

Howard Bancorp Inc
Form 10-K
March 15, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

Commission file number: 001-35489

HOWARD BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland **20-3735949**
State or other jurisdiction (I.R.S. Employer

of incorporation or organization Identification No.)

3301 Boston Street, Baltimore, MD 21224
(Address of principal executive offices) (Zip Code)

(410) 750-0020

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated

filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth c

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The aggregate market value of the voting common stock of the registrant held by non-affiliates on June 30, 2018, was approximately \$324.2 million. At February 28, 2019, the number of outstanding shares of Common Stock, \$0.01 par value, of the Corporation was 19,056,736.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the registrant’s definitive Proxy Statement for the 2019 Annual Meeting of Stockholders.

TABLE OF CONTENTS

PART I	<u>Item 1. Business</u>	<u>2</u>
	<u>Item 1A. Risk Factors</u>	<u>14</u>
	<u>Item 1B. Unresolved Staff Comments</u>	<u>25</u>
	<u>Item 2. Properties</u>	<u>26</u>
	<u>Item 3. Legal Proceedings</u>	<u>28</u>
	<u>Item 4. Mine Safety Disclosures</u>	<u>28</u>
PART II	<u>Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>29</u>
	<u>Item 6. Selected Financial Data</u>	<u>30</u>
	<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
	<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>53</u>
	<u>Item 8. Financial Statements and Supplementary Data</u>	<u>55</u>
	<u>Reports of Independent Registered Public Accounting Firm</u>	<u>55</u>
	<u>Consolidated Financial Statements</u>	<u>57</u>
	<u>Notes to the Consolidated Financial Statements</u>	<u>61</u>
	<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>104</u>
	<u>Item 9A. Controls and Procedures</u>	<u>104</u>
	<u>Item 9B. Other Information</u>	<u>104</u>
PART III	<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>104</u>
	<u>Item 11. Executive Compensation</u>	<u>105</u>
	<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>105</u>
	<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>105</u>
	<u>Item 14. Principal Accounting Fees and Services</u>	<u>105</u>
PART IV	<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>105</u>
	<u>Item 16 Form 10-K Summary</u>	<u>107</u>

FORWARD-LOOKING STATEMENTS

This report contains “forward-looking statements,” as that phrase is defined in the Private Securities Litigation Reform Act of 1995, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect,” “will,” “may,” “should” and words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. These forward-looking statements include, but are not limited to statements of our goals, intentions and expectations, particularly with respect to our business plan and strategies, including opening of additional branches, expansion into new markets, potential acquisitions, increasing capital, market share, loan, investments and asset growth, revenue and profit growth and expanding client relationships. Actual results could differ materially from those anticipated in such forward-looking statements as a result of risks and uncertainties more fully described under "Item 1A. Risk Factors." Factors that might cause such differences include, but are not limited to:

- deterioration in general economic conditions, either nationally or in our market area, or a return to recessionary conditions;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to enter new markets successfully and capitalize on growth opportunities, and to otherwise implement our growth strategy;
- our ability to successfully integrate acquired entities, if any;
- our ability to fully realize the expected benefits and other impacts of our acquisition of First Mariner Bank;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the U.S. Securities and Exchange Commission and the Public Company Accounting Oversight Board;
- changes in our organization, compensation and benefit plans;
- loss of key personnel;
- the impact of recent branch closures and the opening of new branches on expenses;
- our ability to maintain the asset quality of our investment portfolios and the anticipated recovery and collection of unrealized losses on securities available for sale;
- our ability to continue our expected focus on commercial customers as well as continuing to originate residential real estate loans and both maintaining our residential mortgage loan portfolio and continuing to sell loans into the secondary market;
- the impact of the Tax Cuts and Jobs Act of 2018;
- changes in our expected occupancy and equipment expenses;
- changes to our allowance for credit losses, and the adequacy thereof;
- our ability to maintain adequate liquidity levels and future sources of liquidity;
- our ability to retain a large portion of maturing certificates of deposit;
- the impact on us of recent changes to accounting standards;

Edgar Filing: Howard Bancorp Inc - Form 10-K

- the impact of future cash requirements relating to commitments to extend credit;
- the impact of interest rate changes on our net interest income; and
- other risks discussed in this report, including those discussed in “Item 1A. Risk Factors.”

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. You should not put undue reliance on any forward-looking statements. These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not undertake any obligation to update any forward-looking statements after the date of this report.

As used in this report, “Howard Bancorp,” “the Company,” “we,” “us,” and “ours” refer to Howard Bancorp, Inc. and its subsidiaries. References to the “Bank” refer to Howard Bank.

Part I

Item 1. Business

Howard Bancorp, Inc.

Howard Bancorp, Inc., the parent company of Howard Bank, was incorporated in April 2005 under the laws of the State of Maryland to serve as the bank holding company of Howard Bank. The Company is a public company subject to the reporting requirements of the U.S. Securities and Exchange Commission (the “SEC”). We file electronically with the SEC our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We make available on the investor relations page of our website at www.howardbank.com, free of charge, copies of these reports as soon as reasonably practicable after filing or furnishing them to the SEC. The information on our website is not incorporated by reference in this Annual Report on Form 10-K.

Howard Bank

Howard Bank is a Maryland-chartered trust company that was formed in March 2004 and commenced banking operations in August 2004. Howard Bank has currently chosen not to seek and exercise trust powers, and our business, powers and regulatory structure are the same as a Maryland-chartered commercial bank. The Bank is subject to regulation, supervision and regular examination by the Maryland Office of the Commissioner of Financial Regulation (the “Commissioner”) and the Federal Deposit Insurance Corporation (“FDIC”), and our deposits are insured by the FDIC. The Bank has seven subsidiaries; six are intended to hold foreclosed real estate (three of which are inactive) and one owns and manages real estate that is used as a branch location that also has office and retail space.

Howard Bank is headquartered in Baltimore City, Maryland. We consider our primary market area to be the Greater Baltimore metropolitan area. We engage in a general commercial banking business, making various types of loans and accepting deposits. We market our financial services to small-and medium-sized businesses and their owners, professionals and executives, and high-net-worth individuals. Our loans are primarily funded by core deposits of customers in our market.

Our core business strategy involves driving organic growth by delivering advice and superior customer service to clients through local decision makers. We combine the Bank's specialized focus on both local markets and small- and medium-sized business related market segments with a broad array of products, new technology and seasoned banking professionals to position the Bank differently from most competitors. Our experienced executives establish a relationship with each client and bring value to all phases of a client's business and personal banking needs. To develop this strategy, we have established long-standing relationships with key customers in the community and with local business leaders who can create business opportunities.

Our primary source of revenue is net interest income, which is the difference between the interest income we earn on our loan and investment portfolios and the interest expense we pay on deposits and borrowings. Results of operations are also affected by provisions for credit losses, noninterest income and noninterest expense. Our noninterest expense consists primarily of compensation and employee benefits, as well as office occupancy, loan production expense, deposit insurance and general administrative and data processing expenses. Our operations are significantly affected by general economic and competitive conditions, particularly with respect to changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect our financial condition and results of operations.

Our leadership team is deep and experienced both as it relates to tenure with the Company as well as industry experience. Our Chairman and CEO, Mary Ann Scully, founded the Company and has over 35 years of banking experience, mainly in senior executive roles with larger financial institutions. In addition, the Company employs a strong stable of next level senior leadership, which it believes is critical for successful implementation of our strategic initiatives. It is this leadership experience that has driven the Company's growth since its founding. In addition to organic growth, the Company has completed and integrated a bank acquisition, as further discussed below. We consider acquisitions to be a critical component of furthering future growth and will continue to cultivate and pursue strategic initiatives provided they generate meaningful long-term stockholder returns.

Our strategic plan focuses on enhancing stockholder value through market share growth as reflected in balance sheet growth, related revenue growth and resulting growth in operating profits. During the past several years we have expanded our branch locations both through opening new branches and acquiring branch offices via acquisition. While we anticipate opening additional branches in the counties where we now operate and in contiguous counties over the next several years, we currently have no definitive plans or agreements in place with respect to any additional branches. Our long-term vision includes supplementing our historically organic growth with strategically significant acquisitions. We believe that acquiring other financial institutions, in whole or in part, through business line spin-offs, branch sales or the hiring of teams of individuals, will allow us to expand our market, achieve certain operating efficiencies, and grow our stockholder base and thus our share value and liquidity. We believe that our demonstrated expertise in commercial lending and deposit gathering (especially non-interest bearing transactional deposits), our demonstrated ability to attract additional investment and capital, and community leadership positions us as an attractive acquirer. We also anticipate that increasing our capital levels will give us the ability to continue our organic asset growth and expand our relationships with key clients through a larger legal lending limit.

General Development of the Business

On December 6, 2018, the Company entered into Subordinated Note Purchase Agreements with certain institutional accredited investors (the “Purchasers”) pursuant to which the Company sold and issued \$25,000,000 in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes due December 6, 2028 (the “Notes”). The Notes were sold and issued by the Company to the Purchasers at a price equal to 100% of their face amount in a private offering in reliance on the exemptions from registration available under Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), and the provisions of Regulation D thereunder.

