



MARYLAND FINANCIAL BANK

"Your Partner in Correspondent Banking"

Annual Report 2012

Management

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Richard E. Hook, IV, Chairman, Maryland Financial Bank

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H. L. Ward, President & CEO, Monument Bank

Bank Employees

Rachel N. Barnhouser, Loan Operations Manager

Douglas P. Carnes, Cash Management Administrator

Robert R. Chafey, President and Chief Executive Officer

Jonathan P. Grapes, Credit Analyst

Andrew J. Hines, Senior Vice President, Chief Credit Officer

Richard E. Hook, IV, Chairman of the Board

Glenn W. Kirchner, Senior Vice President, Chief Financial Officer

Jennifer A. Kopajtic, Human Resources Manager

John S. Mazzocchi, Jr., SVP, Director, MFB Advisory Services, LLC

Joyce K. Miller, Compliance Officer and IT Manager

Mick Stachura, Senior Vice President, Lending

Raymond L. Sleater, VP, Assoc Director, MFB Advisory Services, LLC

Phyllis L. Testerman, Accounting Manager

Dear Fellow Stockholder:

April 10, 2013

“Our capital ratios remain strong, loan demand is steady, asset quality is improving, and MFB Advisory remains exceedingly active.”

The past year continued the transition of improved financial performance both in terms of reduced operating losses and improved credit quality. But, we are not there yet. Our Bank sustained a net loss of \$134,504 compared to a loss of \$785,487 for the prior year. All of our asset quality ratios continue to improve and the Bank remains well capitalized. Charge-offs were \$174,038 for the year compared to \$1,278,541 for last year.

During the past twelve months we booked \$9.3 million in new loans and syndicated additional loans to other community banks.

Our consulting subsidiary, MFB Advisory Services, LLC, continues to perform loan review engagements for community banks in the mid-Atlantic market. Advisory also provides due diligence reviews in connection with bank mergers and other special projects which help create revenue.

After six years of chairing our Advisory Board, Ed Nolley, General Manager, FIS Bankway Outsourced Solutions, has decided to step down from the Chairmanship. We would like to thank Ed for all of his hard work and support on behalf of our Bank. We extend a warm welcome to our new Chairperson, Melissa Quirk, Chief Operating Officer of Provident State Bank in Preston, Maryland.

On behalf of our Board of Directors and employees, we thank you for your continued support and confidence. Please feel free to call either of us with any questions.

Sincerely,



Richard E. Hook, IV
Chairman of the Board
410-296-1533



Robert R. Chafey
President & CEO
410-296-8306

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The Board of Directors and Stockholders
Maryland Financial Bank
Towson, Maryland

Report of Independent Auditors

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Maryland Financial Bank, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Maryland Financial Bank as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

Baltimore, Maryland
March 26, 2013

101 E. Chesapeake Avenue, Suite 300, Baltimore, Maryland 21286
410-583-6990 FAX 410-583-7061
Website: www.Rowles.com

Maryland Financial Bank and Subsidiary

Consolidated Balance Sheets

December 31,	2012	2011
Assets		
Cash and due from banks	\$ 128,953	\$ 127,724
Interest-bearing deposits in other banks	<u>10,153,609</u>	<u>13,644,530</u>
Cash and cash equivalents	10,282,562	13,772,254
Time deposits in other banks	198,000	198,000
Securities available for sale	7,310,063	7,392,915
Federal Home Loan Bank stock, at cost	104,800	135,700
Loans, net of allowance for loan losses of \$894,870 and \$530,151	50,321,001	46,016,901
Premises and equipment	13,172	14,878
Accrued interest receivable	240,018	213,660
Deferred income taxes	75,891	91,372
Foreclosed real estate	1,209,851	1,659,006
Other assets	<u>107,338</u>	<u>300,441</u>
	<u>\$ 69,862,696</u>	<u>\$ 69,795,127</u>
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	\$ 1,938,303	\$ 2,413,278
Interest-bearing time deposits	<u>49,648,601</u>	<u>44,082,048</u>
Total deposits	51,586,904	46,495,326
Federal funds purchased	11,540,254	16,399,742
Other liabilities	<u>189,658</u>	<u>146,304</u>
	<u>63,316,816</u>	<u>63,041,372</u>
Stockholders' equity		
Preferred stock and additional paid-in capital; authorized 5,000,000 shares, issued and outstanding 1,785 shares in 2012 and 2011	1,761,341	1,742,414
Common stock, \$10 par value; authorized 5,000,000 shares; issued and outstanding 578,424 shares in 2012 and 2011	5,784,240	5,784,240
Additional paid-in capital	2,848,328	2,845,088
Accumulated deficit	(3,937,217)	(3,683,416)
Accumulated other comprehensive income	<u>89,188</u>	<u>65,429</u>
	<u>6,545,880</u>	<u>6,753,755</u>
	<u>\$ 69,862,696</u>	<u>\$ 69,795,127</u>

The accompanying notes are an integral part of these consolidated financial statements.

