it is not unusual for stockholder lawsuits to be filed or threatened against the company and its board of directors and for a company to suffer reputational damage. Such lawsuits could cause us to incur substantial costs and divert the time and attention of our board and management. In addition, reputational damage to the Company may affect our ability to attract and retain deposits and may cause our deposit costs to increase, which could adversely affect our liquidity and earnings. Reputational damage may also affect our ability to attract and retain loan customers and maintain and develop other business relationships, which could likewise adversely affect our earnings. Negative reports issued by short sellers could also negatively impact our ability to attract and retain employees.

**Our ability to pay dividends on our common stock, or repurchase shares of common stock may be limited.**

The payment of a cash dividend on our common stock will depend largely upon the ability of the Bank, the Company's principal operating business, to declare and pay dividends to the Company. Payment of dividends on the common stock will also depend upon the Bank's earnings, financial condition, and need for funds, as well as laws, regulations and governmental policies applicable to the Company and the Bank, which limit the amount of dividends that may be declared. Additionally, under the Basel III Rule, banking institutions that do not meet certain CET1 to risk-weighted asset thresholds may face constraints on its ability to pay dividends and/or effect equity repurchases based on the amount of the shortfall, if any. Refer to "Regulation" under Item 1 and to "Market for Common Stock" under Item 5 for additional information.

**We may issue additional equity securities, or engage in other transactions, which could affect the priority of our common stock, which may adversely affect the market price of our common stock.**

Our Board of Directors may determine from time to time that we need to raise additional capital by issuing additional shares of our common stock or other securities. We are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings, or the prices at which such offerings may be effected. Such offerings could be dilutive to common shareholders. New investors also may have rights, preferences and privileges that are senior to, and that adversely affect, our then current common shareholders. Additionally, if we raise additional capital by making additional offerings of debt or preferred equity securities, upon liquidation of the Company, holders of our debt securities and shares of preferred stock, and lenders with respect to other borrowings, will receive distributions of our available assets prior to the holders of our common stock. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

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**Changes in the value of goodwill and intangible assets could reduce our earnings.**

The Company accounts for goodwill and other intangible assets in accordance with generally accepted accounting principles (“GAAP”), which, in general, requires that goodwill not be amortized, but rather that it be tested for impairment at least annually at the reporting unit level. Testing for impairment of goodwill and intangible assets is performed annually and involves the identification of reporting units and the estimation of fair values. The estimation of fair values involves a high degree of judgment and subjectivity in the assumptions used. Changes in the local and national economy, the federal and state legislative and regulatory environments for financial institutions, the stock market, interest rates and other external factors (such as natural disasters or significant world events) may occur from time to time, often with great unpredictability, and may materially impact the fair value of publicly traded financial institutions and could result in an impairment charge at a future date.

**We may not be able to manage future growth and competition.**

We have grown rapidly in the past several years, through acquisition and through organic growth. We intend to seek further growth in the level of our assets and deposits and selectively in the number of our branches, both within our existing footprint within the Washington, D.C. metropolitan area, although no additional branches are currently anticipated in 2019. We cannot provide any assurance that we will continue to be able to maintain our rate of growth at acceptable risk levels and upon acceptable terms, while managing the costs and implementation risks associated with our growth strategy. We may be unable to continue to increase our volume of loans and deposits or to introduce new products and services at acceptable risk levels for a variety of reasons, including an inability to maintain capital and liquidity sufficient to support continued growth. If we are successful in continuing our growth, we cannot assure you that further growth would offer the same levels of potential profitability, or that we would be successful in controlling costs and maintaining asset quality. Accordingly, an inability to maintain growth, or an inability to effectively manage growth, could adversely affect our results of operations, financial condition and stock price.

**Substantial regulatory limitations on changes of control and anti-takeover provisions of Maryland law may make it more difficult for shareholders to receive a change in control premium.**

With certain limited exceptions, federal regulations prohibit a person or company or a group of persons deemed to be “acting in concert” from, directly or indirectly, acquiring more than 10% (5% if the acquiror is a bank holding company) of any class of the Company’s voting stock or obtaining the ability to control in any manner the election of a majority of its directors or otherwise direct the management or policies of the Company without prior notice or application to and the approval of the Federal Reserve. There are comparable prior approval requirements for changes in control under Maryland law. Also, the Maryland General Corporation Law, as amended, contains several provisions that may make it more difficult for a third party to acquire control of the Company without the approval of its Board of Directors, and may make it more difficult or expensive for a third party to acquire a majority of its outstanding

common stock.



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**The economic environment continues to pose significant challenges for us and could adversely affect our financial condition and results of operations.**

The Company and the Bank are operating in a challenging and uncertain economic environment. Financial institutions continue to be affected by some softness in selected segments of the real estate market and constrained financial markets, highlighted by a historically flat yield curve. While conditions have improved since the depths of the financial crisis, should declines in real estate values, home sales volumes, and financial stress on borrowers as a result of the uncertain economic environment (e.g. government shutdowns) re-emerge, such events could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. A worsening of these conditions would likely exacerbate the adverse effects on the Company and others in the financial institutions industry. For example, deterioration in local economic conditions in our market could drive losses beyond that which is provided for in our allowance for loan losses. The Company may also face the following risks in connection with these events:

Economic conditions that negatively affect commercial real estate values and the job market may result in a deterioration in credit quality of our loan portfolio, and such deterioration in credit quality could have a negative impact on our business;

Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates on loans and other credit facilities;

A reduction in the size, spending or employment levels of the federal, state and/or local governments in the Washington, D.C. metropolitan area could have a negative effect on the economy in the region, on our customers and on real estate prices;

The methodologies we use to establish our allowance for loan losses may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation; and

Compliance with regulations of the banking industry may increase our costs, limit our ability to pursue business opportunities, and divert management efforts.

If these conditions or similar ones continue to exist or worsen, the Company could experience continuing or increased adverse effects on its financial condition and results of operations.

**Our financial condition and results of operations would be adversely affected if our allowance for credit losses is not sufficient to absorb actual losses or if we are required to increase our allowance for loan losses.**

Historically, we have enjoyed a relatively low level of nonperforming assets and net charge-offs, both in absolute dollars, as a percentage of loans and as compared to many of our peer institutions. As a result of this historical experience, we have incurred a relatively lower loan loss provision expense, which has positively impacted our earnings. However, should a higher portion of our loans become delinquent, or if some of our loans are only partially repaid, we may experience losses for reasons beyond our control. Despite our underwriting criteria and historical experience, we may be particularly susceptible to losses due to: (1) the geographic concentration of our loans; (2) the concentration of loans collateralized by commercial real estate; (3) the concentration of higher risk loans, such as commercial real estate, construction and commercial and industrial loans; and (4) the relative lack of seasoning of certain of our loans. As a result, we may not be able to maintain our relatively low levels of nonperforming assets and charge-offs. Although we believe that our allowance for loan losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are necessarily subjective and their accuracy depends on the outcome of future events. If we need to make significant and unanticipated increases in our loss allowance in the future, our results of operations and financial condition would be materially adversely affected at that time.

While we strive to carefully monitor credit quality and to identify loans that may become nonperforming, at any time there are loans included in the portfolio that will result in losses, but that have not been identified as nonperforming or potential problem loans. We cannot be sure that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that are identified. As a result, future additions to the allowance may be necessary.

Economic conditions and uncertainty in the financial markets could adversely affect our ability to accurately assess our allowance for credit losses. Our ability to assess the creditworthiness of our customers or to estimate the values of our assets and collateral for loans will be reduced if the models and approaches we use become less predictive of future behaviors, valuations, assumptions or estimates. We estimate losses inherent in our credit exposure, the adequacy of our allowance for loan losses and the values of certain assets by using estimates based on difficult, subjective, and complex judgments, including estimates as to the effects of economic conditions and how these economic conditions might affect the ability of our borrowers to repay their loans or the value of assets.

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**Changes in tax laws could have an adverse effect on us, the banking industry, our customers, the value of collateral securing our loans and demand for loans.**

The 2017 Tax Act includes a number of provisions which could have an impact on the banking industry, borrowers and the market for single family residential and commercial real estate, and for business borrowing. Among the changes are: lower limits on the deductibility of mortgage interest on single family residential mortgages; limitations on the deductibility of business interest expense; and limitations on the deductibility of property taxes and state and local income taxes. We cannot predict the ultimate impact of these changes. However, such changes may have an adverse effect on the market for and valuation of single family residential properties and commercial real estate, the economics of borrowing by businesses, and on the demand for residential and commercial mortgage and business loans in the future. If home ownership or business borrowing become less attractive, demand for our loans would decrease. The value of the properties securing loans in our portfolio may be adversely impacted as a result of the changing economics of home ownership and borrowing, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations. Additionally, certain borrowers could become less able to service their debts if these changes become effective. These changes could adversely affect our business, financial condition and results of operations.

**Changes in accounting standards could impact reported earnings.**

From time to time there are changes in the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations. In some instances, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements. Changes which have been approved for future implementation, or which are currently proposed or expected to be proposed or adopted include requirements that the Company: (i) calculate the allowance for loan losses on the basis of the current expected credit losses over the lifetime of its loans, or the CECL model, which is expected to be applicable to the Company beginning in 2020; and (ii) record the value of assets and liabilities relating to operating leases on our balance sheet, which became applicable to the Company in 2019. These changes could adversely affect the Company's and Bank's capital, regulatory capital ratios, ability to make larger loans, earnings and performance metrics.

Under the CECL model, banks will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses, and could result in changes to our allowance.