On March 1, 2018, the Company completed its previously announced merger (the “Merger”) with First Mariner Bank, a Maryland chartered trust company (“First Mariner”), pursuant to the Agreement and Plan of Reorganization dated August 14, 2017, and as amended by Amendment No. 1 on November 8, 2017, by and among the Company, the Bank and First Mariner (as amended, the “Agreement”). At the effective time of the Merger, First Mariner merged with and into the Bank, with the Bank continuing as the surviving bank of the Merger and a wholly owned subsidiary of the Company. The Merger was described in the joint proxy and information statement/prospectus filed with the SEC on November 22, 2017.

At the effective time of the Merger, pursuant to the terms of the Agreement, each outstanding share of First Mariner common stock and First Mariner Series A Non-Voting Non-Cumulative Perpetual Preferred Stock issued and outstanding was cancelled and converted into the right to receive 1.6624 shares of the Company’s common stock. To effect the Merger, the Company issued 9,143,222 shares of its common stock to First Mariner stockholders.

On February 1, 2017, the Company closed an underwritten public offering, pursuant to which the Company issued and sold 2,760,000 shares, which included the exercise in full by the underwriters to purchase an additional 360,000 shares, at the public offering price of \$15.00 per share. The amount of gross proceeds raised in this offering was approximately \$41.4 million, after underwriting discounts and estimated expenses, and the amount of net proceeds raised in this offering was \$38.4 million. We used the proceeds of the offering to pay off the loan to Raymond James Bank, N.A. and retained the remainder. This had a positive impact on our liquidity and capital position in 2018 and provided funds that will continue to allow us to grow our loans and investments.

On May 6, 2016, we redeemed all of the 12,562 shares of the Series AA Preferred Stock that we had previously issued to the U.S. Department of the Treasury (“Treasury”) under its Small Business Lending Fund (“SBLF”) program. The aggregate redemption price of the Series AA Preferred Stock was approximately \$12.7 million, including dividends accrued but unpaid through the redemption date.

Our Market Area

Our headquarters are located in Baltimore City, Maryland. We consider our primary market area to be the Greater Baltimore Metropolitan Area in Maryland. We have certain loans in our loan portfolio that are outside our market area, although we do not actively solicit business outside our primary market.

As of December 31, 2018, we had 21 full services branches, as well as 11 mortgage and commercial lending offices located throughout Maryland. For additional detail regarding branch and lending office see “Item 2. Properties” below in this report.

Competitive Position

As a community bank with over \$2 billion in assets, we believe that we are well positioned to navigate the ongoing market consolidation and heightened regulatory environment. We have the ability to outsource certain activities (internal audit, compliance review, information security monitoring) and to source new products and services in a highly efficient manner, allowing us to avoid the risk of impairment of operating earnings faced by some banks. We believe this offers an advantage over our competitors which may be locked into legacy systems, or which may find the onslaught of new regulations and evolving consumer expectations challenging. Strategic partnerships for these outsourced activities include contractual relationships with some of the largest and strongest providers of item processing, data processing, information monitoring and payment systems alternatives. We believe that this provides the Bank with the best of technology and product selection without sacrificing the more intimate delivery advantages of a community bank. We further believe the current economic and regulatory environment will continue to result in greater consolidation among financial institutions, including community banks. Some of that consolidation will occur with larger banks, thus exacerbating the scarcity of banks able to underwrite traditionally and offer advice in interactions with customers as we do, which we believe gives us a wider window of opportunity to extend our brand and value proposition. We believe, however, that to the extent some of that consolidation occurs between and among smaller banks, the resulting combined institutions will be better positioned to differentiate themselves.

We believe that our “Hands On” approach to delivering services to small- and medium-sized businesses is essential to our competitive position. Through a team of experienced advisors and providing them with access to local policy and decision makers, we offer an array of competitive credit and cash management services that we feel fills a “white space” in the market. We believe that we fit well between sophisticated, but often distracted large banks and responsive, but less capable small banks. Our relationship managers, team leaders and executive management generally have decades of banking experiences and are well established in the communities that they serve. They are able to interface with clients directly to share that experience and to provide connections with their own network of other specialized advisors. We believe we also benefit from our committed leadership at both the executive management and board level who bring a broad array of skills and experiences to our company and are able to position the Bank for consistent profitable growth.

Lending Activities

General

Our primary market focus is making loans to and gathering deposits from small- and medium-sized businesses and their owners, professionals and executives, and high-net-worth individuals in our primary market area. Our loans are made to customers primarily in the Greater Baltimore market. Our lending activities consist generally of short- to medium-term commercial lending, commercial mortgage lending for both owner occupied and investment properties, residential mortgage lending, and consumer lending, both secured and unsecured. A substantial portion of our loan portfolio consists of loans to businesses secured by real estate and/or other business assets.

Credit Policies and Administration

We have adopted a comprehensive lending policy that includes stringent underwriting standards for all types of loans. Our lending teams follow pricing guidelines established periodically by our management team. In an effort to manage risk, minimal lending authority is given to individual loan officers. Most loan officers can approve loans up to \$100,000 (with a select number of loan officers having the authority to \$500,000). The Chief Commercial Banking Officer, the Chief Executive Officer and the President can approve loans up to \$2,000,000, or any two together can approve loans up to \$4,000,000. Loans above these amounts are reviewed by an Officers’ Loan Committee (when less than or equal to \$5,000,000) or by a Senior Loan Committee (when greater than \$5,000,000). Under the leadership of our executive management team, we believe that we employ experienced lending officers, secure appropriate collateral, and carefully monitor the financial condition of our borrowers and the concentration of loans in our portfolio.

In addition to the normal repayment risks, all loans in the portfolio are subject to the state of the economy and the related effects on the borrower and/or the real estate market. Generally, longer-term loans have periodic interest rate adjustments and/or call provisions. Senior management monitors the loan portfolio closely to ensure that we minimize past due loans and that we swiftly deal with potential problem loans.

The Bank also retains an outside, independent firm to review the loan portfolio. This firm performs a detailed annual review. We use the results of the firm's report primarily to validate the risk ratings applied to loans in the portfolio and identify any systemic weaknesses in underwriting, documentation or management of the portfolio. Results of the annual review are presented to executive management, the Asset Quality Committee of the board of directors of the Bank and the full board of directors of the Bank and are available to and used by regulatory examiners when they review the Bank's asset quality. We currently use the firm of Strategic Risk Associates to perform this review.

The Bank maintains the normal checks and balances on the loan portfolio not only through the underwriting process but through the utilization of an internal credit administration group that both assists in the underwriting and serves as an additional reviewer of underwriting. The separately-managed loan administration group also has oversight for documentation, compliance and timeliness of collection activities. Our outsourced internal audit firm also reviews documentation, compliance and file management.

Commercial Lending

Our commercial lending consists of lines of credit, revolving credit facilities, accounts receivable and inventory financing, term loans, equipment loans, small business administration ("SBA") loans, stand-by letters of credit and unsecured loans. We originate commercial loans for any business purpose, including the financing of leasehold improvements and equipment, the carrying of accounts receivable, general working capital, contract administration and acquisition activities. These loans typically have maturities of seven years or less. We have a diverse client base and we do not have a concentration of these types of loans in any specific industry segment. We generally secure commercial business loans with accounts receivable and inventory, equipment, indemnity deeds of trust and other collateral such as marketable securities, cash value of life insurance, and time deposits at Howard Bank. Commercial business loans have a higher degree of risk than residential mortgage loans because the availability of funds for repayment generally depends on the success of the business. To help manage this risk, we establish parameters/covenants at the inception of the loan to provide early warning systems before payment default. We normally seek to obtain appropriate collateral and personal guarantees from the borrower's principal owners. We are able, given our business model, to proactively monitor the financial condition of the business.

Commercial Mortgage Lending

We finance commercial real estate for our clients, for both owner-occupied properties and investment properties (including residential properties). We generally will finance owner occupied commercial real estate at a maximum loan-to-value of 85% and non-owner occupied at a maximum loan-to-value of 80%. Our underwriting policies and processes focus on the underlying credit of the owner for owner occupied real estate and on the rental income stream (including rent terms and strength of tenants) for non-owner occupied real estate as well as an assessment of the underlying real estate. Risks inherent in managing a commercial real estate portfolio relate to vacancy rates/absorption rates for surrounding properties, sudden or gradual drops in property values as well as changes in the economic climate. We attempt to mitigate these risks by carefully underwriting loans of this type as well as by following appropriate loan-to-value standards. We are cash flow lenders and never rely solely on property valuations in reaching a lending decision. Personal guarantees are often required for commercial real estate loans as they are for other commercial loans. Most of our real estate loans carry fixed interest rates and amortize over 20 to 25 years but have five- to seven-year maturities. Properties securing our commercial real estate loans primarily include office buildings, office condominiums, distribution facilities and manufacturing plants. Substantially all of our commercial real estate loans are secured by properties located in our market area.

