

FIRST MARINER BANCORP  
Form 10-Q  
August 14, 2008  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2008.**

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

**For the transition period from                      to**

**Commission file number: 0-21815**

**FIRST MARINER BANCORP**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State of Incorporation)

**52-1834860**  
(I.R.S. Employer Identification Number)

**1501 South Clinton Street, Baltimore, MD**  
(Address of principal executive offices)

**21224**  
(Zip Code)

**410-342-2600**  
(Telephone Number)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such report, and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

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

The number of shares of common stock outstanding as of August 8, 2008 is 6,387,398 shares.

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	June 30, 2008 (unaudited)	December 31, 2007
<b>ASSETS</b>		
Cash and due from banks	\$ 29,898	\$ 39,089
Federal funds sold and interest-bearing deposits	51,421	52,232
Trading securities, at fair value	34,183	36,950
Securities available for sale, at fair value	46,123	44,998
Loans held for sale	62,453	80,920
Loans receivable	924,296	854,920
Allowance for loan losses	(14,543)	(12,789)
Loans, net	909,753	842,131
Real estate acquired through foreclosure	19,102	18,981
Restricted stock investments	5,941	5,983
Premises and equipment, net	50,765	52,215
Accrued interest receivable	6,971	7,181
Income taxes recoverable	8,419	4,433
Deferred income taxes	13,476	12,428
Bank-owned life insurance	35,677	34,931
Prepaid expenses and other assets (\$877 and \$0 at fair value, respectively)	14,442	14,350
Total assets	\$ 1,288,624	\$ 1,246,822
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Noninterest-bearing	\$ 147,053	\$ 149,710
Interest-bearing	802,045	755,243
Total deposits	949,098	904,953
Short-term borrowings	31,358	37,509
Long-term borrowings, at fair value	62,910	63,123
Long-term borrowings	101,429	92,007
Junior subordinated deferrable interest debentures	73,724	73,724
Accrued expenses and other liabilities	10,639	10,936
Total liabilities	1,229,158	1,182,252
<b>Stockholders' equity:</b>		
Common stock, \$.05 par value; 20,000,000 shares authorized; 6,387,398 and 6,351,611 shares issued and outstanding, respectively	319	318
Additional paid-in capital	56,603	56,458

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Retained earnings	5,856	9,603
Accumulated other comprehensive loss	(3,312)	(1,809)
Total stockholders' equity	59,466	64,570
Total liabilities and stockholders' equity	\$ 1,288,624	\$ 1,246,822

*See accompanying notes to the consolidated financial statements*

Table of Contents**First Mariner Bancorp and Subsidiaries****Consolidated Statements of Operations***(dollars in thousands except per share data)*

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(unaudited)</b>		<b>(unaudited)</b>	
Interest income:				
Loans	\$ 19,379	\$ 19,901	\$ 39,380	\$ 39,636
Investments and other earning assets	1,646	2,490	3,369	4,734
Total interest income	21,025	22,391	42,749	44,370
Interest expense:				
Deposits	6,018	6,980	12,174	13,909
Short-term borrowings	113	302	316	617
Long-term borrowings	2,983	3,651	6,378	7,179
Total interest expense	9,114	10,933	18,868	21,705
Net interest income	11,911	11,458	23,881	22,665
Provision for loan losses	2,504	2,515	6,327	3,053
Net interest income after provision for loan losses	9,407	8,943	17,554	19,612
Noninterest income:				
Gain on sale of mortgage loans	1,110	457	1,764	2,050
Other mortgage-banking revenue	900	619	1,877	1,349
ATM fees	828	855	1,605	1,571
Service fees on deposits	1,600	1,642	3,135	3,113
Gain (loss) on financial instruments carried at fair value	1,020	47		(64)
Gain on sale of securities available for sale				887
Gain on sale of premises and equipment	589		589	
Commissions on sales of nondeposit investment products	275	243	515	550
Income from bank-owned life insurance	375	365	746	700
Commissions on sales of other insurance products	840	746	1,460	1,333
Other	411	435	885	869
Total noninterest income	7,948	5,409	12,576	12,358
Noninterest expense:				
Salaries and employee benefits	9,692	8,961	18,896	18,317
Occupancy	2,771	2,322	5,402	4,563
Furniture, fixtures and equipment	966	907	1,949	1,769
Professional services	498	449	919	799
Advertising	158	409	588	920
Data processing	515	485	1,063	914
ATM servicing expenses	268	279	512	508
Write-downs and costs of real estate acquired through foreclosure	1,062	837	1,698	923
Secondary marketing valuation	54	2,319	234	2,352
Service and maintenance	625	559	1,298	1,303
Other	2,777	2,951	5,308	5,756
Total noninterest expense	19,386	20,478	37,867	38,124
Net loss before income taxes	(2,031)	(6,126)	(7,737)	(6,154)
Income tax benefit	(1,562)	(2,262)	(3,990)	(2,390)
Net loss	\$ (469)	\$ (3,864)	\$ (3,747)	\$ (3,764)
Net loss per common share:				
Basic	\$ (0.07)	\$ (0.60)	\$ (0.59)	\$ (0.59)

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Diluted	\$	(0.07)	\$	(0.60)	\$	(0.59)	\$	(0.59)
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*See accompanying notes to the consolidated financial statements.*

Table of Contents**First Mariner Bancorp and Subsidiaries****Consolidated Statements of Cash Flows***(dollars in thousands)*