Moreover, the CECL model may create more volatility in the level of the allowance for loan losses. If we are required to materially increase the level of the allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations. We are evaluating the impact the CECL accounting model will have on our accounting, but expect to recognize a one-time cumulative-effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. We cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our financial condition or results of operations.

**Failure to maintain effective systems of internal and disclosure control could have a material adverse effect on the Company's results of operation, financial condition and stock price.**

Effective internal and disclosure controls are necessary for the Company to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If the Company cannot provide reliable financial reports or prevent fraud, its reputation and operating results would be harmed. As part of the Company's ongoing monitoring of internal control, it may discover material weaknesses or significant deficiencies in its internal control that require remediation. A "material weakness" is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

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Any failure to maintain effective controls or to timely implement any necessary improvement of the Company's internal and disclosure controls could, among other things, result in losses from fraud or error, harm the Company's reputation, or cause investors to lose confidence in the Company's reported financial information, all of which could have a material adverse effect on the Company's results of operation, financial condition and stock price.

Management reviews and updates our systems of internal control and disclosure controls and procedures, as well as corporate governance policies and procedures, as appropriate. Any system of controls is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, financial condition, and results of operations.

**Our continued growth depends on our ability to meet minimum regulatory capital levels. Growth and shareholder returns may be adversely affected if sources of capital are not available to help us meet them.**

As we grow, we will have to maintain our regulatory capital levels at or above the required minimum levels. If earnings do not meet our current estimates, if we incur unanticipated losses or expenses, or if we grow faster than expected, we may need to obtain additional capital sooner than expected or we may be required to reduce our level of assets or reduce our rate of growth in order to maintain regulatory compliance. Under those circumstances net income and the rate of growth of net income may be adversely affected. Additional issuances of equity securities could have a dilutive effect on existing shareholders. The significant level of ADC loans in our portfolio, and new loans sought by customers, which may be required to be assigned a higher risk weight, could require us to maintain additional capital for these loans.

**Our results of operations, financial condition and the value of our shares may be adversely affected if we are not able to continue to grow our assets.**

Since opening for business in 1998, our asset level, loans and net income available to common shareholders have increased significantly. We may not be able to achieve continued growth in asset levels, loans, or earnings in future years. Moreover, as our asset size, loan portfolio and earnings increase, it may become more difficult to achieve high rates of increase. Additionally, it may become more difficult to achieve continued improvements in our expense levels and efficiency ratio. We may not be able to maintain the relatively low levels of nonperforming assets that we have experienced to date. Declines in the rate of growth of income or assets or deposits, and increases in operating expenses or nonperforming assets may have an adverse impact on the value of the common stock.

**We are subject to liquidity risk in our operations.**

Liquidity risk is the possibility of being unable to meet obligations as they come due, pay deposits when withdrawn, and fund loan and investment opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. If a financial institution is unable to meet its payment obligations on a daily basis, it is subject to being placed into receivership, regardless of its capital levels. Our largest source of liquidity is customer deposit accounts, including noninterest bearing demand deposit accounts, which constituted 30% of our total deposits at December 31, 2018. If we are unable to increase customer deposits in an amount sufficient to fund loan growth, we may be required to rely on other, potentially more expensive, sources of liquidity, such as FHLB borrowings, brokered deposits and repurchase agreements, to fund loan growth, which could adversely affect our earnings, or reduce our rate of growth, which could adversely effect our earnings and stock price.

We also have a significant amount of deposits, which are in excess of the maximum FDIC insurance coverage limits. At any time, customers who have uninsured deposits may decide to move their deposits to institutions which are perceived as safer, sounder, or “too big to fail” or could elect to use other non-deposit funding products, such as repurchase agreements, that may require the Bank to pay higher interest and to provide securities as collateral for the Bank’s repurchase obligation. At December 31, 2018, the Bank had approximately \$2.87 billion of uninsured deposits, or 41% of our total deposits.

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While we believe that our strong earnings, capital position, relationship banking model and reputation as a safe and sound institution mitigate the risk of losing deposits, there can be no assurance that we will not have to replace a significant amount of deposits with alternative funding sources, such as repurchase agreements, federal funds lines, certificates of deposit, brokered deposits, other categories of interest bearing deposits and FHLB borrowings, all of which are more expensive than noninterest bearing deposits, and can be more expensive than other categories of deposits. While we believe that we would be able to maintain adequate liquidity at reasonable cost, the loss of a significant amount of deposits, particularly noninterest bearing deposits, could have a material adverse effect on our earnings, net interest margin, rate of growth and stock price.

**We may face risks with respect to future expansion or acquisition activity.**

We selectively seek to expand our banking operations through limited *de novo* branching or opportunistic acquisition activities. We cannot be certain that any expansion activity, through *de novo* branching, acquisition of branches of another financial institution or a whole institution, or the establishment or acquisition of nonbanking financial service companies, will prove profitable or will increase shareholder value. The success of any acquisition will depend, in part, on our ability to realize the estimated cost savings and revenue enhancements from combining the businesses of the Company and the target company. Our ability to realize increases in revenue will depend, in part, on our ability to retain customers and employees, and to capitalize on existing relationships for the provision of additional products and services. If our estimates turn out to be incorrect or we are not able to successfully combine companies, the anticipated cost savings and increased revenues may not be realized fully or at all, or may take longer to realize than expected. It is possible that the integration process could result in the loss of key employees, the disruption of each company's ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger. As with any combination of banking institutions, there also may be disruptions that cause us to lose customers or cause customers to withdraw their deposits from our bank. Customers may not readily accept changes to their banking arrangements that we make as part of or following an acquisition. Additionally, the value of an acquisition to the Company is dependent on our ability to successfully identify and estimate the magnitude of any asset quality issues of acquired companies.

**We will be subject to heightened regulatory requirements if our total assets grow and exceed \$10.0 billion.**

As of December 31, 2018, our total assets were \$8.39 billion. We anticipate that our total assets may exceed \$10 billion within the next several years. In addition to our current regulatory requirements, banks with \$10 billion or more in total assets are examined directly by the CFPB with respect to various federal consumer protection laws, subject to enhanced prudential regulation, and subject to additional regulatory requirements. Compliance with these additional ongoing requirements may necessitate additional personnel, the design and implementation of additional internal controls, or the incurrence of significant expenses, any of which could have a material adverse effect on our business, financial condition and results of operations.

**Our concentrations of loans may create a greater risk of loan defaults and losses.**

A substantial portion of our loans are secured by real estate in the Washington, D.C. metropolitan area and substantially all of our loans are to borrowers in that area. We also have a significant amount of real estate construction loans and land related loans for residential and commercial developments. At December 31, 2018, 85% of our loans were secured by real estate, primarily commercial real estate. Management believes that the commercial real estate concentration risk is mitigated by diversification among the types and characteristics of real estate collateral properties, sound underwriting practices, and ongoing portfolio monitoring and market analysis. Of these loans, \$1.62 billion, or 23% of portfolio loans, were land, land development, and construction loans. An additional \$1.55 billion, or 22% of portfolio loans, were commercial and industrial loans, which are generally not secured by real estate. The repayment of these loans often depends on the successful operation of a business or the sale or development of the underlying property and, as a result, is more likely to be adversely affected by adverse conditions in the real estate market or the economy in general. While we believe that our loan portfolio is well diversified in terms of borrowers and industries, these concentrations expose us to the risk that adverse developments in the real estate market, or in the general economic conditions in the Washington, D.C. metropolitan area, could increase the levels of nonperforming loans and charge-offs, and reduce loan demand. In that event, we would likely experience lower earnings or losses. Additionally, if, for any reason, economic conditions in our market area deteriorate, or there is significant volatility or weakness in the economy or any significant sector of the area's economy, our ability to develop our business relationships may be diminished, the quality and collectability of our loans may be adversely affected, the value of collateral may decline and loan demand may be reduced.



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Commercial, commercial real estate and construction loans tend to have larger balances than single family mortgages loans and other consumer loans. Because the loan portfolio contains a significant number of commercial and commercial real estate and construction loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in nonperforming assets. An increase in nonperforming loans could result in: a loss of earnings from these loans, an increase in the provision for loan losses, an increase in loan charge-offs, and/or an increase in operating expenses which could have an adverse impact on our results of operations and financial condition.

**Our concentrations of loans may require us to maintain higher levels of capital.**

Under guidance adopted by the federal banking agencies, banks which have concentrations in construction, land development or commercial real estate loans (other than loans for majority owner occupied properties) would be expected to maintain higher levels of risk management and, potentially, higher levels of capital. Although not currently anticipated, we may be required to maintain higher levels of capital than we would otherwise be expected to maintain as a result of our levels of construction, development and commercial real estate loans.

**Our Residential Lending department may not continue to provide us with significant noninterest income.**

In 2018, the Bank originated \$416 million and sold \$422 million of residential mortgage loans to investors, as compared to \$609 million originated and \$638 million sold to investors in 2017. The residential mortgage business is highly competitive, and highly susceptible to changes in market interest rates, consumer confidence levels, employment statistics, the capacity and willingness of secondary market purchasers to acquire and hold or securitize loans, and other factors beyond our control. The 2017 Tax Act includes changes to the limits of the mortgage interest deduction that could make home ownership less attractive, reducing the demand for residential mortgage loans. Additionally, in many respects, the traditional mortgage origination business is relationship based, and dependent on the services of individual mortgage loan officers. The loss of services of one or more loan officers could have the effect of reducing the level of our mortgage production, or the rate of growth of production. As a result of these factors we cannot be certain that we will be able to continue to maintain or increase the volume or percentage of revenue or net income produced by the residential mortgage business.