Commercial real estate loans generally carry higher interest rates and have shorter terms than one- to four-family residential mortgage loans. Commercial real estate loans, however, entail significant additional risks as compared with residential mortgage lending, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment of loans secured by income-producing properties typically depends on the successful operation of the property, as repayment of the loan generally is dependent, in large part, on sufficient income from the property to cover operating expenses and debt service. Changes in economic conditions that are not in the control of the borrower or lender could affect the value of the collateral for the loan or the future cash flow of the property. Additionally, any decline in real estate values may be more pronounced for commercial real estate than residential properties.

Construction Lending

Construction lending can cover funding for land acquisition, land development and/or construction of residential or commercial structures. Our construction loans generally bear a variable rate of interest and have terms of one to two years. Funds are advanced on a percentage-of-completion basis. These loans are generally repaid at the end of the development or construction phase, although loans for both residential and commercial construction will often convert into a permanent mortgage loan at the end of the term of the loan. Loan to value parameters range from 65% of the value of land to 75% for developed land, 80% for commercial or multifamily construction and 85% for residential construction. These loan-to-value ratios represent the upper limit of advance rates to remain in compliance with Bank policy. Typically, loan-to-value ratios should be somewhat lower than these upper limits, requiring the borrower to provide significant equity at the inception of the loan. Our underwriting looks not only at the value of the property but the expected cash flows to be generated by sale of the parcels or completed construction. The borrower must have solid experience in this type of construction and personal guarantees are usually required.

Construction lending entails significant risks compared with residential mortgage lending. These risks involve larger loan balances concentrated with single borrowers with funds advanced upon the security of the land or the project under construction. The value of the project is estimated prior to the completion of construction. Thus, it is more difficult to evaluate accurately the total loan funds required to complete a project and related loan to value ratios. If the estimate of construction or development cost proves to be inaccurate, we may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment. To mitigate these risks, in addition to the underwriting considerations noted above, we maintain an in-house construction monitoring unit that has oversight for the projects and we require both site visits and frequent reporting before funds are advanced.

Residential Mortgage Lending

We offer a variety of consumer-oriented residential real estate loans. Residential mortgage loans consist primarily of first mortgage loans to individuals, most of which have a loan to value not exceeding 85%. The remainder of this portion of our portfolio consists of home equity lines of credit and fixed rate home equity loans.

Our residential mortgage loans are generally for owner-occupied single family homes. These loans are generally for a primary residence although we will occasionally originate loans for a second home where the borrower has extremely strong credit. We originate adjustable rate residential mortgage loans with initial fixed-rate terms of five to seven years, as well as fixed rate residential mortgage loans with primarily 15- or 30-year terms.

Our home equity loans and home equity lines of credit are primarily secured by a second mortgage on owner occupied one-to four-family residences. Our home equity loans are originated at fixed interest rates and with terms of between five and 30 years for primary residences and between five and 15 years for secondary and rental properties, and are fully amortizing. Our home equity lines allow for the borrower to draw against the line for ten years, after which the line is refinanced into a ten-year fixed loan, with the possibility of a one-time extension of five years. Home equity lines of credit carry a variable rate of interest and minimum monthly payments during the draw period, which are the greater of (i) \$50.00 or (ii) depending on credit score, loan-to-value and debt-to-income ratios, either the interest due or interest due plus 1% of the outstanding loan balance. Home equity loans and lines of credit are generally underwritten with a maximum loan-to-value ratio of 85% (80% when appraised value is greater than \$1 million) for a primary residence when combined with the principal balance of the existing mortgage loan; for home equity loans on secondary and rental properties, the maximum loan-to-value ratio is 65%. We require appraisals on all real estate loans – both commercial and residential. At the time we close a home equity loan or line of credit, we record a mortgage to perfect our security interest in the underlying collateral.

Home equity loans and lines of credit generally have greater risk than one- to four-family residential mortgage loans. In these cases, we face the risk that collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance. In particular, because home equity loans are secured by second mortgages, decreases in real estate values could adversely affect the value of the property serving as collateral for these loans. Thus, the recovery of such property could be insufficient to repay us for the value of these loans.

Loans secured by second mortgages have greater risk than owner-occupied residential loans secured by first mortgages. When customers default on their loans we attempt to foreclose on the property. However, the value of the collateral may not be sufficient to repay the amount of the unpaid loan, and we may be unsuccessful in recovering the remaining balance from these customers. In addition, decreases in property values could adversely affect the value of properties used as collateral for the loans. These second lien loans represent a smaller portion of our portfolio than our first lien residential mortgage loans.

Our home equity and home improvement loan portfolio gives us a diverse client base. Although most of these loans are in our primary market area, the diversity of the individual loans in the portfolio reduces our potential risk.

Consumer Lending

We offer various types of secured and unsecured consumer loans. Generally, our consumer loans are made for personal, family or household purposes as a convenience to our customer base. As a general guideline, a consumer's total debt service should not exceed 40% of their gross income. The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of his or her ability to meet existing obligations and payments on the proposed loan.

Consumer loans may present greater credit risk than residential mortgage loans because many consumer loans are unsecured or are secured by rapidly depreciating assets. Repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance because of the greater likelihood of damage, loss or depreciation. Consumer loan collections also depend on the borrower's continuing financial stability. If a borrower suffers personal financial difficulties, the loan may not be repaid. Also, various federal and state laws, including bankruptcy and insolvency laws, may limit the amount we can recover on such loans.

Loan Originations, Purchases, Sales, Participations and Servicing

All loans that we originate are underwritten pursuant to our policies and procedures, which incorporate standard underwriting guidelines. We originate both fixed and variable rate loans. Our loan origination activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand. We generally retain in our portfolio the majority of loans that we originate, except for first lien residential mortgage loans where we sell the majority of the loans into the secondary market. We do not retain the servicing rights on sold loans.

We occasionally sell participations in commercial loans to correspondent banks if the amount of the loan exceeds our internal limits. More rarely, we purchase loan participations from correspondent banks in the local market as well. Those loans are underwritten in-house with the same care of loans directly originated.

Loan Approval Procedures and Authority

Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our board of directors. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan, and the adequacy of the value of the collateral that will secure the loan, if applicable. To assess a business borrower's ability to repay, we review and analyze, among other factors, current income, credit history including the Bank's prior experience with the borrower, cash flow, any secondary sources of repayment, other debt obligations in regards to the equity/net worth of the borrower and collateral available to the Bank to secure the loan.

We require appraisals of all real property securing one- to four-family residential and commercial real estate loans and home equity loans and lines of credit. All appraisers are state-licensed or state-certified appraisers, and our practice is to have local appraisers approved by our board of directors annually.

Mortgage Banking

Our residential mortgage loans consist of residential first and second mortgage loans, residential construction loans and home equity lines of credit and term loans secured by the residences of borrowers. Borrowers use second mortgage and home equity lines of credit for home improvements, education and other personal expenditures. We make mortgage loans with a variety of terms, including fixed, floating and variable interest rates, with maturities ranging from three months to 30 years.

In general, we make residential mortgage loans based on the borrower's ability to repay the loan from his or her salary and other income; such loans are secured by residential real estate, the value of which is generally readily ascertainable. We make these loans consistent with our appraisal and real estate lending policies, which detail maximum loan-to-value ratios and maturities. We generally make residential mortgage loans and home equity lines of credit secured by owner-occupied property within the guidelines of our regular purchasers of these loans.

Howard Bank generates revenue by providing an extensive line of consumer real estate products and services to customers nationwide. We offer products available to customers through a retail network of mortgage loan officers and bankers as well as a sales force offering our customers direct access to our products.

The Bank originates residential mortgage loans primarily as a correspondent lender. Activity in the residential mortgage loan market is highly sensitive to changes in interest rates and product availability. While the Bank does have delegated underwriting authority from most of its loan purchasers, at times it also employs the services of the purchaser to underwrite the loans. Because the loans are originated within purchaser guidelines and designated automated underwriting and product specific requirements as part of the loan application, the loans sold have a limited recourse provision. Most contracts with investors contain recourse periods. In general, the Bank may be required to repurchase a previously sold mortgage loan or indemnify the purchaser if there is non-compliance with defined loan origination or documentation standards, including fraud, negligence or material misstatement in the loan documents. In addition, the Bank may have an obligation to repurchase a loan if the mortgagor has defaulted early in the loan term. The potential default repurchase period varies by purchaser but can be up to approximately 12 months after sale of the loan to the purchaser. The recourse period for fraud, material misstatement, breach of representations and warranties, noncompliance with law, or similar matters could be as long as the term of the loan. Mortgages subject to recourse are collateralized by single-family residential properties, follow purchaser guidelines, and carry private mortgage insurance, where applicable.