Maryland Financial Bank and Subsidiary

Consolidated Statements of Income

Years Ended December 31,	2012	2011
Interest and dividend revenue		
Loans, including fees	\$ 2,711,930	\$ 3,003,891
Securities available for sale	149,660	115,077
Interest-bearing deposits in other banks	38,320	53,747
Dividends	2,123	1,240
Total interest and dividend revenue	2,902,033	3,173,955
Interest expense		
Deposits	583,487	859,878
Federal funds purchased and other borrowings	29,343	50,420
Total interest expense	612,830	910,298
Net interest income	2,289,203	2,263,657
Provision for loan losses		
Net interest income after provision for loan losses	538,387	627,361
Noninterest revenue		
Consulting fees	286,084	419,273
Other	35,587	53,923
Total noninterest revenue	321,671	473,196
Noninterest expenses		
Salaries and employee benefits	1,308,025	1,379,035
Occupancy and equipment	142,808	136,929
Data processing	117,663	100,194
Marketing and promotion	12,133	14,850
Professional fees	163,193	184,922
Federal deposit insurance premiums	85,394	121,111
Foreclosed real estate losses, write-downs and costs	181,119	761,038
Other	196,656	196,900
Total noninterest expenses	2,206,991	2,894,979
Loss before income taxes	(134,504)	(785,487)
Income taxes	-	3,840
Net loss	(134,504)	(789,327)
Preferred stock dividends and discount accretion	119,297	119,297
Net loss to common shareholders	\$ (253,801)	\$ (908,624)
Loss per common share	\$ (0.44)	\$ (1.84)

The accompanying notes are an integral part of these consolidated financial statements.

Maryland Financial Bank and Subsidiary

Consolidated Statements of Comprehensive Income

Years Ended December 31,	2012	2011
Net loss	<u>\$ (134,504)</u>	<u>\$ (789,327)</u>
Other comprehensive income		
Unrealized gain on securities available for sale	39,240	107,095
Income tax relating to unrealized gain on securities available for sale	<u>15,481</u>	<u>42,249</u>
Other comprehensive income	<u>23,759</u>	<u>64,846</u>
Total comprehensive loss	<u>\$ (110,745)</u>	<u>\$ (724,481)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Maryland Financial Bank and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

	Preferred stock	Common stock	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income	Total stockholders' equity
Balance, December 31, 2010	\$ 1,723,487	\$ 3,748,500	\$ 3,688,954	\$ (2,774,792)	\$ 583	\$ 6,386,732
Net loss	-	-	-	(789,327)	-	(789,327)
Unrealized gain on securities available for sale net of income taxes of \$42,249	-	-	-	-	64,846	64,846
Preferred stock dividend and discount accretion	18,927	-	-	(119,297)	-	(100,370)
Proceeds from issuance of common stock, net of costs	-	2,035,740	(849,926)	-	-	1,185,814
Stock-based compensation	-	-	6,060	-	-	6,060
Balance, December 31, 2011	1,742,414	5,784,240	2,845,088	(3,683,416)	65,429	6,753,755
Net loss	-	-	-	(134,504)	-	(134,504)
Unrealized gain on securities available for sale net of income taxes of \$15,481	-	-	-	-	23,759	23,759
Preferred stock dividend and discount accretion	18,927	-	-	(119,297)	-	(100,370)
Stock-based compensation	-	-	3,240	-	-	3,240
Balance, December 31, 2012	<u>\$ 1,761,341</u>	<u>\$ 5,784,240</u>	<u>\$ 2,848,328</u>	<u>\$ (3,937,217)</u>	<u>\$ 89,188</u>	<u>\$ 6,545,880</u>

The accompanying notes are an integral part of these consolidated financial statements.

Maryland Financial Bank and Subsidiary

Consolidated Statements of Cash Flows

Years Ended December 31,	2012	2011
Cash flows from operating activities		
Interest received	\$ 2,937,596	\$ 3,242,066
Fees and commissions received	321,671	473,196
Interest paid	(612,984)	(1,209,945)
Cash paid to suppliers and employees	(1,885,193)	(2,160,305)
Income taxes paid	-	(3,840)
	761,090	341,172
Cash flows from investing activities		
Proceeds from maturity of securities available for sale	1,146,261	4,088,420
Purchases of securities available for sale	(1,084,723)	(6,249,612)
Redemption of Federal Home Loan Bank stock	30,900	21,600
Net (increase) decrease in loans	(5,588,975)	7,491,747
Purchases of premises, equipment, and software	(9,512)	(3,102)
Proceeds from sale of foreclosed real estate	1,115,827	399,165
	(4,390,222)	5,748,218
Cash flows from financing activities		
Net increase (decrease) in		
Deposits	5,091,578	(3,875,210)
Federal funds purchased	(4,859,488)	(3,927,977)
Preferred stock dividend paid	(92,650)	(92,650)
Proceeds from issuance of common stock	-	1,185,814
	139,440	(6,710,023)
Net decrease in cash and cash equivalents	(3,489,692)	(620,633)
Cash and cash equivalents at beginning of year	13,772,254	14,392,887
Cash and cash equivalents at end of year	\$ 10,282,562	\$13,772,254

The accompanying notes are an integral part of these consolidated financial statements.

Maryland Financial Bank and Subsidiary

Consolidated Statements of Cash Flows (Continued)

Years Ended December 31,	2012	2011
Reconciliation of net loss to net cash provided by operating activities		
Net loss	\$ (134,504)	\$ (789,327)
Adjustments to reconcile net loss to net cash provided by operating activities		
Provision for loan losses	538,387	627,361
Depreciation and amortization	10,632	28,126
Net amortization of investment securities premiums	60,554	20,853
Stock-based compensation	3,240	6,060
Loss on sale of foreclosed real estate	15,523	361,620
Write-down of foreclosed real estate	62,926	274,006
Decrease (increase) in		
Accrued interest receivable	(26,358)	41,798
Other assets	193,689	86,504
Increase (decrease) in		
Deferred loan fees, net	1,367	5,460
Accrued interest payable	(154)	(299,647)
Other liabilities	35,788	(21,642)
	<u>\$ 761,090</u>	<u>\$ 341,172</u>
Supplemental information		
Noncash investing activity		
Transfer from loans receivable to foreclosed real estate	<u>\$ 745,121</u>	<u>\$ 497,150</u>

The accompanying notes are an integral part of these consolidated financial statements.

