FIRST MARINER BANCORP
Form 10-Q
August 14, 2012

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

FORM 10-Q

(Mark One)
ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2012.

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

For the transition period from to
Commission file number: 0-21815

FIRST MARINER BANCORP
(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

The number of shares of common stock outstanding as of August 3, 2012 is 18,860,482 shares.

FIRST MARINER BANCORP AND SUBSIDIARY
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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- the strength of the United States economy in general, the strength of the local economies in which we conduct operations, and the effects of future economic conditions, including inflation, recession, or a continuing decrease in real estate values;
- 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;
- the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities, and interest sensitive assets and liabilities;
- the effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission, the Financial Accounting Standards Board, or other accounting standards setters;
- adverse changes in the securities markets;
- the effects of competition from other commercial banks, thrifts, mortgage-banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally, and internationally, together with competitors offering banking products and services by mail, telephone, and the Internet;
- costs and potential disruption or interruption of operations due to cyber security incidents;
- a decline in demand for our products and services;
- an inability to attract and retain deposits;
- the timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- changes in consumer spending and savings habits;
- the effect of any mergers, acquisitions, or other transactions to which we or our subsidiary may from time to time be a party;
- our ability to effectively manage market risk, credit risk, and operational risk;
- unanticipated regulatory or judicial proceedings;
- the success and timing of our business strategies and our ability to effectively carry out our business and capital plans;
- our ability to continue to operate as a going concern;

our ability to realize the benefits from our cost saving initiatives;

our ability to meet our interest payment obligations on our junior subordinated deferrable interest debentures upon expiration of the deferral period in 2013;

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

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

our ability to successfully implement our plan to reduce First Mariner Bank s risk exposure to problem assets;

the failure of assumptions underlying the establishment of our allowance for loan losses that may prove to be materially incorrect or may not be borne out by subsequent events;

increased loan delinquencies and/or an escalation in problem assets and foreclosures;

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

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

our ability to successfully implement our liquidity contingency plan and meet our liquidity needs;

our ability to satisfy all closing conditions under the Purchase Agreement and related amendment with Priam and under the securities purchase agreement;

the risks described in this Quarterly Report on Form 10-Q, our Quarterly Report on Form 10-Q for the three months ended March 31, 2012, and our Annual Report on Form 10-K as of and for the year ended December 31, 2011.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks, and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, please read the Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q and in Item 1A of Part I of our Annual Report on Form 10-K as of and for the year ended December 31, 2011. Any forward-looking statement speaks only as of the date which such statement was made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

PART I FINANCIAL INFORMATION

Item 1 Financial Statements

First Mariner Bancorp and Subsidiary
Consolidated Statements of Financial Condition
(dollars in thousands, except per share data)

	June 30, 2012	December 31, 2011
	(unaudited)	
ASSETS		
Cash and due from banks	$ 122,161	$ 104,204
Federal funds sold and interest-bearing deposits	29,231	44,585
Securities available for sale (AFS), at fair value	40,537	22,682
Loans held for sale (LHFS), at fair value	247,118	182,992
Loans receivable	660,795	701,751
Allowance for loan losses	(13,522)	(13,801)
Loans, net	647,273	687,950
Real estate acquired through foreclosure	22,433	25,235
Restricted stock investments	6,886	7,085
Premises and equipment, net	37,652	38,278
Accrued interest receivable	3,677	4,025
Bank-owned life insurance (BOLI)	38,058	37,478
Prepaid expenses and other assets	27,065	24,503
Total assets	$ 1,222,091	$ 1,179,017
LIABILITIES AND STOCKHOLDERS DEFICIT		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 99,576	$ 100,303
Interest-bearing	947,248	914,457
Total deposits	1,046,824	1,014,760
Short-term borrowings	47,713	47,981
Long-term borrowings	73,616	73,698
Junior subordinated deferrable interest debentures	52,068	52,068
Accrued expenses and other liabilities (of which, $118 and $18 are at fair value, respectively)	18,990	15,922
Total liabilities	1,239,211	1,204,429
Stockholders deficit:		
Common stock, $.05 par value; 75,000,000 shares authorized; 18,860,482 shares issued and outstanding at both June 30, 2012 and December 31, 2011	939	939
Additional paid-in capital	80,014	80,125
Retained deficit	(95,962)	(103,454)
Accumulated other comprehensive loss	(2,111)	(3,022)
Total stockholders deficit	(17,120)	(25,412)
Total liabilities and stockholders deficit	$ 1,222,091	$ 1,179,017

See accompanying notes to consolidated financial statements

First Mariner Bancorp and Subsidiary
Consolidated Statements of Operations
(dollars in thousands except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
		(unaudited)		
Interest income:				
Loans	$ 10,795	$ 10,946	$ 22,077	$ 22,645
Investments and other earning assets	375	706	711	1,196
Total interest income	11,170	11,652	22,788	23,841
Interest expense:				
Deposits	2,871	4,088	5,959	8,591
Short-term borrowings	31	68	64	171
Long-term borrowings	921	846	1,853	1,624
Total interest expense	3,823	5,002	7,876	10,386
Net interest income	7,347	6,650	14,912	13,455
(Reversal of) provision for loan losses	(428)	5,780	572	6,580
Net interest income after provision for loan losses	7,775	870	14,340	6,875
Noninterest income:				
Total other-than-temporary impairment (OTTI) charges	43	(92)	81	(28)
Less: Portion included in other comprehensive income (pre-tax)	(43)	(45)	(541)	(109)
Net OTTI charges on AFS securities	-	(137)	(460)	(137)
Mortgage-banking revenue	11,117	2,398	20,066	3,333
ATM fees	701	788	1,418	1,559
Service fees on deposits	623	742	1,304	1,477
Gain on sale of AFS securities	-	143	-	143
Loss on sale of other assets	(230)	-	(322)	-
Commissions on sales of nondeposit investment products	87	154	149	272
Income from BOLI	287	334	580	668
Other	249	324	479	492
Total noninterest income	12,834	4,746	23,214	7,807
Noninterest expense:				
Salaries and employee benefits	5,552	5,859	11,331	12,129
Occupancy	2,286	2,029	4,508	4,205
Furniture, fixtures, and equipment	324	446	686	931
Professional services	739	1,318	1,112	2,482
Advertising	231	115	420	250
Data processing	402	389	834	844
ATM servicing expenses	226	230	453	438
Write-downs, losses, and costs of real estate acquired through foreclosure	940	1,658	2,214	3,417
Federal Deposit Insurance Corporation (FDIC) insurance premiums	1,074	1,539	2,122	2,512
Service and maintenance	564	625	1,155	1,277