The Bank enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitments). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. To protect against the price risk inherent in residential mortgage loan commitments, the Bank utilizes “best efforts” in delivering to purchasers. Under a “best efforts” contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to a purchaser and the purchaser commits to a price that it will purchase the loan from the Bank if the loan to the underlying borrower closes. The Bank protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the purchaser commits to purchase a loan at a price representing a premium on the day the borrower commits to an interest rate with the intent that the purchaser has assumed the interest rate risk on the loan. As a result, the Bank is not generally exposed to losses on loans sold utilizing best efforts. Nor will it realize gains related to rate lock commitments due to changes in interest rates. The market values of rate lock commitments and best efforts contracts are not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded. Because of the high correlation between rate lock commitments and best efforts contracts, we do not expect to incur any gain or loss on the rate lock commitments.

Investments and Funding

We balance our liquidity needs based on loan and deposit growth via the investment portfolio and both short- and long-term borrowings. It is our goal to provide adequate liquidity to support our loan growth. A portion of our investment portfolio is generally kept short-term securities for liquidity purposes, and a portion of the portfolio is used to generate additional positive earnings. The Bank’s primary source of funds is, and will continue to be, core deposits generated from our market area. Additional funding is provided by overnight unsecured master notes, customer repurchase agreements, Federal Home Loan Bank of Atlanta (“FHLB”) advances, the Board of Governors of the Federal Reserve (the “FRB”) Discount Window, subordinated debentures and other purchased funds. Other purchased funds may include certificates of deposit (“CDs”) over \$100,000, federal funds purchased, and institutional or brokered deposits. Lines of credit are maintained to protect liquidity levels resulting from unexpected deposit withdrawals and natural-market credit demand.

Our investment policy is reviewed annually by our board of directors. Our board of directors has appointed its Board Asset Liability Committee to serve as the Investment Committee, and the Board Asset Liability Committee therefore meets at regular intervals (not less than quarterly) and provides a report on the investment portfolio performance to our full board of directors. The investment officer is designated by the CEO and is responsible for managing the day-to-day activities of the liquidity and investments in accordance with the policies approved by our board of directors. We actively monitor our investment portfolio and we classify the majority of the portfolio as “available for sale.” In general, under such a classification, we may sell investment instruments as management deems appropriate.

Other Banking Products

We offer our customers wire transfer services, ATM and check cards, automated teller machines (“ATMs”) at all of our branch locations, safe deposit boxes at most branches and credit cards through a third party processor. Additionally, we provide Internet banking capabilities to our customers and merchant card services for our business customers. With our Internet banking service, our customers may view their accounts on line and electronically remit bill payments including an option for same day payment. Our commercial account services include an overnight sweep service and remote deposit capture service.

We complement our existing Internet banking services with Mobiliti Mobile Banking, PopMoney and eStatement products. These state of the art products provide the Bank's consumer customers the ability to view account information and pay bills from their mobile device, easily make payments directly to individuals and, with eStatements, to replace their paper monthly statement with an electronically delivered statement.

Deposit Activities

Deposits are the major source of our funding. We offer a broad array of consumer and business deposit products that include demand, money market, savings and individual retirement accounts, as well as CDs. We offer through key technology partnerships a competitive array of commercial cash management products, which in combination with our in-house courier service and remote deposit/check imaging service, allow us to attract demand deposits. We believe that we pay competitive rates on our interest bearing deposits. As a relationship-oriented organization, we generally seek to obtain deposit relationships with our loan clients.

We also use customer repurchase agreements, FHLB advances, the FRB Discount Window and other purchased funds as a funding mechanism. Other purchased funds may include CDs over \$100,000, federal funds purchased and institutional or brokered deposits.

Employees

Howard Bank has 331 full-time and six part-time employees as of December 31, 2018. None of our employees are represented by any collective bargaining unit, and we believe that relations with our employees are good. Howard Bancorp has no employees.

Lending Limit

The Bank's legal lending limit for loans to one borrower was \$31.8 million as of December 31, 2018, and we further monitor our exposure to one borrower through a policy to limit our "in-house" lending limit to \$25.0 million as of December 31, 2018, which in-house limit can be exceeded on a limited basis. As part of our risk management strategy, we may attempt to participate a portion of larger loans to other financial institutions. This strategy allows us to maintain customer relationships yet observe the legal lending limit and manage credit exposure. However, this strategy may not always be available.

Competition

Our primary market area is highly competitive and heavily branched by other financial institutions of all sizes. We also compete with Internet-based banks. Competition for loans to small- and medium-sized businesses and their owners, professionals and executives, and high-net-worth individuals is intense, and pricing is important. We believe that acquisitions of several local competitors by larger institutions headquartered outside of the State of Maryland during the last several years have enhanced the Bank's position as a locally headquartered and managed community bank, but many of these competitors now have substantially greater resources and lending limits than we do and offer services, such as extensive and established branch networks and trust services, that we do not expect to provide in the near future or ever. Moreover, larger institutions operating in our primary market area may have access to borrowed funds at a lower rate than is available to us. Deposit competition is also strong among institutions in our primary market area.

However, recent mergers of other area banks into large regional and national financial institutions have created opportunities for community-focused and prudently managed community banks. While our board of directors is aware of the competition that these larger institutions and alternative providers of financial services offer, we believe that local independent banks play and will continue to play a significant role in our primary market area. Our board of directors believes it is a significant and distinct advantage to be a locally owned and operated state bank interested in serving the needs of small- and medium-sized businesses and their owners, professionals and executives, and high-net-worth individuals.

SUPERVISION AND REGULATION

Howard Bancorp, Inc.

We are a bank holding company under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). We are subject to regulation and examination by the FRB and the Commissioner, and are required to file periodic reports and any additional information that the FRB and the Commissioner may require. In addition, the FRB and the Commissioner have enforcement authority over Howard Bancorp, which includes the power to remove officers and directors and the authority to issue cease and desist orders to prevent Howard Bancorp from engaging in unsafe or unsound practices or violating laws or regulations governing its business. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. Under this requirement, Howard Bancorp in the future could be required to provide financial assistance to Howard Bank should Howard Bank experience financial distress. In addition, in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company’s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice, a violation of FRB regulations or both. The FRB may require a bank holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the FRB’s determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the bank holding company. Further, federal bank regulatory authorities have additional discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution’s financial condition.

The BHC Act requires regulatory filings by a stockholder or other party that seeks to acquire direct or indirect “control” of a bank, as defined in the BHC Act. The determination whether an investor “controls” bank is based on all of the facts and circumstances surrounding the investment. As a general matter, a party is deemed to control a bank or other company if the party: (i) owns or controls 25% or more of any class of voting securities of the bank or other company; (ii) can elect or appoint a majority of the board of directors, or similar body, of the bank or other company; or (iii) exercises a “controlling influence” over the bank or other company. The FRB may require a company that owns between 5% and 25% of any class of voting securities of a bank or bank holding company to make certain non-control or “passivity” commitments. If a party were deemed to “control” Howard Bancorp for BHC Act purposes, the party would become a bank holding company and subject it to filing and other regulatory requirements.

Separately, an investor that owns or controls 10% or more of any class of voting stock of a bank or bank holding company and (i) the institution has registered securities under Section 12 of the Exchange Act and (ii) no other person owns, controls or has the power to vote a greater percentage of that class of voting securities is considered a “control” person under the Change in Bank Control Act (the “CIBC Act”) and may be required to file a change in control notice with the primary federal regulator of the bank or with the FRB. For the purposes of both the BHC Act and the CIBC Act, ownership by affiliated parties, or parties acting in concert, is typically aggregated.

Pursuant to provisions of the BHC Act and regulations promulgated by the FRB thereunder, Howard Bancorp may only engage in or own companies that engage in activities deemed by the FRB to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto, and the holding company must obtain permission from the FRB prior to engaging in most new business activities. In addition, bank holding companies like Howard Bancorp must be well capitalized and well managed in order to engage in the expanded financial activities permissible only for a financial holding company.

The FRB has adopted guidelines regarding the capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total assets and capital to risk weighted assets. See “— Capital Requirements.” The FRB has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the FRB’s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization’s capital needs, asset quality, and overall financial condition. Under the prompt corrective action rules, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of Howard Bancorp to pay dividends or otherwise engage in capital distributions.

The status of Howard Bancorp as a registered bank holding company under the BHC Act and a Maryland-chartered bank holding company does not exempt it from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

Howard Bank

Howard Bank is a Maryland-chartered trust company (with all powers of a commercial bank), and its deposit accounts are insured by the FDIC up to the maximum legal limits. It is subject to regulation, supervision and regular examination by the Commissioner and the FDIC. The regulations of these agencies govern most aspects of Howard Bank's business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends and location and number of branch offices. The laws and regulations governing Howard Bank generally have been promulgated to protect depositors and the FDIC's Deposit Insurance Fund ("DIF"), and not for the purpose of protecting Howard Bancorp or its stockholders.

Set forth below is a brief description of the material regulatory requirements that are or will be applicable to Howard Bank and Howard Bancorp. The description below is limited to the material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on Howard Bank and Howard Bancorp.

