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GLEN BURNIE BANCORP

Form 10-K

March 17, 2009

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2008 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 0-24047

GLEN BURNIE BANCORP

(Exact name of registrant as specified in its charter)

MARYLAND

(State or other jurisdiction  
of incorporation or organization)

52-1782444

(I.R.S. Employer  
Identification No.)

101 Crain Highway, S.E., Glen Burnie, Maryland  
(Address of principal executive offices)

21061  
(Zip Code)

Registrant's telephone number, including area code (410) 766-3300

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

| Title of Class | Name of Each Exchange on Which Registered |
|----------------|---|
| None           | None                                      |

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

| Title of Class                 |
|--------------------------------|
| Common Stock, \$1.00 par value |
| Common Stock Purchase Rights   |

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2008 was \$26,280,443.

The number of shares of common stock outstanding as of February 4, 2009 was 2,967,729.

documents incorporated by reference

To the extent specified, Part III of this Form 10-K incorporates information by reference to the Registrant's definitive proxy statement for its 2009 Annual Meeting of Shareholders (to be filed).

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GLEN BURNIE BANCORP  
2008 ANNUAL REPORT ON FORM 10-K

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PART I

ITEM 1. BUSINESS

General

Glen Burnie Bancorp (the “Company”) is a bank holding company organized in 1990 under the laws of the State of Maryland. It presently owns all the outstanding shares of capital stock of The Bank of Glen Burnie (the “Bank”), a commercial bank organized in 1949 under the laws of the State of Maryland, serving northern Anne Arundel County and surrounding areas from its main office and branch in Glen Burnie, Maryland and branch offices in Glen Burnie (South Crain location), Odenton, Riviera Beach, Crownsville, Severn, Linthicum and Severna Park, Maryland. The Bank also maintains two remote Automated Teller Machine (“ATM”) locations in Ferndale and Pasadena, Maryland. The Bank maintains a website at [www.thebankofglenburnie.com](http://www.thebankofglenburnie.com). The Bank is the oldest independent commercial bank in Anne Arundel County. The Bank is engaged in the commercial and retail banking business as authorized by the banking statutes of the State of Maryland, including the acceptance of demand and time deposits, and the origination of loans to individuals, associations, partnerships and corporations. The Bank’s real estate financing consists of residential first and second mortgage loans, home equity lines of credit and commercial mortgage loans. Commercial lending consists of both secured and unsecured loans. The Bank also originates automobile loans through arrangements with local automobile dealers. The Bank’s deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation (“FDIC”).

The Company’s principal executive office is located at 101 Crain Highway, S.E., Glen Burnie, Maryland 21061. Its telephone number at such office is (410) 766-3300.

Information on the Company and its subsidiary Bank may be obtained from the Company’s website [www.thebankofglenburnie.com](http://www.thebankofglenburnie.com). Copies of the Company’s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments thereto are available free of charge on the website as soon as they are filed with the SEC through a link to the SEC’s EDGAR reporting system. Simply select the “Investor Relations” menu item, then click on the “All SEC Filings” or “Insider Transactions” link.

Economic and Credit Turmoil of 2008

The turmoil and economic downturn which engulfed the United States and world financial services industry during 2008 and the ensuing overall consequences to numerous industries and the U.S. economy is well known and discussed daily in the media. The Bank and, as a result, the Company, have not been immune to the impact of these difficult economic times. While, due to conservative lending decisions, the Bank has no exposure to the credit issues affecting the sub-prime residential mortgage market, the economic slowdown resulted in the necessity of our contributing \$1,146,000 to our reserve for loan losses in 2008, primarily due to delinquency in our indirect automobile portfolio combined with adjustments we made to the risk factors in our calculation of required loan loss reserves. The economic downturn also resulted in the necessity of the Bank taking in our first OREO (Other Real Estate Owned) property on a defaulted mortgage since 1999. In September, the Federal Housing Finance Agency was named conservator over both the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), two government sponsored agencies in which we had invested through the purchase of \$3,000,000 of AAA rated preferred stock. As a result, we wrote down the value of those investments to \$184,000 by taking a charge to earnings in the third quarter of \$2,816,000. Each of these factors will be discussed as appropriate elsewhere in this report. Nevertheless, despite the sharp economic downturn and these events, which are unusual for us in any year, we realized net income of \$403,962 for 2008, remained well capitalized and did not need to apply for any funding from the U.S. Department of Treasury’s Troubled Asset Relief Program (TARP). During 2008, we continued to lend money and, we believe, meet the needs of our customers and neighbors through a difficult year. We

believe we are a sound, conservatively run financial institution that has been profitable in 2008 despite the deterioration in the economic environment and the outside forces that have affected us this past year.

#### Market Area

The Bank considers its principal market area for lending and deposit products to consist of Northern Anne Arundel County, Maryland, which consists of those portions of the county north of U.S. Route 50. Northern Anne Arundel County includes mature suburbs of the City of Baltimore, which in recent years have experienced modest population growth and are characterized by an aging population. Management believes that the majority of the working population in its market area either commutes to Baltimore or is employed at businesses located at or around the nearby Baltimore Washington International Airport. Anne Arundel County is generally considered to have more affordable housing than other suburban Baltimore areas and attracts younger persons and minorities on this basis. This inflow, however, has not been sufficient to affect current population trends.

## Lending Activities

The Bank offers a full range of consumer and commercial loans. The Bank's lending activities include residential and commercial real estate loans, construction loans, land acquisition and development loans, commercial loans and consumer installment lending including indirect automobile lending. Substantially all of the Bank's loan customers are residents of Anne Arundel County and surrounding areas of Central Maryland. The Bank solicits loan applications for commercial loans from small to medium sized businesses located in its market area. The Company believes that this is a market in which a relatively small community bank, like the Bank, has a competitive advantage in personal service and flexibility. The Bank's consumer lending currently consists primarily of indirect automobile loans originated through arrangements with local dealers.

The Company's total loan portfolio increased during the 2008, 2007, 2006, 2005, and 2004 fiscal years. In 2008, the increase in the loan portfolio was primarily due to increases in refinanced mortgage loans, commercial and residential construction loans and mortgage participations purchased, partially offset by additional mortgage participations sold and a decrease in indirect loans. In 2007, the increases were due to residential and commercial mortgages and construction, offset by a decrease in indirect lending and mortgage participations purchased and an increase in mortgage participations sold. In 2006, the increases were primarily due to an increase in commercial mortgages (due to an increase in participations), offset by decreases in residential mortgages and indirect automobile loans. In 2005, the increases were primarily due to an increase in commercial and industrial mortgages and indirect automobile loans. In 2004, the increases in loans were primarily due to increases in residential mortgages due to a strong housing market environment.

The following table provides information on the composition of the loan portfolio at the indicated dates.

|                                    | 2008      |         | 2007      |         | At December 31,<br>2006 |         | 2005      |         | 2004      |         |
|------------------------------------|-----------|---------|-----------|---------|-------------------------|---------|-----------|---------|-----------|---------|
|                                    | \$        | %       | \$        | %       | \$                      | %       | \$        | %       | \$        | %       |
| <b>Mortgage:</b>                   |           |         |           |         |                         |         |           |         |           |         |
| Residential                        | \$ 87,708 | 36.85%  | \$ 76,781 | 37.98%  | \$ 68,341               | 34.88%  | \$ 71,841 | 37.17%  | \$ 71,039 | 38.27%  |
| Commercial                         | 76,153    | 31.99   | 47,843    | 23.66   | 53,164                  | 27.13   | 37,666    | 19.50   | 31,983    | 17.23   |
| Construction and land development  | 6,590     | 2.77    | 5,876     | 2.91    | 1,609                   | 0.83    | 1,402     | 0.73    | 2,080     | 1.12    |
| <b>Consumer:</b>                   |           |         |           |         |                         |         |           |         |           |         |
| Installment                        | 16,451    | 6.91    | 17,087    | 8.45    | 15,044                  | 7.67    | 15,748    | 8.15    | 19,019    | 10.25   |
| Credit card                        | 173       | 0.07    | 143       | 0.07    | 144                     | 0.08    | 128       | 0.07    | 180       | 0.10    |
| <b>Indirect automobile</b>         |           |         |           |         |                         |         |           |         |           |         |
| Commercial                         | 43,970    | 18.47   | 49,260    | 24.37   | 52,539                  | 26.81   | 60,510    | 31.31   | 55,703    | 30.00   |
| Gross loans                        | 238,019   | 100.00% | 202,174   | 100.00% | 195,918                 | 100.00% | 193,227   | 100.00% | 185,622   | 100.00% |
| Unearned income on loans           | (864)     |         | (816)     |         | (743)                   |         | (821)     |         | (919)     |         |
| Gross loans net of unearned income | 237,155   |         | 201,357   |         | 195,175                 |         | 192,406   |         | 184,703   |         |

|                                   |            |            |            |            |            |
|-----------------------------------|------------|------------|------------|------------|------------|
| Allowance<br>for credit<br>losses | (2,022)    | (1,604)    | (1,839)    | (2,201)    | (2,412)    |
| Loans, net                        | \$ 235,133 | \$ 199,753 | \$ 193,336 | \$ 190,205 | \$ 182,291 |

The following table sets forth the maturities for various categories of the loan portfolio at December 31, 2008. Demand loans and loans which have no stated maturity, are treated as due in one year or less. At December 31, 2008, the Bank had \$51,812,762 in loans due after one year with variable rates and \$163,134,728 in such loans with fixed rates.

|                                   | Due Within<br>One Year<br>(In Thousands) | Due Over One To<br>Five Years | Due Over<br>Five Years | Total      |
|-----------------------------------|--|-------------------------------|------------------------|------------|
| <b>Real Estate - mortgage:</b>    |  |                               |                        |            |
| Residential                       | \$ 6,494                                 | \$ 2,366                      | \$ 78,848              | \$ 87,708  |
| Commercial                        | 6,909                                    | 40,525                        | 28,719                 | 76,153     |
| Construction and land development | 465                                      | 4,075                         | 2,050                  | 6,590      |
| Installment                       | 1,194                                    | 9,529                         | 5,728                  | 16,451     |
| Credit Card                       | 173                                      | -                             | -                      | 173        |
| Indirect automobile               | 1,284                                    | 33,736                        | 8,950                  | 43,970     |
| Commercial                        | 5,386                                    | 26                            | 1,562                  | 6,974      |
|                                   | \$ 21,905                                | \$ 90,257                     | \$ 125,857             | \$ 238,019 |

**Real Estate Lending.** The Bank offers long-term mortgage financing for residential and commercial real estate as well as shorter term construction and land development loans. Residential mortgage and residential construction loans are originated with fixed rates, while commercial mortgages may be originated on either a fixed or variable rate basis. Commercial construction loans are generally originated on a variable rate basis. Substantially all of the Bank's real estate loans are secured by properties in Anne Arundel County, Maryland. Under the Bank's loan policies, the maximum permissible loan-to-value ratio for owner-occupied residential mortgages is 80% of the lesser of the purchase price or appraised value. The Bank, however, will make loans secured by owner-occupied residential real estate with loan-to-value ratios up to 95% (some restrictions may apply), provided the borrower obtains private mortgage insurance for the portion of the loan in excess of 80%. For residential investment properties, the maximum loan-to-value ratio is 80%. The maximum permissible loan-to-value ratio for residential and residential construction loans is 80%. The maximum loan-to-value ratio for permanent commercial mortgages is 75%. The maximum loan-to-value ratio for land development loans is 70% and for unimproved land is 65%. The Bank also offers home equity loans secured by the borrower's primary residence, provided that the aggregate indebtedness on the property does not exceed 80% of its value. Because mortgage lending decisions are based on conservative lending policies, the Company has no exposure to the credit issues affecting the sub-prime residential mortgage market.

**Commercial Lending.** The Bank's commercial loan portfolio consists of demand, installment and time loans for commercial purposes. The Bank's business demand, installment and time lending includes various working capital loans, equipment, vehicles, lines of credit and letters of credit for commercial customers. Demand loans require the payment of interest until called, while installment loans require a monthly payment of principal and interest, and time loans require at maturity a single payment of principal and interest due monthly. Such loans may be made on a secured or an unsecured basis. All such loans are underwritten on the basis of the borrower's creditworthiness rather than the value of the collateral.

**Installment Lending.** The Bank makes consumer and commercial installment loans for the purchase of automobiles, boats, other consumer durable goods, capital goods and equipment. Such loans provide for repayment in regular installments and are secured by the goods financed. Also included in installment loans are overdraft loans and other credit repayable in installments. As of December 31, 2008, approximately 64.10% of the installment loans in the Bank's portfolio (other than indirect automobile lending) had been originated for commercial purposes and 35.90% had been originated for consumer purposes.

**Indirect Automobile Lending.** The Bank commenced its indirect automobile lending program in January 1998. The Bank finances new automobiles for terms of up to 72 months and used automobiles for terms of up to 60 months. For used vehicles, the age of the vehicle plus the term of the loan cannot exceed eight years. The Bank does not lend more than the MSRP on new vehicles. On used vehicles, the Bank will not lend more than 110% of the average wholesale published in a nationally recognized used vehicle pricing guide. The Bank requires all borrowers to obtain vendor's



single interest coverage protecting the Bank against loss in the case a borrower's automobile insurance lapses. The Bank originates indirect loans through a network of approximately 49 dealers which are primarily new car dealers located in Anne Arundel County and the surrounding counties. Participating dealers take loan applications from their customers and transmit them to the Bank for approval.

Other Loans. The Bank offers overdraft protection lines of credit, tied to checking accounts, as a convenience to qualified customers.

Although the risk of non-payment for any reason exists with respect to all loans, certain other specific risks are associated with each type of loan. The primary risks associated with commercial loans, including commercial real estate loans, are the quality of the borrower's management and a number of economic and other factors which induce business failures and depreciate the value of business assets pledged to secure the loan, including competition, insufficient capital, product obsolescence, changes in the borrowers' cost, environmental hazards, weather, changes in laws and regulations and general changes in the marketplace. Primary risks associated with residential real estate loans include fluctuating land and property values and rising interest rates with respect to fixed-rate, long-term loans. Residential construction lending exposes the Company to risks related to builder performance. Consumer loans, including indirect automobile loans, are affected primarily by domestic economic instability and a variety of factors that may lead to the borrower's unemployment, including deteriorating economic conditions in one or more segments of a local or broader economy. Because the Bank deals with borrowers through an intermediary on indirect automobile loans, this form of lending potentially carries greater risks of defects in the application process for which claims may be made against the Bank. Indirect automobile lending may also involve the Bank in consumer disputes under state "lemon" or other laws. The Bank seeks to control these risks by following strict underwriting and documentation guidelines. In addition, dealerships are contractually obligated to indemnify the Bank for such losses for a limited period of time.

The Bank's lending activities are conducted pursuant to written policies approved by the Board of Directors intended to ensure proper management of credit risk. Loans are subject to a well defined credit process that includes credit evaluation of borrowers, establishment of lending limits and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances, as well as procedures for on-going identification and management of credit deterioration. Regular portfolio reviews are performed by the Bank's Senior Credit Officer to identify potential underperforming loans and other credit facilities, estimate loss exposure and to ascertain compliance with the Bank's policies. On a quarterly basis, the Bank's Internal Auditor performs an independent loan review in accordance with the Bank's loan review policy. For significant problem loans, management review consists of evaluation of the financial strengths of the borrower and any guarantor, the related collateral, and the effects of economic conditions.

The Bank's loan approval policy provides for various levels of individual lending authority. The maximum aggregate lending authority granted by the Bank to any one Lending Officer is \$750,000. A combination of approvals from certain officers may be used to lend up to an aggregate of \$1,000,000. The Bank's Executive Committee is authorized to approve loans up to \$3.0 million. Larger loans must be approved by the full Board of Directors.

Under Maryland law, the maximum amount which the Bank is permitted to lend to any one borrower and their related interests may generally not exceed 10% of the Bank's unimpaired capital and surplus, which is defined to include the Bank's capital, surplus, retained earnings and 50% of its allowance for possible loan losses. Under this authority, the Bank would have been permitted to lend up to \$3.34 million to any one borrower at December 31, 2008. By interpretive ruling of the Commissioner of Financial Regulation, Maryland banks have the option of lending up to the amount that would be permissible for a national bank which is generally 15% of unimpaired capital and surplus (defined to include a bank's total capital for regulatory capital purposes plus any loan loss allowances not included in regulatory capital). Under this formula, the Bank would have been permitted to lend up to \$5.02 million to any one borrower at December 31, 2008. At December 31, 2008, the largest amount outstanding to any one borrower and its related interests was \$4,816,000.

#### Non-Performing Loans

It is the policy of the Bank to reverse accrued, and discontinue the accrual of, interest when a loan becomes 90 days or more delinquent and circumstances indicate that collection is doubtful.

The Bank seeks to control delinquencies through diligent collection procedures. For consumer loans, the Bank sends out payment reminders on the seventh and twelfth days after a payment is due. If a consumer loan becomes 15 days past due, the account is transferred to the Bank's collections department, which will contact the borrower by telephone and/or letter before the account becomes 30 days past due. If a consumer loan becomes more than 30 days past due, the Bank will continue its collection efforts and will move to repossession or foreclosure by the 45th day if the Bank has reason to believe that the collateral may be in jeopardy or the borrower has failed to respond to prior communications. The Bank will move to repossess or foreclose in all instances in which a consumer loan becomes more than 60 days delinquent. After repossession of a motor vehicle, the borrower has a 15-day statutory right to redeem the vehicle and is entitled to 10 days' notice before the sale of a repossessed vehicle. The Bank sells the vehicle as promptly as feasible after the expiration of these periods. If the amount realized from the sale of the vehicle is less than the loan amount, the Bank will seek a deficiency judgment against the borrower. The Bank follows similar collection procedures with respect to commercial loans.

While the Bank has weathered the economic and credit turbulence during 2008 and remains strong, the Bank experienced a significant increase in non-accrual loans as of December 31, 2008, from one commercial mortgage loan. The following table sets forth the amount of the Bank's restructured loans, non-accrual loans and accruing loans 90 days or more past due at the dates indicated:

|   | At December 31,        |         |           |           |         |
|---|------------------------|---------|-----------|-----------|---------|
|   | 2008                   | 2007    | 2006      | 2005      | 2004    |
|   | (Dollars In Thousands) |         |           |           |         |
| Restructured Loans  | \$ -                   | \$ 578  | \$ -      | \$ -      | \$ 95   |
| Non-accrual loans:  |                        |         |           |           |         |
| Real estate – mortgage:                                       |                        |         |           |           |         |
| Residential   | \$ -                   | \$ -    | \$ 3      | \$ 14     | \$ 122  |
| Commercial  | 659                    | -       | -         | -         | 255     |
| Real estate - construction                                    |                        |         |           |           |         |
| Installment   | 208                    | 212     | 46        | 159       | 205     |
| Commercial  | -                      | -       | 8         | 12        | 16      |
| Total non-accrual loans                                       | 867                    | 212     | 57        | 185       | 598     |
| Accruing loans past due 90 days or more                       |                        |         |           |           |         |
| Real estate – mortgage:                                       |                        |         |           |           |         |
| Residential   | 3                      | 512     | 2         | 1         | 1       |
| Commercial  | -                      | -       | -         | -         | -       |
| Real estate - construction                                    |                        |         |           |           |         |
| Installment   | 26                     | -       | -         | -         | -       |
| Commercial  | -                      | 128     | -         | -         | -       |
| Total accruing loans past due 90 days or more                 | 34                     | 640     | 2         | 4         | 7       |
| Total non-accrual and past due loans                          | \$ 901                 | \$ 852  | \$ 59     | \$ 189    | \$ 605  |
| Non-accrual and past due loans to gross loans                 | 0.38%                  | 0.43%   | 0.03%     | 0.10%     | 0.33%   |
| Allowance for credit losses to non-accrual and past due loans | 224.42%                | 188.27% | 3,116.95% | 1,164.55% | 398.68% |

For the year ended December 31, 2008, interest of \$29,807 would have been accrued on non-accrual loans if such loans had been current in accordance with their original terms. During that period, interest on non-accrual loans was not included in income. \$859,586, or 99%, of the Bank's total \$866,912 non-accrual loans at December 31, 2008 were attributable to 13 borrowers. No charge-offs have previously been taken on these loans. Two of these borrowers with a loan totaling \$12,402 were in bankruptcy at that date. Because of the legal protections afforded to borrowers in bankruptcy, collections on such loans are difficult and the Bank anticipates that such loans may remain delinquent for an extended period of time. All but one of these loans, the balance of which is \$79,167, is secured by collateral with a value well in excess of the current active balance of the Bank's loan.

At December 31, 2008, there were loans outstanding, totaling \$520,131, not reflected in the above table as to which known information about the borrower's possible credit problems caused management to have serious doubts as to the ability of the borrowers to comply with present loan repayment terms. These loans consist of loans which were not 90 days or more past due but where the borrower is in bankruptcy or has a history of delinquency or the loan to value ratio is considered excessive due to deterioration of the collateral or other factors.

At December 31, 2008, the Company had \$550,000 in real estate acquired in partial or total satisfaction of debt, compared to \$50,000 in such properties at each of December 31, 2007 and 2006. This increase resulted from the foreclosure by the Bank on one residential property during 2008, the first time since 1999 that the Bank took in an OREO (Other Real Estate Owned) property on a defaulted mortgage. All such properties are recorded at the lower of cost or fair value at the date acquired and carried on the balance sheet as other real estate owned. Losses arising at the date of acquisition are charged against the allowance for credit losses. Subsequent write-downs that may be required and expense of operation are included in non-interest expense. Gains and losses realized from the sale of other real estate owned are included in non-interest income or expense. For a description of the properties comprising other real estate owned at December 31, 2008, see “Item 2. — Properties.”

## Allowance For Credit Losses

The Bank's allowance for credit losses is based on the probable estimated losses that may be sustained in its loan portfolio. The allowance is based on two basic principles of accounting. (1) Statement of Financial Accounting Standards (SFAS) No. 5 "Accounting for Contingencies", which requires that losses be accrued when they are probable of occurring and estimable, and (2) SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for credit losses is established through a provision for credit losses charged to expense. Loans are charged against the allowance for credit losses when management believes that the collectibility of the principal is unlikely. The allowance, based on evaluations of the collectibility of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, value of collateral, and current economic conditions and trends that may affect the borrower's ability to pay. Because mortgage lending decisions are based on conservative lending policies, the Company has no exposure to the credit issues affecting the sub-prime residential mortgage market.

In 2008, the Bank increased its provision for credit losses due to net charge offs on installment loans of \$746,000 (primarily made up of charge offs on indirect automobile loans of \$719,000) and adjustments to the risk factors for our loan loss reserve calculation as economic conditions deteriorated.

