

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 and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, 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 and Subsidiary as of December 31, 2015 and 2014, 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 16, 2016

# Maryland Financial Bank and Subsidiary

## Consolidated Balance Sheets

December 31,	2015	2014
<b>Assets</b>		
Cash and cash equivalents due from banks	\$ 140,045	\$ 177,728
Interest-bearing deposits in other banks	<u>10,707,985</u>	<u>5,531,971</u>
Cash and cash equivalents	10,848,030	5,709,699
Time deposits in other banks	198,000	198,000
Securities available for sale	7,299,820	9,214,199
Federal Home Loan Bank of Atlanta stock, at cost	145,700	263,200
Loans, net of allowance for loan losses of <b>\$510,980</b> and \$731,660	40,051,280	40,611,455
Premises and equipment	32,520	25,895
Accrued interest receivable	149,172	163,486
Deferred income taxes	159,099	100,546
Foreclosed real estate	284,506	430,891
Other assets	<u>48,052</u>	<u>127,879</u>
	<u><b>\$ 59,216,179</b></u>	<u><b>\$ 56,845,250</b></u>
<b>Liabilities and Stockholders' Equity</b>		
Deposits		
Noninterest-bearing	\$ 1,383,110	\$ 1,527,340
Interest-bearing time deposits	<u>35,360,177</u>	<u>31,972,001</u>
Total deposits	36,743,287	33,499,341
Federal funds purchased	15,317,062	12,428,405
Federal Home Loan Bank advances	1,000,000	4,600,000
Other liabilities	<u>221,899</u>	<u>199,233</u>
	<u><b>53,282,248</b></u>	<u><b>50,726,979</b></u>
Stockholders' equity		
Preferred stock and additional paid-in capital; authorized 5,000,000 shares, issued and outstanding 1,785 shares in 2015 and 2014	1,785,000	1,785,000
Common stock, \$10 par value; authorized 5,000,000 shares; issued and outstanding <b>578,673</b> shares in 2015 and 2014	5,786,730	5,786,730
Additional paid-in capital	2,847,332	2,847,332
Accumulated deficit	(4,446,608)	(4,352,138)
Accumulated other comprehensive (loss) income	<u>(38,523)</u>	<u>51,347</u>
	<u><b>5,933,931</b></u>	<u><b>6,118,271</b></u>
	<u><b>\$ 59,216,179</b></u>	<u><b>\$ 56,845,250</b></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,	2015	2014
<b>Interest and dividend revenue</b>		
Loans, including fees	\$ 1,979,966	\$ 2,139,128
Securities available for sale	178,393	239,384
Interest-bearing deposits in other banks	16,789	15,097
Dividends	<u>6,215</u>	<u>4,393</u>
Total interest and dividend revenue	<u>2,181,363</u>	<u>2,398,002</u>
<b>Interest expense</b>		
Deposits	316,392	336,949
Borrowed funds	<u>35,573</u>	<u>33,441</u>
Total interest expense	<u>351,965</u>	<u>370,390</u>
Net interest income	1,829,398	2,027,612
<b>Provision (reversal of provision) for loan losses</b>	<u>(135,500)</u>	106,000
Net interest income after provision for loan losses	<u>1,964,898</u>	<u>1,921,612</u>
<b>Noninterest revenue</b>		
Consulting fees	12,068	231,292
Gain on sale of foreclosed real estate	-	46,301
Gain on sale of securities available for sale	25,895	-
Other	<u>32,212</u>	<u>17,869</u>
Total noninterest revenue	<u>70,175</u>	<u>295,462</u>
<b>Noninterest expenses</b>		
Salaries and employee benefits	1,213,677	1,405,865
Occupancy and equipment	126,505	129,490
Data processing	62,452	61,180
Marketing and promotion	13,807	7,122
Professional fees	269,482	178,029
Federal deposit insurance premiums	61,000	77,847
Foreclosed real estate losses, write-downs, and costs	75,989	42,531
Other	<u>307,838</u>	<u>279,219</u>
Total noninterest expenses	<u>2,130,750</u>	<u>2,181,283</u>
(Loss) income before income taxes	(95,677)	35,791
Income tax benefit	<u>(1,207)</u>	<u>(1,289)</u>
<b>Net (loss) income</b>	<u>(94,470)</u>	37,080
Preferred stock dividends and discount accretion	-	4,732
Net (loss) income applicable to common shareholders	<u>\$ (94,470)</u>	<u>\$ 32,348</u>
<b>(Loss) earnings per common share</b>		
Basic	<u>\$ (0.16)</u>	<u>\$ 0.06</u>
Diluted	<u>\$ (0.16)</u>	<u>\$ 0.06</u>