Financial Institutions Article of the Maryland Annotated Code

The Financial Institutions Article of the Maryland Annotated Code (the "Banking Code") contains detailed provisions governing the organization, operations, corporate powers, commercial and investment authority, branching rights and responsibilities of directors, officers and employees of Maryland banking institutions. The Banking Code delegates extensive rulemaking power and administrative discretion to the Commissioner in its supervision and regulation of state-chartered banking institutions. The Commissioner may order any banking institution to discontinue any violation of law or unsafe or unsound business practice.

Capital Requirements

Federal regulations require FDIC-insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio. The existing capital

requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”). These requirements may change significantly with the enactment in May 2018 of the Economic Growth, Regulatory Reform, and Consumer Protection Act (“EGRRCPA”), as explained below.

There are three main categories of capital under the capital adequacy guidelines. Common equity tier 1 capital consists of paid-in common stock, retained earnings and certain common equity Tier 1 minority interests. Various items, including certain amounts of goodwill, intangible assets, deferred tax assets, must be deducted from common equity Tier 1 before capital ratios are calculated. Tier 1 capital (which, together with common equity tier 1 capital, makes up Tier 1 capital) generally consists of perpetual preferred stock and, in certain circumstances and subject to certain limitations, minority investments in certain subsidiaries, less goodwill and other non-qualifying intangible assets, and certain other deductions. Tier 2 capital consists of perpetual preferred stock that is not otherwise eligible to be included as Tier 1 capital, hybrid capital instruments, term subordinated debt and intermediate-term preferred stock and, subject to limitations, general allowances for credit losses. At least half of total capital must consist of Tier 1 capital. Accumulated other comprehensive income (positive or negative) must be reflected in regulatory capital.

Additionally, subject to a transition schedule, the regulations limit a banking organization’s ability to make capital distributions, engage in share repurchases and pay certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The regulations also require unrealized gains and losses on certain “available-for-sale” securities holdings to be included for purposes of calculating regulatory capital unless Howard Bank elects to opt-out from this treatment, which it has.

The risk-based and leverage capital requirements and the capital conservation buffer may be replaced by a single capital requirement known as the community bank leverage ratio (“CBLR”). EGRRCPA provided that banks (and bank holding companies) with less than \$10 billion in total consolidated assets (and that meet certain other prerequisites) may, in place of the current requirements, hold enough tangible equity relative to average total consolidated assets sufficient to satisfy the CBLR standard. These banks would be deemed to meet all generally applicable capital requirements and to be well capitalized under the prompt corrective action regime (described further below). EGRRCPA directs the federal banking agencies to set the precise CBLR within a range of 8% to 10%. In November 2018, the agencies proposed a leverage ratio standard of 9.0%. We do not know if or when the agencies will finalize this rule. The Bank and the Company currently would both satisfy a 9.0% CBLR requirement.

Prompt Corrective Action

Under federal prompt corrective action regulations, the bank regulatory agencies are authorized and, under certain circumstances, required, to take various “prompt corrective actions” to resolve the problems of any bank subject to their jurisdiction that is not adequately capitalized. Depending on their capital levels, every insured depository institution is in one of five capital tiers: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the prompt corrective action regulations, a bank is considered “well capitalized” if

it: (i) has a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 8.0% or greater; (iii) a common equity Tier 1 ratio of 6.5% or greater; (iv) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. As of December 31, 2018, Howard Bank remained “well capitalized” for this purpose and its capital exceeded all applicable requirements. Well capitalized status is a prerequisite for certain types of favorable regulatory treatment, including expedited processing of applications by the FDIC and the ability to rely on brokered deposits.

Howard Bank has been “well capitalized” since it commenced its business operations.

The bank regulatory agencies may impose higher capital requirements on certain banks, and future regulatory change could impose higher capital standards as a routine matter. The regulators may also set higher capital requirements for holding companies whose circumstances warrant it. For example, holding companies experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

As an additional means to identify problems in the financial management of depository institutions, the Federal Deposit Insurance Act requires federal bank regulatory agencies to establish certain non-capital safety and soundness standards for institutions for which they are the primary federal regulator. The standards relate generally to operations and management, asset quality, interest rate exposure and executive compensation. The agencies are authorized to take action against institutions that fail to meet such standards.

Dividends

Howard Bancorp is a legal entity separate and distinct from Howard Bank. Virtually all of Howard Bancorp’s revenue available for the payment of dividends on its common stock results from dividends paid to Howard Bancorp by Howard Bank. Under Maryland law, Howard Bank may declare a cash dividend, after providing for due or accrued expenses, losses, interest and taxes, from its undivided profits or, with the prior approval of the Commissioner, from its surplus in excess of 100% of its required capital stock. Also, if Howard Bank’s surplus is less than 100% of its required capital stock, then, until its surplus is 100% of its capital stock, Howard Bank must transfer to its surplus annually at least 10% of its net earnings and may not declare or pay any cash dividends that exceed 90% of its net earnings. Howard Bank generally may not pay a dividend if, as a result of the dividend, it would be undercapitalized. While the 2.5% capital conservation buffer requirement remains in place, Howard Bank’s ability to pay dividends would be restricted if it failed to maintain the buffer. In addition to these specific restrictions, the bank regulatory agencies have the ability to prohibit or limit proposed dividends if such regulatory agencies determine the payment of such dividends would result in Howard Bank being in an unsafe and unsound condition.

Deposit Insurance Assessments

Howard Bank’s deposit accounts are insured by the FDIC generally up to a maximum of \$250,000 per separately insured depositor. FDIC-insured depository institutions are required to pay deposit insurance assessments to the FDIC. The amount of a particular institution’s deposit insurance assessment is determined by an FDIC risk-based assessment system. The assessment is a function of a financial ratios method that takes into account seven financial ratios and the

institution's weighted average CAMELS component ratings. The assessment must be within a range that depends on the institution's composite CAMELS rating, and the assessment will be adjusted up or down to come within the range. Assessment rates (inclusive of possible adjustments) currently range from 1.5 to 30 basis points of each institution's total assets less tangible capital. The FDIC may increase or decrease the range of assessments uniformly, except that no adjustment can deviate more than two basis points from the base assessment rate without notice and comment rulemaking. The FDIC's current system represents a change, required by the Dodd-Frank Act, from its prior practice of basing the assessment on an institution's aggregate deposits. The FDIC may terminate insurance of deposits upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The FDIC has recently provided a preliminary notification to banks with less than \$10 billion in assets, that they may be eligible for assessment credits as the size of the Deposit Insurance Fund ("DIF") has exceeded predefined levels (a 1.35% DIF ratio). However these credits will not be awarded until the DIF ratio exceeds 1.38%, which as of December 31, 2018 had not yet occurred. Thus, while there exists a chance that FDIC insured institutions may receive credits against future assessments, the triggering event for this has not yet occurred, and there is no assurance that it is likely to occur in the future.

Maryland Regulatory Assessment

The Commissioner annually assesses state banking institutions to cover the expense of regulating banking institutions. The Bank's asset size determines the amount of the assessment.

Liquidity

Howard Bank is subject to the reserve requirements imposed by the State of Maryland. A Maryland banking institution is required to have at all times a reserve equal to at least 15% of its demand deposits. Howard Bank is also subject to the uniform reserve requirements of the FRB's Regulation D, which applies to all insured depository institutions with transaction accounts or non-personal time deposits. During 2018, amounts in transaction accounts above \$16.3 million and up to \$107.9 million were required to have reserves held against them in the ratio of 3% of such amounts. Amounts above \$107.9 million required reserves of \$3.2 million plus 10% of the amount in excess of \$107.9 million. The FRB changes its reserve requirements on an annual basis and Howard Bank is subject to new requirements for 2019. Howard Bank was in compliance with its reserve requirements at December 31, 2018 and is in compliance with its current reserve requirements.

Loans-to-One-Borrower Limitation

With certain limited exceptions, a Maryland banking institution may lend to a single or related group of borrowers an aggregate amount no more than 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by readily marketable collateral, which is defined to include certain securities and bullion, but generally does not include real estate. Howard Bank is in compliance with the loans-to-one borrower limitations.

Commercial Real Estate Loans

Commercial real estate loans are subject to two types of regulatory oversight. If total reported loans for construction, land development, and other land represent more than 100% of a bank's total capital or if total CRE loans represent 300% or more of total capital and have grown by 50% or more in the last 36 months, the bank is expected to have enhanced risk management and will be subject to greater regulatory scrutiny. In addition, the risk-based capital rules (so long as they are applicable) presumptively risk weight commercial real estate loans at 100% but impose a 150% risk weight on loans deemed to be high volatility. Among other things, the capital rules required that a borrower contribute 15% of the equity of a financed project in order for the loan to qualify for the lower risk weight. EGRRCPA narrowed the types of loans potentially subject to the higher risk weight but did not eliminate that risk weight.