Corporate Insurance		402		312		876		680
Consulting fees		316		350		924		665
Loan collection expenses		137		125		189		278
Other		1,744		1,621		3,443		2,883
Total noninterest expense		14,937		16,616		30,267		32,991
Net income (loss) before income taxes		5,672		(11,000)		7,287		(18,309)
Income tax benefit		-		-		(205)		-
Net income (loss)	$	5,672	$	(11,000)	$	7,492	$	(18,309)
Net income (loss) per common share - basic and diluted	$	0.30	$	(0.59)	$	0.40	$	(0.99)

See accompanying notes to consolidated financial statements.

First Mariner Bancorp and Subsidiary
Consolidated Statements of Comprehensive Income (Loss)
(dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
	(unaudited)			
Net income (loss)	$ 5,672	$ (11,000)	$ 7,492	$ (18,309)
Other comprehensive income items:				
Unrealized holding gains on securities arising during the period (net of tax expense of $127, $455, $431, and $529, respectively)	188	673	637	781
Reclassification adjustment for net losses (gains) on securities (net of tax benefit (expense) of $0, $(2), $186, and $(2), respectively) included in net income (loss)	-	(4)	274	(4)
Total other comprehensive income	188	669	911	777
Total comprehensive income (loss)	$ 5,860	$ (10,331)	$ 8,403	$ (17,532)

See accompanying notes to consolidated financial statements.

First Mariner Bancorp and Subsidiary
Consolidated Statements of Changes in Stockholders (Deficit) Equity
(dollars in thousands except per share data)

Six Months Ended June 30, 2012

(unaudited)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Deficit
Balance at December 31, 2011	18,860,482	$ 939	$ 80,125	$ (103,454)	$ (3,022)	$ (25,412)
Net income	-	-	-	7,492	-	7,492
Costs of common stock issued, net	-	-	(11)	-	-	(11)
Change in fair value of warrants	-	-	(100)	-	-	(100)
Changes in unrealized losses on securities, net of taxes	-	-	-	-	911	911
Balance at June 30, 2012	18,860,482	$ 939	$ 80,014	$ (95,962)	$ (2,111)	$ (17,120)

Six Months Ended June 30, 2011

(unaudited)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity (deficit)
Balance at December 31, 2010	18,050,117	$ 902	$ 79,667	$ (73,210)	$ (3,613)	$ 3,746
Net loss	-	-	-	(18,309)	-	(18,309)
Common stock issued, net of costs	810,365	37	350	-	-	387
Stock-based compensation expense	-	-	5	-	-	5
Change in fair value of warrants	-	-	(25)	-	-	(25)
Changes in unrealized losses on securities, net of taxes	-	-	-	-	777	777
Balance at June 30, 2011	18,860,482	$ 939	$ 79,997	$ (91,519)	$ (2,836)	$ (13,419)

See accompanying notes to consolidated financial statements.

First Mariner Bancorp and Subsidiary
Consolidated Statements of Cash Flows
(dollars in thousands)

	Six Months Ended June 30,	
	2012	2011
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	$ 7,492	$ (18,309)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	1,413	1,677
Amortization of unearned loan fees and costs, net	335	290
Amortization of discounts on mortgage-backed securities, net	2	15
Origination fees and gains on sale of mortgage loans	(18,812)	(2,777)
Net OTTI charges on AFS securities	460	137
Gain on sale of AFS securities	-	(143)
Loss on sale of other assets	322	-
Decrease in accrued interest receivable	349	4
Provision for loan losses	572	6,580
Write-downs and losses on sale of real estate acquired through foreclosure	941	2,486
Increase in cash surrender value of BOLI	(580)	(668)
Originations of mortgage LHFS	(1,030,346)	(398,580)
Proceeds from sales of mortgage LHFS	984,690	476,517
Net increase (decrease) in accrued expenses and other liabilities	2,968	(297)
Net increase in prepaids and other assets	(3,177)	(688)
Net cash (used in) provided by operating activities	(53,371)	66,244
Cash flows from investing activities:		
Loan principal repayments, net	35,462	55,413
Repurchase of loans previously sold	-	(435)
Sale of restricted stock investments	199	85
Purchases of premises and equipment	(1,110)	(291)
Activity in AFS securities:		
Maturities/calls/repayments	5,252	7,674
Sales	-	22,695
Purchases	(22,043)	(57,799)
Additional funds disbursed on real estate acquired through foreclosure	-	(772)
Proceeds from sales of real estate acquired through foreclosure	6,511	5,610
Net cash provided investing activities	24,271	32,180
Cash flows from financing activities:		
Net increase (decrease) in deposits	32,064	(126,780)
Net decrease in other borrowed funds	(350)	(995)
Net costs of stock issuance	(11)	(11)
Net cash provided by (used in) financing activities	31,703	(127,786)
Increase (decrease) in cash and cash equivalents	2,603	(29,362)
Cash and cash equivalents at beginning of period	148,789	217,961
Cash and cash equivalents at end of period	$ 151,392	$ 188,599
Supplemental information:		
Interest paid on deposits and borrowed funds	$ 7,126	$ 9,802

Real estate acquired in satisfaction of loans	$	4,650	$	14,205
Transfers of LHFS to loan portfolio	$	342	$	978

See accompanying notes to consolidated financial statements

First Mariner Bancorp and Subsidiary
Notes to Consolidated Financial Statements
(Information as of and for the three and six months ended June 30, 2012 and 2011 is unaudited)

(1) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements for First Mariner Bancorp have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a full presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (U.S.) (GAAP). The consolidated financial statements should be read in conjunction with the audited financial statements included in First Mariner Bancorp s Annual Report on Form 10-K as of and for the year ended December 31, 2011. When used in these notes, the terms the Company, we, us, and our refer to First Mariner Bancorp and, unless the context requires otherwise, its consolidated subsidiary.

