FIRST MARINER BANCORP
Form 10-K
March 30, 2012

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

FORM 10-K

(Mark One)

x **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the fiscal year ended December 31, 2011.

or

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

For the transition period from

Commission file number 0-21815

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

Maryland	**52-1834860**
(State of incorporation)	(IRS Employer Identification Number)
1501 S. Clinton Street, Baltimore, MD	**21224**
(Address of principal executive offices)	(zip code)

410-342-2600
(Telephone number)

Securities registered under Section 12(b) of the Exchange Act:

None

Securities registered under Section 12 (g) of the Exchange Act:

Title of Each Class

Common Stock, par value $0.05 per share

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

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 o No x

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers in response 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. x

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant s most recently completed second fiscal quarter was approximately $9.4 million.

The number of shares of common stock outstanding as of March 16, 2012 was 18,860,482 shares.

Documents incorporated by reference: None

FIRST MARINER BANCORP

Annual Report on Form 10-K

December 31, 2011

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of our statements contained in, or incorporated by reference into, this Annual Report on Form 10-K 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 unfavorable 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;
- our 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;
- our ability to retain key employees;
- 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 Capital Fund I, LP;
- other risks as described in this Annual Report on Form 10-K.

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 I of this Annual Report on Form 10-K. 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

ITEM 1 BUSINESS

General

First Mariner Bancorp (First Mariner) is a bank holding company whose business is conducted primarily through its wholly owned operating subsidiary, First Mariner Bank (the Bank). First Mariner was established in 1995 and has total assets in excess of $1.1 billion as of December 31, 2011. Our executive offices are located in the Canton area of Baltimore City at 1501 South Clinton Street, Baltimore, Maryland 21224. Our telephone number is (410) 342-2600.

We maintain the following Internet sites: www.1stmarinerbank.com; www.1stmarinerbancorp.com; www.1stmarinermortgage.com; and www.vamortgage.com. Information on these websites is not part of, and is not incorporated herein by reference to, this Annual Report on Form 10-K. Our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports are available, free of charge, in the investor relations section of our Internet site at www.1stmarinerbancorp.com as soon as reasonably practicable after we have filed them with the Securities and Exchange Commission (the SEC).

The Bank is our largest operating subsidiary with assets exceeding $1.1 billion as of December 31, 2011 and is the largest bank headquartered in Baltimore, Maryland. The Bank was formed in 1995 through the merger of several small financial institutions. The Bank s primary market area for its core banking operations, which consist of traditional commercial and consumer lending, as well as retail and commercial deposit operations, is central Maryland, as well as portions of Maryland s eastern shore. First Mariner Bank is an independent community bank, and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC).

The Bank is engaged in the general commercial banking business, with particular attention and emphasis on the needs of individuals and small to mid-sized businesses, and delivers a wide range of financial products and services that are offered by many larger competitors. Products and services include traditional deposit products, a variety of consumer and commercial loans, residential and commercial mortgage and construction loans, money transfer services, nondeposit investment products, and mobile and Internet banking and similar services. Most importantly, the Bank provides customers with access to local Bank officers who are empowered to act with flexibility to meet customers needs in an effort to foster and develop long-term loan and deposit relationships.

First Mariner Mortgage, a division of the Bank, engages in mortgage-banking activities, providing mortgages and associated products to customers and selling most of those mortgages into the secondary market. First Mariner Mortgage has offices in Maryland, Delaware, Virginia, and North Carolina. See Note 21 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K for information on the results of our mortgage-banking operations.

Next Generation Financial Services (NGFS), a former division of the Bank, engaged in the origination of reverse and conventional mortgage loans and provided these products directly through commission based loan officers throughout the United States. We transferred all Mortgage Servicing Rights (MSR or MSRs) to the buyer of NGFS during the second quarter of 2011 and finalized the sale during the third quarter of 2011. We have not realized any significant benefit or loss from the sale of NGFS.

We do not conduct any foreign operations.

We operate in two business segments commercial and consumer banking and mortgage-banking. Financial information related to our operations in these segments for each of the three years ended December 31, 2011 is provided in Note 21 to our Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K.

Our Business Strategy

We are currently focused on improving earnings, liquidity, capital adequacy, and controlling asset growth. In order to achieve our objectives, our strategy is to:

- Strengthen the capital position of the Company and the Bank;
- Reduce our long-term debt;
- Aggressively improve the quality of assets currently in our portfolio;
- Adhere to rigorous credit standards in the origination of new loans;
- Reduce our controllable operating expenses to improve our efficiency ratios;
- Work towards obtaining termination of Regulatory Enforcement Actions (see discussions in Item 1A Risk Factors later in Part I of this Annual Report on Form 10-K);
- Review our branch performance to evaluate possible consolidations or relocations that may increase our efficiency;
- Cross-sell our products and services to our existing customers to leverage relationships and enhance our profitability;
- Capitalize on our personal relationship approach that we believe differentiates us from our larger competitors;
- Provide our customers with access to local executives who make key credit and other decisions;
- Maximize mortgage-banking opportunities;
- Pursue commercial lending opportunities with small to mid-sized businesses that are underserved by our larger competitors; and
- Develop innovative financial products and services to generate additional sources of revenue.

Financial Services We Provide

Commercial Banking

Our commercial loan unit focuses on loan originations from small and mid-sized businesses (generally up to $20.0 million in annual sales) and such loans may be accompanied by significant related deposits. Our commercial loan products include commercial mortgage loans for the purchase or refinance of commercial properties; residential and commercial real estate construction and development loans; working capital loans and lines of credit; demand, term, and time loans; and equipment, inventory, and accounts receivable financing. We also offer an array of cash management services and deposit products to our commercial customers, including computerized on-line banking and remote deposit.

Retail Banking

Our retail banking activities emphasize consumer deposit and checking accounts. We offer an extensive range of services to meet the varied needs of our customers of all age demographics. In addition to traditional products and services, we offer contemporary products and services, such as debit cards, mutual funds, annuities, insurance products, Internet banking, electronic bill payment, mobile banking, and personal financial management services. Our consumer loan products include home equity lines of credit, fixed rate second mortgages, new and used auto loans, new and used boat loans, overdraft protection, and unsecured personal credit lines.

Mortgage-Banking

Our mortgage-banking business is structured to provide a source of fee income largely from the process of originating residential mortgage loans for sale in the secondary market, as well as the origination of loans to be held in our loan portfolio. Mortgage-banking products include Federal Housing Administration (FHA) and the federal Veterans Administration (VA) loans, conventional and nonconforming first- and second-lien mortgages, reverse mortgages, and construction and permanent financing.

Our Lending Activities

Loan Portfolio Composition

At December 31, 2011, our loan portfolio totaled $701.8 million, representing 59.5% of our total assets of $1.2 billion. The majority of our lending activity is in the Mid-Atlantic region and our loans are generally secured by residential and commercial real estate. At December 31, 2011 approximately 90% of our total loans were secured by real estate.

Commercial Loans

The Bank originates a variety of loans for business purposes. The majority of our commercial loans are secured. The Bank makes loans to provide working capital to businesses in the form of lines of credit, which may be secured by real estate, accounts receivable, inventory, equipment, or other assets. The financial condition and cash flow of our commercial borrowers are closely monitored by the submission of corporate financial statements, personal financial statements, and income tax returns. The frequency of submissions of required financial information depends on the size and complexity of the credit and the collateral that secures our loan. It is our general policy to obtain personal guarantees from the principals of our commercial loan borrowers.

Commercial Mortgage Loans

The Bank originates mortgage loans secured by commercial real estate. These loans are primarily secured by office buildings, retail buildings, warehouses, and general-purpose business space. Although terms may vary, these commercial mortgage loans generally have maturities of 10 years or less. It is our general policy to obtain personal guarantees from the principals of the borrowers and assignments of all leases related to the collateral.

Commercial and Consumer Construction Loans

The Bank provides interim real estate acquisition, development, and construction loans to builders, developers, and persons who will ultimately occupy their single-family dwellings. These loans are made within the Federal regulatory guidelines for maximum loan-to-value (LTV) ratios. Generally, residential construction loans are made for up to 80% of the appraised value of the property for both individuals and developers. Residential construction loans to developers may be made for over 80% of the appraised value of the property with additional credit enhancements, such as additional collateral. Commercial real estate construction loans are generally made for 75% or less of the appraised value of the property. Development loans, made to improve raw land into lots on which structures may be built, are generally made for 75% or less of the appraised value of the property. The Bank s real estate development and construction loan funds are disbursed periodically at pre-specified stages of completion. We carefully monitor these loans with on-site inspections and control of disbursements. The Bank s real estate development and construction loans are typical debt obligations of the borrowers and do not provide for our participation in residual profits or losses of the projects or involve equity positions through partnerships, joint ventures, or other similar structures.

Loans to individuals for the construction of their primary residences are typically secured by the property under construction, frequently include additional collateral (such as a second mortgage on the borrower s present home), and commonly have maturities of nine to twelve months.

Loans to residential builders for the construction of residential homes require binding sales contracts on the property and pre-qualification of the prospective buyers for permanent mortgage financing. Development loans are made only to developers with a proven track record. Generally, these loans are extended only when the borrower provides evidence that the lots under development will be sold to builders satisfactory to us.

The Bank secures development and construction loans with the properties under development or construction and we typically obtain personal guarantees from the principals. Further, to assure that we do not place reliance solely in the value of the underlying property, we consider the financial condition and reputation of the borrower and any guarantors, the amount of the borrowers equity in the project, independent appraisals, costs estimates, and preconstruction sales information. We have significantly limited our development lending activities over the past four years.

Residential Mortgage Loans

The Bank originates adjustable- and fixed-rate residential mortgage loans. These mortgage loans are generally originated under terms, conditions, and documentation acceptable to the secondary mortgage market. The Bank will place some of these loans into our portfolio, although the vast majority are ultimately sold to investors.

Consumer Loans

The Bank offers a variety of consumer loans, typically secured by residential real estate or personal property, including automobiles and boats. Our home equity loans (closed-end and lines of credit) are typically made up to 70% to 80% of the appraised value, less the amount of any existing prior liens on the property and generally have maximum terms of 15 years. The interest rates on our closed-end home equity loans are fixed, while interest rates on our home equity lines of credit are variable.

Community Reinvestment Act (CRA)

We have a strong commitment to our responsibilities under the federal CRA and actively search for opportunities to meet the development needs of all members of the communities we serve, including persons of low to moderate income in a manner consistent with safe and sound banking practices. We currently fulfill this commitment primarily by participating in loan programs sponsored or guaranteed by the FHA, the VA, the federally funded Neighborhood Stabilization Program, the U.S. Department of Agriculture Rural Development Loans Program, the Federal Home Loan Bank of Atlanta (FHLB) Closing Cost Assistance Program, the Section 8 to Home-Ownership Program, and the Settlement Expense Loan Program.

See Item 7 of Part II of this Annual Report on Form 10-K for more detailed information concerning our loan portfolio, the individual portfolio segments, and their effect on 2011 operations.

Our Credit Administration Process

Our lending activities are subject to written policies approved by the Bank s Board of Directors to ensure proper management of credit risk. We make loans that are subject to a well defined credit process that includes credit evaluation of borrowers, risk-rating of credits, establishment of lending limits and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances, as well as procedures for on-going identification and management of credit deterioration. We conduct regular portfolio reviews to identify potential underperforming credits, estimate loss exposure, geographic and industry concentrations, and to ascertain compliance with our policies. For significant problem loans, we review and evaluate the financial strengths of our borrower and the guarantor, the related collateral, and the effects of economic conditions.

The loan committee of the Bank s Board of Directors is authorized to approve loans up to the Bank s legal lending limit, which is approximately $7.6 million as of December 31, 2011. We have established an in-house limit of $5.0 million, which is reviewed periodically by the Board of Directors, but we do have loans to a limited number of customers in excess of that amount.

We generally do not make loans to be held in our loan portfolio outside our market area unless the borrower has an established relationship with us and conducts its principal business operations within our market area. Consequently, we, and our borrowers, are affected by the economic conditions prevailing in our market area. Approximately 28% of our residential real estate development and construction loan portfolio consisted of loans to Maryland customers and the remaining 72% consisted of loans to customers in the surrounding states and the District of Columbia. Approximately 85% of our commercial loan portfolio (commercial, commercial mortgage, and commercial construction) consisted of loans to Maryland customers with an additional 12% consisting of loans to customers in the surrounding states and the District of Columbia. Commercial and commercial real estate loans to customers in other states in the country amounted to approximately 3% of our portfolio.

Market

We consider our core market area to be the communities within the Baltimore/Washington corridor, particularly Baltimore City and the Maryland counties of Baltimore, Anne Arundel, Carroll, Harford, and Howard, as well as the eastern shore of Maryland. Lending activities are broader and include areas outside of our core market area such as other Maryland counties, the District of Columbia and certain markets in contiguous states, as well as certain regional and national markets.

Our Competition

Banking

We operate in a highly competitive environment, competing for deposits and loans with commercial banks, thrifts, credit unions, mortgage companies, finance companies, Internet-based financial companies, and other financial entities. Our principal competitors include other community commercial banks and larger financial institutions with branches in our market area. Numerous mergers and consolidations involving financial entities in our market area have required us to compete with banks and finance companies with greater resources. Additionally, certain financial institutions have received various amounts of government financial assistance in accordance with legislation passed in late 2008, giving those institutions greater resources with which to compete in our market. See Supervision and Regulation later in this section for further information on government legislation.

The primary factors we face in competing for deposits are interest rates, personalized service, the quality and range of financial services, convenience of office locations, and office hours. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market funds, Internet based banks, and other investment alternatives. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services, responsiveness, and personalized service. Competition for loans comes primarily from other commercial banks, savings associations, mortgage-banking firms, credit unions, finance companies, and other financial intermediaries. Many of the financial institutions operating in our market area offer certain services such as trust and international banking, which we do not offer, and have greater financial resources or have substantially higher lending limits.

To compete with other financial services providers, we principally rely upon local promotional activities, personal relationships established by our officers, directors, and employees with our customers, and specialized services tailored to meet our customers needs. In those instances where we are unable to accommodate a customer s needs, we will arrange for those services to be provided by other financial institutions with which we have a relationship.

Current banking laws facilitate interstate branching and merger activity among banks. This may result in an even greater degree of competition in the banking industry and we may be brought into competition with institutions with which we do not currently compete. As a result, intense competition in our market area may be expected to continue for the foreseeable future.

Mortgage-banking

Our mortgage-banking division also operates in an extremely competitive environment where we compete primarily with mortgage-banking divisions of other financial institutions, which may be larger than we are and have greater resources. Additionally, competition in the mortgage-banking industry comes from the continuing evolution of the secondary mortgage market, the proliferation of mortgage products, increasing interest rate volatility, compounded by homeowners increasing tendency to refinance their mortgages as the refinance process becomes more efficient and cost effective. These swings in mortgage origination volume have placed significant operational and financial pressures on mortgage lenders.

To compete effectively in this environment, we maintain a very high level of operational, technological, and managerial expertise, consistently offer a wide selection of mortgage loans through all marketing channels on a regional scale, provide high-quality service, and price our mortgage loans at competitive rates.

Supervision and Regulation

General

First Mariner and the Bank are extensively regulated under federal and state law. As a registered bank holding company, First Mariner is subject to supervision and examination by and reporting to the Federal Reserve Board (FRB or Federal Reserve).

The Bank is a member of the FHLB System and, with respect to deposit insurance, of the Deposit Insurance Fund (DIF) managed by the FDIC. The Bank must file reports with the Maryland Commissioner of Financial Regulation (Commissioner) and the FDIC concerning its activities and financial condition and obtain regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other banks. The Commissioner and/or the FDIC conduct periodic examinations to test the Bank s safety and soundness and compliance with various regulatory requirements. This regulation and supervision is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the Commissioner, the FDIC, or other legislative bodies, could have a material adverse impact on First Mariner, the Bank, and their operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) made extensive changes in the regulation of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Certain provisions of the Dodd-Frank Act are expected to have a near term impact on First Mariner and the Bank. For example, the Dodd-Frank Act creates a new Consumer Financial Protection Bureau (the Bureau) as an independent bureau of the FRB. The Bureau will assume responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function currently assigned to primary regulators, and will have authority to impose new requirements. However, institutions of less than $10 billion in assets, such as the Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the enforcement authority of, their primary regulator, although the Bureau will have back-up authority to examine and enforce consumer protection laws against all institutions, including institutions with less than $10 billion in assets.

Certain regulatory requirements applicable to First Mariner and the Bank, including some of the changes made by the Dodd-Frank Act, are referred to below or elsewhere in this Annual Report on Form 10-K. The summary of statutory provisions and regulations set forth below or elsewhere does not purport to be a complete description of such statutes and regulations and their effects on First Mariner and the Bank and is qualified in its entirety by reference to the actual laws and regulations.

Regulation of First Mariner

General

First Mariner, as the sole shareholder of the Bank, is a bank holding company and is registered as such with the FRB. Bank holding companies are subject to comprehensive regulation and examination by the FRB under the Bank Holding Company Act of 1956, as amended (the BHCA), and the regulations of the FRB. The FRB also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, issue cease and desist or removal orders, and require that a holding company divest subsidiaries. In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices. First Mariner has entered into a written agreement with the FRB. See Item 1A Risk Factors later in Part I of this Annual Report on Form 10-K for additional information on the agreement with the FRB. See also Capital Resources in Item 7 of Part II of this Annual Report on Form 10-K.

Under the BHCA, a bank holding company must obtain Federal Reserve approval before: (i) acquiring, directly or indirectly, ownership or control of any voting shares of another bank or bank holding company if, after such acquisition, it would own or control more than 5% of such shares (unless it already owns or controls the majority of such shares); (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company. In evaluating such applications, the FRB considers a variety of financial, managerial, and competitive factors and the convenience and needs of the communities involved.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing, or controlling banks or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain nonbanking activities which, by statute or by FRB regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities includes, among others, operating a savings association, mortgage company, finance company, credit card company, or factoring company; performing certain data processing operations; providing certain investment and financial advice; real estate and personal property appraising; providing tax planning and preparation services; and, subject to certain limitations, providing securities brokerage services for customers.

Dividends

The FRB has issued a policy statement on the payment of cash dividends by bank holding companies that expresses the FRB s view that a bank holding company should pay cash dividends only to the extent that the company s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company s capital needs, asset quality, and overall financial condition. The FRB has indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the prompt corrective action regulations adopted by the Federal Reserve pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the FRB may prohibit a bank holding company from paying any dividends if the holding company s bank subsidiary is classified as undercapitalized. See Regulation of the Bank Prompt Corrective Regulatory Action later in this section.

Capital Requirements

The Dodd-Frank Act requires the FRB to issue consolidated regulatory capital requirements for bank holding companies that are at least as stringent as those applicable to insured depository institutions. Such regulations, when finalized, will eliminate the use of certain instruments, such as cumulative preferred stock and trust preferred securities, as Tier 1 holding company capital. However, instruments issued before May 19, 2010 by bank holding companies with less than $15 billion of consolidated assets are grandfathered. Such grandfathering applies to certain trust preferred securities issued by First Mariner, although at December 31, 2011, none of our trust preferred securities qualified for use in our capital calculations due to certain limitations.

Stock Repurchases

A bank holding company is required to give the FRB prior written notice of any purchase or redemption of its 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 violate any law, regulation, Federal Reserve order, directive, or any condition imposed by, or written agreement with, the FRB. This requirement does not apply to bank holding companies that are well capitalized, received one of the two highest examination ratings at their last examination, and are not the subject of any unresolved supervisory issues.

Source of Strength

Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to make capital injections into a troubled subsidiary bank, and generally the FRB may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. A required capital injection may be called for at a time when the holding company does not have the resources to provide it. The Dodd-Frank Act contained provisions codifying the source of strength doctrine and requiring the promulgation of regulations. It is not known when such regulations will be finalized.

In addition, depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by, the FDIC in connection with the default of, or assistance provided to, a commonly controlled FDIC-insured depository institution. Accordingly, in the event that any insured subsidiary of First Mariner causes a loss to the FDIC, other insured subsidiaries could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guaranty liabilities generally are superior in priority to the obligations of the depository institution to its stockholders due solely to their status as stockholders and obligations to other affiliates. At December 31, 2011, the Bank was the only subsidiary depository institution of First Mariner.

Acquisitions of Bank Holding Companies and Banks

Under the BHCA, any company must obtain approval of the FRB prior to acquiring control of First Mariner or the Bank. For purposes of the BHCA, control is defined as ownership of more than 25% of any class of voting securities of First Mariner or the Bank, the ability to control the election of a majority of the directors, or the exercise of a controlling influence over management or policies of First Mariner or the Bank. Any bank holding company must secure FRB approval prior to acquiring 5% or more of the stock of First Mariner or the Bank.

The Change in Bank Control Act and the related regulations of the FRB require any person or persons acting in concert (except for companies required to make application under the BHCA), to file a written notice with, and review the nonobjection of, the FRB before such person or persons may acquire direct or indirect control of First Mariner. The Change in Bank Control Act implementing regulations presume control as the power, directly or indirectly, to vote 10% or more of any voting securities or to direct the management or policies of a bank holding company, such as First Mariner, that has securities registered under the Securities Exchange Act of 1934 (the Exchange Act).

Maryland Bank Holding Company Regulation

Under Maryland law, acquisitions of 25% or more of the voting stock of a Maryland commercial bank or a Maryland bank holding company and other acquisitions of voting stock of such entities which affect the power to direct or to cause the direction of the management or policy of a commercial bank or a bank holding company must be approved in advance by the Commissioner. Any voting stock acquired without the approval required under the statute may not be voted for a period of five years. Certain acquisitions by bank holding companies of 5% or more of the stock of Maryland banks or Maryland bank holding companies are governed by Maryland s holding company statute and also require prior approval of the Commissioner. Also, a bank holding company and its Maryland chartered bank subsidiary, must generally obtain the prior approval of the Commissioner prior to, directly or indirectly, acquiring nonbanking subsidiaries or affiliates.

Regulation of the Bank

The Bank is a Maryland chartered trust company, with all the powers of a commercial bank, regulated and examined by the Commissioner and the FDIC.

Business Activities

Maryland law and the Commissioner regulate the Bank s internal organization as well as deposit, lending, and investment activities. In its lending activities, the maximum legal rate of interest, fees, and charges that may be charged on a particular loan depends on a variety of factors such as the type of borrower, the purpose of the loan, the amount of the loan, and the date the loan is made. Other laws tie the maximum amount that may be loaned to any one customer and related interests to a financial institution s capital levels. Additionally, Maryland law contains a parity statute by which Maryland institutions may, with the approval of the Commissioner, engage in any additional activity, service, or other practice that is permitted for national banks.

The FDIC also regulates many of the areas regulated by the Commissioner and federal law may limit some of the authority provided by Maryland law. Approval of the Commissioner and the FDIC is required for, among other things, business combinations and the establishment of branch offices.

Branching Activities

Any Maryland-chartered bank meeting certain requirements may, with the approval of the Commissioner and the FDIC, establish and operate branches anywhere in the state.

Interstate Branching

Federal law authorizes the responsible federal banking agencies to approve merger transactions between banks located in different states unless the state in which the target is located has opted out. Accordingly, a Maryland bank may acquire branches in a state other than Maryland unless the other state has enacted legislation opting out. Federal law also authorizes *de novo* branching into another state. The Dodd-Frank Act removed a requirement that host states enact a law expressly permitting out of state banks to establish such branches within its borders.

Activities and Investments

Since the enactment of FDICIA, all state-chartered FDIC insured banks have generally been limited to activities as principal to those authorized for national banks, notwithstanding any broader authority that may exist in state law. Additionally, FDICIA limits equity investments by state banks to the types and amounts permitted for national banks. Certain exceptions exist. For example, the FDIC is authorized to permit banks to engage in state-authorized activities or investments that are impermissible for national banks (other than nonsubsidiary equity investments) if the bank meets all applicable capital requirements and it is determined that the activities or investments do not pose a significant risk to the DIF.

Capital Requirements

The Bank is subject to the FDIC s regulatory capital requirements. The capital regulations currently require state banks to meet two minimum capital standards: a 4% Tier 1 (or core) capital to adjusted average quarterly assets (leverage) ratio (3% for institutions receiving the highest rating on the depository institution examination rating system) and an 8% total risk-based capital ratio.

Tier 1 capital is generally defined as common stockholders equity (including retained earnings), certain noncumulative perpetual preferred stock, and related surplus and minority interests in equity accounts of consolidated subsidiaries, less certain deferred tax assets and intangibles other than certain MSRs and credit card relationships.

The risk-based capital standard requires the maintenance of Tier 1 and total capital (which is defined as Tier 1 capital plus Tier 2 (or supplementary) capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining risk-weighted assets, all assets, including certain off-balance sheet items, recourse obligations, residual interests, and direct credit substitutes, are multiplied by risk weightings of 0% to 200%, which are assigned by the FDIC capital regulation based on the risks believed inherent in the type of asset. The components of Tier 2 capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses up to a maximum of 1.25% of risk-weighted assets, and up to 45% of unrealized gains on available-for-sale (AFS) equity securities with readily determinable fair market values. Overall, the amount of Tier 2 capital included as total capital cannot exceed 100% of Tier 1 capital.

The FDIC also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution s capital level is or may become inadequate in light of the particular circumstances. The FDIC has done so in the case of the Bank. See Item 1A Risk Factors later in Part I of this Annual Report on Form 10-K for additional information on the Bank s agreements with its various regulators. See also Capital Resources in Item 7 of Part II of this Annual Report on Form 10-K.

Prompt Corrective Regulatory Action

Federal law requires the appropriate federal regulatory agency to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization leverage. Generally, a bank that has a ratio of total capital to risk-weighted assets of less than 8%, a ratio of Tier 1 capital to risk-weighted assets of less than 4%, or leverage ratio of less than 4% (3% or less for institutions with the highest examination rating) is considered to be undercapitalized. A bank that has a total risk-based capital ratio of less than 6%, a Tier 1 capital ratio of less than 3%, or a leverage ratio that is less than 3% is considered to be significantly undercapitalized and a bank that has a tangible capital to assets ratio equal to or less than 2% is deemed to be critically undercapitalized. Subject to a narrow exception, a receiver or conservator must be appointed within specified time frames for an institution that is critically undercapitalized. The law also provides that an acceptable restoration plan must be filed within 45 days of the date a bank receives notice that it is undercapitalized, significantly undercapitalized, or critically undercapitalized. Compliance with the plan must be guaranteed by any parent company up to the lesser of 5% of the Bank s total assets when deemed to be undercapitalized or the amount necessary to achieve compliance with all applicable capital requirements. In addition, certain mandatory supervisory actions become applicable to any undercapitalized institution including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions (including dividends), and expansion. The FDIC can also take additional discretionary supervisory actions, including the issuance of a capital directive, requiring the sale of the institution, and the replacement of senior executive officers and directors. See Item 1A - Risk Factors later in Part I and Capital Resources in Item 7 of Part II of this Annual Report on Form 10-K for additional information on the Bank s agreements with its various regulators and our capital resources and noncompliance with directed capital requirements.

Safety and Soundness Guidelines

Federal law requires each federal banking agency to establish safety and soundness standards for institutions under its authority. The federal banking agencies, including the FDIC, have released Interagency Guidelines Establishing Standards for Safety and Soundness. The guidelines specify basic standards for matters such as internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk exposure and asset growth, asset quality, earnings, and employee compensation. If the appropriate federal banking agency determines that a depository institution is not in compliance with the safety and soundness guidelines, it may require the institution to submit an acceptable plan to achieve compliance with the guidelines. The institution must submit an acceptable compliance plan within 30 days of receipt of a request for such a plan. Failure to submit or implement a compliance plan may result in regulatory sanctions.

Uniform Lending Standards

Under FDIC s regulations, state banks must adopt and maintain written policies that establish appropriate limits and standards for loans that are secured by interests in real estate or are made for the purpose of financing permanent improvements to real estate. The policies must establish loan portfolio diversification standards, prudent underwriting standards, including LTV limits that are clear and measurable, loan administration procedures and documentation, and loan approval and reporting requirements. Such real estate lending policies must reflect the Interagency Guidelines for Real Estate Lending Policies that have been adopted by the federal banking agencies.

Transactions with Related Parties

Transactions between a bank and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate is any company or entity, which controls, is controlled by or is under common control with the bank. For example, First Mariner is an affiliate of the Bank s for purposes of those laws. Generally, Sections 23A and 23B: (i) limit the extent to which an institution or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10% of such institution s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus; (ii) impose collateral requirements on certain transactions with, including loans to, affiliates; and (iii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a nonaffiliate. The term covered transaction includes loans to, purchases of assets from, and the issuance of guarantees on behalf of an affiliate and certain other transactions.

Banks also are subject to the federal restrictions on loans to executive officers, directors, and greater than 10% stockholders (collectively, insiders). Generally, loans to insiders and certain related interests must be approved in advance by a majority of the board of directors of the institution, with any interested director not participating in the voting, if the loan exceeds the greater of $25,000 or 5% of the bank s capital. Any loan which, combined with prior loans to the insider and their related interest, aggregates $500,000 or more are subject to the board s approval requirements in all cases. Loans to insiders must be made on terms substantially the same as offered in comparable transactions to outside parties. There is an exception for extensions of credit made to officers and directors as part of a bank-wide compensation or benefit program that does not favor directors or officers over other employees. There are further restrictions on loans that can be made to executive officers.