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Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Organization and nature of operations

Maryland Financial Bank (the Bank) was incorporated on July 7, 2004, under the laws of the State of Maryland and commenced operations on October 25, 2004. On March 1, 2005, MFB Advisory Services, LLC was formed as a wholly-owned subsidiary of the Bank to provide consulting and advisory services, primarily credit reviews for other financial institutions.

As a state chartered bank, the Bank is subject to regulation by the FDIC and the Maryland Commissioner of Financial Regulation.

The Bank participates through purchases in commercial and commercial real estate loans with other financial institutions throughout Maryland and contiguous states and makes direct loans to officers and directors of financial institutions. The loan portfolio is generally collateralized by assets of the borrowers. A substantial portion of the Bank's loan portfolio is concentrated in the real estate industry. Therefore, its debtors' ability to repay their loans is dependent upon the real estate sector of the economy. The Bank accepts deposits and purchases federal funds from financial institutions.

Principles of consolidation

The consolidated financial statements include the accounts of Maryland Financial Bank and its wholly-owned subsidiary, MFB Advisory Services, LLC. All intercompany accounts and transactions are eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue 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 evaluation of other than temporary impairment of securities, and the valuation of deferred tax assets.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits in other banks, and federal funds sold, all of which have initial maturities of 90 days or less. Generally, federal funds are purchased or sold for one-day periods.

Subsequent events

The Bank has evaluated events and transactions subsequent to December 31, 2012 through March 26, 2013, the date these financial statements were available to be issued. No significant subsequent events were identified that would affect the presentation of the financial statements.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Time deposits in other banks

Time deposits in other banks mature within one year and are carried at cost.

Concentration of credit risk

Most of the Bank's activities are with customers located within Maryland and contiguous states.

Securities available for sale

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in the maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income (loss). Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal Home Loan Bank of Atlanta stock

Federal Home Loan Bank of Atlanta (FHLB) stock is carried at cost. The Bank is required to maintain an investment in the stock of the FHLB based on its total assets and any outstanding advances from the FHLB.

Loans

Loans are stated at their outstanding unpaid principal balances plus premiums and deferred costs, less deferred fees and the allowance for loan losses. Interest income is accrued on the unpaid principal balances. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to the yield of the related loans. The Bank generally amortizes these amounts over the contractual life of the loan.

The accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due and collateral is insufficient to discharge the debt in full. Past due status is based on the contractual terms of the loan. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Allowance for loan losses

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectable are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Allowance for loan losses (Continued)

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management's periodic evaluation of the adequacy of the allowance is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change.

The allowance consists of specific and general components. The specific component relates to loans that are classified as either doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers loans that are not adversely classified and is based on historical loss experience adjusted for qualitative factors.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

Transfers of financial assets

Transfers of financial assets, including loan and loan participation sales, are accounted for as sales, when control of the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets.

Foreclosed real estate

Real estate acquired through foreclosure is recorded at the lower of cost or fair value less estimated selling costs on the date acquired. In general, cost equals the Bank's investment in the property at the time of foreclosure. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in noninterest expense.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Marketing and promotion expense

The Bank expenses marketing and promotion costs as they are incurred.

Income taxes

Deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carryforwards and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Stock-based compensation

Stock-based compensation includes the cost of all stock-based payments granted subsequent to December 31, 2005, based on the grant date estimated fair value. Compensation cost is recognized ratably using the straight-line attribution method over the expected vesting period or to the retirement eligibility date, if less than the vesting period when vesting is not contingent upon any future performance.

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income (loss). Changes in the unrealized gains and losses on securities available for sale are reported as a separate component of the equity section of the balance sheet and included in comprehensive income (loss).

Off-balance-sheet financial instruments

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the balance sheet when they are funded.

Loss per common share

Loss per common share is computed by dividing net loss to common shareholders by the weighted average number of shares outstanding. The number of shares used to compute basic and diluted loss per share are reconciled as follows:

	2012	2011
Average shares outstanding	578,424	492,711
Dilutive effect to stock options	-	-
Diluted shares	<u>578,424</u>	<u>492,711</u>
Anti-dilutive shares	<u>49,358</u>	<u>49,358</u>

Reclassifications

Certain amounts in the 2011 consolidated financial statements have been reclassified to conform to the 2012 presentation. The reclassifications had no impact on net loss.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

2. Cash and Cash Equivalents

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

The Bank normally carries balances with the Federal Home Loan Bank of Atlanta that are not insured by the Federal Deposit Insurance Corporation. The average balance carried was **\$88,016** and \$346,435 for the years ended December 31, 2012 and 2011, respectively.

3. Securities Available for Sale

The amortized cost and fair value of securities available for sale, with gross unrealized gains and losses were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2012				
Mortgage-backed	<u>\$7,162,766</u>	<u>\$ 147,297</u>	<u>\$ -</u>	<u>\$7,310,063</u>
December 31, 2011				
Mortgage-backed	<u>\$7,284,858</u>	<u>\$ 108,057</u>	<u>\$ -</u>	<u>\$7,392,915</u>

Mortgage-backed securities are payable in monthly installments.