The consolidated financial statements include the accounts of First Mariner and its wholly owned subsidiary, 1st Mariner Bank (the Bank). All significant intercompany accounts and transactions have been eliminated in consolidation. Events occurring after the date of the financial statements were considered in the preparation of the financial statements. Certain reclassifications have been made to amounts previously reported to conform to classifications made in 2012.

The consolidated financial statements as of June 30, 2012 and for the three and six months ended June 30, 2012 and 2011 are unaudited but include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of financial position and results of operations for those periods. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results that will be achieved for the entire year or any future interim period.

The preparation of the financial statements in conformity with GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Going Concern Consideration

Due to the conditions and events discussed later in Note 5, there is doubt regarding our ability to continue as a going concern. Management is taking various steps designed to improve the Bank s capital position. The Bank has developed a written alternative capital plan designed to improve the Bank s capital ratios. Such plan is dependent upon a capital infusion to meet the capital requirements of the various regulatory agreements (see Note 5 for more information on the agreements). The Company continues to work with its advisors in an attempt to improve capital ratios.

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

(3) Securities

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

	June 30, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
		(dollars in thousands)		
Mortgage-backed securities	$ 3,452	$ 157	$ -	$ 3,609
Trust preferred securities	12,875	114	2,491	10,498
U.S. government agency notes	23,346	50	3	23,393
U.S. Treasury securities	2,037	-	1	2,036
Equity securities - banks	206	9	4	211
Equity securities - mutual funds	750	40	-	790
	$ 42,666	$ 370	$ 2,499	$ 40,537

	December 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
		(dollars in thousands)		
Mortgage-backed securities	$ 1,834	$ 125	$ -	$ 1,959
Trust preferred securities	13,420	103	3,255	10,268
U.S. government agency notes	8,507	11	-	8,518
U.S. Treasury securities	1,004	-	-	1,004
Equity securities - banks	189	6	44	151
Equity securities - mutual funds	750	32	-	782
	$ 25,704	$ 277	$ 3,299	$ 22,682

Contractual maturities of debt securities at June 30, 2012 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(dollars in thousands)	
Due in one year or less	$ 8,999	$ 9,006
Due after one year through five years	16,885	16,929
Due after five years through ten years	1,021	1,008
Due after ten years	11,353	8,984
Mortgage-backed securities	3,452	3,609
	$ 41,710	$ 39,536

The following tables show the level of our gross unrealized losses and the fair value of the associated securities by type and maturity for AFS securities:

	June 30, 2012					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(dollars in thousands)					
Trust preferred securities	$ 991	$ 40	$ 4,815	$ 2,451	$ 5,806	$ 2,491
U.S. government agency notes	9,176	3	-	-	9,176	3
U.S. Treasury securities	2,036	1	-	-	2,036	1
Equity securities - banks	-	-	121	4	121	4
	$ 12,203	$ 44	$ 4,936	$ 2,455	$ 17,139	$ 2,499

	December 31, 2011					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(dollars in thousands)					
Trust preferred securities	$ 1,967	$ 66	$ 4,542	$ 3,189	$ 6,509	$ 3,255
Equity securities - banks	-	-	63	44	63	44
	$ 1,967	$ 66	$ 4,605	$ 3,233	$ 6,572	$ 3,299

The trust preferred securities that we hold in our securities portfolio are issued by other banks, bank holding companies, and insurance companies. Certain of these securities have experienced declines in value since acquisition. These declines have occurred due to changes in the market which has limited the demand for these securities and reduced their liquidity. We consider the decline in value for four of the pooled trust preferred securities to be other than temporary and recorded the credit-related portion of the impairment as net OTTI of $460,000 for the six months ended June 30, 2012. We did not record any additional OTTI during the three months ended June 30, 2012. We recorded net OTTI of $137,000 for both the three and six months ended June 30, 2011. See additional information on the pooled trust preferred securities in Note 8.

The following shows the activity in OTTI related to credit losses for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands)			
Balance at beginning of period	$ 9,190	$ 7,892	$ 8,730	$ 7,892
Additional OTTI taken for credit losses	-	137	460	137
Balance at end of period	$ 9,190	$ 8,029	$ 9,190	$ 8,029

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

At June 30, 2012, we held securities with an aggregate carrying value (fair value) of $37.5 million that we have pledged as collateral for certain mortgage-banking and hedging activities, borrowings, government deposits, and customer deposits.

(4) Loans Receivable and Allowance for Loan Losses

Loans receivable are summarized as follows:

	June 30, 2012	December 31, 2011
	(dollars in thousands)	
Commercial	$ 52,505	$ 47,518
Commercial mortgage	299,854	331,943
Commercial construction	52,879	54,433
Consumer construction	16,311	16,456
Residential mortgage	116,143	121,071
Consumer	121,970	129,227
Total loans	659,662	700,648
Unearned loan fees, net	1,133	1,103
	$ 660,795	$ 701,751

Included in consumer loan totals in the above table are overdrawn commercial and retail checking accounts totaling $100,000 as of June 30, 2012 and $184,000 as of December 31, 2011.