*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,	2015	2014
<b>Net (loss) income</b>	<b><u>\$ (94,470)</u></b>	<b><u>\$ 37,080</u></b>
<b>Other comprehensive (loss) income</b>		
Unrealized (loss) gain on securities available for sale	(122,528)	186,303
Reclassification adjustment for realized gain on sale of securities available for sale	<u>(25,895)</u>	<u>-</u>
	<u>(148,423)</u>	<u>186,303</u>
Income tax relating to securities available for sale	<u>(58,553)</u>	<u>73,497</u>
Other comprehensive (loss) income	<u>(89,870)</u>	<u>112,806</u>
<b>Total comprehensive (loss) income</b>	<b><u>\$ (184,340)</u></b>	<b><u>\$ 149,886</u></b>

*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 (loss)	Total
Balance, December 31, 2013	\$ 1,780,268	\$ 5,784,240	\$ 2,848,328	\$ (4,384,486)	\$ (61,459)	\$ 5,966,891
Net income	-	-	-	37,080	-	37,080
Stock issued	-	2,490	(996)	-	-	1,494
Unrealized gain on securities available for sale net of income taxes of \$73,497	-	-	-	-	112,806	112,806
Preferred stock dividend and discount accretion	<u>4,732</u>	<u>-</u>	<u>-</u>	<u>(4,732)</u>	<u>-</u>	<u>-</u>
Balance, December 31, 2014	1,785,000	5,786,730	2,847,332	(4,352,138)	51,347	6,118,271
Net loss	-	-	-	(94,470)	-	(94,470)
Unrealized loss on securities available for sale net of income tax benefit of \$58,553	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(89,870)</u>	<u>(89,870)</u>
<b>Balance, December 31, 2015</b>	<b><u>\$ 1,785,000</u></b>	<b><u>\$ 5,786,730</u></b>	<b><u>\$ 2,847,332</u></b>	<b><u>\$ (4,446,608)</u></b>	<b><u>\$ (38,523)</u></b>	<b><u>\$ 5,933,931</u></b>

*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,	<b>2015</b>	2014
<b>Cash flows from operating activities</b>		
Interest received	\$ 2,270,152	\$ 2,511,334
Fees and commissions received	44,280	249,160
Interest paid	(354,478)	(369,881)
Cash paid to suppliers and employees	(1,946,580)	(2,162,774)
Income taxes paid	1,207	1,289
Cash provided by operating activities	<b>14,581</b>	229,128
<b>Cash flows from investing activities</b>		
Proceeds from maturity of securities available for sale	1,582,670	1,727,752
Proceeds from sale of securities available for sale	2,585,207	-
Purchase of securities available for sale	(2,464,875)	-
Purchase of Federal Home Loan Bank stock	117,500	(134,300)
Loans made, net of principal collected	710,049	2,781,750
Purchases of premises, equipment, and software	(19,067)	(27,543)
Proceeds from sale of foreclosed real estate	79,663	453,771
Cash provided by investing activities	<b>2,591,147</b>	4,801,430
<b>Cash flows from financing activities</b>		
Net increase (decrease) in		
Deposits	3,243,946	(10,160,008)
Federal funds purchased	2,888,657	63,469
Federal Home Loan Bank advances	(3,600,000)	4,600,000
Proceeds from issuance of common stock	-	1,494
Cash provided (used) by financing activities	<b>2,532,603</b>	(5,495,045)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>5,138,331</b>	<b>(464,487)</b>
Cash and cash equivalents at beginning of year	<b>5,709,699</b>	6,174,186
<b>Cash and cash equivalents at end of year</b>	<b>\$10,848,030</b>	\$ 5,709,699