Additionally, Maryland law imposes restrictions on loans to directors, officers, or employees of Maryland commercial banks. Generally, a director, officer, or employee of a commercial bank may not borrow, directly or indirectly, any money from the bank, unless the loan has been approved by the board of directors, or the executive committee of the bank, if that committee is authorized to approve loans. Commercial loans made to nonemployee directors of a bank and certain consumer loans made to nonofficer and nondirector employees of a bank are exempted.

Dividend Restrictions

A Maryland bank s ability to pay dividends is governed by the Maryland law and the regulations of the FDIC. Under Maryland law, if the surplus of a commercial bank is less than 100% of its capital stock then, until the surplus equals at least 100% of the capital stock, the commercial bank: (i) must transfer to its surplus annually at least 10% of its net earnings and (ii) may not declare or pay any cash dividends that exceed 90% of its net earnings. Maryland law provides for dividends only out of undivided profits or, with the approval of the Commissioner, surplus in excess of 100% of required capital stock. Also, under FDIC regulations, no bank may pay a dividend if it would be undercapitalized within the meaning of the prompt corrective action laws, or if it is in default of any deposit insurance assessment. See also Item 1A Risk Factors - Our ability to pay cash dividends is limited later in Part I of this Annual Report on Form 10-K.

Enforcement

The Commissioner has extensive enforcement authority over Maryland banks. Such authority includes the ability to issue cease and desist orders and civil money penalties and to remove directors or officers. The Commissioner may also take possession of a Maryland bank whose capital is impaired and seek to have a receiver appointed by a court.

The FDIC has primary federal enforcement responsibility over state banks under its jurisdiction, including the authority to bring enforcement action against all institution-related parties, including stockholders, and any attorneys, appraisers, and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors, receivership, conservatorship, or termination of deposit insurance. Civil money penalties cover a wide range of violations and actions and range up to $25,000 per day or even up to $1 million per day (in the most egregious cases). Criminal penalties for most financial institution crimes include fines of up to $1 million and imprisonment for up to 30 years.

The Bank has entered into a Consent Order with the FDIC and the Commissioner. See Item 1A Risk Factors later in Part I and Capital Resources in Item 7 of Part II of this Annual Report on Form 10-K.

Community Reinvestment Act

Under the CRA, as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the FDIC, in connection with its examination of a bank, to assess the institution s record of meeting the credit needs of its community and to take the record into account in its evaluation of certain applications by the institution.

Assessments

Maryland banks are required to pay annual assessments to the Commissioner s office to cover the cost of regulating Maryland institutions. The Bank s asset size determines the amount of the assessment.

Insurance of Deposit Accounts

The Bank s deposits are insured up to applicable limits by the DIF of the FDIC. Under the FDIC s risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels, and certain other factors, with less risky institutions paying lower assessments. An institution s assessment rate depends upon the category to which it is assigned. Effective April 1, 2009, assessment rates ranged from 7 to 77.5 basis points. The Dodd-Frank Act requires the FDIC to amend its procedures to base assessments on total assets less tangible equity rather than deposits. On February 7, 2011, the FDIC issued final rules, effective April 1, 2011, implementing changes to the assessment rules resulting from the Dodd-Frank Act. Initially, the base assessment rates will range from 2.5 to 45 basis points. The rate schedules will automatically adjust in the future when the DIF reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

In order to cover losses to the DIF, the FDIC imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital, as of June 30, 2009 (capped at ten basis points of an institution s deposit assessment base). That special assessment was collected on September 30, 2009. In lieu of further special assessments, the FDIC required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The Bank received an automatic waiver of the prepayment requirement. These estimated assessments include an assumed annual assessment base increase of 5%.

Due to the recent difficult economic conditions, deposit insurance per account owner has been raised to $250,000 for all types of accounts. That coverage was made permanent by the Dodd-Frank Act. In addition, the FDIC adopted an optional Temporary Liquidity Guarantee Program by which, for a fee, noninterest bearing transaction accounts would receive unlimited insurance coverage until June 30, 2010, subsequently extended to December 31, 2010 and then to December 31, 2012 by the Dodd-Frank Act, and certain senior unsecured debt issued by institutions and their holding companies between October 13, 2008 and December 31, 2010 would be guaranteed by the FDIC through June 30, 2012, or in some cases, December 31, 2012. The Bank participated in the unlimited noninterest bearing transaction account coverage. The Bank and First Mariner opted to participate in the unsecured debt guarantee program.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund.

The Dodd-Frank Act increased the minimum target DIF ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Company. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Federal Reserve System

Federal Reserve regulations require depository institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). The regulations currently provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $58.8 million; a 10% reserve ratio is applied above $58.8 million. The first $10.7 million of otherwise reservable balances are exempted from the reserve requirements. These amounts are adjusted annually.

Federal Securities Laws

The shares of First Mariner common stock are registered with the SEC under Section 12(g) of the Exchange Act, as amended, and listed on the Over-The-Counter Bulletin Board (OTCBB). First Mariner is subject to information reporting requirements, proxy solicitation requirements, insider trading restrictions, and other requirements of the Exchange Act, including the requirements imposed under the federal Sarbanes-Oxley Act of 2002. Among other things, loans to and other transactions with insiders are subject to restrictions and heightened disclosure, directors and certain committees of the Board must satisfy certain independence requirements, and First Mariner is generally required to comply with certain corporate governance requirements.

Economic Monetary Policies and Economic Controls

We are affected by monetary policies of regulatory agencies, including the FRB, which regulates the national money supply in order to mitigate recessionary and inflationary pressures. Among the techniques available to the FRB are: engaging in open market transactions in U.S. Government securities; changing the discount rate on bank borrowings; changing reserve requirements against bank deposits; prohibiting the payment of interest on demand deposits; and imposing conditions on time and savings deposits. These techniques are used in varying combinations to influence the overall growth of bank loans, investments, and deposits. Their use may also affect interest rates charged on loans or paid on deposits. The effect of governmental policies on our earnings cannot be predicted. However, our earnings will be impacted by movement in interest rates, as discussed in Item 7A of Part II of this Annual Report on Form 10-K.

ITEM 1A RISK FACTORS

We are subject to restrictions and conditions of a Cease and Desist Order issued by the FDIC and the Commissioner (September Order) (the FRB Agreement), and agreements with the FRB (FRB Agreement and New FRB Agreement) (collectively, the FRB Agreements) have incurred and expect to continue to incur significant additional regulatory compliance expense in connection with these enforcement actions.

The FDIC and the Commissioner have issued Cease and Desist Orders against the Bank and the Company. The Bank and the Company have also entered into the FRB Agreement and the New FRB Agreement. The September Order contains a number of significant directives, including higher capital requirements, requirements to reduce the level of our classified assets, operating restrictions, and restrictions on dividend payments by the Bank. These restrictions may impede our ability to operate our business. If we continue to fail to comply with the terms and conditions of the September Order or the New FRB Agreement, the appropriate regulatory authority could take additional enforcement action against us, including the imposition of further operating restrictions, monetary penalties, or possibly place the Bank in receivership. We could also be directed to seek a merger partner. We have incurred and expect to continue to incur significant additional regulatory compliance expense in connection with the enforcement actions and we will incur ongoing expenses attributable to compliance with the terms of the enforcement actions. Although we do not expect it, it is possible regulatory compliance expenses related to the enforcement actions could have a material adverse impact on us in the future. In addition, our ability to independently make certain changes to our business is restricted by the terms of the September Order and the New FRB Agreement, which could negatively impact the scope and flexibility of our business activities. While we believe that we will be able to take actions that will result in the September Order and the New FRB Agreement being terminated in the future, we cannot guarantee that such actions will result in the termination of the September Order and/or the New FRB Agreement. Further, the imposition of the September Order and the New FRB Agreement may make it more difficult to attract and retain qualified employees. Specifically, the significant terms of the September Order are as follows:

- increase capitalization;
- improve earnings;
- reduce nonperforming loans;
- strengthen management policies and practices; and
- reduce reliance on noncore funding.

We have taken steps to increase capitalization through a stock offering in 2010 and through potential private capital infusions (see Recent Developments in Item 7 and Note 11 to the Consolidated Financial Statements included in Item 8, both in Part II of this Annual Report on Form 10-K). We are attempting to improve earnings by reducing our nonperforming loans through workouts and other resolutions, including accelerated write-downs and sales of foreclosed assets. In addition, we are attempting to conservatively increase loan origination in order to improve our interest income. We have adopted a plan to improve enterprise-wide risk management and effectiveness of internal audit programs. To address our reliance on noncore funding, we have adopted a liquidity plan intended to reduce the Bank s reliance on noncore funding, wholesale funding sources, and high-cost rate-sensitive deposits. We have eliminated all brokered deposits.

The significant terms of the New FRB Agreement are as follows:

- develop and implement a strategic business plan that includes (a) actions that will be taken to improve 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;
- submit plans to improve enterprise-wide risk management and effectiveness of internal audit programs;
- prohibits 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;
- adopt a plan to achieve and maintain a leverage capital ratio and a Tier 1 capital to risk-weighted assets ratio of at least 4.0% and a total risk-based capital ratio of at least 8%.

We have adopted all plans required by the New FRB Agreement and have not taken any of the prohibited actions. We have taken steps to increase capitalization (and therefore, our capital ratios) through a stock offering in 2010 and through potential private capital infusions (see Recent Developments in Item 7 and Note 11 to the Consolidated Financial Statements included in Item 8, both in Part II of this Annual Report on Form 10-K).

As of December 31, 2011, the Bank s and the Company s capital levels were not sufficient to achieve compliance with the higher capital requirements we were required to have met by June 30, 2010. The failure to meet and maintain these capital requirements could result in further action by our regulators.

In the September Order, the FDIC and the Commissioner directed the Bank to raise its leverage and total risk-based capital ratios to 6.5% and 10%, respectively, by March 31, 2010 and to 7.5% and 11%, respectively, by June 30, 2010. We did not meet these requirements. We have been in regular communication with the staffs of the FDIC and the Commissioner regarding efforts to satisfy the higher capital requirements.

First Mariner currently does not have any material amounts of capital available to invest in the Bank and any further increases to our allowance for loan losses and operating losses would negatively impact our capital levels and make it more difficult to achieve the capital levels directed by the FDIC and the Commissioner.

Because we have not met all of the capital requirements set forth in the September Order within the prescribed timeframes, the FDIC and the Commissioner could take additional enforcement action against us, including the imposition of monetary penalties, as well as further operating restrictions. The FDIC or the Commissioner could direct us to seek a merger partner or possibly place the Bank in receivership. If the Bank is placed into receivership, the Company would cease operations and liquidate or seek bankruptcy protection. If the Company were to liquidate or seek bankruptcy protection, we do not believe that there would be assets available to holders of the capital stock of the Company.

Additionally, on November 24, 2009, First Mariner s primary regulator, the FRB, required the Company to enter into the New FRB Agreement. In accordance with the requirements of the New FRB Agreement, the Company submitted a written plan to maintain sufficient capital at the holding company level, such that First Mariner satisfies the FRB s minimum capital requirements. To satisfy these 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 must be at least 4.0%, 4.0%, and 8.0%, respectively. At December 31, 2011, those capital ratios were (1.9)%, (2.6)%, and (2.6)%, respectively, which were not in compliance with the minimum requirements. As further described above, the failure to meet all of the capital ratios could subject us to additional enforcement actions.

On April 19, the Company and the Bank entered into a securities purchase agreement with Priam Capital Fund I, LP (Priam), which subsequently was amended on September 21, 2011. For a description of the material terms of the securities purchase agreement, see the Company s Current Report on Form 8-K filed with the SEC on April 25, 2011 and the Company s Current Report on Form 8-K filed with the SEC on September 27, 2011. Pursuant to the securities purchase agreement, Priam would invest, subject to certain conditions, approximately $36.4 million in cash in the Company. Among other conditions, the closing of Priam s investment is conditioned upon the Company raising an additional $123.6 million from other investors. Moreover, either party to the securities purchase agreement is permitted to terminate the agreement at any time for any reason. It is uncertain whether the Company will be able to satisfy all the conditions to the agreement and complete the transaction with Priam. If the securities purchase agreement is terminated, or if the Company is unable to consummate the transactions contemplated thereby, the Company and the Bank will seek alternative strategies to meet the regulatory capital levels specified in the September Order, the FRB Agreement, and the New FRB Agreement, and it is uncertain whether any such alternative strategies will be identified or successfully carried out.

The Bank currently is classified as significantly undercapitalized under prompt corrective action regulations. If a state bank is classified as undercapitalized, significantly undercapitalized, or critically undercapitalized, the FDIC would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital, improvements in management, limits on interest rates paid, prohibitions on transactions with affiliates, termination of certain risky activities, and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, FDICIA requires the bank to be placed into conservatorship or receivership within 90 days, unless the FDIC determines that other action would better achieve the purposes of FDICIA regarding prompt corrective action with respect to undercapitalized banks.

There is doubt about our ability to continue as a going concern.

As discussed above, the Bank is subject to the September Order and the New FRB Agreement, both of which require the Bank and the Company, respectively, to increase leverage and total risk-based capital ratios and, at December 31, 2011, the Company was significantly below the required levels. Failure to increase the Company s capital ratios or further declines in the capital ratios exposes the Company and the Bank to additional restrictions and regulatory actions, including potential receivership of the Bank. This uncertainty as to the Company s ability to meet existing or future regulatory requirements raises doubt about our ability to continue as a going concern. Unless the Company is able to raise sufficient levels of capital in the very near future, we will be unable to meet the capital ratio requirements. The Company s audited financial statements were prepared under the assumption that it will continue our operations on a going concern basis, which contemplates the realization of assets and the discharge of liabilities in the normal course of business. The Company s financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. If the Company cannot continue as a going concern, the Company s shareholders will lose some or all of their investment in the Company. In addition, the Bank s customers, employees, vendors, correspondent institutions, and others with whom the Bank does business may react negatively to the doubt about our ability to continue as a going concern. This negative reaction may lead to heightened concerns regarding the Bank s financial condition that could result in a significant loss in deposits and customer relationships, key employees, vendor relationships and our ability to do business with correspondent institutions upon which we rely.

We may need to raise additional capital through a share issuance in the future that would dilute your ownership if you do not, or are not permitted to, invest in the additional issuances.

Should we in the future need to raise additional capital, we might seek to do so through one or more offerings of our common stock, securities convertible into common stock, or rights to acquire such securities of our common stock. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time and on our financial performance. There has been unprecedented volatility and disruption in the capital and credit markets in recent years, which has produced downward pressure on stock prices and credit availability for numerous issuers, including 1st Mariner. If current levels of market disruption and volatility continue or worsen, and if our stock price remains at its current level, we may be unable to raise additional capital, or we may be able to raise capital only at prices that would be unfavorable and dilutive to our shareholders. As further described above, if we cannot raise additional capital when needed, our results of operations and financial condition may be adversely affected, and our banking regulators may subject us to further regulatory enforcement action.

Under our Articles of Incorporation, we have additional authorized shares of common stock that we can issue from time to time at the discretion of our board of directors, without further action by the shareholders, except where shareholder approval is required by law.

The issuance of any additional shares of common stock or securities convertible into common stock could be substantially dilutive to shareholders of our common stock, particularly those who are not able to or choose not to participate in such additional issuances. Holders of our shares of common stock have no preemptive rights that entitle them to purchase their pro-rata share of any offering of shares of any class or series and, therefore, our shareholders may not be permitted to invest in any future issuances of our common stock and as a result could be diluted.

We have taken actions, and may take additional actions, to help us meet immediate needs for capital, including reducing our assets and liabilities. The disposition of our assets and liabilities could hurt our long-term profitability.

On December 14, 2009, First Mariner consummated the sale of its equity interests in Mariner Finance, LLC (Mariner Finance) to MF Raven Holdings, Inc. for a purchase price of approximately $10.5 million. We retained a 5% ownership stake in the new Mariner Finance entity. We recorded a loss on the sale of $11.1 million during 2009. While this transaction provided First Mariner with $10.5 million in cash to invest in the Bank to increase the Bank s capital, we will realize significantly less income generated by Mariner Finance going forward.

Additionally, we closed our downtown Baltimore branch and our Shrewsbury, Pennsylvania branch in 2010. The closing of the Baltimore and Shrewsbury branches reduced 2010 overhead costs by approximately $500,000 and is expected to reduce annual overhead costs going forward by approximately $1.0 million in support of our strategy of prudently reducing assets and liabilities. Total aggregate deposits in the Baltimore and Shrewsbury branches were approximately $24.9 million. We also closed our Lutherville/Timonium branch during the first quarter of 2012. Management expects to further evaluate its options for selling and/or closing additional branches as necessary. The Bank has not entered into any agreement to sell any branch office and no guarantee can be made that any such agreement will be entered into and if such agreement is entered into, whether such sale will be consummated. The approval of the FDIC and the Commissioner will also need to be obtained by any acquirer before buying any of our branch offices. While we anticipate that such approvals would be received, there can be no guarantee that such approvals will be received. While branch sales and closures, if completed, will likely reduce our assets and liabilities and increase our Bank capital ratios, we expect that our net income in the future will be reduced as a result of the loss of income generated by these branches.

The Company and the Bank are deemed to be in troubled condition within the meaning of federal statutes and regulations.

The Company and Bank are deemed to be in troubled condition within the meaning of federal statutes and regulations. As a result, certain limitations and regulatory requirements apply to the Company and the Bank with respect to future changes to senior executive management and directors and the payment of, or the agreement to pay, certain severance payments to officers, directors, and employees. The Bank must also comply with specified recordkeeping requirements in connection with transactions involving certain securities contracts, commodities contracts, repurchase agreements, and other Qualified Financial Contracts.

There may be a limited market for our common stock, which may adversely affect our stock price.

Effective September 1, 2011, our stock was delisted from the NASDAQ Stock Market and is now quoted on the OTCBB. The market for our stock may become illiquid and our shares might not be actively traded in the future. If our common stock is not actively traded, you may not be able to sell all of your shares of common stock on short notice, and the sale of a large number of shares at one time could temporarily depress the market price. There may be a wide spread between the bid and ask price for our common stock. When there is a wide spread between the bid and ask price, the price at which you may be able to sell our common stock may be significantly lower than the price at which you could buy it at that time.

Negative conditions in the general economy and financial services industry may limit our access to additional funding, adversely impact liquidity, impair our ability to fund operations, and jeopardize our financial viability.

Liquidity is essential to our business. We rely on customer deposits, advances from the FHLB, and lines of credit at other financial institutions to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, no assurance can be given that we would be able to replace such funds in the future. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could further detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn, the financial condition of the FHLB, adverse regulatory action against us, and factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole as the recent turmoil faced by banking organizations in the domestic and worldwide credit markets deteriorates.

The FHLB has reduced our line of credit, which stands at a total of $139.8 million at December 31, 2011 (with an outstanding balance of $111.0 million as of December 31, 2011). The Bank has been notified by the FRB that it is a secondary credit facility. All future borrowings must be approved by the discount committee of the FRB. As part of the September Order, we are not allowed to purchase brokered deposits without first obtaining a regulatory waiver. We are also required to comply with restrictions on deposit rates that we may offer. These factors could significantly affect our ability to fund normal operations. At December 31, 2011, we maintained a significant amount of cash and cash equivalents such that management considered the Bank s liquidity level to be sufficient for the purposes of meeting the Bank s cash flow requirements.

Our financial flexibility will be severely constrained and/or our cost of funds will increase if we are unable to maintain our access to funding or if financing necessary to accommodate future growth is not available at favorable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our profitability would be adversely affected.

The large amount of liquidity on our balance sheet negatively impacts our ability to increase income.

Because the FRB Agreements, the September Order, and our reduced borrowing capacity have limited our access to certain sources of funding, we have maintained significantly more liquidity on our balance sheet then we otherwise would. At December 31, 2011, the Bank s cash and cash equivalents exceeded $148.0 million. The opportunity cost of maintaining liquidity at this level or at similar levels is substantial, because, at December 31, 2011, the cash and cash equivalents we have accumulated yielded substantially less than our other interest-earning assets. Until we raise capital to a level that satisfies the capital requirements of the FRB Agreements and the September Order, we will need to maintain significantly higher levels of liquidity which will, in turn, negatively impact our ability to increase income.

Declines in asset values may result in impairment charges and adversely impact the value of our investments, financial performance, and capital. If we conclude that the decline in value of any of our investment securities is other than temporary, we are required to write down the value of that security.

We maintain an investment portfolio that includes, but is not limited to, mortgage-backed securities and pooled trust preferred collateralized debt obligations. The market value of securities may be affected by factors other than the underlying performance of the issuer, such as adverse changes in business climate and lack of liquidity for the resale of certain securities. As of December 31, 2011, our entire securities portfolio was classified as AFS. Unrealized gains and losses in the estimated value of the AFS portfolio are marked to market and reflected as a separate item in stockholders (deficit) equity as accumulated other comprehensive loss.

We periodically, but not less than quarterly, evaluate securities and other assets for impairment indicators. We may be required to record impairment charges if securities suffer a decline in value that is considered other than temporary. Changes in the expected cash flows, credit enhancement levels, or credit ratings of our securities and/or prolonged price declines may result in our concluding in future periods that the impairment of our securities is other than temporary. If we determine that a significant impairment has occurred, we would be required to charge against earnings the credit-related portion of the other-than-temporary impairment (OTTI), which could have a material adverse effect on results of operations in the period in which the write-off occurs. During the years ended December 31, 2011, 2010, and 2009, we recognized $838,000, $1.2 million, and $2.9 million, respectively, in such charges.

The Bank is a member of the FHLB. A member of the FHLB system is required to purchase stock issued by the relevant FHLB bank based on how much it borrows from the FHLB and the quality of the collateral pledged to secure that borrowing. Included in our investment portfolio (classified as a restricted stock investment) as of December 31, 2011 is $7.1 million in capital stock of the FHLB. The FHLB is experiencing a potential capital shortfall and has, in the past, suspended its quarterly cash dividend, and could possibly require its members, including First Mariner, to make additional capital investments in the FHLB. There can be no guaranty that the FHLB will declare future dividends. In order to avail ourselves of correspondent banking services offered by the FHLB, we must remain a member of the FHLB. If the FHLB were to cease operations, or if we were required to write-off our investment in the FHLB, our business, financial condition, liquidity, capital, and results of operations may be materially and adversely affected.

Accounting guidance indicates that an investor in FHLB stock should recognize impairment if it concludes that it is not probable that it will ultimately recover the par value of its shares. The decision of whether impairment exists is a matter of judgment that should reflect the investor s and FHLB s long-term performance, which includes factors such as its operating performance, the severity and duration of declines in the market value of its net assets related to its capital stock amount, its commitment to make payments required by law or regulation and the level of such payments in relation to its operating performance, the impact of legislation and regulatory changes on the FHLB, and accordingly, on the members of the FHLB, and its liquidity and funding position. After evaluating all of these considerations, we believe the par value of our FHLB stock will be recovered, but future evaluations of the above mentioned factors could result in the Bank recognizing an impairment charge.

Management believes that several factors will affect the market values of our securities portfolio. These include, but are not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates). Also, the passage of time will affect the market values of our securities, in that the closer they are to maturing, the closer the market price should be to par value. These and other factors may impact specific categories of the portfolio differently, and management cannot predict the effect these factors may have on any specific category.

There can be no assurance that future market performance of our securities portfolio will enable us to realize income from sales of securities. Stockholders (deficit) equity will continue to reflect the unrealized gains and losses of these securities. There can be no assurance that the market value of our securities portfolio will not decline, causing a corresponding increase in our stockholders deficit.

We have elected to defer the payment of interest on our outstanding trust preferred securities issued by trust subsidiaries of our holding company and expect to continue to defer the payment of interest for the foreseeable future.

Though we have deferred the payment of interest on the subordinated debentures related to the trust preferred securities, we continue to accrue interest expense related to the trust preferred securities. First Mariner recognized interest expense of $1.6 million, $1.9 million, and $3.1 million on the trust preferred securities during the years ended December 31, 2011, 2010, and 2009, respectively.

Under the terms of the subordinated debentures, our deferral of interest payments for up to 20 consecutive quarters (through the last quarter of 2013) does not constitute an event of default. During the deferral period, the deferred interest payments continue to accrue. To the extent applicable law permits interest on interest, the deferred interest payments also accrue interest at the rates specified in the corresponding indentures, compounded quarterly. All of the deferred interest and the compounded interest are due in full at the end of the applicable deferral period. If we fail to pay the deferred and compounded interest at the end of the deferral period, each trustee of the various trusts, or in most cases the holders of 25% of the outstanding principal amount of any issue of trust preferred securities, would have the right, after any applicable grace period, to declare an event of default. The occurrence of an event of default on the subordinated debentures would entitle the trustees and holders of the trust preferred securities to exercise various remedies, including demanding immediate payment in full of the entire outstanding principal amount of the subordinated debentures.

Currently we have no cash available at First Mariner to resume the payment of interest on the subordinated debentures and the New FRB Agreement prohibits First Mariner from making distributions on our trust preferred securities. Accordingly, our ability to resume the payment of interest on the subordinated debentures will depend on the Bank s ability to generate earnings and pay dividends to First Mariner. In addition, the terms of the September Order currently prohibits the payment of dividends by the Bank without regulatory approval. As a result, if by January 1, 2014 the September Order is not terminated, or if we do not achieve sufficient profitability for the Bank so that our regulators would grant approval for the Bank to pay dividends, we will be unable to resume the payment of interest on the subordinated debentures. Even if the Bank is able to resume paying dividends, we cannot be assured that the amount of dividends would be sufficient to pay the entire amount of interest due under the subordinated debentures at the end of the deferral period.

We have had losses in recent periods.

We incurred a net loss of $30.2 million for the year ended December 31, 2011. For the years ended December 31, 2010 and 2009, we incurred net losses of $46.6 million and $22.3 million, respectively. Our earnings in these periods have been hurt by adverse economic conditions, including falling home prices, increasing foreclosures, and increasing unemployment, in our markets, and our losses for the years ended December 31, 2011, 2010, and 2009 included $14.3 million, $17.8 million, and $11.7 million, respectively, of provisions for loan losses. Our ability to return to profitability will depend on whether we are able to reduce credit losses in the future, which will depend, in part, on whether economic conditions in our markets improve. Management believes that our current business plan will be successful; however, our business plan is subject to current market conditions and its successful implementation is uncertain. There is no assurance that we will be successful in executing our business plan or that even if we successfully implement our business plan, we will be able to curtail our losses now or in the future. If we continue to incur significant operating losses, our stock price may further decline. Even if we increase capital levels so as to meet the Bank and consolidated capital levels mandated by our regulators, if we incur further operating losses, we may in the future need to raise additional capital to maintain Bank and consolidated capital levels that meet or exceed the levels mandated by our regulators.

Higher loan losses could require us to increase our allowance for loan losses through a charge to earnings.

When we loan money we incur the risk that our borrowers do not repay their loans. We reserve for loan losses by establishing an allowance through a charge to earnings. The amount of this allowance is based on our assessment of loan losses inherent in our loan portfolio. The process for determining the amount of the allowance is critical to our financial results and condition. It requires subjective and complex judgments about the future, including forecasts of economic or market conditions that might impair the ability of our borrowers to repay their loans. We might underestimate the loan losses inherent in our loan portfolio and have loan losses in excess of the amount reserved. We might increase the allowance because of changing economic conditions. For example, in a rising interest rate environment, borrowers with adjustable-rate loans could see their payments increase. There may be a significant increase in the number of borrowers who are unable or unwilling to repay their loans, resulting in our charging off more loans and increasing our allowance. In addition, when real estate values decline, the potential severity of loss on a real estate-secured loan can increase significantly, especially in the case of loans with high combined LTV ratios. The decline in the national economy and the local economies of the areas in which the loans are concentrated could result in an increase in loan delinquencies, foreclosures, or repossessions resulting in increased charge-off amounts and the need for additional loan loss allowances in future periods. In addition, our determination as to the amount of our allowance for loan losses is subject to review by regulatory authorities, as part of their examination process, which may result in the establishment of an additional allowance after a review of the information available at the time of their examination. Our allowance for loan losses amounted to $13.8 million, or 1.97% of total loans outstanding and 20.23% of nonperforming assets (NPAs) ($61.9 million) and loans past-due 90 days or more and accruing ($6.3 million), as of December 31, 2011. Our allowance for loan losses at December 31, 2011 may not be sufficient to cover future loan losses. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would decrease our earnings. As of December 31, 2011, we had outstanding loan balances of approximately $625.9 million (89.2% of total loans) that were performing according to their original terms. However, the deterioration of one or more of these performing loans could result in a significant increase in our nonperforming loans and our provision for loan losses, which would negatively impact our results of operations.

We have a high percentage of commercial real estate and real estate construction loans in relation to our total loans.

At December 31, 2011, we had $326.5 million in mortgage loans secured by commercial real estate and $70.6 million in real estate construction loans, which included $16.3 million in consumer construction loans and $54.3 million in commercial construction loans. Commercial mortgage loans and total construction loans represented 46.5% and 10.1%, respectively, of our net loan portfolio. While commercial real estate and construction loans are generally more interest rate sensitive and carry higher yields than do residential mortgage loans, these types of loans generally expose a lender to greater risk of nonpayment and loss than single-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property, the income stream of the borrowers, and, for construction loans, the accuracy of the estimate of the property s value at completion of construction and the estimated cost of construction. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to single-family residential mortgage loans.