Transferred Loans

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

Information on the activity in transferred loans and related accretable yield is as follows for the three months ended June 30:

	Loan Balance		Accretable Yield		Total	
	2012	2011	2012	2011	2012	2011
			(dollars in thousands)			
Beginning balance	$ 12,117	$ 26,119	$ 47	$ 146	$ 12,070	$ 25,973
Loans transferred	226	978	-	-	226	978
Charge-offs	(213)	(302)	(6)	(6)	(207)	(296)
Payments/accretion	(1,257)	(12)	(5)	(30)	(1,252)	18
Ending balance	$ 10,873	$ 26,783	$ 36	$ 110	$ 10,837	$ 26,673

Information on the activity in transferred loans and related accretable yield is as follows for the six months ended June 30:

	Loan Balance	Accretable Yield	Total

	2012	2011	2012	2011	2012	2011
			(dollars in thousands)			
Beginning balance	$ 14,008	$ 26,219	$ 266	$ 178	$ 13,742	$ 26,041
Loans transferred	342	978	-	-	342	978
Loans moved to real estate acquired through foreclosure	-	(83)	-	-	-	(83)
Charge-offs	(285)	(302)	(14)	(6)	(271)	(296)
Payments/accretion	(3,192)	(29)	(216)	(62)	(2,976)	33
Ending balance	$ 10,873	$ 26,783	$ 36	$ 110	$ 10,837	$ 26,673

At June 30, 2012, we had pledged loans with a carrying value of $108.5 million as collateral for Federal Home Loan Bank (FHLB) advances.

Credit Quality

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

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

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

Three months ended June 30, 2012

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 2,778	$ 1,871	$ 1,857	$ 170	$ 2,650	$ 2,518	$ 1,677	$ 13,521
Charge-offs	-	(94)	-	-	-	(546)	-	(640)
Recoveries	-	612	-	-	384	73	-	1,069
Net recoveries (charge-offs)	-	518	-	-	384	(473)	-	429
Provision for (reversal of) loan losses	119	(827)	(179)	(40)	(1,530)	205	1,824	(428)
Ending Balance	$ 2,897	$ 1,562	$ 1,678	$ 130	$ 1,504	$ 2,250	$ 3,501	$ 13,522

Six months ended June 30, 2012

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 2,768	$ 2,011	$ 1,809	$ 156	$ 2,711	$ 2,632	$ 1,714	$ 13,801
Charge-offs	(187)	(320)	(147)	(7)	(514)	(938)	-	(2,113)
Recoveries	-	612	52	-	420	178	-	1,262
Net (charge-offs) recoveries	(187)	292	(95)	(7)	(94)	(760)	-	(851)
Provision for (reversal of) loan losses	316	(741)	(36)	(19)	(1,113)	378	1,787	572
Ending Balance	$ 2,897	$ 1,562	$ 1,678	$ 130	$ 1,504	$ 2,250	$ 3,501	$ 13,522
Ending balance - individually evaluated for impairment	$ 4	$ 31	$ -	$ -	$ 234	$ -	$ -	$ 269
Ending balance - collectively evaluated for impairment	2,893	1,531	1,678	130	1,270	2,250	3,501	13,253
	$ 2,897	$ 1,562	$ 1,678	$ 130	$ 1,504	$ 2,250	$ 3,501	$ 13,522
Ending loan balance - individually evaluated for impairment	$ 3,757	$ 27,642	$ 17,148	$ 669	$ 17,934	$ 1,135		$ 68,285
Ending loan balance - collectively evaluated for	48,870	272,139	35,690	15,479	98,239	122,093		592,510

impairment							
	$ 52,627	$ 299,781	$ 52,838	$ 16,148	$ 116,173	$ 123,228	$ 660,795

Three months ended June 30, 2011

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 163	$ 2,600	$ 1,772	$ 478	$ 3,166	$ 2,624	$ 3,294	$ 14,097
Charge-offs	(2,873)	(469)	(597)	-	(1,189)	(961)	-	(6,089)
Recoveries	-	168	-	-	7	152	-	327
Net charge-offs	(2,873)	(301)	(597)	-	(1,182)	(809)	-	(5,762)
Provision for (reversal of) loan losses	2,943	287	607	(118)	911	1,274	(124)	5,780
Ending Balance	$ 233	$ 2,586	$ 1,782	$ 360	$ 2,895	$ 3,089	$ 3,170	$ 14,115

Six months ended June 30, 2011

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Charge-offs	(2,873)	(509)	(597)	(24)	(1,539)	(1,431)	-	(6,973)
Recoveries	-	168	-	-	14	211	-	393
Net charge-offs	(2,873)	(341)	(597)	(24)	(1,525)	(1,220)	-	(6,580)
Provision for (reversal of) loan losses	2,815	385	326	(433)	1,388	1,892	207	6,580
Ending Balance	$ 233	$ 2,586	$ 1,782	$ 360	$ 2,895	$ 3,089	$ 3,170	$ 14,115
Ending balance - individually evaluated for impairment	$ -	$ 82	$ 17	$ -	$ 418	$ -	$ -	$ 517
Ending balance - collectively evaluated for impairment	233	2,504	1,765	360	2,477	3,089	3,170	13,598
	$ 233	$ 2,586	$ 1,782	$ 360	$ 2,895	$ 3,089	$ 3,170	$ 14,115
Ending loan balance - individually evaluated for impairment	$ 1,563	$ 21,857	$ 12,724	$ 509	$ 22,184	$ 1,147		$ 59,984
Ending loan balance - collectively evaluated for impairment	60,291	307,608	40,715	21,003	105,309	141,701		676,627
	$ 61,854	$ 329,465	$ 53,439	$ 21,512	$ 127,493	$ 142,848		$ 736,611

We use creditworthiness categories to grade commercial loans. Our internal grading system is based on experiences with similarly graded loans. Category ratings are reviewed each quarter. Our internal risk ratings are as follows:

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

High Credit Quality (RR2) This category includes credits that are secured by up to 70% advance against municipal or corporate bonds carrying an A rating or better, U.S. Government securities, and marketable securities of companies with an A or better debt rating. For individual credits, the credit must be secured by any of the aforementioned items or first deed of trust on residential owner-occupied property with a loan-to-value (LTV) ratio of 80% or less and adequate cash flow to service the debt. Permanent real estate loans on fully leased properties with A-rated tenants and a 70% or less LTV ratio with

income coverage of 1.25 times or higher may qualify for this rating, with confirmation of tenants financial condition. No commercial construction loans may carry this rating at inception. At June 30, 2012 and December 31, 2011, none of our loans carried this risk rating.