Community Reinvestment Act and Fair Lending Laws

Under the Community Reinvestment Act of 1977 ("CRA"), the FDIC is required to assess the record of all financial institutions regulated by it to determine if such institutions are meeting the credit needs of the communities (including low and moderate income neighborhoods) that they serve. CRA performance evaluations are based on a four-tiered rating system: Outstanding, Satisfactory, Needs to Improve and Substantial Noncompliance. CRA performance evaluations are considered in evaluating applications for such things as mergers, acquisitions and new branches. Howard Bank has a CRA rating of "Satisfactory." In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics, such as ethnicity, gender, and race, as specified in each statute. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the FDIC, the Department of Housing and Urban Development, and the Department of Justice, and in private civil actions by borrowers.

Transactions with Related Parties

Transactions between banks and their related parties or affiliates are limited by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies which are controlled by such parent holding company are affiliates of the bank.

Generally, Section 23A of the Federal Reserve Act and the FRB's Regulation W limit the "covered transactions" in which a bank or its subsidiaries may engage with any one affiliate to an amount equal to 10.0% of such bank's capital stock and surplus, and limit such covered transactions with all affiliates to an amount equal to 20.0% of such bank's capital stock and surplus. The term "covered transaction" includes loans, asset purchases, issuances of guarantees, and other similar transactions that expose the bank to the credit risk of an affiliate. In addition, loans or other extensions of credit by the bank to an affiliate must be collateralized in accordance with regulatory requirements. The bank's transactions with affiliates must be consistent with safe and sound banking practices and may not involve the purchase by the bank of any low-quality asset. Section 23B applies to covered transactions as well as certain other transactions and requires that all such transactions be on terms substantially the same, or at least as favorable, to the bank or subsidiary as those provided to non-affiliates.

Section 22(h) of the Federal Reserve Act and the FRB's Regulation O govern extensions of credit made by a bank to its directors, executive officers, and principal stockholders ("insiders"). Among other things, these provisions require that extensions of credit to insiders be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features. Further, such extensions may not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Howard Bank's capital. Extensions of credit in excess of certain limits must also be approved by the board of directors.

Standards for Safety and Soundness

Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. Interagency guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to implement an acceptable compliance plan. Failure to implement such a plan can result in further enforcement action, including the issuance of a "cease and desist" order or the imposition of civil money penalties.

Anti-Money Laundering and OFAC

Under federal law, financial institutions must maintain programs to prevent money laundering and the financing of terrorism that include established internal policies, procedures and controls; a designated compliance officer; an ongoing employee training program; testing of the program by an independent audit function; and a “know your customer” program with enhanced due diligence of certain customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering; they must file currency transaction reports for deposits and withdrawals of large amounts of currency and suspicious activity reports of possible criminal activity. Financial institutions also must assess their money laundering risk with respect to private banking and foreign correspondent banking relationships. Law enforcement authorities have been granted increased access to financial information maintained by financial institutions. Bank regulators routinely examine institutions for compliance with these obligations, and they must consider an institution’s compliance in connection with the regulatory review of applications, including applications for banking mergers and acquisitions. The regulatory authorities have imposed “cease and desist” orders and civil money penalty sanctions against institutions found to be violating these obligations.

Bank Secrecy Act and anti-money laundering compliance has been a special focus of the Office of Comptroller of the Currency and the other Federal banking agencies in recent years. Any non-compliance is likely to result in an enforcement action, often with substantial monetary penalties and reputation damage. A savings association or bank that is required to strengthen its compliance program often must put on hold any initiatives that require banking agency approval.

The Office of Foreign Assets Control, (“OFAC”) is responsible for helping to ensure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC sends bank regulatory agencies lists of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. If Howard Bancorp or Howard Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, Howard Bancorp or Howard Bank must freeze such account, file a suspicious activity report and notify the appropriate authorities.

Consumer Protection Laws

Howard Bank is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy. These laws include the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, and the Real Estate Settlement Procedures Act, and various state law counterparts. Further, the Dodd-Frank Act established the Consumer Financial Protection Bureau (“CFPB”), which has the responsibility for making rules and regulations under the federal consumer protection laws relating to financial products and services.

The CFPB also has a broad mandate to prohibit unfair, deceptive or abusive acts and practices and is specifically empowered to require certain disclosures to consumers and draft model disclosure forms. Failure to comply with consumer protection laws and regulations can subject financial institutions to enforcement actions, fines and other penalties. The FDIC will examine Howard Bank for compliance with CFPB rules and will enforce CFPB rules with respect to Howard Bank.

In addition, federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution's policies and practices regarding the handling of customers' nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, a financial institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure. Further, under the "Interagency Guidelines Establishing Information Security Standards," banks must implement a comprehensive information security program that includes administrative, technical, and physical safeguards to ensure the security and confidentiality of customer information. Federal law makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The FRB's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through the FRB's power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the FRB affect the levels of bank loans, investments and deposits through the FRB's control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

Federal and State Securities Laws

Our common stock is registered with the SEC under the Exchange Act. As such, we are subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Exchange Act.

Further, if we wish to sell common stock or other securities to raise capital in the future, we will be subject to the registration, anti-fraud, and other applicable provisions of state and federal securities laws. For example, we will have to register the sales of such securities under the Securities Act, the Maryland Securities Act, and the applicable securities laws of each state in which we offer or sell the securities, unless an applicable exemption from registration exists with respect to such sales. Such exemptions may, among other things, limit the number and types of persons we could sell such securities to and the manner in which we could market the securities. We would also be subject to federal and state anti-fraud requirements with respect to any statements we make to potential purchasers in connection with the offer and sale of such securities.

Sarbanes-Oxley Act of 2002

The Sarbanes Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. We have prepared policies, procedures and systems designed to ensure compliance with the Sarbanes Oxley Act and related regulations.

London Inter-Bank Offered Rate (“LIBOR”)

In 2017, a committee of private-market derivative participants and their regulators convened by the Federal Reserve, the Alternative Reference Rate Committee (“ARRC”), was created to identify an alternative reference interest rate to replace LIBOR.

The ARRC announced the Secured Overnight Funding Rate (“SOFR”), a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as its preferred alternative to LIBOR. The Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. Subsequently, the FRB announced final plans for the production of SOFR, which resulted in the commencement of its published rates by the Federal Reserve Bank of New York on April 2, 2018. The Company has contracts, including loan and derivative contracts, that are currently indexed to LIBOR and are monitoring these developments and evaluating related risks.

Item 1A. Risk Factors

You should consider carefully the following risks, along with the other information contained in and incorporated into this annual report. The risks and uncertainties described below are not the only ones that may affect us. Additional risks and uncertainties also may adversely affect our business and operations. If any of the following events actually

occur, our business and financial results could be materially adversely affected.

Risk Factors Relating to Our Business and Our Common Stock

Because our loan portfolio consists largely of commercial business and commercial real estate loans, our portfolio carries a higher degree of risk than would a portfolio composed primarily of residential mortgage loans.

Our loan portfolio is made up largely of commercial business loans and commercial real estate loans, most of which is collateralized by real estate. These types of loans generally expose a lender to a higher degree of credit risk of non-payment and loss than do residential mortgage loans because of several factors, including dependence on the successful operation of a business or a project for repayment, the collateral securing these loans may not be sold as easily as residential real estate, and loan terms with a balloon payment rather than full amortization over the loan term. In addition, commercial real estate and commercial loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Underwriting and portfolio management activities cannot completely eliminate all risks related to these loans. Any significant failure to pay on time by our customers or a significant default by our customers would materially and adversely affect us.

We make both secured and some unsecured commercial and industrial loans. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is wholly dependent upon the success of the borrowers' businesses. Secured commercial and industrial loans are generally collateralized by accounts receivable, inventory, equipment or other assets owned by the borrower and include a personal guaranty of the business owner. Compared to real estate, that type of collateral is more difficult to monitor, its value is harder to ascertain, it may depreciate more rapidly and it may not be as readily saleable if repossessed. Further, commercial and industrial loans generally will be serviced primarily from the operation of the business, which may not be successful, and commercial real estate loans generally will be serviced from income on the properties securing the loans.

While any declines in the value of our real estate collateral securing loans have been reflected in existing reserves, the discounts and reserves we have taken against our loan portfolio based on our internal review of economic conditions and their impact on real estate values in our market areas may be insufficient. Further deterioration in the real estate market or a prolonged economic recovery could adversely affect the value of the properties securing the loans or revenues from borrowers' businesses, thereby increasing the risk of non-performing loans and increased portfolio losses that could materially and adversely affect us.

The small businesses that make up the majority of our commercial borrowers generally do not have the cash reserves to help cushion them from an economic slowdown to the same extent that large borrowers do and thus may be more

heavily impacted by an economic downturn. A continued sluggish economy or another economic slowdown may have a negative effect on the ability of our commercial borrowers to make timely repayments of their loans, which could have an adverse impact on our earnings.