Current regulatory guidance suggests that institutions whose commercial real estate loans exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk and may be required to maintain higher capital ratios than institutions with lower concentrations in commercial real estate lending. Based on our commercial real estate concentration as of December 31, 2011, we may be subject to further supervisory analysis during future examinations. Although we continuously evaluate our concentration and risk management strategies, we cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management cannot predict the extent to which this guidance will impact our operations or capital requirements.

Mortgage-banking activities generate a significant portion of our noninterest income.

A significant portion of our business involves originating residential mortgage loans through our mortgage division, which accounted for approximately 58.5%, 60.1%, and 57.0% of our noninterest income for the years ended December 31, 2011, 2010, and 2009, respectively. Real estate loan origination activity, including refinancing, is generally greater during periods of low or declining interest rates and favorable economic conditions. Adverse changes in market conditions and/or higher interest rates could have an adverse impact on our earnings through lower origination volumes.

We face interest rate risk on our loans held for sale (LHFS) portfolio.

We are exposed to interest rate risk in both our pipeline of mortgage originations (loans that have yet to close with the borrower) and in our warehouse loans (those loans that have closed with the borrower but have yet to be funded by investors). We have managed this interest rate risk through hedging strategies. We hedge a portion of our mortgage loan pipeline and warehouse utilizing derivatives in the form of forward sales of mortgage-backed securities. We expect that these derivative financial instruments will experience changes in fair value opposite to the change in fair value of the derivative loan commitments and our warehouse. However, the process of selling loans and the use of forward sales of mortgage-backed securities to hedge interest rate risk associated with customer interest rate lock commitments (IRLC or IRLCs) involves greater risk than selling loans on an individual basis through forward delivery commitments. Hedging interest rate risk requires management to estimate the expected fallout (rate lock commitments with customers that do not complete the loan process). Additionally, the fair value of the hedge may not correlate precisely with the change in fair value of the rate lock commitments with the customer due to changes in market conditions, such as demand for loan products, or prices paid for differing types of loan products. Variances from management s estimates for customer fallout or market changes making the forward sale of mortgage-backed securities ineffective may result in higher volatility in our profits from selling mortgage loans originated for sale. We engage an experienced third party to assist us in managing our activities in hedging and marketing sales strategy.

We face credit risk related to our residential mortgage production activities.

We face credit risk related to our residential mortgage production activities. Credit risk is the potential for financial loss resulting from the failure of a borrower or an institution to honor its contractual obligations to us. We manage mortgage credit risk principally by selling substantially all of the mortgage loans that we produce, limiting credit recourse to the Bank in those transactions, and by retaining high credit quality mortgages in our loan portfolio. We also limit our risk of loss on mortgage loan sales by establishing limits on activity to any one investor and by entering into contractual relationships with only those financial institutions that are approved by our Secondary Marketing Committee. The period of time between closing on a loan commitment with the borrower and funding by the investor ranges from between 15 and 90 days.

Secondary mortgage market conditions could have a material impact on our financial condition and results of operations.

In addition to being affected by interest rates, the secondary mortgage markets are also subject to investor demand for residential mortgage loans. These conditions may fluctuate or even worsen in the future. In light of current conditions, there is a higher risk to retaining a larger portion of mortgage loans than we would in other environments until they are sold to investors. As a result, a prolonged period of secondary market illiquidity may reduce our loan production volumes and could have a material adverse effect on our financial condition and results of operation.

We face risk related to covenants in our loan sales agreements with investors.

Our sales agreements with investors who purchase our loans generally contain covenants which may require us to repurchase loans under certain provisions, including delinquencies. Any loans we are required to repurchase may be considered impaired loans, with the potential for charge-offs and/or loss provision charges. The addition of these repurchased loans to our portfolio could adversely affect our earnings and asset quality ratios.

There may be certain loans in our portfolio that were originated for sale, but for various reasons, are unable to be sold. These loans are transferred to our loan portfolio at fair value, with any deterioration in value charged against mortgage-banking revenue. Any deterioration in value of the loan during the period held in the portfolio is charged to the allowance.

Increased and/or special FDIC assessments will hurt our earnings.

Beginning in late 2008, the economic environment caused higher levels of bank failures, which dramatically increased FDIC resolution costs and led to a significant reduction in the DIF. As a result, the FDIC has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. The base assessment rate was increased by seven basis points ($.07 for every $100 of deposits) for the first quarter of 2009. The FDIC made further refinements to its risk-based assessment that were effective April 1, 2009 and that effectively made the range 7 to 77.5 basis points. These increases in the base assessment rate have increased our deposit insurance costs and negatively impacted our earnings. In addition, in May 2009, the FDIC imposed a special assessment on all insured institutions due to recent bank and savings association failures. The emergency assessment amounted to 5 basis points on each institution s assets minus Tier one (core) capital as of June 30, 2009, subject to a maximum equal to 10 basis points times the institution s assessment base. Our special assessment, which was reflected in earnings for the quarter ended June 30, 2009, was $638,000.

On February 7, 2011, the FDIC issued final rules, effective April 1, 2011, implementing changes to the assessment rules resulting from the Dodd-Frank Act. Initially, the base assessment rates will range from 2.5 to 45 basis points. The rate schedules will automatically adjust in the future when the DIF reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

The FDIC may impose additional emergency special assessments if necessary to maintain public confidence in federal deposit insurance or as a result of deterioration in the DIF reserve ratio due to institution failures. Any additional emergency special assessment imposed by the FDIC will negatively impact our earnings.

On November 12, 2009, the FDIC adopted a final rule requiring that all institutions prepay their assessments for the fourth quarter of 2009 and all of 2010, 2011, and 2012. The FDIC exempted certain institutions from the prepayment requirement if it would adversely affect the safety and soundness of the institution. We were granted an exemption to this prepayment requirement.

We currently hold a significant amount of bank owned life insurance (BOLI).

We currently hold a significant amount of BOLI on key employees and executives that have cash surrender values of $37.5 million as of December 31, 2011. The eventual repayment of the cash surrender value is subject to the ability of various insurance companies to pay benefits in the event of the death of an insured employee or return the cash surrender value to us in the event of our need for liquidity. We continuously monitor the financial strength of the various insurance companies with whom we carry policies. However, there is no assurance that one or more of these companies will not experience a decline in financial strength, which could impair its ability to pay benefits or return our cash surrender value. Additionally, should we need to liquidate these policies for liquidity needs, we would be subject to taxation on the increase in cash surrender value as well as penalties for early termination of the insurance contracts. These events would have a negative impact on our earnings.

Fluctuating interest rates may adversely affect our profitability.

Our profitability is dependent to a large extent upon net interest income, which is the difference, or spread, between the interest earned on loans, securities, and other interest-earning assets and the interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. In a rapidly changing interest rate environment, we may not be able to manage this risk effectively. Changes in interest rates also can affect: (1) our ability to originate and/or sell loans; (2) the value of our interest-earning assets, which would negatively impact shareholders (deficit) equity and our ability to realize gains from the sale of such assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay adjustable or variable rate loans. Interest rates are highly sensitive to many factors, including government monetary policies, domestic and international economic and political conditions, and other factors beyond our control. If we are unable to manage interest rate risk effectively, our business, financial condition, and results of operations could be materially adversely affected.

Our litigation related costs might continue to increase.

The Bank is subject to a variety of legal proceedings that have arisen in the ordinary course of the Bank s business. In the current economic environment the Bank s involvement in litigation has increased, primarily as a result of defaulted borrowers asserting claims in order to defeat or delay foreclosure proceedings. The Bank believes that it has meritorious defenses in legal actions where it has been named as a defendant and is vigorously defending these suits. Although management, based on discussion with litigation counsel, believes that such proceedings will not have a material adverse effect on the financial condition or operations of the Bank, there can be no assurance that a resolution of any such legal matters will not result in significant liability to the Bank nor have a material adverse impact on its financial condition and results of operations or the Bank s ability to meet applicable regulatory requirements. The expenses of pending legal proceedings will adversely affect the Bank s results of operations until they are resolved. There can be no assurance that the Bank s loan workout and other activities will not expose the Bank to additional legal actions, including lender liability or environmental claims.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry in general, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the value of the collateral held by us cannot be realized upon liquidation or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure. There is no assurance that any such losses would not materially and adversely affect our results of operations.

We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations.

We are subject to extensive regulation, supervision, and examination by federal and state banking authorities. Any change in applicable regulations or laws could have a substantial impact on us and our operations. Additional legislation and regulations that could significantly affect our powers, authority, and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Legislation proposed by Congress in the past would give bankruptcy courts the power to reduce the increasing number of home foreclosures by giving bankruptcy judges the authority to restructure mortgages and reduce a borrower s payments. Property owners would be allowed to keep their property while working out their debts. Other similar bills placing additional temporary moratoriums on foreclosure sales or otherwise modifying foreclosure procedures to the benefit of borrowers and the detriment of lenders could be enacted by either Congress or the state of Maryland in the future. Any such laws may further restrict our collection efforts on residential mortgage loans.

On July 21, 2010, the President signed into law the Dodd-Frank Act, which contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. These include provisions for, among other things, strengthening holding company capital requirements. Also included is the creation of a new federal agency to administer and enforce consumer and fair lending laws, a function that is now performed by the depository institution regulators. The full impact of the Dodd-Frank Act on our business and operations may not be known for years until full and final regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased compliance costs and regulatory burden, increased interest expense, and higher capital standards. See additional information on the Dodd-Frank Act under Supervision and Regulation in Item 1 above.

We face significant operational risks.

We operate in many different businesses in diverse markets and rely on the ability of our employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from our operations, including, but not limited to, the risk of fraud by employees or persons outside of the Company and the Bank, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, catastrophic failures resulting from terrorist acts or natural disasters, breaches of the internal control system, compliance requirements, and business continuation and disaster recovery. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. We maintain a system of internal controls to mitigate against such occurrences and maintain insurance coverage for such risks that are insurable, but should such an event occur that results in a breakdown in the internal control system, improper operation of systems, or improper employee actions, we could suffer financial loss, face regulatory action, and suffer damage to our reputation.

Additionally, the financial services industry is continually undergoing rapid technological change 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 depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, 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 effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue, and/or cause us to incur additional expenses. Operations in several of our markets could be disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to our banking and operation facilities. Although we have not experienced such an occurrence to date, severe weather or natural disasters, acts of war or terrorism, or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

The loss of senior management could hurt our operations.

We rely heavily on our senior officer team. The loss of any of our senior officers could have an adverse effect on us because we have been operating with as small a staff as possible to reduce expenses. In late 2011, the Chairman of the Board and Chief Executive Officer (CEO) of the Company and the Bank retired and the President of the Bank resigned to pursue another opportunity. Such individuals have not been replaced, and their duties have been assumed by other officers. Moreover, as a result of our capital levels and the September Order, we are subject to regulations that limit our flexibility in offering compensation arrangements that would better enable us to retain our senior officers, and we may find it difficult to attract replacement officers in the event we were to lose existing senior officers. In addition, as a community bank, we have fewer management-level personnel who are in a position to assume the responsibilities of our senior officers.

A continuation of recent turmoil in the financial markets could have an adverse effect on our financial position or results of operations.

Beginning in 2008, U.S. and global financial markets have been experiencing severe disruption and volatility, and general economic conditions have declined significantly. Adverse developments in credit quality, asset values, and revenue opportunities throughout the financial services industry, as well as general uncertainty regarding the economic, industry, and regulatory environment, have had a marked negative impact on the industry. Dramatic declines in the U.S. housing market over the past few years, with falling home prices, increasing foreclosures, and increasing unemployment, have negatively affected the credit performance of residential mortgage loans and resulted in significant write-downs of asset values by many financial institutions. The U.S. and the governments of other countries have taken steps to try to stabilize the financial system, including investing in financial institutions, and have also been working to design and implement programs to improve general economic conditions. Notwithstanding the actions of the U.S. and other governments, these efforts may not succeed in restoring industry, economic, or market conditions and may result in adverse unintended consequences. Factors that could continue to pressure financial services companies, including First Mariner, are numerous and include (i) worsening credit quality, leading, among other things, to increases in loan losses and reserves, (ii) continued or worsening disruption and volatility in financial markets, leading, among other things, to continuing reductions in asset values, (iii) capital and liquidity concerns regarding financial institutions generally, (iv) limitations resulting from or imposed in connection with governmental actions intended to stabilize or provide additional regulation of the financial system, or (v) recessionary conditions that are deeper or last longer than currently anticipated.

Our financial condition and results of operations are dependent on the economy in the Bank s market area.

First Mariner Bank s primary market area for its core banking operations consists of central Maryland and portions of Maryland s eastern shore. Because of the Bank s concentration of business activities in its market area, our financial condition and results of operations depend upon economic conditions in the Bank s market area. Adverse economic conditions in our market area could reduce our growth rate, affect the ability of our customers to repay their loans, and generally affect our financial condition and results of operations. Conditions such as inflation, recession, unemployment, high interest rates, short money supply, scarce natural resources, international disorders, terrorism, and other factors beyond our control may adversely affect our profitability. We are less able than a larger institution to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Any sustained period of increased payment delinquencies, foreclosures, or losses caused by adverse market or economic conditions in the state of Maryland could adversely affect the value of our assets, revenues, results of operations, and financial condition. Moreover, we cannot give any assurance we will benefit from any market growth or favorable economic conditions in our primary market areas if they do occur.

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring, and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be materially adversely affected.

Our ability to pay cash dividends is limited.

Holders of shares of our common stock are entitled to dividends if declared by our board of directors out of funds legally available for that purpose. In general, future dividend policy is subject to the discretion of the board of directors and will depend upon our future earnings, capital requirements, regulatory constraints, and our financial condition, as well as that of the Bank.

Although the board of directors has declared cash dividends in the past, it has discontinued such payments to conserve cash and capital resources and does not intend to declare cash dividends until current earnings are sufficient to generate adequate internal capital to support growth. Moreover, the New FRB Agreement prohibits the payment of dividends to our stockholders. Our future ability to pay dividends will be largely dependent upon the receipt of dividends from the Bank. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. Federal law prohibits the payment of a dividend by an insured depository institution if the depository institution is considered undercapitalized or if the payment of the dividend would make the institution undercapitalized. For a Maryland commercial bank, dividends may be paid out of undivided profits or, with the prior approval of the Commissioner, from surplus in excess of 100% of required capital stock. If, however, the surplus of a Maryland bank is less than 100% of its required capital stock, then cash dividends may not be paid in excess of 90% of net earnings.

Our ability to pay dividends is further subject to our ability to make payments of interest under junior subordinated debentures due through 2035 held by our statutory trusts Mariner Capital Trust (MCT) II, III, IV, V, VI, and VII (collectively, the Trusts). These payments are necessary to fund the distributions that the Trusts each must pay to holders of its trust preferred securities (collectively, the Trust Preferred Securities). We have elected to defer interest payments on the debentures. This deferment is permitted by the terms of the debentures and does not constitute an event of default thereunder. Interest on the debentures and dividends on the related Trust Preferred Securities continue to accrue and will have to be paid in full prior to the expiration of the deferral period, which may not exceed 20 consecutive quarters and expires with the last quarter of 2013, and prior to the declaration of any dividends. Under the terms of the Trust Preferred Securities, we are not permitted to pay dividends to our stockholders while we are deferring interest payments on the debentures.

Finally, First Mariner and the Bank have entered into regulatory agreements with our regulators which, among other things, require us to seek prior regulatory approval before the Bank pays dividends to First Mariner and/or before First Mariner pays dividends on its common stock.

Contracts with our officers may discourage a takeover or adversely affect our takeover value.

We have entered into change in control agreements with three of our officers. These agreements provide for a payment to each officer of a multiple of his or her salary and bonus upon the occurrence of either a change in control that results in the loss of employment or a significant change in his or her employment. Thus, we may be required to make significant payments in the event that the rights under these agreements are triggered by a change in control. As a result, these contracts may discourage a takeover or adversely affect the consideration payable to stockholders in the event of a takeover. Notwithstanding the foregoing, because the Company and the Bank are considered to be in troubled condition for regulatory purposes, payments made under any change of control agreement are subject to certain regulatory restrictions and limitations. The Company and the Bank must apply for and receive the approval of the FRB and the FDIC, respectively, in order to make payments under these agreements.

Our Articles and Bylaws and Maryland law may discourage a corporate takeover.

Our Articles and Amended and Restated Bylaws (Bylaws) contain certain provisions designed to enhance the ability of the board of directors to deal with attempts to acquire control of the Company. These provisions provide for the classification of our board of directors into three classes; directors of each class serve for staggered three year periods. The Articles also provide for supermajority voting provisions for the approval of certain business combinations.

Maryland law also contains anti-takeover provisions that apply to us. The Maryland Business Combination Act generally prohibits, subject to certain limited exceptions, corporations from being involved in any business combination (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer, or issuance or reclassification of equity securities) with any interested shareholder for a period of five years following the most recent date on which the interested shareholder became an interested shareholder. An interested shareholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock.

Although these provisions do not preclude a takeover, they may have the effect of discouraging a future takeover attempt which would not be approved by our board of directors, but pursuant to which stockholders might receive a substantial premium for their shares over then-current market prices. As a result, stockholders who might desire to participate in such a transaction might not have the opportunity to do so. Such provisions will also render the removal of our board of directors and of management more difficult and, therefore, may serve to perpetuate current management. Further, such provisions could potentially adversely affect the market price of our common stock.

ITEM 2 PROPERTIES

We lease our executive offices located at 1501 South Clinton Street, Baltimore, Maryland. This location also houses our headquarters branch office. We occupy approximately 84,000 square feet at this location.

We own our former headquarters branch office (now a drive-thru satellite office) located at 3301 Boston Street, Baltimore, Maryland. This location houses drive-up banking facilities as well as other administration offices.

We operate retail bank branches at the following locations:*

Maryland:

Annapolis (2)
161 A Jennifer Road
Annapolis, MD 21401

Arbutus (2)
3720 Washington Blvd., Suite 100
Baltimore, MD 21227

Bel Air (3)
12 A Bel Air South Parkway
Bel Air, MD 21015

Canton Drive-Thru (1) (4)
3301 Boston Street
Baltimore, MD 21224

Canton Tower/Headquarters (2)
1501 South Clinton Street
Baltimore, MD 21224

Carroll Island (2)
176 Carroll Island Road
Baltimore, MD 21220

Cockeysville (3)
9840 York Road
Cockeysville, MD 21030

Columbia (2)
8835 Centre Park Drive, Suite 100
Columbia, MD 21045

Dundalk (2)
7860 Wise Avenue
Baltimore, MD 21222

Easton (1)
8662 Alicia Drive
Easton, MD 21601

Ellicott City (3)
10065 Baltimore National Pike
Ellicott City, MD 21042

Glen Burnie (3)
305 South Crain Highway
Glen Burnie, MD 21061

Hickory (3)
1403 Conowingo Road
Belair, MD 21014

Loch Raven (1)
1641 East Joppa Road
Baltimore, MD 21286

Lutherville/Timonium (2) (5)
1738 York Road
Lutherville, MD 21093

Odenton (1)
1600 Annapolis Road
Odenton, MD 21113

Owings Mills (3)
4800 Painters Mill Road
Owings Mills, MD 21117

Perry Hall (1)
8843 Bel Air Road
Perry Hall, MD 21236

Pikesville (1)
1013 Reisterstown Road
Baltimore, MD 21208

Pikesville Drive-Thru (2)(4)
1100 Reisterstown Road
Baltimore, MD 21208

Severna Park (2)
366A Gov Ritchie Highway
Severna Park, MD 21146

Westminster (1)
1010 Baltimore Boulevard
Westminster, MD 21157

White Marsh (1)
10101 Philadelphia Road
White Marsh, MD 21237

Woodlawn (3)
7007 Security Boulveard
Baltimore, MD 21244

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* For our branch hours and remote ATM locations, please refer to our website at www.1stmarinerbank.com.

(1) Company owns branch

(2) Company leases branch

(3) Company owns branch, but leases related land

(4) Office is a satellite branch

(5) Branch closed in 2012

We operate mortgage offices at the following locations:

Maryland:

Annapolis (2)
2661 Riva Road
Annapolis, MD 21401

Bel Air (2)
303 South Main Street
Bel Air, MD 21014

Bethesda (2)
4800 Hamden Lane, Suite 200
Bethesda, MD 20814

Canton/Headquarters (1)
3301 Boston Street
Baltimore, MD 21224

Easton (1)
8662 Alicia Drive
Easton, MD 21601

Eldersburg (2)
1643 Liberty Road, Unit 101
Sykesville, MD 21784

Ellicott City (3)
10065 Baltimore National Pike
Ellicott City, MD 21042

Rockville (2)
15722 Crabbs Branch Way
Rockville, MD 20855

Salisbury (2)
1131 S. Salisbury Blvd, Ste D
Salisbury, MD 21801

Severna Park (2)
838 Ritchie Highway
Severna Park, MD 21146

Solomon s Island (2)
13940 H. G. Trueman Road
Solomon s Island, MD 20688

Waldorf (2)
3200 Crain Hwy, Units 102 & 103
Waldorf, MD 20603

White Marsh (1)
10101 Philadelphia Road
White Marsh, MD 21237

Delaware:

Seaford (2)
22350 Sussex Highway
Seaford, DE 19973

Virginia:

Landsdowne (2)
19301 Winmeade Drive Suite 200
Landsdowne, VA 20176

North Carolina:

VA Mortgage (2)
203 Wolf Creek Professional Center
Havelock, NC 28532

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(1) Company owns office

(2) Company leases office

(3) Company owns office, but leases related land

The Bank s branches range in total size from 2,000 to 4,000 square feet and mortgage offices generally range in size from 1,200 to 2,000 square feet. We believe that all of our locations are suitable and adequate to conduct business and support growth in customer and transaction volume.

For more information on our lease commitments and costs, see Note 7 of the Notes to Consolidated Financial Statements, included in Item 8 of Part II of this Annual Report on Form 10-K.

ITEM 3 LEGAL PROCEEDINGS

We are party to certain legal actions that are routine and incidental to our business. In management s opinion, the outcome of these matters, individually or in the aggregate, will not have a material effect on our results of operations or financial position.

ITEM 4 MINE SAFETY DISCLOSURES

Not Applicable.

PART II

ITEM 5 MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Common Stock

First Mariner s common stock is quoted on the OTCBB under the symbol FMAR. Currently, there are approximately 4,200 holders of record of First Mariner common stock. On March 16, 2012, the closing sales price of First Mariner common stock was $0.40 per share.

The table below sets forth for the periods indicated the low and high market prices of the common stock.

	Low	High
2011 Quarter ended:		
Fourth quarter	$ 0.05	$ 0.30
Third quarter	0.16	0.74
Second quarter	0.23	0.81
First quarter	0.39	1.05
2010 Quarter ended:		
Fourth quarter	$ 0.35	$ 0.84
Third quarter	0.60	1.03
Second quarter	0.89	2.98
First quarter	0.88	1.51

We do not pay cash dividends on our shares of common stock. Currently, we have no plans to pay cash dividends on our common stock. For a discussion of the limitations on First Mariner s ability to pay dividends, see Item 1 of Part I of this Annual Report on Form 10-K under the heading Supervision and Regulation.

Equity Compensation Plan Information

The following table sets forth the securities authorized for issuance under the Company s equity compensation plans as of December 31, 2011:

Plan Category	(A) Number of securities to be issued upon exercise of outstanding options, warrants, and rights	(B) Weighted-average exercise price of oustanding options, warrants, and rights	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A))
Equity compensation plans approved by security holders	836,228	$ 7.98	1,406,666
Equity compensation plans not approved by security holders			
Total	836,228	$ 7.98	1,406,666

Issuer Purchases of Equity Securities

None.

ITEM 6 SELECTED FINANCIAL DATA

	2011	2010	2009	2008	2007
	(dollars in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Net interest income	$ 28,182	$ 29,838	$ 27,112	$ 28,440	$ 32,195
Provision for loan losses	14,330	17,790	11,660	10,856	6,700
Noninterest income	23,249	28,192	28,271	17,227	20,757
Noninterest expense	67,951	67,498	67,834	65,252	67,297
Income tax (benefit) expense before discontinued operations	(606)	19,131	(10,887)	(13,632)	(9,342)
(Loss) income from discontinued operations (1)		(200)	(9,060)	1,721	1,640
Net loss	(30,244)	(46,589)	(22,284)	(15,088)	(10,063)
Consolidated Statement of Financial Condition Data:					
Total assets	$ 1,179,017	$ 1,309,637	$ 1,384,551	$ 1,307,497	$ 1,246,822
Loans receivable, net	687,950	797,572	879,312	961,919	842,131
Deposits	1,014,760	1,121,889	1,146,504	950,233	904,953
Long-term borrowings	73,698	33,888	95,672	177,868	155,130
Junior subordinated deferrable interest debentures	52,068	52,068	73,724	73,724	73,724
Stockholders (deficit) equity	(25,412)	3,746	26,987	46,015	64,570
Per Share Data:					
Number of shares of common stock outstanding at year end	18,860,482	18,050,117	6,452,631	6,452,631	6,351,611
Net loss per common share Basic and Diluted	$ (1.62)	$ (3.15)	$ (3.45)	$ (2.36)	$ (1.57)
Cash dividends declared					
Performance and Capital Ratios:					
Return on average assets	(2.50)%	(3.43)%	(1.69)%	(1.16)%	(0.79)%
Return on average equity	NM(2)	(119.97)%	(53.81)%	(24.37)%	(13.83)%
Net interest margin	3.03%	2.91%	2.43%	2.74%	3.12%
Average equity to average assets	(0.91)%	2.86%	3.15%	4.78%	5.75%
Leverage ratio (Bank)	3.0%	4.7%	6.2%	5.8%	7.1%
Tier 1 capital to risk-weighted assets (Bank)	4.2%	6.8%	7.9%	6.8%	8.6%
Total capital to risk-weighted assets (Bank)	5.5%	8.0%	9.1%	8.8%	10.4%
Asset Quality Ratios:					
Nonperforming assets to total assets	5.25%	5.48%	4.15%	4.42%	3.48%
Allowance for loan losses at year-end to:					
Total loans, net of unearned income	1.97%	1.74%	1.31%	1.71%	1.50%
Nonperforming assets and 90 day past-due loans	20.23%	18.89%	17.46%	24.88%	27.57%
Net charge-offs to average total loans, net of unearned income	1.94%	1.80%	1.37%	1.35%	1.09%

(1) Reflects (loss) income from discontinued operations of Mariner Finance.

(2) NM = not meaningful

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

The Company

First Mariner Bancorp is a bank holding company incorporated under the laws of Maryland and registered under the federal Bank Holding Company Act of 1956, as amended. First Mariner Bancorp s business is conducted primarily through its wholly-owned subsidiary, First Mariner Bank (the Bank). The Company had over 500 employees (approximately 503 full-time equivalent employees) as of December 31, 2011.

The Bank, with assets exceeding $1.1 billion as of December 31, 2011, is engaged in the general commercial banking business, with particular attention and emphasis on the needs of individuals and small to mid-sized businesses, and delivers a wide range of financial products and services that are offered by many larger competitors. The Bank s primary market area for its core banking operations, which consist of traditional commercial and consumer lending, as well as retail and commercial deposit operations, is central Maryland and portions of Maryland s eastern shore. Products and services of the Bank include traditional deposit products, a variety of consumer and commercial loans, residential and commercial mortgage and construction loans, wire transfer services, nondeposit investment products, and Internet banking and similar services. Most importantly, the Bank provides customers with access to local Bank officers who are empowered to act with flexibility to meet customers needs in an effort to foster and develop long-term loan and deposit relationships. The Bank is an independent community bank and its deposits are insured by the FDIC.

First Mariner Mortgage, a division of the Bank, engages in mortgage-banking activities, providing mortgages and associated products to customers and selling most of those mortgages into the secondary market. First Mariner Mortgage had assets of $183.0 million and $140.3 million as of December 31, 2011 and December 31, 2010, respectively, and generated revenue of $17.4 million and $21.7 million, respectively, for the years ended December 31, 2011 and 2010. It recognized income before income taxes of $6.3 million and $8.2 million during 2011 and 2010, respectively. Origination volume during 2011 was $1.1 billion compared to $1.3 billion in 2010. During 2011, 66% of the originations were made in the state of Maryland, 14% in the immediately surrounding states and Washington, DC., and the remaining 20% in other states throughout the country. First Mariner Mortgage has offices in Maryland, Delaware, Virginia, and North Carolina. See Note 21 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K for more detailed information on the results of our mortgage-banking operations.

NGFS, a former division of the Bank, engaged in the origination of reverse and conventional mortgage loans and provided these products directly through commission based loan officers throughout the United States. We transferred all MSRs to the buyer of NGFS during the second quarter of 2011 and finalized the sale during the third quarter of 2011. We have not realized any significant benefit or loss from the sale of NGFS.

Recent Developments

Change in Executive Leadership of the Company

On December 21, 2011, we were notified by Edwin F. Hale, Sr., the Company s and the Bank s then Chairman and CEO, of Mr. Hale s retirement effective December 22, 2011. Michael R. Watson, a current director of the Company and the Bank, has been appointed interim Chairman of the Board of the Company and the Bank.

On December 22, 2011, Mark Keidel, at the time the Company s and the Bank s President and Chief Operating Officer, was appointed as the interim CEO (principal executive officer) of the Company and the Bank.