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

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

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

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

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

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

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

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

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

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

Credits to customers who have not provided the Bank with current or satisfactory financial data (unless the credit is

secured by liquid marketable collateral or guaranteed by financially sound parties);

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

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

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

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

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

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

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

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

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

All nonaccrual loans.

Doubtful (RR9) Doubtful classifications have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently known facts, conditions, and values highly questionable and improbable. A doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific, reasonable, and pending factors which may strengthen and work to the advantage of the credit in the near term. Account officers attempt to identify any principal loss in the credit, where possible, thereby limiting the excessive use of the doubtful classification. The classification is a deferral of the estimated loss until its more exact status may be determined. Pending factors include proposed mergers, acquisition or liquidation procedures, new capital injection, perfecting liens on additional collateral, and refinancing plans. At June 30, 2012 and December 31, 2011, none of our loans carried this risk rating.

Loss (RR10) Losses must be taken as soon as they are realized. In some instances and on a temporary basis, a portion of a loan may receive this rating (split rating) when the actual loss cannot be currently identified. In these instances, additional facts or information is necessary to determine the final amount to be charged against the loan loss reserve. When applied for these purposes, this risk rating may be used for a period not to exceed three months. Subsequent to the identification of this split rating, the remaining balance will be risk rated substandard. This category includes advances in excess of calculated current fair value which are considered uncollectible and do not warrant continuance as bankable assets. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may occur in the future. Credits to distressed borrowers lacking an identifiable and realistic source of repayment are generally charged-off. Loans where repayment is dependent upon events that are not predictable in terms of result or timing (such as protracted litigation) are generally charged-off. At June 30, 2012 and December 31, 2011, none of our loans carried this risk rating.

The following table shows the credit quality breakdown of our commercial loan portfolio by class as of June 30, 2012 and December 31, 2011:

	Commercial		Commercial Mortgage		Consumer Construction		Commercial Construction		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	(dollars in thousands)									
RR8	$ 4,464	$ 5,672	$ 22,708	$ 26,677	$ 16,014	$ 17,105	$ -	$ -	$ 43,186	$ 49,454
RR7	7,374	9,051	20,018	17,065	9,278	9,152	-	-	36,670	35,268
RR6	9,767	10,208	40,357	39,722	14,807	13,132	-	-	64,931	63,062
RR5	16,941	19,825	118,574	122,880	10,733	12,013	-	136	146,248	154,854
RR4	13,049	7,074	95,068	117,088	2,006	2,947	16,148	16,144	126,271	143,253
RR3	1,000	1,000	3,056	3,098	-	-	-	-	4,056	4,098
RR1	32	12	-	-	-	-	-	-	32	12
	$ 52,627	$ 52,842	$ 299,781	$ 326,530	$ 52,838	$ 54,349	$ 16,148	$ 16,280	$ 421,394	$ 450,001

We do not individually grade residential mortgage or consumer loans. Such loans are classified as performing or nonperforming. Loan performance is reviewed each quarter. The following table shows performing and nonperforming (nonaccrual) residential mortgage and consumer loans by class as of June 30, 2012 and December 31, 2011:

	Residential Mortgage		Home Equity & 2nd Mortgage		Other Consumer		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
	(dollars in thousands)							
Nonaccrual loans	$ 7,694	$ 7,585	$ 1,121	$ 905	$ 14	$ -	$ 8,829	$ 8,490
Performing loans	108,479	113,534	102,579	108,539	19,514	21,187	230,572	243,260
	$ 116,173	$ 121,119	$ 103,700	$ 109,444	$ 19,528	$ 21,187	$ 239,401	$ 251,750

The following tables show the aging of our loans receivable by class. Also included are loans that are 90 days or more past due as to interest and principal and still accruing because they are well-secured and in the process of collection.

As of June 30, 2012:

	31-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
	(dollars in thousands)						
Commercial	$ -	$ 203	$ 3,156	$ 3,359	$ 49,268	$ 52,627	$ -
Commercial mortgage	834	2,024	15,610	18,468	281,313	299,781	-
Commercial construction	-	-	5,002	5,002	47,836	52,838	-
Consumer construction	124	-	669	793	15,355	16,148	-
Residential mortgage	3,949	2,017	7,694	13,660	102,513	116,173	-
Home equity and 2nd mortgage	2,171	783	1,121	4,075	99,625	103,700	-
Other consumer	51	143	14	208	19,320	19,528	-
	$ 7,129	$ 5,170	$ 33,266	$ 45,565	$ 615,230	$ 660,795	$ -

As of December 31, 2011:

	31-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
				(dollars in thousands)			
Commercial	$ 477	$ -	$ 4,596	$ 5,073	$ 47,769	$ 52,842	$ 30
Commercial mortgage	12,630	4,116	18,227	34,973	291,557	326,530	1,272
Commercial construction	-	5,170	7,981	13,151	41,198	54,349	2,032
Consumer construction	306	-	956	1,262	15,018	16,280	238
Residential mortgage	6,266	-	10,085	16,351	104,768	121,119	2,500
Home equity and 2nd mortgage	3,203	251	1,142	4,596	104,848	109,444	237
Other consumer	283	137	7	427	20,760	21,187	7
	$ 23,165	$ 9,674	$ 42,994	$ 75,833	$ 625,918	$ 701,751	$ 6,316