The Bank did not sell any securities available for sale during 2012 or 2011.

There were no pledged securities as of December 31, 2012 or 2011.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

4. Loans

The composition of loans receivable at December 31, 2012 and 2011, is as follows:

	2012	2011
Commercial real estate	\$ 35,081,840	\$ 32,822,671
Residential real estate	6,809,002	3,493,078
Construction and land development	2,313,510	3,619,709
Commercial	3,594,339	3,446,922
Consumer	<u>3,449,851</u>	<u>3,217,020</u>
Total loans	51,248,542	46,599,400
Premium on loans purchased	21,044	-
Deferred loan fees and costs, net	(53,715)	(52,348)
Allowance for loan losses	<u>(894,870)</u>	<u>(530,151)</u>
	<u>\$ 50,321,001</u>	<u>\$ 46,016,901</u>

Summaries of transactions in the allowance for loan losses, by loan classification, during the years ended December 31, 2012 and 2011, follow:

	December 31, 2011	Provision for loan losses	Charge offs	Recoveries	December 31, 2012
	Balance				Balance
Commercial real estate	\$ 339,003	\$ 182,971	\$ -	\$ -	\$ 521,974
Residential real estate	27,649	20,575	-	-	48,224
Construction and land development	73,246	72,521	(29,618)	-	116,149
Commercial	40,723	81,414	-	-	122,137
Consumer	<u>49,530</u>	<u>180,906</u>	<u>(144,420)</u>	<u>370</u>	<u>86,386</u>
	<u>\$ 530,151</u>	<u>\$ 538,387</u>	<u>\$ (174,038)</u>	<u>\$ 370</u>	<u>\$ 894,870</u>

	December 31, 2010	Provision for loan losses	Charge offs	Recoveries	December 31, 2011
	Balance				Balance
Commercial real estate	\$ 507,242	\$ 132,566	\$ (300,805)	\$ -	\$ 339,003
Residential real estate	32,340	(4,691)	-	-	27,649
Construction and land development	543,802	90,180	(560,736)	-	73,246
Commercial	40,013	417,710	(417,000)	-	40,723
Consumer	<u>57,934</u>	<u>(8,404)</u>	<u>-</u>	<u>-</u>	<u>49,530</u>
	<u>\$ 1,181,331</u>	<u>\$ 627,361</u>	<u>\$ (1,278,541)</u>	<u>\$ -</u>	<u>\$ 530,151</u>

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

4. Loans (Continued)

Past due loans, segregated by age and class of loans, as of December 31, 2012 and 2011, were as follows:

December 31, 2012	Loans 30-89 days past due	Loans 90 or more days past due	Total past due loans	Current loans	Total loans	Accruing loans 90 or more days past due	Nonaccrual loans	Interest not accrued on nonaccrual loans
Commercial real estate	\$1,214,644	\$ 871,421	\$2,086,065	\$32,995,775	\$35,081,840	\$ -	\$ 907,332	\$124,379
Residential real estate	-	331,928	331,928	6,477,074	6,809,002	331,928	-	-
Construction and land development	-	459,856	459,856	1,853,654	2,313,510	-	459,856	120,892
Commercial	-	300,686	300,686	3,293,653	3,594,339	-	300,686	95,047
Consumer	<u>300,000</u>	-	<u>300,000</u>	<u>3,149,851</u>	<u>3,449,851</u>	-	-	-
	<u>\$1,514,644</u>	<u>\$1,963,891</u>	<u>\$3,478,535</u>	<u>\$47,770,007</u>	<u>\$51,248,542</u>	<u>\$331,928</u>	<u>\$1,667,874</u>	<u>\$340,318</u>

December 31, 2011

Commercial real estate	\$ 236,043	\$ 991,015	\$1,227,058	\$31,595,613	\$32,822,671	\$ -	\$ 991,015	\$103,138
Residential real estate	-	-	-	3,493,078	3,493,078	-	-	-
Construction and land development	-	1,143,251	1,143,251	2,476,458	3,619,709	-	1,143,251	157,439
Commercial	-	300,686	300,686	3,146,236	3,446,922	-	300,686	72,861
Consumer	-	-	-	3,217,020	3,217,020	-	-	-
	<u>\$ 236,043</u>	<u>\$2,434,952</u>	<u>\$2,670,995</u>	<u>\$43,928,405</u>	<u>\$46,599,400</u>	<u>\$ -</u>	<u>\$2,434,952</u>	<u>\$333,438</u>

Impaired loans are defined as loans that have been assessed for impairment, although management may determine that the loan does not require a specific reserve. Impaired loans as of December 31, 2012 and 2011, were as follows:

December 31, 2012	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average recorded investment	Interest recognized
Commercial real estate	\$ 2,484,918	\$ 572,140	\$1,790,973	\$ 2,363,113	\$ 251,573	\$2,469,735	\$ 74,329
Residential real estate	-	-	-	-	-	-	-
Construction and land development	1,209,856	459,856	750,000	1,209,856	40,500	1,358,288	29,342
Commercial	717,686	300,686	-	300,686	-	300,686	-
Consumer	-	-	-	-	-	-	-
	<u>\$ 4,412,460</u>	<u>\$1,332,682</u>	<u>\$2,540,973</u>	<u>\$ 3,873,655</u>	<u>\$ 292,073</u>	<u>\$4,128,709</u>	<u>\$103,671</u>