*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,	<b>2015</b>	2014
<b>Reconciliation of net (loss) income to net cash provided by operating activities</b>		
Net (loss) income	\$ (94,470)	\$ 37,080
<b>Adjustments to reconcile net (loss) income to net cash provided by operating activities</b>		
Provision (reversal of provision) for loan losses	(135,500)	106,000
Depreciation and amortization	13,105	16,706
Net amortization of investment securities premiums	88,849	100,151
Gain on sale of foreclosed real estate	-	(46,301)
Gain on sale of securities available for sale	(25,895)	-
Write-down of foreclosed real estate	66,722	17,000
Decrease (increase) in		
Accrued interest receivable	14,314	41,130
Other assets	79,164	8,259
Increase (decrease) in		
Deferred loan fees, net	(14,374)	(27,949)
Accrued interest payable	(2,513)	509
Other liabilities	25,179	(23,457)
Cash provided by operating activities	<u>\$ 14,581</u>	<u>\$ 229,128</u>

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

# 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 purchases participation interests in commercial and commercial real estate loans from 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 valuation of foreclosed real estate, and the valuation of deferred tax assets.

#### *Concentration of credit risk*

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

#### *Subsequent events*

The Bank has evaluated events and transactions subsequent to December 31, 2015 through March 16, 2016, 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.

#### *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.

# 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.

#### *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 revenue using a method that approximates the constant yield 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. Additional stock is purchased and redeemed based on 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 revenue 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 deferred fees and costs, and premiums 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 and interest. 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.

#### *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, (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)

#### *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 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).

#### *Earnings (loss) per common share*

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

	2015	2014
Average shares outstanding	578,673	578,660
Dilutive effect to stock options	<u>-</u>	<u>-</u>
Diluted shares	<u>578,673</u>	<u>578,660</u>
Anti-dilutive shares	<u>-</u>	<u>47,208</u>

#### *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.

#### *Reclassifications*

Certain amounts in the 2014 consolidated financial statements have been reclassified to conform to the 2015 presentation. The reclassifications had no impact on the net loss for the year ended December 31, 2014.

### 2. Cash and Cash Equivalents

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 balances carried were **\$110,902** and \$115,145 for the years ended December 31, 2015 and 2014, respectively.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 2. Cash and Cash Equivalents (Continued)

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same ownership category. The combined total is insured up to \$250,000.

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.

#### 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
<b>December 31, 2015</b>				
Mortgage-backed	<u>\$ 7,363,442</u>	<u>\$ 20,736</u>	<u>\$ (84,358)</u>	<u>\$ 7,299,820</u>
December 31, 2014				
Mortgage-backed	<u>\$ 9,129,397</u>	<u>\$ 100,868</u>	<u>\$ (16,066)</u>	<u>\$ 9,214,199</u>

Mortgage-backed securities are payable in monthly installments.

Gross gains of **\$25,895** were realized on the sale of securities available for sale during the year ended December 31, 2015. Proceeds from the sales were **\$2,585,207**. The Bank did not sell any securities available for sale during 2014.

As of December 31, 2015, securities with a fair value of **\$1,412,109** were pledged for advances from the Federal Home Loan Bank of Atlanta. As of December 31, 2014, securities with a fair value of \$6,796,760 were pledged for advances from the Federal Home Loan Bank of Atlanta.

Information pertaining to securities with gross unrealized losses at December 31, 2015 and 2014, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than 12 months		12 months or longer		Total	
<b>December 31, 2015</b>	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Mortgage-backed	<u>\$4,749,454</u>	<u>\$(58,622)</u>	<u>\$722,117</u>	<u>\$(25,736)</u>	<u>\$5,471,571</u>	<u>\$(84,358)</u>
December 31, 2014						
Mortgage-backed	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 803,230</u>	<u>\$ (16,066)</u>	<u>\$ 803,230</u>	<u>\$ (16,066)</u>

The unrealized losses are considered temporary because the impairment in value is caused by fluctuation in the current interest rate market. Management has the intent and ability to hold these securities until they recover in value.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 4. Loans