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

	June 30, 2012			Six Months Ended June 30, 2012			Six Months Ended June 30, 2011		
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**	**Charge-Offs**	**Average Recorded Investment**	**Interest Income Recognized**	**Charge-Offs**
	(dollars in thousands)								
With no related allowance:									
Commercial	$ 3,598	$ 3,598	$ -	$ 4,330	$ 24	$ 187	$ 1,517	$ 10	$ 2,873
Commercial mortgage	$ 23,185	$ 23,185	$ -	$ 22,911	$ 260	$ 320	$ 21,413	$ 189	$ 381
Commercial construction	$ 17,148	$ 17,148	$ -	$ 13,571	$ 162	$ 147	$ 12,602	$ 66	$ 597
Consumer construction	$ 669	$ 669	$ -	$ 654	$ 16	$ 7	$ 1,048	$ 1	$ 24
Residential mortgage	$ 10,231	$ 10,231	$ -	$ 9,490	$ 186	$ 346	$ 11,316	$ 86	$ 1,090
Home equity & 2nd mortgage	$ 1,121	$ 1,121	$ -	$ 1,014	$ 9	$ 938	$ 713	$ 2	$ 1,431
Other consumer	$ 14	$ 14	$ -	$ 5	$ 1	$ -	$ 224	$ -	$ -
With a related allowance:									
Commercial	155	159	4	156	2	-	-	-	-
Commercial mortgage	4,426	4,457	31	4,705	68	-	3,614	48	128
Commercial construction	-	-	-	-	-	-	444	2	-
Consumer construction	-	-	-	-	-	-	52	3	-
Residential mortgage	7,469	7,703	234	7,459	142	168	12,274	259	449
Home equity & 2nd mortgage	-	-	-	-	-	-	-	-	-
Other consumer	-	-	-	-	-	-	-	-	-
Total:									
Commercial	$ 3,753	$ 3,757	$ 4	$ 4,486	$ 26	$ 187	$ 1,517	$ 10	$ 2,873
Commercial mortgage	$ 27,611	$ 27,642	$ 31	$ 27,616	$ 328	$ 320	$ 25,027	$ 237	$ 509
Commercial construction	$ 17,148	$ 17,148	$ -	$ 13,571	$ 162	$ 147	$ 13,046	$ 68	$ 597
Consumer construction	$ 669	$ 669	$ -	$ 654	$ 16	$ 7	$ 1,100	$ 4	$ 24
Residential mortgage	$ 17,700	$ 17,934	$ 234	$ 16,949	$ 328	$ 514	$ 23,590	$ 345	$ 1,539
Home equity & 2nd mortgage	$ 1,121	$ 1,121	$ -	$ 1,014	$ 9	$ 938	$ 713	$ 2	$ 1,431
Consumer	$ 14	$ 14	$ -	$ 5	$ 1	$ -	$ 224	$ -	$ -

	December 31, 2011		
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**
	(dollars in thousands)		
With no related allowance:			
Commercial	$ 4,804	$ 4,804	$ -
Commercial mortgage	$ 21,039	$ 21,039	$ -
Commercial construction	$ 11,066	$ 11,066	$ -
Consumer construction	$ 718	$ 718	$ -
Residential mortgage	$ 8,723	$ 8,723	$ -
Home equity & 2nd mortgage	$ 905	$ 905	$ -
Other consumer	$ -	$ -	$ -

With a related allowance:			
Commercial	157	161	4
Commercial mortgage	5,249	5,306	57
Commercial construction	-	-	-
Consumer construction	-	-	-
Residential mortgage	9,075	9,297	222
Home equity & 2nd mortgage	-	-	-
Other consumer	-	-	-
Total:			
Commercial	$ 4,961	$ 4,965	$ 4
Commercial mortgage	$ 26,288	$ 26,345	$ 57
Commercial construction	$ 11,066	$ 11,066	$ -
Consumer construction	$ 718	$ 718	$ -
Residential mortgage	$ 17,798	$ 18,020	$ 222
Home equity & 2nd mortgage	$ 905	$ 905	$ -
Consumer	$ -	$ -	$ -

The following table shows loans in nonaccrual status by class:

	June 30, 2012	December 31, 2011	June 30, 2011
	(dollars in thousands)		
Commercial	$ 3,156	$ 4,566	$ 1,401
Commercial mortgage	15,610	16,955	17,099
Commercial construction	5,002	5,949	7,448
Consumer construction	669	718	509
Residential mortgage	7,694	7,585	10,955
Home equity and 2nd mortgage	1,121	905	340
Other consumer	14	-	671
	$ 33,266	$ 36,678	$ 38,423

The interest which would have been recorded on nonaccrual loans if those loans had been performing in accordance with their contractual terms for the six months ended June 30, 2012 and 2011 was approximately $1.4 million and $2.2 million, respectively, and the actual interest income recorded on such loans for the six months ended June 30, 2012 and 2011 was approximately $253,000 and $314,000, respectively.

The following table shows the breakdown of TDRs by portfolio segment:

	June 30, 2012	December 31, 2011	June 30, 2011
	(dollars in thousands)		
Commercial	$ 606	$ 422	$ 162
Commercial mortgage	12,838	10,296	5,345
Commercial construction	12,247	5,221	5,629
Consumer construction	-	-	-
Residential mortgage	11,958	11,908	13,334
Home equity and 2nd mortgage	-	-	389
Other consumer	-	-	-
	$ 37,649	$ 27,847	$ 24,859
Nonaccrual TDRs (included in above totals)	$ 2,630	$ 2,506	$ 3,298

The following table shows the breakdown of loans we modified during the three and six months ended June 30:

	Three Months Ended June 30,					
	2012			2011		
	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification

				(dollars in thousands)						
Commercial	2	$	211	$	211	-	$	-	$	-
Commercial mortgage	2		566		574	-		-		-
Commercial construction	1		5,060		5,060	-		-		-
Residential mortgage	-		-		-	1		566		579
	5	$	5,837	$	5,845	1	$	566	$	579

	Six Months Ended June 30,					
	2012			2011		
	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
	(dollars in thousands)					
Commercial	2	$ 211	$ 211	1	$ 163	$ 163
Commercial mortgage	6	2,749	2,757	2	2,195	2,195
Commercial construction	2	7,093	7,093	-	-	-
Residential mortgage	1	863	863	1	566	579
	11	$ 10,916	$ 10,924	4	$ 2,924	$ 2,937

The majority of our TDRs are the result of renewals where the only concession is that the interest rate is not considered to be a market rate. As such, the best illustration of the financial impact of the TDRs is the effect on the allowance for loan losses.