**Our financial condition, earnings and asset quality could be adversely affected if we are required to repurchase loans originated for sale by our Residential Lending department.**

The Bank originates residential mortgage loans for sale to secondary market investors, subject to contractually specified and limited recourse provisions. Because the loans are intended to be originated within investor guidelines,

using designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. In general, the Bank may be required to repurchase a previously sold mortgage loan or indemnify the investor if there is non-compliance with defined loan origination or documentation standards including fraud, negligence, material misstatement in the loan documents or non-compliance with applicable law. In addition, the Bank may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term or return profits made should the loan prepay within a short period. The potential mortgagor early default repurchase period is up to approximately twelve months after sale of the loan to the investor. The recourse period for fraud, material misstatement, breach of representations and warranties, non-compliance with law, or similar matters could be as long as the term of the loan. Mortgages subject to recourse are collateralized by single family residential properties, have loan-to-value ratios of 80% or less, or have private mortgage insurance. Our experience to date has been minimal in the case of loan repurchases due to default, fraud, breach of representations, material misstatement, or legal non-compliance. Should repurchases become a material issue, our earnings and asset quality could be adversely impacted, which could adversely impact our share price.

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**Our financial condition, earnings and asset quality could be adversely affected if our consumer facing operations do not operate in compliance with applicable regulations.**

While all aspects of our operations are subject to detailed and complex compliance regimes, those portions of our lending operations which most directly deal with consumers pose particular challenges given the emphasis on consumer compliance by bank regulators at all levels. Residential mortgage lending raises significant compliance risks resulting from the detailed and complex nature of mortgage lending regulations imposed by federal regulatory agencies, and the relatively independent operating environment in which mortgage lending officers operate. As a result, despite the education, compliance training, supervision and oversight we exercise in these areas, individual loan officers intentionally trying to conceal improper activities could result in the Bank being strictly liable for restitution or damages to individual borrowers, and to regulatory enforcement activity.

**Litigation and regulatory actions, possibly including enforcement actions, could subject us to significant fines, penalties, judgments or other requirements resulting in increased expenses or restrictions on our business activities.**

In the normal course of business, from time to time, we have in the past and may in the future be named as a defendant in various legal actions, arising in connection with our current and/or prior business activities. Legal actions could include claims for substantial compensatory or punitive damages or claims for indeterminate amounts of damages. Further we may be subject to regulatory enforcement actions. We may also, from time to time, be the subject of subpoenas, requests for information, reviews, investigations and proceedings (both formal and informal) by governmental agencies regarding our current and/or prior business activities. Any such legal or regulatory actions may subject us to substantial compensatory or punitive damages, significant fines, penalties, obligations to change our business practices or other requirements resulting in increased expenses, diminished income and damage to our reputation. Our involvement in any such matters, whether tangential or otherwise, and even if the matters are ultimately determined in our favor, could also cause significant harm to our reputation and divert management attention from the operation of our business. Further, any settlement, regulatory order or agreement, informal enforcement action, or adverse judgment in connection with any formal or informal proceeding or investigation by government agencies may result in additional litigation, investigations or proceedings as other litigants and/or government agencies begin independent reviews of the same activities. As a result, the outcome of legal and regulatory actions could have a material adverse effect on our business, results of operations and results of operations.

**Changes in interest rates and other factors beyond our control could have an adverse impact on our financial performance and results.**

Our operating income and net income depend to a great extent on our net interest margin, i.e., the difference between the interest yields we receive on loans, securities and other interest bearing assets and the interest rates we pay on

interest bearing deposits and other liabilities. Net interest margin is affected by changes in market interest rates, because different types of assets and liabilities may react differently, and at different times, to market interest rate changes. When interest bearing liabilities mature or re-price more quickly than interest earning assets in a period, an increase in market rates of interest could reduce net interest income. Similarly, when interest earning assets mature or re-price more quickly than interest bearing liabilities, falling interest rates could reduce net interest income. These rates are highly sensitive to many factors beyond our control, including competition, general economic conditions and monetary and fiscal policies of various governmental and regulatory authorities, including the Federal Reserve Board.

We attempt to manage our risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest earning assets and interest bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on our net interest margin and results of operations. At December 31, 2018, our cumulative net asset sensitive twelve month gap position was +5% of total assets. As such, we expect modest increases of approximately 4.8% and 7.9%, respectively, in projected net interest income and net income over a twelve month period resulting from a 100 basis point increase in rates and our residential mortgage origination and sale volume could decline as interest rates increase. The results of our interest rate sensitivity simulation model depend upon a number of assumptions, which may not prove to be accurate. There can be no assurance that we will be able to successfully manage our interest rate risk.

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Adverse changes in the real estate market in our market area could also have an adverse effect on our cost of funds and net interest margin, as we have a large amount of noninterest bearing deposits related to real estate sales and development. While we expect that we would be able to replace the liquidity provided by these deposits, the replacement funds would likely be more costly, negatively impacting earnings.

**Uncertainty relating to the phasing out of LIBOR may adversely affect our results of operations.**

In July 2017, the Financial Conduct Authority (the authority that regulates LIBOR) announced it intends to stop compelling banks to submit rates for the calculation of LIBOR after 2021. The Alternative Reference Rates Committee, or ARRC, has proposed that the Secured Overnight Financing Rate, or SOFR, is the rate that represents best practice as the alternative to USD-LIBOR for use in derivatives and other financial contracts that are currently indexed to USD-LIBOR. ARRC has proposed a paced market transition plan to SOFR from USD-LIBOR and organizations are currently working on industry wide and company specific transition plans as it relates to derivatives and cash markets exposed to USD-LIBOR. The Company has material contracts that are indexed to USD-LIBOR and is monitoring this activity and evaluating the related risks.

The inability to obtain LIBOR rates, and the uncertainty as to the nature, comparability and utility of alternative reference rates which have been or may be established may adversely affect the value of LIBOR-based loans, investment securities and other financial instruments in our portfolio, and may impact the availability and cost of hedging instruments and borrowings. If LIBOR rates are no longer available, and the Bank is required to implement substitute indices for the calculation of interest rates under its loan agreements, it may incur additional expenses in effecting the transition, and may be subject to disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute indices, which could have an adverse affect on its results of operations.

**We may not be able to successfully compete with others for business.**

The Washington, D.C. metropolitan area in which we operate is considered highly attractive from an economic and demographic viewpoint, and is a highly competitive banking market. We compete for loans, deposits, and investment dollars with numerous regional and national banks, online divisions of out-of-market banks, and other community banking institutions, as well as other kinds of financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, private lenders and nontraditional competitors such as fintech companies and internet-based lenders, depositories and payment systems. Our profitability depends upon our continued ability to successfully compete with traditional and new financial services providers, some of which maintain a physical presence in our market areas and others of which maintain only a virtual presence. Many competitors have substantially greater resources than us, and some operate under less stringent regulatory environments. The differences in resources and regulations may make it harder for us to compete profitably, reduce the rates that we can earn on loans and investments, increase the rates we must offer on deposits and other funds, and

adversely affect our overall financial condition and earnings.

The Bank has been very successful in developing new customer relationships. These new relationships have resulted in significant increases in both loans and deposits, and have contributed to increased earnings. Going forward, should competitive pressures increase, we are subject to the risk that we may not be able to retain the loans and deposits produced by these new relationships. While we believe that our relationship banking model will enable us to keep a significant percentage of these new relationships, there can be no assurance that we will be able to do so, that we would be able to maintain favorable pricing, margins and asset quality, or that we will be able to grow at the same rate we did when alternative financing was not widely available.

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**The banking industry is highly regulated, and the regulatory framework, together with any future legislative or regulatory changes, may have a materially adverse effect on our operations.**

The banking industry is highly regulated and supervised under federal and state laws and regulations (“laws and regulations”) that are intended primarily for the protection of depositors, customers, the public, the banking system as a whole or the FDIC Deposit Insurance Fund, not for the protection of our shareholders and creditors. The Company and Bank are subject to regulation and supervision by the Federal Reserve, the FDIC, as well as our state regulator. Compliance with these laws and regulations can be difficult and costly, and changes to laws and regulations can impose additional compliance costs. The laws and regulations applicable to the Company and Bank govern a variety of matters, including permissible types, amounts and terms of loans and investments they may make, the maximum interest rate that may be charged, the amount of reserves that must hold against deposits, the types of deposits that may be accepted and the rates that may be paid on such deposits, maintenance of adequate capital and liquidity, changes in control of the Company and Bank, transactions between the Bank and its affiliates, handling of nonpublic information, restrictions on dividends and establishment of new offices. We must obtain approval from our regulators before engaging in certain activities, and there is risk that such approvals may not be granted, either in a timely manner or at all. These requirements may constrain our operations, and the adoption of new laws and changes to or repeal of existing laws may have a further impact on our business, financial condition and results of operations. Also, the burden imposed by those laws and regulations may place banks in general, including the Bank in particular, at a competitive disadvantage compared to its non-bank competitors. Our failure to comply with any applicable laws or regulations, or regulatory policies and interpretations of such laws and regulations, could result in sanctions by regulatory agencies, civil money penalties or damage to our reputation, all of which could have a material adverse effect on our business, financial condition and results of operations.