The composition of loans receivable at December 31, 2015 and 2014, is as follows:

	2015	2014
Commercial real estate	<b>\$24,212,357</b>	\$25,896,442
Residential real estate	<b>8,980,162</b>	6,917,420
Construction and land development	<b>5,722</b>	857,998
Commercial	<b>4,196,697</b>	4,499,278
Consumer	<b>3,087,681</b>	3,164,128
Total loans	<b>40,482,619</b>	41,335,266
Premium on loans purchased	<b>75,619</b>	18,201
Deferred loan fees and costs, net	<b>4,022</b>	(10,352)
Allowance for loan losses	<b>(510,980)</b>	(731,660)
	<b><u>\$40,051,280</u></b>	<u>\$40,611,455</u>

Summaries of transactions in the allowance for loan losses, by loan classification, during the years ended December 31, 2015 and 2014, follow:

Year ended December 31, 2015	Beginning balance	Provision		Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment		Outstanding loan balances evaluated for impairment	
		for loan losses	Charge offs			Individually	Collectively	Individually	Collectively
Commercial real estate	\$279,881	\$ (31,940)	\$ -	\$ 39,078	\$287,019	\$56,000	\$231,019	\$1,329,609	\$22,882,748
Residential real estate	77,682	31,676	-	-	109,358	-	109,358	-	8,980,162
Construction and land development	-	-	-	-	-	-	-	5,722	-
Commercial	197,066	(169,142)	-	19,552	47,476	-	47,476	-	4,196,697
Consumer	177,031	33,906	(143,810)	-	67,127	21,590	45,537	234,802	2,852,879
	<u>\$731,660</u>	<u>\$(135,500)</u>	<u>\$(143,810)</u>	<u>\$ 58,630</u>	<u>\$510,980</u>	<u>\$77,590</u>	<u>\$433,390</u>	<u>\$1,570,133</u>	<u>\$38,912,486</u>

Year ended December 31, 2014

Commercial real estate	\$ 477,782	\$ (3,495)	\$ (227,124)	\$ 32,718	\$ 279,881	\$ -	\$ 279,881	\$ 631,476	\$ 25,264,966
Residential real estate	107,225	(29,543)	-	-	77,682	-	77,682	-	6,917,420
Construction and land development	31,159	(8,176)	(22,983)	-	-	-	-	857,998	-
Commercial	109,942	87,124	-	-	197,066	77,000	120,066	300,686	4,198,592
Consumer	54,105	60,090	-	62,836	177,031	143,809	33,222	372,808	2,791,320
	<u>\$ 780,213</u>	<u>\$ 106,000</u>	<u>\$ (250,107)</u>	<u>\$ 95,554</u>	<u>\$ 731,660</u>	<u>\$220,809</u>	<u>\$ 510,851</u>	<u>\$ 2,162,968</u>	<u>\$ 39,172,298</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, 2015 and 2014, were as follows:

	Loans		Total past due loans	Current loans	Total loans	Accruing	Nonaccrual loans	Interest not
	Loans 30-89 days past due	Loans 90 or more days past due				loans 90 or more days past due		accrued on nonaccrual loans
<b>December 31, 2015</b>								
Commercial real estate	\$659,422	\$1,329,609	\$1,989,031	\$22,223,326	\$24,212,357	\$ -	\$1,329,609	\$126,780
Residential real estate	-	-	-	8,980,162	8,980,162	-	-	-
Construction and land development	-	5,722	5,722	-	5,722	-	5,722	41,684
Commercial	-	-	-	4,196,697	4,196,697	-	-	-
Consumer	21,590	213,213	234,803	2,852,878	3,087,681	-	213,213	3,056
	<u>\$681,012</u>	<u>\$1,548,544</u>	<u>\$2,229,556</u>	<u>\$38,253,063</u>	<u>\$40,482,619</u>	<u>\$ -</u>	<u>\$1,548,544</u>	<u>\$171,520</u>
December 31, 2014								
Commercial real estate	\$ -	\$ 32,324	\$ 32,324	\$ 25,864,118	\$ 25,896,442	\$ -	\$ 32,324	\$ 44,111
Residential real estate	-	-	-	6,917,420	6,917,420	-	-	-
Construction and land development	-	144,889	144,889	713,109	857,998	-	144,889	23,105
Commercial	-	300,686	300,686	4,198,592	4,499,278	-	300,686	136,391
Consumer	-	372,808	372,808	2,791,320	3,164,128	228,998	143,810	5,213
	<u>\$ -</u>	<u>\$ 850,707</u>	<u>\$ 850,707</u>	<u>\$ 40,484,559</u>	<u>\$ 41,335,266</u>	<u>\$228,998</u>	<u>\$ 621,709</u>	<u>\$ 208,820</u>