Construction loans are subject to risks during the construction phase that are not present in standard residential real estate and commercial real estate loans. These risks include:

- the viability of the contractor;
- the value of the project being subject to successful completion;
- the contractor's ability to complete the project, to meet deadlines and time schedules and to stay within cost estimates;
- and
- concentrations of such loans with a single contractor and its affiliates.

Real estate construction and land loans also present risks of default in the event of declines in property values or volatility in the real estate market during the construction phase. If we are forced to foreclose on a project prior to completion, we may not be able to recover the entire unpaid portion of the loan, may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate amount of time. If any of these risks were to occur, it could adversely affect our financial condition, results of operations and cash flows.

The federal banking agencies have issued guidance regarding high concentrations of commercial real estate loans within bank loan portfolios. The guidance requires financial institutions that exceed certain levels of commercial real estate lending compared with their total capital to maintain heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. If there is any deterioration in our commercial real estate or real estate construction and land portfolios or if our regulators conclude that we have not implemented appropriate risk management practices, it could adversely affect our business and result in a requirement of increased capital levels, and such capital may not be available at that time.

We are subject to security and operational risks relating to our use of technology that could damage our reputation and our business.

We are subject to certain operational risks including, but not limited to, data processing system failures and errors, inadequate or failed internal processes, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We rely heavily on data processing, software, communication, and information systems on a variety of computing platforms and networks and over the Internet to conduct our business. Despite instituted safeguards, we cannot be certain that all of our systems are entirely free from vulnerability to attack or other technological difficulties or failures. Information security risks have increased significantly due to the use of online, telephone and mobile banking channels by clients and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. Our technologies, systems, networks and our clients' devices have been subject to, and are likely to continue to be the target of, cyber-attacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse,

loss or destruction of our or our clients' confidential, proprietary and other information, the theft of client assets through fraudulent transactions or disruption of our or our clients' or other third parties' business operations. System failure or errors, security breaches in our Internet banking activities or other communication and information systems, or other technology difficulties or failures, could result in information being lost or misappropriated, interrupt of our operations, damage our reputation, result in a loss of customer business, cause us to incur expenses to rectify, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations. We rely on standard Internet and other security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from damage or compromises or breaches of our security measures. We continue to monitor developments in this area and consider whether additional protective measures are necessary or appropriate, and we have obtained insurance protection intended to cover losses due to network security breaches; there is no guarantee, however, that such insurance would cover all costs associated with any breach, damage or failure of our computer systems and network infrastructure.

We rely on certain external vendors. Our business is dependent on the use of outside service providers that support our day-to-day operations including data processing and electronic communications.

Our business is dependent on the use of outside service providers that support our day-to-day operations including data processing and electronic communications. Our operations are exposed to the risk that a service provider may not perform in accordance with established performance standards required in our agreements for any number of reasons including equipment or network failure, a change in their senior management, their financial condition, their product line or mix and how they support existing customers, or a simple change in their strategic focus. While we have comprehensive policies and procedures in place to mitigate risk at all phases of service provider management from selection to performance monitoring and renewals, the failure of a service provider to perform in accordance with contractual agreements could be disruptive to our business, which could have a material adverse effect on our financial conditions and results of operations.

Because our loan portfolio includes residential real estate loans, our earnings are sensitive to the credit risks associated with these types of loans.

We originate and retain in our portfolio residential mortgage loans and intend to increase our origination of these types of loans. While residential real estate loans are more diversified than loans to commercial borrowers, and our local real estate market and economy have performed better than many other markets, a downturn could cause higher unemployment, more delinquencies, and could adversely affect the value of properties securing loans in our portfolio. In addition, should values begin to decline again, the real estate market may take longer to recover or not recover to previous levels. These risks increase the probability of an adverse impact on our financial results as fewer borrowers would be eligible to borrow and property values could be below necessary levels required for adequate coverage on the requested loan.

Our residential lending department may not continue to provide us with significant noninterest income.

We sell in the secondary market most residential mortgage loans that we originate, earning noninterest income in the form of gains on sale and fees in connection with originating these loans. The residential mortgage business is highly competitive and highly susceptible to changes in market interest rates, consumer confidence levels, employment statistics, the capacity and willingness of secondary market purchasers to acquire and hold or securitize loans, and other factors beyond our control. Additionally, in many respects, the mortgage origination business is relationship-based and dependent on the services of individual mortgage loan officers. The loss of services of one or more loan officers could have the effect of reducing the level of our mortgage production or the rate of growth of production. Further, when interest rates rise the demand for mortgage loans tends to fall and may reduce the number of loans available for sale. In addition to interest rate levels, weak or deteriorating economic conditions also tend to reduce loan demand. As a result of these factors we cannot be certain that we will be able to continue to increase the volume or percentage of revenue or net income produced by the residential mortgage business.

Our financial condition, earnings and asset quality could be adversely affected if we are required to repurchase loans originated for sale by our residential lending department.

As discussed in “Item 1. Business — Mortgage Banking,” most loans that we sell in the secondary market are with recourse. Therefore, we may be required to repurchase a previously sold mortgage loan or indemnify the purchaser if there is non-compliance with defined loan origination or documentation standards, including fraud, negligence or material misstatement in the loan documents, if the mortgagor has defaulted early in the loan term, or noncompliance with applicable law. While to date we have had to repurchase only a minimal amount of loans previously sold, should repurchases become a material issue, our earnings and asset quality could be adversely impacted, which could adversely impact the market price of our common stock.

If our allowance for credit losses is not sufficient to cover actual loan losses, our earnings would decrease.

We maintain an allowance for credit losses that we believe is adequate for absorbing any potential losses in our loan portfolio. Management, through a periodic review and consideration of our loan portfolio, determines the amount of the allowance for credit losses. We cannot, however, predict with certainty the amount of probable losses in our portfolio or be sure that our allowance will be adequate in the future. If management's assumptions and judgments prove to be incorrect and the allowance for credit losses is inadequate to absorb future losses, our losses will increase and our earnings will suffer.

In particular, it is more difficult to estimate loan losses for those types of loans - commercial and commercial real estate - that constitute the majority of our portfolio as compared to, for example, residential mortgage loans. Also, because these types of loans tend to have large loan balances, a loss on a single loan could have a significant adverse effect on our operations.

We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for credit losses, we review our loans and our loss and delinquency experience, and we evaluate economic conditions. If our assumptions are incorrect, our allowance for credit losses may not be sufficient to cover probable incurred losses in our loan portfolio, resulting in additions to the allowance and a corresponding decrease to earnings. Material additions to the allowance could materially decrease our net income. If delinquencies and defaults should increase, we may be required to further increase our provision for loan losses.

In addition, if the loans we acquired in our acquisition of First Mariner do not perform as we have estimated, our allowance for credit losses may not be adequate. See "We have, relatively limited or no experience with the performance of loans acquired in our acquisition of First Mariner. Certain of our estimates related to accounting for acquired loans may differ from actual results," below.

Significant increases to our allowance materially decrease our net income. In addition, bank regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or recognize further loan charge-offs to the allowance for credit losses. Any increase in the allowance for credit losses or loan charge-offs might have a material adverse effect on our financial condition and results of operations.

The Financial Accounting Standards Board has adopted a new accounting standard that will become effective for us on January 1, 2020. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans and recognize the expected credit losses as allowances for credit losses. This will change the current method of providing allowances for credit losses that are probable, which would likely require us to increase our allowance for credit losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for credit losses.

We have relatively limited experience with the performance of loans acquired in our recent acquisition of First Mariner. Certain of our estimates related to accounting for acquired loans may differ from actual results.

We acquired First Mariner on March 1, 2018. It is difficult to assess the future performance of loans recently added to our portfolio as part of this acquisition because our relatively limited experience with such loans does not provide us with a significant history from which to judge future collectability. These loans may experience higher delinquency or charge-off levels than our historical loan portfolio experience, which could adversely affect our future performance.

In addition, under generally accepted principles for business combinations, there is no loan loss allowance initially recorded for acquired loans, which are recorded at net fair value on the acquisition date. This net fair value generally includes embedded loss estimates for acquired loans with deteriorated credit quality. These estimates are based on projections of expected cash flows for these problem loans, which in many cases rely on estimates deriving from the liquidation of collateral.

If the estimates we have made regarding the performance of loans we have acquired are inaccurate, the fair value estimates may exceed the actual collectability of the balances, and this may result in the related loans being considered by us as impaired, which would result in a reduction in interest income. The tangible book value we measure is based in part on these estimates, and if fair value estimates differ from actual collectability, then subsequent earnings may also differ from original estimates. Measures of tangible book value and earnings impact of business combinations are frequently used in evaluating the merits and value of business combinations. Numerous assumptions and estimates are integral to purchased loan accounting, and actual results could be different from prior estimates.

Our growth strategy may not be successful, may be dilutive and may have other adverse consequences.

As previously mentioned, a key component of our growth strategy is to pursue acquisitions of other financial institutions or branches of other financial institutions. As consolidation of the banking industry continues, the competition for suitable acquisition candidates may increase. We compete with other banking companies for acquisition opportunities, and there are a limited number of candidates that meet our acquisition criteria.