Banks and other financial institutions are extensively regulated and currently face an uncertain regulatory environment. Applicable federal and state laws, regulations, interpretations, enforcement policies and accounting principles have been subject to significant changes in recent years, and may be subject to significant future changes. Future changes may have a material adverse effect on our business, financial condition and results of operations. Federal regulatory agencies may adopt changes to their regulations or change the manner in which existing regulations are applied. We cannot predict the substance or effect of pending or future legislation or regulation or the application of laws and regulations to us. Compliance with current and potential regulation, as well as regulatory scrutiny, may significantly increase our costs, impede the efficiency of our internal business processes, require us to increase regulatory capital, and limit our ability to pursue business opportunities in an efficient manner by requiring it to expend significant time, effort and resources to ensure compliance and respond to any regulatory inquiries or investigations.

In addition, given the current economic and financial environment, regulators may elect to alter standards or the interpretation of the standards used to measure regulatory compliance or to determine the adequacy of liquidity, risk management or other operational practices for financial service companies in a manner that impacts our ability to implement our strategy and could affect us in substantial and unpredictable ways, and could have a material adverse effect on our business, financial condition and results of operations. Furthermore, the regulatory agencies have extremely broad discretion in their interpretation of laws and regulations and their assessment of the quality of our

loan portfolio, securities portfolio and other assets. If any regulatory agency's assessment of the quality of our assets, operations, lending practices, investment practices, capital structure or other aspects of our business differs from our assessment, we may be required to take additional charges or undertake, or refrain from taking, actions that could have a material adverse effect on our business, financial condition and results of operations.

**Our customers and businesses in the Washington, D.C. metropolitan area in general, may be adversely impacted as a result of changes in government spending.**

The Washington, D.C. metropolitan area is characterized by a significant number of businesses that are federal government contractors or subcontractors, or which depend on such businesses for a significant portion of their revenues. While the Company does not have a significant level of loans to federal government contractors or their subcontractors, the impact of a shutdown of federal government operations, a decline in federal government spending, a reallocation of government spending to different industries or different areas of the country, or a delay in payments to such contractors, could have a ripple effect. Temporary layoffs, staffing freezes, salary reductions or furloughs of government employees or government contractors could have adverse impacts on other businesses in the Company's market and the general economy of the greater Washington, D.C. metropolitan area, and may indirectly lead to a loss of revenues by the Company's customers, including vendors and lessors to the federal government and government contractors or to their employees, as well as a wide variety of commercial and retail businesses. Accordingly, such potential federal government actions could lead to increases in past due loans, nonperforming loans, loan loss reserves, and charge-offs, and a decline in liquidity.



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**We rely upon independent appraisals to determine the value of the real estate, which secures a significant portion of our loans, and the values indicated by such appraisals may not be realizable if we are forced to foreclose upon such loans.**

A significant portion of our loan portfolio consists of loans secured by real estate. We rely upon independent appraisers to estimate the value of such real estate. Appraisals are only estimates of value and the independent appraisers may make mistakes of fact or judgment, which adversely affect the reliability of their appraisals. In addition, events occurring after the initial appraisal may cause the value of the real estate to increase or decrease. As a result of any of these factors, the real estate securing some of our loans may be more or less valuable than anticipated at the time the loans were made. If a default occurs on a loan secured by real estate that is less valuable than originally estimated, we may not be able to recover the outstanding balance of the loan and will suffer a loss.

**We are exposed to risk of environmental liabilities with respect to properties to which we take title.**

In the course of our business we lend against, and may foreclose and take title to, real estate, potentially becoming subject to environmental liabilities associated with the properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and cleanup costs or we may be required to investigate or clean up hazardous or toxic substances or chemical releases at a property. Costs associated with investigation or remediation activities can be substantial. If the Bank is the lender to, or owner or former owner of, a contaminated site, it may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. These costs and claims could adversely affect our business.

**Our operations rely on certain external vendors.**

Our business is dependent on the use of outside service providers that support our day-to-day operations including data processing and electronic communications. Our operations are exposed to risk that a service provider may not perform in accordance with established performance standards required in our agreements for any number of reasons including equipment or network failure, a change in their senior management, their financial condition, their product line or mix and how they support existing customers, or a simple change in their strategic focus. While we have comprehensive policies and procedures in place to mitigate risk at all phases of service provider management from selection, to performance monitoring and renewals, the failure of a service provider to perform in accordance with contractual agreements could be disruptive to our business, which could have a material adverse effect on our financial conditions and results of our operations.

**Our operations, including our transactions with customers, are increasingly conducted via electronic means, and this has increased risks related to cybersecurity.**

We are exposed to the risk of cyber-attacks in the normal course of business. In addition, we are exposed to cyber-attacks on vendors and merchants that affect us and our customers. In general, cyber incidents can result from deliberate attacks or unintentional events. We have observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, policies and procedures are in place to identify, protect, detect, respond, and recover from the possible security breach of its information systems and cyber-fraud. While we maintain insurance coverage that may, subject to policy terms and conditions including significant self-insured deductibles, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses. While we have not incurred any material losses related to cyber-attacks, nor are we aware of any specific or threatened cyber incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information, and repairing system damage that may have been caused; deploying additional personnel and protection technologies, training employees, and engaging third-party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; disruption or failures of physical infrastructure, operating systems or networks that support our business and customers resulting in the loss of customers and business opportunities; additional regulatory scrutiny and possible regulatory penalties; litigation; and, reputational damage adversely affecting customer or investor confidence.

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**A breach or interruption of information security or cyber-related threats could negatively affect our earnings.**

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. Although we maintain insurance coverage that may, subject to policy terms and conditions including significant self-insured deductibles, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, adversely affecting customer or investor confidence, result in a loss of customer business, subject us to additional regulatory scrutiny and possible regulatory penalties, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

**Failure to keep up with the rapid technological changes in the financial services industry could have a material adverse effect on our competitive position and profitability.**

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Our future success will depend, in part, upon our ability to address the needs of customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to implement new technology-driven products and services effectively or be successful in marketing these products and services to customers. Failure to successfully keep pace with technological change affecting the financial services industry could harm our ability to compete effectively and could have a material adverse effect on our business, financial condition or results of operations. As these technologies are improved in the future, we may be required to make significant capital expenditures in order to remain competitive, which may increase our overall expenses and have a material adverse effect on our business, financial condition and results of operations.

**We depend on the use of data and modeling in both management's decision-making generally and in meeting regulatory expectations in particular.**

The use of statistical and quantitative models and other quantitatively-based analyses is endemic to bank decision-making and regulatory compliance processes, and the employment of such analyses is becoming increasingly widespread in our operations. Liquidity stress testing, interest rate sensitivity analysis, allowance for loan loss

measurement, portfolio stress testing and the identification of possible violations of anti-money laundering regulations are examples of areas in which we are dependent on models and the data that underlies them. We anticipate that model-derived insights will be used more widely in decision-making in the future. While these quantitative techniques and approaches improve our decision-making, they also create the possibility that faulty data or flawed quantitative approaches could yield adverse outcomes or regulatory scrutiny. Secondly, because of the complexity inherent in these approaches, misunderstanding or misuse of their outputs could similarly result in suboptimal decision-making, which could have a material adverse effect on our business, financial condition and results of operations.

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**We are subject to laws regarding the privacy, information security and protection of personal information, and any violation of these laws or another incident involving personal, confidential, or proprietary information of individuals could damage our reputation and otherwise adversely affect our business.**

Our business requires the collection and retention of large volumes of customer data, including personally identifiable information, or PII, in various information systems that we maintain and in those maintained by third party service providers. We also maintain important internal company data such as PII about our employees and information relating to our operations. We are subject to complex and evolving laws and regulations governing the privacy and protection of PII of individuals (including customers, employees and other third parties), as well as planning for responding to data security breaches. Various federal and state banking regulators and states have also enacted data breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in the event of a security breach. Ensuring that our collection, use, transfer and storage of PII complies with all applicable laws and regulations can increase our costs. Furthermore, we may not be able to ensure that customers and other third parties have appropriate controls in place to protect the confidentiality of the information that they exchange with us, particularly where such information is transmitted by electronic means. If personal, confidential or proprietary information of customers or others were to be mishandled or misused (in situations where, for example, such information was erroneously provided to parties who are not permitted to have the information, or where such information was intercepted or otherwise compromised by third parties), we could be exposed to litigation or regulatory sanctions under privacy and data protection laws and regulations. Concerns regarding the effectiveness of our measures to safeguard PII, or even the perception that such measures are inadequate, could cause us to lose customers or potential customers and thereby reduce our revenues. Accordingly, any failure, or perceived failure, to comply with applicable privacy or data protection laws and regulations may subject us to inquiries, examinations and investigations that could result in requirements to modify or cease certain operations or practices or in significant liabilities, fines or penalties, and could damage our reputation and otherwise adversely affect our operations, financial condition and results of operations.

**ITEM 1B.**

**UNRESOLVED STAFF COMMENTS**

None

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All properties out of which the Company operates are leased properties. As of December 31, 2018, the Company and its subsidiaries operated out of 29 leased facilities; 20 of which are leased for branch offices in the Washington, D.C. metropolitan area: six in Suburban, Maryland; nine located in Northern Virginia; and five in the District of Columbia.