December 31, 2011

Commercial real estate	\$ 3,082,832	\$ 991,015	\$1,806,012	\$ 2,797,027	\$ 104,447	\$3,074,908	\$ 49,282
Residential real estate	-	-	-	-	-	-	-
Construction and land development	2,111,252	1,143,251	750,000	1,893,251	40,500	2,122,651	32,661
Commercial	717,686	300,686	-	300,686	-	717,686	-
Consumer	-	-	-	-	-	-	-
	<u>\$ 5,911,770</u>	<u>\$2,434,952</u>	<u>\$2,556,012</u>	<u>\$ 4,990,964</u>	<u>\$ 144,947</u>	<u>\$5,915,245</u>	<u>\$ 81,943</u>

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

4. **Loans** (Continued)

The Bank was not committed to advance any funds in connection with impaired loans at December 31, 2012 or 2011.

Credit quality indicators

As part of the ongoing monitoring of the credit quality of the Bank's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grade of loans, the level of classified loans, net charge offs, nonperforming loans, and the general economic conditions in the Bank's market.

The Bank utilizes a risk grading matrix to assign a risk grade to each of its loans. A description of the general characteristics of loans characterized as watch list or classified is as follows:

Pass/Watch

Loans graded as Pass/Watch are secured by generally acceptable assets which reflect above-average risk. The loans warrant closer scrutiny by management than is routine, due to circumstances affecting the borrower, the borrower's industry or the overall economic environment. Borrowers may reflect weaknesses such as inconsistent or weak earnings, break even or moderately deficit cash flow, thin liquidity, minimal capacity to increase leverage, or volatile market fundamentals or other industry risks. Such loans are typically secured by acceptable collateral, at or near appropriate margins, with realizable liquidation values.

Special Mention

A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Borrowers may exhibit poor liquidity and leverage positions resulting from generally negative cash flow or negative trends in earnings. Access to alternative financing may be limited to finance companies for business borrowers and may be unavailable for commercial real estate borrowers.

Substandard

A substandard loan is inadequately protected by the current financial condition and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Borrowers may exhibit recent or unexpected unprofitable operations, an inadequate debt service coverage ratio, or marginal liquidity and capitalization. These loans require more intense supervision by Bank management.

Doubtful

A doubtful loan has all the weaknesses inherent in a substandard loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

4. Loans (Continued)

Doubtful (Continued)

The following tables present the December 31, 2012 and 2011, balances of classified loans based on risk grade. Classified loans include Pass/Watch, Special Mention, Substandard, and Doubtful loans.

December 31, 2012	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
Commercial real estate	\$ 3,096,027	\$ 705,043	\$ 2,363,112	\$ -	\$ 6,164,182
Residential real estate	-	331,928	-	-	331,928
Construction and land development	-	-	1,209,856	-	1,209,856
Commercial	-	-	-	300,686	300,686
Consumer	<u>240,873</u>	-	-	-	<u>240,873</u>
	<u>\$3,336,900</u>	<u>\$1,036,971</u>	<u>\$3,572,968</u>	<u>\$300,686</u>	<u>\$8,247,525</u>

December 31, 2011

Commercial real estate	\$ 3,142,733	\$ -	\$ 3,108,723	\$ 222,937	\$ 6,474,393
Residential real estate	-	-	-	-	-
Construction and land development	-	-	1,505,127	388,124	1,893,251
Commercial	-	-	300,686	-	300,686
Consumer	<u>250,891</u>	<u>24,498</u>	<u>-</u>	<u>-</u>	<u>275,389</u>
	<u>\$3,393,624</u>	<u>\$ 24,498</u>	<u>\$4,914,536</u>	<u>\$611,061</u>	<u>\$8,943,719</u>

Classified loans also include certain loans that have been modified in trouble debt restructurings (TDR) where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Bank's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

Summaries of TDR loans as of December 31, 2012 and 2011, follow:

December 31, 2012	Performing	Nonperforming	Total
Commercial real estate	\$ 1,455,780	\$ 335,192	\$ 1,790,972
Residential real estate	-	-	-
Construction and land development	750,000	-	750,000
Commercial	-	-	-
Consumer	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$2,205,780</u>	<u>\$335,192</u>	<u>\$2,540,972</u>

December 31, 2011

Commercial real estate	\$ 1,806,012	\$ -	\$ 1,806,012
Residential real estate	-	-	-
Construction and land development	750,000	-	750,000
Commercial	-	-	-
Consumer	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$2,556,012</u>	<u>\$ -</u>	<u>\$2,556,012</u>

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

5. Premises and Equipment

The components of premises and equipment at December 31, 2012 and 2011, are as follows:

	Useful lives	2012	2011
Furniture, fixtures, and equipment	5 to 7 years	\$157,200	\$ 157,200
Computer equipment	3 years	144,201	138,154
		301,401	295,354
Accumulated depreciation		288,229	280,476
		\$ 13,172	\$ 14,878
Depreciation expense		\$ 7,657	\$ 25,643

Included in other assets at December 31, 2012 and 2011, is computer software carried at an amortized cost of **\$3,298** and \$2,712, respectively. Software amortization expense was **\$2,975** and \$2,483 in 2012 and 2011, respectively.