Transactions in the allowance for credit losses during the last five fiscal years were as follows:

|                            | Year Ended December 31, |          |          |          |          |
|----------------------------|-------------------------|----------|----------|----------|----------|
|                            | 2008                    | 2007     | 2006     | 2005     | 2004     |
|                            | (Dollars In Thousands)  |          |          |          |          |
| Beginning Balance          | \$ 1,604                | \$ 1,839 | \$ 2,201 | \$ 2,412 | \$ 2,246 |
| Loans charged off          |                         |          |          |          |          |
| Real estate - mortgage:    |                         |          |          |          |          |
| Residential                | -                       | -        | 1        | -        | -        |
| Commercial                 | -                       | -        | -        | -        | -        |
| Real estate - construction |                         |          |          |          |          |
| Installment                | 1,079                   | 591      | 528      | 495      | 502      |
| Credit card & related      |                         |          |          |          |          |
| Commercial                 | 2                       | -        | 253      | 127      | 49       |
| Total                      | 1,081                   | 591      | 782      | 622      | 551      |
| Recoveries                 |                         |          |          |          |          |
| Real estate - mortgage:    |                         |          |          |          |          |
| Residential                | -                       | -        | 1        | -        | 35       |
| Commercial                 | -                       | -        | -        | -        | -        |
| Real estate - construction |                         |          |          |          |          |
| Installment                | 333                     | 258      | 335      | 276      | 293      |
| Credit card & related      |                         |          |          |          |          |
| Commercial                 | 20                      | 48       | 22       | 185      | 49       |
| Total                      | 353                     | 306      | 358      | 461      | 377      |

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|   |            |            |            |            |            |
|---|------------|------------|------------|------------|------------|
| Net charge offs/(recoveries)                | 728        | 285        | 424        | 161        | 174        |
| Provisions (credited) charged to operations | 1,146      | 50         | 62         | (50)       | 340        |
| Ending balance                              | \$ 2,022   | \$ 1,604   | \$ 1,839   | \$ 2,201   | \$ 2,412   |
| Average loans                               | \$ 219,485 | \$ 199,632 | \$ 186,706 | \$ 191,706 | \$ 181,881 |
| Net charge-offs to average loans            | 0.33%      | 0.14%      | 0.23%      | 0.09%      | 0.10%      |

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The following table shows the allowance for credit losses broken down by loan category as of December 31, 2008, 2007, 2006, 2005, and 2004:

| Portfolio                      | At December 31,             |   |                             |   |
|--------------------------------|-----------------------------|---|-----------------------------|---|
|                                | 2008                        |   | 2007                        |   |
|                                | Allowance For Each Category | Percentage Of Loans In Each Category To Total Loans | Allowance For Each Category | Percentage Of Loans In Each Category To Total Loans |
| (Dollars In Thousands)         |                             |   |                             |   |
| <b>Real Estate - mortgage:</b> |                             |   |                             |   |
| Residential                    | \$ 123                      | 36.85%  | \$ 117                      | 37.98%  |
| Commercial                     | 460                         | 31.99   | 163                         | 23.66   |
| Real Estate — construction     | 63                          | 2.77  | 102                         | 2.91  |
| Installment                    | 161                         | 6.91  | 55                          | 8.45  |
| Credit Card                    | -                           | 0.07  | -                           | 0.07  |
| Indirect automobile            | 942                         | 18.47   | 892                         | 24.37   |
| Commercial                     | 240                         | 2.94  | 257                         | 2.56  |
| Unallocated                    | 33                          | -   | 18                          | -   |
| Total                          | \$ 2,022                    | 100.00%   | \$ 1,604                    | 100.00%   |

| Portfolio                      | At December 31,             |   |                             |   |                             |   |
|--------------------------------|-----------------------------|---|-----------------------------|---|-----------------------------|---|
|                                | 2006                        |   | 2005                        |   | 2004                        |   |
|                                | Allowance For Each Category | Percentage Of Loans In Each Category To Total Loans | Allowance For Each Category | Percentage Of Loans In Each Category To Total Loans | Allowance For Each Category | Percentage Of Loans In Each Category To Total Loans |
| (Dollars In Thousands)         |                             |   |                             |   |                             |   |
| <b>Real Estate – mortgage:</b> |                             |   |                             |   |                             |   |
| Residential                    | \$ 149                      | 34.88%  | \$ 153                      | 37.17%  | \$ 153                      | 38.27%  |
| Commercial                     | 314                         | 27.13   | 277                         | 19.50   | 328                         | 17.23   |
| Real Estate – construction     | 14                          | 0.83  | 8                           | 0.73  | 13                          | 1.12  |
| Installment                    | 103                         | 7.67  | 103                         | 8.15  | 136                         | 10.25   |
| Credit Card                    | -                           | 0.08  | -                           | 0.07  | -                           | 0.10  |
| Indirect automobile            | 1,119                       | 26.81   | 1,260                       | 31.31   | 1,254                       | 30.00   |
| Commercial                     | 260                         | 2.60  | 264                         | 3.07  | 343                         | 3.03  |
| Unallocated                    | 120                         | -   | 136                         | -   | 185                         | -   |
| Total                          | \$ 1,839                    | 100.00%   | \$ 2,201                    | 100.00%   | \$ 2,412                    | 100.00%   |

#### Investment Securities

The Bank maintains a substantial portfolio of investment securities to provide liquidity as well as a source of earnings. The Bank's investment securities portfolio consists primarily of U.S. Treasury securities, securities issued by U.S. Government agencies including mortgage-backed securities, securities issued by certain states and their political subdivisions, and corporate trust preferred securities. The tax treatment of the Bank's portfolio of securities issued by certain states and their political subdivisions allows the Company to use the full tax advantage of this portfolio. In the third quarter of 2008, as a result of the appointment of the Federal Housing Finance Agency as conservator over



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Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), the Bank wrote-down \$2,816,000 on investments in three series of preferred stock issued by Fannie Mae and Freddie Mac held by the Company, as required by SFAS 115.

The following table presents at amortized cost the composition of the investment portfolio by major category at the dates indicated.

|   | At December 31, |           |           |
|---|-----------------|-----------|-----------|
|   | 2008            | 2007      | 2006      |
|   | (In Thousands)  |           |           |
| U.S. Treasury securities                                | \$ -            | \$ -      | \$ -      |
| U.S. Government agencies and mortgage backed securities | 25,571          | 44,094    | 57,119    |
| Obligations of states and political subdivisions        | 31,466          | 32,311    | 36,811    |
| Corporate trust preferred                               | 2,169           | 2,167     | 3,080     |
| Total investment securities                             | \$ 59,206       | \$ 78,572 | \$ 97,010 |

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The following table sets forth the scheduled maturities, amortized costs and weighted average yields for the Company's investment securities portfolio at December 31, 2008:

|   | One Year Or Less |          | One To Five Years |          | Five to Ten Years |          | More Than Ten Years |          | Total     |          |
|---|------------------|----------|-------------------|----------|-------------------|----------|---------------------|----------|-----------|----------|
|   | Weighted         | Weighted | Weighted          | Weighted | Weighted          | Weighted | Weighted            | Weighted | Weighted  | Weighted |
|   | Amort.           | Amort.   | Amort.            | Amort.   | Amort.            | Amort.   | Amort.              | Amort.   | Amort.    | Amort.   |
|   | Average          | Average  | Average           | Average  | Average           | Average  | Average             | Average  | Average   | Average  |
|   | Cost             | Cost     | Cost              | Cost     | Cost              | Cost     | Cost                | Cost     | Cost      | Cost     |
|   | Yield            | Yield    | Yield             | Yield    | Yield             | Yield    | Yield               | Yield    | Yield     | Yield    |
| U.S. Treasury securities                                | \$ -             | -%       | \$ -              | -%       | \$ -              | -%       | \$ -                | -%       | \$ -      | -%       |
| U.S. Government agencies and mortgage backed securities | -                | -        | -                 | -        | 4,568             | 4.76     | 21,003              | 4.96     | 25,571    | 4.16     |
| Obligations of states and political subdivisions        | -                | -        | 4,577             | 2.89     | 1,557             | 3.82     | 25,332              | 4.42     | 31,466    | 4.17     |
| Corporate trust preferred                               | -                | -        | -                 | -        | -                 | -        | 2,169               | 8.70     | 2,169     | 8.70     |
| Total investment securities                             | \$ -             | -%       | \$ 4,577          | 2.89%    | \$ 6,125          | 4.52%    | \$ 48,504           | 4.85%    | \$ 59,206 | 4.66%    |

At December 31, 2008, the Bank had no investments in securities of a single issuer (other than the U.S. Government securities and securities of federal agencies and government-sponsored enterprises), which aggregated more than 10% of stockholders' equity.

#### Deposits And Other Sources of Funds

The funds needed by the Bank to make loans are primarily generated by deposit accounts solicited from the communities surrounding its branches in northern Anne Arundel County. Consolidated total deposits were \$269,768,000 as of December 31, 2008. The Bank uses borrowings from the Federal Home Loan Bank ("FHLB") of Atlanta to supplement funding from deposits. The Bank was permitted to borrow up to \$66.01 million under a line of credit from the FHLB of Atlanta as of December 31, 2008.

Deposits. The Bank's deposit products include regular savings accounts (statements), money market deposit accounts, demand deposit accounts, NOW checking accounts, IRA and SEP accounts, Christmas Club accounts and certificates of deposit. Variations in service charges, terms and interest rates are used to target specific markets. Ancillary products and services for deposit customers include safe deposit boxes, money orders and travelers checks, night depositories, automated clearinghouse transactions, wire transfers, ATMs, telephone banking, and a customer call center. The Bank is a member of the Cirrus(R) and Star(R) ATM networks.

As stated above, the Bank obtains deposits principally through its network of branch offices. The Bank does not solicit brokered deposits. At December 31, 2008, the Bank had approximately \$37.6 million in certificates of deposit and other time deposits of \$100,000 or more, including IRA accounts. The following table provides information as to the maturity of all time deposits of \$100,000 or more at December 31, 2008:

Amount  
(In Thousands)

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|                               |    |        |
|-------------------------------|----|--------|
| Three months or less          | \$ | 5,230  |
| Over three through six months |    | 4,495  |
| Over six through 12 months    |    | 9,847  |
| Over 12 months                |    | 18,071 |
| Total                         | \$ | 37,643 |

Borrowings. In addition to deposits, the Bank from time to time obtains advances from the FHLB of Atlanta of which it is a member. FHLB of Atlanta advances may be used to provide funds for residential housing finance, for small business lending, and to meet specific and anticipated needs. The Bank may draw on a \$66.01 million line of credit from the FHLB of Atlanta, which is secured by a floating lien on the Bank's residential first mortgage loans and various federal and agency securities. There was \$10 million in a convertible advance under this credit arrangement at December 31, 2008. The advance matures in November 1, 2017, is callable monthly, and bears a 3.28% rate of interest. There was a \$5 million convertible advance settled July 21, 2008 with a final maturity of July 23, 2018. This advance has a 2.73% rate of interest and is callable quarterly, starting July 23, 2009. There was a \$5 million convertible advance taken out August 22, 2008 which has a final maturity of August 22, 2018. This advance has a 3.344% rate of interest and is callable quarterly, starting August 22, 2011. There was \$7 million in a long-term convertible advance under this credit arrangement at December 31, 2008. The advance matures in September 2010 and bears a 5.84% rate of interest. On September 7, 2000, the Company issued \$5,155,000 of its 10.6% Junior Subordinated Deferrable Interest Debentures to Glen Burnie Statutory Trust I, a Connecticut statutory trust wholly owned by the Company. The Trust, in turn, issued \$5 million of its 10.6% capital securities to institutional investors. The debentures are scheduled to mature on September 7, 2030, unless called by the Company not earlier than September 7, 2010. It is the Company's intention to call these debentures at the earliest opportunity. The Bank also has an unsecured line of credit in the amount of \$9 million from another commercial bank but currently has no balance outstanding. The Bank has a mortgage note on the 103 Crain Highway address with a balance of \$71,712 as of December 31, 2008. This note is payable monthly through October 2010 and has a 7% interest rate.

## Competition

The Bank faces competition for deposits and loans from other community banks, branches or affiliates of larger banks, savings and loan associations, savings banks and credit unions, which compete vigorously (currently, sixteen FDIC-insured depository institutions operate within two miles of the Bank's headquarters). With respect to indirect lending, the Bank faces competition from other banks and the financing arms of automobile manufacturers. The Bank competes in this area by offering competitive rates and responsive service to dealers.

The Bank's interest rates, loan and deposit terms, and offered products and services are impacted, to a large extent, by such competition. The Bank attempts to provide superior service within its community and to know, and facilitate services, to, its customers. It seeks commercial relationships with small to medium size businesses, which the Bank believes would welcome personal service and flexibility. The bank believes its greatest competition comes from larger intra- and inter-state financial institutions.

## Other Activities

The Company also owns all outstanding shares of capital stock of GBB Properties, Inc. ("GBB"), another Maryland corporation which was organized in 1994 and which is engaged in the business of acquiring, holding and disposing of real property, typically acquired in connection with foreclosure proceedings (or deeds in lieu of foreclosure) instituted by the Bank or acquired in connection with branch expansions by the Bank.

## Employees

At December 31, 2008, the Bank had 114 full-time equivalent employees. Neither the Company nor GBB currently has any employees.

## Regulation of the Company

General. The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956 (the "BHCA"). As such, the Company is registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and subject to Federal Reserve Board regulation, examination, supervision and reporting requirements. As a bank holding company, the Company is required to furnish to the Federal Reserve Board annual and quarterly reports of its operations at the end of each period and to furnish such additional information as the Federal Reserve Board may require pursuant to the BHCA. The Company is also subject to regular inspection by Federal Reserve Board examiners.

Under the BHCA, a bank holding company must obtain the prior approval of the Federal Reserve Board before: (1) acquiring direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Riegle-Neal Act") authorizes the Federal Reserve Board to approve an application of an adequately capitalized and adequately managed bank holding company to acquire control of, or acquire all or substantially all of the assets of, a bank located in a state other than such holding company's home state, without regard to whether the transaction is prohibited by the laws of any state. The Federal Reserve Board may not approve the acquisition of a bank that has not been in existence for the minimum time period (not exceeding five years) specified by the statutory law of the host state. The Riegle-Neal Act also prohibits the Federal Reserve Board from approving such an application if the applicant (and its depository institution

affiliates) controls or would control more than 10% of the insured deposits in the United States or 30% or more of the deposits in the target bank's home state or in any state in which the target bank maintains a branch. The Riegle-Neal Act does not affect the authority of states to limit the percentage of total insured deposits in the state which may be held or controlled by a bank or bank holding company to the extent such limitation does not discriminate against out-of-state banks or bank holding companies. Individual states may also waive the 30% state-wide concentration limit contained in the Riegle-Neal Act. Under Maryland law, a bank holding company is prohibited from acquiring control of any bank if the bank holding company would control more than 30% of the total deposits of all depository institutions in the State of Maryland unless waived by the Maryland Commissioner of Financial Regulation.

Additionally, the federal banking agencies are authorized to approve interstate merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks opted out of the Riegle-Neal Act by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997 which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. The State of Maryland did not pass such a law during this period. Interstate acquisitions of branches will be permitted only if the law of the state in which the branch is located permits such acquisitions. Interstate mergers and branch acquisitions will also be subject to the nationwide and statewide insured deposit concentration amounts described above.

The BHCA also prohibits, with certain exceptions, a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of a company that is not a bank or a bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities which, by statute or by Federal Reserve Board regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The activities of the Company are subject to these legal and regulatory limitations under the BHCA and the Federal Reserve Board's regulations thereunder. Notwithstanding the Federal Reserve Board's prior approval of specific nonbanking activities, the Federal Reserve Board has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

Effective with the enactment of the Gramm-Leach-Bliley Act ("G-L-B") on November 12, 1999, bank holding companies whose financial institution subsidiaries are well capitalized and well managed and have satisfactory Community Reinvestment Act records can elect to become "financial holding companies" which will be permitted to engage in a broader range of financial activities than are currently permitted to bank holding companies. Financial holding companies are authorized to engage in, directly or indirectly, financial activities. A financial activity is an activity that is: (i) financial in nature; (ii) incidental to an activity that is financial in nature; or (iii) complementary to a financial activity and that does not pose a safety and soundness risk. The G-L-B Act includes a list of activities that are deemed to be financial in nature. Other activities also may be decided by the Federal Reserve Board to be financial in nature or incidental thereto if they meet specified criteria. A financial holding company that intends to engage in a new activity to acquire a company to engage in such an activity is required to give prior notice to the Federal Reserve Board. If the activity is not either specified in the G-L-B Act as being a financial activity or one that the Federal Reserve Board has determined by rule or regulation to be financial in nature, the prior approval of the Federal Reserve Board is required.

The Maryland Financial Institutions Code prohibits a bank holding company from acquiring more than 5% of any class of voting stock of a bank or bank holding company without the approval of the Commissioner of Financial Regulation except as otherwise expressly permitted by federal law or in certain other limited situations. The Maryland Financial Institutions Code additionally prohibits any person from acquiring voting stock in a bank or bank holding company without 60 days' prior notice to the Commissioner if such acquisition will give the person control of 25% or more of the voting stock of the bank or bank holding company or will affect the power to direct or to cause the direction of the policy or management of the bank or bank holding company. Any doubt whether the stock acquisition will affect the power to direct or cause the direction of policy or management shall be resolved in favor of reporting to the Commissioner. The Commissioner may deny approval of the acquisition if the Commissioner determines it to be anti-competitive or to threaten the safety or soundness of a banking institution. Voting stock acquired in violation of this statute may not be voted for five years.

Capital Adequacy. The Federal Reserve Board has adopted guidelines regarding the capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See “Regulation of the Bank — Capital Adequacy.”

**Dividends and Distributions.** The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the company's capital needs, asset quality, and overall financial condition.

Bank holding companies are required to give the Federal Reserve Board notice of any purchase or redemption of their outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the bank holding company's consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would violate any law, regulation, Federal Reserve Board order, directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. Bank holding companies whose capital ratios exceed the thresholds for "well capitalized" banks on a consolidated basis are exempt from the foregoing requirement if they were rated composite 1 or 2 in their most recent inspection and are not the subject of any unresolved supervisory issues.

#### Regulation of the Bank

**General.** As a state-chartered bank with deposits insured by the FDIC but which is not a member of the Federal Reserve System (a "state non-member bank"), the Bank is subject to the supervision of the Maryland Commissioner of Financial Regulation and the FDIC. The Commissioner and FDIC regularly examine the operations of the Bank, including but not limited to capital adequacy, reserves, loans, investments and management practices. These examinations are for the protection of the Bank's depositors and not its stockholders. In addition, the Bank is required to furnish quarterly and annual call reports to the Commissioner and FDIC. The FDIC's enforcement authority includes the power to remove officers and directors and the authority to issue cease-and-desist orders to prevent a bank from engaging in unsafe or unsound practices or violating laws or regulations governing its business.

The Bank's deposits are insured by the FDIC to the legal maximum of \$250,000 for each insured depositor. Some of the aspects of the lending and deposit business of the Bank that are subject to regulation by the Federal Reserve Board and the FDIC include reserve requirements and disclosure requirements in connection with personal and mortgage loans and savings deposit accounts. In addition, the Bank is subject to numerous Federal and state laws and regulations which set forth specific restrictions and procedural requirements with respect to the establishment of branches, investments, interest rates on loans, credit practices, the disclosure of customer information, the disclosure of credit terms and discrimination in credit transactions.

**Patriot Act.** The USA Patriot Act (the "Patriot Act"), includes provisions pertaining to domestic security, surveillance procedures, border protection, and terrorism laws to be administered by the Secretary of the Treasury. Title III of the Patriot Act entitled, "International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001" includes amendments to the Bank Secrecy Act which expand the responsibilities of financial institutions in regard to anti-money laundering activities with particular emphasis upon international money laundering and terrorism financing activities through designated correspondent and private banking accounts.

Section 313(a) of the Patriot Act prohibits any insured financial institution such as the Bank, from providing correspondent accounts to foreign banks which do not have a physical presence in any country (designated as "shell banks"), subject to certain exceptions for regulated affiliates of foreign banks. Section 313(a) also requires financial institutions to take reasonable steps to ensure that foreign bank correspondent accounts are not being used to indirectly provide banking services to foreign shell banks, and Section 319(b) requires financial institutions to maintain records of the owners and agent for service of process of any such foreign banks with whom correspondent accounts have



been established.

Section 312 of the Patriot Act creates a requirement for special due diligence for correspondent accounts and private banking accounts. Under Section 312, each financial institution that establishes, maintains, administers, or manages a private banking account or a correspondent account in the United States for a non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person shall establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and record instances of money laundering through those accounts.

The Company and the Bank are not currently aware of any account relationships between the Bank and any foreign bank or other person or entity as described above under Sections 313(a) or 312 of the Patriot Act.

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The terrorist attacks on September 11, 2001 have realigned national security priorities of the United States and it is reasonable to anticipate that the United States Congress may enact additional legislation in the future to combat terrorism including modifications to existing laws such as the Patriot Act to expand powers as deemed necessary. The enactment of the Patriot Act has increased the Bank's compliance costs, and the impact of any additional legislation enacted by Congress may have upon financial institutions is uncertain. However, such legislation would likely increase compliance costs and thereby potentially have an adverse effect upon the Company's results of operations.

Community Reinvestment Act. Community Reinvestment Act ("CRA") regulations evaluate banks' lending to low and moderate income individuals and businesses across a four-point scale from "outstanding" to "substantial noncompliance," and are a factor in regulatory review of applications to merge, establish new branch offices or form bank holding companies. In addition, any bank rated in "substantial noncompliance" with the CRA regulations may be subject to enforcement proceedings. The Bank has a current rating of "satisfactory" for CRA compliance.

Capital Adequacy. The Federal Reserve Board and the FDIC have established guidelines with respect to the maintenance of appropriate levels of capital by bank holding companies and state non-member banks, respectively. The regulations impose two sets of capital adequacy requirements: minimum leverage rules, which require bank holding companies and banks to maintain a specified minimum ratio of capital to total assets, and risk-based capital rules, which require the maintenance of specified minimum ratios of capital to "risk-weighted" assets.

The regulations of the Federal Reserve Board and the FDIC require bank holding companies and state non-member banks, respectively, to maintain a minimum leverage ratio of "Tier 1 capital" (as defined in the risk-based capital guidelines discussed in the following paragraphs) to total assets of 3.0%. Although setting a minimum 3.0% leverage ratio, the capital regulations state that only the strongest bank holding companies and banks, with composite examination ratings of 1 under the rating system used by the Federal bank regulators, would be permitted to operate at or near such minimum level of capital. All other bank holding companies and banks are expected to maintain a leverage ratio of at least 1% to 2% above the minimum ratio, depending on the assessment of an individual organization's capital adequacy by its primary regulator. Any bank or bank holding company experiencing or anticipating significant growth would be expected to maintain capital well above the minimum levels. In addition, the Federal Reserve Board has indicated that whenever appropriate, and in particular when a bank holding company is undertaking expansion, seeking to engage in new activities or otherwise facing unusual or abnormal risks, it will consider, on a case-by-case basis, the level of an organization's ratio of tangible Tier 1 capital (after deducting all intangibles) to total assets in making an overall assessment of capital.

The risk-based capital rules of the Federal Reserve Board and the FDIC require bank holding companies and state non-member banks, respectively, to maintain minimum regulatory capital levels based upon a weighting of their assets and off-balance sheet obligations according to risk. Risk-based capital is composed of two elements: Tier 1 capital and Tier 2 capital. Tier 1 capital consists primarily of common stockholders' equity, certain perpetual preferred stock (which must be noncumulative in the case of banks), and minority interests in the equity accounts of consolidated subsidiaries; less all intangible assets, except for certain purchased mortgage servicing rights and credit card relationships. Tier 2 capital elements include, subject to certain limitations, the allowance for losses on loans and leases; perpetual preferred stock that does not qualify as Tier 1 capital and long-term preferred stock with an original maturity of at least 20 years from issuance; hybrid capital instruments, including perpetual debt and mandatory convertible securities; and subordinated debt and intermediate-term preferred stock.

The risk-based capital regulations assign balance sheet assets and credit equivalent amounts of off-balance sheet obligations to one of four broad risk categories based principally on the degree of credit risk associated with the obligor. The assets and off-balance sheet items in the four risk categories are weighted at 0%, 20%, 50% and 100%. These computations result in the total risk-weighted assets. The risk-based capital regulations require all banks and bank holding companies to maintain a minimum ratio of total capital (Tier 1 capital plus Tier 2 capital) to total

risk-weighted assets of 8%, with at least 4% as Tier 1 capital. For the purpose of calculating these ratios: (i) Tier 2 capital is limited to no more than 100% of Tier 1 capital; and (ii) the aggregate amount of certain types of Tier 2 capital is limited. In addition, the risk-based capital regulations limit the allowance for loan losses includable as capital to 1.25% of total risk-weighted assets.

FDIC regulations and guidelines additionally specify that state non-member banks with significant exposure to declines in the economic value of their capital due to changes in interest rates may be required to maintain higher risk-based capital ratios. The Federal banking agencies, including the FDIC, have proposed a system for measuring and assessing the exposure of a bank's net economic value to changes in interest rates. The Federal banking agencies, including the FDIC, have stated their intention to propose a rule establishing an explicit capital charge for interest rate risk based upon the level of a bank's measured interest rate risk exposure after more experience has been gained with the proposed measurement process. Federal Reserve Board regulations do not specifically take into account interest rate risk in measuring the capital adequacy of bank holding companies.

The FDIC has issued regulations which classify state non-member banks by capital levels and which authorize the FDIC to take various prompt corrective actions to resolve the problems of any bank that fails to satisfy the capital standards. Under such regulations, a well-capitalized bank is one that is not subject to any regulatory order or directive to meet any specific capital level and that has or exceeds the following capital levels: a total risk-based capital ratio of 10%, a Tier 1 risk-based capital ratio of 6%, and a leverage ratio of 5%. An adequately capitalized bank is one that does not qualify as well-capitalized but meets or exceeds the following capital requirements: a total risk-based capital ratio of 8%, a Tier 1 risk-based capital ratio of 4%, and a leverage ratio of either (i) 4% or (ii) 3% if the bank has the highest composite examination rating. A bank not meeting these criteria is treated as undercapitalized, significantly undercapitalized, or critically undercapitalized depending on the extent to which the bank's capital levels are below these standards. A state non-member bank that falls within any of the three undercapitalized categories established by the prompt corrective action regulation will be subject to severe regulatory sanctions. As of December 31, 2008, the Bank was well capitalized as defined by the FDIC's regulations.

**Branching.** Maryland law provides that, with the approval of the Commissioner, Maryland banks may establish branches within the State of Maryland without geographic restriction and may establish branches in other states by any means permitted by the laws of such state or by federal law. The Riegle-Neal Act authorizes the FDIC to approve interstate branching de novo by state banks, only in states that specifically allow for such branching.

**Dividend Limitations.** Pursuant to the Maryland Financial Institutions Code, Maryland banks may only pay dividends from undivided profits or, with the prior approval of the Commissioner, their surplus in excess of 100% of required capital stock. The Maryland Financial Institutions Code further restricts the payment of dividends by prohibiting a Maryland bank from declaring a dividend on its shares of common stock until its surplus fund equals the amount of required capital stock or, if the surplus fund does not equal the amount of capital stock, in an amount in excess of 90% of net earnings. In addition, the Bank is prohibited by federal statute from paying dividends or making any other capital distribution that would cause the Bank to fail to meet its regulatory capital requirements. Further, the FDIC also has authority to prohibit the payment of dividends by a state non-member bank when it determines such payment to be an unsafe and unsound banking practice.

**Deposit Insurance.** The Bank is required to pay semi-annual assessments based on a percentage of its insured deposits to the FDIC for insurance of its deposits by the Bank Insurance Fund ("BIF"). Under the Federal Deposit Insurance Act, the FDIC is required to set semi-annual assessments for BIF-insured institutions to maintain the designated reserve ratio of the BIF at 1.25% of estimated insured deposits or at a higher percentage of estimated insured deposits that the FDIC determines to be justified for that year by circumstances raising a significant risk of substantial future losses to the BIF.

Under the risk-based deposit insurance assessment system adopted by the FDIC, the assessment rate for an insured depository institution depends on the assessment risk classification assigned to the institution by the FDIC, which is determined by the institution's capital level and supervisory evaluations. Based on the data reported to regulators for the date closest to the last day of the seventh month preceding the semi-annual assessment period, institutions are assigned to one of three capital groups — "well capitalized, adequately capitalized or undercapitalized." Within each capital group, institutions are assigned to one of three subgroups on the basis of supervisory evaluations by the institution's primary supervisory authority and such other information as the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance fund. Under the current assessment schedule, well-capitalized banks with the best supervisory ratings are not required to pay any premium for deposit insurance. All BIF-insured banks, however, will be required to begin paying an assessment to the FDIC in an amount equal to 2.12 basis points times their assessable deposits to help fund interest payments on certain bonds issued by the Financing Corporation, an agency established by the federal government to finance takeovers of insolvent thrifts.

Transactions with Affiliates. A state non-member bank or its subsidiaries may not engage in “covered transactions” with any one affiliate in an amount greater than 10% of such bank’s capital stock and surplus, and for all such transactions with all affiliates a state non-member bank is limited to an amount equal to 20% of capital stock and surplus. All such transactions must also be on terms substantially the same, or at least as favorable, to the bank or subsidiary as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. An affiliate of a state non-member bank is any company or entity which controls or is under common control with the state non-member bank and, for purposes of the aggregate limit on transactions with affiliates, any subsidiary that would be deemed a financial subsidiary of a national bank. In a holding company context, the parent holding company of a state non-member bank (such as the Company) and any companies which are controlled by such parent holding company are affiliates of the state non-member bank. The BHCA further prohibits a depository institution from extending credit to or offering any other services, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution, subject to certain limited exceptions.

Loans to Directors, Executive Officers and Principal Stockholders. Loans to directors, executive officers and principal stockholders of a state non-member bank must be made on substantially the same terms as those prevailing for comparable transactions with persons who are not executive officers, directors, principal stockholders or employees of the Bank unless the loan is made pursuant to a compensation or benefit plan that is widely available to employees and does not favor insiders. Loans to any executive officer, director and principal stockholder together with all other outstanding loans to such person and affiliated interests generally may not exceed 15% of the bank's unimpaired capital and surplus and all loans to such persons may not exceed the institution's unimpaired capital and unimpaired surplus. Loans to directors, executive officers and principal stockholders, and their respective affiliates, in excess of the greater of \$100,000 or 5% of capital and surplus (up to \$500,000) must be approved in advance by a majority of the board of directors of the bank with any "interested" director not participating in the voting. State non-member banks are prohibited from paying the overdrafts of any of their executive officers or directors. In addition, loans to executive officers may not be made on terms more favorable than those afforded other borrowers and are restricted as to type, amount and terms of credit.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

## ITEM 2. PROPERTIES

The following table sets forth certain information with respect to the Bank's offices:

|  | Year<br>Opened | Owned/<br>Leased | Book Value | Approximate<br>Square Footage | Deposits      |
|--|----------------|------------------|------------|-------------------------------|---------------|
| <b>Main Office:</b>                                      |                |                  |            |                               |               |
| 101 Crain Highway, S.E.<br>Glen Burnie, MD 21061         | 1953           | Owned            | \$ 670,156 | 10,000                        | \$ 80,355,138 |
| <b>Branches:</b>   |                |                  |            |                               |               |
| <b>Odenton</b>   |                |                  |            |                               |               |
| 1405 Annapolis Road<br>Odenton, MD 21113                 | 1969           | Owned            | 165,543    | 6,000                         | 36,582,755    |
| <b>Riviera Beach</b>                                     |                |                  |            |                               |               |
| 8707 Ft. Smallwood Road<br>Pasadena, MD 21122            | 1973           | Owned            | 138,513    | 2,500                         | 29,136,358    |
| <b>Crownsville</b>                                       |                |                  |            |                               |               |
| 1221 Generals Highway<br>Crownsville, MD 21032           | 1979           | Owned            | 297,696    | 3,000                         | 46,607,554    |
| <b>Severn</b>  |                |                  |            |                               |               |
| 811 Reece Road<br>Severn, MD 21144                       | 1984           | Owned            | 172,822    | 2,500                         | 27,461,301    |
| <b>South Crain</b>                                       |                |                  |            |                               |               |
| 7984 Crain Highway<br>Glen Burnie, MD 21061              | 1995           | Leased           | 148,317    | 2,600                         | 21,945,968    |
| <b>Linthicum</b>   |                |                  |            |                               |               |
| Burwood Village Shopping Center<br>Glen Burnie, MD 21060 | 2005           | Leased           | 167,510    | 2,500                         | 12,469,351    |
| <b>Severna Park</b>                                      |                |                  |            |                               |               |
| 534 Ritchie Highway<br>Severna Park, MD 21146            | 2002           | Leased           | 121,986    | 2,184                         | 15,731,659    |
| <b>Operations Centers:</b>                               |                |                  |            |                               |               |
| 106 Padfield Blvd.<br>Glen Burnie, MD 21061              | 1991           | Owned            | 936,598    | 16,200                        | N/A           |
| 103 Crain Highway, S.E.<br>Glen Burnie, MD 21061         | 2000           | Owned            | 280,305    | 3,727                         | N/A           |

At December 31, 2008, the Bank owned one foreclosed real estate property with a total book value of \$550,000.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company and the Bank are involved in various legal actions relating to their business activities. At December 31, 2008, there were no actions to which the Company or the Bank was a party which involved claims for money damages exceeding 10% of the Company's consolidated current assets in any one case or in any group of proceedings presenting in large degree the same legal and factual issues.

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

Not applicable.



## EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below is information about the Company's executive officers.

| NAME                   | AGE | POSITIONS   |
|------------------------|-----|---|
| F. William Kuethe, Jr. | 76  | President Emeritus                                |
| Michael G. Livingston  | 55  | President and Chief Executive Officer             |
| John E. Porter         | 55  | Senior Vice President and Chief Financial Officer |

F. WILLIAM KUETHE, JR. was appointed to the honorary position of President Emeritus of the Company and the Bank effective January 1, 2008 when he retired from full-time employment and stepped down from his positions of President and Chief Executive Officer of the Company and the Bank which he held since 1995. Mr. Kuethe has been a director of the Company and the Bank since 1995 and was President of Glen Burnie Mutual Savings Bank from 1960 through 1995. Mr. Kuethe is a former licensed appraiser and real estate broker with banking experience from 1960 to present, at all levels. He is the father of Frederick W. Kuethe, III, a director of the Company.

MICHAEL G. LIVINGSTON was appointed President and Chief Executive Officer of the Company and the Bank effective January 1, 2008. Prior to that date, Mr. Livingston was Deputy Chief Executive Officer and Executive Vice President since August 2004, Chief Operating Officer since January 2004, Deputy Chief Operating Officer from February 2003 through December 2003, Senior Vice President from January 1998 until August 2004, and Chief Lending Officer of the Bank from 1996 until August 2004. Mr. Livingston was elected as a director of the Company and the Bank on January 1, 2005.

JOHN E. PORTER was appointed Senior Vice President in January 1998. He has been Treasurer and Chief Financial Officer of the Company since 1995 and Vice President, Treasurer and Chief Financial Officer of the Bank since 1990.

## PART II

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

The Common Stock is traded on the Nasdaq SmallCap Market under the symbol "GLBZ". As of February 4, 2009, there were 442 record holders of the Common Stock. The closing price for the Common Stock on that date was \$8.54. A 20% stock dividend had been declared for stockholders' of record on January 12, 2008, payable January 18, 2008.

The following table sets forth the high and low sales prices for the Common Stock for each full quarterly period during 2008 and 2007 as reported by Nasdaq. The quotations represent prices between dealers and do not reflect the retailer markups, markdowns or commissions, and may not represent actual transactions. Also shown are dividends declared per share for these periods.

| Quarter Ended | 2008     |          |           | 2007     |          |           |
|---------------|----------|----------|-----------|----------|----------|-----------|
|               | High     | Low      | Dividends | High     | Low      | Dividends |
| March 31,     | \$ 14.12 | \$ 10.25 | \$ 0.10   | \$ 15.42 | \$ 14.21 | \$ 0.10   |
| June 30,      | 12.95    | 11.00    | 0.10      | 14.79    | 14.38    | 0.10      |
| September 30  | 12.00    | 8.90     | 0.10      | 14.82    | 12.84    | 0.10      |
| December 31   | 10.94    | 8.54     | 0.15      | 14.17    | 12.81    | 0.15      |

A regular dividend of \$0.10 and a bonus dividend of \$0.05 were declared for stockholders' of record on December 29, 2008, payable on January 9, 2009 and January 12, 2009, respectively.

The Company intends to pay dividends approximating forty percent (40%) of its profits for each quarter. However, dividends remain subject to declaration by the Board of Directors in its sole discretion and there can be no assurance that the Company will be legally or financially able to make such payments. Payment of dividends may be limited by federal and state regulations which impose general restrictions on a bank's and bank holding company's right to pay dividends (or to make loans or advances to affiliates which could be used to pay dividends). Generally, dividend payments are prohibited unless a bank or bank holding company has sufficient net (or retained) earnings and capital as determined by its regulators. See "Item 1. Business - Supervision and Regulation - Regulation of the Company - Dividends and Distributions" and "Item 1. Business — Supervision and Regulation - Regulation of the Bank - Dividend Limitations." The Company does not believe that those restrictions will materially limit its ability to pay dividends.

## Performance Graph

The following graph compares the cumulative total return on the Common Stock during the five years ended December 31, 2008 with that of a broad market index (Nasdaq Composite), and a peer group consisting of publicly traded Maryland, Virginia and District of Columbia commercial banks with total assets between \$200 million and \$500 million ("Peer Group"). The Peer Group is comprised of Pinnacle Bankshares Corp., Bank of the James Financial Group, Inc., Botetourt Bankshares, Inc., Village Bank and Trust Financial Corp., Bay Banks of VA., Inc., Citizens Bancorp of Virginia, First Capital Bancorp, Inc., Old Line Bankshares, Inc., Patapsco Bancorp Inc., Frederick County Bancorp Inc., Central Virginia Bankshares, Inc., Bay National Corp., Annapolis Bancorp, Inc., Calvin B. Taylor Bankshares Inc., Abigail Adams National Bancorp, Inc., and Carrollton Bancorp. A significant number of the banks we used in the Peer Group in prior years no longer qualified for the criteria which would afford a reasonable comparison to the Company and, accordingly, a new Peer Group was developed. The graph assumes \$100 was invested on December 31, 2003 in the Common Stock and in each of the indices and assumes reinvestment of

dividends. The following information shall not be deemed to be “soliciting material” or to be “filed” with the SEC or subject to Regulation 14A under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) or to the liabilities of Section 18 of the Exchange Act, except to the extent that the Company specifically incorporates it by reference into a later filing with the SEC.

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**Total Return Analysis**

|                     | 12/31/2003 | 12/31/2004 | 12/31/2005 | 12/31/2006 | 12/31/2007 | 12/31/2008 |
|---------------------|------------|------------|------------|------------|------------|------------|
| Glen Burnie Bancorp | \$ 100.00  | \$ 97.00   | \$ 87.76   | \$ 86.20   | \$ 80.29   | \$ 70.71   |
| Peer Group          | \$ 100.00  | \$ 112.75  | \$ 116.32  | \$ 123.59  | \$ 102.40  | \$ 64.23   |
| Nasdaq Composite    | \$ 100.00  | \$ 109.16  | \$ 111.47  | \$ 123.05  | \$ 140.12  | \$ 84.12   |

Source: Zacks Investment Research.

## ITEM 6. SELECTED FINANCIAL DATA

The following table presents consolidated selected financial data for the Company and its subsidiaries for each of the periods indicated. Dividends and earnings per share have been adjusted to give retroactive effect to a 20% stock dividend paid on January 18, 2008, one paid on January 23, 2006, and one paid on January 6, 2004.

|  | Year Ended December 31,                     |            |            |            |            |
|--|---|------------|------------|------------|------------|
|  | 2008  | 2007       | 2006       | 2005       | 2004       |
|  | (Dollars In Thousand Except Per Share Data) |            |            |            |            |
| <b>Operations Data:</b>                            |   |            |            |            |            |
| Net Interest Income                                | \$ 11,922                                   | \$ 11,866  | \$ 11,821  | \$ 11,966  | \$ 12,016  |
| Provision for Credit Losses                        | 1,146                                       | 50         | 62         | (50)       | 340        |
| Other Income                                       | 2,051                                       | 2,157      | 2,244      | 2,114      | 2,372      |
| Other Expense                                      | 13,102                                      | 10,433     | 10,682     | 10,625     | 10,360     |
| Net Income   | 404   | 2,782      | 2,720      | 2,775      | 3,056      |
| <b>Share Data:</b>                                 |   |            |            |            |            |
| Basic Net Income Per Share                         | \$ 0.14                                     | \$ 0.93    | \$ 0.92    | \$ 0.94    | \$ 1.04    |
| Diluted Net Income Per Share                       | 0.14  | 0.93       | 0.92       | 0.94       | 1.04       |
| Cash Dividends Declared Per Common Share           | 0.45  | 0.45       | 0.45       | 0.41       | 0.36       |
| <b>Weighted Average Common Shares Outstanding:</b> |   |            |            |            |            |
| Basic  | 2,981,124                                   | 2,988,796  | 2,972,362  | 2,956,417  | 2,942,638  |
| Diluted  | 2,981,124                                   | 2,988,796  | 2,972,362  | 2,956,417  | 2,942,638  |
| <b>Financial Condition Data:</b>                   |   |            |            |            |            |
| Total Assets                                       | \$ 332,502                                  | \$ 307,274 | \$ 317,746 | \$ 306,561 | \$ 302,312 |
| Loans Receivable, Net                              | 235,133                                     | 199,753    | 193,337    | 190,205    | 182,291    |
| Total Deposits                                     | 269,768                                     | 252,917    | 274,833    | 265,248    | 261,674    |
| Long Term Borrowings                               | 27,072                                      | 17,107     | 7,140      | 7,171      | 7,200      |
| Junior Subordinated Debentures                     | 5,155                                       | 5,155      | 5,155      | 5,155      | 5,155      |
| Total Stockholders' Equity                         | 27,908                                      | 29,736     | 28,201     | 26,625     | 25,744     |
| <b>Performance Ratios:</b>                         |   |            |            |            |            |
| Return on Average Assets                           | 0.13%                                       | 0.89%      | 0.84%      | 0.89%      | 1.00%      |
| Return on Average Equity                           | 1.49  | 9.60       | 10.00      | 10.50      | 12.51      |
| Net Interest Margin (1)                            | 4.31  | 4.39       | 4.31       | 4.46       | 4.61       |
| Dividend Payout Ratio                              | 332.98                                      | 48.33      | 49.18      | 43.52      | 34.67      |
| <b>Capital Ratios:</b>                             |   |            |            |            |            |
| Average Equity to Average Assets                   | 8.99%                                       | 9.28%      | 8.36%      | 8.47%      | 8.16%      |
| Leverage Ratio                                     | 10.50                                       | 11.34      | 10.30      | 10.17      | 9.85       |
| Total Risk-Based Capital Ratio                     | 14.93                                       | 17.50      | 17.07      | 16.98      | 16.40      |
| <b>Asset Quality Ratios:</b>                       |   |            |            |            |            |
| Allowance for Credit Losses to Gross Loans         | 0.85%                                       | 0.80%      | 0.94%      | 1.14%      | 1.30%      |
|  | 0.38%                                       | 0.43%      | 0.03%      | 0.10%      | 0.33%      |

|  |         |         |           |           |         |
|--|---------|---------|-----------|-----------|---------|
| Non-accrual and Past Due Loans to<br>Gross Loans                 |         |         |           |           |         |
| Allowance for Credit Losses to<br>Non-Accrual and Past Due Loans | 224.42% | 188.27% | 3,116.95% | 1,164.55% | 398.68% |
| Net Loan Charge-offs (Recoveries) to<br>Average Loans            | 0.33%   | 0.14%   | 0.23%     | 0.09%     | 0.10%   |

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(1) Presented on a tax-equivalent basis

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

### Forward-Looking Statements

When used in this discussion and elsewhere in this Annual Report on Form 10-K, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "intends," "estimate," "project" or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and readers are advised that various factors, including regional and national economic conditions, unfavorable judicial decisions, substantial changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected. The Company does not undertake and specifically disclaims any obligation to update any forward-looking statements to reflect occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

### Overview

During 2008, net interest income before provision for credit losses increased to \$11,922,003 from \$11,866,208 in 2007, a 0.47% increase. Total interest income increased from \$17,837,256 in 2007 to \$18,176,036 in 2008, a 1.90% increase. Interest expense for 2008 totaled \$6,254,033, a 4.74% increase from \$5,971,048 in 2007. Net income in 2008 was \$403,962 compared to \$2,782,141 in 2007. The decrease in net income was primarily due to a write-down of \$2,816,000 taken in the third quarter on investments in three series of preferred stock issued by Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) held by the Company, as a result of the appointment of the Federal Housing Finance Agency as conservator over Fannie Mae and Freddie Mac. In 2008, the Company recorded a provision for loan losses of \$1,145,649, an increase from the \$50,000 provision made in 2007.

The Bank and, as a result, the Company, have not been immune to the impact of the economic downturn in the United States during 2008. While, due to conservative lending decisions, the Bank has no exposure to the credit issues affecting the sub-prime residential mortgage market, the economic slowdown resulted in the necessity of our increasing our reserve for loan losses in 2008, as noted above, primarily due to delinquency in our indirect automobile portfolio combined with adjustments we made to the risk factors in our calculation of required loan loss reserves. In addition to the Fannie Mae and Freddie Mac losses noted above, the economic downturn also resulted in the necessity of the Bank taking in our first OREO (Other Real Estate Owned) property on a defaulted mortgage since 1999. Despite the sharp economic downturn and these events, we realized net income of \$403,962 for 2008, remained well capitalized and did not need to apply for any funding from the U.S. Department of Treasury's Troubled Asset Relief Program (TARP). In 2008, the Bank saw continued growth in the loan portfolio. The loan portfolio increased by \$35,379,000, primarily due to increases in commercial and residential mortgage loans.

All per share amounts throughout this report have been adjusted to give retroactive effect to a 20% stock dividend paid on January 23, 2006 and to a 20% stock dividend paid on January 18, 2008.

### Comparison of Results of Operations for the Years Ended December 31, 2008, 2007 and 2006

General. For the year ended December 31, 2008, the Company reported consolidated net income of \$403,962 (\$0.14 basic and diluted earnings per share) compared to consolidated net income of \$2,782,141 (\$0.93 basic and diluted earnings per share) for the year ended December 31, 2007 and consolidated net income of \$2,720,045 (\$0.92 basic and diluted earnings per share) for the year ended December 31, 2006. The decrease in consolidated net income was due to

the write down on Fannie Mae and Freddie Mac preferred stock and the increase in the provision for loan losses.

Net Interest Income. The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund income producing assets. Net interest income is determined by the spread between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.



Net interest income is affected by the mix of loans in the Bank's loan portfolio. Currently a majority of the Bank's loans are residential and commercial mortgage loans secured by real estate and indirect automobile loans secured by automobiles.

In 2008, the Bank reduced its portfolio of above market rate savings products and continued to direct its efforts to increase higher yielding commercial loans. This strategy produced significant increases in the Bank's commercial loan portfolio. Because mortgage lending decisions are based on conservative lending policies the Company has no exposure to the credit issues affecting the sub-prime residential mortgage market. At the same time, we have reduced our exposure to lower yielding indirect automobile loans.

Consolidated net interest income for the year ended December 31, 2008 was \$11,922,003 compared to \$11,866,208 for the year ended December 31, 2007 and \$11,821,431 for the year ended December 31, 2006. The \$55,795 increase for the most recent year was primarily due to an increase in loan income partially offset by decreases in interest income on securities and increases in interest expense on long term borrowings. The \$44,777 increase for 2007 compared to 2006 was primarily due to an increase in loan income partially offset by decreases in interest income on securities and increases in interest expense on deposits, short term borrowings and long term borrowings. The interest income, net of tax, for 2008 was \$12,594,339, a \$28,869 or 0.23% decrease from the after tax net interest income for 2007, which was \$12,623,208, a \$117,935 or 0.92% decrease from the \$12,741,143 after tax net interest income for 2006.

Interest expense increased from \$5,971,048 in 2007 to \$6,254,033 in 2008, a \$282,985 or a 4.74% increase, primarily due to increased borrowings used to fund the outflow from maturing higher rate 15-month certificates of deposit and IRAs and to fund loan growth. Interest expense increased from \$5,833,765 in 2006 to \$5,971,048 in 2007, a \$137,283 or a 2.35% increase, primarily due to increased borrowings used to fund the outflow from maturing higher rate 15-month certificates of deposit and IRAs and the interest paid on the 15-month certificates of deposit and IRAs. Net interest margin for the year ended December 31, 2008 was 4.31% compared to 4.39% and 4.31% for the years ended December 31, 2007 and 2006, respectively.

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The following table allocates changes in income and expense attributable to the Company's interest-earning assets and interest-bearing liabilities for the periods indicated between changes due to changes in rate and changes in volume. Changes due to rate/volume are allocated to changes due to volume.

|  | Year Ended December 31, |          |                |                       |                |          |
|--|-------------------------|----------|----------------|-----------------------|----------------|----------|
|  | 2008                    | VS.      | 2007           | 2007                  | VS.            | 2006     |
|  | Change Due To:          |          | Change Due To: |                       | Change Due To: |          |
|  | Increase/<br>Decrease   | Rate     | Volume         | Increase/<br>Decrease | Rate           | Volume   |
|  | (In Thousands)          |          |                |                       |                |          |
| <b>ASSETS:</b>   |                         |          |                |                       |                |          |
| Interest-earning assets:   |                         |          |                |                       |                |          |
| Federal funds sold   | \$ (134)                | \$ (18)  | \$ (116)       | \$ (61)               | \$ -           | \$ (61)  |
| Interest-bearing deposits  | 31                      | (207)    | 238            | (134)                 | 7              | (141)    |
| Investment securities:   |                         |          |                |                       |                |          |
| U.S. Treasury securities, obligations of U.S. government agencies and mortgage-backed securities |                         |          |                |                       |                |          |
|  | (591)                   | 7        | (598)          | (793)                 | 14             | (807)    |
| Obligations of states and political subdivisions(1)  |                         |          |                |                       |                |          |
|  | (75)                    | 43       | (118)          | (307)                 | (20)           | (287)    |
| All other investment securities  |                         |          |                |                       |                |          |
|  | (58)                    | 1        | (59)           | (124)                 | 1              | (125)    |
| Total investment securities  |                         |          |                |                       |                |          |
|  | (724)                   | 51       | (775)          | (1,224)               | (5)            | (1,219)  |
| Loans, net of unearned income:   |                         |          |                |                       |                |          |
| Demand, time and lease   |                         |          |                |                       |                |          |
|  | (58)                    | (179)    | 121            | (8)                   | 17             | (25)     |
| Mortgage and construction  |                         |          |                |                       |                |          |
|  | 1,749                   | 152      | 1,597          | 719                   | (265)          | 984      |
| Installment and credit card  |                         |          |                |                       |                |          |
|  | (183)                   | 253      | (436)          | 406                   | 504            | (98)     |
| Total gross loans(2)   |                         |          |                |                       |                |          |
|  | 1,508                   | 226      | 1,282          | 1,117                 | 256            | 861      |
| Allowance for credit losses  |                         |          |                |                       |                |          |
|  | -                       | -        | -              | -                     | -              | -        |
| Total net loans  |                         |          |                |                       |                |          |
|  | 1,508                   | 226      | 1,282          | 1,117                 | 256            | 861      |
| Total interest-earning assets  |                         |          |                |                       |                |          |
|  | \$ 681                  | \$ 52    | \$ 629         | \$ (302)              | \$ 258         | \$ (560) |
| <b>LIABILITIES:</b>  |                         |          |                |                       |                |          |
| Interest-bearing deposits:   |                         |          |                |                       |                |          |
| Savings and NOW  |                         |          |                |                       |                |          |
|  | \$ (79)                 | \$ (69)  | \$ (10)        | \$ (11)               | \$ -           | \$ (11)  |
| Money market   |                         |          |                |                       |                |          |
|  | (41)                    | (27)     | (14)           | (3)                   | -              | (3)      |
| Other time deposits  |                         |          |                |                       |                |          |
|  | 76                      | (209)    | 285            | 57                    | 298            | (241)    |
| Total interest-bearing deposits  |                         |          |                |                       |                |          |
|  | (44)                    | (305)    | 261            | 43                    | 298            | (255)    |
| Non-interest-bearing deposits  |                         |          |                |                       |                |          |
|  | -                       | -        | -              | -                     | -              | -        |
| Borrowed funds   |                         |          |                |                       |                |          |
|  | 328                     | (577)    | 905            | 94                    | (71)           | 165      |
| Total interest-bearing liabilities   |                         |          |                |                       |                |          |
|  | \$ 284                  | \$ (882) | \$ 1,166       | \$ 137                | \$ 227         | \$ (90)  |

(1) Tax equivalent basis.

(2) Non-accrual loans included in average balances.



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The following table provides information for the designated periods with respect to the average balances, income and expense and annualized yields and costs associated with various categories of interest-earning assets and interest-bearing liabilities.

|  | Year Ended December 31, |          |                |                    |          |                |                    |          |                |
|--|-------------------------|----------|----------------|--------------------|----------|----------------|--------------------|----------|----------------|
|  | 2008                    |          |                | 2007               |          |                | 2006               |          |                |
|  | Average<br>Balance      | Interest | Yield/<br>Cost | Average<br>Balance | Interest | Yield/<br>Cost | Average<br>Balance | Interest | Yield/<br>Cost |
| (Dollars In Thousands)   |                         |          |                |                    |          |                |                    |          |                |
| <b>ASSETS:</b>   |                         |          |                |                    |          |                |                    |          |                |
| Interest-earning assets:   |                         |          |                |                    |          |                |                    |          |                |
| Federal funds sold   | \$ 433                  | \$ 5     | 1.15%          | \$ 2,665           | \$ 139   | 5.22%          | \$ 3,848           | \$ 200   | 5.20%          |
| Interest-bearing deposits  | 6,560                   | 130      | 1.98           | 1,929              | 99       | 5.13           | 4,901              | 233      | 4.76           |
| Investment securities:   |                         |          |                |                    |          |                |                    |          |                |
| U.S. Treasury securities, obligations of U.S. government agencies and mortgage-backed securities | 38,532                  | 1,963    | 5.09           | 50,392             | 2,554    | 5.07           | 66,501             | 3,347    | 5.04           |
| Obligations of states and political subdivisions(1)  | 32,421                  | 2,134    | 6.58           | 34,288             | 2,209    | 6.45           | 38,723             | 2,516    | 6.50           |
| All other investment securities  | 2,168                   | 193      | 8.90           | 2,839              | 251      | 8.84           | 4,257              | 375      | 8.81           |
| Total investment securities  | 73,121                  | 4,290    | 5.87           | 87,519             | 5,014    | 5.73           | 109,481            | 6,238    | 5.70           |
| Loans, net of unearned income:   |                         |          |                |                    |          |                |                    |          |                |
| Demand, time and lease   | 6,082                   | 390      | 6.41           | 4,788              | 448      | 9.36           | 5,064              | 456      | 9.01           |
| Mortgage and construction  | 151,656                 | 9,775    | 6.45           | 126,391            | 8,026    | 6.35           | 111,426            | 7,307    | 6.56           |
| Installment and credit card  | 61,747                  | 4,291    | 6.95           | 68,453             | 4,474    | 6.54           | 70,216             | 4,068    | 5.80           |
| Total gross loans(2)   | 219,485                 | 14,456   | 6.59           | 199,632            | 12,948   | 6.49           | 186,706            | 11,831   | 6.34           |
| Allowance for credit losses  | (1,479)                 |          |                | (1,766)            |          |                | (2,071)            |          |                |
| Total net loans  | 218,006                 | 14,456   | 6.63           | 197,866            | 12,948   | 6.54           | 184,635            | 11,831   | 6.41           |
| Total interest-earning assets  | 298,120                 | 18,881   | 6.33           | 289,979            | 18,200   | 6.28           | 302,865            | 18,502   | 6.11           |

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|                                       |            |       |       |            |       |       |            |       |       |
|---------------------------------------|------------|-------|-------|------------|-------|-------|------------|-------|-------|
| Cash and due from banks               | 7,891      |       |       | 8,862      |       |       | 9,493      |       |       |
| Other assets                          | 14,740     |       |       | 13,661     |       |       | 13,045     |       |       |
| Total assets                          | \$ 320,751 |       |       | \$ 312,502 |       |       | \$ 325,403 |       |       |
| LIABILITIES AND STOCKHOLDERS' EQUITY: |            |       |       |            |       |       |            |       |       |
| Interest-bearing deposits:            |            |       |       |            |       |       |            |       |       |
| Savings and NOW                       | \$ 69,468  | 184   | 0.26% | \$ 72,831  | 263   | 0.36% | \$ 77,761  | 274   | 0.36% |
| Money market                          | 13,751     | 62    | 0.45  | 15,918     | 103   | 0.65  | 16,415     | 106   | 0.65  |
| Other time deposits                   | 110,049    | 4,534 | 4.12  | 103,491    | 4,458 | 4.31  | 109,499    | 4,401 | 4.02  |
| Total interest-bearing deposits       | 193,268    | 4,780 | 2.47  | 192,240    | 4,824 | 2.51  | 203,675    | 4,781 | 2.35  |
| Short-term borrowed funds             | 2,209      | 51    | 2.31  | 2,294      | 119   | 5.19  | 1,603      | 81    | 5.06  |
| Long-term borrowed funds              | 26,287     | 1,424 | 5.42  | 13,949     | 1,028 | 7.37  | 12,309     | 972   | 7.90  |
| Total interest-bearing liabilities    | 221,764    | 6,255 | 2.82  | 208,483    | 5,971 | 2.86  | 217,587    | 5,834 | 2.69  |
| Non-interest-bearing deposits         | 68,340     |       |       | 73,415     |       |       | 79,199     |       |       |
| Other liabilities                     | 1,806      |       |       | 1,609      |       |       | 1,407      |       |       |
| Stockholders' equity                  | 28,841     |       |       | 28,995     |       |       | 27,210     |       |       |
| Total liabilities and equity          | \$ 320,751 |       |       | \$ 312,502 |       |       | \$ 325,403 |       |       |
| Net interest income                   | \$ 12,626  |       |       | \$ 12,229  |       |       | \$ 12,668  |       |       |
| Net interest spread                   |            |       | 3.51% |            |       | 3.42% |            |       | 3.42% |
| Net interest margin                   |            |       | 4.31% |            |       | 4.39% |            |       | 4.31% |

1 Tax equivalent basis. The incremental tax rate applied was (104.7%) for 2008 and 34.27% for 2007.

2 Non-accrual loans included in average balance.

Provision for Credit Losses. During the year ended December 31, 2008, the Company made a provision of \$1,145,649 for credit losses, compared to a provision of \$50,000 and \$62,000 for credit losses for the years ended December 31, 2007 and 2006, respectively. The increase in the provision for credit losses for 2008 was due to net charge offs on installment loans of \$746,000 (primarily made up of charge offs on indirect automobile loans of \$719,000) and adjustments to the risk factors for our loan loss reserve calculation as economic conditions deteriorated. At December 31, 2008, the allowance for credit losses equaled 224.42% of non-accrual and past due loans compared to 188.27% and 3,116.95% at December 31, 2007 and 2006, respectively. During the year ended December 31, 2008, the Company recorded net charge-offs of \$728,000 compared to \$285,000 and \$424,256 in net charge-offs during the years ended December 31, 2007 and 2006, respectively.

**Other Income.** Other income includes service charges on deposit accounts, other fees and commissions, net gains on investment securities, and income on life insurance. Other income decreased from \$2,157,292 in 2007 to \$2,050,587 in 2008, a \$106,705, or 4.95% decrease. The decrease was primarily due to a decrease in service charges and other fees and commissions, partially offset by gains on investment securities. Other income decreased from \$2,244,390 in 2006 to \$2,157,292 in 2007, an \$87,098, or 3.88% decrease. The decrease was primarily due to a decrease in gains on investment securities with lesser decreases in service charges and other fees and commissions.

**Other Expenses.** Other expenses increased from \$10,433,019 in 2007 to \$13,102,341 in 2008, a \$2,669,322 or 25.59% increase. This increase, which consists of non-interest operating expenses, was primarily due to the write-down of one Fannie Mae and two Freddie Mac securities in the amount of \$2,816,000. Lesser increases occurred in salaries and wages and occupancy costs, partially offset by decreases in employee benefits and furniture and equipment. Other expenses decreased from \$10,596,661 in 2006 to \$10,433,019 in 2007, a \$163,190 or 1.55% decrease. This decrease, which consists of non-interest operating expenses, was primarily due to a decrease in salaries, employee benefits, and furniture and equipment costs partially offset by an increase in occupancy and other miscellaneous expenses.

**Income Taxes.** During the year ended December 31, 2008, the Company recorded income tax benefit of \$679,362, compared to income tax expense of \$758,340 for the year ended December 31, 2007. This decrease was primarily due to a tax benefit of \$1,110,770 from the write-down of \$2,816,000 for the Fannie Mae and Freddie Mac securities. In addition to this, the amount of tax exempt income on municipal securities decreased and there was a larger amount contributed to provision for credit losses. During the year ended December 31, 2007, the Company recorded income tax expense of \$758,340, compared to income tax expense of \$687,115 for the year ended December 31, 2006. This increase was primarily due to less tax exempt income on municipal securities.

#### Comparison of Financial Condition at December 31, 2008, 2007 and 2006

The Company's total assets increased to \$332,502,215 at December 31, 2008 from \$307,273,868 at December 31, 2007. The Company's total assets decreased to \$307,273,868 at December 31, 2007 from \$317,745,601 at December 31, 2006.

The Company's net loan portfolio increased to \$235,132,621 at December 31, 2008 compared to \$199,753,132 at December 31, 2007 and \$193,336,604 at December 31, 2006. The increase in the loan portfolio during the 2008 period is primarily due to an increase in refinanced mortgage loans, commercial and residential construction loans, demand commercial secured loans and mortgage participations purchased. They were partially offset by a decline in indirect automobile loans and additional mortgage participations sold. The increase in the loan portfolio during the 2007 period is primarily due to an increase in refinanced mortgage loans, commercial and residential construction loans, personal and commercial secured installment loans. They were partially offset by a decline in indirect automobile loans and mortgage participations purchased.

During 2008, the Company's total investment securities portfolio (including both investment securities available for sale and investment securities held to maturity) totaled \$57,948,645, a \$19,917,368 or 25.58%, decrease from \$77,866,013 at December 31, 2007. This decrease is primarily attributable to a decrease in mortgage backed securities. During 2007, the Company's total investment securities portfolio (including both investment securities available for sale and investment securities held to maturity) totaled \$77,866,013, an \$18,628,646 or 19.31%, decrease from \$96,494,659 at December 31, 2006. This decrease is primarily attributable to a decrease in mortgage backed securities and government agencies.

Deposits as of December 31, 2008 totaled \$269,767,598, an increase of \$16,850,832, or 6.66%, from the \$252,916,766 total as of December 31, 2007. Deposits as of December 31, 2007 totaled \$252,916,766, a decrease of \$21,916,691, or 7.98%, from the \$274,833,457 total as of December 31, 2006. Demand deposits as of December 31,

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2008 totaled \$63,538,759, a \$5,221,614, or 7.59%, decrease from \$68,760,373 at December 31, 2007. NOW and Super NOW accounts, as of December 31, 2008, decreased by \$2,075,226, or 8.96% from their 2007 level to \$21,079,314. Money market accounts decreased by \$184,175, or 1.42%, from their 2007 level, to total \$12,764,167 at December 31, 2008. Savings deposits decreased by \$1,579,894, or 3.33%, from their 2007 level, to \$45,801,719 at December 31, 2008. Time deposits over \$100,000 totaled \$37,643,347 on December 31, 2008, an increase of \$9,759,573, or 35.00% from December 31, 2007. Other time deposits (made up of certificates of deposit less than \$100,000 and individual retirement accounts) totaled \$88,940,292 on December 31, 2008, a \$16,153,569 or 22.19% increase from December 31, 2007.

Total stockholders' equity as of December 31, 2008 decreased by \$1,827,902, or 6.15%, from the 2007 period. The decrease was attributed to an increase in accumulated other comprehensive loss, net of tax, and the excess of the cash dividends paid and common stock shares repurchased and retired over the net income for 2008. Total stockholders' equity as of December 31, 2007 increased by \$1,535,641, or 5.45%, from the 2006 period. The increase was attributed to the excess of net income over the cash dividends paid and partially offset by an increase in accumulated other comprehensive loss, net of tax.

#### Off-Balance Sheet Arrangements

Off-Balance Sheet Arrangements. The Bank is a party to financial instruments in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated financial statements.

Loan commitments and lines of credit are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Many of the loan commitments and lines of credit are expected to expire without being drawn upon; accordingly, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral or other security obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, accounts receivable, inventory, property and equipment, personal residences, income-producing commercial properties, and land under development. Personal guarantees are also obtained to provide added security for certain commitments.

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to guarantee the installation of real property improvements and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral and obtains personal guarantees supporting those commitments for which collateral or other securities is deemed necessary.

The Bank's exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. As of December 31, 2008, the Bank has accrued \$200,000 for unfunded commitments related to these financial instruments with off balance sheet risk, which is included in other liabilities.

#### Market Risk Management

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates or equity pricing. The Company's principal market risk is interest rate risk that arises from its lending, investing and deposit taking activities. The Company's profitability is dependent on the Bank's net interest income. Interest rate risk can significantly affect net interest income to the degree that interest bearing liabilities mature or reprice at different intervals than interest earning assets. The Bank's Asset/Liability and Risk Management Committee oversees the management of interest rate risk. The primary purpose of the committee is to manage the exposure of net interest margins to unexpected changes due to interest rate fluctuations. The Company does not utilize derivative financial or commodity instruments or hedging strategies in its management of interest rate risk. The primary tool used by the committee to monitor interest rate risk is a "gap" report which measures the dollar difference between the amount of interest bearing assets and interest bearing liabilities subject to repricing within a given time period. These efforts affect the loan pricing and deposit rate policies of the Company as well as the asset



mix, volume guidelines, and liquidity and capital planning.

The following table sets forth the Bank's interest-rate sensitivity at December 31, 2008.

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|   | 0-3 Months         | Over 3 To<br>12 Months | Over 1<br>Through 5 Years | Over 5<br>Years   | Total             |
|---|--------------------|------------------------|---------------------------|-------------------|-------------------|
| (Dollars In Thousands)                            |                    |                        |                           |                   |                   |
| <b>Assets:</b>                                    |                    |                        |                           |                   |                   |
| Cash and due from banks                           | \$ -               | \$ -                   | \$ -                      | \$ -              | \$ 14,844         |
| Federal funds and overnight deposits              | 6,394              | -                      | -                         | -                 | 6,394             |
| Securities  | -                  | -                      | 4,561                     | 53,388            | 57,949            |
| Loans   | 12,858             | 9,047                  | 90,257                    | 125,857           | 238,019           |
| Fixed Assets                                      | -                  | -                      | -                         | -                 | 3,099             |
| Other Assets                                      | -                  | -                      | -                         | -                 | 12,197            |
| <b>Total assets</b>                               | <b>\$ 19,252</b>   | <b>\$ 9,047</b>        | <b>\$ 94,818</b>          | <b>\$ 179,245</b> | <b>\$ 332,502</b> |
| <b>Liabilities:</b>                               |                    |                        |                           |                   |                   |
| Demand deposit accounts                           | \$ -               | \$ -                   | \$ -                      | \$ -              | \$ 63,539         |
| NOW accounts                                      | 21,079             | -                      | -                         | -                 | 21,079            |
| Money market deposit accounts                     | 12,764             | -                      | -                         | -                 | 12,764            |
| Savings accounts                                  | 45,802             | 204                    | -                         | -                 | 46,006            |
| IRA accounts                                      | 2,860              | 8,997                  | 21,188                    | 907               | 33,952            |
| Certificates of deposit                           | 16,347             | 39,980                 | 35,760                    | 341               | 92,428            |
| Other liabilities                                 | -                  | -                      | -                         | -                 | 29,671            |
| Junior Subordinated Debenture                     | -                  | -                      | -                         | -                 | 5,155             |
| Stockholders' equity                              | -                  | -                      | -                         | -                 | 27,908            |
| <b>Total liabilities and Stockholders' equity</b> | <b>\$ 98,852</b>   | <b>\$ 49,181</b>       | <b>\$ 56,948</b>          | <b>\$ 1,248</b>   | <b>\$ 332,502</b> |
| <b>GAP</b>  | <b>\$ (79,600)</b> | <b>\$ (40,134)</b>     | <b>\$ 37,870</b>          | <b>\$ 177,997</b> |                   |
| <b>Cumulative GAP</b>                             | <b>(79,600)</b>    | <b>(119,734)</b>       | <b>(81,864)</b>           | <b>96,133</b>     |                   |
| <b>Cumulative GAP as a % of total assets</b>      | <b>(23.96%)</b>    | <b>(36.04%)</b>        | <b>(24.64%)</b>           | <b>28.94%</b>     |                   |

The foregoing analysis assumes that the Bank's assets and liabilities move with rates at their earliest repricing opportunities based on final maturity. Mortgage backed securities are assumed to mature during the period in which they are estimated to prepay and it is assumed that loans and other securities are not called prior to maturity. Certificates of deposit and IRA accounts are presumed to reprice at maturity. NOW savings accounts are assumed to reprice at within three months although it is the Company's experience that such accounts may be less sensitive to changes in market rates.