<b>Maryland Branch Locations:</b>	<b>Virginia Branch Locations:</b>
Bethesda 7815 Woodmont Avenue Bethesda, Maryland 20814	Ballston 4420 N. Fairfax Drive Arlington, Virginia 22203
Chevy Chase 5480 Wisconsin Avenue Chevy Chase, Maryland 20815	Chantilly 13986 Metrotech Drive Chantilly, Virginia 20151
Park Potomac 12505 Park Potomac Avenue Potomac, Maryland 20854	Dulles Town Center 45745 Nokes Boulevard Sterling, Virginia 20166
Shady Grove 9600 Blackwell Road Rockville, Maryland 20850	Fairfax 11166 Fairfax Boulevard Fairfax, Virginia 22030
Silver Spring 8665-B Georgia Avenue Silver Spring, Maryland 20910	Merrifield 2905 District Avenue Fairfax, Virginia 22031
Twinbrook 12300 Twinbrook Parkway Rockville, Maryland 20852	Old Town Alexandria 277 S. Washington Street Alexandria, Virginia 22314
	Reston

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12011 Sunset Hills Road  
Reston, Virginia 20190

Rosslyn

1919 N. Lynn Street  
Arlington, Virginia 22209

Tysons Corner

8245 Boone Boulevard  
Tysons Corner, Virginia  
22182

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**Washington, D.C. Branch Locations:**

Dupont Circle

1228 Connecticut Avenue, NW  
Washington, D.C. 20036

K Street  
2001 K Street, NW,  
Washington, D.C. 20006

Gallery Place

700 7th Street, NW  
Washington, D.C. 20001

McPherson Square  
1425 K Street, NW  
Washington, D.C. 20005

Georgetown

3143 N Street, NW  
Washington, D.C. 20007

**Corporate Offices and Commercial Lending Centers:**

Executive Offices and Commercial Lending Center

7830 Old Georgetown Road

Bethesda, Maryland 20814

Tysons Corner Corporate Offices

Commercial Lending Center

8245 Boone Boulevard, Suite 820

Tysons Corner, Virginia 22182

K Street Corporate / Commercial Lending Center

Commercial Deposit Operations Center

2001 K Street, NW, Suite 150  
Washington, D.C. 20006

**Residential Real Estate Lending:**

Residential Lending Center

6010 Executive Boulevard, Suite 300

**Other Properties:**

Operation Centers

11961 and 12200 Tech Road



Rockville, Maryland 20852

Silver Spring, Maryland 20904

Reston Office

Administration Center

Residential Lending Center

6010 Executive Boulevard, Suite 800

12011 Sunset Hills Road

Rockville, Maryland 20852

Reston, Virginia 20190

Tysons Office

Residential Lending Center

8245 Boone Boulevard, Suite 820

Tysons Corner, Virginia 22182

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**ITEM 3.**

**LEGAL PROCEEDINGS**

From time to time the Company and its subsidiaries are participants in various legal proceedings incidental to their business. In the opinion of management, the liabilities (if any) resulting from such legal proceedings will not have a material effect on the financial position of the Company.

**ITEM 4.**

**MINE SAFETY DISCLOSURES**

Not applicable.

**PART II**

**ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
5. AND ISSUER PURCHASES OF COMMON EQUITY**

Market for Common Stock. The Company's common stock is listed for trading on the Nasdaq Capital Market under the symbol "EGBN." Over the twelve month period ended December 31, 2018, the average daily trading volume amounted to approximately 204,346 shares, an increase from approximately 155,771 shares over the twelve month period ended December 31, 2017. No assurance can be given that a more active trading market will develop or can be maintained. No cash dividends for common shareholders were declared during such periods. As of February 8, 2019, there were 34,417,186 shares of common stock outstanding, held by approximately 680 shareholders of record. Based on the most recent mailings, the Company believes beneficial shareholders number approximately 20,589. Our directors and executive officers currently own approximately 8.22% of our outstanding shares of common stock.

*Dividends.* The Company does not currently pay a cash dividend on its common stock.

The payment of a cash dividend on common stock will depend largely upon the ability of the Bank, the Company's principal operating business, to declare and pay dividends to the Company. Payment of dividends on the common stock will also depend upon the Bank's earnings, financial condition, and need for funds, as well as governmental policies and regulations applicable to the Company and the Bank.

Regulations of the Federal Reserve Board and Maryland law place limits on the amount of dividends the Bank may pay to the Company without prior approval. Prior regulatory approval is required to pay dividends which exceed the Bank's net profits for the current year plus its retained net profits for the preceding two calendar years, less required transfers to surplus. Under Maryland law, dividends may only be paid out of retained earnings. State and federal bank regulatory agencies also have authority to prohibit a bank from paying dividends if such payment is deemed to be an unsafe or unsound practice, and the Federal Reserve Board has the same authority over bank holding companies. At December 31, 2018 the Bank could pay dividends to the Company to the extent of its earnings so long as it maintained required capital ratios.

The Federal Reserve Board has established requirements with respect to the maintenance of appropriate levels of capital by registered bank holding companies. Compliance with such standards, as presently in effect, or as they may be amended from time to time, could possibly limit the amount of dividends that the Company may pay in the future. In 1985, the Federal Reserve Board issued a policy statement on the payment of cash dividends by bank holding companies. In the statement, the Federal Reserve Board expressed its view that a holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income, or which could only be funded in ways that weaken the holding company's financial health, such as by borrowing. As a depository institution, the deposits of which are insured by the FDIC, the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. The Bank currently is not in default under any of its obligations to the FDIC.

*Issuer Repurchase of Common Stock.* No shares of the Company's common stock were repurchased by or on behalf of the Company during 2018 or 2017.

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See Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters for “Securities Authorized for Issuance Under Equity Compensation Plans.”

*Stock Price Performance.* The following table compares the cumulative total return on a hypothetical investment of \$100 in the Company’s common stock on December 31, 2013 through December 31, 2018, with the hypothetical cumulative total return on the Nasdaq Stock Market Index (U.S. Companies) and the KBW Regional Banking Index for the comparable period, including reinvestment of dividends. The Nasdaq Bank index includes a broad range of financial services companies listed on the Nasdaq Stock Market, while the KBW Regional Banking Index seeks to reflect the performance of publicly traded companies that do business as regional banks or thrifts listed on all U.S. stock markets.

Index	<i>Period Ending</i>					
	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18
Eagle Bancorp, Inc.	100.00	115.96	164.77	198.99	189.03	159.03
Nasdaq Composite Index	100.00	114.75	122.74	133.62	173.22	168.30
KBW Nasdaq Regional Banking Index	100.00	102.42	108.48	150.80	153.45	126.59

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The following table shows selected historical consolidated financial data for the Company. It should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations at page 43 and the Consolidated Financial Statements and Notes thereto included elsewhere in this report.

*Use of Non-GAAP Financial Measures*

The information set forth below contains certain financial information determined by methods other than in accordance with GAAP. These non-GAAP financial measures are "tangible common equity," "tangible book value per common share," "efficiency ratio (adjusted for merger expenses)," and "return on average common equity." Management uses these non-GAAP measures in its analysis of our performance because it believes these measures are material and will be used as a measure of our performance by investors.

These disclosures should not be considered in isolation or as a substitute for results determined in accordance with GAAP, and are not necessarily comparable to non-GAAP performance measures which may be presented by other bank holding companies. Management compensates for these limitations by providing detailed reconciliations between GAAP information and the non-GAAP financial measures. A reconciliation table is set forth below following the selected historical consolidated financial data.

(dollars in thousands except per share data)	Years Ended December 31,				
	2018	2017	2016	2015	2014
<b><u>Balance Sheets - Period End</u></b>					
Securities	\$784,139	\$589,268	\$538,108	\$504,772	\$404,903
Loans held for sale	19,254	25,096	51,629	47,492	44,317
Loans	6,991,447	6,411,528	5,677,893	4,998,368	4,312,399
Allowance for credit losses	69,944	64,758	59,074	52,687	46,075
Intangible assets, net	105,766	107,212	107,419	108,542	109,908
Total assets	8,389,137	7,479,029	6,890,096	6,075,577	5,246,684
Deposits	6,974,285	5,853,984	5,716,114	5,158,444	4,310,768
Borrowings	247,709	618,466	285,390	141,284	279,224
Total liabilities	7,280,196	6,528,591	6,047,297	5,336,976	4,625,925
Preferred shareholders' equity	—	—	—	—	71,900
Common shareholders' equity	1,108,941	950,438	842,799	738,601	548,859
Total shareholders' equity	1,108,941	950,438	842,799	738,601	620,759
Tangible common equity (1)	1,003,175	843,226	735,380	630,059	438,951

## Statements of Operations

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Interest income	\$393,286	\$324,034	\$285,805	\$253,180	\$191,573
Interest expense	76,293	40,147	27,640	19,238	13,095
Provision for credit losses	8,660	8,971	11,331	14,638	10,879
Noninterest income	22,586	29,372	27,284	26,628	18,345
Noninterest expense (2)	126,711	118,552	115,016	110,716	99,728
Income before taxes	204,208	185,736	159,102	135,216	86,216
Income tax expense (7)	51,932	85,504	61,395	51,049	31,958
Net income (2)(7)	152,276	100,232	97,707	84,167	54,258
Preferred dividends	—	—	—	601	614
Net income available to common shareholders (2)(7)	152,276	100,232	97,707	83,566	53,644
Total Revenue	339,579	313,259	285,449	260,570	196,823