Impaired loans as of December 31, 2015 and 2014, were as follows:

	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average	Interest recognized
						recorded investment	
<b>December 31, 2015</b>							
Commercial real estate	\$1,329,608	\$1,101,155	\$228,453	\$1,329,608	\$56,000	\$1,268,516	\$27,579
Residential real estate	-	-	-	-	-	-	-
Construction and land development	39,866	5,722	-	5,722	-	6,382	-
Commercial	-	-	-	-	-	-	-
Consumer	234,803	213,213	21,590	234,803	21,590	244,154	12,890
	<u>\$1,604,277</u>	<u>\$1,320,090</u>	<u>\$250,043</u>	<u>\$1,570,133</u>	<u>\$77,590</u>	<u>\$1,519,052</u>	<u>\$40,469</u>
December 31, 2014							
Commercial real estate	\$ 631,476	\$ 631,476	\$ -	\$ 631,476	\$ -	\$ 636,706	\$ 61,540
Residential real estate	-	-	-	-	-	-	-
Construction and land development	880,980	857,998	-	857,998	-	897,198	36,051
Commercial	300,686	-	300,686	300,686	77,000	300,686	-
Consumer	372,808	228,998	143,810	372,808	143,809	380,511	13,562
	<u>\$ 2,185,950</u>	<u>\$ 1,718,472</u>	<u>\$ 444,496</u>	<u>\$ 2,162,968</u>	<u>\$220,809</u>	<u>\$ 2,215,101</u>	<u>\$111,153</u>

The Bank was not committed to advance any funds in connection with impaired loans at December 31, 2015 or 2014.

# Maryland Financial Bank and Subsidiary

## Notes to Consolidated Financial Statements (Continued)

### 4. Loans (Continued)

#### *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 watch list or classified loans 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, 2015 and 2014, balances of classified loans based on risk grade. Classified loans include Pass/Watch, Special Mention, Substandard, and Doubtful loans.

<b>December 31, 2015</b>	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
Commercial real estate	<b>\$3,550,275</b>	<b>\$1,904,934</b>	<b>\$1,329,609</b>	\$ -	<b>\$6,784,818</b>
Residential real estate	<b>649,011</b>	-	-	-	<b>649,011</b>
Construction and land development	-	-	<b>5,722</b>	-	<b>5,722</b>
Commercial	-	<b>309,104</b>	-	-	<b>309,104</b>
Consumer	-	<b>110,642</b>	<b>234,803</b>	-	<b>345,445</b>
	<u><b>\$4,199,286</b></u>	<u><b>\$2,324,680</b></u>	<u><b>\$1,570,134</b></u>	<u><b>\$ -</b></u>	<u><b>\$8,094,100</b></u>
<hr/>					
December 31, 2014					
Commercial real estate	\$ 3,180,572	\$ 1,459,107	\$ 631,476	\$ -	\$ 5,271,155
Residential real estate	819,602	-	-	-	819,602
Construction and land development	-	-	857,999	-	857,999
Commercial	325,756	-	-	300,686	626,442
Consumer	-	136,200	228,998	143,810	509,008
	<u>\$ 4,325,930</u>	<u>\$ 1,595,307</u>	<u>\$ 1,718,473</u>	<u>\$ 444,496</u>	<u>\$ 8,084,206</u>

Classified loans also include certain loans that have been modified in troubled debt restructurings (TDRs) 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.