NASDAQ Delisting

On August 30, 2011, we received a letter from NASDAQ notifying us that NASDAQ had determined to deny our request for continued listing on NASDAQ. NASDAQ indicated that it would suspend the trading of the shares of Company common stock effective at the open of business on September 1, 2011. The Company s common stock was quoted on the OTCBB starting on September 1, 2011. NASDAQ s determination was based on the Company s failure to comply with: (1) NASDAQ Listing Rule 5450(b), which requires maintenance of a minimum of $2.5 million in shareholders equity; and (2) NASDAQ Listing Rule 5450(a)(1), which requires maintenance of a minimum bid price of $1.00 per share.

Securities Purchase Agreement

On April 19, 2011, the Company and the Bank entered into a securities purchase agreement with Priam, which was subsequently amended on September 21, 2011. For a description of the material terms of the securities purchase agreement, see the Company s Current Report on Form 8-K filed with the SEC on April 25, 2011. For additional information on the terms of the amendment, see Exhibit 10.1 to the Company s Form 10-Q filed with the SEC on November 7, 2011 and the Company s Current Report on Form 8-K filed with the SEC on September 27, 2011.

Critical Accounting Policies

The Company s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated 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 consolidated financial statements at fair value warrants an impairment write-down or 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. When applying accounting policies in such areas that are subjective in nature, management must use its best judgment to arrive at the carrying value of certain assets and liabilities. Below is a discussion of our critical accounting policies.

Securities

We designate securities into one of three categories at the time of purchase. Debt securities that we have the intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt and equity securities are classified as trading if bought and held principally for the purpose of sale in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as held to maturity and debt and equity securities not classified as trading securities are considered AFS and are reported at estimated fair value, with unrealized gains and losses reported as a separate component of stockholders (deficit) equity, net of tax effects, in accumulated other comprehensive loss.

Securities AFS are evaluated periodically to determine whether a decline in their value is other than temporary. The term other than temporary is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the security.

The initial indications of OTTI for both debt and equity securities are a decline in the market value below the amount recorded for a security and the severity and duration of the decline. In determining whether an impairment is other than temporary, we consider the length of time and the extent to which the market value has been below cost, recent events specific to the issuer, including investment downgrades by rating agencies and economic conditions of its industry, our intent to sell the security, and if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. For marketable equity securities, we also consider the issuer s financial condition, capital strength, and near-term prospects. For debt securities and for perpetual preferred securities that are treated as debt securities for the purpose of OTTI analysis, we also consider the cause of the price decline (general level of interest rates and industry- and issuer-specific factors), the issuer s financial condition, near-term prospects and current ability to make future payments in a timely manner, the issuer s ability to service debt, and any change in agencies ratings at evaluation date from acquisition date and any likely imminent action. Once a decline in value is determined to be other than temporary, the security is segmented into credit- and noncredit-related components. Any impairment adjustment due to identified credit-related components is recorded as an adjustment to current period earnings, while noncredit-related fair value adjustments are recorded through accumulated other comprehensive loss. In situations where we intend to sell or it is more likely than not that we will be required to sell the security, the entire OTTI loss is recognized in earnings.

Gains or losses on the sales of securities are calculated using a specific-identification basis and are determined on a trade-date basis. Premiums and discounts on securities are amortized (accreted) over the term of the security using methods that approximate the interest method. Gains and losses on trading securities are recognized regularly in income as the fair value of those securities changes.

Allowance for loan losses

Our allowance for loan losses represents an estimated amount that, in management s judgment, will be adequate to absorb probable incurred losses on existing loans. The allowance for loan losses consists of an allocated component and an unallocated component. Management uses a disciplined process and methodology to establish the allowance for losses each quarter. To determine the total allowance for loan losses, we estimate the reserves needed for each class of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis. The allowance for loan losses consists of amounts applicable to: (1) the commercial loan portfolio; (2) the commercial mortgage loan portfolio; (3) the construction loan portfolios (both commercial and consumer); (4) the residential mortgage loan portfolio; (5) the home equity and second mortgage loan portfolio; and (6) the other consumer loan portfolio.

To determine the balance of the allowance account, loans are pooled by portfolio class and losses are modeled using historical experience, quantitative analysis, and other mathematical techniques over the loss emergence period. For each class of loan, significant judgment is exercised to determine the estimation method that fits the credit risk characteristics of that portfolio class. We use internally developed models in this process. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the allowance are validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

The establishment of the allowance for loan losses relies on a consistent process that requires multiple layers of management review and judgment and responds timely to changes in economic conditions and other influences. From time to time, events or economic factors may affect the loan portfolio, causing management to provide additional amounts to or release balances from the allowance for loan losses.

Management monitors differences between estimated and actual incurred loan losses utilizing charge-off history. Loans deemed uncollectible are charged against, while recoveries are credited to, the allowance. Management adjusts the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense.

Commercial (including commercial mortgages) and construction loans (including both commercial and consumer) are generally evaluated for impairment when the loan becomes 90 days past due and/or is rated as substandard. The difference between the fair value of the collateral, less estimated selling costs and the carrying value of the loan is charged-off at that time. Residential mortgage loans are generally charged down to their fair value when the loan becomes 120 days past due or is placed in nonaccrual status, whichever is earlier. Consumer loans are generally charged-off when the loan becomes 120 days past due or when it is determined that the amounts due are uncollectible (whichever is earlier). The above charge-off guidelines may not apply if the loan is both well secured and in the process of collection. These charge-off policies have not changed in the last three years.

As an additional portion of the allowance for loan losses, we also estimate probable losses related to unfunded loan commitments. These commitments are subject to individual review and are analyzed for impairment the same as a correspondent loan would be.

Loan impairment

We determine a loan to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. In general, impaired loans consist of nonaccrual loans and troubled debt restructures (TDR or TDRs). We do not consider a loan impaired during a period of delay in payment if we expect to collect all amounts due, including interest past due. Generally we consider a period of delay in payment to include delinquency up to 90 days, but may extend this period if the loan is collateralized by residential or commercial real estate with a low LTV ratio, and where collection and repayment efforts are progressing. We evaluate our commercial, commercial mortgage, commercial construction, and consumer construction classes of loans individually for impairment. We evaluate larger groups of smaller-balance homogeneous loans, which include our residential mortgage, home equity and second mortgage, and other consumer classes of loans collectively for impairment.

We identify impaired loans and measure impairment (1) at the present value of expected cash flows discounted at the loan s effective interest rate, (2) at the observable market price, or (3) at the fair value of the collateral if the loan is collateral dependent. If our measure of the impaired loan is less than the recorded investment in the loan, we record a charge-off for the deficiency unless it s a TDR, for which we recognize an impairment loss through an allocated portion of the allowance for loan losses.

When the ultimate collectability of an impaired loan s principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent any interest has been foregone, and then they are recorded as recoveries of any amounts previously charged-off. When this doubt no longer exists, cash receipts are applied under the contractual terms of the loan agreement.

Loan nonaccrual status

For smaller loans, we place loans in nonaccrual status when they are contractually past due 90 days as to either principal or interest, unless the loan is well secured and in the process of collection, or earlier, when, in the opinion of management, the collection of principal and interest is in doubt. For larger loans and certain mortgage loans, management applies Financial Accounting Standards Board (FASB) guidance on impaired loan accounting to determine accrual status. Under that guidance, when it is probable that we will be unable to collect all payments due, including interest, we place the loan in nonaccrual status. A loan remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. Specifically, in order for a nonaccrual loan to be returned to accrual status, a borrower must make six consecutive monthly payments and the borrower must demonstrate the ability to keep the loan current going forward.

As a result of our ongoing review of the loan portfolio, we may classify loans as nonaccrual even though the presence of collateral or the borrower s financial strength may be sufficient to provide for ultimate repayment. Loans are charged-off when a loan or a portion thereof is considered uncollectible. We determine that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date. Interest and fees continue to accrue on past due loans until the date the loan goes in nonaccrual status.

Loan income recognition

Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees and certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual loan terms or until the date of sale or disposition. Accrual of interest is discontinued when its receipt is in doubt, which typically occurs when a loan becomes impaired. Any interest accrued to income in the year when interest accruals are discontinued is generally reversed. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the principal balance and accrued interest. Payments on nonaccrual loans are applied to principal. See additional information on loan impairment and nonaccrual status above.

Real estate acquired through foreclosure

We record real estate acquired through foreclosure at the lower of cost or market value (LCM) on the acquisition date and at the lower of such initial amount or estimated fair value less estimated selling costs thereafter. Estimated fair value is based upon many subjective factors, including location and condition of the property and current economic conditions, among other things. Because the calculation of fair value relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.

Write-downs at the time of transfer are made through the allowance for loan losses. Write-downs subsequent to transfer are included in our noninterest expenses, along with operating income, net of related expenses of such properties and gains or losses realized upon disposition.

Income taxes

Deferred income taxes are recognized for the tax consequences of temporary differences between financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income taxes are provided on income and expense items when they are reported for financial statement purposes in periods different from the periods in which these items are recognized in the income tax returns. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based upon consideration of available evidence, including tax planning strategies and other factors.

We recognize a tax position as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. As of December 31, 2011 and 2010, we maintained a valuation allowance against the full amount of our deferred tax assets.

The calculation of tax liabilities is complex and requires the use of estimates and judgment since it involves the application of complex tax laws that are subject to different interpretations by us and the various tax authorities. These interpretations are subject to challenge by the tax authorities upon audit or to reinterpretation based on management s ongoing assessment of facts and evolving case law.

Periodically and in the ordinary course of business, we are involved in inquiries and reviews by tax authorities that normally require management to provide supplemental information to support certain tax positions we take in our tax returns. Uncertain tax positions are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. Management believes it has taken appropriate positions on its tax returns, although the ultimate outcome of any tax review cannot be predicted with certainty. No assurance can be given that the final outcome of these matters will not be different than what is reflected in the current and historical financial statements.

We recognize interest and penalties related to income tax matters in income tax (benefit) expense.

Other financial instruments carried at fair value

We record certain financial instruments at fair value (other than those described above), which inherently require assumptions and judgments in their valuation. Such financial instruments include LHFS, IRLCs, forward sales of mortgage-backed securities, and warrants.

LHFS

LHFS are carried at fair value, which is determined based on outstanding investor commitments or, in the absence of such commitments, based on current investor yield requirements or third party pricing models. Gains and losses are recognized through mortgage-banking revenue in the Consolidated Statements of Operations.

IRLCs

We engage an experienced third party to estimate the fair market value of our IRLCs. IRLCs are valued based upon mandatory pricing quotes from correspondent lenders less estimated costs to process and settle the loan. Fair value is adjusted for the estimated probability of the loan closing with the borrower. Gains and losses are recognized through mortgage-banking revenue in the Consolidated Statements of Operations.

Forward sales of mortgage-backed securities

Fair value for forward sales of mortgage-backed securities is determined based upon the quoted market values of the securities. Gains and losses are recognized through mortgage-banking revenue in the Consolidated Statements of Operations.

Warrants

The fair value of warrants is calculated using the Black-Scholes-Merton option-pricing model.

Results of Operations and Financial Condition

The following discussion compares our financial condition at December 31, 2011 to the financial condition at December 31, 2010 and results of operations for the years ended December 31, 2011, 2010, and 2009. This discussion should be read in conjunction with our accompanying financial statements and related notes as well as statistical information included elsewhere in this report.

Performance Overview

We recorded a net loss of $30.2 million for 2011 compared to net loss of $46.6 million for 2010, with diluted losses per share totaling $1.62 for 2011 compared to diluted losses per share of $3.15 in 2010. Discontinued operations contributed $200,000 in losses in 2010.

Our results for 2011 were significantly impacted by persistent negative trends in the real estate markets. We experienced significant charge-offs in real estate loans in 2011 (although less than in 2010) as a substantial amount of these loans were moved to real estate acquired through foreclosure. In addition, as declines in real estate values have continued in 2011, we recorded $7.8 million in additional write-downs, losses on, and expenses related to real estate acquired through foreclosure in 2011. We provided for additional loan loss reserves throughout 2011 for the anticipated loss exposure caused by the depressed real estate market. The provision for loan losses in 2011 was $14.3 million compared to $17.8 million in 2010. In addition, earnings were further impacted by the loss of interest income on loans placed on nonaccrual status and the cost of carrying foreclosed properties.

Our largest category of revenue, net interest income, decreased $1.7 million, or 5.5%, in 2011 compared to 2010, primarily due to lower volume and yields on average interest-earning assets. Noninterest income decreased $4.9 million or 17.5%. We experienced decreases in most major noninterest income categories, with the exception of ATM fees, gains from the sale of AFS securities and net OTTI. Gains from the sale of AFS securities increased by $704,000 from 2010 to 2011 and net OTTI improved by $411,000 from 2010 to 2011. During 2010, we recognized a $958,000 gain on a debt exchange transaction. See discussion of the exchange transaction under Borrowings later in this Item.

Total expenses increased primarily due to increases in professional fees related to regulatory compliance, loan workouts, and capital-raising activities. This increase was significantly offset by reductions in other expenses that were the result of cost-cutting measures taken in 2011.

We recorded a loss from the discontinued operations of Mariner Finance of $200,000 in 2010. We recorded an income tax benefit of $606,000 in 2011 and income tax expense from continuing operations of $19.1 million in 2010, which was the result of the establishment of the valuation allowance on our deferred tax assets.

Return on average assets, the quotient of net income divided by total average assets, measures how effectively we utilize the Company s assets to produce income. Our return on average assets was a negative (2.50)% for 2011 compared to a negative (3.43)% for 2010. All 2011 performance indicators were significantly affected by current losses.

Our total assets decreased by $130.6 million, or 10.0%, during 2011, primarily a result of decreased net loans. Earning assets decreased $76.3 million, or 7.4%, from $1.0 billion in 2010 to $959,000 in 2011. We purchased $62.8 million in AFS securities during 2011, partially offset by sales of AFS securities of $49.5 million. Deposits decreased by $107.1 million and short- and long-term borrowings increased by $3.4 million from December 31, 2010 to December 31, 2011. Stockholders equity decreased $29.2 million, reflecting the 2011 losses.

Our asset quality showed some improvement from 2010 to 2011 as our level of NPAs decreased from $71.7 million at December 31, 2010 to $61.9 million at December 31, 2011. At December 31, 2011, our allowance for loan losses amounted to $13.8 million, which totaled 20.2% of NPAs plus loans past due 90 days or more as of December 31, 2011, compared to 18.9% as of December 31, 2010. Our level of NPAs amounted to 5.3% of total assets at December 31, 2011 compared to 5.5% of total assets at December 31, 2010. Our ratio of net charge-offs to average total loans was 1.9% in 2011 compared to 1.8% in 2010.

Bank capital adequacy levels (as defined by banking regulation) deteriorated from 2010 to 2011, reflecting the 2011 net loss; the Bank was considered significantly undercapitalized at December 31, 2011. As of December 31, 2011, the Bank s leverage, Tier 1 capital to risk-weighted assets, and total capital to risk-weighted assets ratios were 3.0%, 4.2%, and 5.5%, respectively, compared to 4.7%, 6.8%, and 8.0%, respectively, at December 31, 2010. Our regulatory capital levels decreased due primarily to the level of losses in 2011. As a result of being below well capitalized levels, the Bank is under various operating restrictions and mandates in accordance with agreements with regulators as described in additional detail later in this Item under Capital Resources.

Results of Operations

Net Interest Income/Margins

Our primary source of earnings is net interest income, which is the difference between the interest income we earn on interest-earning assets, such as loans and securities, and the interest expense we pay on interest-bearing sources of funds, such as deposits and borrowings. Net interest income is a function of several factors, including changes in the volume and mix of interest-earning assets and funding sources, and market interest rates. While management policies influence these factors, external forces, including customer needs and demands, competition, the economic policies of the federal government, and the monetary policies of the FRB, are also determining factors.

Net interest income for 2011 decreased by $1.7 million to $28.2 million compared to $29.8 million for 2010 primarily due to a decrease in the volume of average interest-earning assets. We also experienced a decrease in the yields on interest-earning assets. These decreases to net interest income were partially offset by decreases in both the rates paid and volume of average interest-bearing liabilities.

The net interest margin is the key performance measure for our net interest income. Our net interest margin is affected by our loan pricing, our mix of earning assets, levels of NPAs, and our distribution and pricing of deposits and borrowings. Our net interest margin (net interest income divided by average earning assets) increased to 3.03% for 2011, compared to 2.91% for 2010.

Interest income

Total interest income decreased by $7.7 million from 2010 to 2011 due to both a decreased level of average earning assets of $95.1 million, which we shrunk in our continued attempt to improve the quality of our loan portfolio, and a decrease in the yields on earning assets from 5.39% to 5.11%. Yields on earning assets continue to be affected by the level of NPAs and corresponding interest reversals.

Average loans outstanding decreased by $99.7 million. We experienced decreases in all loan segments due primarily to our continued efforts to improve the quality of our loan portfolio as well as due to a weak real estate market, which has led to the reduction of new real estate loans and reduced values of the collateral of currently-held real estate loans.

Average LHFS decreased $18.8 million, due to lower origination volumes. Average securities increased by $14.6 million. During 2011, we purchased $62.8 million in securities in order to better utilize our liquidity.

Interest expense

Interest expense decreased by $6.1 million to $19.3 million for 2011 compared to $25.4 million for 2010. We experienced a decrease in the average rate paid on interest-bearing liabilities, from 2.11% for 2010 to 1.75% for 2011. We also experienced a $99.8 million decrease in the level of average interest-bearing liabilities. The decrease in the rate paid on interest-bearing deposits from 2.03% in 2010 to 1.68% in 2011 was due to the decreased rate environment and our reduction in rates due to our high level of liquidity. All deposit types experienced decreased rates during 2011.

Average interest-bearing deposits decreased by $92.5 million due to maturing time deposits from our national nonbrokered time deposit program (see description later in this Item under Deposits) combined with decreases in NOW and money market accounts. A decrease in average borrowings of $7.3 million was due primarily to the cancellation of certain junior subordinated debt (see Borrowings later in this Item). We experienced a decrease in the costs of borrowed funds from 2.58% for 2010 to 2.16% for 2011 due to the decline in variable-rate trust preferred security costs, decreased junior subordinated debt, and lower short-term borrowing costs.

The table below sets forth the average balances, net interest income and expense, and average yields and rates for our interest-earning assets and interest-bearing liabilities for 2011, 2010, and 2009.

Comparative Average Balances, Yields, and Rates:

	2011			2010			2009		
	Average Balance	**Interest (1)**	**Yield/ Rate**	**Average Balance**	**Interest (1)**	**Yield/ Rate**	**Average Balance (4)**	**Interest (1)**	**Yield/ Rate**
	(dollars in thousands)								
ASSETS									
Loans (2):									
Commercial	$ 63,433	$ 3,398	5.36%	$ 76,738	$ 3,997	5.21%	$ 87,421	$ 4,415	5.05%
Commercial mortgage	337,955	20,749	6.14%	351,001	21,900	6.24%	337,803	22,743	6.73%
Commercial construction	55,698	3,167	5.69%	76,663	4,029	5.26%	102,097	5,352	5.24%
Consumer construction	22,851	1,043	4.56%	40,650	2,178	5.36%	58,498	3,352	5.73%
Residential mortgage	130,885	6,934	5.30%	155,438	8,741	5.62%	152,280	8,937	5.87%
Consumer	142,477	6,398	4.49%	152,497	7,070	4.64%	151,246	6,860	4.54%
Total loans	753,299	41,689	5.53%	852,987	47,915	5.62%	889,345	51,659	5.81%
LHFS	89,812	3,813	4.25%	108,634	4,911	4.52%	99,503	5,080	5.11%
Securities, trading and AFS	42,333	1,567	3.70%	27,705	1,917	6.92%	48,274	2,955	6.12%
Interest-bearing deposits	37,328	438	1.17%	27,912	478	1.71%	71,963	108	0.15%
Restricted stock investments, at cost	7,036			7,661			7,770	8	0.10%
Total earning assets	929,808	47,507	5.11%	1,024,899	55,221	5.39%	1,116,855	59,810	5.36%
Allowance for loan losses	(14,657)			(13,051)			(11,979)		
Cash and other nonearning assets	294,397			346,744			211,014		
Total assets	$ 1,209,548	47,507		$ 1,358,592	55,221		$ 1,315,890	59,810	
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY									
Interest-bearing deposits:									
NOW	$ 6,182	17	0.27%	$ 7,405	47	0.63%	$ 6,784	44	0.65%
Savings	57,450	112	0.19%	56,271	152	0.27%	55,122	178	0.32%
Money market	127,584	715	0.56%	140,067	875	0.62%	163,910	1,376	0.84%
Time	743,309	14,819	1.99%	823,248	19,752	2.40%	713,855	23,275	3.26%
Total interest-bearing deposits	934,525	15,663	1.68%	1,026,991	20,826	2.03%	939,671	24,873	2.65%
Borrowings	169,496	3,662	2.16%	176,786	4,557	2.58%	213,011	7,825	3.67%
Total interest-bearing liabilities	1,104,021	19,325	1.75%	1,203,777	25,383	2.11%	1,152,682	32,698	2.84%
Noninterest-bearing demand deposits	103,201			107,119			116,508		
Other noninterest-bearing liabilities	13,276			8,862			5,285		
Stockholders (deficit) equity	(10,950)			38,834			41,415		
Total liabilities and stockholders (deficit) equity	$ 1,209,548	19,325		$ 1,358,592	25,383		$ 1,315,890	32,698	
Net interest income/net interest spread		$ 28,182	3.36%		$ 29,838	3.28%		$ 27,112	2.52%
Net interest margin (3)			3.03%			2.91%			2.43%

(1) There are no tax equivalency adjustments.
(2) The average balances of nonaccrual loans for the years ended December 31, 2011, 2010, and 2009, which are included in the average loan balances for these years, were $40.1 million, $47.2 million, and $35.3 million, respectively.
(3) Net interest margin is calculated as net interest income divided by average earning assets.
(4) Average assets and liabilities of our discontinued subsidiary, Mariner Finance, are included in other nonearning assets and other noninterest-bearing liabilities.

The Rate/Volume Analysis below indicates the changes in our net interest income as a result of changes in volume and rates. We maintain an asset and liability management policy designed to provide a proper balance between rate sensitive assets and rate sensitive liabilities to attempt to optimize interest margins while providing adequate liquidity for our anticipated needs.

Rate/Volume Analysis (1):

	2011 Compared to 2010			2010 Compared to 2009		
	Change Due to Variance In			Change Due to Variance In		
(dollars in thousands)	**Rates**	**Volume**	**Total**	**Rates**	**Volume**	**Total**
INTEREST INCOME						
Loans:						
Commercial	$ 111	$ (710)	$ (599)	$ 135	$ (553)	$ (418)
Commercial mortgage	(346)	(805)	(1,151)	(1,709)	866	(843)
Commercial construction	310	(1,172)	(862)	14	(1,337)	(1,323)
Consumer construction	(286)	(849)	(1,135)	(206)	(968)	(1,174)
Residential mortgage	(485)	(1,322)	(1,807)	(379)	183	(196)
Consumer	(218)	(454)	(672)	153	57	210
Total loans	(914)	(5,312)	(6,226)	(1,992)	(1,752)	(3,744)
LHFS	(286)	(812)	(1,098)	(611)	442	(169)
Securities, trading and AFS	(1,112)	762	(350)	347	(1,385)	(1,038)
Interest-bearing deposits	(175)	135	(40)	475	(105)	370
Restricted stock investments, at cost				(8)		(8)
Total interest income	(2,487)	(5,227)	(7,714)	(1,789)	(2,800)	(4,589)
INTEREST EXPENSE						
Interest-bearing deposits:						
NOW	(23)	(7)	(30)	(1)	4	3
Savings	(43)	3	(40)	(30)	4	(26)
Money market	(86)	(74)	(160)	(319)	(182)	(501)
Time	(3,133)	(1,800)	(4,933)	(6,744)	3,221	(3,523)
Total interest-bearing deposits	(3,285)	(1,878)	(5,163)	(7,094)	3,047	(4,047)
Borrowings	(713)	(182)	(895)	(2,081)	(1,187)	(3,268)
Total interest expense	(3,998)	(2,060)	(6,058)	(9,175)	1,860	(7,315)
Net interest income	$ 1,511	$ (3,167)	$ (1,656)	$ 7,386	$ (4,660)	$ 2,726

(1) Changes in interest income and interest expense that result from variances in both volume and rates have been allocated to rate and volume changes in proportion to the absolute dollar amounts of the change in each.

Noninterest Income

We derive noninterest income principally from mortgage-banking activities, service fees on our deposit accounts, ATM fees, commissions on sales of nondeposit investment products (brokerage fees), and income from BOLI. Our noninterest income for the year ended December 31, 2011 totaled $23.2 million, compared to $28.2 million for the year ended December 31, 2010, a decrease of $4.9 million or 17.5%.

Mortgage-banking revenue decreased from $17.0 million in 2010 to $13.6 million in 2011 primarily due to a decline in the volume of loan originations and the change to fair value accounting for LHFS in 2010 ($2.2 million). The volume of loans sold decreased from $1.3 billion in 2010 to $1.1 billion in 2011.

We recognized $758,000 in gains on sales of AFS securities in 2011, compared to $54,000 during 2010. During 2011, we recognized $838,000 in net OTTI charges on AFS securities, compared to $1.2 million in net OTTI charges recorded in 2010. See Securities discussion later in this Item for more information on these OTTI charges and the related securities.

Deposit service charges declined to $2.9 million in 2011 from $3.9 million in 2010 due primarily to the implementation of new federal regulations. During 2010, we experienced a recovery of value of our trading assets and certain long-term borrowings of $1.7 million. Those trading assets were sold in 2010 and the related liabilities were refinanced in 2010 with liabilities not recorded at fair value.

During 2010, we recognized a $958,000 gain on a debt exchange transaction. See Borrowings later in this Item for details about the transaction.

Other income increased $1.2 million in 2011. Included in this line item for 2011 is an insurance recovery of $1.0 million to settle certain outstanding title insurance claims.

The following table shows the detail of our noninterest income for the years ended December 31:

(dollars in thousands)	**2011**	**2010**	**2009**
Net OTTI charges on AFS securities	$ (838)	$ (1,249)	$ (2,936)
Mortgage-banking revenue	13,595	16,950	16,112
ATM fees	3,046	3,038	3,072
Gain on debt exchange		958	
Service fees on deposits	2,945	3,944	5,261
Gain on financial instruments carried at fair value		1,661	3,038
Gain on sale of AFS securities, net	758	54	420
Gain on disposal of premises and equipment		67	
Commissions on sales of nondeposit investment products	437	496	540
Income from BOLI	1,291	1,415	1,377
Other	2,015	858	1,387
	$ 23,249	$ 28,192	$ 28,271

Noninterest Expense

Our noninterest expense increased $453,000, or 0.7%, to $68.0 million compared to $67.5 million for 2010.

Write-downs and costs of real estate acquired through foreclosure decreased $577,000, as foreclosures decreased during 2011. We still experienced significant write-downs on real estate acquired through foreclosure as current appraisals reflected declines in property values. Corporate insurance costs increased due to additional insurance acquired in 2011. We experienced an increase in our deposit insurance costs of $484,000 as our premium rates assessed by the FDIC increased due to our capital adequacy levels and financial condition. See Capital Resources later in this Item for additional information on capital adequacy.

The decreases in salaries and employee benefits, occupancy, and furniture and equipment costs were a reflection of our continuing efforts in reducing controllable costs. Professional service and consulting costs increased due to regulatory compliance costs, efforts to raise capital, and legal costs related to loan workouts.

The following table shows the detail of our other noninterest expense for the years ended December 31:

(dollars in thousands)	**2011**	**2010**	**2009**
Office supplies	$ 440	$ 468	$ 504
Printing	308	406	332
Marketing/promotion	755	951	286
Postage	699	558	763
Overnight delivery/courier	392	436	525
Security	230	270	259
Dues and subscriptions	378	407	490
Director fees	332	313	276
Employee education and training	57	94	161
Automobile expense	109	135	144
Travel and entertainment	237	173	332
Other	1,853	2,593	1,546
	$ 5,790	$ 6,804	$ 5,618

Income Tax (Benefit) Expense

Due to continued operating losses and the uncertainty surrounding future profitability, we have established a valuation allowance against the full amount of our deferred taxes. The establishment of the valuation allowance does not preclude the company from realizing these assets in the future.

We recorded an income tax benefit of $606,000 on a net loss before taxes of $30.9 million, resulting in an effective tax rate of (2.0)% for 2011. The tax benefit in 2011 was the result of a refundable income tax credit (see discussion below). We recorded an income tax expense of $19.1 million on a net loss before taxes and discontinued operations of $27.3 million, resulting in an effective tax rate before discontinued operations of 70.1% for 2010. Included in 2010 was the charge-off of $35.6 million for the establishment of the valuation allowance against our net deferred tax assets.

The Bank has earned significant state tax incentives totaling $5.5 million through its participation in the One Maryland Economic Development (One Maryland) and Job Creation Tax Credit programs. We will realize the benefits of the incentives in our reported earnings as the credits can be utilized, in accordance with accounting standards that govern the recognition of investment tax credits. The amount of the credit that we can utilize will largely be determined by the level of Maryland taxable income for the Bank only, and will be recognized as a reduction in our income tax expense. During 2011, 2010, and 2009, we utilized $606,000, $600,000 and $591,000, respectively, in credits related to this incentive program as a portion of the credits earned are funded regardless of taxable income levels. Any unused One Maryland credits can be carried forward and will expire in 2016. The Job Creation Tax Credit can be carried forward for five years.

