GLEN BURNIE BANCORP
Form 10-K/A
November 13, 2009
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
(Amendment No. 1)

x 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<br>(State or other jurisdiction<br>of incorporation or organization) | 52-1782444<br>(I.R.S. Employer<br>Identification No.) |
| 101 Crain Highway, S.E., Glen Burnie, Maryland<br>(Address of principal executive offices) | 21061<br>(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 x

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 x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

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. x

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 x

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

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).

The Registrant hereby amends Item 15(a)(1) of its Annual Report on Form 10-K for the fiscal year ended December 31, 2008, which was filed with the Commission on March 17, 2009. The purpose of the amendment is to add the signature of the Registrant's Independent Registered Public Accounting Firm on its Report included on page F-1 of the Form 10-K.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) 1. Financial Statements.


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

| Exhibit No. | |
|---|---|
| 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 |

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GLEN BURNIE BANCORP

November 12, 2009 By: /s/ Michael G. Livingston
Michael G. Livingston
President and Chief Executive Officer

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.

/s/ Trice, Gary & Myers LLC
Salisbury, Maryland
March 9, 2009

Glen Burnie Bancorp and Subsidiaries

Consolidated Balance Sheets

| December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| Assets | | | |
| 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 |
| | | | |
| Total assets | $ 332,502,215 | $ 307,273,868 | $ 317,745,601 |
| | | | |
| Liabilities and Stockholders' Equity | | | |
| Liabilities: | | | |
| Deposits: | | | |
| Noninterest-bearing | $ 63,538,759 | $ 68,760,373 | $ 74,729,298 |
| Interest-bearing | 206,228,839 | 184,156,393 | 200,104,159 |
| Total deposits | 269,767,598 | 252,916,766 | 274,833,457 |
| 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 |

| | | | |
|---|---|---|---|
| Accrued interest payable on junior subordinated debentures | 171,518 | 171,518 | 171,518 |
| Other liabilities | 1,272,907 | 1,165,482 | 1,187,372 |
| Total liabilities | 304,593,963 | 277,537,714 | 289,545,088 |
| | | | |
| 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) |
| Total stockholders' equity | 27,908,252 | 29,736,154 | 28,200,513 |
| | | | |
| Total liabilities and stockholders' equity | $ 332,502,215 | $ 307,273,868 | $ 317,745,601 |

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 |
|---|---|---|---|
| Interest income on: | | | |
| 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 |
| Total interest income | 18,176,036 | 17,837,256 | 17,655,196 |
| | | | |
| Interest expense on: | | | |
| 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 |
| Total interest expense | 6,254,033 | 5,971,048 | 5,833,765 |
| | | | |
| Net interest income | 11,922,003 | 11,866,208 | 11,821,431 |
| | | | |
| Provision for credit losses | 1,145,649 | 50,000 | 62,000 |
| | | | |
| Net interest income after provision for credit losses | 10,776,354 | 11,816,208 | 11,759,431 |
| | | | |
| Other income: | | | |
| 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 |
| Total other income | 2,050,587 | 2,157,292 | 2,244,390 |
| | | | |
| Other expenses: | | | |
| 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 |
| Total other expenses | 13,102,341 | 10,433,019 | 10,596,661 |
| | | | |
| (Loss) income before income taxes (benefits) | (275,400) | 3,540,481 | 3,407,160 |
| | | | |
| Federal and state income taxes (benefits) | (679,362) | 758,340 | 687,115 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 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

| 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 Shares | Common Stock Par Value | Surplus | Retained Earnings | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balances, December 31, 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 share | - | - | - | (1,337,545) | - | (1,337,545) |
| Dividends reinvested under dividend reinvestment plan | 15,113 | 15,113 | 229,946 | - | - | 245,059 |
| Shares issued under employee stock purchase plan | 2,395 | 2,395 | 31,496 | - | - | 33,891 |
| Stock split effected in form of 20% stock dividend | 411,101 | 411,101 | | (411,101) | | - |
| Other comprehensive loss, net of tax | - | - | - | - | (86,378) | (86,378) |
| Balances, December 31, 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 share | - | - | - | (1,344,481) | - | (1,344,481) |
| Dividends reinvested under dividend reinvestment plan | 12,791 | 12,791 | 187,668 | - | - | 200,459 |
| Shares issued under employee stock purchase plan | 1,041 | 1,041 | 13,554 | - | - | 14,595 |
| Other comprehensive loss, net of tax | - | - | - | - | (117,073) | (117,073) |
| Balances, December 31, 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 adoption of EITF 06-04 | - | - | - | (179,794) | - | (179,794) |
| Shares repurchased and 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 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 403,962 | $ 2,782,141 | $ 2,720,045 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | |
| 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) |
| Changes in assets and liabilities: | | | |
| (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 |
| Net cash provided by operating activities | 2,376,896 | 3,043,691 | 2,960,672 |
| Cash flows from investing activities: | | | |
| 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) |
| Net cash (used) provided by investing activities | (20,649,259) | 11,534,934 | (13,537,082) |
| Cash flows from financing activities: | | | |
| 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) | - | - |

| | | | |
|---|---|---|---|
| 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.

Glen Burnie Bancorp and Subsidiaries

Consolidated Statements of Cash Flows
(Continued)

| Years Ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| Supplementary Cash Flow Information: | | | |
| 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.

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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.

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 collectibiltiy 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.

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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 Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| 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 |

| December 31, 2007 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| 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 |
| Held to maturity: | | | | |
| 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 Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale: | | | | |
| 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 |
| Held to maturity: | | | | |
| 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 Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Obligations of U.S. | | | | | | |
| 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

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 | Fair | Amortized | Fair |
| December 31, 2008 | Cost | Value | Cost | Value |
| 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 |
|---|---|---|---|
| Mortgage: | | | |
| 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.

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Premises and Equipment

A summary of premises and equipment is as follows:

| | Useful 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.

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

| | | | |
|---|---|---|---|
| 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.

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.

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 |
|---|---|---|---|
| Loan commitments: | | | |
| 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 |
| Unused lines of credit: | | | |
| 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 |
| Letters of credit: | $ 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

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:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16. Stockholders' Equity (continued)

| | Shares | Grant 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.

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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 | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2008 | | | | | | |
| Total Capital (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 (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 (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 (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 (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 | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| (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% |

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 |
| Financial assets: | | | | | | |
| 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 |
| | | | | | | |
| Financial liabilities: | | | | | | |
| 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 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 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

| | 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:

Balance Sheets

| December 31, | 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 |
| Total assets | $ 33,620,564 | $ 35,447,682 | $ 33,893,611 |
| 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 |
| Total liabilities | 5,712,312 | 5,711,528 | 5,693,098 |
| 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) |
| Total stockholders' equity | 27,908,252 | 29,736,154 | 28,200,513 |
| Total liabilities and stockholders' equity | $ 33,620,564 | $ 35,447,682 | $ 33,893,611 |

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).

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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 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ 403,962 | $ 2,782,141 | $ 2,720,045 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| 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 |
| Cash flows from financing activities: | | | |
| Proceeds from dividend reinvestment plan | 194,054 | 200,459 | 245,059 |
| Proceeds from issuance of common stock | - | 14,595 | 33,891 |
| | (577,239) | - | - |

| | | | |
|---|---|---|---|
| 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 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 22. Quarterly Results of Operations (Unaudited)

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

2008

| (Dollars in thousands, except per share amounts) | Three months ended, December 31 | September 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 |

2007

| (Dollars in thousands, except per share amounts) | Three months ended, December 31 | September 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 |

2006

| (Dollars in thousands, except per share amounts) | Three months ended, December 31 | September 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)