	<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(unaudited)</b>	
Cash flows from operating activities:		
Net loss	\$ (3,747)	\$ (3,764)
Adjustments to reconcile net loss to net cash from operating activities:		
Stock-based compensation	18	29
Depreciation and amortization	2,759	2,503
Amortization of unearned loan fees and costs, net	(133)	(305)
Amortization of premiums and discounts on loans, net	(877)	(472)
Amortization of premiums and discounts on mortgage-backed securities, net	9	7
Loss on financial instruments carried at fair value		64
Gain on sale of securities available for sale		(887)
Gain on sale of mortgage loans	(1,764)	(2,050)
Decrease in accrued interest receivable	210	2,487
Provision for loan losses	6,327	3,053
Write-downs and losses on sale of real estate acquired through foreclosure	1,689	1,030
Secondary marketing valuation	234	2,352
Gain on sale of premises and equipment	(589)	
Increase in cash surrender value of bank-owned life insurance	(746)	(700)
Originations of mortgage loans held for sale	(684,893)	(495,550)
Proceeds from mortgage loans held for sale	700,944	493,694
Net decrease in accrued expenses and other liabilities	(531)	(5,013)
Net (increase) decrease in prepaids and other assets	(5,026)	809
Net cash provided by (used in) operating activities	13,884	(2,713)
Cash flows from investing activities:		
Loan principal (disbursements), net of repayments	(75,584)	52,222
Repurchase of loans previously sold		(29,851)
Purchases of premises and equipment	(2,065)	(6,047)
Proceeds from sale of premises and equipment	1,344	21
Redemptions of restricted stock investments	43	466
Maturities/calls/repayments of trading securities	2,555	2,050
Activity in securities available for sale:		
Sales of securities available for sale		1,301
Maturities/calls/repayments of securities available for sale	4,930	54,656
Purchase of securities available for sale	(7,668)	(999)
Additional disbursements on real estate acquired through foreclosure	(32)	
Proceeds from sales of real estate acquired through foreclosure	5,047	2,662
Net cash (used in) provided by investing activities	(71,430)	76,481
Cash flows from financing activities:		
Net increase (decrease) in deposits	44,145	(20,792)
Net increase in other borrowed funds	3,271	15,102
Proceeds from stock issuance	195	207
Repurchase of common stock, net of costs	(67)	(140)
Net cash provided by (used in) financing activities	47,544	(5,623)
(Decrease) increase in cash and cash equivalents	(10,002)	68,145
Cash and cash equivalents at beginning of period	91,321	42,969
Cash and cash equivalents at end of period	\$ 81,319	\$ 111,114



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## Supplemental information:

Interest paid on deposits and borrowed funds	\$	18,616	\$	21,633
Income taxes paid	\$		\$	
Real estate acquired in satisfaction of loans	\$	6,824	\$	16,640
Transfer of loans held for sale to loan portfolio	\$	4,179	\$	1,001

*See accompanying notes to the consolidated financial statements.*

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**First Mariner Bancorp and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Information as of and for the three and six months*

*ended June 30, 2008 and 2007 is unaudited)*

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis Of Presentation*

The accompanying consolidated financial statements for First Mariner Bancorp (the Company) have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a full presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (U.S.). The consolidated financial statements should be read in conjunction with the audited financial statements included in our 2007 Annual Report on Form 10-K.

The consolidated financial statements include the accounts of the Company's subsidiaries, First Mariner Bank (the Bank), Mariner Finance, LLC (Mariner Finance), and FM Appraisals, LLC (FM Appraisals). All significant intercompany balances and transactions have been eliminated.

The consolidated financial statements as of June 30, 2008 and for the three and six months ended June 30, 2008 and 2007 are unaudited but include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of financial position and results of operations for those periods. The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of the results that will be achieved for the entire year.

The preparation of the financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for credit losses (the allowance), the valuation allowance on repurchased loans, fair value of trading securities, other than temporary impairment of securities available for sale, fair value of real estate acquired through foreclosure, fair value of long-term borrowings carried at fair value, and deferred tax assets.

Certain reclassifications have been made to amounts previously reported to conform to the classifications made in 2008.

*Repurchased Loans*

In certain instances, our loan sales agreements are subject to recourse provisions, which would require us to repurchase the assets under certain circumstances. In the case of loan sale agreements, these recourse provisions generally relate to a sold loan's delinquency during a specified period of time subsequent to the sale (early payment default) or to an early payoff of the loan. We sell loans to many different investors, each with different early payment default and early payoff provisions in their agreements. Early payment default provisions range from none up to and including delinquency during the first 24 months from the origination of the loan. Early payoff provisions generally range from payoff in the first 30 days from the origination of the loan to payoff in the first six months from the origination of the loan. We measure this potential liability based upon past repurchase experience, by calculating past repurchases as a percent of volume and taking a reserve in that amount against future repurchases. We continually revise this calculation based upon experience up until the point that our potential liability for a recourse obligation on a loan has passed.

In accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, we record repurchased loans at estimated fair value at the time of repurchase. Repurchased loans are valued at the time of repurchase at the individual loan level and not on a pool basis. The basis for the valuation is a collateral based approach. For each loan repurchased, management utilizes independent third party valuation models, including broker price opinions, to establish a collateral value. Management believes that the more current valuation model estimates would be more reliable than the original values received from appraisals performed at the time the loan is closed with the borrower, considering market deterioration. Where more than one valuation model is available, which has been true for the vast majority of the loans repurchased in the past, the estimates are averaged to determine collateral value for the property. If only one model for the valuation is available, that source is used to estimate value. In the rare case where there is no model available or the values have high disparities between the two, the original appraisal is used. This has been the case in a very small minority of repurchased loans. Ordering new full appraisals is deemed too costly and time prohibitive given the volume and speed of past repurchase requests.

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Once the collateral value is established, management further reduces the expected cash flow by 3% to absorb estimated accrued and unpaid interest and 5% to absorb estimated selling and disposal costs. This discounted amount is considered to be the loans' realizable value. The realizable value is compared to the loan amount and any shortfall is established with a charge to other operating expense.

We monitor repurchased loans for subsequent changes in cash flows expected to be collected and account for them in accordance with SOP 03-3. Any change after initial valuation of the expected cash flows is recorded through the allowance for loan losses. While we do not expect the market for these loans to improve in the near future, if the cash flows were to increase, we would look at the related yields and record accretion, where appropriate.