In addition to gap analysis, the Bank utilizes a simulation model to quantify the effect a hypothetical immediate plus or minus 200 basis point change in rates would have on net interest income and the economic value of equity. The model takes into consideration the effect of call features of investments as well as prepayments of loans in periods of declining rates. When actual changes in interest rates occur, the changes in interest earning assets and interest bearing liabilities may differ from the assumptions used in the model and, in the Bank's experience, the changes historically realized have been narrower than those projected by the model. However, the Bank believes that the model is a prudent forecasting tool. As of December 31, 2008, the model produced the following sensitivity profile for net interest income and the economic value of equity.

| Immediate Change in Rates |      |      |      |
|---------------------------|------|------|------|
| -200                      | -100 | +100 | +200 |

|                                      | Basis Points | Basis Points | Basis Points | Basis Points |
|--------------------------------------|--------------|--------------|--------------|--------------|
| % Change in Net Interest Income      | 4.0%         | 1.5%         | 2.2%         | 1.1%         |
| % Change in Economic Value of Equity | -25.5%       | -11.6%       | 7.9%         | -0.9%        |

### Liquidity and Capital Resources

The Company currently has no business other than that of the Bank and does not currently have any material funding commitments. The Company's principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank's principal sources of funds for investments and operations are net income, deposits from its primary market area, principal and interest payments on loans, interest received on investment securities and proceeds from maturing investment securities. Its principal funding commitments are for the origination or purchase of loans and the payment of maturing deposits. Deposits are considered the primary source of funds supporting the Bank's lending and investment activities. The Bank also uses borrowings from the FHLB of Atlanta to supplement deposits, residential and small business lending, and to meet specific and anticipated needs.

The Bank's most liquid assets are cash and cash equivalents, which are cash on hand, amounts due from financial institutions, federal funds sold and money market mutual funds. The levels of such assets are dependent on the Bank's operating financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows.

Cash and cash equivalents (cash due from banks, interest-bearing deposits in other financial institutions, and federal funds sold), as of December 31, 2008, totaled \$21,237,903, an increase of \$6,442,843 or 43.55%, from the December 31, 2007 total of \$14,795,060. Most of this increase was due to federal funds sold with a lesser increase in interest-bearing deposits in FHLB but was offset by a decrease in cash and due from banks.

As of December 31, 2008, the Bank was permitted to draw on a \$66.01 million line of credit from the FHLB of Atlanta. Borrowings under the line are secured by a floating lien on the Bank's residential mortgage loans and its portfolio of U.S. Government and agency securities. As of December 31, 2008, a \$7 million long-term convertible advance was outstanding under this line. There was also a \$10 million convertible advance (callable monthly and with a final maturity of November 1, 2017.) There was a \$5 million convertible advance settled July 21, 2008 with a final maturity of July 23, 2018. This advance has a 2.73% rate of interest and is callable quarterly, starting July 23, 2009. There was a \$5 million convertible advance taken out August 22, 2008 which has a final maturity of August 22, 2018. This advance has a 3.344% rate of interest and is callable quarterly, starting August 22, 2011. In addition the Bank has unsecured lines of credit totaling \$9 million from a commercial bank on which there is no outstanding balances at December 31, 2008. Furthermore, on September 7, 2000, the Company issued \$5,155,000 of its 10.6% Junior Subordinated Deferrable Interest Debentures to Glen Burnie Statutory Trust I, a Connecticut statutory trust wholly owned by the Company. The Trust, in turn, issued \$5,000,000 of its 10.6% capital securities to institutional investors. The debentures are scheduled to mature on September 7, 2030, unless called by the Company not earlier than September 7, 2010. As of December 31, 2008, the full \$5,155,000 was outstanding.

Federal banking regulations require the Company and the Bank to maintain specified levels of capital. At December 31, 2008, the Company was in compliance with these requirements with a leverage ratio of 10.50%, a Tier 1 risk-based capital ratio of 14.08% and total risk-based capital ratio of 14.93%. At December 31, 2008, the Bank met the criteria for designation as a well capitalized depository institution under FDIC regulations.

#### Impact of Inflation and Changing Prices

The consolidated financial statements and notes thereto presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

#### Critical Accounting Policies

The Company's accounting policies are more fully described in Note 1 of the Notes to the Consolidated Financial Statements, starting on page F-8 and are essential to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. As discussed there, the preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, the determination of estimates requires the exercise of judgment. Management has used the best information available to make the estimations necessary to value the related assets and liabilities based on historical experience and on various assumptions which

are believed to be reasonable under the circumstances. Actual results could differ from those estimates, and such differences may be material to the financial statements. The Company reevaluates these variables as facts and circumstances change. Historically, actual results have not differed significantly from the Company's estimates. The following is a summary of the more judgmental accounting estimates and principles involved in the preparation of the Company's financial statements, including the identification of the variables most important in the estimation process:

Allowance for Credit Losses. The Bank's allowance for credit losses is determined based upon estimates that can and do change when the actual events occur, including historical losses as an indicator of future losses, fair market value of collateral, and various general or industry or geographic specific economic events. The use of these estimates and values is inherently subjective and the actual losses could be greater or less than the estimates. For further information regarding our allowance for credit losses, see "Allowance for Credit Losses" under Item 1- "Business" of this Annual Report.

Accrued Taxes. Management estimates income tax expense based on the amount it expects to owe various tax authorities. Income taxes are discussed in more detail in Note 10 to the consolidated financial statements. Accrued taxes represent the net estimated amount due or to be received from taxing authorities. In estimating accrued taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance in the context of the Company's tax position.

#### Recently Issued Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 Revised 2007 (SFAS 141R), Business Combinations. SFAS 141R's objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after December 31, 2008. On January 1, 2008, the Company adopted SFAS No. 141R. The Company has determined that the adoption of this pronouncement did not have a significant impact on the financial statements.

In February 2007, the FASB issued Statement No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115 which is effective as of the beginning of the first fiscal year that begins after November 15, 2007. Management has not elected to adopt this SFAS but will continue to evaluate the impact of adopting this Statement on the Company's financial statements for future periods.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS 160's objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 shall be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the implementation of SFAS 160 to have a material impact on its consolidated financial statements.

In September 2006, the FASB ratified the consensus reached by the Emerging Issued Task Force (EITF) on Issue No. 06-04, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. Therefore, this Issue would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

The consensus in this Issue is effective for fiscal years beginning after December 15, 2007, with earlier application permitted. Entities should recognize the effects of applying the consensus in this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. On January 1, 2008, the Company adopted EITF No. 06-04 and under option (a) recorded a cumulative accrued expense and reduction in stockholder's equity totaling \$179,794 statements.

On January 12, 2009, the FASB issued FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20 (FSP). FASB FSP 99-20-1 amends the impairment guidance in FASB EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be held by a Transferor in Securitized Financial Assets. The intent of the FSP is to reduce complexity and achieve more consistent determinations as to whether other-than-temporary impairments of available for sale or held to maturity debt securities have occurred. The FSP is effective for interim and annual reporting periods ending after December 15, 2008. The adoption of this FSP did not have an impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133.” This Statement amends and expands the disclosure requirements of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.” The Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect the implementation of SFAS 161 to have a material impact on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Principles.” This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (“GAAP”) in the United States. The Statement is directed to entities rather than auditors because entities are responsible for the selection of accounting principles for financial statements that are presented in conformity with GAAP. This Statement is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.” The Company does not expect the implementation of SFAS 162 to have a material impact on its consolidated financial statements.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and supplementary data required by this Item 8 are included in the Company’s Consolidated Financial Statements and set forth in the pages indicated in Item 16(a) of this Annual Report.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

#### ITEM 9A. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to management in a timely manner. The Company’s Chief Executive Officer and Chief Financial Officer have evaluated this system of disclosure controls and procedures as of the end of the period covered by this annual report, and have concluded that the system is effective.

##### Management’s Annual Report on Internal Control over Financial Reporting

The Company’s management, including its Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles (GAAP). Internal control over financial reporting includes those policies and procedures that: (i) pertain to



the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management (with the participation of the Company's Chief Executive Officer and Chief Financial Officer) conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2008.

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

#### Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the fourth quarter of 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B.

#### OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information with respect to the identity and business experience of the directors of the Company and their remuneration set forth in the section captioned “Proposal I — Election of Directors” in the Company’s definitive Proxy Statement to be filed pursuant to Regulation 14A and issued in conjunction with the 2009 Annual Meeting of Stockholders (the “Proxy Statement”) is incorporated herein by reference. The information with respect to the identity and business experience of executive officers of the Company is set forth in Part I of this Form 10-K. The information with respect to the Company’s Audit Committee is incorporated herein by reference to the section captioned “Meetings and Committees of the Board of Directors” in the Proxy Statement. The information with respect to compliance with Section 16(a) of the Exchange Act is incorporated herein by reference to the section captioned “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement. The information with respect to the Company’s Code of Ethics is incorporated herein by reference to the section captioned “Code of Ethics” in the Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the sections captioned “Director Compensation” and “Executive Compensation” in the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated herein by reference to the sections captioned “Voting Securities and Principal Holders Thereof” and “Securities Ownership of Management” in the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated herein by reference to the section captioned “Election of Directors” and “Transactions with Management” in the Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated herein by reference to the section captioned “Authorization for Appointment of Auditors – Disclosure of Independent Auditor Fees” in the Proxy Statement.

## PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

## (a) 1. Financial Statements.

|   | Page |
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| Independent Auditors' Report F-1  | F-1  |
| Consolidated Balance Sheets as of December 31, 2008, 2007 and 2006  | F-2  |
| Consolidated Statements of Income for the Years Ended December 31, 2008, 2007 and 2006                          | F-3  |
| Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2008, 2007 and 2006            | F-4  |
| Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2008, 2007 and 2006 | F-5  |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007 and 2006                      | F-6  |
| Notes to Consolidated Financial Statements  | F-8  |

## (a) 2. Financial Statement Schedules.

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

## (a) 3. Exhibits required to be filed by Item 601 of Regulation S-K.

## Exhibit No.

- 3.1 Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Amendment No. 1 to the Registrant's Form 8-A filed December 27, 1999, File No. 0-24047)
- 3.2 Articles of Amendment, dated October 8, 2003 (incorporated by reference to Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2003, File No. 0-24047)
- 3.3 Articles Supplementary, dated November 16, 1999 (incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed December 8, 1999, File No. 0-24047)
- 3.4 By-Laws (incorporated by reference to Exhibit 3.4 to the Registrant's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2003, File No. 0-24047)
- 4.1 Rights Agreement, dated as of February 13, 1998, between Glen Burnie Bancorp and The Bank of Glen Burnie, as Rights Agent, as amended and restated as of December 27, 1999 (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Form 8-A filed December 27, 1999, File No. 0-24047)
- 10.1 Glen Burnie Bancorp Director Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to Post-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-8, File No. 33-62280)
- 10.2 The Bank of Glen Burnie Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to Post-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-8, File No. 333-46943)
- 10.3 Amended and Restated Change-in-Control Severance Plan (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2001, File No. 0-24047)
- 10.4 The Bank of Glen Burnie Executive and Director Deferred Compensation Plan (incorporated by reference to Exhibit 10.4 to the Registrant's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 1999, File No. 0-24047)
- 21 Subsidiaries of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2001, File No. 0-24047)

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Consent of Trice Geary & Myers LLC

31.1

Rule 15d-14(a) Certification of Chief Executive Officer

31.2

Rule 15d-14(a) Certification of Chief Financial Officer

32.1

Section 1350 Certifications

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/s/ Karen B. Thorwarth  
Karen B. Thorwarth

Director

March 13, 2009

/s/ Mary Lou Wilcox  
Mary Lou Wilcox

Director

March 13, 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors  
Glen Burnie Bancorp and Subsidiaries  
Glen Burnie, Maryland

We have audited the accompanying consolidated balance sheets of Glen Burnie Bancorp and subsidiaries as of December 31, 2008, 2007, and 2006, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years then ended. Glen Burnie Bancorp and subsidiaries' management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Glen Burnie Bancorp and subsidiaries as of December 31, 2008, 2007, and 2006, and the consolidated results of their operations and their consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Salisbury, Maryland  
March 9, 2009



## Glen Burnie Bancorp and Subsidiaries

## Consolidated Balance Sheets

| December 31,   | 2008                  | 2007                  | 2006                  |
|--|-----------------------|-----------------------|-----------------------|
| <b>Assets</b>  |                       |                       |                       |
| Cash and due from banks  | \$ 6,960,377          | \$ 8,220,582          | \$ 9,005,691          |
| Interest-bearing deposits in other financial institutions                                    | 7,883,816             | 5,847,562             | 342,309               |
| Federal funds sold   | 6,393,710             | 726,916               | 3,971,978             |
| Cash and cash equivalents  | 21,237,903            | 14,795,060            | 13,319,978            |
| Investment securities available for sale, at fair value                                      | 57,948,645            | 77,182,181            | 95,811,296            |
| Investment securities held to maturity (fair value 2007 \$726,193; 2006 \$729,960)           | -                     | 683,832               | 683,363               |
| Federal Home Loan Bank stock, at cost  | 1,767,600             | 1,381,900             | 928,000               |
| Maryland Financial Bank stock, at cost   | 100,000               | 100,000               | 100,000               |
| Common stock in the Glen Burnie Statutory Trust I  | 155,000               | 155,000               | 155,000               |
| Ground rents, at cost  | 184,900               | 202,900               | 219,100               |
| Loans, less allowance for credit losses 2008 \$2,021,690; 2007 \$1,604,491; 2006 \$1,839,094 | 235,132,621           | 199,753,132           | 193,336,604           |
| Premises and equipment, at cost, less accumulated depreciation                               | 3,099,448             | 3,087,908             | 3,406,014             |
| Accrued interest receivable on loans and investment securities                               | 1,680,392             | 1,508,640             | 1,627,433             |
| Deferred income tax benefits   | 2,286,483             | 453,512               | 292,131               |
| Other real estate owned  | 550,000               | 50,000                | 50,000                |
| Cash value of life insurance   | 7,434,573             | 7,161,403             | 6,892,455             |
| Other assets   | 924,650               | 758,400               | 924,227               |
| <b>Total assets</b>  | <b>\$ 332,502,215</b> | <b>\$ 307,273,868</b> | <b>\$ 317,745,601</b> |
| <b>Liabilities and Stockholders' Equity</b>  |                       |                       |                       |
| <b>Liabilities:</b>  |                       |                       |                       |
| <b>Deposits:</b>   |                       |                       |                       |
| Noninterest-bearing  | \$ 63,538,759         | \$ 68,760,373         | \$ 74,729,298         |
| Interest-bearing   | 206,228,839           | 184,156,393           | 200,104,159           |
| <b>Total deposits</b>  | <b>269,767,598</b>    | <b>252,916,766</b>    | <b>274,833,457</b>    |
| Short-term borrowings  | 629,855               | 502,529               | 545,349               |
| Long-term borrowings   | 27,071,712            | 17,107,135            | 7,140,170             |
| Junior subordinated debentures owed to unconsolidated subsidiary trust                       | 5,155,000             | 5,155,000             | 5,155,000             |
| Dividends payable  | 385,794               | 385,010               | 366,580               |
| Accrued interest payable on deposits   | 139,579               | 134,274               | 145,642               |

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|  |                    |                    |                    |
|--|--------------------|--------------------|--------------------|
| Accrued interest payable on junior subordinated debentures | 171,518            | 171,518            | 171,518            |
| Other liabilities  | 1,272,907          | 1,165,482          | 1,187,372          |
| <b>Total liabilities</b>                                   | <b>304,593,963</b> | <b>277,537,714</b> | <b>289,545,088</b> |

Commitments and contingencies

Stockholders' equity:

|  |                   |                   |                   |
|--|-------------------|-------------------|-------------------|
| Common stock, par value \$1, authorized 15,000,000 shares; issued and outstanding 2008 2,967,727 shares; 2007 2,498,465 shares; 2006 2,484,633 shares; | 2,967,727         | 2,498,465         | 2,484,633         |
| Surplus  | 11,568,241        | 11,921,129        | 11,719,907        |
| Retained earnings  | 14,129,637        | 15,750,156        | 14,312,496        |
| Accumulated other comprehensive loss, net of tax   | (757,353)         | (433,596)         | (316,523)         |
| <b>Total stockholders' equity</b>  | <b>27,908,252</b> | <b>29,736,154</b> | <b>28,200,513</b> |

|   |                       |                       |                       |
|---|-----------------------|-----------------------|-----------------------|
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 332,502,215</b> | <b>\$ 307,273,868</b> | <b>\$ 317,745,601</b> |
|---|-----------------------|-----------------------|-----------------------|

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

## Glen Burnie Bancorp and Subsidiaries

## Consolidated Statements of Income

| Years Ended December 31,                                     | 2008              | 2007              | 2006              |
|--|-------------------|-------------------|-------------------|
| <b>Interest income on:</b>                                   |                   |                   |                   |
| Loans, including fees  | \$ 14,456,017     | \$ 13,326,693     | \$ 11,830,676     |
| U.S. Government agency securities                            | 1,962,553         | 2,553,527         | 3,347,090         |
| State and municipal securities                               | 1,410,676         | 1,451,540         | 1,653,109         |
| Corporate trust preferred securities                         | 192,749           | 250,526           | 374,588           |
| Federal funds sold   | 5,034             | 139,075           | 200,418           |
| Other  | 149,007           | 115,895           | 249,315           |
| <b>Total interest income</b>                                 | <b>18,176,036</b> | <b>17,837,256</b> | <b>17,655,196</b> |
| <b>Interest expense on:</b>                                  |                   |                   |                   |
| Deposits   | 4,780,185         | 4,824,425         | 4,780,871         |
| Short-term borrowings  | 50,567            | 119,101           | 80,994            |
| Long-term borrowings   | 877,101           | 481,092           | 425,470           |
| Junior subordinated debentures                               | 546,180           | 546,430           | 546,430           |
| <b>Total interest expense</b>                                | <b>6,254,033</b>  | <b>5,971,048</b>  | <b>5,833,765</b>  |
| <b>Net interest income</b>                                   | <b>11,922,003</b> | <b>11,866,208</b> | <b>11,821,431</b> |
| <b>Provision for credit losses</b>                           | <b>1,145,649</b>  | <b>50,000</b>     | <b>62,000</b>     |
| <b>Net interest income after provision for credit losses</b> | <b>10,776,354</b> | <b>11,816,208</b> | <b>11,759,431</b> |
| <b>Other income:</b>   |                   |                   |                   |
| Service charges on deposit accounts                          | 737,070           | 814,392           | 831,140           |
| Other fees and commissions                                   | 849,417           | 953,873           | 1,026,144         |
| Gains on investment securities, net                          | 190,930           | 120,079           | 176,453           |
| Income on life insurance                                     | 273,170           | 268,948           | 210,653           |
| <b>Total other income</b>                                    | <b>2,050,587</b>  | <b>2,157,292</b>  | <b>2,244,390</b>  |
| <b>Other expenses:</b>                                       |                   |                   |                   |
| Salaries and wages   | 4,694,461         | 4,623,067         | 4,769,495         |
| Employee benefits  | 1,525,023         | 1,702,535         | 1,748,294         |
| Occupancy  | 903,976           | 886,345           | 850,843           |
| Furniture and equipment                                      | 754,191           | 844,147           | 864,151           |
| Impairment loss on investment securities                     | 2,816,000         | -                 | -                 |
| Other expenses   | 2,408,690         | 2,376,925         | 2,363,878         |
| <b>Total other expenses</b>                                  | <b>13,102,341</b> | <b>10,433,019</b> | <b>10,596,661</b> |
| <b>(Loss) income before income taxes (benefits)</b>          | <b>(275,400)</b>  | <b>3,540,481</b>  | <b>3,407,160</b>  |
| <b>Federal and state income taxes (benefits)</b>             | <b>(679,362)</b>  | <b>758,340</b>    | <b>687,115</b>    |

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|  |    |         |    |           |    |           |
|--|----|---------|----|-----------|----|-----------|
| Net income   | \$ | 403,962 | \$ | 2,782,141 | \$ | 2,720,045 |
| Basic and diluted earnings per share of common stock | \$ | 0.14    | \$ | 0.93      | \$ | 0.92      |

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

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## Glen Burnie Bancorp and Subsidiaries

## Consolidated Statements of Comprehensive Income

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| Years Ended December 31,   | 2008        | 2007         | 2006         |
|--|-------------|--------------|--------------|
| Net income   | \$ 403,962  | \$ 2,782,141 | \$ 2,720,045 |
| Other comprehensive loss, net of tax   |             |              |              |
| Unrealized holding losses arising during the period (net of deferred tax benefits 2008 \$1,264,081; 2007 \$23,422; 2006 \$6,826) | (1,913,998) | (37,231)     | (10,849)     |
| Reclassification adjustment for impairment loss included in net income (net of deferred tax benefits 2008 \$1,110,771)           | 1,705,229   | -            | -            |
| Reclassification adjustment for gains included in net income (net of deferred taxes 2008 \$75,942; 2007 \$50,237; 2006 \$47,522) | (114,988)   | (79,842)     | (75,529)     |
| Total other comprehensive loss   | (323,757)   | (117,073)    | (86,378)     |
| Comprehensive income   | \$ 80,205   | \$ 2,665,068 | \$ 2,633,667 |

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

## Glen Burnie Bancorp and Subsidiaries

## Consolidated Statements of Changes in Stockholders' Equity

Years Ended December 31, 2008, 2007, and 2006

|  | Common Stock<br>Shares | Par Value    | Surplus       | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|--|------------------------|--------------|---------------|----------------------|---|----------------------------------|
| Balances, December 31,<br>2005                           | 2,056,024              | \$ 2,056,024 | \$ 11,458,465 | \$ 13,341,097        | \$ (230,145)                                  | \$ 26,625,441                    |
| Net income   | -                      | -            | -             | 2,720,045            | -   | 2,720,045                        |
| Cash dividends, \$.45 per<br>share                       | -                      | -            | -             | (1,337,545)          | -   | (1,337,545)                      |
| Dividends reinvested under<br>dividend reinvestment plan | 15,113                 | 15,113       | 229,946       | -                    | -   | 245,059                          |
| Shares issued under<br>employee stock purchase<br>plan   | 2,395                  | 2,395        | 31,496        | -                    | -   | 33,891                           |
| Stock split effected in form<br>of 20% stock dividend    | 411,101                | 411,101      | -             | (411,101)            | -   | -                                |
| Other comprehensive loss,<br>net of tax                  | -                      | -            | -             | -                    | (86,378)                                      | (86,378)                         |
| Balances, December 31,<br>2006                           | 2,484,633              | 2,484,633    | 11,719,907    | 14,312,496           | (316,523)                                     | 28,200,513                       |
| Net income   | -                      | -            | -             | 2,782,141            | -   | 2,782,141                        |
| Cash dividends, \$.45 per<br>share                       | -                      | -            | -             | (1,344,481)          | -   | (1,344,481)                      |
| Dividends reinvested under<br>dividend reinvestment plan | 12,791                 | 12,791       | 187,668       | -                    | -   | 200,459                          |
| Shares issued under<br>employee stock purchase<br>plan   | 1,041                  | 1,041        | 13,554        | -                    | -   | 14,595                           |
| Other comprehensive loss,<br>net of tax                  | -                      | -            | -             | -                    | (117,073)                                     | (117,073)                        |
| Balances, December 31,<br>2007                           | 2,498,465              | 2,498,465    | 11,921,129    | 15,750,156           | (433,596)                                     | 29,736,154                       |
| Net income   | -                      | -            | -             | 403,962              | -   | 403,962                          |
| Cummulative effect of<br>adoption of EITF 06-04          | -                      | -            | -             | (179,794)            | -   | (179,794)                        |
| Shares repurchased and<br>retired                        | (50,300)               | (50,300)     | (526,939)     | -                    | -   | (577,239)                        |
|  | -                      | -            | -             | (1,345,128)          | -   | (1,345,128)                      |

|   |           |              |               |               |              |               |
|---|-----------|--------------|---------------|---------------|--------------|---------------|
| Cash dividends, \$.45 per share                       |           |              |               |               |              |               |
| Dividends reinvested under dividend reinvestment plan | 20,003    | 20,003       | 174,051       | -             | -            | 194,054       |
| Stock split effected in form of 20% stock dividend    | 499,559   | 499,559      | -             | (499,559)     | -            | -             |
| Other comprehensive loss, net of tax                  | -         | -            | -             | -             | (323,757)    | (323,757)     |
| Balances, December 31, 2008                           | 2,967,727 | \$ 2,967,727 | \$ 11,568,241 | \$ 14,129,637 | \$ (757,353) | \$ 27,908,252 |