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(dollars in thousands except per share data)	Years Ended December 31,									
	2018	2017	2016	2015	2014					
<u>Per Common Share Data</u>										
Net income, basic (2)(3)	\$4.44	\$2.94	\$2.91	\$2.54	\$2.01					
Net income, diluted (2)(3)	4.42	2.92	2.86	2.50	1.95					
Book value (3)	32.25	27.80	24.77	22.07	18.21					
Tangible book value (3)(4)	29.17	24.67	21.61	18.83	14.56					
Common shares outstanding	34,387,919	34,185,163	34,023,850	33,467,893	30,139,396					
Weighted average common shares outstanding, basic	34,306,336	34,138,536	33,587,254	32,836,449	26,683,759					
Weighted average common shares outstanding, diluted	34,443,040	34,320,639	34,181,616	33,479,592	27,550,978					
<u>Ratios</u>										
Net interest margin	4.10	% 4.15	% 4.16	% 4.33	% 4.44	%	%	%	%	%
Efficiency ratio (2)(5)	37.31	% 37.84	% 40.29	% 42.49	% 50.67	%	%	%	%	%
Return on average assets (2)(3)	1.91	% 1.41	% 1.52	% 1.49	% 1.31	%	%	%	%	%
Return on average common equity (2)(3)	14.89	% 11.06	% 12.27	% 12.32	% 13.50	%	%	%	%	%
Return on average tangible common equity (2)(3)	16.63	% 12.54	% 14.19	% 14.69	% 14.27	%	%	%	%	%
CET1 capital (to risk weighted assets) (6)	12.49	% 11.23	% 10.80	% 10.68	% —	%	%	%	%	%
Total capital (to risk weighted assets)	16.08	% 15.02	% 14.89	% 12.75	% 12.97	%	%	%	%	%
Tier 1 capital (to risk weighted assets)	12.49	% 11.23	% 10.80	% 10.68	% 10.39	%	%	%	%	%
Tier 1 capital (to average assets)	12.10	% 11.45	% 10.72	% 10.90	% 10.69	%	%	%	%	%
Tangible common equity ratio	12.11	% 11.44	% 10.84	% 10.56	% 8.54	%	%	%	%	%
<u>Asset Quality</u>										
Nonperforming assets and loans 90+ past due	\$17,671	\$14,632	\$20,569	\$19,091	\$35,667					
Nonperforming assets and loans 90+ past due to total assets	0.21	% 0.20	% 0.30	% 0.31	% 0.68	%	%	%	%	%
Nonperforming loans to total loans	0.23	% 0.21	% 0.31	% 0.26	% 0.52	%	%	%	%	%
Allowance for credit losses to loans	1.00	% 1.01	% 1.04	% 1.05	% 1.07	%	%	%	%	%
Allowance for credit losses to nonperforming loans	429.72	% 489.20	% 330.49	% 397.95	% 205.30	%	%	%	%	%
Net charge-offs	\$3,475	\$3,286	\$4,945	\$8,026	\$5,724					
Net charge-offs to average loans	0.05	% 0.06	% 0.09	% 0.17	% 0.17	%	%	%	%	%

(1)

Tangible common equity, a non-GAAP financial measure, is defined as total common shareholders' equity reduced by goodwill and other intangible assets.

- (2) The reported figure for 2014 includes the effect of \$4.7 million of merger related expenses (\$3.5 million net of tax), or \$0.14 per diluted share.

The reported figure for 2017 includes one time charges to reduce the carrying value of net deferred tax assets by \$14.6 million, required as a result of the reduction in corporate income tax rates to 21% in the 2017 Tax Act. As the magnitude of the net deferred tax asset revaluation distorts the operational results of the Company, we present (3) in the GAAP reconciliation below and in Management's Discussion and Analysis of Financial Condition and Results of Operations certain performance ratios excluding the effect of the net deferred tax asset revaluation during the year ended December 31, 2017. We believe this information is important to enable shareholders and other interested parties to assess the core operational performance of the Company.

- (4) Tangible book value per common share, a non-GAAP financial measure, is defined as tangible common shareholders' equity divided by total common shares outstanding.

- (5) Computed by dividing noninterest expense by the sum of net interest income and noninterest income.

- (6) Not applicable to fiscal years prior to 2015.



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Non-GAAP Reconciliation (Unaudited) (dollars in thousands except per share data)	Years Ended December 31,				
	2018	2017	2016	2015	2014
Common shareholders' equity	\$1,108,941	\$950,438	\$842,799	\$738,601	\$548,859
Less: Intangible assets	(105,766 )	(107,212 )	(107,419)	(108,542)	(109,908)
Tangible common equity	\$1,003,175	\$843,226	\$735,380	\$630,059	\$438,951
Book value per common share	\$32.25	\$27.80	\$24.77	\$22.07	\$18.21
Less: Intangible book value per common share	(3.08 )	(3.13 )	(3.16 )	(3.24 )	(3.65 )
Tangible book value per common share	\$29.17	\$24.67	\$21.61	\$18.83	\$14.56
Total assets	\$8,389,137	\$7,479,029			
Less: Intangible assets	(105,766 )	(107,212 )			
Tangible assets	\$8,283,371	\$7,371,817			
Tangible common equity ratio	12.11	% 11.44	%		
Average common shareholders' equity	\$1,022,642	\$906,169			
Less: Average intangible assets	(106,806 )	(107,117 )			
Average tangible common equity	\$915,836	\$799,052			
Net Income	\$152,276	\$100,232			
Average tangible common equity	\$915,836	\$799,052			
Annualized Return on Average Tangible Common Equity	16.63	% 12.54	%		

(dollars in thousands except per share data)	Year Ended December 31, 2017		
	GAAP	Change	Non-GAAP
<b>Income Statements:</b>			
Income tax expense	85,504	(14,588)	70,916
Net income	\$100,232	\$(14,588)	\$114,820
<b>Earnings Per Common Share</b>			
Basic	\$2.94	\$0.43	\$3.36
Diluted	\$2.92	\$0.42	\$3.35
<b>Performance Ratios (annualized):</b>			
Return on average assets	1.41	%	1.62 %
Return on average common equity	11.06	%	12.67 %

Assets	As of December 31, 2017		
	GAAP	Change	Non-GAAP
Deferred income taxes	28,770	14,588	43,358
Total Assets	\$7,479,029	\$14,588	\$7,493,617
<b>Shareholders' Equity</b>			

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Retained earnings	431,544	14,588	446,132
Total Shareholders' Equity	950,438	14,588	965,026
Total Liabilities and Shareholders' Equity	\$7,479,029	\$14,588	\$7,493,617

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**ITEM MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
7. OF OPERATIONS**

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of the Company. The Company’s primary subsidiary is the Bank, and the Company’s other direct and indirect operating subsidiaries are Bethesda Leasing, LLC, Eagle Insurance Services, LLC, and ECV.

This discussion and analysis should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto, appearing elsewhere in this report.

*Caution About Forward Looking Statements.* This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. These forward looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, objectives, expected operating results and the assumptions upon which those statements are based. Forward looking statements include without limitation, any statement that may predict, forecast, indicate or imply future results, performance or achievements, and are typically identified with words such as “may,” “could,” “should,” “will,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend” or words or phrases of similar meaning. These forward looking statements are based largely on our expectations and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are, in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed, or implied by the forward looking statements.

The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward looking statements:

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 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;

Results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for credit losses, to write-down assets or to hold more capital;

Our management of risks inherent in our real estate loan portfolio, and the risk of a prolonged downturn in the real estate market, which could impair the value of, and our ability to sell, properties which stand as collateral for loans we make;

Changing bank regulatory conditions, policies or programs, whether arising as new legislation or regulatory initiatives, that could lead to restrictions on activities of banks generally, or our subsidiary bank in particular, more restrictive regulatory capital requirements, increased costs, including deposit insurance premiums, regulation or prohibition of certain income producing activities or changes in the secondary market for loans and other products;

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

The willingness of customers to substitute competitors' products and services for our products and services;

The impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies;

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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 Public Company Accounting Oversight Board or the Financial Accounting Standards Board;

Technological and social media changes;

Cybersecurity breaches, threats, and cyber-fraud that cause the Bank to sustain financial losses;

The effect of acquisitions we may make, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;

The growth and profitability of noninterest or fee income being less than expected;

Changes in the level of our nonperforming assets and charge-offs;

Changes in consumer spending and savings habits;

Unanticipated regulatory or judicial proceedings; and

The factors discussed under the caption “Risk Factors” in this report.

If one or more of the factors affecting our forward looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward looking information and statements contained in this report. You should not place undue reliance on our forward looking information and statements. We will not update the forward looking statements to reflect actual results or changes in the factors affecting the forward looking statements.

GENERAL

The Company is a growth-oriented, one-bank holding company headquartered in Bethesda, Maryland, which has celebrated twenty years of successful operations. The Company provides general commercial and consumer banking services through the Bank, its wholly owned banking subsidiary, a Maryland chartered bank which is a member of the Federal Reserve System. The Company was organized in October 1997, to be the holding company for the Bank. The Bank was organized in 1998 as an independent, community oriented, full service banking alternative to the super regional financial institutions, which dominate the Company’s primary market area. The Company’s philosophy is to provide superior, personalized service to its customers. The Company focuses on relationship banking, providing each customer with a number of services and becoming familiar with and addressing customer needs in a proactive, personalized fashion. The Bank currently has a total of twenty branch offices, including nine in Northern Virginia, six in Suburban Maryland, and five in Washington, D.C.