Contractual interest accruals on loans repurchased are generally permitted for a period of time if there is sufficient collateral (realizable value) to support the level of accrued interest. For the most part, there is sufficient realizable value to continue the accrual of interest for first lien repurchased mortgages at the time of repurchase, while interest accruals at the time of repurchase are generally discontinued for second lien loans repurchased. As of June 30, 2008, no repurchased second lien mortgage loans remained on accrual status. Management regularly monitors the performance of repurchased loans through its ongoing delinquency tracking methods and makes decisions relative to interest accruals in accordance to its methodologies established for portfolio loans. Where loans become severely delinquent (90 days past due) and collateral values are not sufficient, the accrual of interest is discontinued and any post acquisition accrued interest is reversed against previously recognized interest income. No accretion of any amounts recorded to write-down the loans at initial repurchase have been taken during 2007 or 2008 as a substantial amount of the repurchased loans have become severely delinquent and values continue to deteriorate throughout the period.

To date, we have not returned any repurchased loan to accrual status from non-accrual status. Given the severity of delinquency and reduced values associated with most of our non-accrual repurchased loans, we would foresee a very low probability for the return to accrual status of any repurchased loan. A return to accrual status would require a substantial improvement in expected cash flow and a history of regular payment. We see little likelihood of these events occurring in our nonaccrual repurchased loans at this time. Moreover, these improvements would need to be sufficient to eliminate any specific reserves established after the acquisition, before any accrual of interest or accretion of write-down would be recognized.

*Transfers of Financial Assets*

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

*Derivatives and Hedging Activities*

We account for derivatives in accordance with Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended*. We designate a derivative as held for trading, an economic hedge not designated as a SFAS No. 133 hedge, or a

qualifying SFAS 133 hedge when we enter into the derivative contract. The designation may change based upon management's reassessment or changing circumstances. Derivatives utilized by the Company include swaps and forward settlement contracts. A swap agreement is a contract between two parties to exchange cash flows based on specified underlying notional amounts, assets and/or indices. Forward settlement contracts are agreements to buy or sell a quantity of a financial instrument, index, currency or commodity at a predetermined future date, and rate or price.

We designate at inception whether a derivative contract is considered hedging or non-hedging for SFAS 133 accounting purposes. All of our derivatives are non-exchange traded contracts, and as such, their fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

For SFAS 133 hedges, we formally document at inception all relationships between hedging instruments and hedged items, as well as risk management objectives and strategies for undertaking various accounting hedges. We utilize derivatives to manage interest rate sensitivity in certain cases. These cash flow hedges are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate or foreign exchange fluctuation. We use dollar offset or regression analysis at the hedge's inception and for each reporting period thereafter to assess whether the derivative used in a hedging transaction is expected to be and has been effective in offsetting changes in the fair value of the hedged item. We would discontinue hedge accounting if it were determined that a derivative is not expected to be or has ceased to be effective as a hedge.

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We recognize gains and losses on swap contracts in the Consolidated Statement of Financial Condition in accumulated other comprehensive income, net of tax effects; such gains and losses are reclassified into the line item in the Consolidated Statement of Operations in which the hedged item is recorded in the same period the hedged item affects earnings. Hedge ineffectiveness and gains and losses on the excluded component of a derivative in assessing hedge effectiveness are recorded in earnings in the same income statement line item that is used to record hedge effectiveness. We recognize any gains and losses on interest rate lock commitments or forward sales commitments on loan pipeline through mortgage-banking revenue in the Consolidated Statements of Operations.

## NOTE 2 COMPREHENSIVE (LOSS ) INCOME

The following table shows the Company's comprehensive (loss) income for the three and six months ended June 30, 2008 and 2007:

(dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net loss	\$ (469)	\$ (3,864)	\$ (3,747)	\$ (3,764)
Other comprehensive income items:				
Cumulative effect of accounting change for certain investments, net of tax expense of \$0, \$0, \$0 and \$625, respectively				993
Unrealized holding (losses) gains on securities arising during the period (net of tax (benefit) expense of \$(959), \$(92), \$(1,333), and \$208, respectively)	(1,472)	(147)	(2,047)	330
Unrealized holding gains on swaps arising during the period (net of tax expense of \$354, \$0, \$354, and \$0, respectively)	544		544	
Less: reclassification adjustment for gains on securities (net of taxes of \$0, \$0, \$0, and \$343, respectively) included in net loss				(544)
Total other comprehensive (loss) income	(928)	(147)	(1,503)	779
Total comprehensive loss	\$ (1,397)	\$ (4,011)	\$ (5,250)	\$ (2,985)

## NOTE 3 PER SHARE DATA

Basic earnings per share is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per share is computed after adjusting the denominator of the basic earnings per share computation for the effects of all dilutive potential common shares outstanding during the period. The dilutive effects of options, warrants and their equivalents are computed using the treasury stock method. For the three and six month periods ended June 30, 2008 and 2007, all options were antidilutive and excluded from the computations due to our realized net loss.

Information relating to the calculation of earnings per common share is summarized as follows:

Three Months Ended

Six Months Ended

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(dollars in thousands, except for per share data)	June 30,		June 30,	
	2008	2007	2008	2007
Net loss - basic and diluted	\$ (469)	\$ (3,864)	\$ (3,747)	\$ (3,764)
Weighted-average share outstanding - basic	6,366,804	6,430,015	6,359,317	6,425,439
Dilutive securities - options and warrants				
Adjusted weighted-average shares outstanding - dilutive	6,366,804	6,430,015	6,359,317	6,425,439
Loss per share - basic	\$ (0.07)	\$ (0.60)	\$ (0.59)	\$ (0.59)
Loss per share - diluted	\$ (0.07)	\$ (0.60)	\$ (0.59)	\$ (0.59)

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## NOTE 4 - STOCK BASED COMPENSATION

We have stock option award arrangements, which provide for the granting of options to acquire common stock to our directors and key employees. Option prices are equal to or greater than the estimated fair market value of the common stock at the date of the grant. As of June 30, 2008, 824,169 of the outstanding options are fully vested, 32,000 of the outstanding options vest over a three year period, and 2,719 of the outstanding options vest over the next nine months. All options expire ten years after the date of grant. There have been no modifications to the existing plan. We recognized stock compensation expense of \$12,000, \$13,000, \$18,000 and \$29,000, for the three and six months ended June 30, 2008 and 2007 respectively. We anticipate incurring an additional \$93,000 in compensation expense, net of taxes, over the next three years related to the unvested options.