6. Interest-Bearing Time Deposits

The aggregate amounts of interest-bearing time deposits in denominations of \$100,000 or more were **\$45,695,770** and \$39,571,491 as of December 31, 2012 and 2011, respectively.

At December 31, 2012, the scheduled maturities of certificates of deposit were as follows:

Year	Amount
2013	\$ 21,830,631
2014	21,309,601
2015	1,838,000
2016	4,180,369
2017	490,000
	\$ 49,648,601

Included in certificates of deposit as of December 31, 2012 and 2011, are wholesale certificates of deposit of **\$403,818** and \$402,446, respectively. Included in certificates of deposit as of December 31, 2012, are brokered certificates of deposit of **\$2,277,000**. There were no brokered certificates of deposit as of December 31, 2011.

7. Federal Funds

Federal funds are reported on a gross basis. Federal funds sold are stated as assets and federal funds purchased are stated as liabilities. The average interest rate paid on federal funds purchased was **0.20%** and 0.22% for the years ended December 31, 2012 and 2011, respectively. Federal funds purchased mature daily.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

8. Available Borrowings

As of December 31, 2012, the Bank has pledged real estate loans totaling **\$27,681,887** to the Federal Reserve Bank of Richmond to provide a borrowing capacity of **\$19,390,425** under its discount window program.

The Bank has a **\$7,140,000** line of credit available through the FHLB. The Bank would be required to pledge investment securities in its portfolio to draw upon the line of credit. There were no advances outstanding on these lines at December 31, 2012 or 2011.

9. TARP Capital Purchase Program

On March 27, 2009, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Program ("CPP"), the Bank entered into a Letter Agreement and the related Securities Purchase Agreement - Standard Terms (collectively, the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Bank issued (1) 1,700 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A with liquidation preference of \$1,000 per share ("Series A Preferred Stock"), and (2) a warrant to purchase an additional 85 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B ("Series B Preferred Stock"), for an aggregate purchase price of \$1.7 million. The Series A Preferred Stock qualifies as Tier 1 capital and pays dividends at a rate of 5% per annum until May 15, 2014. Beginning May 15, 2014, the dividend rate will increase to 9% per annum. On and after May 15, 2012, the Bank may, at its option, redeem shares of Series A Preferred Stock, in whole or in part, at any time and from time to time, for cash at a per share amount equal to the sum of the liquidation preference per share plus any accrued and unpaid dividends to but excluding the redemption date. The redemption of the Series A Preferred Stock requires prior regulatory approval. On March 27, 2009, the Treasury exercised all of the warrants on the Series B Preferred Stock at the liquidation price of \$1,000 per share. The Series B Preferred Stock qualifies as Tier 1 capital and pays dividends at a rate of 9% per annum. The Series B Preferred Stock may not be redeemed until all the Series A Preferred Stock has been redeemed. The Series A Preferred Stock and Series B Preferred Stock were issued in a transaction exempt from registration pursuant to the Securities Act of 1933, as amended.

In accordance with the Purchase Agreement, whenever the dividends payable on the shares have not been paid for an aggregate of six quarterly dividend periods or more, whether or not consecutive, the authorized number of directors of the Bank shall automatically be increased by two and the holders of the shares may elect two directors to fill the newly created directorships at the Bank's next annual meeting and at each subsequent annual meeting until full dividends have been paid on the shares for four consecutive quarters. The Bank did not declare or pay the dividend on the Series A and Series B Preferred Stock for four consecutive quarterly payments starting with the November 15, 2009, payment. The Bank resumed declaring and paying the dividend on the Series A and Series B Preferred Stock on November 15, 2010, and has continued quarterly payments throughout 2011 and 2012.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

10. Lease Commitments

The Bank has entered a lease agreement for its banking office through January 31, 2015. The Bank has the option to extend the lease agreement for one additional five-year period. The Bank is also required to pay a monthly fee for its portion of certain operating expenses, including real estate taxes, insurance, utilities, maintenance, and repairs above a base year amount in addition to the base rent.

The lease requires the following minimum payments:

<u>Year</u>	<u>Payments</u>
2013	\$ 99,669
2014	102,410
2015	<u>8,729</u>
	<u>\$210,808</u>

Rent expense for the office and equipment leases for the years ended December 31, 2012 and 2011, totaled **\$91,471** and \$94,209, respectively.

11. Income Taxes

The Bank did not incur federal income tax expense during the years ended December 31, 2012 and 2011.

A reconciliation of the statutory income tax rate of 34% to the income tax expense (benefit) included in the statements of income is as follows for the years ended December 31, 2012 and 2011:

	2012		2011
Federal income tax at statutory rate	34.0	%	34.0
Nondeductible expenses	2.5		0.9
State income tax	-		0.5
Change in valuation allowance	(36.5)		(34.9)
Effective income tax rate	-	%	0.5
			%

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

11. **Income Taxes** (Continued)

The components of the net deferred tax asset at December 31, are as follows:

	2012	2011
Deferred tax assets		
Net operating loss and charitable contribution carryforwards	\$1,204,201	\$1,451,678
Allowance for loan losses	112,253	17,207
Depreciation	3,203	4,501
Foreclosed real estate write-downs and holding costs	<u>152,540</u>	<u>147,638</u>
	<u>1,472,197</u>	<u>1,621,024</u>
Valuation allowance	<u>(1,260,862)</u>	<u>(1,324,535)</u>
Total deferred tax assets, net of valuation allowance	<u>211,335</u>	<u>296,489</u>
Deferred tax liabilities		
Unrealized gain on securities available for sale	58,109	42,629
Cash basis accounting	65,099	149,981
Deferred loan costs	<u>12,236</u>	<u>12,507</u>
Total deferred tax liability	<u>135,444</u>	<u>205,117</u>
Net deferred tax asset	<u>\$ 75,891</u>	<u>\$ 91,372</u>

The Bank has net operating loss carryforwards available for federal and state income tax purposes of approximately \$3,044,648, which will begin to expire in 2024.