The Bank offers a broad range of commercial banking services to its business and professional clients as well as full service consumer banking services to individuals living and/or working primarily in the Bank's market area. The Bank emphasizes providing commercial banking services to sole proprietors, small and medium-sized businesses, non-profit organizations and associations, and investors living and working in and near the primary service area. These services include the usual deposit functions of commercial banks, including business and personal checking accounts, "NOW" accounts and money market and savings accounts, business, construction, and commercial loans, residential mortgages and consumer loans, and cash management services. The Bank is also active in the origination and sale of residential mortgage loans and the origination of SBA loans. The residential mortgage loans are originated for sale to third-party investors, generally large mortgage and banking companies, under best efforts and mandatory delivery commitments with the investors to purchase the loans subject to compliance with pre-established criteria. The Bank generally sells the guaranteed portion of the SBA loans in a transaction apart from the loan origination generating noninterest income from the gains on sale, as well as servicing income on the portion participated. The Company originates multifamily FHA loans through HUD's MAP. The Company securitizes these loans through Ginnie Mae's MBS I program, and sells the resulting securities in the open market to authorized dealers in the normal course of business and generally retains the MSR for a period of time before the MSR is packaged into a portfolio and sold. Bethesda Leasing, LLC, a subsidiary of the Bank, holds title to and manages other real estate owned, or OREO, assets. Eagle Insurance Services, LLC, a subsidiary of the Bank, offers access to insurance products and services through a referral program with a third party insurance broker. Additionally, the Bank offers investment advisory services through referral programs with third parties.

As 2018 began, expectations were high that the Federal Reserve Open Market Committee, or FOMC, would continue moving short-term interest rates higher and in fact they adjusted the Federal Funds Target rate up by 25 bps four times over the course of the year. They also announced their plans for reducing the Federal Reserve's balance sheet as U.S. Treasuries and mortgage backed securities mature and that cash flow is not reinvested. Actual GDP growth for 2018 in the U.S. should be above 2017 and in line with 3% expectations, but the final quarter of 2018 and annual growth reports were delayed by the lapse in federal funding that occurred during the first month of 2019. The 2018 U.S. official unemployment rate declined to 3.9% by year-end. 2018 saw steady job growth, wage growth and a steady labor force participation level. These fundamentals were factored into the Federal Reserve Board's monetary policy, which increased short-term interest rates by 100 basis points from a target range between 125 and 150 basis points at the beginning of 2018, to between 225 and 250 basis points at the end of 2018, after four rate hikes although the Federal Reserve Board has indicated that they will likely slow down further interest rate increases in 2019.

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Longer-term U.S. interest rates averaged higher in 2018, with the ten year U.S. Treasury rate averaging 2.96% in 2018 versus 2.33% in 2017. The yield curve continued to flatten (two year versus ten year U.S. Treasury rates) during 2018 as the front end of the yield curve rose faster than the long end. Long-term interest rates relative stability was partly a function of attractive yields in U.S. Treasury securities relative to European bonds, as there remained some perceived weaknesses in European Central Bank economies generally, along with geopolitical risks. Energy prices (oil and natural gas), after a period of low prices in 2016, and a steady climb over the course of 2017 and early 2018 came back down below 2017 prices by the end of the year. Inflationary factors remained close to the FOMC's target rate of 2.00% throughout 2018.

As the ten year U.S. Treasury rate remained in a range of 2.70%-3.05% for most of 2018, the volume of residential mortgage lending began to taper throughout the year. Overall, real estate values were stable to increasing in 2018 as interest rates remained historically low and job growth and personal income levels rose modestly. Political gridlock continued in Washington, D.C. over concerns of public debt and deficits, tax policy and spending levels, although major corporate and personal tax reform was passed late in 2017 and benefited business earnings and consumer spending, while deficit spending continued and remains a point of serious concern.

The Company's primary market, the Washington, D.C. metropolitan area, has continued to perform well relative to other parts of the country, due to good growth in the private sector along with increased government spending, and this was no different in 2018. Private sector growth was attributable in part to a diverse economy including a large healthcare component, substantial business services, and a highly educated work force.

During 2018, the Company enhanced its marketplace positioning by remaining proactive in growing client relationships. The Company has had the financial resources to meet, and has remained committed to meeting, the credit needs of its community, resulting in continued growth in the Bank's loan portfolio during 2018. Furthermore, the Company's capital position was enhanced in 2018 by very strong and consistent earnings. The Company believes its strategy of remaining growth-oriented, retaining talented staff and maintaining focus on seeking quality lending and deposit relationships has proven successful and is evidenced in its financial and performance ratios. Additionally, the Company believes such focus and strategy of relationship building has fostered future growth opportunities, as the Company's reputation in the marketplace has continued to grow. At December 31, 2018, the Company had total assets of approximately \$8.39 billion, total loans of \$6.99 billion, total deposits of \$6.97 billion and twenty branches in the Washington, D.C. metropolitan area.

Operating in the more competitive economic environment of 2018, the Bank was able to produce solid growth in loans. Additionally, the Bank was able to grow its net interest spread earnings substantially, maintain an above average net interest margin, retain a strong position regarding asset quality, and generate enhanced operating leverage due to its seasoned and professional staff. The Company increased its net income in each quarter of 2018, continuing a trend of consecutive quarterly increases on an operating basis dating back to the first quarter of 2009.

## CRITICAL ACCOUNTING POLICIES

The Company's Consolidated Financial Statements are prepared in accordance with GAAP and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the Consolidated Financial Statements; accordingly, as this information changes, the Consolidated Financial Statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or a valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility.



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### Investment Securities

The fair values and the information used to record valuation adjustments for investment securities available-for-sale are based either on quoted market prices or are provided by other third-party sources, when available. The Company's investment portfolio is categorized as available-for-sale with unrealized gains and losses net of income tax being a component of shareholders' equity and accumulated other comprehensive income (loss).

### Business Combinations

Business combinations are accounted for by applying the acquisition method in accordance with Accounting Standards Codification ("ASC") Topic 805, "*Business Combinations*." Under the acquisition method, identifiable assets acquired and liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date are measured at their fair values as of that date, and are recognized separately from goodwill. Results of operations of the acquired entities are included in the consolidated statement of income from the date of acquisition. Adjustments to fair value for credit and current interest rate considerations at the date of acquisition are subsequently amortized to interest income and interest expense based on the remaining life of the asset or liability. Ongoing assessments of fair value are made at each balance sheet date.

### Allowance for Credit Losses

The allowance for credit losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two principles of accounting: (a) ASC Topic 450, "*Contingencies*," which requires that losses be accrued when they are probable of occurring and are estimable and (b) ASC Topic 310, "*Receivables*," which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, can be determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows, or values observable in the secondary markets.

Three components comprise our allowance for credit losses: a specific allowance, a formula allowance and a nonspecific or environmental factors allowance. Each component is determined based on estimates that can and do change when actual events occur.

The specific allowance allocates a reserve to identified impaired loans. Impaired loans are assigned specific reserves based on an impairment analysis. Under ASC Topic 310, "*Receivables*," a loan for which reserves are individually

allocated may show deficiencies in the borrower's overall financial condition, payment record, support available from financial guarantors and for the fair market value of collateral. When a loan is identified as impaired, a specific reserve is established based on the Company's assessment of the loss that may be associated with the individual loan.

The formula allowance is used to estimate the loss on internally risk rated loans, exclusive of those identified as requiring specific reserves. The portfolio of unimpaired loans is stratified by loan type and risk assessment. Allowance factors relate to the type of loan and level of the internal risk rating, with loans exhibiting higher risk and loss experience receiving a higher allowance factor.

The environmental allowance is also used to estimate the loss associated with pools of non-classified loans. These non-classified loans are also stratified by loan type, and environmental allowance factors are assigned by management based upon a number of conditions, including delinquencies, loss history, changes in lending policy and procedures, changes in business and economic conditions, changes in the nature and volume of the portfolio, management expertise, concentrations within the portfolio, quality of internal and external loan review systems, competition, and legal and regulatory requirements.

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The allowance captures losses inherent in the loan portfolio, which have not yet been recognized. Allowance factors and the overall size of the allowance may change from period to period based upon management's assessment of the above described factors, the relative weights given to each factor, and portfolio composition.

Management has significant discretion in making the judgments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, a borrower's prospects of repayment, and in establishing allowance factors on the formula and environmental components of the allowance. The establishment of allowance factors involves a continuing evaluation, based on management's ongoing assessment of the global factors discussed above and their impact on the portfolio. The allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based upon the same volume and classification of loans. Changes in allowance factors can have a direct impact on the amount of the provision, and a related after tax effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. Alternatively, errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance being in excess of amounts necessary to cover losses in the portfolio, and may result in lower provisions in the future. For additional information regarding the provision for credit losses, refer to the discussion under the caption "Provision for Credit Losses" below.

## Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets and MSR's that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights. Intangible assets that have finite lives, such as core deposit intangibles, are amortized over their estimated useful lives and subject to periodic impairment testing. Intangible assets (other than goodwill) are amortized to expense using accelerated or straight-line methods over their respective estimated useful lives.

Goodwill is subject to impairment testing at the reporting unit level, which must be conducted at least annually. The Company performs impairment testing during the fourth quarter of each year or when events or changes in circumstances indicate the assets might be impaired.

The Company performs a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Determining the fair value of a reporting unit under the goodwill impairment test is judgmental and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. Estimates of fair value are primarily determined using discounted cash flows, market comparisons and recent transactions. These approaches use significant estimates and assumptions including projected future cash flows, discount rates reflecting the market rate

of return, projected growth rates and determination and evaluation of appropriate market comparables. Based on the results of qualitative assessments of all reporting units, the Company concluded that no impairment existed at December 31, 2018. However, future events could cause the Company to conclude that goodwill or other intangibles have become impaired, which would result in recording an impairment loss. Any resulting impairment loss could have a material adverse impact on the Company's financial condition and results of operations.