There was one consumer loan TDR outstanding as of December 31, 2014, with a balance outstanding of \$143,809 that had been fully reserved in the allowance for loan losses as of December 31, 2014. This loan was charged-off during the year ended December 31, 2015. There were no TDRs outstanding as of December 31, 2015.

#### 5. Premises and Equipment

The components of premises and equipment at December 31, 2015 and 2014, are as follows:

	Useful lives	2015	2014
Furniture, fixtures, and equipment	5 to 7 years	<b>\$ 155,302</b>	\$155,302
Computer equipment	3 years	<b>91,486</b>	74,933
		<u><b>246,788</b></u>	<u>230,235</u>
Accumulated depreciation		<u><b>214,268</b></u>	<u>204,340</u>
		<u><b>\$ 32,520</b></u>	<u>\$ 25,895</u>
Depreciation expense		<u><b>\$ 12,442</b></u>	<u>\$ 14,900</u>

Included in other assets at December 31, 2015 and 2014, is computer software carried at an amortized cost of **\$1,157** and \$1,820, respectively. Software amortization expense was **\$663** and \$1,806 in 2015 and 2014, respectively.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 6. Interest-Bearing Time Deposits

The aggregate amount of interest-bearing time deposits in denominations of \$250,000 or more was **\$5,539,999** and \$3,003,658 as of December 31, 2015 and 2014, respectively.

At December 31, 2015, the scheduled maturities of certificates of deposit were as follows:

	Amount
Less than one year	\$24,834,970
Over one to three years	<u>10,525,207</u>
	<u><u>\$35,360,177</u></u>

Included in certificates of deposit as of December 31, 2015 and 2014, are brokered certificates of deposit of **\$3,359,999** and \$528,000, respectively.

#### 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 **0.24%** and 0.23% for the years ended December 31, 2015 and 2014, respectively. Federal funds purchased mature daily.

#### 8. Borrowings

The Bank's borrowing from the Federal Home Loan Bank as of December 31, 2015 and 2014, is summarized as follows:

Maturity date	Interest rate	December 31, 2015 balance	December 31, 2014 balance
April 7, 2016	0.460%	<b>\$1,000,000</b>	\$ -
May 13, 2015	0.355%	<u>-</u>	<u>4,600,000</u>
		<u><b>\$1,000,000</b></u>	<u><u>\$4,600,000</u></u>

As of December 31, 2015, the Bank has pledged real estate loans totaling **\$20,083,608** to the Federal Reserve Bank of Richmond to provide a borrowing capacity of **\$10,929,747** under its discount window program. As of December 31, 2014, the Bank had pledged real estate loans totaling \$21,918,252 to the Federal Reserve Bank of Richmond to provide a borrowing capacity of \$13,449,306 under its discount window program.

The Bank has a \$5,921,000 line of credit available through the FHLB. As of December 31, 2015, remaining credit availability is **\$4,921,000**. The Bank would be required to pledge additional investment securities in its portfolio to further draw upon the line of credit.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 9. Preferred Stock

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 paid dividends at a rate of 5% per annum until May 15, 2014. Beginning May 15, 2014, the dividend rate increased 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. 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 continued quarterly payments through the August 15, 2013, payment. The Bank discontinued declaring and paying the dividends on the Series A and Series B Preferred Stock starting with the November 15, 2013, payment as it negotiated repayment. Through December 31, 2015, and the date these financial statements were available to be issued, the Bank did not pay the dividend on the preferred shares for a total of 14 quarters.

Management was informed that the Treasury auctioned and sold all of the Series A and B shares to an investor during the year ended December 31, 2014.

#### 10. Lease Commitments

The Bank extended a lease agreement for its banking office through April 30, 2020. The Bank has the option to extend the lease agreement for one additional five-year period. The Bank has a one-time right to terminate the lease effective as of April 30, 2018. 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.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 10. Lease Commitments (Continued)

The lease requires the following minimum payments:

Year	Payments
2016	\$103,071
2017	105,664
2018	108,311
2019	111,011
2020	37,781
	\$465,838

Rent expense for the years ended December 31, 2015 and 2014, totaled **\$96,944** and \$95,148, respectively.

#### 11. Income Taxes

The Bank did not incur federal income tax expense during the years ended December 31, 2015 and 2014. The Bank's subsidiary has incurred an income tax liability in certain states in which it provides services.