Information with respect to stock options is as follows for the six months ended June 30, 2008:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at beginning of period	813,788	\$ 12.47		
Granted	49,600	5.28		
Exercised				
Forfeited/Cancelled	(4,500)	17.04		
Outstanding at end of period	858,888	\$ 12.03	5.0	\$
Exercisable at end of period	824,169	\$ 12.27	4.8	\$

The weighted average fair values of our option grants for the six months ended June 30, 2008 and 2007 were \$2.26 and \$6.28, respectively, on the dates of grants. The fair values of our options granted were calculated using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions for the six months ended June 30, 2008 and 2007:

	2008	2007
Dividend yield	0.00%	0.00%
Expected volatility	28.00%	28.38%
Risk-free interest rate	3.77%	4.63%
Expected lives	8 years	8 years

The total intrinsic value of options exercised and the related tax benefit during the six months ended June 30, 2008 and 2007 amounted to \$0, \$11,320, \$0, and \$0, respectively, and proceeds from exercises of stock options amounted to \$0 and \$28,005 for the six months ended June 30, 2008 and 2007, respectively.

While our employee stock purchase plan provides for a 10% discount from market value at issuance, we do not recognize compensation expense on the discount because substantially all employees that meet limited employment qualifications may participate in the plan on an equitable basis; the plan incorporates no option features; the purchase price is based solely on the market price of the shares at the date of purchase; employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid and; the discount from



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the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering.

### NOTE 5 COMMITMENTS AND CONTINGENT LIABILITIES

We are party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of customers. These financial instruments include commitments to extend credit, available lines of credit, and standby letters of credit. Our exposure to credit risk is represented by the contractual amounts of those financial instruments. We apply the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments. A summary of the financial instruments at June 30, 2008 whose contract amounts represent potential credit risk is as follows:

(dollars in thousands)	June 30, 2008	December 31, 2007
Commitments to extend credit (includes unused lines of credit)	\$ 209,953	\$ 200,760
Standby letters of credit	4,097	4,973

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## NOTE 6 SEGMENT INFORMATION

We are in the business of providing financial services, and we operate in three business segments commercial and consumer banking, consumer finance, and mortgage-banking. Commercial and consumer banking is conducted through the Bank and involves delivering a broad range of financial services, including lending and deposit taking, to individuals and commercial enterprises. This segment also includes our treasury and administrative functions. Consumer finance is conducted through Mariner Finance, and involves originating small direct consumer loans and the purchase of retail installment sales contracts. Mortgage-banking is conducted through First Mariner Mortgage and Next Generation Financial Services, divisions of the Bank, and involves originating first- and second-lien residential mortgages for sale in the secondary market and to the Bank. The results of our subsidiary, FM Appraisals, are included in the mortgage-banking segment.

The following table presents certain information regarding our business segments:

**For the six month period ended June 30, 2008:**

(dollars in thousands)	Commercial and Consumer Banking	Consumer Finance	Mortgage- Banking	Total
Interest income	\$ 30,580	\$ 10,067	\$ 2,102	\$ 42,749
Interest expense	15,444	1,698	1,726	18,868
Net interest income	15,136	8,369	376	23,881
Provision for loan losses	2,036	1,827	2,464	6,327
Net interest income (loss) after provision for loan losses	13,100	6,542	(2,088)	17,554
Noninterest income	6,233	1,844	4,499	12,576
Noninterest expense	24,417	7,003	6,447	37,867
Net intersegment income	114		(114)	
Net loss before income taxes	\$ (4,970)	\$ 1,383	\$ (4,150)	\$ (7,737)
Total assets	\$ 1,135,892	\$ 90,279	\$ 62,453	\$ 1,288,624

**For the six month period ended June 30, 2007:**

(dollars in thousands)	Commercial and Consumer Banking	Consumer Finance	Mortgage- Banking	Total
Interest income	\$ 33,625	\$ 7,892	\$ 2,853	\$ 44,370
Interest expense	17,910	1,945	1,850	21,705
Net interest income	15,715	5,947	1,003	22,665
(Reversal of) provision for loan losses	(2,141)	903	4,291	3,053
Net interest income (loss) after provision for loan losses	17,856	5,044	(3,288)	19,612
Noninterest income	7,924	1,561	2,873	12,358
Noninterest expense	24,512	5,177	8,435	38,124
Net intersegment income	83		(83)	
Net income (loss) before income taxes	\$ 1,351	\$ 1,428	\$ (8,933)	\$ (6,154)
Total assets	\$ 1,082,037	\$ 72,872	\$ 97,276	\$ 1,252,185

NOTE 7 FAIR VALUE

We group financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- |         |  |
|---------|--|
| Level 1 | Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.   |
| Level 2 | Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. |

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Level 3            Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table shows details of the financial instruments as of June 30, 2008 for which we elected to apply the fair value option:

(dollars in thousands)	Carrying Value (Fair Value)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Trading Gains and (Losses)	Total Changes In Fair Values Included In Period Earnings
Trading securities	\$ 34,183	\$ 34,183	\$	\$ (212)	\$ (212)
Securities available for sale	46,123		46,123		
Long-term borrowings at fair value	62,910		62,910	212	212
Interest rate swaps	40,877		40,877		

We may be required, from time to time, to measure certain other financial assets and liabilities at fair value on a nonrecurring basis. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis as of June 30, 2008, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the assets:

(dollars in thousands)	Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Alt A and other consumer loans	\$ 26,901	\$	\$	\$ 26,901
Commercial impaired loans	19,403			19,403
Real estate acquired through foreclosure	19,102			19,102

*High Loan-To-Value Ratio/Low Documentation ( ALT A ) loans*

In accordance with AICPA SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, we record repurchased loans at their estimated fair value at the time of repurchase. At June 30, 2008, we maintained \$10.946 million of ALT A loans repurchased in accordance with covenants in our sales agreements with investors. Such loans amounted to \$17.736 million as of December 31, 2007. We did not repurchase any loans during the first six months of 2008.

In establishing the loan s estimated fair value, management makes significant assumptions concerning the ultimate collectibility of delinquent loans and their ultimate realizable value. While these projections are made with the most current data available to management, actual realized losses could differ due to the changes in the borrowers willingness or ability to resolve the delinquency status, changes in the actual volume of future repurchases, changes in the real estate market, or changes in market values of those loans which are liquidated. Management updates these assumptions continually as greater experience becomes available.

In accordance with SFAS No. 65, *Accounting for Certain Mortgage Banking Activities*, any loans which are originally originated for sale into the secondary market and which we subsequently elect to transfer into the Company's loan portfolio are valued at fair value at the time of the transfer with any decline in value recorded as a charge to operating expense. At June 30, 2008, we held \$15.955 million in consumer (primarily ALT A) loans in our portfolio that were transferred from loans held for sale at fair value. Such loans amounted to \$15.793 million at December 31, 2007.

### ***Impaired Loans***

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment in accordance with the provisions of SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using the discounted cash flow method.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment

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is utilized. This method requires obtaining a current independent appraisal or utilizing some other method of valuation for the collateral and applying a discount factor to the value based on our loan review policy and procedures.

If the impaired loan is determined not to be collateral dependent, then the discounted cash flow method is used. This method requires the impaired loan to be recorded at the present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate of a loan is the contractual interest rate adjusted for any net deferred loan fees or costs, premiums, or discounts existing at origination or acquisition of the loan.

Management establishes a specific reserve for loans that have an estimated fair value that is below the carrying value. Impaired loans had a carrying amount of \$46.304 million as of June 30, 2008 and \$47.976 million as of December 31, 2007, with specific reserves of \$2.743 million as of June 30, 2008 and \$2.544 million as of December 31, 2007.

When there is little prospect of collecting either principal or interest, loans, or portions of loans, may be charged-off to the allowance for loan losses. Losses are recognized in the period an obligation becomes uncollectible. The recognition of a loss does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be occur in the future. During the first six months of 2008, the Company charged-off \$3.086 million of impaired loans to the allowance for loan losses.

***Real Estate Acquired Through Foreclosure***

We record foreclosed real estate assets at the lower of cost or estimated fair value on their acquisition dates and at the lower of such initial amount or estimated fair value less estimated selling costs thereafter. Estimated fair value is generally based upon independent appraisal of the collateral, discounted based on various economic factors consistent with our loan review policies. We held real estate acquired through foreclosure of \$19.102 million as of June 30, 2008 and \$18.981 million as of December 31, 2007. During the first six months of 2008, we added \$6.824 million, net of reserves, to real estate acquired through foreclosure and took write-downs, included in noninterest expense, of \$1.689 million.

**NOTE 8 DERIVATIVES AND HEDGING**

We maintain and account for hedging derivatives, in the form of interest rate swaps ( swaps ) and interest rate lock commitments, in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. We recognize gains and losses on swap contracts in the Consolidated Statement of Financial Condition in accumulated other comprehensive income, net of tax effects. We recognize any gains and losses on interest rate lock commitments or forward sales commitments on loan pipeline through mortgage-banking revenue in the Consolidated Statement of Operations.

Information pertaining to the carrying amounts of our derivative financial instruments follows as of June 30, 2008 and December 31, 2007:

(dollars in thousands)	June 30, 2008		December 31, 2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Interest Rate Swaps	\$ 40,000	\$ 40,877	\$ 18,867	\$ 18,843
Interest rate lock commitments	46,620	45,909	18,867	18,843
Forward sales commitments on loan pipeline and funded loans	100,878	101,588	89,256	89,280

## NOTE 9 RECENT ACCOUNTING PRONOUNCEMENTS

*Pronouncement Issued But Not Yet Effective*

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. This statement requires enhanced disclosures in order to enable investors to better understand the effects of derivative instruments and hedging activities on an entity's financial position, financial performance, and cash flows. This statement is effective for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Management does not anticipate the adoption of this standard to have a material impact on the disclosures to our financial statements.

**Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read and reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in our Annual Report on Form 10-K for the year ended December 31, 2007.

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Forward-Looking Statements

This quarterly report on Form 10-Q may contain forward-looking language within the meaning of The Private Securities Litigation Reform Act of 1995. Statements may include expressions about our confidence, policies, and strategies, provisions and allowance for loan losses, adequacy of capital levels, and liquidity. All statements included or incorporated by reference in this Quarterly Report on Form 10-Q, other than statements that are purely historical, are forward-looking statements. Statements that include the use of terminology such as anticipates, expects, intends, plans, believes, estimates, and similar expressions also identify forward-looking statements. The forward-looking statements are based on our current intent, belief, and expectations. Forward-looking statements in this Quarterly Report on Form 10-Q include, but are not limited to, statements of our plans, strategies, objectives, intentions, including, among other statements, statements involving our projected loan and deposit growth, loan collateral values, collectibility of loans, anticipated changes in other operating income, payroll and branching expenses, branch, office and product expansion of the Company and its subsidiaries, and liquidity and capital levels. Such forward-looking statements involve certain risks and uncertainties, including general economic conditions, competition in the geographic and business areas in which we operate, inflation, fluctuations in interest rates, legislation, and government regulation. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that are difficult to predict. For a more complete discussion of risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements, see Risk Factors filed as Item 1A of Part I in our Form 10-K for the year ended December 31, 2007 and Item 1a in Part II of this Form 10-Q. Except as required by applicable laws, we do not intend to publish updates or revisions of any forward-looking statements we make to reflect new information, future events, or otherwise.

The Company

The Company is a bank holding company incorporated under the laws of Maryland and registered under the federal Bank Holding Company Act of 1956, as amended. The Company's business is conducted primarily through its wholly owned subsidiaries, First Mariner Bank (the Bank), Mariner Finance, LLC (Mariner Finance), and FM Appraisals, LLC (FM Appraisals).

The Bank, which is the largest operating subsidiary of the Company with assets exceeding \$1.168 billion as of June 30, 2008, is engaged in the general commercial banking business, with particular attention and emphasis on the needs of individuals and small to mid-sized businesses, and delivers a wide range of financial products and services that are offered by many larger competitors. The Bank's primary market area for its core banking operations, which consist of traditional commercial and consumer lending, as well as retail and commercial deposit operations, is central Maryland as well as portions of Maryland's eastern shore. The Bank also has one branch in Pennsylvania. Products and services of the Bank include traditional deposit products, a variety of consumer and commercial loans, residential and commercial mortgage and construction loans, wire transfer services, non-deposit investment products, and internet banking and similar services. Most importantly, the Bank provides customers with access to local Bank officers who are empowered to act with flexibility to meet customers' needs in an effort to foster and develop long-term loan and deposit relationships. The Bank is an independent community bank and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC).

First Mariner Mortgage, a division of the Bank, engages in mortgage-banking activities, providing mortgages and associated products to customers and selling most of those mortgages into the secondary market. First Mariner Mortgage has offices in Maryland, Delaware, Massachusetts, Connecticut, and North Carolina.

Next Generation Financial Services (NGFS), a division of the Bank, engages in the origination of reverse and conventional mortgages, providing these products directly through commission based loan officers throughout the United States. NGFS originates reverse mortgages for sale to Fannie Mae and other private investors. The Bank does not originate any reverse mortgages for its portfolio and currently sells all of its



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originations into the secondary market. The Bank retains the servicing rights on reverse mortgages sold to Fannie Mae. NGFS is one of the largest originators of reverse mortgages in the United States.

Mariner Finance engages in traditional consumer finance activities, making small direct cash loans to individuals, the purchase of installment loan sales contracts from local merchants and retail dealers of consumer goods, and loans to individuals via direct mail solicitations, as well as a low volume of mortgage loans. Mariner Finance currently operates branches in Maryland, Delaware, Virginia, New Jersey, and Tennessee. Mariner Finance had total assets of \$90.279 million as of June 30, 2008.

FM Appraisals is a residential real estate appraisal preparation and management company that is headquartered in Baltimore City. FM Appraisals offers appraisal services for residential real estate lenders, including appraisal preparation, the compliance oversight of sub-contracted appraisers, appraisal ordering and administration, and appraisal review services. FM Appraisals provides these services to First Mariner Mortgage, NGFS, and Mariner Finance.

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Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U. S. ( GAAP ) and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the consolidated financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. When applying accounting policies in such areas that are subjective in nature, management must use its best judgment to arrive at the carrying value of certain assets and liabilities. Below is a discussion of our critical accounting policies.

*Allowance for loan losses*

A variety of estimates impact the carrying value of the loan portfolio including the calculation of the allowance for loan losses, valuation of underlying collateral, and the timing of loan charge-offs.

The allowance is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payments on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio. Current trends in delinquencies and charge-offs, the views of Bank regulators, changes in the size and composition of the loan portfolio, and peer comparisons are also factors. The analysis also requires consideration of the economic climate and direction and change in the interest rate environment, which may impact a borrower's ability to pay, legislation impacting the banking industry, and environmental and economic conditions specific to the Bank's service areas. Because the calculation of the allowance for loan losses relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.

*Securities available for sale*

Securities available for sale are evaluated periodically to determine whether a decline in their value is other than temporary. The term "other than temporary" is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the security. Management reviews criteria such as the magnitude and duration of the decline, as well as the reasons for the decline, to predict whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

*Deferred income taxes*

Under the liability method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not.

***Loan income recognition***

Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees and certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual loan terms. Accrual of interest is discontinued when its receipt is in doubt, which typically occurs when a loan becomes impaired. Any interest accrued to income in the year when interest accruals are discontinued is generally reversed. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the principal balance and accrued interest. Loans are returned to accrual status once the doubt concerning collectibility has been removed and the borrower has demonstrated the ability to pay and remain current. Payments on nonaccrual loans are generally applied to principal.

***Loan Repurchases***

Our sales agreements with investors who buy our loans generally contain covenants which may require us to repurchase loans under certain provisions, including delinquencies, or return premiums paid by those investors should the loan be paid off early. These covenants are usual and customary within the mortgage-banking industry. We maintain a reserve (included in other liabilities) for potential losses relating to these sales covenants.

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Loans repurchased are accounted for under AICPA SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. Under the SOP, loans repurchased must be recorded at market value at the time of repurchase with any deficiency for recording the loan compared to proceeds paid charged to earnings. Repurchased loans are carried on the balance sheet in the loan portfolio. Any further change in the underlying risk profile or further impairment is recorded as a specific reserve in the allowance for loan losses through the provision for loan losses.

Repurchased loans which are foreclosed upon are transferred to Real Estate Acquired Through Foreclosure at the time of ratification of foreclosure and recorded at estimated fair value. These assets remain in Real Estate Acquired Through Foreclosure until their disposition. Any declines in value subsequent to foreclosure reduce the carrying amounts through a charge to noninterest expense.

***Real Estate Acquired Through Foreclosure***

We record foreclosed real estate assets at the lower of cost or estimated fair value on their acquisition dates and at the lower of such initial amount or estimated fair value less estimated selling costs thereafter. Estimated fair value is based upon many subjective factors, including location and condition of the property and current economic conditions, among other things. Because the calculation of fair value relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.

Write-downs at time of transfer are made through the allowance for loan losses. Write-downs subsequent to transfer are included in our noninterest expenses, along with operating income, net of related expenses of such properties and gains or losses realized upon disposition.

Mortgage-Banking Update

As of June 30, 2008, we held in our loan portfolio \$10.946 million in repurchased ALT A loans and \$15.955 million in loans transferred from our loans held for sale portfolio (primarily ALT A). During the first six months of 2008, \$2.778 million of ALT A loans were placed on nonaccrual, \$6.824 million of previously classified nonaccrual loans were transferred to real estate acquired through foreclosure, and \$4.590 million were sold to third parties out of real estate acquired through foreclosure. We recognized \$4.162 million in total charges related to ALT A loans during the first six months of 2008, consisting of \$1.698 million for write-downs, expenses, and sales of real estate acquired through foreclosure, and \$2.464 million in additional provisions (after charge-offs and recoveries) to the allowance for loan losses related to these loans. During the first six months of 2007, we recognized \$5.188 million in total charges related to ALT A loans, consisting of \$923,000 for write-downs, expenses, and sales of real estate acquired through foreclosure, and \$4.265 million in additional provisions (after charge-offs and recoveries) to the allowance for loan losses related to these loans.

We discontinued origination of ALT A loans during the first quarter of 2007 and closed our wholesale lending division in July of 2007. The majority of our problem ALT A loans were originated through the wholesale division.

Financial Condition

The Company experienced balance sheet growth (+\$41.802 million) for the second quarter in a row, ending the quarter with total assets of \$1.289 billion at June 30, 2008, compared to \$1.247 billion at December 31, 2007. Earning assets increased \$48.414 million or 4.5% to \$1.124 billion at June 30, 2008 from \$1.076 billion at December 31, 2007. The growth in assets was due to increases in loans outstanding (+\$69.376 million) and securities available for sale (+\$1.125 million), partially offset by decreases in loans held for sale (-\$18.467 million), cash and due from banks (-\$9.191 million), and other earning assets (-\$3.620 million). We funded the growth in assets with increases in deposits (+\$44.145 million) and long-term borrowings (+\$9.209 million), partially offset by decreases in short-term borrowings (-\$6.151 million).

### *Securities*

We utilize the securities portfolio as part of our overall asset/liability management practices to enhance interest revenue while providing necessary liquidity for the funding of loan growth or deposit withdrawals. As of June 30, 2008, we held \$46.123 million in securities classified as available for sale ( AFS ) and \$34.183 million in securities classified as trading. As of December 31, 2007, we held \$44.998 million in securities available for sale and \$36.950 million in trading securities. Total securities declined \$1.642 million due to normal principal payments on mortgage-backed securities, scheduled maturities of other securities, and a decline in market values, partially offset by purchases of securities of \$7.668 million during the first six months of 2008. At June 30, 2008, our net unrealized loss on securities classified as available for sale totaled \$6.421 million compared to a net unrealized loss of \$2.997 million at December 31, 2007. The decline in value resulted primarily from declines in the values of trust preferred securities, particularly our holdings of pooled trust preferred obligations, which have an amortized cost of \$10.992 million and a related unrealized loss of \$5.200 million as of June 30, 2008.

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Trust preferred securities, most of which are considered to be temporarily impaired, are issues of other banks and bank holding companies we currently hold in our portfolio. Certain of these securities have experienced declines in credit ratings from credit rating firms, which have devalued these specific securities. These declines have occurred primarily over the past six months due to changes in the market which have limited the demand for these securities and reduced their liquidity. While some of these issuers have reported weaker financial performance since acquisition of these securities, the majority of these issuers continue to possess more than acceptable credit risk in management's opinion. Management closely monitors these securities for changes in credit risk and we have the ability to hold these securities to their maturity without any loss of principal or interest. Management does not consider the impairment of these securities to be other than temporary.

All of the remaining securities that are temporarily impaired are impaired due to declines in fair values resulting from increases in interest rates or wider credit spreads compared to the time they were purchased. We have the ability to hold these securities to maturity, when we expect these securities will be repaid in full, and do not expect to realize losses on any of these holdings. As such, management does not consider the impairments to be other than temporary.

All trading securities are mortgage-backed securities. The securities available for sale portfolio composition is as follows:

	June 30, 2008		December 31, 2007	
(dollars in thousands)	Balance	Percent of Total	Balance	Percent of Total
Securities available for sale:				
Mortgage-backed securities	\$ 16,476	35.7%	\$ 18,079	40.2%
Trust preferred securities	17,320	37.5%	19,034	42.3%
US Treasury securities	1,016	2.2%	1,017	2.3%
Obligations of state and municipal subdivisions	2,198	4.8%	2,975	6.6%
Corporate obligations	7,994	17.4%	1,915	4.2%
Equity securities	369	0.8%	478	1.1%
Foreign government bonds	750	1.6%	1,500	3.3%
Total securities available for sale	\$ 46,123	100.0%	\$ 44,998	100.0%

*Loans*

Total loans increased \$69.376 million during the first six months of 2008. Higher balances occurred in all loan categories, except for the commercial construction portfolio, which decreased \$14.311 million since December 31, 2007. Although we have been aggressive in our loan origination activity, as evidenced by the growth in our total loan portfolio, the poor market environment has impacted the demand for construction and development lending products. The total loan portfolio was comprised of the following:

	June 30, 2008		December 31, 2007	
(dollars in thousands)	Balance	Percent of Total	Balance	Percent of Total
Loans secured by first mortgages on real estate:				
Residential	\$ 94,221	10.2%	\$ 84,973	9.9%
Commercial	297,669	32.2%	280,102	32.7%

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Consumer residential construction	96,597	10.4%	86,430	10.1%
Commercial construction	115,336	12.5%	129,647	15.2%
	603,823	65.3%	581,152	67.9%
Commercial	100,617	10.9%	72,356	8.4%
Loans secured by second mortgages on real estate	115,192	12.4%	98,833	11.6%
Consumer	102,661	11.1%	100,671	11.8%
Loans secured by deposits and other	3,010	0.3%	2,430	0.3%
Total loans	925,303	100.0%	855,442	100.0%
Unamortized loan discounts, net	(405)		(445)	
Unearned loan fees, net	(602)		(77)	
	\$ 924,296		\$ 854,920	