#### Accounting for Income Taxes

The Company accounts for income taxes by recording deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods. The Company's accounting policy follows the prescribed authoritative guidance that a minimal probability threshold of a tax position must be met before a financial statement benefit is recognized. The Company recognized, when applicable, interest and penalties related to unrecognized tax benefits in other non-interest expenses in the Consolidated Statements of Operations. Assessment of uncertain tax positions requires careful consideration of the technical merits of a position based on management's analysis of tax regulations and interpretations. Significant judgment may be involved in applying the applicable reporting and accounting requirements.

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Management expects that the Company's adherence to the required accounting guidance may result in volatility in quarterly and annual effective income tax rates due to the requirement that any change in judgment or measurement of a tax position taken in a prior period be recognized as a discrete event in the period in which it occurs. Factors that could impact management's judgment include changes in income, tax laws and regulations, and tax planning strategies.

## Stock Based Compensation

The Company follows the provisions of ASC Topic 718, "*Compensation*," which requires the expense recognition for the fair value of share based compensation awards, such as stock options, restricted stock awards, and performance based shares. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. The Company's practice is to utilize reasonable and supportable assumptions.

## Derivatives

FASB ASC 815, *Derivatives and Hedging* ("ASC 815"), provides the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (a) how and why an entity uses derivative instruments, (b) how the entity accounts for derivative instruments and related hedged items, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Further, qualitative disclosures are required that explain the Company's objectives and strategies for using derivatives, as well as quantitative disclosures about the fair value of and gains and losses on derivative instruments.

## RESULTS OF OPERATIONS

### **Overview**

For the year ended December 31, 2018, the Company's net income was \$152.3 million, a 52% increase (33% increase on an operating basis) over the \$100.2 million (\$114.8 million on an operating basis) for the year ended December 31, 2017.

For the year ended December 31, 2017, operating earnings exclude one time charges of \$14.6 million (\$0.42 per diluted common share), required as a result of the 2017 Tax Act.

Where appropriate, parenthetical references refer to operating earnings, which the Company believes are more relevant comparisons to current and historical period results of operations. Reconciliations of 2017 GAAP earnings to operating earnings are contained in the tables on page 42.

Net income per basic and diluted common share for the year ended December 31, 2018 was \$4.44 and \$4.42, respectively as compared to \$2.94 per basic common share and \$2.92 per diluted common share (\$3.36 per basic common share and \$3.35 per diluted common share on an operating basis) for 2017, an increase of 51% per basic and diluted common share (32% on an operating basis per basic and diluted common share).

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For the year ended December 31, 2018, the Company reported a return on average assets, or ROAA, of 1.91% as compared to 1.41% for the year ended December 31, 2017 (1.62% on an operating basis). The return on average common equity, or ROACE, for the year ended December 31, 2018 was 14.89%, as compared to 11.06% (12.67% on an operating basis) for the year ended December 31, 2017. The return on average tangible common equity for the year ended December 31, 2018 was 16.63%, as compared to 12.54% (14.37% on an operating basis) for the year ended December 31, 2017.

The Company's earnings are largely dependent on net interest income, the difference between interest income and interest expense, which represented 93% and 91% of total revenue (defined as net interest income plus noninterest income) for the full year of 2018 and 2017, respectively.

The net interest margin, which measures the difference between interest income and interest expense (i.e., net interest income) as a percentage of average earning assets, decreased 5 basis points from 4.15% for the year ended December 31, 2017 to 4.10% for the year ended December 31, 2018. Average earning asset yields increased by 36 basis points (4.73% to 5.09%) for the year ended December 31, 2018 compared to the same period in 2017, while the cost of interest bearing liabilities increased by 67 basis points (to 1.61% from 0.94%). For 2018, in spite of competitive factors, the Company has been able to increase its loan portfolio yields relative to 2017 levels (5.54% versus 5.17%) due to disciplined loan pricing practices.

For the year ended December 31, 2018, the net interest spread decreased by 31 basis points (to 3.48% from 3.79%) as compared to 2017, due primarily to an increase in the average cost of interest bearing liabilities. The cost of interest bearing liabilities increased in 2018 largely as a result of interest rate increases by the FOMC and increased competition for deposits within our market area. Overall, the Company believes its deposit mix and cost of funds remain favorable. The benefit of noninterest sources funding earning assets increased by 26 basis points to 62 basis points for the year ended December 31, 2018 as compared to 36 basis points for the year ended December 31, 2017 as a result of a favorable mix of noninterest bearing deposits. The percentage of average noninterest deposits relative to average total deposits increased to 33% for the full year 2018 from 32% for the same period in 2017.

The combination of a 31 basis point decrease in the net interest spread and a 26 basis point increase in the value of noninterest sources resulted in the 5 basis point decrease in the net interest margin for the year ended December 31, 2018 as compared to the same period in 2017.

The Company believes it has effectively managed its net interest margin and net interest income during 2018 as market interest rates (on average) have remained relatively low. This factor has been significant to overall earnings performance during the past year as net interest income represented 93% of the Company's total revenue for the year ended December 31, 2018.

The provision for credit losses was \$8.7 million for the year ended December 31, 2018 as compared to \$9.0 million for the year ended December 31, 2017. Net charge-offs of \$3.5 million during 2018 represented 0.05% of average loans, excluding loans held for sale, as compared to \$3.3 million or 0.06% of average loans, excluding loans held for sale, in 2017.

At December 31, 2018, the allowance for credit losses represented 1.00% of loans outstanding, as compared to 1.01% at December 31, 2017. The allowance for credit losses represented 430% of nonperforming loans at December 31, 2018, as compared to 489% at December 31, 2017.

Total noninterest income for the year ended December 31, 2018 decreased to \$22.6 million from \$29.4 million for the year ended December 31, 2017, a 23% decrease.

The efficiency ratio, which measures the ratio of noninterest expense to total revenue, remained favorable at 37.31% for the year ended December 31, 2018 as compared to 37.84% for the same period in 2017. Total noninterest expenses totaled \$126.7 million for the year ended December 31, 2018, as compared to \$118.6 million for the year ended December 31, 2017, a 7% increase. As a percentage of average assets, total noninterest expense was 1.59% for the year of 2018 as compared to 1.67% for the same period in 2017.



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The ratio of common equity to total assets increased from 12.71% at December 31, 2017 to 13.22% at December 31, 2018 due to growth from earnings. As discussed in the “Capital Resources and Adequacy” section, the regulatory capital ratios of the Bank and Company remain above well capitalized levels.

**Net Interest Income and Net Interest Margin**

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans, loans held for sale, investment securities, and interest bearing deposits with banks. The cost of funds represents interest expense on deposits, customer repurchase agreements and other borrowings, which consist of federal funds purchased, advances from the FHLB and subordinated notes. Noninterest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income.

Net interest income in 2018 was \$317.0 million compared to \$283.9 million in 2017 and \$258.2 million in 2016.

For the year ended December 31, 2018, net interest income increased 12% over the same period for 2017. Average loans increased \$698.2 million (12%) and average deposits increased by \$656.9 million (11%). The net interest margin was 4.10% for the year ended December 31, 2018, as compared to 4.15% for the same period in 2017. The Company has been able to improve its loan yields in 2018 as compared to 2017 levels due to disciplined loan pricing practices, and has managed its funding costs while maintaining a favorable deposit mix; much of which has occurred from sales efforts to increase and deepen client relationships. The Company believes its net interest margin remains favorable as compared to its peer banking companies.

The table below presents the average balances and rates of the major categories of the Company’s assets and liabilities for the years ended December 31, 2018, 2017 and 2016. Included in the table is a measurement of interest rate spread and margin. Interest rate spread is the difference (expressed as a percentage) between the interest rate earned on earning assets less the interest expense on interest bearing liabilities. While the interest rate spread provides a quick comparison of earnings rates versus cost of funds, management believes that the net interest margin provides a better measurement of performance. The net interest margin (as compared to the net interest spread) includes the effect of noninterest bearing sources in its calculation and is net interest income expressed as a percentage of average earning assets.

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**Eagle Bancorp, Inc.**  
**Consolidated Average Balances, Interest Yields And Rates (Unaudited)**  
**(dollars in thousands)**

	Years Ended December 31, 2018			2017			2016		
	Average Balance	Interest	Average Yield / Rate	Average Balance	Interest	Average Yield / Rate	Average Balance	Interest	Average Yield / Rate
Assets									
Interest earning assets:									
Interest bearing deposits with other banks and other short-term investments	\$356,017	\$6,616	1.86 %	\$313,296	\$3,258	1.04 %	\$341,574	\$1,654	0.48 %
Loans held for sale	23,877	1,095	4.59 %	35,813	1,400	3.91 %	53,590	1,903	3.55 %
Loans (1)(2)	6,638,136	367,511	5.54 %	5,939,985	307,110	5.17 %	5,338,716	272,585	5.11 %
Investment securities available for sale (2)	692,753	17,907	2.58 %	557,049	12,214	2.19 %	468,773	9,629	2.05 %
Federal funds sold	15,618	157	1.01 %	7,672	52	0.68 %	7,950	34	0.43 %
Total interest earning assets	7,726,401	393,286	5.09 %	6,853,815	324,034	4.73 %	6,210,603	285,805	4.60 %
Noninterest earning assets	299,653			296,562			282,060		
Less: allowance for credit losses	67,113			61,166			55,889		
Total noninterest earning assets	232,540			235,396			226,171		
Total Assets	\$7,958,941			\$7,089,211			\$6,436,774		
Liabilities and Shareholders' Equity									

Interest  
bearing  
liabilities: