FIRST MARINER BANCORP
Form 10-Q
November 16, 2012

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012.

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

For the transition period from to

Commission file number: 0-21815

FIRST MARINER BANCORP

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

The number of shares of common stock outstanding as of November 9, 2012 is 18,860,482 shares.

EXPLANATORY NOTE

First Mariner Bancorp (the Company) was unable to meet the filing deadline of November 14, 2012 with respect to this Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the Form 10-Q) due to Hurricane Sandy and its aftermath. The Company is relying on the Order Under Section 17A and Section 36 of the Securities Exchange Act of 1934 Granting Exemptions from Specified Provisions of the Exchange Act and Certain Rules Thereunder issued by the Securities Exchange Commission (the Commission) on November 14, 2012, pursuant to which a registrant subject to the reporting requirements of Exchange Act Section 13(a) or 15(d) is exempt from any requirement to file or furnish materials with the Commission under Exchange Act Sections 13(a), 13(d), 13(f), 13(g), 14(a), 14(c), 15(d) and 16(a) and certain other rules and regulations of the Commission, as applicable, for the period from and including October 29, 2012 to November 20, 2012, where certain conditions are satisfied. The Company was unable to file the Form 10-Q on a timely basis because the Company s EDGAR service provider, which is located in lower Manhattan, was severely impacted by Hurricane Sandy and was delayed in preparing the Form 10-Q, including the Interactive Data Files filed as an exhibit thereto. The Company was not advised of a delay in the preparation of the Form 10-Q, including the Interactive Data Files, until shortly before the filing deadline, at which point there was insufficient time to make alternative arrangements to meet the filing deadline.

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

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

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

our ability to continue to operate as a going concern;

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

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

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

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

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

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

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

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

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

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

the risks described in this Quarterly Report on Form 10-Q, our Quarterly Report on Form 10-Q for the six months ended June 30, 2012, our Quarterly Report on Form 10-Q for the three months ended March 31, 2012, and our Annual Report on Form 10-K as of and for the year ended December 31, 2011.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks, and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, please read the Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q, our Quarterly Reports on Form 10-Q for the quarters ended June 30, 2012 and March 31, 2012 and in Item 1A of Part I of our Annual Report on Form 10-K as of and for the year ended December 31, 2011. Any forward-looking statement speaks only as of the date which such statement was made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

PART I FINANCIAL INFORMATION

Item 1 Financial Statements

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

	September 30, 2012	December 31, 2011
	(unaudited)	
ASSETS		
Cash and due from banks	$ 78,897	$ 104,204
Federal funds sold and interest-bearing deposits	32,310	44,585
Securities available for sale (AFS), at fair value	45,334	22,682
Loans held for sale (LHFS), at fair value	371,554	182,992
Loans receivable	643,468	701,751
Allowance for loan losses	(12,096)	(13,801)
Loans, net	631,372	687,950
Real estate acquired through foreclosure	19,978	25,235
Restricted stock investments	6,829	7,085
Premises and equipment, net	37,534	38,278
Accrued interest receivable	4,015	4,025
Bank-owned life insurance (BOLI)	38,332	37,478
Prepaid expenses and other assets	27,879	24,503
Total assets	$ 1,294,034	$ 1,179,017
LIABILITIES AND STOCKHOLDERS DEFICIT		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 99,372	$ 100,303
Interest-bearing	1,008,779	914,457
Total deposits	1,108,151	1,014,760
Short-term borrowings	47,261	47,981
Long-term borrowings	73,567	73,698
Junior subordinated deferrable interest debentures	52,068	52,068
Accrued expenses and other liabilities (of which, $115 and $18 are at fair value, respectively)	21,756	15,922
Total liabilities	1,302,803	1,204,429
Stockholders deficit:		
Common stock, $.05 par value; 75,000,000 shares authorized; 18,860,482 shares issued and outstanding at both September 30, 2012 and December 31, 2011	939	939
Additional paid-in capital	80,006	80,125
Retained deficit	(88,036)	(103,454)
Accumulated other comprehensive loss	(1,678)	(3,022)
Total stockholders deficit	(8,769)	(25,412)

Total liabilities and stockholders deficit	$	1,294,034	$	1,179,017

See accompanying notes to consolidated financial statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
		(unaudited)		
Interest income:				
Loans	$ 11,567	$ 11,222	$ 33,644	$ 33,867
Investments and other earning assets	352	455	1,063	1,651
Total interest income	11,919	11,677	34,707	35,518
Interest expense:				
Deposits	2,898	3,625	8,857	12,217
Short-term borrowings	35	61	99	232
Long-term borrowings	927	852	2,780	2,476
Total interest expense	3,860	4,538	11,736	14,925
Net interest income	8,059	7,139	22,971	20,593
Provision for loan losses		5,000	572	11,580
Net interest income after provision for loan losses	8,059	2,139	22,399	9,013
Noninterest income:				
Total other-than-temporary impairment (OTTI) charges		(299)	175	(327)
Less: Portion included in other comprehensive income (pre-tax)		(382)	(635)	(491)
Net OTTI charges on AFS securities		(681)	(460)	(818)
Mortgage-banking revenue	15,384	4,609	35,450	7,942
ATM fees	649	755	2,067	2,314
Service fees on deposits	623	717	1,927	2,194
Gain on sale of AFS securities		638		781
(Loss) gain on sales and disposals of premises and equipment and other assets	(949)	2	(1,271)	4
Commissions on sales of nondeposit investment products	62	75	211	347
Income from BOLI	273	316	853	984
Other	238	1,289	717	1,779
Total noninterest income	16,280	7,720	39,494	15,527
Noninterest expense:				
Salaries and employee benefits	6,107	5,876	17,438	18,003
Occupancy	1,835	2,202	6,343	6,407
Furniture, fixtures, and equipment	332	426	1,018	1,357
Professional services	973	1,259	2,085	3,742
Advertising	189	219	609	470
Data processing	403	393	1,237	1,237
ATM servicing expenses	225	217	678	655
Write-downs, losses, and costs of real estate acquired through foreclosure	1,325	3,218	3,539	6,635
Federal Deposit Insurance Corporation (FDIC) insurance premiums	1,009	878	3,131	3,390
Service and maintenance	644	594	1,799	1,872
Corporate Insurance	695	388	1,571	1,069
Consulting fees	395	377	1,319	1,042

Loan collection expenses	101	329	290	608
Other	2,180	1,443	5,623	4,322
Total noninterest expense	16,413	17,819	46,680	50,809
Net income (loss) before income taxes	7,926	(7,960)	15,213	(26,269)
Income tax benefit			(205)	
Net income (loss)	$ 7,926	$ (7,960)	$ 15,418	$ (26,269)
Net income (loss) per common share - basic and diluted	$ 0.42	$ (0.42)	$ 0.82	$ (1.41)

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	**2011**	**2012**	**2011**
		(unaudited)		
Net income (loss)	$ 7,926	$ (7,960)	$ 15,418	$ (26,269)
Other comprehensive income items:				
Unrealized holding gains (losses) on securities arising during the period (net of tax expense (benefit) of $293, $(219), $724, and $309, respectively)	433	(324)	1,070	457
Reclassification adjustment for net losses on securities (net of tax benefit of $0, $17, $186, and $15, respectively) included in net income (loss)		26	274	22
Total other comprehensive income (loss)	433	(298)	1,344	479
Total comprehensive income (loss)	$ 8,359	$ (8,258)	$ 16,762	$ (25,790)

See accompanying notes to consolidated financial statements.

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

Nine Months Ended September 30, 2012

(unaudited)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Deficit
Balance at December 31, 2011	18,860,482	$ 939	$ 80,125	$ (103,454)	$ (3,022)	$ (25,412)
Net income				15,418		15,418
Costs of common stock issued, net			(22)			(22)
Change in fair value of warrants			(97)			(97)
Changes in unrealized gains on securities, net of taxes					1,344	1,344
Balance at September 30, 2012	18,860,482	$ 939	$ 80,006	$ (88,036)	$ (1,678)	$ (8,769)

Nine Months Ended September 30, 2011

(unaudited)

	Number of Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity (Deficit)
Balance at December 31, 2010	18,050,117	$ 902	$ 79,667	$ (73,210)	$ (3,613)	$ 3,746
Net loss				(26,269)		(26,269)
Common stock issued, net of costs	810,365	37	341			378
Stock-based compensation expense			5			5
Change in fair value of warrants			89			89
Changes in unrealized gains on securities, net of taxes					479	479
Balance at September 30, 2011	18,860,482	$ 939	$ 80,102	$ (99,479)	$ (3,134)	$ (21,572)

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2012	**2011**
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	$ 15,418	$ (26,269)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	2,043	2,472
Amortization of unearned loan fees and costs, net	496	283
Amortization of discounts on mortgage-backed securities, net	6	29
Origination fees and gains on sale of mortgage loans	(33,615)	(6,750)
Net OTTI charges on AFS securities	460	818
Gain on sale of AFS securities		(781)
Loss (gain) on disposition and sale of premises and equipment and other assets	1,271	(4)
Decrease (increase) in accrued interest receivable	10	(4)
Provision for loan losses	572	11,580
Write-downs and losses on sale of real estate acquired through foreclosure	1,818	5,704
Increase in cash surrender value of BOLI	(853)	(984)
Originations of mortgage LHFS	(1,773,267)	(691,831)
Proceeds from sales of mortgage LHFS	1,617,977	710,702
Net increase in accrued expenses and other liabilities	5,736	4,318
Net increase in prepaids and other assets	(4,283)	(11,710)
Net cash used in operating activities	(166,211)	(2,427)
Cash flows from investing activities:		
Loan principal repayments, net	49,315	49,542
Repurchase of loans previously sold	(827)	(435)
Sale of restricted stock investments	256	126
Purchases of premises and equipment	(2,571)	(327)
Activity in AFS securities:		
Maturities/calls/repayments	9,217	16,206
Sales		49,511
Purchases	(29,001)	(59,799)
Additional funds disbursed on real estate acquired through foreclosure		(1,755)
Proceeds from sales of real estate acquired through foreclosure	9,722	8,570
Net cash provided investing activities	36,111	61,639
Cash flows from financing activities:		
Net increase (decrease) in deposits	93,392	(90,010)
Net decrease in other borrowed funds	(852)	(479)
Net costs of stock issuance	(22)	(20)
Net cash provided by (used in) financing activities	92,518	(90,509)
Decrease in cash and cash equivalents	(37,582)	(31,297)
Cash and cash equivalents at beginning of period	148,789	217,961
Cash and cash equivalents at end of period	$ 111,207	$ 186,664

Supplemental information:		
Interest paid on deposits and borrowed funds	$ 10,522	$ 13,997
Real estate acquired in satisfaction of loans	$ 6,283	$ 16,073
Transfers of LHFS to loan portfolio	$ 342	$ 2,031

See accompanying notes to consolidated financial statements

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

(1) Summary of Significant Accounting Policies
Basis of Presentation

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

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

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

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

(2) Going Concern Consideration

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

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

(3) Securities

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

	September 30, 2012			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
	(dollars in thousands)			
Mortgage-backed securities	$ 5,341	$ 215	$	$ 5,556
Trust preferred securities	11,264	96	2,279	9,081
U.S. government agency notes	25,349	110	1	25,458
U.S. Treasury securities	3,037	1		3,038
Equity securities - banks	1,288	134	18	1,404
Equity securities - mutual funds	750	47		797
	$ 47,029	$ 603	$ 2,298	$ 45,334

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

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

	Amortized Cost	**Estimated Fair Value**
	(dollars in thousands)	
Due in one year or less	$ 8,004	$ 8,024
Due after one year through five years	20,382	20,471

Due after five years through ten years	1,020	1,008
Due after ten years	10,244	8,074
Mortgage-backed securities	5,341	5,556
	$ 44,991	$ 43,133

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

	September 30, 2012											
	Less than 12 months				12 months or more				Total			
	Estimated Fair Value		Unrealized Losses		Estimated Fair Value		Unrealized Losses		Estimated Fair Value		Unrealized Losses	
	(dollars in thousands)											
Trust preferred securities	$		$		$	4,910	$	2,279	$	4,910	$	2,279
U.S. government agency notes		3,025		1						3,025		1
Equity securities - banks						107		18		107		18
	$	3,025	$	1	$	5,017	$	2,297	$	8,042	$	2,298

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

The trust preferred securities that we hold in our securities portfolio are issued by other banks, bank holding companies, and insurance companies. Certain of these securities have experienced declines in value since acquisition. These declines have occurred due to changes in the market which has limited the demand for these securities and reduced their liquidity. We consider the decline in value for four of the pooled trust preferred securities to be other than temporary and recorded the credit-related portion of the impairment as net OTTI of $460,000 for the nine months ended September 30, 2012. We did not record any additional OTTI during the three months ended September 30, 2012. We recorded net OTTI of $681,000 and $818,000 for the three and nine months ended September 30, 2011, respectively. See additional information on the pooled trust preferred securities in Note 8.

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	(dollars in thousands)							
Balance at beginning of period	$	9,190	$	8,029	$	8,730	$	7,892
Additional OTTI taken for credit losses				681		460		818
Balance at end of period	$	9,190	$	8,710	$	9,190	$	8,710

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

At September 30, 2012, we held securities with an aggregate carrying value (fair value) of $40.1 million that we have pledged as collateral for certain mortgage-banking and hedging activities, borrowings, government deposits, and customer deposits.

(4) Loans Receivable and Allowance for Loan Losses

Loans receivable are summarized as follows:

	September 30, 2012	December 31, 2011
	(dollars in thousands)	
Commercial	$ 45,632	$ 47,518
Commercial mortgage	296,353	331,943
Commercial construction	48,351	54,433
Consumer construction	19,071	16,456
Residential mortgage	112,811	121,071
Consumer	120,251	129,227
Total loans	642,469	700,648
Unearned loan fees, net	999	1,103
	$ 643,468	$ 701,751

Included in consumer loan totals in the above table are overdrawn commercial and retail checking accounts totaling $171,000 as of September 30, 2012 and $184,000 as of December 31, 2011.

Transferred Loans

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

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

	Loan Balance		Accretable Yield		Total	
	2012	2011	2012	2011	2012	2011
			(dollars in thousands)			
Beginning balance	$ 10,873	$ 26,783	$ 36	$ 110	$ 10,837	$ 26,673
Loans transferred		1,053				1,053
Charge-offs	(781)		(4)	(10)	(777)	10
Payments/accretion	(1,625)	(10)	(8)	(10)	(1,617)	
Ending balance	$ 8,467	$ 27,826	$ 24	$ 90	$ 8,443	$ 27,736

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

	Loan Balance	Accretable Yield	Total

	2012	2011	2012	2011	2012	2011
			(dollars in thousands)			
Beginning balance	$ 14,008	$ 26,219	$ 266	$ 178	$ 13,742	$ 26,041
Loans transferred	342	2,031			342	2,031
Loans moved to real estate acquired through foreclosure		(83)				(83)
Charge-offs	(1,066)	(302)	(18)	(16)	(1,048)	(286)
Payments/accretion	(4,817)	(39)	(224)	(72)	(4,593)	33
Ending balance	$ 8,467	$ 27,826	$ 24	$ 90	$ 8,443	$ 27,736

At September 30, 2012, we had pledged loans with a carrying value of $111.5 million as collateral for Federal Home Loan Bank (FHLB) advances.

Credit Quality

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

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

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

Three months ended September 30, 2012

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
				(dollars in thousands)				
Beginning Balance	$ 2,897	$ 1,562	$ 1,678	$ 130	$ 1,504	$ 2,250	$ 3,501	$ 13,522
Charge-offs		(253)	(206)		(365)	(638)		(1,462)
Recoveries					5	31		36
Net charge-offs		(253)	(206)		(360)	(607)		(1,426)
(Reversal of) provision for loan losses	(901)	299	(992)	91	434	391	678	
Ending Balance	$ 1,996	$ 1,608	$ 480	$ 221	$ 1,578	$ 2,034	$ 4,179	$ 12,096

Nine months ended September 30, 2012

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
				(dollars in thousands)				
Beginning Balance	$ 2,768	$ 2,011	$ 1,809	$ 156	$ 2,711	$ 2,632	$ 1,714	$ 13,801
Charge-offs	(187)	(573)	(353)	(7)	(879)	(1,576)		(3,575)
Recoveries		612	52		425	209		1,298
Net (charge-offs) recoveries	(187)	39	(301)	(7)	(454)	(1,367)		(2,277)
(Reversal of) provision for loan losses	(585)	(442)	(1,028)	72	(679)	769	2,465	572
Ending Balance	$ 1,996	$ 1,608	$ 480	$ 221	$ 1,578	$ 2,034	$ 4,179	$ 12,096
Ending balance - individually evaluated for impairment	$ 149	$ 24	$	$	$ 202	$	$	$ 375
Ending balance - collectively evaluated for impairment	1,847	1,584	480	221	1,376	2,034	4,179	11,721
	$ 1,996	$ 1,608	$ 480	$ 221	$ 1,578	$ 2,034	$ 4,179	$ 12,096
Ending loan balance - individually	$ 9,872	$ 32,810	$ 11,652	$ 655	$ 17,740	$ 936		$ 73,665

evaluated for impairment							
Ending loan balance - collectively evaluated for impairment	35,845	263,464	36,667	18,231	95,075	120,521	569,803
	$ 45,717	$ 296,274	$ 48,319	$ 18,886	$ 112,815	$ 121,457	$ 643,468

Three months ended September 30, 2011

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 233	$ 2,586	$ 1,782	$ 360	$ 2,895	$ 3,089	$ 3,170	$ 14,115
Charge-offs	(2,367)	(1,325)	(131)		(670)	(590)		(5,083)
Recoveries			24		23	33		80
Net charge-offs	(2,367)	(1,325)	(107)		(647)	(557)		(5,003)
Provision for (reversal of) loan losses	4,823	605	(7)	(125)	976	92	(1,364)	5,000
Ending Balance	$ 2,689	$ 1,866	$ 1,668	$ 235	$ 3,224	$ 2,624	$ 1,806	$ 14,112

Nine months ended September 30, 2011

	Commercial	Commercial Mortgage	Commercial Construction	Consumer Construction	Residential Mortgage	Consumer	Unallocated	Total
	(dollars in thousands)							
Beginning Balance	$ 291	$ 2,542	$ 2,053	$ 817	$ 3,032	$ 2,417	$ 2,963	$ 14,115
Charge-offs	(5,240)	(1,834)	(728)	(24)	(2,209)	(2,021)		(12,056)
Recoveries		168	24		37	244		473
Net charge-offs	(5,240)	(1,666)	(704)	(24)	(2,172)	(1,777)		(11,583)
Provision for (reversal of) loan losses	7,638	990	319	(558)	2,364	1,984	(1,157)	11,580
Ending Balance	$ 2,689	$ 1,866	$ 1,668	$ 235	$ 3,224	$ 2,624	$ 1,806	$ 14,112
Ending balance - individually evaluated for impairment	$ 4	$ 89	$	$ 1	$ 352	$ 4	$	$ 450
Ending balance - collectively evaluated for impairment	2,685	1,777	1,668	234	2,872	2,620	1,806	13,662
	$ 2,689	$ 1,866	$ 1,668	$ 235	$ 3,224	$ 2,624	$ 1,806	$ 14,112
Ending loan balance - individually evaluated for	$ 4,400	$ 24,302	$ 11,701	$ 757	$ 19,742	$ 1,595		$ 62,497

impairment								
Ending loan balance - collectively evaluated for impairment	58,375	310,804	42,375	20,836	104,836	136,949		674,175
	$ 62,775	$ 335,106	$ 54,076	$ 21,593	$ 124,578	$ 138,544		$ 736,672

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

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

High Credit Quality (RR2) This category includes credits that are secured by up to 70% advance against municipal or corporate bonds carrying an A rating or better, U.S. Government securities, and marketable securities of companies with an A or better debt rating. For individual credits, the credit must be secured by any of the aforementioned items or first deed of trust on residential owner-occupied property with a loan-to-value (LTV) ratio of 80% or less and adequate cash flow to service the debt. Permanent real estate loans on fully leased properties with A-rated tenants and a 70% or less LTV ratio with income coverage of 1.25 times or higher may qualify for this rating, with confirmation of tenants financial condition. No commercial construction loans may carry this rating at inception. At September 30, 2012 and December 31, 2011, none of our loans carried this risk rating.

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

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

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

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

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

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

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

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

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

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

Credits to customers who have not provided the Bank with current or satisfactory financial data (unless the credit is secured by liquid marketable collateral or guaranteed by financially sound parties);

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

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

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

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

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

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

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

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

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

All nonaccrual loans.

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

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

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

	Commercial		Commercial Mortgage		Commercial Construction		Consumer Construction		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	(dollars in thousands)									
RR8	$ 2,810	$ 5,672	$ 27,835	$ 26,677	$ 10,857	$ 17,105	$	$	$ 41,502	$ 49,454
RR7	7,370	9,051	20,371	17,065	9,862	9,152			37,603	35,268
RR6	10,039	10,208	49,603	39,722	15,853	13,132			75,495	63,062
RR5	17,249	19,825	107,472	122,880	10,836	12,013		136	135,557	154,854
RR4	8,225	7,074	87,788	117,088	911	2,947	18,886	16,144	115,810	143,253
RR3		1,000	3,205	3,098					3,205	4,098
RR1	24	12							24	12
	$ 45,717	$ 52,842	$ 296,274	$ 326,530	$ 48,319	$ 54,349	$ 18,886	$ 16,280	$ 409,196	$ 450,001

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

	Residential Mortgage		Home Equity & 2nd Mortgage		Other Consumer		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
	(dollars in thousands)							
Nonaccrual loans	$ 7,732	$ 7,585	$ 920	$ 905	$ 16	$	$ 8,668	$ 8,490
Performing loans	105,083	113,534	102,309	108,539	18,212	21,187	225,604	243,260
	$ 112,815	$ 121,119	$ 103,229	$ 109,444	$ 18,228	$ 21,187	$ 234,272	$ 251,750

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

September 30, 2012:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days or More and Accruing
	(dollars in thousands)						
Commercial	$	$	$ 2,156	$ 2,156	$ 43,561	$ 45,717	$
Commercial mortgage	4,268		20,601	24,869	271,405	296,274	
Commercial construction	95		4,580	4,675	43,644	48,319	
Consumer construction	192		655	847	18,039	18,886	
Residential mortgage	3,455	1,001	7,732	12,188	100,627	112,815	
Home equity and 2nd mortgage	2,578	11	920	3,509	99,720	103,229	
Other consumer	70	2	16	88	18,140	18,228	
	$ 10,658	$ 1,014	$ 36,660	$ 48,332	$ 595,136	$ 643,468	$

December 31, 2011:

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

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

	September 30, 2012			Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Charge-Offs	Average Recorded Investment	Interest Income Recognized	Charge-Offs
	(dollars in thousands)								
With no related allowance:									
Commercial	$ 2,589	$ 2,589	$	$ 3,895	$ 38	$ 187	$ 2,197	$ 7	$ 5,240
Commercial mortgage	$ 30,354	$ 30,354	$	$ 24,772	$ 409	$ 573	$ 20,948	$ 58	$ 1,706
Commercial construction	$ 11,652	$ 11,652	$	$ 13,091	$ 85	$ 353	$ 12,376	$ 69	$ 728
Consumer construction	$ 655	$ 655	$	$ 654	$ 22	$ 7	$ 874	$ 1	$ 24
Residential mortgage	$ 9,466	$ 9,466	$	$ 9,484	$ 191	$ 711	$ 10,402	$ 85	$ 1,506
Home equity & 2nd mortgage	$ 920	$ 920	$	$ 990	$ 20	$ 1,576	$ 915	$ 5	$ 2,021
Other consumer	$ 16	$ 16							