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

	2015	2014
<b>Deferred tax assets</b>		
Net operating loss and charitable contribution carryforwards	<b>\$1,501,269</b>	\$1,444,156
Allowance for loan losses	-	65,991
Depreciation	<b>234</b>	1,185
Cash basis accounting	<b>18,812</b>	-
Foreclosed real estate write-downs and holding costs	<b>68,173</b>	41,854
Unrealized loss on securities available for sale	<b>25,099</b>	-
	<b>1,613,587</b>	1,553,186
Valuation allowance	<b>(1,416,156)</b>	(1,385,654)
Total deferred tax assets, net of valuation allowance	<b>197,431</b>	167,532
<b>Deferred tax liabilities</b>		
Unrealized gain on securities available for sale	-	33,454
Allowance for loan losses	<b>24,559</b>	-
Cash basis accounting	-	21,739
Deferred loan costs	<b>13,773</b>	11,793
Total deferred tax liabilities	<b>38,332</b>	66,986
Net deferred tax asset	<b>\$ 159,099</b>	\$ 100,546

The Bank has net operating loss carryforwards available for federal income tax purposes of approximately \$3,782,099, which will begin to expire in 2025.

The Bank does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Bank remains subject to examination of income tax returns for the years ending after December 31, 2011.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 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 to the officers of the Bank. 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.

Information regarding the stock options is presented below:

	Options	Weighted average exercise price	Weighted average remaining contractual life
Outstanding at December 31, 2013	47,208	\$ 20	1.9
Granted in 2014	-	-	-
Exercised in 2014	-	-	-
Forfeited in 2014	-	-	-
	47,208	20	0.9
Outstanding at December 31, 2014	47,208	20	0.9
Granted in 2015	-	-	-
Exercised in 2015	-	-	-
Forfeited in 2015	(47,208)	(20)	-
	-	\$ -	-
<b>Outstanding at December 31, 2015</b>	-	\$ -	-
Options exercisable at December 31, 2015	-	\$ -	-

There was no intrinsic value of options outstanding in 2015 or 2014.

There were no stock options granted in 2015 or 2014.

#### 13. Warrants

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 was exercisable up to three years after the date of the issuance of the Unit in 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 issuance of the Unit in the offering. Warrants for 202,039 shares expired in 2014 unexercised. Warrants for 101,020 shares remain outstanding at December 31, 2015. They will expire in 2017, if not exercised.

# Maryland Financial Bank and Subsidiary

## Notes to Consolidated Financial Statements (Continued)

### 13. Warrants (Continued)

In connection with the initial private placement offering of the Bank, warrants were issued to purchase 1.5 shares of common stock at \$20.00 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 were exercisable within ten years from the date of issuance, expired in 2014.

### 14. 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.

Activity in these loans during the years ended December 31, 2015 and 2014, was as follows:

	2014
Beginning balance	\$57,187
Advances	-
Payments	(57,187)
Change in related parties	-
Ending balance	<u>\$ -</u>

There were no new related-party loans during the year ended December 31, 2015.

The Bank participates in loans originated by affiliated companies and also sells participations in loans to affiliated companies. These transactions are not included in the table above.

Deposits and federal funds purchased from related parties at December 31, 2015 and 2014, amounted to **\$7,475,103** and \$3,887,775, respectively. Related parties include community banks whose executives are members of our Board of Directors.

### 15. 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.

# Maryland Financial Bank and Subsidiary

## Notes to Consolidated Financial Statements (Continued)

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

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.

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

	Contract amount	
	2015	2014
Unfunded commitments under lines of credit		
Fixed rate	\$ 99,962	\$ 137,560
Variable rate	1,674,448	895,689

There were no commitments to originate loans as of December 31, 2015 or 2014.

### 16. 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.

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital. Common Equity Tier 1 capital for the Bank is reduced by goodwill and other intangible assets, if any, net of associated deferred tax liabilities and subject to transition provisions.