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Our commercial construction portfolio consists of construction and development loans for commercial purposes and includes loans made to builders and developers of residential real estate projects. Of the total included above, \$68.230 million represents loans made to borrowers for the development of residential real estate. This segment of the portfolio has exhibited greater weakness over the first six months of 2008 due to overall weakness in the residential housing sector. The breakdown is as follows as of June 30, 2008:

(dollars in thousands)	Balance	Number of Loans
Raw residential land	\$ 6,583	4
Residential subdivisions	25,905	22
Single residential lots	4,074	14
Single family construction	12,375	19
Townhome construction	2,860	10
Multi-family unit construction	16,433	12
	\$ 68,230	81

As of June 30, 2008, \$7.840 million (11%) of these loans are currently on nonaccrual. The collateral for over 80% of these loans is located in Maryland, with the majority of the remainder of the loans secured by collateral in Delaware and the District of Columbia. We have engaged an independent third party to review the rest of this portfolio to assist in the determination of exposure.

*Credit Risk Management*

Credit risk is the risk of loss arising from the inability of a borrower to meet its obligations. We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

We provide for loan losses through the establishment of an allowance for loan losses (the allowance) by provisions charged against earnings. Our allowance represents an estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either consumer or commercial and monitor credit risk separately as discussed below. We evaluate the adequacy of our allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

The allowance consists of three elements: (1) specific reserves and valuation allowances for individual credits; (2) general reserves for types or portfolios of loans based on historical loan loss experience, judgmentally adjusted for current conditions and credit risk concentrations; and (3) unallocated reserves. Combined specific reserves and general reserves by loan type are considered allocated reserves. All outstanding loans are considered in evaluating the adequacy of the allowance.



## Commercial

Our commercial portfolio includes all secured and unsecured loans to borrowers for commercial purposes, including commercial lines of credit and commercial real estate. Our process for evaluating commercial loans includes performing updates on all loans that we have rated for risk. Our commercial loans are generally reviewed individually, in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, to determine impairment, accrual status, and the need for specific reserves. Our methodology incorporates a variety of risk considerations, both qualitative and quantitative. Quantitative factors include our historical loss experience by loan type, collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are evaluated in connection with our unallocated portion of our allowance for loan losses. We periodically engage outside firms and experts to independently assess our methodology and perform various loan review functions.

The process of establishing the allowance with respect to our commercial loan portfolio begins when a loan officer initially assigns each loan a risk grade, using established credit criteria. Approximately 50% of our risk grades are subject to review and validation annually by an independent consulting firm, as well as periodically by our internal credit review function. Our methodology employs management's judgment as to the level of future losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business. In determining our ability to collect

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certain loans, we also consider the fair value of any underlying collateral. We also evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

A commercial loan is determined to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Such a loan is not considered impaired during a period of delay in payment if we expect to collect all amounts due, including past-due interest. We generally consider a period of delay in payment to include delinquency up to 90 days. Commercial loans we consider impaired at June 30, 2008 and December 31, 2007 totaled \$19.403 million and \$14.447 million, respectively. The reserve for loan losses for commercial impaired loans was approximately \$760,000 at June 30, 2008 and \$241,000 at December 31, 2007. The average recorded investment in commercial impaired loans was approximately \$15.509 million and \$14.309 million for the six months ended June 30, 2008 and June 30, 2007, respectively, and no income has been accrued or collected on the majority of these loans while they have been classified as impaired.

The following table shows the breakout of commercial impaired loans:

(dollars in thousands)	June 30, 2008	December 31, 2007
Impaired loans with allowance for loan losses allocated in accordance with SFAS 114	\$ 4,574	\$ 2,268
Impaired loans with no allowance for loan losses allocated in accordance with SFAS 114	14,829	12,179
	\$ 19,403	\$ 14,447

In general, we place commercial impaired loans on nonaccrual status. Once a loan is placed on nonaccrual, it remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. All payments made on nonaccrual loans are applied to the principal balance of the loan.

## Consumer

Our consumer portfolio includes residential mortgage loans and other loans to individuals. Consumer and residential mortgage loans, excluding repurchased and transferred loans, are segregated into homogeneous pools with similar risk characteristics. Trends and current conditions in consumer and residential mortgage pools are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for the consumer and residential mortgage portfolios are consistent with those for the commercial portfolios. Certain loans in the consumer portfolio identified as having the potential for further deterioration are analyzed individually to confirm the appropriate risk grading and accrual status, and to determine the need for a specific reserve. Consumer loans originated on the Bank that are greater than 120 days past due are generally charged off. For consumer loans originated by Mariner Finance, all such loans greater than 90 days past due are considered nonaccrual and are generally charged off when they become 180 days past due.

## ALT A Mortgages Repurchased

## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

In accordance with AICPA SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, we record repurchased loans at their estimated fair value at the time of repurchase. At June 30, 2008, we maintained \$10.946 million of loans repurchased in accordance with covenants in our sales agreements with investors.

In establishing the loan's estimated fair value, management makes significant assumptions concerning the ultimate collectibility of delinquent loans and their ultimate realizable value. While these projections are made with the most current data available to management, actual realized losses could differ due to the changes in the borrowers' willingness or ability to resolve the delinquency status, changes in the actual volume of future repurchases, changes in the real estate market, or changes in market values of those loans which are liquidated. Management updates these assumptions continually as greater experience becomes available.

We believe our exposure to and resolution of our repurchase obligations are substantially complete. We did not repurchase any loans during the first six months of 2008.

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The following table shows the total portfolio of repurchased loans and their status:

**As of June 30, 2008:**

(dollars in thousands)	Principal Balance at Repurchase	Initial Write-Down	Carrying Value	Additional Allocated Reserves (1)
Nonaccrual 1st mortgages	\$ 4,691	\$ 160	\$ 4,531	\$ 697
Nonaccrual 2nd mortgages	302	24	278	278
Delinquent 1st mortgages (2)	1,661		1,661	55
Modifications (3)	4,729	253	4,476	