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

## Glen Burnie Bancorp and Subsidiaries

## Consolidated Statements of Cash Flows

| Years Ended December 31,   | 2008                | 2007              | 2006                |
|--|---------------------|-------------------|---------------------|
| <b>Cash flows from operating activities:</b>   |                     |                   |                     |
| Net income   | \$ 403,962          | \$ 2,782,141      | \$ 2,720,045        |
| <b>Adjustments to reconcile net income to net cash provided by operating activities</b>                  |                     |                   |                     |
| Depreciation, amortization, and accretion  | 421,229             | 496,172           | 571,741             |
| Provision for credit losses  | 1,145,649           | 50,000            | 62,000              |
| Deferred income (benefits) taxes, net  | (1,605,603)         | (87,720)          | 26,357              |
| Gains on disposals of assets, net  | (173,393)           | (119,652)         | (175,634)           |
| Impairment losses on investment securities   | 2,816,000           | -                 | -                   |
| Income on investment in life insurance   | (273,170)           | (268,948)         | (210,653)           |
| <b>Changes in assets and liabilities:</b>  |                     |                   |                     |
| (Increase) decrease in accrued interest receivable   | (171,752)           | 118,793           | (175,627)           |
| (Increase) decrease in other assets  | (118,962)           | 106,163           | 38,161              |
| Increase (decrease) in accrued interest payable  | 5,305               | (11,368)          | 62,531              |
| (Decrease) increase in other liabilities   | (72,369)            | (21,890)          | 41,751              |
| <b>Net cash provided by operating activities</b>   | <b>2,376,896</b>    | <b>3,043,691</b>  | <b>2,960,672</b>    |
| <b>Cash flows from investing activities:</b>   |                     |                   |                     |
| Maturities of held to maturity mortgage-backed securities  | -                   | -                 | 468,199             |
| Maturities of available for sale mortgage-backed securities  | 4,402,208           | 7,301,634         | 9,331,430           |
| Maturities of other available for sale investment securities   | -                   | 300,000           | 4,330,544           |
| Sales of held to maturity debt securities  | 684,100             | -                 | -                   |
| Sales of available for sale debt securities  | 25,977,280          | 17,889,342        | 22,431,078          |
| Purchases of available for sale mortgage-backed securities   | (981,811)           | -                 | (25,365,231)        |
| Purchases of other available for sale investment securities  | (13,318,481)        | (6,907,162)       | (20,398,575)        |
| Purchase of FHLB stock   | (385,700)           | (453,900)         | (9,100)             |
| Purchase of life insurance contracts   | -                   | -                 | (1,000,000)         |
| Increase in loans, net   | (36,525,138)        | (6,466,528)       | (3,193,606)         |
| Purchases of premises and equipment  | (501,717)           | (128,452)         | (131,821)           |
| <b>Net cash (used) provided by investing activities</b>  | <b>(20,649,259)</b> | <b>11,534,934</b> | <b>(13,537,082)</b> |
| <b>Cash flows from financing activities:</b>   |                     |                   |                     |
| Decrease in noninterest-bearing deposits, NOW accounts, money market accounts, and savings accounts, net | (5,221,614)         | (5,968,925)       | (4,584,623)         |
| Increase (decrease) in time deposits, net  | 22,072,446          | (15,947,766)      | 14,169,812          |
| Increase (decrease) in short-term borrowings   | 127,326             | (42,820)          | (76,701)            |
| Proceeds from long-term borrowings   | 10,000,000          | 10,000,000        | -                   |
| Repayments of long-term borrowings   | (35,423)            | (33,035)          | (30,807)            |
| Cash dividends paid  | (1,344,344)         | (1,326,051)       | (1,309,970)         |
| Common stock dividends reinvested  | 194,054             | 200,459           | 245,059             |
| Repurchase and retirement of common stock  | (577,239)           | -                 | -                   |



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|  |               |               |               |
|--|---------------|---------------|---------------|
| Issuance of common stock                         | -             | 14,595        | 33,891        |
| Net cash provided (used) by financing activities | 25,215,206    | (13,103,543)  | 8,446,661     |
| Increase (decrease) in cash and cash equivalents | 6,942,843     | 1,475,082     | (2,129,749)   |
| Cash and cash equivalents, beginning of year     | 14,795,060    | 13,319,978    | 15,449,727    |
| Cash and cash equivalents, end of year           | \$ 21,737,903 | \$ 14,795,060 | \$ 13,319,978 |

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

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Glen Burnie Bancorp and Subsidiaries

Consolidated Statements of Cash Flows  
(Continued)

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| Years Ended December 31,   | 2008         | 2007         | 2006         |
|--|--------------|--------------|--------------|
| <b>Supplementary Cash Flow Information:</b>                                |              |              |              |
| Interest paid  | \$ 6,248,728 | \$ 5,982,416 | \$ 5,771,234 |
| Income taxes paid  | 600,000      | 886,156      | 626,374      |
| Total increase in unrealized depreciation on available for sale securities | (551,125)    | (190,732)    | (140,725)    |

The Notes to Consolidated Financial Statements are an integral part of these consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1. Summary of Significant Accounting Policies

The Bank of Glen Burnie (the “Bank”) provides financial services to individuals and corporate customers located in Anne Arundel County and surrounding areas of Central Maryland, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain Federal and State of Maryland (the “State”) agencies and undergoes periodic examinations by those regulatory authorities. The accounting and financial reporting policies of the Bank conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the banking industry.

Significant accounting policies not disclosed elsewhere in the consolidated financial statements are as follows:

#### Principles of Consolidation:

The consolidated financial statements include the accounts of Glen Burnie Bancorp (“Bancorp” or the “Company”) and its subsidiaries, The Bank of Glen Burnie and GBB Properties, Inc., a company engaged in the acquisition and disposition of other real estate. Intercompany balances and transactions have been eliminated. The Parent Only financial statements (see Note 21) of the Company account for the subsidiaries using the equity method of accounting.

The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under accounting principles generally accepted in the United States. Voting interest entities are entities, in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity’s activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIE’s) are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interest, that will absorb a majority of the entity’s expected losses, receive a majority of the entity’s expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company’s wholly owned subsidiary, Glen Burnie Statutory Trust I, is a VIE for which the Company is not the primary beneficiary. Accordingly, the accounts of this entity are not included in the Company’s consolidated financial statements.

#### Use of Estimates:

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted within 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 dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

#### Securities Held to Maturity:

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the effective interest rate method over the period to maturity. Securities transferred into held to maturity from the available for sale portfolio are recorded at fair value at time of transfer with unrealized gains or losses reflected in equity and amortized over the remaining life of the security.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (continued)

Securities Available for Sale:

Marketable debt securities not classified as held to maturity are classified as available for sale. Securities available for sale may be sold in response to changes in interest rates, loan demand, changes in prepayment risk, and other factors. Changes in unrealized appreciation (depreciation) on securities available for sale are reported in other comprehensive income, net of tax. Realized gains (losses) on securities available for sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. The gains and losses on securities sold are determined by the specific identification method. Premiums and discounts are recognized in interest income using the effective interest rate method over the period to maturity. Additionally, declines in the fair value of individual investment securities below their cost that are other than temporary are reflected as realized losses in the consolidated statements of income.

Other Securities:

Federal Home Loan Bank (“FHLB”) and Maryland Financial Bank (“MFB”) stocks are equity interests that do not necessarily have readily determinable fair values for purposes of Statement of Financial Accounting Standards (“SFAS”) No 115, Accounting for Certain Investments in Debt and Equity Securities, because their ownership is restricted and they lack a market. FHLB stock can be sold back only at its par value of \$100 per share and only to the FHLB or another member institution.

Loans and Allowance for Credit Losses:

Loans are generally carried at the amount of unpaid principal, adjusted for deferred loan fees, which are amortized over the term of the loan using the effective interest rate method. Interest on loans is accrued based on the principal amounts outstanding. It is the Bank’s policy to discontinue the accrual of interest when a loan is specifically determined to be impaired or when principal or interest is delinquent for ninety days or more. When a loan is placed on nonaccrual status all interest previously accrued but not collected is reversed against current period interest income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Cash collections on such loans are applied as reductions of the loan principal balance and no interest income is recognized on those loans until the principal balance has been collected. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. The carrying value of impaired loans is based on the present value of the loan’s expected future cash flows or, alternatively, the observable market price of the loan or the fair value of the collateral.

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management’s periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least quarterly and more often if deemed necessary.

The allowance for loan losses typically consists of an allocated component and an unallocated component. The components of the allowance for loan losses represent an estimation done pursuant to either SFAS No 5, Accounting for Contingencies, or SFAS No 114, Accounting by Creditors for Impairment of a Loan. The allocated component of the allowance for loan losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on regular analyses of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The historical loan loss element is determined statistically using a loss migration analysis that examines loss experience and the related internal gradings of loans charged off. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The allocated component of the allowance for loan losses also includes consideration of concentrations and changes in portfolio mix and volume.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (continued)

Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. In addition, the unallocated allowance includes a component that explicitly accounts for the inherent imprecision in loan loss migration models. The historical losses used in the migration analysis may not be representative of actual unrealized losses inherent in the portfolio. At December 31, 2008, there was approximately a \$33,000 unallocated component of the allowance reflected in the allowance for credit losses.

Reserve for Unfunded Commitments:

The reserve for unfunded commitments is established through a provision for unfunded commitments charged to other expenses. The reserve is calculated by utilizing the same methodology and factors as the allowance for credit losses. The reserve, based on evaluations of the collectibility of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

Other Real Estate Owned ("OREO"):

OREO comprises properties acquired in partial or total satisfaction of problem loans. The properties are recorded at the lower of cost or fair value (appraised value) at the date acquired. Losses arising at the time of acquisition of such properties are charged against the allowance for credit losses. Subsequent write-downs that may be required and expenses of operation are included in other income or expenses. Gains and losses realized from the sale of OREO are included in other income or expenses. Loans converted to OREO through foreclosure proceedings totaled \$550,000 for the year ended December 31, 2008. No loans were converted to OREO in 2007 or 2006. The Bank financed no sales of OREO for 2008, 2007, or 2006.

Bank Premises and Equipment:

Bank premises and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the lesser of the terms of the leases or their estimated useful lives. Expenditures for improvements that extend the life of an asset are capitalized and depreciated over the asset's remaining useful life. Gains or losses realized on the disposition of premises and equipment are reflected in the consolidated statements of income. Expenditures for repairs and maintenance are charged to other expenses as incurred. Computer software is recorded at cost and amortized over three to five years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (continued)

Long-Lived Assets:

The carrying value of long-lived assets and certain identifiable intangibles, including goodwill, is reviewed by the Bank for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as prescribed in SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Asset. As of December 31, 2008, 2007, and 2006, certain loans existed which management considered impaired (See Note 4). During the year ended December 31, 2008, management deemed certain investment securities were impaired and recorded an impairment loss on these securities (See Note 3).

Income Taxes:

The provision for Federal and state income taxes is based upon the results of operations, adjusted for tax-exempt income. Deferred income taxes are provided by applying enacted statutory tax rates to temporary differences between financial and taxable bases.

Temporary differences which give rise to deferred tax benefits relate principally to accrued deferred compensation, accumulated impairment losses on investment securities, allowance for credit losses, unused alternative minimum tax credits, net unrealized depreciation on investment securities available for sale, and reserve for unfunded commitments.

Temporary differences which give rise to deferred tax liabilities relate principally to accumulated depreciation, and accumulated securities discount accretion.

Credit Risk:

The Bank has unsecured deposits and Federal funds sold with several other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation ("FDIC").

Cash and Cash Equivalents:

The Bank has included cash and due from banks, interest-bearing deposits in other financial institutions, and Federal funds sold as cash and cash equivalents for the purpose of reporting cash flows.

Accounting for Stock Options:

The Company follows SFAS No. 123R, Share-Based Payments, for accounting and reporting for stock-based compensation plans. SFAS No. 123R defines a fair value at grant date based method of accounting for measuring compensation expense for stock-based plans to be recognized in the statement of income.

Earnings per share:

Basic earnings per common share are determined by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share are calculated including the average dilutive common stock equivalents outstanding during the period. Dilutive common equivalent shares consist of stock options, calculated using the treasury stock method.





## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 1. Summary of Significant Accounting Policies (continued)

## Financial Statement Presentation:

Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation.

## Note 2. Restrictions on Cash and Due from Banks

The Federal Reserve requires the Bank to maintain noninterest-bearing cash reserves against certain categories of average deposit liabilities. Such reserves averaged approximately \$4,781,000, \$5,368,000, and \$5,530,000 during the years ended December 31, 2008, 2007, and 2006, respectively.

## Note 3. Investment Securities

Investment securities are summarized as follows:

| December 31, 2008          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|----------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>Available for sale:</b> |                   |                              |                               |               |
| U.S. Government agencies   | \$ 8,686,877      | \$ 191,455                   | \$ 140,280                    | \$ 8,738,052  |
| State and municipal        | 31,466,012        | 235,128                      | 979,935                       | 30,721,205    |
| Corporate trust preferred  | 2,168,928         | -                            | 971,426                       | 1,197,502     |
| Mortgage-backed            | 16,884,368        | 413,682                      | 6,164                         | 17,291,886    |
|                            | \$ 59,206,185     | \$ 840,265                   | \$ 2,097,805                  | \$ 57,948,645 |
| <b>December 31, 2007</b>   |                   |                              |                               |               |
| December 31, 2007          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| <b>Available for sale:</b> |                   |                              |                               |               |
| U.S. Government agencies   | \$ 8,489,126      | \$ 44,593                    | \$ 761,906                    | \$ 7,771,813  |
| State and municipal        | 31,627,159        | 272,449                      | 164,764                       | 31,734,844    |
| Corporate trust preferred  | 2,167,271         | 253,283                      | -                             | 2,420,554     |
| Mortgage-backed            | 35,605,038        | 110,145                      | 460,213                       | 35,254,970    |
|                            | \$ 77,888,594     | \$ 680,470                   | \$ 1,386,883                  | \$ 77,182,181 |
| <b>Held to maturity:</b>   |                   |                              |                               |               |
| State and municipal        | \$ 683,832        | \$ 42,361                    | \$ -                          | \$ 726,193    |
|                            | \$ 683,832        | \$ 42,361                    | \$ -                          | \$ 726,193    |



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 3. Investment Securities (continued)

| December 31, 2006          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value    |
|----------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>Available for sale:</b> |                   |                              |                               |               |
| U.S. Government agencies   | \$ 11,484,102     | \$ 6,250                     | \$ 299,634                    | \$ 11,190,718 |
| State and municipal        | 36,127,782        | 429,062                      | 179,207                       | 36,377,637    |
| Corporate trust preferred  | 3,079,958         | 372,316                      | -                             | 3,452,274     |
| Mortgage-backed            | 45,635,133        | 39,152                       | 883,618                       | 44,790,667    |
|                            | \$ 96,326,975     | \$ 846,780                   | \$ 1,362,459                  | \$ 95,811,296 |
| <b>Held to maturity:</b>   |                   |                              |                               |               |
| State and municipal        | \$ 683,363        | \$ 46,597                    | \$ -                          | \$ 729,960    |
|                            | \$ 683,363        | \$ 46,597                    | \$ -                          | \$ 729,960    |

The gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2008 are as follows:

## Securities available for sale:

|                            | Less than 12 months |                    | 12 months or more |                    | Total         |                    |
|----------------------------|---------------------|--------------------|-------------------|--------------------|---------------|--------------------|
|                            | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value     | Unrealized<br>Loss | Fair<br>Value | Unrealized<br>Loss |
| <b>Obligations of U.S.</b> |                     |                    |                   |                    |               |                    |
| Government agencies        | \$ 1,026,580        | \$ 45,420          | \$ 13,500         | \$ 94,860          | \$ 1,040,080  | \$ 140,280         |
| State and Municipal        | 14,504,594          | 670,225            | 3,436,150         | 309,710            | 17,940,744    | 979,935            |
| Corporate trust preferred  | 1,197,502           | 971,426            | -                 | -                  | 1,197,502     | 971,426            |
| Mortgaged-backed           | 1,001,761           | 6,164              | -                 | -                  | 1,001,761     | 6,164              |
|                            | \$ 17,730,437       | \$ 1,693,235       | \$ 3,449,650      | \$ 404,570         | \$ 21,180,087 | \$ 2,097,805       |

In September 2008, Freddie Mac and Fannie Mae government sponsored entities entered into conservatorship agreements with the U.S. Treasury Department. This conservatorship precludes these entities from paying preferred stock dividends. As a result, the market values declined significantly and the Company recorded an impairment loss of \$2,816,000 during the year ended December 31, 2008. The write down represented 94% of the initial investment in these securities.

Declines in the fair value of held to maturity and available for sale 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, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2008, management had the ability and intent to hold the securities classified as available for sale for a period of time sufficient for a recovery of cost. On December 31, 2008, the Bank held 14 investment securities having continuous unrealized loss positions for more than 12

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 3. Investment Securities (continued)

months. Management has determined that all unrealized losses are either due to increases in market interest rates over the yields available at the time the underlying securities were purchased, current call features that are nearing, and the effect the sub-prime market has had on all mortgaged-backed securities. The Bank has no mortgaged-backed securities collateralized by sub-prime mortgages. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2008, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Company's consolidated income statement.

Contractual maturities of investment securities at December 31, 2008, 2007, and 2006 are shown below. Actual maturities may differ from contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have no stated maturity and primarily reflect investments in various Pass-through and Participation Certificates issued by the Federal National Mortgage Association and the Government National Mortgage Association. Repayment of mortgage-backed securities is affected by the contractual repayment terms of the underlying mortgages collateralizing these obligations and the current level of interest rates.

|  | Available for Sale |               | Held to Maturity |            |
|--|--------------------|---------------|------------------|------------|
|  | Amortized Cost     | Fair Value    | Amortized Cost   | Fair Value |
| December 31, 2008                            |                    |               |                  |            |
| Due within one year                          | \$ -               | \$ -          |                  |            |
| Due over one to five years                   | 4,577,077          | 4,560,487     |                  |            |
| Due over five to ten years                   | 5,563,224          | 5,685,637     |                  |            |
| Due over ten years                           | 32,181,516         | 30,410,635    |                  |            |
| Mortgage-backed, due in monthly installments | 16,884,368         | 17,291,886    |                  |            |
|  | \$ 59,206,185      | \$ 57,948,645 |                  |            |
| December 31, 2007                            |                    |               |                  |            |
| Due within one year                          | \$ 1,000,000       | \$ 996,094    | \$ -             | \$ -       |
| Due over one to five years                   | 9,638,992          | 9,635,177     | -                | -          |
| Due over five to ten years                   | 4,089,402          | 4,068,131     | -                | -          |
| Due over ten years                           | 27,555,162         | 27,227,809    | 683,832          | 726,193    |
| Mortgage-backed, due in monthly installments | 35,605,038         | 35,254,970    | -                | -          |
|  | \$ 77,888,594      | \$ 77,182,181 | \$ 683,832       | \$ 726,193 |
| December 31, 2006                            |                    |               |                  |            |
| Due within one year                          | \$ 300,989         | \$ 298,897    | \$ -             | \$ -       |
| Due over one to five years                   | 10,355,087         | 10,221,909    | -                | -          |
| Due over five to ten years                   | 9,938,119          | 9,826,970     | -                | -          |
| Due over ten years                           | 30,097,647         | 30,672,853    | 683,363          | 729,960    |

|  |               |               |            |            |
|--|---------------|---------------|------------|------------|
| Mortgage-backed, due in monthly installments | 45,635,133    | 44,790,667    | -          | -          |
|  | \$ 96,326,975 | \$ 95,811,296 | \$ 683,363 | \$ 729,960 |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 3. Investment Securities (continued)

Proceeds from sales of available for sale securities prior to maturity totaled \$25,977,280, \$17,889,342, and \$22,431,078 for the years ended December 31, 2008, 2007, and 2006, respectively. The Bank realized gains of \$195,780 and losses of \$4,850 on those sales for 2008. The Bank realized gains of \$230,038 and losses of \$109,959 on those sales for 2007. The Bank realized gains of \$225,438 and losses of \$48,985 on those sales for 2006. Realized gains and losses were calculated based on the amortized cost of the securities at the date of trade. Income tax expense relating to net gains on sales of investment securities totaled \$75,942, \$47,761, and \$68,146 for the years ended December 31, 2008, 2007, and 2006, respectively.

In July 2008, the Company sold its remaining two positions in securities classified as held to maturity. Inasmuch as these positions were liquidated prior to maturity in a manner which did not meet the prescribed requirements of SFAS 115, the Company may be precluded for a period of time from classifying any securities positions as held to maturity.

The Bank has no derivative financial instruments required to be disclosed under SFAS No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments.

## Note 4. Loans

Major categories of loans are as follows:

|                                   | 2008           | 2007           | 2006           |
|-----------------------------------|----------------|----------------|----------------|
| <b>Mortgage:</b>                  |                |                |                |
| Residential                       | \$ 87,707,878  | \$ 76,780,857  | \$ 68,340,050  |
| Commercial                        | 76,152,837     | 47,842,942     | 53,164,479     |
| Construction and land development | 6,589,673      | 5,876,285      | 1,609,132      |
| Demand and time                   | 6,974,607      | 5,184,349      | 5,077,680      |
| Installment                       | 60,593,752     | 66,490,020     | 67,726,942     |
|                                   | 238,018,747    | 202,174,453    | 195,918,283    |
| Unearned income on loans          | (864,436)      | (816,830)      | (742,585)      |
|                                   | 237,154,311    | 201,357,623    | 195,175,698    |
| Allowance for credit losses       | (2,021,690)    | (1,604,491)    | (1,839,094)    |
|                                   | \$ 235,132,621 | \$ 199,753,132 | \$ 193,336,604 |

The Bank has an automotive indirect lending program where vehicle collateralized loans made by dealers to consumers are acquired by the Bank. The Bank's installment loan portfolio included approximately \$43,970,000, \$49,260,000, and \$52,539,000 of such loans at December 31, 2008, 2007, and 2006, respectively.