During the six months ended June 30, 2012, the allowance for loan losses for TDRs was reduced by $14,000 ($26,000 for commercial mortgage, offset by an increase of $12,000 for residential mortgage). During the six months ended June 30, 2012, we charged-off $192,000 for two TDR residential mortgage loans and one TDR commercial mortgage loan and transferred two TDR residential mortgage loan in the amount of $516,000 to real estate acquired through foreclosure.

The following table shows defaults during the stated period of modifications made during the previous year:

	Six Months Ended June 30,			
	2012		2011	
	Number of Modifications	Recorded Investment	Number of Modifications	Recorded Investment
	(dollars in thousands)			
Commercial	1	$ 22	$ -	$ -

(5) Regulatory Matters, Capital Adequacy, and Liquidity

Regulatory matters and capital adequacy

Various regulatory capital requirements administered by the federal banking agencies apply to First Mariner and the Bank. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average quarterly assets. As of June 30, 2012 and December 31, 2011, the Bank was undercapitalized under the regulatory framework for prompt corrective action.

Our regulatory capital amounts and ratios as of June 30, 2012 and December 31, 2011 were as follows:

	Actual		Minimum Requirements for Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(dollars in thousands)			
June 30, 2012:						
Total capital (to risk-weighted assets):						
Consolidated	$ (15,009)	(1.8)%	$ 67,833	8.0%	$ 84,791	10.0%
Bank	53,588	6.3%	67,758	8.0%	84,698	10.0%
Tier 1 capital (to risk-weighted assets):						
Consolidated	(15,009)	(1.8)%	33,916	4.0%	50,875	6.0%
Bank	42,939	5.1%	33,879	4.0%	50,819	6.0%
Tier 1 capital (to average quarterly assets):						
Consolidated	(15,009)	(1.3)%	47,021	4.0%	58,777	5.0%
Bank	42,939	3.7%	46,985	4.0%	58,732	5.0%
December 31, 2011:						
Total capital (to risk-weighted assets):						
Consolidated	$ (22,393)	(2.6)%	$ 68,242	8.0%	$ 85,302	10.0%
Bank	46,659	5.5%	68,243	8.0%	85,304	10.0%
Tier 1 capital (to risk-weighted assets):						
Consolidated	(22,393)	(2.6)%	34,121	4.0%	51,181	6.0%
Bank	35,935	4.2%	34,122	4.0%	51,183	6.0%
Tier 1 capital (to average quarterly assets):						
Consolidated	(22,393)	(1.9)%	47,533	4.0%	59,416	5.0%
Bank	35,935	3.0%	47,468	4.0%	59,335	5.0%

The FDIC, through the Deposit Insurance Fund, insures deposits of accountholders up to $250,000, with the exception of noninterest-bearing transaction accounts, which are insured without limit through December 31, 2012. The Bank pays an annual premium to provide for this insurance.

The Bank is a member of the FHLB System and is required to maintain an investment in the stock of the FHLB based on specific percentages of outstanding mortgages, total assets, or FHLB advances. Purchases and sales of stock are made directly with the Bank at par value.

On September 18, 2009, the Bank entered into an Agreement with the FDIC and the Commissioner of Financial Regulation for the state of Maryland (the Commissioner), pursuant to which it consented to the entry of an Order to Cease and Desist (the September Order), which directs the Bank to (i) increase its capitalization, (ii) improve earnings, (iii) reduce nonperforming loans, (iv) strengthen management policies and practices, and (v) reduce reliance on noncore funding. The September Order required the Bank to adopt a plan to achieve and maintain a Tier I leverage capital ratio of at least 7.5% and a total risk-based capital ratio of at least 11% by June 30, 2010. As of June 30, 2012, we did not yet meet the requirements. The failure to achieve these capital requirements could result in further action by our regulators.

As part of the September Order, within 30 days after the end of each calendar year, the Bank must submit an annual budget and profit plan and a plan that takes into account the Bank s pricing structure, the Bank s cost of funds and how this can be reduced, and the level of provision expense for adversely classified loans. To address reliance on noncore funding, the Bank was required to submit a liquidity plan intended to reduce the Bank s reliance on noncore funding, wholesale funding sources, and high-cost rate-sensitive deposits. While the September Order is in effect, the Bank may not pay dividends or management fees without the FDIC s prior consent, may not accept, renew, or roll over any brokered deposits, and is restricted in the yields that it may pay on deposits.

First Mariner Bancorp is also a party to agreements with the Federal Reserve Bank (FRB) (the FRB Agreements), which, together, require it to: (i) develop and implement a strategic business plan that includes (a) actions that will be taken to improve our operating performance and reduce the level of parent company leverage, (b) a comprehensive budget and an expanded budget review process, (c) a description of the operating assumptions that form the basis for major projected income and expense components and provisions needed to maintain an adequate loan loss reserve, and (d) a capital plan incorporating all capital needs, risks, and regulatory guidelines; and (ii) submit plans to improve enterprise-wide risk management and effectiveness of internal audit programs. First Mariner Bancorp has also agreed to provide the FRB with advance notice of any significant capital transactions. The FRB

Agreements also prohibit First Mariner and the Bank from taking any of the following actions without the FRB s prior written approval: (i) declaring or paying any dividends; (ii) taking dividends from the Bank; (iii) making any distributions of interest, principal, or other sums on First Mariner s subordinated debentures or trust preferred securities; (iv) incurring, increasing, or guaranteeing any debt; or (v) repurchasing or redeeming any shares of its stock. To satisfy the FRB s minimum capital requirements, First Mariner s consolidated Tier I capital to average quarterly assets, Tier I capital to risk-weighted assets, and total capital to risk-weighted assets ratios at each quarter end must be at least 4.0%, 4.0%, and 8.0%, respectively. At June 30, 2012, those capital ratios were (1.3)%, (1.8)%, and (1.8)%, respectively, which were not in compliance with the minimum requirements. The failure to achieve these capital requirements could result in further action by our regulators.