Under the revised prompt corrective action requirements, as of January 1, 2015, insured depository institutions are required to meet the following in order to qualify as "well capitalized:" (1) a common equity Tier 1 risk-based capital ratio of 6.5%; (2) a Tier 1 risk-based capital ratio of 8%; (3) a total risk-based capital ratio of 10%; and (4) a Tier 1 leverage ratio of 5%. Management believes that, as of December 31, 2015, the Bank met all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 16. Regulatory Matters (Continued)

The implementation of the capital conservation buffer will begin on January 1, 2016, at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

The following table presents actual and required capital ratios as of December 31, 2015, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2015, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules. The table presents actual and required capital ratios as of December 31, 2014, under the rules in effect prior to the Basel III Capital Rules.

As of December 31, 2015, the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the Bank's category.

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized under the regulatory framework for prompt corrective action.

The Bank's actual capital amounts and ratios at December 31, 2015 and 2014, are presented below:

	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2015</b>						
<i>(dollar amounts in thousands)</i>						
Tier 1 leverage ratio	<b>\$5,944</b>	<b>10.76%</b>	<b>\$2,209</b>	<b>4.00%</b>	<b>\$2,761</b>	<b>5.00%</b>
Tier 1 capital (to risk-weighted assets)	<b>5,944</b>	<b>15.15%</b>	<b>2,354</b>	<b>6.00%</b>	<b>3,139</b>	<b>8.00%</b>
Common equity tier 1 capital ratio (to risk-weighted assets)	<b>4,194</b>	<b>10.69%</b>	<b>1,766</b>	<b>4.50%</b>	<b>2,551</b>	<b>6.50%</b>
Total capital ratio (to risk-weighted assets)	<b>6,435</b>	<b>16.40%</b>	<b>3,139</b>	<b>8.00%</b>	<b>3,924</b>	<b>10.00%</b>
<b>December 31, 2014</b>						
Tier 1 capital (to average assets)	\$ 6,067	10.62%	\$ 2,284	4.00%	\$ 2,855	5.00%
Tier 1 capital (to risk-weighted assets)	6,067	15.51%	1,565	4.00%	2,348	6.00%
Total capital (to risk-weighted assets)	6,559	16.76%	3,130	8.00%	3,913	10.00%

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 17. 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.

#### *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:

	Total	Quoted prices in active markets identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<b>December 31, 2015</b>				
Securities available for sale	<u>\$7,299,820</u>	<u>\$ -</u>	<u>\$7,299,820</u>	<u>\$ -</u>
<b>December 31, 2014</b>				
Securities available for sale	<u>\$ 9,214,199</u>	<u>\$ -</u>	<u>\$ 9,214,199</u>	<u>\$ -</u>

## Maryland Financial Bank and Subsidiary

### Notes to Consolidated Financial Statements (Continued)

#### 17. Fair Value Measurements (Continued)

##### *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, 2015 and 2014, the fair values consist of loan balances of **\$1,570,133** and \$2,162,968, net of specific allowances of **\$77,590** and \$220,809, respectively.

Foreclosed real estate - The Bank's foreclosed real estate is measured at fair value less cost to sell on a nonrecurring basis. 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.

<b>December 31, 2015</b>	Total	Level 1 inputs	Level 2 inputs	Level 3 inputs
Impaired loans	<u><b>\$1,492,543</b></u>	<u>\$ -</u>	<u>\$ -</u>	<u><b>\$1,492,543</b></u>
Foreclosed real estate	<u><b>\$ 284,506</b></u>	<u>\$ -</u>	<u>\$ -</u>	<u><b>\$ 284,506</b></u>
<hr/>				
December 31, 2014				
Impaired loans	<u>\$ 1,942,159</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,942,159</u>
Foreclosed real estate	<u>\$ 430,891</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 430,891</u>

Transactions in foreclosed real estate during the years ended December 31, 2015 and 2014, were as follows:

	2015	2014
Beginning of year balance	<b>\$430,891</b>	\$ 855,361
Write-downs	<b>(66,722)</b>	(17,000)
Proceeds from sale	<b>(79,663)</b>	(453,771)
Gain (loss) on sale	-	46,301
End of year balance	<u><b>\$284,506</b></u>	<u>\$ 430,891</u>