12. **Stock Options and Equity Incentive Plan**

Under the 2005 Equity Incentive Plan (the Plan), the Bank is permitted to grant stock options (including incentive stock options within the meaning of Internal Revenue Code Section 422 and nonstatutory stock options), stock appreciation rights, restricted or unrestricted stock awards, phantom stock, performance awards, other stock-based awards, or any combination of the foregoing. The shares of common stock that may be issued with respect to awards granted under the Plan shall not exceed an aggregate of 75,000 shares of common stock over the life of the Plan. To date, only options have been granted under this plan. The exercise price of each option equals the fair value of the stock on the date of grant and an option's maximum term is ten years. Vesting periods range from five to seven years from date of grant.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

12. Stock Options and Equity Incentive Plan (Continued)

Information regarding the stock options is presented below:

	Options	Weighted average exercise price	Weighted average remaining contractual life
Outstanding at December 31, 2010	49,358	\$ 20	5.0
Granted in 2011	-	-	-
Exercised in 2011	-	-	-
Forfeited in 2011	-	-	-
Outstanding at December 31, 2011	49,358	20	3.9
Granted in 2012	-	-	-
Exercised in 2012	-	-	-
Forfeited in 2012	-	-	-
Outstanding at December 31, 2012	<u>49,358</u>	<u>20</u>	<u>2.9</u>
Options exercisable at December 31, 2012	<u>49,358</u>	<u>\$ 20</u>	<u>2.9</u>

The intrinsic value of options outstanding at December 31, 2012 and 2011, is \$0.

	Number of options	Weighted average grant date fair value
Nonvested options at January 1, 2012	583	\$ 6.05
Vested	<u>583</u>	6.05
Nonvested options at December 31, 2012	<u>-</u>	

There were no stock options granted in 2012 or 2011.

In connection with a Rights Offering in 2011, the Bank issued 202,039 Units at \$6.00 per Unit. Each Unit consisted of one share of common stock, one warrant to purchase one share of common stock at \$6.00 per share, which is exercisable up to three years after the date of the offering, and one warrant to purchase one-half of one share of common stock at \$6.00 per share, which is exercisable up to six years after the date of the offering.

In connection with the initial private placement offering of the Bank, warrants were issued to purchase 1.5 shares of common stock at \$20 per share for every share that the stockholder purchased in the offering. As a result, the Bank issued 110,250 warrants. The warrants were issued in recognition of the financial and organizational risk undertaken by the purchasers in the offering. The warrants, which are exercisable within ten years from the date of issuance, will expire in 2014.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

13. Transactions with Related Parties

The Bank has transactions in the ordinary course of business with its directors, principal stockholders, and affiliated companies, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Affiliated companies include financial institutions with which a director of the Bank is affiliated. At December 31, 2012 and 2011, the total amount of loans outstanding to related parties were **\$148,000** and \$483,002, respectively.

Activity in these loans during the years ended December 31, 2012 and 2011, was as follows:

	2012	2011
Beginning balance	\$483,002	\$488,985
Advances	-	-
Payments	-	(5,983)
Change in related parties	<u>(335,002)</u>	<u>-</u>
Ending balance	<u>\$148,000</u>	<u>\$483,002</u>

Deposits and federal funds purchased from related parties held by the Bank at December 31, 2012 and 2011, amounted to **\$5,915,818** and \$3,504,011, respectively.

14. Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies, but may include residential or commercial real estate, accounts receivable, inventory, and equipment.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

14. Financial Instruments with Off-Balance-Sheet Risk (Continued)

The following financial instruments were outstanding whose contract amounts represent credit risk at December 31:

	Contract amount	
	2012	2011
Unfunded commitments under lines of credit:		
Fixed rate	\$ 655,464	\$ 226,984
Variable rate	2,173,146	1,986,723

There were no commitments to originate loans as of December 31, 2012 or 2011.

15. Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2012 and 2011, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2012, the most recent notification from the Federal Deposit Insurance Corporation (FDIC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes to have changed the Bank's category.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

15. Regulatory Matters (Continued)

The Bank's actual capital amounts and ratios at December 31, 2012 and 2011, are presented below:

<i>(dollar amounts in thousands)</i>	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2012						
Total capital (to risk-weighted assets)	\$ 7,084	14.19%	\$ 3,994	8.00%	\$ 4,992	10.00%
Tier 1 capital (to risk-weighted assets)	6,457	12.93%	1,997	4.00%	2,995	6.00%
Tier 1 capital (to average assets)	6,457	9.07%	2,848	4.00%	3,560	5.00%
December 31, 2011						
Total capital (to risk-weighted assets)	\$ 7,185	15.22%	\$ 3,776	8.00%	\$ 4,721	10.00%
Tier 1 capital (to risk-weighted assets)	6,688	14.17%	1,888	4.00%	2,832	6.00%
Tier 1 capital (to average assets)	6,688	8.66%	3,090	4.00%	3,863	5.00%

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations. The Maryland Banking Code provides that cash dividends may be declared and paid out of accumulated net earnings.