Financial Condition

At December 31, 2011, our total assets were $1.2 billion compared to $1.3 billion at December 31, 2010, a decrease of 10.0%. Earning assets decreased $76.3 million, or 7.4%, to $959,000 at December 31, 2011 from $1.0 billion at December 31, 2010. We experienced decreases in all of our interest-earning asset categories, with the exception of LHFS, which increased $42.6 million. Stockholders equity decreased $29.2 million primarily due to the net loss in 2011. Deposits decreased by $107.1 million and short- and long-term borrowings increased $3.4 million from December 31, 2010 to December 31, 2011.

Securities

We utilize the securities portfolio as part of our overall asset/liability management practices to enhance interest revenue while providing necessary liquidity for the funding of loan growth or deposit withdrawals. We continually monitor the credit risk associated with the securities we hold and diversify the risk in the securities portfolios. As of December 31, 2011 and 2010, we held $22.7 million and $27.8 million, respectively, in securities classified as AFS.

Our securities portfolio at December 31, 2011 was comprised of marketable securities. The maturity structure of our securities portfolio is significantly influenced by the level of prepayment activity on mortgage-backed securities. At December 31, 2011, the average duration of our securities portfolio was 2.0 years, slightly shorter than the average duration of 2.4 years at December 31, 2010, primarily due to the sale of longer-term securities in 2011 as well as a decrease in the projected lives of our mortgage-backed securities.

AFS securities decreased $5.1 million from December 31, 2010. During 2011, we sold $49.5 million in AFS securities for a net gain on the sales of $758,000. We recorded $838,000 in net OTTI charges related to pooled trust preferred securities during 2011, compared to $1.2 million in net OTTI charges for 2010. Overall market values of securities have improved as evidenced by a net unrealized loss on securities classified as AFS of $3.0 million at December 31, 2011 compared to a net unrealized loss of $3.6 million at December 31, 2010.

Changes in current market conditions, such as interest rates and the economic uncertainties in the mortgage, housing, and banking industries have severely impacted the securities market. The secondary market for various types of securities has been limited and has negatively impacted security values. Quarterly, we review each security in our AFS portfolio to determine the nature of any decline in value and evaluate if any impairment should be classified as OTTI. As of December 31, 2011 and 2010, we determined that OTTI had occurred with respect to four of our pooled trust preferred securities.

All of the remaining securities that are temporarily impaired are impaired due to declines in fair values resulting from changes in interest rates or increased credit/liquidity spreads compared to the time they were purchased. We have the intent to hold these securities to maturity and it is more likely than not that we will not be required to sell the securities before recovery of value. As such, management considers the impairments to be temporary.

The trust preferred securities we hold in our securities portfolio were issued by other banks, bank holding companies, and insurance companies. Certain of these securities have experienced declines in credit ratings from credit rating firms, which have devalued these specific securities. While some of these issuers have reported weaker financial performance since acquisition of these securities, in management s opinion, they continue to possess acceptable credit risk. We monitor the actual default rates and interest deferrals for possible losses and contractual shortfalls of interest or principal, which could warrant further recognition of impairment.

Our total investment in trust preferred securities, corporate obligations, common equity securities, and mutual funds totaled $11.2 million as of December 31, 2011 compared to $12.4 million as of December 31, 2010.

Our AFS securities portfolio composition was as follows as of December 31:

(dollars in thousands)	2011	2010	2009	2008	2007
Mortgage-backed securities	$ 1,959	$ 2,325	$ 11,742	$ 22,248	$ 18,079
Trust preferred securities	10,268	10,464	13,338	12,866	19,034
U.S. government agency notes	8,518	12,071			
U.S. Treasury securities	1,004	1,001	1,003	1,003	1,017
Obligations of state and municipal subdivisions					2,975
Corporate obligations		1,010	930	2,548	1,915
Equity securities - banks	151	197	162	251	478
Equity securities - mutual funds	782	758	750		
Foreign government bonds			350	750	1,500
	$ 22,682	$ 27,826	$ 28,275	$ 39,666	$ 44,998

The amortized cost, estimated fair values, and weighted average yields of debt securities at December 31, 2011, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations. Equity securities are excluded as they have no stated maturity.

		Unrealized			
(dollars in thousands)	Amortized Cost	Gains	Losses	Estimated Fair Value	Weighted-Average Yield
Mortgage-backed securities:					
Due after ten years	$ 1,834	$ 125	$	$ 1,959	4.73%
Trust preferred securities:					
Due one to five years	502	16		518	8.00%
Due five to ten years	1,023		73	950	8.00%
Due after ten years	11,895	87	3,182	8,800	5.72%
U.S. government agency notes:					
Due within one year	5,507	8		5,515	0.95%
Due one to five years	3,000	3		3,003	1.00%
U.S. Treasury securities:					
Due within one year	1,004			1,004	4.75%
	$ 24,765	$ 239	$ 3,255	$ 21,749	4.11%

Weighted yields are based on amortized cost. Mortgage-backed securities are assigned to maturity categories based on their final maturity.

LHFS

We originate residential mortgage loans for sale on the secondary market. At December 31, 2011 and 2010, such LHFS amounted to $183.0 million and $140.3 million, respectively.

When we sell mortgage loans we make certain representations to the purchaser related to loan ownership, loan compliance and legality, and accurate documentation, among other things. If a loan is found to be out of compliance with any of the representations subsequent to the date of purchase, we may be required to repurchase the loan or indemnify the purchaser for losses related to the loan, depending on the agreement with the purchaser. In addition other factors may cause us to be required to repurchase or make-whole a loan previously sold.

Prior to January 1, 2008, we used investor contracts that required us to repurchase and make-whole requests on loans sold prior to that date. We experienced losses on loans closed prior to 2008 due to borrower loan payment default. After January 1, 2008, we revised our contract and terms process to include the elimination of early payment default as a risk factor in the majority of our investor contracts and resulting loan sales. The most common reasons for a loan repurchase for loans sold since January 1, 2008 is due to a documentation error, a disagreement with an investor, or on rare occasions for fraud. Repurchase requests are negotiated with each investor at the time we are notified of the demand and an appropriate reserve is taken at that time. Repurchase and or make-whole requests are initially negotiated by the secondary marketing department and monitored by the secondary marketing committee where most disagreements are resolved with no reserve requirement or loss to the Company. In the event there is an unresolved repurchase or make-whole request, the loan is managed by the secondary marketing committee and is elevated to be monitored by the mortgage overview committee to determine the final settlement terms with the investor. Repurchases amounted to $517,000 and $1.2 million during 2011 and 2010, respectively. Our reserve for potential repurchases was $660,000 and $127,000 as of December 31, 2011 and 2010, respectively. These reserves were calculated based upon an analysis of the specific loans in question. We do not foresee increases in repurchases to be a growing trend nor do we see it having a significant impact on our financial results.

Prior to August 2010, we recorded LHFS at LCM. After that date, we recorded LHFS at fair value as we selected the fair value option for accounting purposes. The initial change in 2010 resulted in increased mortgage-banking revenue of $2.2 million.

Loans

Our loan portfolio is expected to produce higher yields than investment securities and other interest-earning assets; the absolute volume and mix of loans and the volume and mix of loans as a percentage of total earning assets is an important determinant of our net interest margin.

Approximately 86% of our loans receivable are to customers located in the state of Maryland. Loans are extended only after evaluation by management of customers creditworthiness and other relevant factors on a case-by-case basis. For residential mortgage loans, we generally follow Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), FHA, VA, or other secondary marketing standard underwriting guidelines. Conventional mortgage loans with an LTV ratio greater than 80% generally require mortgage insurance. Loans underwritten to FHA or VA guidelines generally have LTV s greater than 95% and have Mortgage Insurance Guarantees from the U.S. Government. For all other loans with real estate collateral, we generally do not lend more than 90% of the appraised value of a property at origination. In addition, we generally obtain personal guarantees of repayment from our borrowers and/or others for commercial (including commercial mortgage) and construction (both commercial and consumer) loans and disburse the proceeds of construction and similar loans only as work progresses on the related projects.

We consider our residential lending to generally involve less risk than other forms of lending, although our payment experience on these loans is dependent, to some extent, on economic and market conditions in our primary lending area. In 2011 and 2010, loss levels on residential mortgage loans were significant due to the declines in residential real estate values and higher defaults experienced in this portfolio. Commercial (including commercial mortgage) and construction (both commercial and consumer) loan repayments are generally dependent on the operations of the related properties or the financial condition of the borrower or guarantor. Accordingly, repayment of such loans can be more susceptible to adverse conditions in the real estate market and the regional economy. We experienced significant losses in both 2011 and 2010 in these loan segments as well.

The following table sets forth the composition of our loan portfolio as of December 31:

(dollars in thousands)	**2011**	**Percent of Total**	**2010**	**Percent of Total**	**2009**	**Percent of Total**
Commercial	$ 52,842	7.5%	$ 78,801	9.7%	$ 77,634	8.7%
Commercial mortgage	326,530	46.5%	349,411	43.1%	339,794	38.1%
Commercial construction	54,349	7.8%	58,764	7.2%	99,490	11.2%
Consumer construction	16,280	2.3%	30,792	3.8%	47,379	5.3%
Residential mortgage	121,119	17.3%	144,209	17.8%	176,159	19.8%
Consumer	130,631	18.6%	149,710	18.4%	150,495	16.9%
Total loans	$ 701,751	100.0%	$ 811,687	100.0%	$ 890,951	100.0%

(dollars in thousands)	**2008**	**Percent of Total**	**2007**	**Percent of Total**
Commercial	$ 91,111	9.3%	$ 72,590	8.5%
Commercial mortgage	319,143	32.6%	279,578	32.7%
Commercial construction	109,484	11.2%	129,272	15.1%
Consumer construction	69,589	7.1%	86,621	10.1%
Residential mortgage	138,323	14.1%	84,892	10.0%
Consumer	251,046	25.7%	201,967	23.6%
Total loans	$ 978,696	100.0%	$ 854,920	100.0%

Total loans decreased $109.9 million during 2011. We experienced lower balances in all loan segments. During 2011, we were less aggressive in our loan origination activity, as we focused on improving asset quality and controlling our growth of assets to improve our capital ratios.

Approximately 42.5% of our loans have adjustable rates as of both December 31, 2011 and 2010, including adjustable rate first mortgage loans indexed to either U.S. Treasury obligations or LIBOR and variable home equity lines of credit tied to the Prime interest rate. Our variable rate loans adjust to the current interest rate environment, whereas fixed rates do not allow this flexibility. If interest rates were to increase in the future, our interest earned on the variable rate loans would improve, and if rates were to fall, the interest we earn on such loans would decline, thus impacting our interest income. Some variable rate loans have rate floors and/or ceilings which may delay and/or limit changes in interest income in a period of changing rates. See our discussion in Interest Rate Sensitivity later in this Item for more information on interest rate fluctuations.

The following table sets forth the maturity distribution for our loan portfolio at December 31, 2011. Some of our loans may be renewed or repaid prior to maturity. Therefore, the following table should not be used as a forecast of our future cash collections.

	Maturing						
	In one year or less		After 1 through 5 years		After 5 years		
(dollars in thousands)	**Fixed**	**Variable**	**Fixed**	**Variable**	**Fixed**	**Variable**	**Total**
Commercial	$ 15,970	$ 8,517	$ 23,572	$ 4,265	$ 8	$ 510	$ 52,842
Commercial mortgage	87,369	28,291	143,995	29,443	20,970	16,462	326,530
Commercial construction	21,163	18,254	6,330	3,363	38	5,201	54,349
Consumer construction	14,745		757		778		16,280
Residential mortgage	533	1,577	2,990	7,819	24,833	83,367	121,119
Consumer	3,886	18,668	7,931	56,047	27,964	16,135	130,631
Total loans	$ 143,666	$ 75,307	$ 185,575	$ 100,937	$ 74,591	$ 121,675	$ 701,751

Commercial Construction Portfolio

Our commercial construction portfolio consists of construction and development loans for commercial purposes and includes loans made to builders and developers of residential real estate projects. Of the total included above as of December 31, 2011, $22.2 million represents loans made to borrowers for the development of residential real estate. This segment of the portfolio has exhibited greater weakness (relative to our other loan portfolios) during 2011 and 2010 due to overall weakness in the residential housing sector.

The breakdown of the portion of the commercial construction portfolio made to borrowers for residential real estate is as follows as of December 31:

(dollars in thousands)	**2011**	**2010**
Raw residential land	$ 5,931	$ 6,617
Residential subdivisions	4,171	5,653
Single residential lots	3,005	3,589
Single family construction	3,351	4,949
Townhome construction	209	912
Multi-family unit construction	5,561	6,135
	$ 22,228	$ 27,855

Transferred Loans

In accordance with the FASB guidance on accounting for certain mortgage-banking activities, any loans which are originally originated for sale into the secondary market and which we subsequently transfer into the Company s loan portfolio are valued at fair value at the time of the transfer with any decline in value recorded as a charge to operating expense. We maintained $13.2 million in first-lien mortgage loans and $566,000 in second-lien mortgage loans that were transferred from LHFS to our residential mortgage and consumer loan portfolios, respectively, at December 31, 2011. We maintained $24.8 million in transferred first-lien mortgage loans and $1.2 million in transferred second-lien mortgage loans at December 31, 2010.

Credit Risk Management

Credit risk is the risk of loss arising from the inability of a borrower to meet its obligations and entails both general risks, which are inherent in the process of lending, and risks specific to individual borrowers. Our credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry, or collateral type.

We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

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. Our allowance methodology employs management s assessment as to the level of future losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and/or lines of business. In determining our ability to collect certain loans, we also consider the fair value of any underlying collateral. In addition, we evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

For purposes of determining the allowance for loan losses, we have segmented our loan portfolio by product type. Our 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. As of December 31, 2011, we divided consumer loans into two classes, (1) home equity and second mortgage loans and (2) other consumer loans. For each class of loan, significant judgment is exercised to determine the estimation method that fits the credit risk characteristics of its portfolio segment. We use internally developed models in this process. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the allowance are independently validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

To establish the allowance for loan losses, which we do on a quarterly basis, 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, which gives us the most current and relevant charge-off data. The result of that calculation for each loan class is then applied to the current loan portfolio balances to determine the required allowance for loan loss level per loan class. We then apply additional loss multipliers to the different classes of loans to reflect various environmental factors. This amount is considered our unallocated reserve. These factors capture any changes in economic trends, portfolio composition, real estate trends, as well as other factors and are meant to supplement the required reserves. For individually evaluated loans (impaired loans), we do additional analyses to determine the impairment amount (see below for more detail on these calculations). In general, this impairment amount is included as an allocated portion of the allowance for loan losses for TDRs 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.

See our charge-off policies under Critical Accounting Policies Allowance for loan losses above.

See information on partial charge-offs later in this section.

Commercial

Credit risk in commercial lending, which includes commercial, commercial mortgage, commercial construction, and consumer construction loans, can vary significantly, as losses as a percentage of outstanding loans can shift widely during economic cycles and are particularly sensitive to changing economic conditions.

The risks associated with each portfolio class are as follows:

Commercial and Commercial Mortgage - The primary loan-specific risks in commercial and commercial mortgage loans are: deterioration of the business and/or collateral values; deterioration of the financial condition of the borrowers and/or guarantors, which creates a risk of default; and the risk that real estate collateral values determined through appraisals are not reflective of the true property values.

Portfolio risk includes the condition of the economy, potentially changing demand for these types of loans, and volume and geographic concentrations of these types of loans.

Commercial Construction   loan-specific and portfolio risks related to commercial construction loans also carry the loan-specific and portfolio risks of commercial and commercial mortgage loans as described above. Additional loan-specific risks include project budget overruns and performance variables related to the contractor and subcontractors. An additional loan-specific risk for commercial construction of residential developments is the risk that the builder has a geographical concentration of developments.

Consumer Construction   loan-specific and portfolio risks related to consumer construction loans to builders and to ultimate homeowners carry the same risks as commercial construction loans as described above.

In general, improving economic conditions result in improved operating results on the part of commercial customers, enhancing their ability to meet debt service requirements. However, any improvements in operating cash flows can be offset by the impact of rising interest rates that could occur during improved economic times. Declining economic conditions may have an adverse affect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

Our commercial loans are generally reviewed individually, in accordance with FASB guidance on accounting for loan impairment, to determine impairment, accrual status, and the need for allocated reserves. We use creditworthiness categories to grade commercial loans. Our internal grading system is based on experiences with similarly graded loans and incorporates a variety of risk considerations, both qualitative and quantitative (see definitions of our various grades and the composition of our loan portfolio within those grades in Note 6 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K). Quantitative factors include collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are evaluated in connection with the unallocated portion of our allowance for loan losses. We periodically engage outside firms and experts to independently assess our methodology and perform various loan review functions.

Consumer

Our consumer portfolio includes first- and second-lien mortgage loans and other loans to individuals. The risks associated with each portfolio class are as follows:

Residential Mortgage, Home Equities, and 2^{nd} Mortgages The primary loan-specific risks related to residential mortgage, home equity, and 2^{nd} mortgage lending include: unemployment; deterioration in real estate values; our ability to assess the creditworthiness of the customer; deterioration in the borrowers financial condition, whether the result of personal issues or a general economic downturn; and the risk that property values determined through appraisals are not reflective of the true property values. The portfolio risks for these types of loans are the same as for commercial and commercial mortgages as described above.

Other Consumer - The primary loan-specific risks of consumer loans are: unemployment; deterioration of the borrower s financial condition, whether the result of personal issues or a general economic downturn; and for certain consumer loans such as auto loans and boat loans, there is also a risk of deterioration in the value of the collateral. The portfolio risks for these types of loans are the same as for commercial and commercial mortgages as described above.

Generally, consumer loans are segregated into homogeneous pools with similar risk characteristics. We do not individually grade residential mortgage or consumer loans. Such loans are classified as performing or nonperforming. Trends such as delinquency and loss and current economic conditions in consumer loan pools are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for the different consumer portfolios are consistent with those for the commercial portfolios.

Unallocated

The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the required portion of the allowance and is based upon management s evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes, loan concentrations by class and geography and any changes in such concentrations, specific industry conditions within portfolio categories, duration of the current business cycle, bank regulatory examination results, and management s judgment with respect to various other conditions including changes in management, including credit, loan administration, and origination staff, changes in underwriting standards, lending policies, and procedures, the impact of any new or modified lines of business, level and trends in nonaccrual and delinquent loans and charge-offs, changes in underlying collateral for collateral dependent loans, and management and the quality of risk identification systems. Executive management reviews these conditions quarterly. Economic factors are an important consideration in determining the adequacy of the loan loss reserve. A strong regional and national economy will reduce the probability of losses. Weaker regional and national economies will usually result in higher unemployment, higher vacancies in commercial real estate, and declining values on both commercial and residential properties, which will gradually increase the probability of losses. Key measures of economic strength or weakness are unemployment levels, interest rates, and economic growth and confidence.

In calculating the range of unallocated reserves to be included in our allowance calculation, we apply a range of basis points to the respective portfolios for environmental factors. The bottom range would be zero. The top range consists of the following basis points for the respective portfolios at December 31:

	2011					
	Commercial	**Commercial Mortgage**	**Commercial Construction**	**Consumer Construction**	**Residential Mortgage**	**Consumer**
Concentration of credit and changes in level of concentration		5	5	8	10	
Nature and volume of portfolio		25	25	4	4	
Trends of past due and classified loans	1	9	9	8	8	
Economic factors	24	24	24	9	9	43
Value of underlying collateral for collateral dependent loans		21	21	21	21	5
	25	84	84	50	52	48

	2010					
	Commercial	**Commercial Mortgage**	**Commercial Construction**	**Consumer Construction**	**Residential Mortgage**	**Consumer**
Concentration of credit and changes in level of concentration		5	5	8	10	
Nature and volume of portfolio		25	25	4	4	
Trends of past due and classified loans	1	10	10	10	10	
Economic factors	25	25	25	6	6	40
Value of underlying collateral for collateral dependent loans		15	15	15	15	
	26	80	80	43	45	40

Each of the above factors is evaluated quarterly. The factors applied to commercial mortgage and commercial and consumer construction loans were increased in 2011 primarily due to a trend of decreasing appraised values. The factors applied to residential mortgage and consumer loans were increased in 2011 as a result of increased unemployment rates, the general economic downturn, and the trend of decreasing appraisal values.

We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may inherently exist within the loan portfolio. The assessments aspects involved in analyzing the quality of individual loans and assessing collateral values can also contribute to undetected, but probable, losses.

See additional detail on our allowance methodology and risk rating system in Note 6 to the Consolidated Financial Statements in Item 8 of Part II of this Annual Report on Form 10-K.

The following table summarizes the activities in our allowance for loan losses by portfolio segment for the years ended December 31:

(dollars in thousands)	**2011**	**2010**	**2009**	**2008**	**2007**
Allowance for loan losses, beginning of year	$ 14,115	$ 11,639	$ 16,777	$ 12,789	$ 12,399
Charge-offs:					
Commercial	(5,484)	(1,979)	(517)		(67)
Commercial mortgage	(3,335)	(1,395)	(871)	(630)	(495)
Commercial construction	(730)	(4,252)	(2,370)	(401)	(1,481)
Consumer construction	(43)	(804)	(1,493)	(331)	
Residential mortgage	(2,720)	(3,757)	(4,546)	(4,658)	(1,038)
Consumer (1)	(2,868)	(3,787)	(2,650)	(5,446)	(5,908)
Total charge-offs	(15,180)	(15,974)	(12,447)	(11,466)	(8,989)
Recoveries:					
Commercial				13	
Commercial mortgage	173		4	3	
Commercial construction	27	7			
Consumer construction					
Residential mortgage	39	104	46	9	43
Consumer (2)	297	549	231	367	421
Total recoveries	536	660	281	392	464
Net charge-offs	(14,644)	(15,314)	(12,166)	(11,074)	(8,525)
Allowance for acquired loans (3)				279	
Provision for loan losses - Bank	14,330	17,790	11,660	10,856	6,700
Provision for loan losses - Mariner Finance				3,927	2,215
Mariner Finance allowance for loan losses			(4,632)		
Allowance for loan losses, end of year	$ 13,801	$ 14,115	$ 11,639	$ 16,777	$ 12,789
Loans (net of premiums and discounts):					
Year-end balance	$ 701,751	$ 811,687	$ 890,951	$ 978,696	$ 854,920
Average balance during year	753,299	852,987	889,345	821,699	781,843
Allowance as a percentage of year-end loan balance	1.97%	1.74%	1.31%	1.71%	1.50%
Percent of average loans:					
Provision for loan losses (4)	1.90%	2.09%	1.31%	1.32%	0.86%
Net charge-offs	1.94%	1.80%	1.37%	1.35%	1.09%

(1) For 2008 and 2007, includes charge-offs of $3.4 million and $2.2 million, respectively, related to Mariner Finance consumer loans. 2011, 2010, and 2009 do not include any activity from the discontinued operations of Mariner Finance.

(2) For 2008 and 2007, includes recoveries of $298,000 and $387,000, respectively, related to Mariner Finance consumer loans. 2011, 2010, and 2009 do not include any activity from the discontinued operations of Mariner Finance.

(3) Allowance acquired by Mariner Finance in a transaction with Loans, USA.

(4) For 2008 and 2007, includes only the provision related to the Bank.

The following table summarizes our allocation of allowance by loan segment as of December 31:

(dollars in thousands)	2011 Amount	2011 Percent of Total	2011 Percent of Loans to Total Loans	2010 Amount	2010 Percent of Total	2010 Percent of Loans to Total Loans	2009 Amount	2009 Percent of Total	2009 Percent of Loans to Total Loans
Commercial	$ 2,768	20.1%	7.5%	$ 291	2.1%	9.7%	$ 817	7.0%	8.7%
Commercial mortgage	2,011	14.6%	46.5%	2,542	18.0%	43.1%	3,336	28.7%	38.1%
Commercial construction	1,809	13.1%	7.8%	2,053	14.5%	7.2%	1,647	14.1%	11.2%
Consumer construction	156	1.1%	2.3%	817	5.8%	3.8%	293	2.5%	5.3%
Residential mortgage	2,711	19.6%	17.3%	3,032	21.5%	17.8%	2,062	17.7%	19.8%
Consumer	2,632	19.1%	18.6%	2,417	17.1%	18.4%	882	7.6%	16.9%
Unallocated	1,714	12.4%		2,963	21.0%		2,602	22.4%	
Total	$ 13,801	100.0%	100.0%	$ 14,115	100.0%	100.0%	$ 11,639	100.0%	100.0%

(dollars in thousands)	2008 Amount	2008 Percent of Total	2008 Percent of Loans to Total Loans	2007 Amount	2007 Percent of Total	2007 Percent of Loans to Total Loans
Commercial	$ 824	4.9%	9.3%	$ 606	4.7%	8.5%
Commercial mortgage	2,985	17.8%	32.6%	2,316	18.1%	32.7%
Commercial construction	2,702	16.1%	11.2%	1,456	11.4%	15.1%
Consumer construction	583	3.5%	7.1%	719	5.6%	10.1%
Residential mortgage	1,576	9.4%	14.1%	1,542	12.1%	10.0%
Consumer	4,683	27.9%	25.7%	4,021	31.4%	23.6%
Unallocated	3,424	20.4%		2,129	16.7%	
Total	$ 16,777	100.0%	100.0%	$ 12,789	100.0%	100.0%

Based upon management s evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The allowance for loan losses totaled $13.8 million and $14.1 million as of December 31, 2011 and December 31, 2010, respectively. Any changes in the allowance from period to period reflect management s ongoing application of its methodologies to establish the allowance, which, in 2011, included increases in the allowance for commercial and consumer loans. Decreases in the allowance allocated to the other loan segments are a reflection of charge-offs and decreases in the corresponding loan balances. Recent economic conditions have had a broad impact on our loan portfolio as a whole. While the Mid-Atlantic region may be not be as adversely affected by the current economic conditions as other markets in the nation, we are experiencing a negative impact from the economic pressures on our borrowers.

The provision for loan losses recognized to maintain the allowance was $14.3 million for 2011 compared to $17.8 million for 2010. Our allowance as a percentage of outstanding loans has increased from 1.74% as of December 31, 2010 to 1.97% as of December 31, 2011. We recorded net charge-offs of $14.6 million during 2011 compared to net charge-offs of $15.3 million during 2010. Net charge-offs as compared to average loans outstanding increased to 1.94% for 2011 compared to 1.80% for 2010. We recorded a significant amount of charge offs as a result of our policy to charge off all fair value deficiencies instead of carrying an allocated reserve (except with respect to nonaccrual TDRs). Partial charge-offs of nonaccrual loans decrease the amount of nonperforming and impaired loans, as well as any allocated allowance attributable to that loan. They decrease our allowance for loan losses, as well as our allowance for loan losses to nonperforming loans ratio and our allowance for loan losses to total loans ratio. Partial charge-offs increase our net charge-offs to average loans

ratio. Total partial charge-offs of nonaccrual loans for 2011 and 2010 amounted to $7.2 million and $6.4 million, respectively. The total amount of nonaccrual loans (prior to charge offs) for which we recorded partial charge-offs for 2011 and 2010 amounted to $44.9 million and $32.0 million, respectively.

In addition to the significant amount of charge-offs, transfers to real estate acquired through foreclosure continued to be significant during 2011.

Although management uses available information to establish the appropriate level of the allowance for loan losses, future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses and related methodology. Such agencies may require us to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Management believes the allowance for loan losses is adequate as of December 31, 2011. Our total allowance at December 31, 2011 is considered by management to be sufficient to address the credit losses inherent in the current loan portfolio. We based this determination on several factors:

- We maintain appropriate oversight committees to track deteriorating credits thereby timely identifying potential problems and noting when current appraisals are due;
- In accordance with FASB guidance, we individually analyze all NPAs and all credits risk rated 8 or above for impairment. We immediately charge-off any deficiencies in collateral value that is identified in the impairment analysis (thus, placing all NPAs and risk-ratings (RR) of RR8 at fair value) (see additional detail related to risk ratings in Note 6 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form-10-K);
- We calculate our required reserves based upon a rolling 24 month average of actual charge-offs, thereby utilizing current trend data of actual losses. These calculated loss percentages are then applied to our current loan balance by loan segment to determine the required reserves;
- We apply environmental factors to calculate an unallocated reserve range. This unallocated reserve is meant to cover any negative economic and business trends that may develop; and
- The combination of the calculated required reserve plus the range of the unallocated reserve results in a total range to our allowance for loan losses. Our allowance for loan losses has been within the estimated ranges.

Our determination of the appropriate allowance level is based upon a number of assumptions we make about future events, which we believe are reasonable, but which may or may not prove valid. Thus, there can be no assurance that our charge-offs in future periods will not exceed our allowance for loan losses or that we will not need to make additional increases in our allowance for loan losses.

Nonperforming Assets

For smaller loans, we place loans in nonaccrual status when they are contractually past due 90 days as to either principal or interest, unless the loan is well secured and in the process of collection, or earlier, when, in the opinion of management, the collection of principal and interest is in doubt. For larger loans and other individually identified loans, management applies FASB guidance on impaired loan accounting to determine accrual status. Under that guidance, when it is probable that we will be unable to collect all payments due, including interest, we place the loan in nonaccrual status. A loan remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. Specifically, in order for a nonaccrual loan to be returned to accrual status, a borrower must make six consecutive monthly payments and the borrower must demonstrate the ability to keep the loan current going forward.