The Bank makes loans to customers located primarily in Anne Arundel County and surrounding areas of Central Maryland. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

Executive officers, directors, and their affiliated interests enter into loan transactions with the Bank in the ordinary course of business. These loans are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with unrelated borrowers. They do not involve more than normal risk of collectibility or present other unfavorable terms. At December 31, 2008, 2007, and 2006, the amounts of such loans outstanding totaled \$4,344,974, \$4,009,224, and \$3,293,148, respectively. During 2008, loan additions and



repayments totaled \$653,500 and \$317,750, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 4. Loans (continued)

The allowance for credit losses is as follows:

|                             | 2008         | 2007         | 2006         |
|-----------------------------|--------------|--------------|--------------|
| Balance, beginning of year  | \$ 1,604,491 | \$ 1,839,094 | \$ 2,201,350 |
| Provision for credit losses | 1,145,649    | 50,000       | 62,000       |
| Recoveries                  | 352,933      | 305,841      | 357,803      |
| Loans charged off           | (1,081,383)  | (590,444)    | (782,059)    |
| Balance, end of year        | \$ 2,021,690 | \$ 1,604,491 | \$ 1,839,094 |

Loans on which the accrual of interest has been discontinued totaled \$866,912, \$212,416, and \$57,429 at December 31, 2008, 2007, and 2006, respectively. Interest that would have been accrued under the terms of these loans totaled \$29,807, \$20,037, and \$10,658 for the years ended December 31, 2008, 2007, and 2006, respectively. Loans past due 90 days or more and still accruing interest totaled \$22,551, \$639,982 and \$1,751 at December 31, 2008, 2007 and 2006, respectively.

Information regarding loans classified by the Bank as impaired is summarized as follows:

|   | 2008         | 2007       | 2006      |
|---|--------------|------------|-----------|
| Loans classified as impaired with a valuation allowance | \$ 1,387,043 | \$ 212,416 | \$ 57,429 |
| Allowance for credit losses on impaired loans           | 629,036      | 159,312    | 35,423    |
| Average balance of impaired loans                       | 1,458,245    | 95,605     | 6,846     |

Following is a summary of cash receipts on impaired loans and how they were applied:

|   |            |      |          |
|---|------------|------|----------|
| Cash receipts applied to reduce principal balance | \$ 131,730 | \$ - | \$ 9,723 |
| Cash receipts recognized as interest income       | 41,062     | -    | -        |
| Total cash receipts                               | \$ 172,792 | \$ - | \$ 9,723 |

No troubled debt restructurings transpired in 2008. All prior investments in troubled debt were performing under the terms of the modified agreement.

At December 31, 2007, the recorded investment in new troubled debt restructurings totaled \$578,345. The allowance for credit losses relating to troubled debt restructurings totaled \$0 at December 31, 2007. The average recorded investment in troubled debt restructurings totaled \$611,379 for the year ended December 31, 2007. The Bank recognized \$51,742 in interest income on troubled debt restructurings for cash payments received in 2007. All prior investments in troubled debt were performing under the terms of the modified agreement.

No troubled debt restructurings transpired in 2006. All prior investments in troubled debt were performing under the terms of the modified agreement.

The Bank has no commitments to loan additional funds to the borrowers of restructured, impaired, or non-accrual loans.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5. Premises and Equipment

A summary of premises and equipment is as follows:

|                          | Useful<br>lives | 2008         | 2007         | 2006         |
|--------------------------|-----------------|--------------|--------------|--------------|
| Land                     |                 | \$ 684,977   | \$ 684,977   | \$ 684,977   |
| Buildings                | 5-50 years      | 4,796,309    | 4,738,733    | 4,710,503    |
| Equipment and fixtures   | 5-30 years      | 5,056,015    | 5,450,210    | 5,456,049    |
| Construction in progress |                 | 121,973      | 60,226       | 26,088       |
|                          |                 | 10,659,274   | 10,934,146   | 10,877,617   |
| Accumulated depreciation |                 | (7,559,826)  | (7,846,238)  | (7,471,603)  |
|                          |                 | \$ 3,099,448 | \$ 3,087,908 | \$ 3,406,014 |

Construction in progress at December 31, 2008 relates primarily to a future branch site.

Depreciation expense totaled \$347,040, \$412,198, and \$450,278 for the years ended December 31, 2008, 2007, and 2006, respectively. Amortization of software and intangible assets totaled \$96,312, \$109,797, and \$97,954 for the years ended December 31, 2008, 2007, and 2006, respectively.

The Bank leases its South Crain Highway, Severna Park, and Linthicum branches. Minimum lease obligations under the South Crain Highway branch are \$115,400 per year through September 2009, adjusted annually by the CPI. Minimum lease obligations under the Severna Park branch were \$30,000 per year through September 2012. Minimum lease obligations under the Linthicum branch are \$92,700 per year through December 2014, adjusted annually on a pre-determined basis, with one ten year extension option. The Bank is also required to pay all maintenance costs under all these leasing arrangements. Rent expense totaled \$257,467, \$252,087, and \$236,166 for the years ended December 31, 2008, 2007, and 2006, respectively.

## Note 6. Short-term borrowings

Short-term borrowings are as follows:

|                               | 2008       | 2007       | 2006       |
|-------------------------------|------------|------------|------------|
| Notes payable - U.S. Treasury | \$ 629,855 | \$ 502,529 | \$ 545,349 |

Notes payable to the U.S. Treasury represents Federal treasury tax and loan deposits accepted by the Bank from its customers to be remitted on demand to the Federal Reserve Bank. The Bank pays interest on these balances at a slight discount to the Federal funds rate. This arrangement is secured by investment securities with an amortized cost of approximately \$1,000,000, \$500,000 and \$1,000,000 at December 31, 2008, 2007, and 2006, respectively.

The Bank owned 17,676 shares of common stock of the FHLB at December 31, 2008. The Bank is required to maintain an investment of .2% of total assets, adjusted annually, plus 4.5% of total advances, adjusted for advances and repayments. The credit available under this facility is determined at 20% of the Bank's total assets, or approximately \$66,010,000 at December 31, 2008. Long-term advances totaled \$27,000,000 under this credit

arrangement at December 31, 2008 (see Note 7). This credit facility is secured by a floating lien on the Bank's residential mortgage loan portfolio. Average short-term borrowings under this facility approximated \$1,924,000, \$1,616,000 and \$1,047,000 for 2008, 2007, and 2006, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 6. Short-term borrowings (continued)

The Bank also has available \$9,000,000 in a short-term credit facility, an unsecured line of credit, from another bank for short-term liquidity needs, if necessary. No outstanding borrowings existed under this credit arrangement at December 31, 2008, 2007, and 2006.

## Note 7. Long-term Borrowings

Long-term borrowings are as follows:

|  | 2008          | 2007          | 2006         |
|--|---------------|---------------|--------------|
| Federal Home Loan Bank of Atlanta, convertible advances  | \$ 27,000,000 | \$ 17,000,000 | \$ 7,000,000 |
| Mortgage payable-individual, interest at 7%, payments of \$3,483, including principal and interest, due monthly through October 2010, secured by real estate | 71,712        | 107,135       | 140,170      |
|  | \$ 27,071,712 | \$ 17,107,135 | \$ 7,140,170 |

The Federal Home Loan Bank of Atlanta, convertible advances total includes the following:

A \$7,000,000 convertible advance issued in 2000, which matures in September 2010, with interest at 5.84%, payable quarterly. The Federal Home Loan Bank of Atlanta has the option of converting the rate to a three-month LIBOR; however, if converted, the borrowing can be repaid without penalty. The proceeds of the convertible advance were used to purchase higher yielding investment securities.

A \$10,000,000 convertible advance issued in 2007, which has a final maturity of November, 1, 2017, but is callable monthly. This advance has a 3.28% interest rate, with interest payable monthly. The proceeds of the convertible advance were used to fund loans and purchase investment securities.

A \$5,000,000 convertible advance issued in 2008, which has a final maturity of July 23, 2018, but is callable quarterly starting July 23, 2009. This advance has a 2.73% interest rate, with interest payable quarterly. The proceeds of the convertible advance were used to fund loans.

A \$5,000,000 convertible advance issued in 2008, which has a final maturity of August 22, 2018, but is callable quarterly starting August 22, 2011. This advance has a 3.34% interest rate, with interest payable quarterly. The proceeds of the convertible advance were used to fund loans.

At December 31, 2008, the scheduled maturities of long-term borrowings are approximately as follows:

|                     | 2008       |
|---------------------|------------|
| 2009                | \$ 38,000  |
| 2010                | 7,034,000  |
| 2014 and thereafter | 20,000,000 |

\$ 27,072,000

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 8. Junior Subordinated Debentures owed to Unconsolidated Subsidiary Trust

The Bancorp sponsored a trust, Glen Burnie Statutory Trust I, of which 100% of the common equity is owned by the Company. The trust was formed for the purpose of issuing Company-obligated mandatorily redeemable capital securities (the capital securities) to third-party investors and investing the proceeds from the sale of such capital securities solely in junior subordinated debt securities of the Company (the debentures). The debentures held by the trust are the sole assets of that trust. Distributions on the capital securities issued by the trust are payable semi-annually at a 10.6% rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of each of the guarantees. The debentures held by the trust carry non-call provisions over the first 10 year period, and a declining 10 year premium call thereafter. Both the capital securities of the statutory trust and the junior subordinated debentures are scheduled to mature on September 7, 2030, unless called by the Bancorp not earlier than September 7, 2010.

Despite the fact that Trust I is not included in the Company's consolidated financial statements, the \$5.0 million in trust preferred securities issued by the trust are included in the Tier 1 capital of the Bank for regulatory capital purposes as allowed by the Federal Reserve Board (the "Board"). In April 2005, the Board amended its risk-based capital standards for bank holding companies to allow the continued inclusion of outstanding and prospective issuances of trust preferred securities in the Tier 1 capital of bank holding companies, subject to stricter quantitative limits and qualitative standards. The Board also revised the quantitative limits applied to the aggregate amount of cumulative perpetual preferred stock, trust preferred securities, and minority interest in the equity accounts of most consolidated subsidiaries (collectively, restricted core capital elements) included in the Tier 1 capital of bank holding companies. The new quantitative limits become effective after a five-year transition period, ending March 31, 2009. In addition, the Board also revised the qualitative standards for capital instruments included in regulatory capital consistent with longstanding Board policies. The Board has adopted this final rule to address supervisory concerns, competitive equity considerations and changes in generally accepted accounting principles and to strengthen the definition of regulatory capital for bank holding companies. The Company does not expect that the quantitative limits will preclude it from including the \$5.0 million in trust preferred securities in Tier 1 capital in the future.

## Note 9. Deposits

Major classifications of interest-bearing deposits are as follows:

|  | 2008           | 2007           | 2006           |
|--|----------------|----------------|----------------|
| NOW and SuperNOW                           | \$ 21,079,314  | \$ 23,154,540  | \$ 22,274,015  |
| Money Market                               | 12,764,167     | 12,948,342     | 15,341,221     |
| Savings                                    | 45,801,719     | 47,381,613     | 50,234,238     |
| Certificates of Deposit, \$100,000 or more | 27,882,777     | 20,654,230     | 22,380,391     |
| Other time deposits                        | 98,700,862     | 80,017,668     | 89,874,294     |
|  | \$ 206,228,839 | \$ 184,156,393 | \$ 200,104,159 |



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 9. Deposits (continued)

Interest expense on deposits is as follows:

|  | 2008         | 2007         | 2006         |
|--|--------------|--------------|--------------|
| NOW and SuperNOW                           | \$ 30,618    | \$ 47,885    | \$ 52,047    |
| Money Market                               | 62,475       | 103,472      | 106,264      |
| Savings                                    | 153,301      | 214,998      | 222,018      |
| Certificates of Deposit, \$100,000 or more | 976,446      | 915,889      | 859,707      |
| Other time deposits                        | 3,557,345    | 3,542,181    | 3,540,835    |
|  | \$ 4,780,185 | \$ 4,824,425 | \$ 4,780,871 |

At December 31, 2008, the scheduled maturities of time deposits are approximately as follows:

|                     | 2008           |
|---------------------|----------------|
| 2009                | \$ 68,385,000  |
| 2010                | 34,732,000     |
| 2011                | 5,444,000      |
| 2012                | 3,146,000      |
| 2013                | 13,626,000     |
| 2014 and thereafter | 1,251,000      |
|                     | \$ 126,584,000 |

Deposit balances of executive officers and directors and their affiliated interests totaled approximately \$2,611,000, \$2,213,000, and \$2,308,000 at December 31, 2008, 2007, and 2006, respectively.

The Bank had no brokered deposits at December 31, 2008, 2007, and 2006.

## Note 10. Income Taxes

The components of income tax expense for the years ended December 31, 2008, 2007, and 2006 are as follows:

|  | 2008               | 2007            | 2006           |
|--|--------------------|-----------------|----------------|
| <b>Current:</b>                          |                    |                 |                |
| Federal                                  | \$ 655,129         | \$ 646,449      | \$ 493,052     |
| State                                    | 271,112            | 199,611         | 167,706        |
| <b>Total current</b>                     | <b>926,241</b>     | <b>846,060</b>  | <b>660,758</b> |
| <b>Deferred income taxes (benefits):</b> |                    |                 |                |
| Federal                                  | (1,275,873)        | (80,277)        | 25,655         |
| State                                    | (329,730)          | (7,443)         | 702            |
| <b>Total deferred</b>                    | <b>(1,605,603)</b> | <b>(87,720)</b> | <b>26,357</b>  |

|                              |    |           |    |         |    |         |
|------------------------------|----|-----------|----|---------|----|---------|
| Income tax (benefit) expense | \$ | (679,362) | \$ | 758,340 | \$ | 687,115 |
|------------------------------|----|-----------|----|---------|----|---------|

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 10. Income Taxes (continued)

A reconciliation of income tax expense computed at the statutory rate of 34% to the actual income tax expense for the years ended December 31, 2008, 2007, and 2006 is as follows:

|   | 2008         | 2007         | 2006         |
|---|--------------|--------------|--------------|
| (Loss) income before income taxes (benefit)           | \$ (275,400) | \$ 3,540,481 | \$ 3,407,160 |
| Taxes computed at Federal income tax rate             | \$ (93,636)  | \$ 1,203,764 | \$ 1,158,434 |
| Increase (decrease) resulting from:                   |              |              |              |
| Tax-exempt income                                     | (547,038)    | (581,208)    | (610,541)    |
| State income taxes, net of Federal income tax benefit | (38,688)     | 126,832      | 110,686      |
| Other   | -            | 8,952        | 28,536       |
| Income tax (benefit) expense                          | \$ (679,362) | \$ 758,340   | \$ 687,115   |

The relationship between pre-tax loss and income tax benefits for 2008 is affected by increased deferred tax benefits attributable to tax methodologies utilized for loan loss provisions.

The components of the net deferred income tax benefits as of December 31, 2008, 2007, and 2006 are as follows:

|   | 2008         | 2007       | 2006       |
|---|--------------|------------|------------|
| Deferred income tax benefits:   |              |            |            |
| Accrued deferred compensation   | \$ 82,049    | \$ -       | \$ -       |
| Impairment loss on investment securities                                | 1,110,771    | -          | -          |
| Allowance for credit losses   | 563,737      | 80,300     | 90,186     |
| Alternative minimum tax credits   | 66,371       | 94,642     | 37,678     |
| Net unrealized depreciation on investment securities available for sale | 500,186      | 272,816    | 199,155    |
| Reserve for unfunded commitments  | 78,890       | 78,890     | 77,240     |
| Total deferred income tax benefits                                      | 2,402,004    | 526,648    | 404,259    |
| Deferred income tax liabilities:  |              |            |            |
| Accumulated depreciation  | 41,113       | 15,769     | 42,991     |
| Accumulated securities discount accretion                               | 74,408       | 57,367     | 69,137     |
| Total deferred income tax liabilities                                   | 115,521      | 73,136     | 112,128    |
| Net deferred income tax benefits  | \$ 2,286,483 | \$ 453,512 | \$ 292,131 |

## Note 11. Pension and Profit Sharing Plans

The Bank has a money purchase pension plan, which provides for annual employer contributions based on employee compensation, and covers substantially all employees. Annual contributions, included in employee benefit expense, totaled \$220,000, \$201,321 and \$200,005 for the years ended December 31, 2008, 2007 and 2006, respectively. The Bank is also making additional contributions under this plan for the benefit of certain employees, whose retirement funds were negatively affected by the termination of a prior defined benefit pension plan. These additional

contributions, also included in employee benefit expense, totaled \$33,452, \$37,105, and \$47,495 for the years ended December 31, 2008, 2007, and 2006, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 11. Pension and Profit Sharing Plans (continued)

The Bank also has a defined contribution retirement plan qualifying under Section 401(k) of the Internal Revenue Code that is funded through a profit sharing agreement and voluntary employee contributions.

The plan provides for discretionary employer matching contributions to be determined annually by the Board of Directors. The plan covers substantially all employees. The Bank's contributions to the plan, included in employee benefit expense, totaled \$116,027, \$340,254, and \$335,724 for the years ended December 31, 2008, 2007, and 2006, respectively.

## Note 12. Post-Retirement Health Care Benefits

The Bank has previously provided health care benefits to employees who retire at age 65 with five years of full time service immediately prior to retirement and two years of participation in the medical benefits plan. In 2001, the Bank amended the plan to include the current Board of Directors and their spouses and the spouses of current retirees. In the first quarter of 2002, the Bank again amended the plan so that all post-retirement healthcare benefits currently provided by the Bank to the above qualified participants terminated on December 31, 2006. The plan was funded only to the extent of the Bank's monthly payments of insurance premiums, which totaled \$50,483 for the year ended December 31, 2006.

The following table sets forth the financial status of the plan at December 31, 2006:

Net post-retirement benefit income for the year ended December 31, 2006 includes the following:

|                                    | 2006        |
|------------------------------------|-------------|
| Interest cost                      | \$ 3,081    |
| Amortization of net gain           | (37,723)    |
| Net post-retirement benefit income | \$ (34,642) |

Assumptions used in the accounting for net post-retirement benefit expense were as follows:

|                             | 2006 |
|-----------------------------|------|
| Health care cost trend rate | 5.0% |
| Discount rate               | 6.5% |

If the assumed health cost trend rate were increased to 6% for 2006, the total of the service and interest cost components of net periodic post-retirement health care income cost would increase by \$0 to (\$34,642) as of for the year ended December 31, 2006.

## Note 13. Other Benefit Plans

The Bank has life insurance contracts on several officers and is the sole owner and beneficiary of the policies. Cash value totaled \$7,434,573, \$7,161,403, and \$6,892,455 at December 31, 2008, 2007, and 2006, respectively. Income on their insurance investment totaled \$273,170, \$268,948, and \$210,653 for 2008, 2007, and 2006, respectively.

The Bank has an unfunded grantor trust, as part of a change in control severance plan, covering substantially all employees. Participants in the plan are entitled to cash severance benefits upon termination of employment, for any reason other than just cause, should a “change in control” of the Company occur.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 14. Other Operating Expenses

Other operating expenses include the following:

|   | 2008         | 2007         | 2006         |
|---|--------------|--------------|--------------|
| Professional services                           | \$ 485,685   | \$ 479,877   | \$ 434,465   |
| Stationery, printing and supplies               | 214,815      | 225,709      | 209,385      |
| Postage and delivery                            | 187,017      | 222,642      | 224,856      |
| FDIC assessment                                 | 35,544       | 31,605       | 33,847       |
| Directors fees and expenses                     | 198,939      | 210,097      | 207,796      |
| Marketing                                       | 255,921      | 236,917      | 232,258      |
| Data processing                                 | 100,562      | 109,797      | 104,976      |
| Correspondent bank services                     | 60,706       | 95,407       | 89,924       |
| Telephone                                       | 160,242      | 157,811      | 165,529      |
| Liability insurance                             | 71,497       | 67,959       | 81,508       |
| Losses and expenses on real estate owned (OREO) | 8,343        | 2,905        | 922          |
| Other ATM expense                               | 232,670      | 242,429      | 235,116      |
| Other   | 396,749      | 293,770      | 343,296      |
|   | \$ 2,408,690 | \$ 2,376,925 | \$ 2,363,878 |

## Note 15. Commitments and Contingencies

Financial instruments:

The Bank is a party to financial instruments in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated financial statements.

Outstanding loan commitments, unused lines of credit and letters of credit are as follows:

|                                   | 2008          | 2007          | 2006          |
|-----------------------------------|---------------|---------------|---------------|
| <b>Loan commitments:</b>          |               |               |               |
| Construction and land development | \$ 400,000    | \$ -          | \$ 482,000    |
| Other mortgage loans              | 2,590,000     | 685,000       | 528,000       |
|                                   | \$ 2,990,000  | \$ 685,000    | \$ 1,010,000  |
| <b>Unused lines of credit:</b>    |               |               |               |
| Home-equity lines                 | \$ 6,395,182  | \$ 7,507,778  | \$ 6,410,947  |
| Commercial lines                  | 13,380,292    | 18,335,771    | 10,805,449    |
| Unsecured consumer lines          | 785,487       | 815,960       | 809,802       |
|                                   | \$ 20,560,961 | \$ 26,659,509 | \$ 18,026,198 |
| <b>Letters of credit:</b>         | \$ 196,530    | \$ 197,000    | \$ 296,136    |

Loan commitments and lines of credit are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Many of the loan commitments and lines of credit are expected to expire without being drawn upon; accordingly, the total commitment amounts do not necessarily

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15. Commitments and Contingencies (continued)

represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral or other security obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, accounts receivable, inventory, property and equipment, personal residences, income-producing commercial properties, and land under development. Personal guarantees are also obtained to provide added security for certain commitments.

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to guarantee the installation of real property improvements and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral and obtains personal guarantees supporting those commitments for which collateral or other securities is deemed necessary.

The Bank's exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. As of December 31, 2008, the Bank has accrued \$200,000 as a reserve for losses on unfunded commitments related to these financial instruments with off balance sheet risk, which is included in other liabilities.

Note 16. Stockholders' Equity

Restrictions on dividends:

Banking regulations limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agencies. Regulatory approval is required to pay dividends that exceed the Bank's net profits for the current year plus its retained net profits for the preceding two years. Retained earnings from which dividends may not be paid without prior approval totaled approximately \$12,430,000, \$11,363,000, and \$9,367,000 at December 31, 2008, 2007, and 2006, respectively, based on the earnings restrictions and minimum capital ratio requirements noted below.

Stock repurchase program:

In February 2008, the Company instituted a Stock Repurchase Program. Under the program, the Company may spend up to \$1,000,000 to repurchase its outstanding stock. The repurchases may be made from time to time at a price not to exceed \$12.50 per share. During 2008, the Company repurchased 50,300 shares at an average price of \$11.48. In December 2008, the Company extended the program until December 31, 2009 and replenished the repurchase funds to \$1,000,000.

Employee stock purchase benefit plans:

The Company has a stock-based compensation plan, which is described below. As determined under SFAS No. 123R utilizing the Black-Scholes option pricing model, management of the Company has not recorded any compensation expense for options issued during the years ended December 31, 2007 and 2006, as there would be no material impact in the reported net income. There were no options issued during the year ended December 31, 2008.