The foregoing will subject us to increased regulatory scrutiny and may have an adverse impact on our business operations. Failure to comply with the provisions of these regulatory requirements may result in more restrictive actions from our regulators, including more severe and restrictive enforcement actions.

Liquidity

The Bank s principal sources of liquidity are cash and cash equivalents (which are cash on hand and amounts due from financial institutions, federal funds sold, money market mutual funds, and interest bearing deposits), AFS securities, deposit accounts, and borrowings. The levels of such sources are dependent on the Bank s operating, financing, and investing activities at any given time. We attempt to primarily rely on core deposits from customers to provide stable and cost-effective sources of funding to support our loan growth. We also seek to augment such deposits with longer term and higher yielding certificates of deposit. Cash and cash equivalents, which totaled $151.4 million at June 30, 2012, have immediate availability to meet our short-term funding needs. Our entire securities portfolio is classified as AFS, is highly marketable (excluding our holdings of pooled trust preferred securities), and is available to meet our liquidity needs. Additional sources of liquidity include LHFS, which totaled $247.1 million at June 30, 2012, are committed to be sold into the secondary market, and generally are funded within 60 days and our residential real estate portfolio, which includes loans that are underwritten to secondary market criteria. Additionally, our residential construction loan portfolio provides a source of liquidity as construction periods generally range from 9-12 months, and these loans are subsequently refinanced with permanent first-lien mortgages and sold into the secondary market.

(6) Stock Options and Warrants

We have stock option plans, which provide for the granting of options to acquire First Mariner common stock to our directors and key employees. Option exercise prices are equal to or greater than the fair market value of the common stock on the date of the grant.

We account for stock options issued under our stockholder-approved Long-Term Incentive Plan (the Plan) in accordance with FASB guidance on share-based payments. The plan permits the granting of share options and shares to our directors and key employees. As of June 30, 2012, all options and warrants are fully vested and all compensation expense related to currently outstanding options and warrants has been recognized.

All options expire 10 years after the date of grant. The warrants expire five years after date of issuance.

Information with respect to stock options and warrants is as follows for the six months ended June 30, 2012 and 2011:

	2012				**2011**			
	Number of Shares	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term** *(in years)*	**Aggregate Intrinsic Value** *(in thousands)*	**Number of Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term** *(in years)*	**Aggregate Intrinsic Value** *(in thousands)*
Outstanding at beginning of period	836,228	$ 7.98			930,228	$ 7.92		
Forfeited/cancelled	(241,400)	12.40			(89,400)	2.63		
Outstanding and exercisable at end of period	594,828	6.19	2.7	$ -	840,828	8.02	3.2	$ -

There were no options or warrants granted or exercised during 2012 or 2011.

Options and warrants outstanding are summarized as follows at June 30, 2012:

Exercise Price	Options and Warrants Outstanding and Exercisable *(shares)*	Weighted Average Remaining Contractual Life *(in years)*
$ 1.09	18,348	3.0
1.15	347,826	2.7
4.15	11,200	5.8
5.41	2,754	5.5
5.70	19,500	5.7
9.86	1,350	0.3
11.68	53,250	0.5
11.95	600	0.6
13.00	700	0.8
13.33	7,300	4.8
13.52	3,000	0.8
16.67	4,800	2.8
16.70	1,800	3.3
16.95	2,300	1.3
17.45	17,250	3.5
17.77	71,850	2.6
18.20	4,950	1.8
18.38	17,650	1.5
18.94	2,350	4.4
19.30	6,050	3.8
	594,828	

(7) Income (Loss) Per Share

Basic income (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted income (loss) per share is computed after adjusting the denominator of the basic income (loss) per share computation for the effects of all dilutive potential common shares outstanding during the period. The dilutive effects of options, warrants, and their equivalents are computed using the treasury stock method. For the three and six month periods ended June 30, 2012 and 2011, all options and warrants were antidilutive and excluded from the computations.

Information relating to the calculation of income (loss) per common share is summarized as follows for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Weighted-average share outstanding - basic and diluted	18,860,482	18,640,914	18,860,482	18,524,312
Net income (loss) *(dollars in thousands)*	$ 5,672	$ (11,000)	$ 7,492	$ (18,309)
Basic and diluted income (loss) per share	$ 0.30	$ (0.59)	$ 0.40	$ (0.99)

(8) Fair Value of Financial Instruments

We group financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Financial Instruments Measured on a Recurring Basis

The following table presents fair value measurements for assets, liabilities, and off-balance sheet items that are measured at fair value on a recurring basis:

	June 30, 2012				
	Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Changes In Fair Values Included In Period Income
	(dollars in thousands)				
Securities:					
Mortgage-backed securities	$ 3,609	$ -	$ 3,609	$ -	$ -
Trust preferred securities	10,498	-	9,735	763	(460) (1)
U.S. government agency notes	23,393	-	23,393	-	-
U.S. Treasury securities	2,036	-	2,036	-	-
Equity securities - banks	211	-	211	-	-
Equity securities - mutual funds	790	-	790	-	-
	$ 40,537	$ -	$ 39,774	$ 763	$ (460)
Warrants	$ 118	$ -	$ -	$ 118	$ -
LHFS	247,118	-	247,118	-	2,774
Interest rate lock commitments (IRLC or IRLCs) (notional amount of $314,778)	319,542	-	319,542	-	2,940
Forward contracts to sell mortgage-backed securities (notional amount of $180,970)	183,355	-	183,355	-	(6,863)

(1) Represents net OTTI charges taken on certain Level 3 securities

	December 31, 2011				
	Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Changes In Fair Values Included In Period Losses
	(dollars in thousands)				
Securities:					
Mortgage-backed securities	$ 1,959	$ -	$ 1,959	$ -	$ -
Trust preferred securities	10,268	-	9,586	682	(838) (1)
U.S. government agency notes	8,518	-	8,518	-	-
U.S. Treasury securities	1,004	-	1,004		