Given the volatility of the real estate market, it is very important for us to have current appraisals on our NPAs. Generally, we annually obtain appraisals on NPAs. Previously, for residential and consumer nonperforming loans below $500,000, an alternative valuation method (AVM) may have been used in lieu of an appraisal. AVMs were obtained from an unrelated independent third party company. The third party valuation utilized a comparative sales based methodology analysis. It also had the ability to handle geographic anomalies, and advanced algorithms which, when coupled with access to multiple data sources, returned accurate and reliable valuation results. The turnaround time for these AVMs was generally within a few minutes of our request. As such, the use of AVMs in no way adversely impacted our overall valuation process, nor did it negatively affect the amount or timing of any provisions or charge-offs. In fact, the quick turnaround time of these AVMs helped identify potential losses immediately. There could be circumstances where we might utilize AVMs, along with additional corroborating procedures, again in the future.

As part of our asset monitoring activities, we maintain a Workout Committee that meets three times per month. During these Workout Committee meetings, all NPAs and loan delinquencies are reviewed. We also produce a nonperforming asset report which is distributed weekly to senior management and is also discussed and reviewed at the Workout Committee meetings. This report contains all relevant data on the NPAs, including the latest appraised value and valuation date. Accordingly, these reports identify which assets will require an updated appraisal. As a result, we have not experienced any internal delays in identifying which loans/credits require appraisals. With respect to the ordering process of the appraisals, we have not experienced any delays in turnaround time nor has this been an issue over the past three years. Furthermore, we have not had any delays in turnaround time or variances thereof in our specific operating markets, which are predominantly the Baltimore metropolitan area and surrounding counties and portions of northern Virginia.

As a result of our ongoing review of the loan portfolio, we may classify loans as nonaccrual even though the presence of collateral or the borrower s financial strength may be sufficient to provide for ultimate repayment. In general, loans are charged off when a loan or a portion thereof is considered uncollectible. We determine that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date. Interest and fees continue to accrue on past due loans until the date the loan goes in nonaccrual status.

NPAs, expressed as a percentage of total assets, totaled 5.25% at December 31, 2011 and 5.48% at December 31, 2010. The ratio of allowance for loan losses to nonperforming loans was 37.6% at December 31, 2011 and 27.9% at December 31, 2010. The increase in this ratio from 2010 to 2011 was primarily a reflection of the decrease in the amount required for the allowance for loan losses. Part of the decrease in nonperforming loans was due to full and partial charge-offs of nonperforming loans that existed at December 31, 2010. We record a significant amount of charge offs as it is our policy to charge off all fair value deficiencies instead of carrying an allocated reserve (except with respect to nonaccrual TDRs).

The distribution of our NPAs and loans greater than 90 days past due and accruing is illustrated in the following table at December 31:

(dollars in thousands)	**2011**	**2010**	**2009**	**2008**	**2007**
Nonaccruing loans:					
Commercial	$ 4,566	$ 1,501	$ 535	$ 603	$
Commercial mortgage	16,955	26,991	9,773	4,134	3,926
Commercial construction	5,949	7,987	10,992	14,544	5,268
Consumer construction	718	1,257	3,815	8,222	3,362
Residential mortgage	7,585	11,877	9,333	8,115	10,026
Consumer	905	946	1,351	3,145	1,807
	36,678	50,559	35,799	38,763	24,389
Real estate acquired through foreclosure:					
Commercial	83				
Commercial mortgage	10,555	3,317	4,112	2,080	1,101
Commercial construction	6,174	7,094	9,347	4,909	3,601
Consumer construction	2,768	3,553	4,203	2,826	2,299
Residential mortgage	5,655	7,154	2,098	9,079	11,980
Consumer		67	1,870	100	
	25,235	21,185	21,630	18,994	18,981
Total nonperforming assets	$ 61,913	$ 71,744	$ 57,429	$ 57,757	$ 43,370
Loans past-due 90 days or more and accruing:					
Commercial	$ 30	$	$ 499	$	$ 92
Commercial mortgage	1,272	1,952	3,886	1,634	663
Commercial construction	2,032	250		210	
Consumer construction	238			1,587	219
Residential mortgage	2,500	776	4,651	3,258	1,825
Consumer	244		188	2,990	220
	$ 6,316	$ 2,978	$ 9,224	$ 9,679	$ 3,019

For information on nonaccruing TDRs, see table under TDRs later in this section.

Nonaccrual loans decreased $13.9 million from December 31, 2010 to $36.7 million at December 31, 2011. The commercial loan nonaccrual balance consisted of 13 loans, with the largest balance amounting to $1.0 million. Nine of the commercial loans in nonaccrual status as of December 31, 2011 in the amount of $4.1 million were placed in nonaccrual status during 2011. All of the remaining nonaccrual commercial loans were in nonaccrual status as of December 31, 2010. Of the $1.5 million in nonaccrual commercial loans as of December 31, 2010, one loan for $548,000 was transferred to real estate acquired through foreclosure, $134,000 were charged off, one loan in the amount of $162,000 was paid off, and one loan in the amount of $162,000 was returned to accrual status during 2011.

The commercial mortgage loan nonaccrual balance consisted of 33 loans, with the largest balance amounting to $3.3 million. Of the $17.0 million commercial mortgage balance in nonaccrual status as of December 31, 2011, 20 loans totaling $8.9 million were placed on nonaccrual status during 2011. All of the remaining nonaccrual commercial mortgage loans were in nonaccrual status as of December 31, 2010. Of the balance at December 31, 2010, $9.1 million in commercial mortgage loans were transferred to real estate acquired through foreclosure during 2011, $3.4 million were charged off, $3.3 million were paid off, and $2.2 million were returned to accrual status.

The commercial construction nonaccrual balance consisted of eight loans, with the largest balance amounting to $3.9 million. We placed four commercial construction nonaccrual loans totaling $713,000 in nonaccrual status in 2011. All of the remaining nonaccrual commercial construction loans were in nonaccrual status as of December 31, 2010. Of the $8.0 million in commercial construction loans in nonaccrual status as of December 31, 2010, $924,000 were charged off, $903,000 were paid off, and $323,000 were transferred to real estate acquired through foreclosure during 2011.

The consumer construction nonaccrual balance consisted of five loans in the amount of $718,000, all of which were placed in nonaccrual status during 2011. Of the $1.3 million in consumer construction loans in nonaccrual status at December 31, 2010, we transferred two loans totaling $315,000 to real estate acquired through foreclosure, charged off one loan totaling $24,000, and returned one loan in the amount of $918,000 to accrual status.

The residential mortgage nonaccrual balance consisted of 31 loans, with the largest balance amounting to $791,000. We placed $3.1 million of these loans in nonaccrual status during 2011. Of the $11.9 million balance of nonaccrual residential mortgage loans at December 31, 2010, we transferred $5.1 million to real estate acquired through foreclosure, received a pay off on five loans for $990,000, returned $837,000 to accrual status, and charged off $526,000.

The consumer loan nonaccrual balance consisted of seven loans, five of which were placed in nonaccrual status during 2011. These loans are well secured and we have determined that they do not require charge-off as of December 31, 2011.

The interest which would have been recorded on nonaccrual loans if those loans had been performing in accordance with their contractual terms was approximately $2.2 million, $3.6 million, and $4.6 million in 2011, 2010, and 2009, respectively. The actual interest income recorded on those loans in 2011, 2010, and 2009 was approximately $827,000, $1.6 million, and $1.2 million, respectively.

Real estate acquired through foreclosure increased $4.1 million when compared to December 31, 2010, with increases in the commercial and commercial mortgage loan segments. We transferred approximately $7.7 million in commercial mortgage loans to real estate acquired through foreclosure during 2011. The entire balance of commercial loans acquired through foreclosure was transferred during 2011. The net decreases in the remaining loan segments were due to resolution of the properties through foreclosure sales or buyouts.

Loans 90 days delinquent and accruing, which are loans that are well secured and in the process of collection, increased from $3.0 million at December 31, 2010 to $6.3 million as of December 31, 2011. The commercial, commercial construction, and consumer construction loan totals each consist of one loan. The commercial mortgage loan total of $1.3 million consists of four loans, with the largest amounting to $730,000, the residential mortgage loan total of $2.5 million consisted of fifteen loans, with the largest amounting to $2.0 million, and the consumer loan total consists of one home equity loan, one second mortgage loan, and three other consumer loans.

Not all of the loans newly classified as nonaccrual since December 31, 2010 required impairment reserves, as some of the loans collateral had estimated fair values greater than the carrying amount of the loan or the loan has been written down to its estimated fair value. Additionally, in general, we charge-off all impairment amounts immediately for all loans that are not TDRs.

TDRs

In situations where, for economic or legal reasons related to a borrower s financial difficulties, management may grant a concession for other than an insignificant period of time or amount to the borrower that would not otherwise be considered, the related loan is classified as a TDR. Such concessions could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. These loans are excluded from pooled loss forecasts and a separate reserve is provided under the accounting guidance for loan impairment. At the time that a loan is modified, management evaluates any possible impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. Any impairment amount is then charged to the allowance.

The composition of our TDRs is illustrated in the following table at December 31:

(dollars in thousands)	2011	2010	2009	2008	2007
Commercial:					
Nonaccrual	$ 22	$	$	$	$
90 days or more and accruing	$	$	$	$	$
< 90 days past due/current	$ 400	$	$ 2,850	$	$
	422		2,850		
Commercial mortgage:					
Nonaccrual	907	1,490	810		
90 days or more and accruing					
< 90 days past due/current	9,389	2,856	799	1,469	1,484
	10,296	4,346	1,609	1,469	1,484
Commercial construction:					
Nonaccrual	103	353	203		
90 days or more and accruing					
< 90 days past due/current	5,118	5,287	4,876		
	5,221	5,640	5,079		
Consumer construction:					
Nonaccrual					
90 days or more and accruing					
< 90 days past due/current					
Residential mortgage:					
Nonaccrual	1,473		1,197	2,361	
90 days or more and accruing	2,164	450	638	1,519	
< 90 days past due/current	8,271	12,697	3,885	7,881	
	11,908	13,147	5,720	11,761	
Consumer:					
Nonaccrual		923			
90 days or more and accruing					
< 90 days past due/current		121			
		1,044			
Totals:					
Nonaccrual	$ 2,505	$ 2,766	$ 2,210	$ 2,361	$
90 days or more and accruing	$ 2,164	$ 450	$ 638	$ 1,519	$
< 90 days past due/current	$ 23,178	$ 20,961	$ 12,410	$ 9,350	$ 1,484
	$ 27,847	$ 24,177	$ 15,258	$ 13,230	$ 1,484

The interest income which would have been recorded on TDRs if those loans had been handled in accordance with their contractual terms was approximately $1.2 million in 2011, $2.1 million in 2010, and $865,000 in 2009 and the actual interest income recorded on these loans in 2011, 2010, and 2009 was approximately $713,000, $915,000, and $661,000, respectively.

The following table shows the breakdown of loans modified during the years ended December 31:

	2011			2010		
(dollars in thousands)	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
Commercial	4	$ 699	$ 424		$	$
Commercial mortgage	10	7,821	7,821	3	3,087	3,247
Commercial construction				6	5,177	5,177
Residential mortgage	1	566	579	17	11,027	11,066
Home equity and 2nd mortgage				10	1,148	1,148
	15	$ 9,086	$ 8,824	36	$ 20,439	$ 20,638

	2009		
(dollars in thousands)	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
Commercial	3	$ 3,135	$ 3,135
Commercial mortgage	5	2,777	2,777
Commercial construction	2	5,079	5,079
Residential mortgage	17	4,500	4,473
	27	$ 15,491	$ 15,464

Impaired Loans

The following tables show the breakout of impaired loans by class at December 31:

	2011					
(dollars in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**	**Charge-Offs**
With no related allowance:						
Commercial	$ 4,804	$ 4,804	$	$ 2,719	$ 155	$ 5,484
Commercial mortgage	$ 21,039	$ 21,039	$	$ 20,966	$ 483	$ 3,207
Commercial construction	$ 11,066	$ 11,066	$	$ 12,114	$ 67	$ 730
Consumer construction	$ 718	$ 718	$	$ 842	$ 32	$ 43
Residential mortgage	$ 8,723	$ 8,723	$	$ 10,066	$ 260	$ 1,780
Home equity & 2nd mortgage	$ 905	$ 905	$	$ 913	$ 18	$ 2,868
Other consumer	$	$	$	$ 134	$	$
With a related allowance:						
Commercial	157	161	4	63	2	
Commercial mortgage	5,249	5,306	57	4,150	73	128
Commercial construction				266		
Consumer construction				112		
Residential mortgage	9,075	9,297	222	11,526	378	940
Home equity & 2nd mortgage				14		
Other consumer						
Totals:						
Commercial	$ 4,961	$ 4,965	$ 4	$ 2,782	$ 157	$ 5,484
Commercial mortgage	$ 26,288	$ 26,345	$ 57	$ 25,116	$ 556	$ 3,335
Commercial construction	$ 11,066	$ 11,066	$	$ 12,380	$ 67	$ 730
Consumer construction	$ 718	$ 718	$	$ 954	$ 32	$ 43
Residential mortgage	$ 17,798	$ 18,020	$ 222	$ 21,592	$ 638	$ 2,720
Home equity & 2nd mortgage	$ 905	$ 905	$	$ 927	$ 18	$ 2,868
Consumer	$	$	$	$ 134	$	$

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

Residential mortgage	12,661	13,147	486	5,339	695	
Home equity & 2nd mortgage				2,065		
Other consumer				1		
Total:						
Commercial	$ 1,501	$ 1,501	$	$ 2,069	$ 40	$ 1,979
Commercial mortgage	$ 29,760	$ 29,848	$ 88	$ 20,301	$ 884	$ 1,395
Commercial construction	$ 13,259	$ 13,273	$ 14	$ 13,214	$ 328	$ 4,252
Consumer construction	$ 1,257	$ 1,257	$	$ 2,200	$ 35	$ 804
Residential mortgage	$ 24,538	$ 25,024	$ 486	$ 17,312	$ 1,076	$ 3,757
Home equity & 2nd mortgage	$ 1,067	$ 1,067	$	$ 3,450	$ 15	$ 3,787
Consumer	$	$ 70	$	$ 14	$	$

Not all of the loans newly classified as impaired since December 31, 2010 required impairment reserves, as some of the loans collateral had estimated fair values greater than the carrying amount of the loan or the loan has been written down to its estimated fair value. Additionally, in general, we charge-off all impairment amounts immediately for all loans that are not TDRs.

Deposits

We use deposits as the primary source of funding of our loans. We offer individuals and businesses a wide variety of deposit accounts. These accounts include checking (NOW), savings, money market, and certificates of deposit (time deposits) and are obtained primarily from communities we serve.

Deposits totaled $1.0 billion at December 31, 2011, decreasing $107.1 million, or 9.5%, from the December 31, 2010 level. We experienced significant decreases in time, NOW, and money market deposits. The decrease in time deposits was primarily rate driven, with a significant amount of the decrease incurred in our nonbrokered national time deposit campaign, which is a program where the Bank utilizes several nonbrokered rate listing services to provide incremental funding as needed. We pay an annual subscription fee for the privilege of posting rates on their websites. The subscription-based services allow the Bank to place or receive funds from other subscribers. Requests to invest are placed through the listing website and the account is funded by wire. At the present time, only financial institutions are allowed to place funds with the Bank.

We experienced additional decreases in time deposits and in other deposit types as customers moved funds out of lower-yielding deposit types into higher-yielding deposit types or out of the Bank in search of better-yielding products.

The following table details the average amount and the average rate paid for each category of deposits as of December 31:

	2011		2010		2009	
(dollars in thousands)	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**	**Average Balance**	**Average Rate**
NOW	$ 6,182	0.27%	$ 7,405	0.63%	$ 6,784	0.65%
Savings	57,450	0.19%	56,271	0.27%	55,122	0.32%
Money market	127,584	0.56%	140,067	0.62%	163,910	0.84%
Time	743,309	1.99%	823,248	2.40%	713,855	3.26%
Total interest-bearing deposits	934,525	1.68%	1,026,991	2.03%	939,671	2.65%
Noninterest-bearing demand deposits	103,201		107,119		116,508	
Total deposits	$ 1,037,726	1.51%	$ 1,134,110	1.84%	$ 1,056,179	2.35%

The following table provides the maturities of certificates of deposit in amounts of $100,000 or more at December 31:

(dollars in thousands)	2011	2010
Maturing in:		
3 months or less	$ 62,239	$ 51,724
Over 3 months through 6 months	61,249	64,772
Over 6 months through 12 months	188,436	128,941
Over 12 months	151,942	232,271
	$ 463,866	$ 477,708

Core deposits represent deposits which we believe will not be affected by changes in interest rates and, therefore, will be retained regardless of the movement of interest rates. We consider our core deposits to be all noninterest-bearing, NOW, money market s less than $100,000, and saving deposits, as well as all time deposits less than $100,000 that mature in greater than one year. At December 31, 2011 and 2010, our core deposits were $361.2 million and $413.3 million, respectively. The remainder of our deposits could be susceptible to attrition due to interest rate movements.

Borrowings

Our borrowings consist of short-term promissory notes issued to certain qualified investors, short-term and long-term advances from the FHLB, and a mortgage loan at December 31, 2011 and 2010. Our short-term promissory notes are in the form of commercial paper, which reprice daily and have maturities of 270 days or less. Our advances from the FHLB may be in the form of short-term or long-term obligations. Short-term advances have maturities for one year or less and may contain prepayment penalties. Long-term borrowings through the FHLB have original maturities up to 15 years and generally contain prepayment penalties.

The FHLB advances are available under a specific collateral pledge and security agreement, which requires that we maintain collateral for all of our borrowings equal to 125% of advances. We may pledge as collateral specific first- and second-lien mortgage loans or commercial mortgages up to 10% of the Bank s total assets. Long-term FHLB advances are fixed-rate instruments with various call provisions. Generally, short-term advances are in the form of overnight borrowings with rates changing daily. At December 31, 2011, our total available credit line with the FHLB was $139.8 million. Our outstanding FHLB advance balance at December 31, 2011 and 2010 was $111.0 million and $107.0 million, respectively.

The Bank has been notified by the FRB that it is a secondary credit facility. All future borrowings must be approved by the discount committee of the FRB.

Long-term borrowings, which totaled $73.7 million and $33.9 million at December 31, 2011 and 2010, respectively, consist of long-term advances from the FHLB and a mortgage loan on our former headquarters building. We held $65.0 million and $25.0 million in long-term FHLB advances at December 31, 2011 and 2010, respectively. As of December 31, 2011 and 2010, the balance on the mortgage loan was $8.7 million and $8.9 million, respectively.

Short-term borrowings consist of short-term promissory notes and short-term advances from the FHLB. These borrowings decreased from $84.4 million at December 31, 2010 to $48.0 million at December 31, 2011. We held $46.0 million and $82.0 million in short-term FHLB advances at December 31, 2011 and 2010, respectively.

In the past, to further our funding and capital needs, we raised capital by issuing Trust Preferred Securities through the Trusts, which are wholly-owned by First Mariner Bancorp. The Trusts used the proceeds from the sales of the Trust Preferred Securities, combined with First Mariner Bancorp s equity investment in these Trusts, to purchase subordinated deferrable interest debentures from First Mariner Bancorp. The debentures are the sole assets of the Trusts. Aggregate debentures outstanding as of both December 31, 2011 and 2010 totaled $52.1 million.

The Trust Preferred Securities are mandatorily redeemable, in whole or in part, upon repayment of their underlying subordinated debentures at their respective maturities or their earlier redemption. The subordinated debentures are redeemable prior to maturity at First Mariner s option on or after its optional redemption dates. In 2009, we elected to defer interest payments on the debentures. This deferral is permitted by the terms of the debentures and does not constitute an event of default thereunder. Interest on the debentures and dividends on the related Trust Preferred Securities continue to accrue and will have to be paid in full prior to the expiration of the deferral period. The total deferral period may not exceed 20 consecutive quarters and expires with the last quarter of 2013.

First Mariner Bancorp has fully and unconditionally guaranteed all of the obligations of the Trusts.

Under applicable regulatory guidelines, a portion of the Trust Preferred Securities may qualify as Tier I capital, and the remaining portion may qualify as Tier II capital, with certain limitations. At December 31, 2011, none of our outstanding Trust Preferred Securities qualify as either Tier I or Tier II capital due to limitations.

During 2010, we executed Exchange agreements (the Exchanges) with our former Chairman and CEO, Edwin F. Hale, Sr. and with an unaffiliated third party. The agreements exchanged trust preferred securities for shares of common stock and warrants of the Company. Upon completion of the Exchanges, the Company canceled the trust preferred securities and the related accrued interest on the securities in exchange for the common stock and warrants, eliminating the long term debt. The transaction with the unaffiliated third party resulted in a gain of $571,000, net of taxes of $387,000.

See Notes 9 and 10 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K for further details about our borrowings.

Capital Resources

Stockholders equity decreased $29.2 million in 2011 to a deficit of $(25.4) million from $3.7 million as of December 31, 2010.

Common stock and additional paid-in-capital increased by $495,000 due to the issuance, net of costs, of common stock to directors and certain employees as part of their compensation as well as the change in the value of the outstanding warrants. We did not repurchase any common stock during 2011, nor was any stock issued through the employee stock purchase plan. Accumulated other comprehensive loss, which is derived from the fair value calculations for securities AFS, decreased by $591,000. Retained deficit increased by the net loss of $30.2 million for 2011.

Banking regulatory authorities have implemented strict capital guidelines directly related to the credit risk associated with an institution s assets. Banks and bank holding companies are required to maintain capital levels based on their risk adjusted assets so that categories of assets with higher defined credit risks will require more capital support than assets with lower risk. Additionally, capital must be maintained to support certain off-balance sheet instruments.

Capital is classified as Tier I capital (common stockholders equity less certain intangible assets plus a portion of the Trust Preferred Securities, subject to certain limitations) and Total Capital (Tier I plus the allowed portion of the allowance for loan losses plus any off-balance sheet reserves and the allowable portion of Trust Preferred Securities not included in Tier I capital, subject to certain limitations). Minimum required levels must at least equal 4% for Tier I capital and 8% for Total Capital. In addition, institutions must maintain a minimum 4% leverage capital ratio.

We regularly monitor the Company s capital adequacy ratios to assure that the Bank meets its regulatory capital requirements. The regulatory capital ratios are shown below at December 31:

	2011	**2010**	**2009**	**Minimum Requirements for Capital Adequacy Purposes**	**To be Well Capitalized Under Prompt Corrective Action Provision**
Regulatory capital ratios:					
Leverage:					
Consolidated	(1.9)%	0.7%	1.4%	4.0%	5.0%
Bank	3.0%	4.7%	6.2%	4.0%	5.0%
Tier 1 capital to risk-weighted assets:					
Consolidated	(2.6)%	1.0%	1.8%	4.0%	6.0%
Bank	4.2%	6.8%	7.9%	4.0%	6.0%
Total capital to risk-weighted assets:					
Consolidated	(2.6)%	2.1%	3.6%	8.0%	10.0%
Bank	5.5%	8.0%	9.1%	8.0%	10.0%

On September 18, 2009, the Bank entered into the September Order with the FDIC and the Commissioner, 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 leverage capital ratio of at least 7.5% and a total risk-based capital ratio of at least 11% by June 30, 2010. We did not meet the requirements at June 30, 2010, December 31, 2010, or December 31, 2011. 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 has adopted and submitted a liquidity plan 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, or pay effective yields on deposits that are greater than those generally paid in its markets.

First Mariner Bancorp is also a party to the FRB Agreements, which, 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 leverage, 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 December 31, 2011, those capital ratios were (1.9)%, (2.6)%, and (2.6)%, 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.

See information related to two Exchange Agreements under Borrowings above. Also, see information regarding the Securities Purchase Agreement included in Recent Developments at the beginning of this section.

Liquidity

Liquidity describes our ability to meet financial obligations, including lending commitments and contingencies, which arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of our customers, as well as to meet current and planned expenditures. These cash requirements are met on a daily basis through the inflow of deposit funds, the maintenance of short-term overnight investments, maturities and calls in our securities portfolio, and available lines of credit with the FHLB, which requires pledged collateral. Fluctuations in deposit and short-term borrowing balances may be influenced by the interest rates paid, general consumer confidence, and the overall economic environment. There can be no assurances that deposit withdrawals and loan fundings will not exceed all available sources of liquidity on a short-term basis. Such a situation would have an adverse effect on our ability to originate new loans and maintain reasonable loan and deposit interest rates, which would negatively impact earnings.

The borrowing requirements of customers include commitments to extend credit and the unused portion of lines of credit (collectively commitments), which totaled $242.0 million at December 31, 2011. Historically, many of the commitments expire without being fully drawn; therefore, the total commitment amounts do not necessarily represent future cash requirements. Commitments for real estate development and construction, which totaled $17.5 million, are generally short-term in nature, satisfying cash requirements with principal repayments as construction properties financed are generally repaid with permanent financing. Available credit lines represent the unused portion of credit previously extended and available to the customer as long as there is no violation of material contractual conditions. Commitments to extend credit for residential mortgage loans of $138.1 million at December 31, 2011 generally expire within 60 days. Commercial commitments to extend credit and unused lines of credit of $15.3 million at December 31, 2011 generally do not extend for more than 12 months. Consumer commitments to extend credit and unused lines of credit of $11.3 million at December 31, 2011 are generally open ended. At December 31, 2011, available home equity lines totaled $59.8 million. Home equity credit lines generally extend for a period of 10 years.

Capital expenditures for various branch locations and equipment can be a significant use of liquidity. As of December 31, 2011, we plan on expending approximately $1.6 million on our premises and equipment over the next 12 months.

Customer withdrawals are also a principal use of liquidity, but are generally mitigated by growth in customer funding sources, such as deposits and short-term borrowings. Such balances may fluctuate up and down in any given period.

The Bank s liquidity is represented by its cash and cash equivalents (which are cash on hand or amounts due from financial institutions, federal funds sold, money market mutual funds, and interest bearing deposits) and AFS securities, the sources of which are deposit accounts and borrowings. The level of liquidity is 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 $148.8 million at December 31, 2011, 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 $183.0 million at December 31, 2011, 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. Our loan to deposit ratio stood at 69.2% at December 31, 2011 and 72.4% at December 31, 2010.

We also have the ability to utilize established credit lines with the FHLB and the FRB as additional sources of liquidity. To utilize the vast majority of our credit lines, we must pledge certain loans and/or securities before advances can be obtained.

We are not permitted to purchase brokered deposits without first obtaining a regulatory waiver. We are also required to comply with restrictions on deposit rates that we may offer. These factors could significantly affect our ability to fund normal operations. Our ability to acquire deposits or borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole as the recent turmoil faced by banking organizations in the domestic and worldwide credit markets deteriorates. At December 31, 2011, management considered the Bank s liquidity level to be sufficient for the purposes of meeting the Bank s cash flow requirements.

First Mariner Bancorp is a separate entity and apart from First Mariner Bank and must provide for its own liquidity. In addition to its operating expenses, First Mariner Bancorp is responsible for the payment of any dividends that may be declared for its shareholders and interest and principal on outstanding debt. A significant amount of First Mariner Bancorp s revenues are obtained from subsidiary service fees and dividends. Payment of such dividends to First Mariner Bancorp by First Mariner Bank is limited under Maryland law (see Supervision and Regulation in Item 1 of Part I above in this Annual Report on Form 10-K). As noted earlier, First Mariner and its bank subsidiary have entered into agreements with the FRB, FDIC, and the Commissioner that, among other things, require First Mariner and its bank subsidiary to obtain the prior approval of its regulators before paying a dividend or otherwise making a distribution on its stock. In addition, First Mariner elected to defer regularly scheduled quarterly interest payments on its junior subordinated debentures issued in connection with its Trust Preferred Securities offerings. First Mariner is prohibited from paying any dividends or making any other distribution on its common stock for so long as interest payments are being deferred.

We are not aware of any undisclosed known trends, demands, commitments, or uncertainties that are reasonably likely to result in material changes in our liquidity.

Interest Rate Sensitivity

Interest rate sensitivity is an important factor in the management of the composition and maturity configurations of our earning assets and our funding sources. The primary objective of our asset/liability management is to ensure the steady growth of our primary earnings component, net interest income. Our net interest income can fluctuate with significant interest rate movements. We may attempt to structure the statement of financial condition so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. However, imbalances in these repricing opportunities at any point in time may be appropriate to mitigate risks from fee income subject to interest rate risk, such as mortgage-banking activities.

The measurement of our interest rate sensitivity, or gap, is one of the techniques used in asset/liability management. Interest sensitive gap is the dollar difference between our assets and liabilities which are subject to interest rate pricing within a given time period, including both floating rate or adjustable rate instruments and instruments which are approaching maturity. More assets repricing or maturing than liabilities over a given time period is considered asset-sensitive and is reflected as a positive gap, and more liabilities repricing or maturing than assets over a given time period is considered liability-sensitive and is reflected as negative gap. An asset-sensitive position (i.e., a positive gap) will generally enhance earnings in a rising interest rate environment and will negatively impact earnings in a falling interest rate environment, while a liability-sensitive position (i.e., a negative gap) will generally enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable.

Our management and our board of directors oversee the asset/liability management function and meet periodically to monitor and manage the statement of financial condition, control interest rate exposure, and evaluate pricing strategies. We evaluate the asset mix of the statement of financial condition continually in terms of several variables: yield, credit quality, funding sources, and liquidity. Our management of the liability mix of the statement of financial condition focuses on expanding our various funding sources and promotion of deposit products with desirable repricing or maturity characteristics.