Employees who have completed one year of service are eligible to participate in the employee stock purchase plan. The number of shares of common stock granted under options will bear a uniform relationship to compensation. The plan allows employees to buy stock under options granted at 85% of the fair market value of the stock on the date of grant. Options are vested when granted and will expire no later than 27 months from the grant date or upon termination of employment. Activity under this plan is as follows:

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 16. Stockholders' Equity (continued)

|   | Shares  | Grant<br>Price |
|---|---------|----------------|
| Outstanding December 31, 2005                         | -       |                |
| Granted on June 8, 2006, expiring December 11, 2006   | 4,755   | \$ 14.15       |
| Exercised   | (2,395) |                |
| Expired   | (2,360) | \$ 14.15       |
| Outstanding December 31, 2006                         | -       |                |
| Granted on August 9, 2007, expiring December 10, 2007 | 3,126   | \$ 14.02       |
| Exercised   | (1,041) |                |
| Expired   | (2,085) | \$ 14.02       |
| Outstanding December 31, 2007                         | -       |                |

At December 31, 2008, shares of common stock reserved for issuance under the plan totaled 48,011.

The Board of Directors may suspend or discontinue the plan at its discretion.

#### Dividend reinvestment and stock purchase plan:

The Company's dividend reinvestment and stock purchase plan allows all participating stockholders the opportunity to receive additional shares of common stock in lieu of cash dividends at 95% of the fair market value on the dividend payment date.

During 2008, 2007, and 2006, shares of common stock purchased under the plan totaled 20,003, 12,791, and 15,113, respectively. At December 31, 2008, shares of common stock reserved for issuance under the plan totaled 145,844.

The Board of Directors may suspend or discontinue the plan at its discretion.

#### Stockholder purchase plan:

The Company's stockholder purchase plan allows participating stockholders an option to purchase newly issued shares of common stock. The Board of Directors shall determine the number of shares that may be purchased pursuant to options. Options granted will expire no later than three months from the grant date. Each option will entitle the stockholder to purchase one share of common stock, and will be granted in proportion to stockholder share holdings. At the discretion of the Board of Directors, stockholders may be given the opportunity to purchase unsubscribed shares.

There was no activity under this plan for the years ended December 31, 2008, 2007, and 2006.

At December 31, 2008, shares of common stock reserved for issuance under the plan totaled 313,919.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16. Stockholders' Equity (continued)

The Board of Directors may suspend or discontinue the plan at its discretion.

Under all three plans, options granted, exercised, and expired, shares issued and reserved, and grant prices have been restated for the effects of any stock dividends or stock splits.

Regulatory capital requirements:

The Company and Bank are subject to various regulatory capital requirements administered by Federal and State banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. The Company and Bank must meet specific capital guidelines that involve quantitative measures of their respective assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting principles. The Company's and 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 Company and Bank to maintain minimum amounts and ratios (as defined in the regulations) of total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes, as of December 31, 2008, 2007, and 2006, that both the Company and Bank meet all capital adequacy requirements to which they are subject.

The Bank has been notified by its regulator that, as of its most recent regulatory examination, it is regarded as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. There have been no conditions or events since that notification that management believes have changed the Bank's category.

As discussed in Note 8, the capital securities held by the Glen Burnie Statutory Trust I qualifies as Tier I capital for the Company under Federal Reserve Board guidelines.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 16. Stockholders' Equity (continued)

A comparison of capital as of December 31, 2008, 2007, and 2006 with minimum requirements is approximately as follows:

|   | Actual<br>Amount | Ratio | For Capital<br>Adequacy Purposes<br>Amount | Ratio | To Be Well Capitalized<br>Under Prompt Corrective<br>Action Provisions<br>Amount      Ratio |       |
|---|------------------|-------|--|-------|---|-------|
| As of December 31, 2008                     |                  |       |  |       |   |       |
| Total Capital<br>(to Risk Weighted Assets)  |                  |       |  |       |   |       |
| Company                                     | \$ 35,687,000    | 14.9% | \$ 19,122,000                              | 8.0%  | N/A   |       |
| Bank  | 35,707,000       | 15.0% | 19,107,000                                 | 8.0%  | \$ 23,884,000   | 10.0% |
| Tier I Capital<br>(to Risk Weighted Assets) |                  |       |  |       |   |       |
| Company                                     | 33,665,000       | 14.1% | 9,564,000                                  | 4.0%  | N/A   |       |
| Bank  | 33,485,000       | 14.0% | 9,553,000                                  | 4.0%  | 14,330,000  | 6.0%  |
| Tier I Capital<br>(to Average Assets)       |                  |       |  |       |   |       |
| Company                                     | 33,665,000       | 10.5% | 12,825,000                                 | 4.0%  | N/A   |       |
| Bank  | 33,485,000       | 10.2% | 13,196,000                                 | 4.0%  | 16,495,000  | 5.0%  |
| As of December 31, 2007                     |                  |       |  |       |   |       |
| Total Capital<br>(to Risk Weighted Assets)  |                  |       |  |       |   |       |
| Company                                     | \$ 36,774,000    | 17.6% | \$ 16,744,000                              | 8.0%  | N/A   |       |
| Bank  | 36,592,000       | 17.5% | 16,728,000                                 | 8.0%  | \$ 20,910,000   | 10.0% |
| Tier I Capital<br>(to Risk Weighted Assets) |                  |       |  |       |   |       |
| Company                                     | 35,170,000       | 16.8% | 8,374,000                                  | 4.0%  | N/A   |       |
| Bank  | 34,788,000       | 16.6% | 8,363,000                                  | 4.0%  | 12,544,000  | 6.0%  |
| Tier I Capital                              |                  |       |  |       |   |       |

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|                     |            |       |            |      |            |      |
|---------------------|------------|-------|------------|------|------------|------|
| (to Average Assets) |            |       |            |      |            |      |
| Company             | 35,170,000 | 11.3% | 12,494,000 | 4.0% | N/A        |      |
| Bank                | 34,788,000 | 11.3% | 12,271,000 | 4.0% | 15,339,000 | 5.0% |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 16. Stockholders' Equity (continued)

|  | Actual        |       | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|--|---------------|-------|-------------------------------|-------|--|-------|
|  | Amount        | Ratio | Amount                        | Ratio | Amount   | Ratio |
| As of December 31, 2006                  |               |       |                               |       |  |       |
| Total Capital (to Risk Weighted Assets)  |               |       |                               |       |  |       |
| Company                                  | \$ 35,357,000 | 17.1% | \$ 16,570,000                 | 8.0%  | N/A  |       |
| Bank                                     | 35,240,000    | 17.0% | 16,564,000                    | 8.0%  | \$ 20,705,000  | 10.0% |
| Tier I Capital (to Risk Weighted Assets) |               |       |                               |       |  |       |
| Company                                  | 33,518,000    | 16.2% | 8,281,000                     | 4.0%  | N/A  |       |
| Bank                                     | 33,201,000    | 16.0% | 8,285,000                     | 4.0%  | 12,427,000   | 6.0%  |
| Tier I Capital (to Average Assets)       |               |       |                               |       |  |       |
| Company                                  | 33,518,000    | 10.3% | 13,017,000                    | 4.0%  | N/A  |       |
| Bank                                     | 33,201,000    | 10.2% | 13,046,000                    | 4.0%  | 16,307,000   | 5.0%  |

## Note 17. Earnings Per Common Share

Earnings per common share are calculated as follows:

|  | 2008       | 2007         | 2006         |
|--|------------|--------------|--------------|
| Basic:                                     |            |              |              |
| Net income                                 | \$ 403,962 | \$ 2,782,141 | \$ 2,720,045 |
| Weighted average common shares outstanding | 2,981,124  | 2,988,796    | 2,972,362    |
| Basic net income per share                 | \$ 0.14    | \$ 0.93      | \$ 0.92      |

Diluted earnings per share calculations were not required for 2008, 2007, and 2006 as there were no options outstanding at December 31, 2008, 2007, and 2006.

In January 2008, the Company declared a six for five stock split effected in the form of a 20% stock dividend.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 18. Fair Values of Financial Instruments

In accordance with the disclosure requirements of SFAS No. 107, the estimated fair value and the related carrying values of the Company's financial instruments are as follows:

|   | 2008            |              | 2007            |              | 2006            |              |
|---|-----------------|--------------|-----------------|--------------|-----------------|--------------|
|   | Carrying Amount | Fair Value   | Carrying Amount | Fair Value   | Carrying Amount | Fair Value   |
| <b>Financial assets:</b>                                  |                 |              |                 |              |                 |              |
| Cash and due from banks                                   | \$ 6,960,377    | \$ 6,960,377 | \$ 8,220,582    | \$ 8,220,582 | \$ 9,005,691    | \$ 9,005,691 |
| Interest-bearing deposits in other financial institutions | 7,883,816       | 7,883,816    | 5,847,562       | 5,847,562    | 342,309         | 342,309      |
| Federal funds sold  | 6,393,710       | 6,393,710    | 726,916         | 726,916      | 3,971,978       | 3,971,978    |
| Investment securities available for sale                  | 57,948,645      | 57,948,645   | 77,182,181      | 77,182,181   | 95,811,296      | 95,811,296   |
| Investment securities held to maturity                    | -               | -            | 683,832         | 726,193      | 683,363         | 729,960      |
| Federal Home Loan Bank Stock                              | 1,767,600       | 1,767,600    | 1,381,900       | 1,381,900    | 928,000         | 928,000      |
| Maryland Financial Bank Stock                             | 100,000         | 100,000      | 100,000         | 100,000      | 100,000         | 100,000      |
| Common stock-Statutory Trust I                            | 155,000         | 155,000      | 155,000         | 155,000      | 155,000         | 155,000      |
| Ground rents  | 184,900         | 184,900      | 202,900         | 202,900      | 219,100         | 219,100      |
| Loans, less allowance for credit losses                   | 235,132,621     | 239,446,000  | 199,753,132     | 203,326,000  | 193,336,604     | 192,492,000  |
| Accrued interest receivable                               | 1,680,392       | 1,680,392    | 1,508,640       | 1,508,640    | 1,627,433       | 1,627,433    |
| <b>Financial liabilities:</b>                             |                 |              |                 |              |                 |              |
| Deposits  | 269,767,598     | 272,091,000  | 252,916,766     | 251,088,000  | 274,833,457     | 273,033,000  |
| Short-term borrowings                                     | 629,855         | 629,855      | 502,529         | 502,529      | 545,349         | 545,349      |

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|  |            |            |            |            |            |            |
|--|------------|------------|------------|------------|------------|------------|
| Long-term borrowings   | 27,071,712 | 27,162,000 | 17,107,135 | 16,982,135 | 7,140,170  | 7,151,651  |
| Dividends payable  | 385,794    | 385,794    | 385,010    | 385,010    | 366,580    | 366,580    |
| Accrued interest payable   | 139,579    | 139,579    | 134,274    | 134,274    | 145,642    | 145,642    |
| Accrued interest payable on junior subordinated debentures             | 171,518    | 171,518    | 171,518    | 171,518    | 171,518    | 171,518    |
| Junior subordinated debentures owed to unconsolidated subsidiary trust | 5,155,000  | 5,281,827  | 5,155,000  | 6,031,097  | 5,155,000  | 5,155,000  |
| Unrecognized financial instruments:                                    |            |            |            |            |            |            |
| Commitments to extend credit   | 23,550,961 | 23,550,961 | 27,344,509 | 27,344,509 | 19,036,198 | 19,036,198 |
| Standby letters of credit  | 196,530    | 196,530    | 197,000    | 197,000    | 296,136    | 296,136    |

For purposes of the disclosures of estimated fair value, the following assumptions were used.

Loans:

The estimated fair value for loans is determined by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Investment securities:

Estimated fair values are based on quoted market prices.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18. Fair Values of Financial Instruments (continued)

Deposits:

The estimated fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the rates currently offered for deposits of similar maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Other assets and liabilities:

The estimated fair values for cash and due from banks, interest-bearing deposits in other financial institutions, Federal funds sold, accrued interest receivable and payable, and short-term borrowings are considered to approximate cost because of their short-term nature.

Other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. In addition, non-financial instruments typically not recognized in the financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

Note 19. Fair Value Measurements

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS No. 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis or on a nonrecurring basis.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Fair Value Hierarchy

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities)

Level 3 – Significant unobservable inputs (including the Bank's own assumptions in determining the fair value of assets or liabilities)

In determining the appropriate levels, the Company performs a detailed analysis of assets and liabilities that are subject to SFAS No. 157.

Fair value measurements on a recurring basis at December 31, 2008 are as follows:

Fair

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|                               | Level 1 | Level 2       | Level 3 | Value         |
|-------------------------------|---------|---------------|---------|---------------|
| Securities available for sale | \$ -    | \$ 57,948,645 | \$ -    | \$ 57,948,645 |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 19. Fair Value Measurements (continued)

Securities available-for-sale are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

The Bank may also be required, from time to time, to measure certain other financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP. Fair value measurements on a non-recurring basis at December 31, 2008 are as follows:

|                | Level 1 | Level 2    | Level 3    | Fair Value   |
|----------------|---------|------------|------------|--------------|
| Impaired loans | \$ -    | \$ -       | \$ 758,007 | \$ 758,007   |
| OREO           | -       | 550,000    | -          | 550,000      |
|                | \$ -    | \$ 550,000 | \$ 758,007 | \$ 1,308,007 |

The Bank is predominantly a cash flow lender with real estate serving as collateral on a majority of loans. Loans which are deemed to be impaired and foreclosed real estate assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Bank determines such fair values from independent appraisals. If the independent appraisals are current (within approximately six months), management deems them level 2 inputs. Non-current appraisals from which management derives fair values are considered level 3 inputs.

## Note 20. Recently Issued Accounting Pronouncements

In December 2007, the FASB issued Statement No. 141 Revised 2007 (SFAS 141R), Business Combinations. SFAS 141R's objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after December 31, 2008. On January 1, 2008, the Company adopted SFAS No. 141R. The Company has determined that the adoption of this pronouncement did not have a significant impact on the financial statements.

In February 2007, the FASB issued Statement No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115 which is effective as of the beginning of the first fiscal year that begins after November 15, 2007. Management has not elected to adopt this SFAS but will continue to evaluate the impact of adopting this Statement on the Company's financial statements for future periods.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS 160's objective is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 shall be effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not expect the implementation of SFAS 160 to have a material impact on its consolidated financial statements.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20. Recently Issued Accounting Pronouncements (continued)

In September 2006, the FASB ratified the consensus reached by the Emerging Issued Task Force (EITF) on Issue No. 06-04, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. Therefore, this Issue would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

The consensus in this Issue is effective for fiscal years beginning after December 15, 2007, with earlier application permitted. Entities should recognize the effects of applying the consensus in this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. On January 1, 2008, the Company adopted EITF No. 06-04 and under option (a) recorded a cumulative accrued expense and reduction in stockholder's equity totaling \$179,794 statements.

On January 12, 2009, the FASB issued FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20 (FSP). FASB FSP 99-20-1 amends the impairment guidance in FASB EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be held by a Transferor in Securitized Financial Assets. The intent of the FSP is to reduce complexity and achieve more consistent determinations as to whether other-than-temporary impairments of available for sale or held to maturity debt securities have occurred. The FSP is effective for interim and annual reporting periods ending after December 15, 2008. The adoption of this FSP did not have an impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133." This Statement amends and expands the disclosure requirements of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect the implementation of SFAS 161 to have a material impact on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Principles." This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ("GAAP") in the United States. The Statement is directed to entities rather than auditors because entities are responsible for the selection of accounting principles for financial statements that are presented in conformity with GAAP. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Company does not expect the implementation of SFAS 162 to have a material impact on its consolidated financial statements.





## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 21. Parent Company Financial Information

The Balance Sheets, Statements of Income, and Statements of Cash Flows for Glen Burnie Bancorp (Parent Only) are presented below:

| December 31,  | Balance Sheets                       |                      |                      |
|---|--------------------------------------|----------------------|----------------------|
|   | 2008                                 | 2007                 | 2006                 |
|   | Assets                               |                      |                      |
| Cash  | \$ 338,902                           | \$ 532,222           | \$ 441,919           |
| Investment in The Bank of Glen Burnie                 | 32,727,244                           | 34,354,422           | 32,884,293           |
| Investment in GBB Properties, Inc.                    | 261,999                              | 263,787              | 265,579              |
| Investment in the Glen Burnie Statutory Trust I       | 155,000                              | 155,000              | 155,000              |
| Due from subsidiaries                                 | 22,878                               | 22,709               | 26,820               |
| Other assets  | 114,541                              | 119,542              | 120,000              |
| <b>Total assets</b>                                   | <b>\$ 33,620,564</b>                 | <b>\$ 35,447,682</b> | <b>\$ 33,893,611</b> |
|   | Liabilities and Stockholders' Equity |                      |                      |
| Dividends payable                                     | \$ 385,794                           | \$ 385,010           | \$ 366,580           |
| Accrued interest payable on borrowed funds            | 171,518                              | 171,518              | 171,518              |
| Other liabilities                                     | -                                    | -                    | -                    |
| Borrowed funds from subsidiary                        | 5,155,000                            | 5,155,000            | 5,155,000            |
| <b>Total liabilities</b>                              | <b>5,712,312</b>                     | <b>5,711,528</b>     | <b>5,693,098</b>     |
| Stockholders' equity:                                 |                                      |                      |                      |
| Common stock  | 2,967,727                            | 2,498,465            | 2,484,633            |
| Surplus   | 11,568,241                           | 11,921,129           | 11,719,907           |
| Retained earnings                                     | 14,129,637                           | 15,750,156           | 14,312,496           |
| Accumulated other comprehensive loss, net of benefits | (757,353)                            | (433,596)            | (316,523)            |
| <b>Total stockholders' equity</b>                     | <b>27,908,252</b>                    | <b>29,736,154</b>    | <b>28,200,513</b>    |
| <b>Total liabilities and stockholders' equity</b>     | <b>\$ 33,620,564</b>                 | <b>\$ 35,447,682</b> | <b>\$ 33,893,611</b> |

The borrowed funds from subsidiary balance represents the junior subordinated debt securities payable to the wholly-owned subsidiary trust that was deconsolidated as a result of applying the provisions of FIN 46. The Company continues to guarantee the capital securities issued by the trust, which totaled \$5,000,000 at December 31, 2008 (See Note 8).



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 21. Parent Company Financial Information (continued)

## Statements of Income

| Years Ended December 31,  | 2008         | 2007         | 2006         |
|---|--------------|--------------|--------------|
| Dividends and distributions from subsidiaries   | \$ 1,902,239 | \$ 1,565,000 | \$ 1,350,000 |
| Other income  | 16,430       | 16,430       | 16,430       |
| Interest expense on junior subordinated debentures                                      | (546,180)    | (546,430)    | (546,430)    |
| Other expenses  | (69,468)     | (62,271)     | (59,453)     |
| Income before income tax benefit and equity in undistributed net income of subsidiaries | 1,303,021    | 972,729      | 760,547      |
| Income tax benefit  | 226,356      | 224,002      | 227,647      |
| Change in undistributed equity of subsidiaries  | (1,125,415)  | 1,585,410    | 1,731,851    |
| Net income  | \$ 403,962   | \$ 2,782,141 | \$ 2,720,045 |

## Statements of Cash Flows

| Years Ended December 31,   | 2008       | 2007         | 2006         |
|--|------------|--------------|--------------|
| <b>Cash flows from operating activities:</b>   |            |              |              |
| Net income   | \$ 403,962 | \$ 2,782,141 | \$ 2,720,045 |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |            |              |              |
| Decrease in other assets   | 5,001      | 458          | 7,250        |
| (Increase) decrease in due from subsidiaries   | (169)      | 4,111        | (3,932)      |
| Decrease in other liabilities  | -          | -            | (2,032)      |
| Change in undistributed equity of Subsidiaries   | 1,125,415  | (1,585,410)  | (1,731,851)  |
| Net cash provided by operating activities  | 1,534,209  | 1,201,300    | 989,480      |
| <b>Cash flows from financing activities:</b>   |            |              |              |
| Proceeds from dividend reinvestment plan   | 194,054    | 200,459      | 245,059      |
| Proceeds from issuance of common stock   | -          | 14,595       | 33,891       |
|  | (577,239)  | -            | -            |

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Repurchase and retirement of  
common stock

|                                       |             |             |             |
|---------------------------------------|-------------|-------------|-------------|
| Dividends paid                        | (1,344,344) | (1,326,051) | (1,309,970) |
| Net cash used in financing activities | (1,727,529) | (1,110,997) | (1,031,020) |
| (Decrease) increase in cash           | (193,320)   | 90,303      | (41,540)    |
| Cash, beginning of year               | 532,222     | 441,919     | 483,459     |
| Cash, end of year                     | \$ 338,902  | \$ 532,222  | \$ 441,919  |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 22. Quarterly Results of Operations (Unaudited)

The following is a summary of consolidated unaudited quarterly results of operations:

| (Dollars in thousands,<br>except per share amounts) | 2008                |                 |          |          |
|---|---------------------|-----------------|----------|----------|
|   | Three months ended, |                 |          |          |
|   | December<br>31      | September<br>30 | June 30  | March 31 |
| Interest income                                     | \$ 4,604            | \$ 4,667        | \$ 4,492 | \$ 4,413 |
| Interest expense                                    | 1,661               | 1,546           | 1,499    | 1,548    |
| Net interest income                                 | 2,943               | 3,121           | 2,993    | 2,865    |
| Provision for credit losses                         | 700                 | 239             | 152      | 55       |
| Net securities gains                                | 50                  | 86              | 48       | 7        |
| Income before income taxes                          | 272                 | (1,915)         | 743      | 625      |
| Net income  | 1,382               | (2,118)         | 604      | 536      |
| Net income per share (basic and diluted)            | \$ 0.47             | \$ (0.71)       | \$ 0.20  | \$ 0.18  |

| (Dollars in thousands,<br>except per share amounts) | 2007                |                 |          |          |
|---|---------------------|-----------------|----------|----------|
|   | Three months ended, |                 |          |          |
|   | December<br>31      | September<br>30 | June 30  | March 31 |
| Interest income                                     | \$ 4,487            | \$ 4,476        | \$ 4,465 | \$ 4,409 |
| Interest expense                                    | 1,506               | 1,441           | 1,507    | 1,517    |
| Net interest income                                 | 2,981               | 3,035           | 2,958    | 2,892    |
| Provision for credit losses                         | -                   | -               | 20       | 30       |
| Net securities gains                                | -                   | 115             | 4        | 1        |
| Income before income taxes                          | 903                 | 1,049           | 873      | 715      |
| Net income  | 700                 | 785             | 691      | 606      |
| Net income per share (basic and diluted)            | \$ 0.23             | \$ 0.27         | \$ 0.23  | \$ 0.20  |

| (Dollars in thousands,<br>except per share amounts) | 2006                |                 |          |          |
|---|---------------------|-----------------|----------|----------|
|   | Three months ended, |                 |          |          |
|   | December<br>31      | September<br>30 | June 30  | March 31 |
| Interest income                                     | \$ 4,542            | \$ 4,492        | \$ 4,447 | \$ 4,174 |
| Interest expense                                    | 1,609               | 1,538           | 1,480    | 1,206    |
| Net interest income                                 | 2,933               | 2,954           | 2,967    | 2,968    |
| Provision for credit losses                         | 62                  | -               | -        | -        |
| Net securities gains                                | 106                 | 70              | -        | -        |
| Income before income taxes                          | 903                 | 912             | 844      | 748      |
| Net income  | 609                 | 772             | 713      | 626      |
|   | \$ 0.21             | \$ 0.26         | \$ 0.24  | \$ 0.21  |

Net income per share (basic and diluted)

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