16. Fair Value Measurements

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Generally accepted accounting principles define fair value, establish a framework for measuring fair value, require certain disclosures about fair values, and establish a hierarchy for determining fair value measurements. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs that reflect the Bank's own assumptions about the asset or liability in situations in which there is little, if any, market activity for the asset or liability at the measurement date.

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

16. Fair Value Measurements (Continued)

Fair value measurements on a recurring basis

Securities available for sale - The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges, if available. If quoted prices are not available, fair value is determined using quoted prices for similar securities.

The Bank has categorized its securities available for sale as follows:

December 31, 2012	Total	Quoted prices in active markets identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Investment securities available for sale	<u>\$7,310,063</u>	<u>\$ -</u>	<u>\$7,310,063</u>	<u>\$ -</u>
<hr/> December 31, 2011				
Investment securities available for sale	<u>\$7,392,915</u>	<u>\$ -</u>	<u>\$7,392,915</u>	<u>\$ -</u>

Fair value measurements on a nonrecurring basis

Impaired loans - The Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values. As of December 31, 2012 and 2011, the fair values consist of loan balances of **\$3,873,655** and \$4,990,964, net of specific allowances of **\$292,073** and \$144,947, respectively.

Foreclosed real estate - The Bank's foreclosed real estate is measured at fair value less cost to sell on a nonrecurring basis. As of December 31, 2012 and 2011, the fair value of foreclosed real estate was estimated to be **\$1,209,851** and \$1,659,006, respectively. Fair value was determined based on offers and/or appraisals. Cost to sell the real estate was based on standard market factors. The Bank has categorized its foreclosed real estate as Level 3. For the years ended December 31, 2012 and 2011, the Bank recorded charge offs of **\$29,618** and \$192,736, respectively, to the allowance for loan losses when the Bank transferred property from loans receivable to foreclosed real estate.

December 31, 2012	Total	Level 1 inputs	Level 2 inputs	Level 3 inputs
Impaired loans	<u>\$3,581,582</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$3,581,582</u>
Foreclosed real estate	<u>\$1,209,851</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,209,851</u>
<hr/> December 31, 2011				
Impaired loans	<u>\$4,846,017</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$4,846,017</u>
Foreclosed real estate	<u>\$1,659,006</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,659,006</u>

Maryland Financial Bank and Subsidiary

Notes to Consolidated Financial Statements (Continued)

16. Fair Value Measurements (Continued)

Fair value measurements on a nonrecurring basis (Continued)

Transactions in foreclosed real estate during the years ended December 31, 2012 and 2011, were as follows:

	2012	2011
Beginning of year balance	\$1,659,006	\$2,196,647
Improvements and additions	745,121	497,150
Write-downs	(62,926)	(274,006)
Proceeds from sale	(1,115,827)	(399,165)
Loss on sale	<u>(15,523)</u>	<u>(361,620)</u>
End of year balance	<u>\$1,209,851</u>	<u>\$1,659,006</u>

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Maryland Financial Bank

Loan Participations (Buy & Sell)
SBA Assistance 504 & 7A
M&A Partnership
DDA & Federal Funds
Term Jumbo CD's
Fed Funds Lines of Credit
Holding Company Loans
Director & Officer Loans
Credit Card Services
Mortgage Servicing
Funding & Liquidity Risk Management
Interest Rate Risk Management
Investment Portfolio Independent Advice
CFO Relief

MFB Advisory Services, LLC

Independent Loan Review
Loan Policy, Procedure & Practice Review
Commercial & Business Lending Training
Annual Review Underwriting
Portfolio Stress Testing
Asset Quality Reporting
Asset Concentration Reporting
Due Diligence Buy/Sell

Strategic and Networking Partners

Ambassador Financial Group	Midlantic Financial Services
American Bankers Association	Monocacy Financial Advisors, LLC
Banc Consulting Partners	Mortgage Depart. Services, LLC
Bank Financial Services Group	NetBank Audit
Bank Realty LP	Nolan, Plumhoff & Williams
Baxter Fentriss and Company	Ober Kaler
Broder & Associates	Optimum Systems Plus
Chatham Financial	Overton & Associates
CliftonLarsonAllen	ParenteBeard LLC
Compushare	Partners Engineering & Science
Equias Alliance, LLC	Quality Environmental Solutions
Evaluation & Review Associates	RCM &D
Evergreen Advisors	Rowles &Company, LLP
Federal Home Loan Bk of Atlanta	Sageworks, Inc
Federal National Commercial Credit	Sandler O'Neill
FinSecure, LLC, a Berkley Co.	Saratoga Insurance Brokers
FIS Bankway Hosted Solutions	Shapiro, Sher, Guinot & Sandler
Hofmeister, Breza & Leavers	Stegman & Company
Independent Community Bankers of America	Stifel Nicolaus Weisel
Isabella Associates	Strategic Banking Partners
Janney Montgomery Scott, LLC	Strategic Risk Associates
Kaplan & Associates, Inc.	Stuart Greenberg, Inc
LCS Inc.	Terrapin Financial Services, LLC
Long Term Financial	The Kafafian Group, Inc.
M.I. Magill	The Mergis Group
MACHA-Mid-Atlantic Pymt Assoc.	Thomas Compliance Associates
Madison Capital LLC	TIB-The Independent Bankers Bk
	UBS Financial Services Inc

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