In theory, we can diminish interest rate risk through maintaining a nominal level of interest rate sensitivity. In practice, this is made difficult by a number of factors including cyclical variation in loan demand, different impacts on our interest-sensitive assets and liabilities when interest rates change, and the availability of our funding sources. Accordingly, we strive to manage the interest rate sensitivity gap by adjusting the maturity of and establishing rates on the earning asset portfolio and certain interest-bearing liabilities commensurate with our expectations relative to market interest rates. Additionally, we may employ the use of off-balance sheet instruments, such as interest rate swaps or caps, to manage our exposure to interest rate movements. Generally, we attempt to maintain a balance between rate-sensitive assets and liabilities that is appropriate to minimize our overall interest rate risk, not just our net interest margin.

Our interest rate sensitivity position as of December 31, 2011 is presented in the following table. Our assets and liabilities are scheduled based on maturity or repricing data except for mortgage loans and mortgage-backed securities that are based on prevailing prepayment assumptions and core deposits which are based on core deposit studies done for banks in the Mid-Atlantic region. These assumptions are validated periodically by management. The difference between our rate-sensitive assets and rate-sensitive liabilities, or the interest rate sensitivity gap, is shown at the bottom of the table. As of December 31, 2011, we had a one-year cumulative negative gap of $23.0 million compared to a one-year cumulative positive gap of $50.2 million at December 31, 2010.

(dollars in thousands)	**180 days or less**	**181 days-one year**	**One-five years**	**> 5 years or non-sensitive**	**Total**
Interest-earning assets:					
Interest-bearing deposits	$ 44,585	$	$	$	$ 44,585
Securities AFS	21,453	2,251	5,022	(6,044)	22,682
Restricted stock investments	7,085				7,085
LHFS	182,992				182,992
Loans	393,041	64,928	208,642	35,140	701,751
Total interest-earning assets	$ 649,156	$ 67,179	$ 213,664	$ 29,096	$ 959,095
Interest-bearing liabilities:					
NOW	$ 534	$ 699	$ 5,592	$ 2,563	$ 9,388
Savings	5,159	4,332	34,656	10,830	54,977
Money market	85,566	2,856	22,844	10,472	121,738
Certificates of deposit	316,500	223,641	188,213		728,354
Borrowings and junior subordinated debentures	84,049	16,000	40,000	33,698	173,747
Total interest-bearing liabilities	$ 491,808	$ 247,528	$ 291,305	$ 57,563	$ 1,088,204
Interest rate sensitive gap position:					
Period	$ 157,348	$ (180,349)	$ (77,641)	$ (28,467)	
% of assets	13.35%	(15.30)%	(6.59)%	(2.41)%	
Cumulative	$ 157,348	$ (23,001)	$ (100,642)	$ (129,109)	
% of assets	13.35%	(1.95)%	(8.54)%	(10.95)%	
Cumulative risk sensitive assets to risk sensitive liabilities	131.99%	96.89%	90.24%	88.14%	

While we monitor interest rate sensitivity gap reports, we primarily test our interest rate sensitivity through the deployment of simulation analysis. We use earnings simulation models to estimate what effect specific interest rate changes would have on our net interest income and net income. Simulation analysis provides us with a more rigorous and dynamic measure of interest sensitivity. Changes in prepayments have been included where changes in behavior patterns are assumed to be significant to the simulation, particularly mortgage related assets. Call features on certain securities and borrowings are based on their call probability in view of the projected rate change, and pricing features such as interest rate floors are incorporated. Our fee income produced by mortgage-banking operations may also be impacted by changes in rates. As long-term rates increase, the volume of fixed-rate mortgage loans originated for sale in the secondary market may decline and reduce our revenues generated by this line of business. We attempt to structure our asset and liability management strategies to mitigate the impact on net interest income by changes in market interest rates. However, there can be no assurance that we will be able to manage interest rate risk so as to avoid significant adverse effects on net interest income. At December 31, 2011, the simulation model provided the following profile of our interest rate risk measured over a one-year time horizon, assuming a parallel shift in a yield curve based off the U.S. dollar forward swap curve adjusted for certain pricing assumptions:

	Immediate Rate Change	
	+200BP	-200BP
Net interest income	0.97%	(4.27)%

Both of the above tools used to assess interest rate risk have strengths and weaknesses. Because the gap analysis reflects a static position at a single point in time, it is limited in quantifying the total impact of market rate changes which do not affect all earning assets and interest-bearing liabilities equally or simultaneously. In addition, gap reports depict the existing structure, excluding exposure arising from new business. While the simulation process is a powerful tool in analyzing interest rate sensitivity, many of the assumptions used in the process are highly qualitative and subjective, and are subject to the risk that past historical activity may not generate accurate predictions of the future. The model also assumes parallel movements in interest rates, which means both short-term and long-term rates will change equally. Nonparallel changes in interest rates (short-term rates changing differently from long-term rates) could result in significant differences in projected income amounts when compared to parallel tests. Both measurement tools taken together, however, provide an effective evaluation of our exposure to changes in interest rates, enabling management to better control the volatility of earnings.

We are party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed (locked) by both us and the borrower for specified periods of time. When the borrower locks an interest rate, we effectively extend a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but we must honor the interest rate for the specified time period. We are exposed to interest rate risk during the accumulation of IRLCs and loans prior to sale. We utilize forward sales commitments to economically hedge the changes in fair value of the loan due to changes in market interest rates.

Off-Balance Sheet Arrangements

We enter into off-balance sheet arrangements in the normal course of business. These arrangements consist primarily of commitments to extend credit, lines of credit, and letters of credit. In addition, the Company has certain operating lease obligations.

Credit Commitments

Credit commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Our exposure to credit loss in the event of nonperformance by the borrower is the contract amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. We are not aware of any accounting loss we would incur by funding our commitments.

See detailed information on credit commitments above under Liquidity.

Contractual Obligations

First Mariner has certain obligations to make future payments under contract. At December 31, 2011, the aggregate contractual obligations and commitments are:

	Payments Due by Period				
(dollars in thousands)	Total	Less than one year	Over 1-3 Years	Over 3-5 years	After 5 years
Certificates of deposit	$ 728,354	$ 465,450	$ 227,121	$ 35,783	$
Borrowings and junior subordinated debentures	173,747	47,981	40,000		85,766
Annual rental commitments under noncancelable leases	23,286	4,374	8,176	6,314	4,422
	$ 925,387	$ 517,805	$ 275,297	$ 42,097	$ 90,188

Derivatives

We maintain and account for derivatives, in the form of IRLCs and forward sales commitments, in accordance with FASB guidance on accounting for derivative instruments and hedging activities. We recognize gains and losses on IRLCs and forward sales commitments on the loan pipeline through mortgage-banking revenue in the Consolidated Statements of Operations.

The Bank, through First Mariner Mortgage, enters into IRLCs, under which we originate residential mortgage loans with interest rates determined prior to funding. IRLCs on mortgage loans that we intend to sell in the secondary market are considered derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 14 days to 60 days. For these IRLCs, we protect the Company from changes in interest rates through the use of forward sales of to be issued (TBA) mortgage-backed securities.

We are exposed to price risk from the time a mortgage loan closes until the time the loan is sold. To manage this risk, we also utilize forward sales of TBA mortgage-backed securities. During the period of the rate lock commitment and from the time a loan is closed with the borrowers and sold to investors, we remain exposed to basis (execution, timing, and/or volatility) risk in that the changes in value of our hedges may not equal or completely offset the changes in value of the rate commitments being hedged. This can result due to changes in the market demand for our mortgage loans brought about by supply and demand considerations and perceptions about credit risk relative to the agency securities. We also mitigate counterparty risk by entering into commitments with proven counterparties and pre-approved financial intermediaries.

The market value of IRLCs is not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Bank determines the fair value of IRLCs by measuring the change in the value of the underlying asset, while taking into consideration the probability that the IRLCs will close.

Information pertaining to the carrying amounts of our derivative financial instruments follows as of December 31:

	2011		2010	
(dollars in thousands)	**Notional Amount**	**Estimated Fair Value**	**Notional Amount**	**Estimated Fair Value**
IRLCs	$ 138,075	$ 139,899	$ 71,228	$ 71,753
Forward contracts to sell mortgage-backed securities	102,250	101,772	125,500	127,424

Changes in interest rates could materially affect the fair value of the IRLCs or the forward commitments. In the case of the loan related derivatives, fair value is also impacted by the probability that the rate lock commitment will close (fallout factor). In addition, changes in interest rates could result in changes in the fallout factor, which might magnify or counteract the sensitivities. This is because the impact of an interest rate shift on the fallout ratio is nonsymmetrical and nonlinear.

Impact of Inflation and Changing Prices

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with GAAP and practices within the banking industry, which generally require the measurement of financial condition and operating results in terms of historical dollars, without considering the changes in the relative purchasing power of money over time due to inflation. As a financial institution, virtually all of our assets and liabilities are monetary in nature and interest rates have a more significant impact on our performance than the effects of general levels of inflation. A prolonged period of inflation could cause interest rates, wages, and other costs to increase and could adversely affect our results of operations unless mitigated by increases in our revenues correspondingly. However, we believe that the impact of inflation on our operations was not material for 2011 or 2010.

Recent Accounting Pronouncements

See Note 24 to our Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K for discussion of recent accounting pronouncements.

Financial Review 2010/2009

We recorded a net loss of $46.6 million for 2010 compared to a net loss of $22.3 million for 2009, with diluted losses per share totaling $3.15 for 2010 compared to diluted losses per share of $3.45 in 2009.

Our results for 2010 were significantly impacted by persistent negative trends in the real estate markets. We experienced significant charge-offs in real estate loans in 2010 as a substantial amount of these loans were moved to real estate acquired through foreclosure. In addition, as declines in real estate values continued in 2010, we recorded $8.4 million in additional write-downs, losses on, and expenses related to real estate acquired through foreclosure in 2010. We provided for additional loan loss reserves throughout 2010 for the anticipated loss exposure caused by the depressed real estate market. The provision for loan losses in 2010 was $17.8 million compared to $11.7 million in 2009. The increase of $6.1 million in the provision for loan losses reflects needed increases in the allowance for loan losses primarily as a result of weaknesses in the commercial construction, consumer construction, residential mortgage, and consumer loan portfolios and the need to replenish charge-offs of loans within the commercial and commercial mortgage portfolios. In addition to these losses, earnings were further impacted by the loss of interest income on loans placed on nonaccrual status and the cost of carrying foreclosed properties.

Our largest category of revenue, net interest income, increased $2.7 million, or 10.1%, in 2010 compared to 2009, primarily due to lower rates paid on average interest-bearing liabilities. Noninterest income decreased $79,000. We experienced decreases in most major noninterest income categories with the exception of mortgage-banking income, which increased $838,000, and income from BOLI, which increased $38,000. We recognized a $958,000 gain on a debt exchange transaction in 2010 and experienced reduced levels of net OTTI charges in 2010 ($1.2 million) compared to 2009 ($2.9 million). See discussion of the exchange transaction under Borrowings above.

Total expenses decreased primarily from cost-cutting measures taken in 2010. The full effect of these cost-cutting measures were partially offset by increases in costs of real estate acquired through foreclosure and FDIC insurance premiums.

We recorded a loss from the discontinued operations of Mariner Finance of $200,000 in 2010 compared to $9.1 million in 2009. We recorded income tax expense from continuing operations of $19.1 million in 2010, which was the result of the establishment of the valuation allowance on our deferred tax assets. During 2009, we recorded an income benefit from continuing operations of $10.9 million.

The return on average assets was (3.43)% for 2010 compared to (1.69)% for 2009. The return on average equity for 2010 was (119.97)% compared to (53.81)% for 2009. Average equity to average assets was 2.86% for 2010 compared to 3.15% for 2009. The decrease in the return on average assets reflected the continuing effect of NPAs and loan charge-offs. All 2010 performance indicators were significantly affected by the losses.

Our total assets decreased by $74.9 million or 5.4% during 2010, primarily a result of decreased net loans and the establishment of the valuation allowance against our deferred tax assets. Earning assets decreased $32.0 million or 3.0%. Deposits decreased by $24.6 million from December 31, 2009 to December 31, 2010. Stockholders equity decreased $23.2 million or 86.1%, reflecting the 2010 loss, partially offset by the completion of a stock offering and the exchanges of common stock and warrants for certain trust preferred securities in 2010. See discussion under Borrowings earlier in this Item for more information on the exchange transactions.

Our asset quality showed some deterioration at December 31, 2010 compared to 2009. At December 31, 2010, our allowance for loan losses amounted to $14.1 million, which totaled 19.7% of NPAs as of December 31, 2010, compared to 20.3% as of December 31, 2009. Our level of NPAs increased to 5.5% of total assets at December 31, 2010 from 4.2% of total assets at December 31, 2009. Our level of loan delinquencies showed some signs of improvement as our loans 90 days delinquent and still accruing interest decreased to $3.0 million from $9.2 million in 2009. Our ratio of net charge-offs to average total loans was 1.8% in 2010 compared to 1.4% in 2009.

Bank capital adequacy levels (as defined by banking regulation) deteriorated from 2009 to 2010; however, the Bank was still considered adequately capitalized at December 31, 2010. The ratios for the Bank as of December 31, 2010 for leverage, Tier 1 capital to risk-weighted assets, and total capital to risk-weighted assets were 4.7%, 6.8%, and 8.0%, respectively, compared to 6.2%, 7.9%, and 9.1%, respectively, at December 31, 2009. Our regulatory capital levels increased due primarily to the sale of Mariner Finance, which provided First Mariner with the ability to infuse additional capital into the Bank.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For a discussion of interest rate risk, see Item 7 of Part II of this Annual Report on Form 10-K under the heading Interest Rate Sensitivity.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
First Mariner Bancorp
Baltimore, Maryland

We have audited the accompanying consolidated statements of financial condition of First Mariner Bancorp and Subsidiaries (the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders (deficit) equity, and cash flows for each of the years in the three-year period ended December 31, 2011. The Company s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of their internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company continued to incur significant net losses in 2011, primarily from loan losses and costs associated with real estate acquired through foreclosure. The Company has insufficient capital per regulatory guidelines and has failed to reach capital levels required in the Cease and Desist Order issued by the Federal Deposit Insurance Corporation in September 2009. These matters raise doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are described in Note 2 of the consolidated financial statements. The 2011 consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Stegman & Company

Baltimore, Maryland
March 30, 2012

FIRST MARINER BANCORP AND SUBSIDIARIES
Consolidated Statements of Financial Condition

	December 31, 2011	December 31, 2010
	(dollars in thousands)	
ASSETS		
Cash and due from banks	$ 104,204	$ 169,557
Federal funds sold and interest-bearing deposits	44,585	48,404
Securities available for sale (AFS), at fair value	22,682	27,826
Loans held for sale (LHFS), at fair value	182,992	140,343
Loans receivable	701,751	811,687
Allowance for loan losses	(13,801)	(14,115)
Loans, net	687,950	797,572
Real estate acquired through foreclosure	25,235	21,185
Restricted stock investments	7,085	7,095
Premises and equipment, net	38,278	41,068
Accrued interest receivable	4,025	3,844
Bank-owned life insurance (BOLI)	37,478	36,188
Prepaid expenses and other assets	24,503	16,555
Total assets	$ 1,179,017	$ 1,309,637
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 100,303	$ 103,450
Interest-bearing	914,457	1,018,439
Total deposits	1,014,760	1,121,889
Short-term borrowings	47,981	84,399
Long-term borrowings	73,698	33,888
Junior subordinated deferrable interest debentures	52,068	52,068
Accrued expenses and other liabilities ($18 and $137 at fair value, respectively)	15,922	13,647
Total liabilities	1,204,429	1,305,891
Stockholders (deficit) equity:		
Common stock, $.05 par value; 75,000,000 shares authorized; 18,860,482 and 18,050,117 shares issued and outstanding at December 31, 2011 and 2010, respectively	939	902
Additional paid-in capital	80,125	79,667
Retained deficit	(103,454)	(73,210)
Accumulated other comprehensive loss	(3,022)	(3,613)
Total stockholders (deficit) equity	(25,412)	3,746
Total liabilities and stockholders (deficit) equity	$ 1,179,017	$ 1,309,637

See accompanying notes to Consolidated Financial Statements

FIRST MARINER BANCORP AND SUBSIDIARIES
Consolidated Statements of Operations

	For the Years Ended December 31,		
	2011	2010	2009
	(dollars in thousands, except per share data)		
Interest income:			
Loans	$ 45,502	$ 52,826	$ 56,739
Securities and other earning assets	2,005	2,395	3,071
Total interest income	47,507	55,221	59,810
Interest expense:			
Deposits	15,663	20,826	24,873
Short-term borrowings	266	347	644
Long-term borrowings	3,396	4,210	7,181
Total interest expense	19,325	25,383	32,698
Net interest income	28,182	29,838	27,112
Provision for loan losses	14,330	17,790	11,660
Net interest income after provision for loan losses	13,852	12,048	15,452
Noninterest income:			
Total other-than-temporary impairment (OTTI) charges	(305)	(445)	(3,307)
Less: Portion included in other comprehensive loss (pre-tax)	(533)	(804)	371
Net OTTI charges on AFS securities	(838)	(1,249)	(2,936)
Mortgage-banking revenue	13,595	16,950	16,112
ATM fees	3,046	3,038	3,072
Gain on debt exchange		958	
Service fees on deposits	2,945	3,944	5,261
Gain on financial instruments carried at fair value		1,661	3,038
Gain on sale of AFS securities, net	758	54	420
Gain on disposal of premises and equipment		67	
Commissions on sales of nondeposit investment products	437	496	540
Income from BOLI	1,291	1,415	1,377
Other	2,015	858	1,387
Total noninterest income	23,249	28,192	28,271
Noninterest expense:			
Salaries and employee benefits	23,520	25,205	26,469
Occupancy	8,627	9,245	8,974
Furniture, fixtures, and equipment	1,735	2,334	2,941
Professional services	6,498	3,074	3,866
Advertising	663	633	915
Data processing	1,629	1,795	1,880
ATM servicing expenses	866	866	944
Write-downs, losses, and costs of real estate acquired through foreclosure	7,789	8,366	6,832
Federal Deposit Insurance Corporation (FDIC) insurance premiums	4,285	3,801	3,480
Service and maintenance	2,487	2,317	2,437
Corporate Insurance	1,595	1,230	1,035
Consulting fees	1,592	1,043	1,049

Loan collection expenses		875		785		1,394
Other		5,790		6,804		5,618
Total noninterest expense		67,951		67,498		67,834
Net loss from continuing operations before income taxes and discontinued operations		(30,850)		(27,258)		(24,111)
Income tax (benefit) expense - continuing operations		(606)		19,131		(10,887)
Net loss from continuing operations		(30,244)		(46,389)		(13,224)
Loss from discontinued operations				(200)		(9,060)
Net loss	$	(30,244)	$	(46,589)	$	(22,284)
Net loss per common share from continuing operations:						
Basic	$	(1.62)	$	(3.14)	$	(2.05)
Diluted	$	(1.62)	$	(3.14)	$	(2.05)
Net loss per common share from discontinued operations:						
Basic	$		$	(0.01)	$	(1.40)
Diluted	$		$	(0.01)	$	(1.40)
Net loss per common share:						
Basic	$	(1.62)	$	(3.15)	$	(3.45)
Diluted	$	(1.62)	$	(3.15)	$	(3.45)

See accompanying notes to Consolidated Financial Statements.

FIRST MARINER BANCORP AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders (Deficit) Equity

For the Years Ended December 31, 2011, 2010, and 2009

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained (Deficit) Earnings	Accumulated Other Comprehensive Loss	Total Stockholders (Deficit) Equity	Comprehensive Loss
	(dollars in thousands, except number of shares)						
Balance at January 1, 2009	6,452,631	$ 323	$ 56,741	$ (5,485)	$ (5,564)	$ 46,015	
Cumulative effect of accounting change				1,148	(1,148)		
Net loss				(22,284)		(22,284)	$ (22,284)
Changes in unrealized losses on AFS securities, net of taxes					2,511	2,511	2,511
Deconsolidation of Mariner Finance, LLC (Mariner Finance)					715	715	715
Comprehensive loss							$ (19,058)
Stock-based compensation expense			30			30	
Balance at December 31, 2009	6,452,631	323	56,771	(26,621)	(3,486)	26,987	
Net loss				(46,589)		(46,589)	$ (46,589)
Changes in unrealized losses on AFS securities, net of taxes					(127)	(127)	(127)
Comprehensive loss							$ (46,716)
Common stock issued, net of costs	9,484,998	473	9,861			10,334	
Stock-based compensation expense			29			29	
Warrants issued, net of reduction in value			(137)			(137)	
Debt exchange	1,830,873	92	12,626			12,718	
Stock issued to Directors	281,615	14	517			531	
Balance at December 31, 2010	18,050,117	902	79,667	(73,210)	(3,613)	3,746	
Net loss				(30,244)		(30,244)	$ (30,244)
Changes in unrealized losses on AFS securities, net of taxes					591	591	591
Comprehensive loss							$ (29,653)
Common stock issued, net of costs	810,365	37	334			371	
			5			5	

Stock-based compensation expense						
Change in fair value of warrants			119			119
Balance at December 31, 2011	18,860,482	$ 939	$ 80,125	$ (103,454)	$ (3,022)	$ (25,412)

See accompanying notes to Consolidated Financial Statements

FIRST MARINER BANCORP AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	For the Years Ended December 31,		
	2011	2010	2009
		(dollars in thousands)	
Cash flows from operating activities:			
Net loss	$ (30,244)	$ (46,589)	$ (22,284)
Adjustments to reconcile net loss to net cash from operating activities:			
Loss from discontinued operations		200	9,060
Stock-based compensation	5	29	30
Depreciation and amortization	3,229	3,851	4,632
Amortization (accretion) of unearned loan fees and costs, net	414	289	(54)
Amortization (accretion) of premiums and discounts on mortgage-backed securities, net	30	(20)	(9)
Gain on financial instruments carried at fair value		(1,661)	(3,038)
Origination fees and gain on sale of mortgage loans	(11,810)	(14,105)	(12,169)
Gain on debt exchange		(958)	
Net OTTI charges on AFS securities	838	1,249	2,936
Gain on sale of AFS securities, net	(758)	(54)	(420)
(Increase) decrease in accrued interest receivable	(181)	1,116	137
Provision for loan losses	14,330	17,790	11,660
Write-downs and losses on sale of real estate acquired through foreclosure	6,976	6,333	6,261
Gain on disposal of premises and equipment		(67)	
Increase in cash surrender value of BOLI	(1,291)	(1,415)	(1,377)
Originations of mortgage LHFS	(1,099,114)	(1,349,786)	(1,625,187)
Proceeds from mortgage LHFS	1,066,244	1,346,213	1,560,667
Deferred income taxes	609	28,086	(3,663)
Net increase (decrease) in accrued expenses and other liabilities	2,785	(636)	1,606
Net (increase) decrease in prepaids and other assets	(8,958)	4,397	(11,368)
Net cash used in operating activities	(56,896)	(5,738)	(82,580)
Cash flows from investing activities:			
Loan principal repayments, net of (disbursements)	79,352	43,236	(32,480)
Proceeds from sale of Mariner Finance			8,734
Repurchases of loans previously sold	(517)	(1,208)	(113)
Sales (purchases) of restricted stock investments	10	839	(868)
Purchases of premises and equipment	(448)	(2,208)	(689)
Proceeds from disposals of premises and equipment	9	811	31
Sales of trading securities		10,083	
Maturities/calls/repayments of trading securities		735	2,374
Activity in AFS securities:			
Maturities/calls/repayments	19,310	3,151	7,133
Sales	49,515	8,011	9,279
Purchases	(62,799)	(12,090)	(1,749)
Redemption of bank-owned life insurance			3,040
Additional funds disbursed on real estate acquired through foreclosure	(1,754)		
Proceeds from sales of real estate acquired through foreclosure	8,802	15,733	10,912
Net cash provided investing activities	91,480	67,093	5,604
Cash flows from financing activities:			
Net (decrease) increase in deposits	(107,129)	(24,616)	196,271
Net increase (decrease) in other borrowed funds	3,393	(2,815)	(12,931)
Net (costs of) proceeds from stock issuance	(20)	10,334	

Net cash (used in) provided by financing activities	(103,756)	(17,097)	183,340
(Decrease) increase in cash and cash equivalents	(69,172)	44,258	106,364
Cash and cash equivalents at beginning of period	217,961	173,703	67,339
Cash and cash equivalents at end of period	$ 148,789	$ 217,961	$ 173,703
Supplemental information:			
Interest paid on deposits and borrowed funds	$ 18,024	$ 25,515	$ 30,981
Real estate acquired through foreclosure	$ 18,699	$ 21,622	$ 19,809
Transfers of LHFS to loan portfolio	$ 2,031	$ 8,150	$ 14,808

See accompanying notes to Consolidated Financial Statements

FIRST MARINER BANCORP AND SUBSIDIARIES

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2011, 2010, and 2009

(1) Summary of Significant Accounting Policies

Organization, Basis of Presentation, and Use of Estimates

First Mariner Bancorp (First Mariner, on a parent only basis and we, our, or us on a consolidated basis) is a bank holding company incorporated under the laws of the state of Maryland. First Mariner is headquartered in Baltimore, Maryland, and was originally established as MarylandsBank Corp. in May 1994. MarylandsBank Corp. s name was changed to First Mariner Bancorp in May 1995. First Mariner Bancorp owns 100% of common stock of First Mariner Bank (the Bank) and prior to August 1, 2010, FM Appraisals, LLC (FM Appraisals). On August 1, 2010, FM Appraisals was pushed down as a subsidiary of the Bank. We sold our consumer finance company subsidiary, Mariner Finance, in December, 2009. We retain a 5% interest in the newly formed Mariner Finance entity.

Most of our activities are with customers within the Central Maryland region. A portion of activities related to mortgage lending are more dispersed and cover parts of the Mid-Atlantic region and other regions outside of the state of Maryland. Note 5 describes the types of securities that we invest in and Note 6 discusses our lending activities. We do not have any concentrations to any one industry or customer.

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

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

Cash and Cash Equivalents

We consider all highly liquid securities with original maturities of three months or less to be cash equivalents. For reporting purposes, assets grouped in the Consolidated Statements of Financial Condition under the captions Cash and due from banks and Federal funds sold and interest-bearing deposits are considered cash or cash equivalents. For financial statement purposes, these assets are carried at cost. Federal funds sold and interest-bearing deposits have overnight maturities and are generally in excess of amounts that would be recoverable under FDIC insurance.

Securities

We designate securities into one of three categories at the time of purchase. Debt securities that we have the intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt and equity securities are classified as trading if bought and held principally for the purpose of sale in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as held to maturity and debt and equity securities not classified as trading securities are considered AFS and are reported at estimated fair value, with unrealized gains and losses reported as a separate component of stockholders (deficit) equity, net of tax effects, in accumulated other comprehensive loss.

Securities AFS are evaluated periodically to determine whether a decline in their value is other than temporary. The term other than temporary is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the security.

The initial indications of OTTI for both debt and equity securities are a decline in the market value below the amount recorded for a security and the severity and duration of the decline. In determining whether an impairment is other than temporary, we consider the length of time and the extent to which the market value has been below cost, recent events specific to the issuer, including investment downgrades by rating agencies and economic conditions of its industry, our intent to sell the security, and if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. For marketable equity securities, we also consider the issuer s financial condition, capital strength, and near-term prospects. For debt securities and for perpetual preferred securities that are treated as debt securities for the purpose of OTTI analysis, we also consider the cause of the price decline (general level of interest rates and industry- and issuer-specific factors), the issuer s financial condition, near-term prospects and current ability to make future payments in a timely manner, the issuer s ability to service debt, and any change in agencies ratings at evaluation date from acquisition date and any likely imminent action. Once a decline in value is determined to be other than temporary, the security is segmented into credit- and noncredit-related components. Any impairment adjustment due to identified credit-related components is recorded as an adjustment to current period earnings, while noncredit-related fair value adjustments are recorded through accumulated other comprehensive loss. In situations where we intend to sell or it is more likely than not that we will be required to sell the security, the entire OTTI loss is recognized in earnings.

Gains or losses on the sales of securities are calculated using a specific-identification basis and are determined on a trade-date basis. Premiums and discounts on securities are amortized (accreted) over the term of the security using methods that approximate the interest method. Gains and losses on trading securities are recognized regularly in income as the fair value of those securities changes.

LHFS

Loans originated for sale prior to August 1, 2010 are carried at the lower of aggregate cost or market value (LCM) and subsequent to August 1, 2010, at fair value, as we selected the fair value option for accounting for LHFS. Fair value is determined based on outstanding investor commitments or, in the absence of such commitments, on current investor yield requirements or third party pricing models. Gains and losses on loan sales are determined using the specific-identification method and are recognized through mortgage-banking revenue in the Consolidated Statement of Operations.

Loans Receivable

Our loans receivable are stated at their principal balance outstanding, net of related deferred fees and costs.

Loan income recognition

Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees and certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual loan terms or until the date of sale or disposition. Accrual of interest is discontinued when its receipt is in doubt, which typically occurs when a loan becomes impaired. Any interest accrued to income in the year when interest accruals are discontinued is generally reversed. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the principal balance and accrued interest. Payments on nonaccrual loans are applied to principal. See additional information on loan impairment and nonaccrual status below.

Nonaccrual status

For smaller loans, we place loans in nonaccrual status when they are contractually past due 90 days as to either principal or interest, unless the loan is well secured and in the process of collection, or earlier, when, in the opinion of management, the collection of principal and interest is in doubt. For larger loans and certain mortgage loans, management applies Financial Accounting Standards Board (FASB) guidance on impaired loan accounting to determine accrual status. Under that guidance, when it is probable that we will be unable to collect all payments due, including interest, we place the loan in nonaccrual status. A loan remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. Specifically, in order for a nonaccrual loan to be returned to accrual status, a borrower must make six consecutive monthly payments and the borrower must demonstrate the ability to keep the loan current going forward.

As a result of our ongoing review of the loan portfolio, we may classify loans as nonaccrual even though the presence of collateral or the borrower s financial strength may be sufficient to provide for ultimate repayment. We recognize interest on nonaccrual loans only when it is received. Loans are charged-off when a loan or a portion thereof is considered uncollectible. We determine that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date. Interest and fees continue to accrue on past due loans until the date the loan goes in nonaccrual status.

Loan impairment

We determine a loan to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. In general, impaired loans consist of nonaccrual loans and troubled debt restructures (TDR or TDRs) (see information on TDRs below). We do not consider a loan impaired during a period of delay in payment if we expect to collect all amounts due, including interest past due. Generally we consider a period of delay in payment to include delinquency up to 90 days, but may extend this period if the loan is collateralized by residential or commercial real estate with a low loan-to-value (LTV) ratio, and where collection and repayment efforts are progressing. We evaluate our commercial, commercial mortgage, commercial construction, and consumer construction classes of loans individually for impairment. We evaluate larger groups of smaller-balance homogeneous loans, which include our residential mortgage, home equity and second mortgage, and other consumer classes of loans collectively for impairment.

We identify impaired loans and measure impairment (1) at the present value of expected cash flows discounted at the loan s effective interest rate, (2) at the observable market price, or (3) at the fair value of the collateral if the loan is collateral dependent. If our measure of the impaired loan is less than the recorded investment in the loan, we record a charge-off for the deficiency unless it s a TDR, for which we recognize an impairment loss through an allocated portion of the allowance for loan losses.

When the ultimate collectability of an impaired loan s principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent any interest has been foregone, and then they are recorded as recoveries of any amounts previously charged-off. When this doubt no longer exists, cash receipts are applied under the contractual terms of the loan agreement.

Loan fees and costs

Origination and commitment fees and direct origination costs on loans held for investment generally are deferred and amortized to income over the contractual lives of the related loans using the interest method. Under certain circumstances, commitment fees are recognized over the commitment period or upon expiration of the commitment. Fees to extend loans three months or less are recognized in income upon receipt. Unamortized loan fees are recognized in income when the related loans are sold or prepaid.

Transferred Loans

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

TDRs

We strive to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. In situations where, for economic or legal reasons related to a borrower s financial difficulties, we may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related now-modified loan is classified as a TDR. These modified terms may include rate reductions, principal forgiveness, payment extensions, payment forbearance, and/or other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. These loans are excluded from pooled loss forecasts and a separate reserve is provided under the accounting guidance for loan impairment. At the time that a loan is modified, we evaluate any possible impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. Any impairment amount is then set up as an allocated portion of the allowance.

Loan Servicing

We recognize as assets the rights to service mortgage loans for others (MSRs) based on their estimated fair value at the time of sale of the underlying mortgage loan. We account for MSRs in accordance with FASB guidance on accounting for the servicing of financial assets. Fair value is determined through a review of valuation assumptions that are supported by market and economic data collected from various outside sources.

Amortization of MSRs is recorded based on the cash flows as estimated by future net servicing income, including the write-off of MSRs associated with loans that are paid in full. The projected future cash flows are calculated and updated monthly by applying market-based assumptions. Impairment for MSRs is determined based on the fair value of the rights, stratified by predominate risk characteristics. Any impairment would be recognized through a charge against earnings.

As of December 31, 2011, we no longer held any MSRs as we sold all of our MSRs to Next Generation Financial Services (NGFS) during 2011.

Allowance for Loan Losses

Our allowance for loan losses represents an estimated amount that, in management s judgment, will be adequate to absorb probable incurred losses on existing loans. The allowance for loan losses consists of an allocated component and an unallocated component. We use a disciplined process and methodology to establish the allowance for losses each quarter. To determine the total allowance for loan losses, we estimate the reserves needed for each class of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis. The allowance for loan losses consists of amounts applicable to: (1) the commercial loan portfolio; (2) the commercial mortgage loan portfolio; (3) the construction loan portfolios (both commercial and consumer); (4) the residential mortgage loan portfolio; (5) the home equity and second mortgage loan portfolio; and (6) the other consumer loan portfolio.

To determine the balance of the allowance account, loans are pooled by portfolio class and losses are modeled using historical experience, quantitative analysis, and other mathematical techniques over the loss emergence period. For each class of loan, significant judgment is exercised to determine the estimation method that fits the credit risk characteristics of that portfolio class. We use internally developed models in this process. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the allowance are validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

The establishment of the allowance for loan losses relies on a consistent process that requires multiple layers of management review and judgment and responds timely to changes in economic conditions and other influences. From time to time, events or economic factors may affect the loan portfolio, causing management to provide additional amounts to or release balances from the allowance for loan losses.

We monitor differences between estimated and actual incurred loan losses utilizing charge-off history. Loans deemed uncollectible are charged against, while recoveries are credited to, the allowance. We adjust the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense.

Commercial (including commercial mortgages) and construction loans (including both commercial and consumer) are generally evaluated for impairment when the loan becomes 90 days past due and/or is rated as substandard. The difference between the fair value of the collateral, less estimated selling costs and the carrying value of the loan is charged-off at that time. Residential mortgage loans are generally charged down to their fair value when the loan becomes 120 days past due or is placed in nonaccrual status, whichever is earlier. Consumer loans are generally charged-off when the loan becomes 120 days past due or when it is determined that the amounts due are uncollectible (whichever is earlier). The above charge-off guidelines may not apply if the loan is both well secured and in the process of collection. These charge-off policies have not changed in the last three years.

As an additional portion of the allowance for loan losses, we also estimate probable losses related to unfunded loan commitments. These commitments are subject to individual review and are analyzed for impairment the same as a correspondent loan would be.

Real Estate Acquired Through Foreclosure

We record real estate acquired through foreclosure at the LCM on the acquisition date and at the lower of such initial amount or estimated fair value less estimated selling costs thereafter. Estimated fair value is based upon many subjective factors, including location and condition of the property and current economic conditions, among other things. Because the calculation of fair value relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.

Write-downs at the time of transfer are made through the allowance for loan losses. Write-downs subsequent to transfer are included in our noninterest expenses, along with operating income, net of related expenses of such properties and gains or losses realized upon disposition.

Restricted Stock Investments

The Bank, as a member of the Federal Home Loan Bank System, is required to maintain an investment in capital stock of the Federal Home Loan Bank of Atlanta (FHLB) in varying amounts based on asset size and on amounts borrowed from the FHLB. Because no ready market exists for this stock and it has no quoted market value, the Bank s investment in this stock is carried at cost.

The Bank maintains an investment in capital stock of several bankers banks. Because no ready market exists for these stocks and they have no quoted market values, the Bank s investment in these stocks is carried at cost.

Premises and Equipment

Our premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are accumulated using straight-line and accelerated methods over the estimated useful lives of the assets. Additions and betterments are capitalized and charges for repairs and maintenance are expensed when incurred. The cost and accumulated depreciation or amortization is eliminated from the accounts when an asset is sold or retired and the resultant gain or loss is credited or charged to income. Premises and equipment have estimated useful lives ranging from 3 to 39 years. We capitalize the cost of imputed interest we incur for significant real estate construction and development and charge the amount of capitalized interest to depreciation expense on a straight-line basis over the useful life of the asset. Capitalized interest is computed and capitalized based on the average invested amount in the development project over the construction period at the rate of the Company s incremental borrowing cost for the construction period.

BOLI

BOLI is carried at the aggregate cash surrender value of life insurance policies owned where the Company or its subsidiaries are named beneficiaries. Increases in cash surrender value derived from crediting rates for underlying insurance policies is credited to noninterest income.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Borrowings

Prior to December 31, 2010, we maintained certain of our long-term borrowings at fair value, with corresponding changes in fair values recorded in income. The determination of which borrowings were accounted for using the fair value option was made based upon interest rates and maturities and how those corresponded to the interest rates and maturities of assets accounted for using the fair value option. During 2010, those borrowings were refinanced with short-term borrowings which were not accounted for at fair value.

Income Taxes

Deferred income taxes are recognized for the tax consequences of temporary differences between financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income taxes are provided on income and expense items when they are reported for financial statement purposes in periods different from the periods in which these items are recognized in the income tax returns. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based upon consideration of available evidence, including tax planning strategies and other factors.

We recognize a tax position as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. As of December 31, 2011 and 2010, we maintained a full valuation allowance against our deferred tax assets.

The calculation of tax liabilities is complex and requires the use of estimates and judgment since it involves the application of complex tax laws that are subject to different interpretations by us and the various tax authorities. These interpretations are subject to challenge by the tax authorities upon audit or to reinterpretation based on management s ongoing assessment of facts and evolving case law.

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Periodically and in the ordinary course of business, we are involved in inquiries and reviews by tax authorities that normally require management to provide supplemental information to support certain tax positions we take in our tax returns. Uncertain tax positions are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. Management believes it has taken appropriate positions on its tax returns, although the ultimate outcome of any tax review cannot be predicted with certainty. No assurance can be given that the final outcome of these matters will not be different than what is reflected in the current and historical financial statements.

We recognize interest and penalties related to income tax matters in income tax (benefit) expense.

Stock-Based Compensation

We account for stock-based compensation under the fair value-based compensation method in accordance with FASB guidance.

Advertising

We expense our advertising costs as incurred, except payments for major sponsorships which are amortized over an estimated life not to exceed one year. Advertising expenses were $663,000, $633,000, and $915,000 for the years ended December 31, 2011, 2010, and 2009, respectively.

Derivatives and Hedging Activities

We account for derivatives in accordance with FASB literature on accounting for derivative instruments and hedging activities. When we enter into the derivative contract, we designate a derivative as held for trading, an economic hedge, or a qualifying hedge as detailed in the literature. The designation may change based upon management s reassessment or changing circumstances. Derivatives utilized by the Company include interest rate lock commitments (IRLC or IRLCs) and forward settlement contracts. IRLCs occur when we originate mortgage loans with interest rates determined prior to funding. Forward settlement contracts are agreements to buy or sell a quantity of a financial instrument, index, currency, or commodity at a predetermined future date, and rate or price.

We designate at inception whether a derivative contract is considered hedging or nonhedging. All of our derivatives are nonexchange traded contracts, and as such, their fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

For qualifying hedges, we formally document at inception all relationships between hedging instruments and hedged items, as well as risk management objectives and strategies for undertaking various accounting hedges. We utilize derivatives to manage interest rate sensitivity in certain cases.

Cash flow hedges, which consist of swaps, are hedges that are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate or foreign exchange fluctuation. We use dollar offset or regression analysis at the hedge s inception and for each reporting period thereafter to assess whether the derivative used in a hedging transaction is expected to be, and has been, effective in offsetting changes in the fair value of the hedged item. We no longer utilize swaps since the sale of Mariner Finance.

For all hedges, we discontinue hedge accounting if it is determined that a derivative is not expected to be, or has ceased to be, effective as a hedge.

We recognize gains and losses on swap contracts in the Consolidated Statements of Financial Condition in accumulated other comprehensive loss, net of tax effects; such gains and losses are reclassified into the line item in the Consolidated Statements of Operations in which the hedged item is recorded in the same period the hedged item affects earnings. Hedge ineffectiveness and gains and losses on the excluded component of a derivative in assessing hedge effectiveness are recorded in earnings in the same income statement line item that is used to record hedge effectiveness.

We do not designate IRLCs or forward sales commitments on residential mortgage originations as hedges. We recognize any gains and losses on IRLCs and forward sales commitments on residential mortgage originations through mortgage-banking revenue in the Consolidated Statements of Operations.

(2) Going Concern Consideration

Due to the conditions and events discussed later in Note 11, 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 11 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) Discontinued Operations

In December 2009, we completed the sale of our consumer finance company subsidiary, Mariner Finance. In accordance with FASB guidance, the operating results of Mariner Finance, along with the loss recognized from the sale, are included in the Consolidated Statements of Operations as discontinued operations. Such discontinued operations are detailed as follows for the years ended December 31:

(dollars in thousands)	**2010**	**2009**
Interest income	$	$ 24,262
Interest expense		(3,147)
Net interest income		21,115
Provision for loan losses		(4,865)
Noninterest income		4,467
Noninterest expenses		(17,332)
Net income before income taxes		3,385
Income tax expense		(1,335)
Net income		2,050
Loss on write-down of Mariner Finance to fair value		(9,485)
Write-off of deferred taxes related to Mariner Finance	(200)	(1,625)
Net loss on disposal of Mariner Finance	(200)	(11,110)
Net loss from discontinued operations	$ (200)	$ (9,060)

The following table shows the net assets of Mariner Finance as of December 14, 2009, the date of the sale of Mariner Finance:

(dollars in thousands)	
Cash and due from banks and interest-bearing deposits	$ 1,220
Loans receivable	109,983
Allowance for loan losses	(5,216)
Loans, net	104,767
Real estate acquired through foreclosure	360
Other assets	2,677
Total assets	109,024
Borrowings	83,792
Other liabilities	4,555
Total liabilities	88,347
Net assets of Mariner Finance	$ 20,677

(4) Restrictions on Cash and Due From Banks

The Bank is required by the Federal Reserve Board (FRB) to maintain certain cash reserve balances based principally on deposit liabilities. At both December 31, 2011 and 2010 the required reserve balance was $1.0 million. The Bank pledged $3.1 million in cash for exposure on debit card transactions as of both December 31, 2011 and 2010.

At December 31, 2011, we had pledged $32.7 million in cash against certain borrowings.

(5) Securities

The composition of our securities portfolio is as follows at December 31:

	2011			
(dollars in thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
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

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

The amount of OTTI recorded as accumulated other comprehensive loss as of December 31, 2011 and 2010 was $533,000 and $804,000, respectively, on trust preferred securities.

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

(dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 6,511	$ 6,519
Due after one year through five years	3,502	3,521
Due after five years through ten years	1,023	950
Due after ten years	11,895	8,800
Mortgage-backed securities	1,834	1,959
	$ 24,765	$ 21,749

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 at December 31:

2011

	Less than 12 months		12 months or more		Total	
(dollars in thousands)	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
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

2010

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

For AFS securities, gross unrealized losses totaled $3.3 million as of December 31, 2011 and equaled 50.2% of the fair value of securities with unrealized losses as of that date. A total of 10 securities were in an unrealized loss position as of December 31, 2011, with the largest single unrealized loss in any one security totaling $1.8 million. Eight securities were in an unrealized loss position for twelve months or more.

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 these securities to be other than temporary and have recorded the credit-related portion of the impairment as net OTTI of $838,000, $1.2 million, and $2.9 million during 2011, 2010, and 2009, respectively.

The following shows the activity in OTTI related to credit losses for the years ended December 31:

(dollars in thousands)	**2011**	**2010**	**2009**
Balance at beginning of year	$ 7,892	$ 6,643	$ 5,605
Reduction - cumulative effect of accounting change			(1,898)
Additional net OTTI recorded for credit losses	838	1,249	2,936
Balance at end of year	$ 8,730	$ 7,892	$ 6,643

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

During 2011, 2010, and 2009, we recognized gross losses on the sale of AFS securities of $23,000, $420,000, and $20,000, respectively. During 2011, 2010, and 2009, we recognized gross gains on sale of AFS securities of $781,000, $474,000, and $440,000, respectively.

At December 31, 2011, we held securities with an aggregate carrying value (fair value) of $16.9 million that we have pledged as collateral for certain mortgage-banking and hedging activities, borrowings, government deposits, and customer deposits.

(6) Loans Receivable (Financing Receivables) and Allowance for Loan Losses

Loans receivable represent our only form of financing receivables and are summarized as follows at December 31:

(dollars in thousands)	**2011**	**2010**
Commercial	$ 47,518	$ 78,607
Commercial mortgage	331,943	349,691
Commercial construction	54,433	58,742
Consumer construction	16,456	31,107
Residential mortgage	121,071	144,194
Consumer	129,227	148,166
Total loans	700,648	810,507
Unearned loan fees, net	1,103	1,180
	$ 701,751	$ 811,687

Included in consumer loan totals in the above table are overdrawn commercial and retail checking accounts totaling $184,000 and $186,000 as of December 31, 2011 and 2010, respectively.

Transferred Loans

Information on the activity in transferred loans and related accretable yield is as follows for the years ended December 31:

	Loan Balance		**Accretable Yield**		**Total**	
(dollars in thousands)	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Beginning balance	$ 26,219	$ 24,575	$ 178	$ 423	$ 26,041	$ 24,152
Loans transferred	2,031	8,150			2,031	8,150
Loans moved to real estate acquired through foreclosure	(2,494)	(281)		(8)	(2,494)	(273)
Charge-offs	(742)	(2,810)	(31)	(45)	(711)	(2,765)
Sales/payments/amortization	(11,006)	(3,415)	119	(192)	(11,125)	(3,223)
Ending balance	$ 14,008	$ 26,219	$ 266	$ 178	$ 13,742	$ 26,041

As of December 31, 2010, we maintained servicing on mortgage loans sold to the Federal National Mortgage Association (FNMA) of approximately $323.3 million. We sold our servicing rights to NGFS during the second quarter of 2011 in conjunction with the closing of that sales transaction in the third quarter of 2011.

At December 31, 2011, we had pledged loans with a carrying value of $85.8 million as collateral for 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 classes of loans to reflect various environmental factors. This amount is considered our unallocated reserve. For individually evaluated loans (impaired loans), we do additional analyses to determine the impairment. In general, this impairment is included as part of the 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 tables presents by portfolio segment, the changes in the allowance for loan losses, and the recorded investment in loans:

As of and for the year ended December 31, 2011:

(dollars in thousands)	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
Beginning Balance	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Charge-offs	(5,484)	(3,335)	(730)	(43)	(2,720)	(2,868)		(15,180)
Recoveries		173	27		39	297		536
Net charge-offs	(5,484)	(3,162)	(703)	(43)	(2,681)	(2,571)		(14,644)
Provision for (reversal of) loan losses	7,961	2,631	459	(618)	2,360	2,786	(1,249)	14,330
Ending Balance	$ 2,768	$ 2,011	$ 1,809	$ 156	$ 2,711	$ 2,632	$ 1,714	$ 13,801
Ending balance - individually evaluated for impairment	$ 4	$ 57	$	$	$ 222	$	$	$ 283
Ending balance - collectively evaluated for impairment	2,764	1,954	1,809	156	2,489	2,632	1,714	13,518
	$ 2,768	$ 2,011	$ 1,809	$ 156	$ 2,711	$ 2,632	$ 1,714	$ 13,801
Ending loan balance - individually evaluated for impairment	$ 4,965	$ 26,345	$ 11,066	$ 718	$ 18,020	$ 905		$ 62,019
Ending loan balance - collectively evaluated for impairment	47,877	300,185	43,283	15,562	103,099	129,726		639,732
	$ 52,842	$ 326,530	$ 54,349	$ 16,280	$ 121,119	$ 130,631		$ 701,751

As of and for the year ended December 31, 2010:

(dollars in thousands)	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
Beginning Balance	$ 817	$ 3,336	$ 1,647	$ 293	$ 2,062	$ 882	$ 2,602	$ 11,639
Charge-offs	(1,979)	(1,395)	(4,252)	(804)	(3,757)	(3,787)		(15,974)
Recoveries			7		104	549		660
Net charge-offs	(1,979)	(1,395)	(4,245)	(804)	(3,653)	(3,238)		(15,314)
Provision for loan losses	1,453	601	4,651	1,328	4,623	4,773	361	17,790
Ending Balance	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Ending balance - individually evaluated for impairment	$	$ 88	$ 14	$	$ 486	$	$	$ 588
Ending balance - collectively evaluated for impairment	291	2,454	2,039	817	2,546	2,417	2,963	13,527
	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Ending loan balance - individually evaluated for impairment	$ 1,501	$ 29,848	$ 13,273	$ 1,257	$ 25,024	$ 1,067		$ 71,970
Ending loan balance - collectively evaluated for impairment	77,300	319,563	45,491	29,535	119,185	148,643		739,717
	$ 78,801	$ 349,411	$ 58,764	$ 30,792	$ 144,209	$ 149,710		$ 811,687

As of and for the year ended December 31, 2009:

(dollars in thousands)	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
Beginning Balance	$ 824	$ 2,985	$ 2,702	$ 583	$ 1,576	$ 4,683	$ 3,424	$ 16,777
Charge-offs	(517)	(871)	(2,370)	(1,493)	(4,546)	(2,650)		(12,447)
Recoveries		4			46	231		281
Net charge-offs	(517)	(867)	(2,370)	(1,493)	(4,500)	(2,419)		(12,166)
Mariner Finance allowance						(4,632)		(4,632)
Provision for (reversal of) loan losses	510	1,218	1,315	1,203	4,986	3,250	(822)	11,660
Ending Balance	$ 817	$ 3,336	$ 1,647	$ 293	$ 2,062	$ 882	$ 2,602	$ 11,639
Ending balance - individually evaluated	$	$ 51	$ 277	$	$ 158	$ 247	$	$ 733

for impairment								
Ending balance - collectively evaluated for impairment	817	3,285	1,370	293	1,904	635	2,602	10,906
	$ 817	$ 3,336	$ 1,647	$ 293	$ 2,062	$ 882	$ 2,602	$ 11,639
Ending loan balance - individually evaluated for impairment	$ 3,385	$ 10,572	$ 15,867	$ 3,815	$ 13,857	$ 1,351		$ 48,847
Ending loan balance - collectively evaluated for impairment	74,249	329,222	83,623	43,564	162,302	149,144		842,104
	$ 77,634	$ 339,794	$ 99,490	$ 47,379	$ 176,159	$ 150,495		$890,951

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 an 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 December 31, 2011 and 2010, none of our loans carried this risk rating.

Above Average Credit Quality (RR3) This category includes business loans to publicly traded companies with a B rating or better, commercial construction loans with a contingent-free take-out or substantial pre-leasing (75% or more of leasable space) with an LTV ratio of 70% or less, residential construction loans with pre-sold units and an 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 Robert Morris and Associates averages, and loans to individuals with acceptable financial condition and sufficient net cash flow to service the debt as long as the source of repayment is identifiable and sufficient to liquidate the debt within an acceptable period of time and a secondary source of repayment is evident.

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

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

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

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

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 December 31, 2011 and 2010, none of our loans carried this risk rating.

Loss (RR10) Losses must be taken as soon as they are realized. In some instances and on a temporary basis, a portion of a loan may receive this rating (split rating) when the actual loss cannot be currently identified. In these instances, additional facts or information is necessary to determine the final amount to be charged against the loan loss reserve. When applied for these purposes, this risk rating may be used for a period not to exceed nine 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 December 31, 2011 and 2010, none of our loans carried this risk rating.

The following table shows the credit quality breakdown of our commercial loan portfolio by class as of December 31:

(dollars in thousands)	Commercial		Commercial Mortgage		Commercial Construction		Consumer Construction		Total	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
RR8	$ 5,672	$ 1,939	$ 26,677	$ 33,492	$ 17,105	$ 14,677	$	$ 1,150	$ 49,454	$ 51,258
RR7	9,051	7,241	17,065	10,921	9,152	6,686		136	35,268	24,984
RR6	10,208	9,174	39,722	23,097	13,132	15,081		98	63,062	47,450
RR5	19,825	22,417	122,880	126,297	12,013	13,811	136		154,854	162,525
RR4	7,074	36,257	117,088	155,336	2,947	8,509	16,144	29,408	143,253	229,510
RR3	1,000	1,000	3,098	268					4,098	1,268
RR1	12	773							12	773
	$ 52,842	$ 78,801	$ 326,530	$ 349,411	$ 54,349	$ 58,764	$ 16,280	$ 30,792	$ 450,001	$ 517,768

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

	Residential Mortgage		Home Equity & 2nd Mortgage		Other Consumer		Total	
(dollars in thousands)	2011	2010	2011	2010	2011	2010	2011	2010
Nonaccrual loans	$ 7,585	$ 11,877	$ 905	$ 946	$	$	$ 8,490	$ 12,823
Performing loans	113,534	132,332	108,539	119,874	21,187	28,890	243,260	281,096
	$ 121,119	$ 144,209	$ 109,444	$ 120,820	$ 21,187	$ 28,890	$ 251,750	$ 293,919

The following tables show the aging of our loans receivable by class at December 31. 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).

	2011						
(dollars in thousands)	31-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
Commercial	$ 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

2010

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

Impaired loans include nonaccrual loans and TDRs. The following tables show the breakout of impaired loans by class at December 31:

	2011					
(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Charge-Offs
With no related allowance:						
Commercial	$ 4,804	$ 4,804	$	$ 2,719	$ 155	$ 5,484
Commercial mortgage	$ 21,039	$ 21,039	$	$ 20,966	$ 483	$ 3,207
Commercial construction	$ 11,066	$ 11,066	$	$ 12,114	$ 67	$ 730
Consumer construction	$ 718	$ 718	$	$ 842	$ 32	$ 43
Residential mortgage	$ 8,723	$ 8,723	$	$ 10,066	$ 260	$ 1,780
Home equity & 2nd mortgage	$ 905	$ 905	$	$ 913	$ 18	$ 2,868
Other consumer	$	$	$	$ 134	$	$
With a related allowance:						
Commercial	157	161	4	63	2	
Commercial mortgage	5,249	5,306	57	4,150	73	128
Commercial construction				266		
Consumer construction				112		
Residential mortgage	9,075	9,297	222	11,526	378	940
Home equity & 2nd mortgage				14		
Other consumer						
Totals:						
Commercial	$ 4,961	$ 4,965	$ 4	$ 2,782	$ 157	$ 5,484
Commercial mortgage	$ 26,288	$ 26,345	$ 57	$ 25,116	$ 556	$ 3,335
Commercial construction	$ 11,066	$ 11,066	$	$ 12,380	$ 67	$ 730
Consumer construction	$ 718	$ 718	$	$ 954	$ 32	$ 43
Residential mortgage	$ 17,798	$ 18,020	$ 222	$ 21,592	$ 638	$ 2,720
Home equity & 2nd mortgage	$ 905	$ 905	$	$ 927	$ 18	$ 2,868
Consumer	$	$	$	$ 134	$	$

	2010					
(dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Charge-Offs
With no related allowance:						
Commercial	$ 1,501	$ 1,501	$	$ 2,069	$ 40	$ 1,979
Commercial mortgage	$ 26,534	$ 26,534	$	$ 17,437	$ 811	$ 1,232
Commercial construction	$ 12,814	$ 12,814	$	$ 10,647	$ 310	$ 2,320
Consumer construction	$ 1,257	$ 1,257	$	$ 2,200	$ 35	$ 804
Residential mortgage	$ 11,877	$ 11,877	$	$ 11,973	$ 381	$ 3,757
Home equity & 2nd mortgage	$ 1,067	$ 1,067	$	$ 1,385	$ 15	$ 3,787
Other consumer	$	$	$	$ 13	$	$
With a related allowance:						
Commercial						
Commercial mortgage	3,226	3,314	88	2,864	73	163
Commercial construction	445	459	14	2,567	18	1,932
Consumer construction						
Residential mortgage	12,661	13,147	486	5,339	695	
Home equity & 2nd mortgage				2,065		
Other consumer				1		
Total:						
Commercial	$ 1,501	$ 1,501	$	$ 2,069	$ 40	$ 1,979
Commercial mortgage	$ 29,760	$ 29,848	$ 88	$ 20,301	$ 884	$ 1,395
Commercial construction	$ 13,259	$ 13,273	$ 14	$ 13,214	$ 328	$ 4,252

Consumer construction	$	1,257	$	1,257	$		$	2,200	$	35	$	804
Residential mortgage	$	24,538	$	25,024	$	486	$	17,312	$	1,076	$	3,757
Home equity & 2nd mortgage	$	1,067	$	1,067	$		$	3,450	$	15	$	3,787
Consumer	$		$		$		$	14	$		$	

The following table shows loans on nonaccrual status by class as of December 31:

(dollars in thousands)	2011	2010
Commercial	$ 4,566	$ 1,501
Commercial mortgage	16,955	26,991
Commercial construction	5,949	7,987
Consumer construction	718	1,257
Residential mortgage	7,585	11,877
Home equity and 2nd mortgage	905	946
	$ 36,678	$ 50,559

The interest which would have been recorded on nonaccrual loans if those loans had been performing in accordance with their contractual terms was approximately $2.2 million, $3.6 million, and $4.6 million in 2011, 2010, and 2009, respectively. The actual interest income recorded on those loans in 2011, 2010, and 2009 was approximately $827,000, $1.6 million, and $1.2 million, respectively.

The following table shows the breakdown of loans we modified during the years ended December 31:

	2011			2010		
(dollars in thousands)	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
Commercial	4	$ 699	$ 424		$	$
Commercial mortgage	10	7,821	7,821	3	3,087	