Consequently, we may not be able to identify suitable candidates for acquisitions. If we are unable to locate suitable acquisition candidates willing to sell on terms acceptable to us, our net income could decline and we would be required to find other methods to grow our business. We may also open additional branches organically and expand into new markets or offer new products and services. These activities would involve a number of risks, including:

- the time and expense associated with identifying and evaluating potential acquisitions and merger partners; using inaccurate estimates and judgments to evaluate credit, operations, management and market risks with respect to the target institution or its branches or assets;
- diluting our existing stockholders in an acquisition;
- the time and expense associated with evaluating new markets for expansion, hiring experienced local management and opening new offices or branches as there may be a substantial time lag between these activities before we generate sufficient assets and deposits to support the costs of the expansion;
- operating in markets in which we have had no or only limited experience;
- taking a significant amount of time negotiating a transaction or working on expansion plans, resulting in management's time and attention being diverted from the operation of our existing business;
- we may not be able to correctly identify profitable or growing markets for new branches;
- the time and expense associated with integrating the operations and personnel of the combined businesses;
- the ability to realize the anticipated benefits of the acquisition;
- creating an adverse short-term effect on our results of operations;
- losing key employees and customers as a result of an acquisition that is poorly received;
- time and costs associated with regulatory approvals;

· lack of information on a target institution or its branches or assets;
· inability to obtain additional financing (including by issuing additional common equity), if necessary, on favorable terms or at all; and
· unforeseen adjustments, write-downs, write-offs or restructuring or other impairment charges.

In addition, we may not be able to integrate successfully or operate profitably any financial institutions we may acquire. We may experience disruption and incur unexpected expenses in integrating acquisitions. Any acquisitions we do make may not enhance our cash flows, business, financial condition, results of operations or prospects and may have an adverse effect on our results of operations, particularly during periods in which the acquisitions are being integrated into our operations.

Also, the costs to lease and start up new branch facilities or to acquire existing financial institutions or branches, and the additional costs to operate these facilities, may increase our noninterest expense. It also may be difficult to adequately and profitably manage the anticipated growth from the new branches. We can provide no assurance that any new branch sites will successfully attract a sufficient level of deposits and other banking business to offset their operating expenses.

Further, we plan to continue to make investments in our infrastructure in the future. We also currently plan to open additional branches in the areas where we now operate and in other markets over the next few years. We anticipate that this will have the short-term effect of, at least temporarily, increasing our expenses at a faster rate than revenue growth, which will have an adverse effect on net income.

If we grow too quickly and are not able to control costs and maintain asset quality, growth could materially and adversely affect our financial condition and results of operations. Further, we may not be successful in our growth strategy, which would negatively impact our financial condition and results of operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing consumers to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, which may increase as consumers become more comfortable with these new technologies and offerings, could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results

of operations.

Strong competition within our market area may limit our growth and profitability.

Competition in the banking and financial services industry within our market area is intense. In our market area, we compete with, among others, commercial banks, savings institutions, mortgage brokerage firms, credit unions, mutual funds, insurance companies and brokerage and investment banking firms operating locally and elsewhere. There are also a number of smaller community-based banks that pursue similar operating strategies as Howard Bank. In addition, some of our competitors have recently offered loans with lower fixed rates and on more attractive terms than we have been willing to offer. Our continued profitability depends upon our continued ability to successfully compete in our market area. The greater resources and broader range of deposit and loan products offered by our competition may limit our ability to increase our interest earning assets and profitability. See “Item 1. Business -Competition” for more information about competition in our market area.

We expect competition to remain intense in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Increased competition among financial services companies due to the recent consolidation of certain competing financial institutions may adversely affect our ability to market our products and services. Also, technological advances have lowered barriers to entry and made it possible for banks to compete in our market without a retail footprint by offering competitive rates and for non-banks to offer products and services that have traditionally been provided by banks. Additionally, due to their size, many of our competitors may offer a broader range of products and services as well as better pricing for certain products and services than we can, which could affect our ability to grow and remain profitable on a long-term basis. Our profitability depends upon our ability to successfully compete in our market area, and competition for deposits and the origination of loans could limit our ability to successfully implement our business plan, and could adversely affect our results of operations in the future. Further, if we must raise interest rates paid on deposits or lower interest rates charged on our loans, our net interest margin and profitability could be adversely affected.

Furthermore, competition in the banking and financial services industry is coming not only from traditional competitors but from technology-oriented financial services (“FinTech”) companies, which are subject to limited regulation. They offer user friendly front-end, quick turnaround times for loans and other benefits. While we are considering the possibility of developing relationships with FinTech companies for efficiency in processing and/or as a source of loans and other benefits, we cannot limit the possibility that our customers or future prospects will work directly with a FinTech company instead. This could impact our growth and profitability going forward.

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology driven by new or modified products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

We must comply with extensive and complex governmental regulation, which could have an adverse effect on our business and our growth strategy, and we may be adversely affected by changes in laws and regulations.

The banking industry is subject to extensive regulation by state and federal banking authorities. Many of these regulations are intended to protect depositors, the public or the FDIC insurance funds, not stockholders. Regulatory requirements affect our lending practices, capital structure, investment practices, dividend policy and many other aspects of our business. These requirements may constrain our operations, and changes in regulations could adversely affect us. The burden imposed by these federal and state regulations may place banks in general, and Howard Bank specifically, at a competitive disadvantage compared to less regulated competitors. In addition, the cost of compliance with regulatory requirements could adversely affect our ability to operate profitably or increase profitability. See “Supervision and Regulation” for more information about applicable banking laws and regulations. Further, if we are not in compliance with such requirements, we could be subject to fines or other regulatory action that could restrict our ability to operate or otherwise have a material adverse effect on our business and financial condition. Although we believe we are in material compliance with all applicable regulations, it is possible there are violations of which we are unaware that could be discovered by our regulators in the course of an examination or otherwise, which could trigger such fines or other adverse consequences.

Further, regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, classification of our assets and determination of the level of our allowance for credit losses. If regulators require Howard Bank to charge off loans or increase its allowance for credit losses, our earnings would suffer. Any change in such regulation and oversight, whether in the form of regulatory policy, regulation, legislation or supervisory action, may have a material impact on our operations. For a further discussion, see “Supervision and Regulation.”

In addition, because regulation of financial institutions changes regularly and is the subject of constant legislative debate, we cannot forecast how federal or state regulation of financial institutions may change in the future and impact our operations. Changes in regulation and oversight, including in the form of changes to statutes, regulations or regulatory policies or changes in interpretation or implementation of statutes, regulations or policies, could affect the services and products we offer, increase our operating expenses, increase compliance challenges and otherwise adversely impact our financial performance and condition. In addition, the burden imposed by these federal and state regulations may place banks in general, and Howard Bank specifically, at a competitive disadvantage compared to less regulated competitors.

The Company and the Bank have implemented an enhanced organizational structure to ensure that our risk management activities are scaled to the entire enterprise. The office of strategic risk management, reporting to an executive vice president with direct reporting to the CEO and a dotted line reporting to the full board, is responsible for credit, compliance and operational, physical and IT security, legal, reputational and other on and off balance sheet risks.

Further, as a public company, we incur significant legal, accounting, insurance and other expenses in connection with compliance with rules of the SEC and The Nasdaq Stock Market LLC.

Non-Compliance with the USA PATRIOT Act, the Bank Secrecy Act or other laws and regulations could result in fines or sanctions.

Financial institutions are required under the USA PATRIOT and Bank Secrecy Acts to develop programs to prevent financial institutions from being used for money-laundering and terrorist activities. Financial institutions are also obligated to file suspicious activity reports with Treasury's Department's Office of Financial Crimes Enforcement Network if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure or the inability to comply with these regulations could result in fines or penalties, curtailment of expansion opportunities, intervention or sanctions by regulators and costly litigation or expensive additional controls and systems. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. In addition, the U.S. Government has previously imposed laws and regulations relating to residential and consumer lending activities that create significant new compliance burdens and financial risks. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, we cannot assure you that these policies and procedures will be effective in preventing violations of these laws and regulations.

Adverse changes in economic conditions could adversely affect our business, results of operations and financial condition.

Our business and earnings are affected by general business conditions in the United States as well as in our local market area. We continue to operate in a challenging and uncertain economic environment. Since the recession ended almost nine years ago, economic growth has been slow by historic standards and uneven. Further, the current expansion is already the third longest in U.S. history, and many economists believe that the risk of a recession in the short-term (2020-2021) is increasing. A return to recessionary conditions or prolonged stagnant or deteriorating economic conditions could significantly affect the markets in which we do business, the demand for our products and services, the value of our loans and investments, and our ongoing operations, costs and profitability. Economic uncertainties even outside of a recession, including concerns about U.S. debt levels, tariffs on imports into the United States, Congress' inability to pass yearly budgets, and cuts in government spending, may negatively impact economic conditions going forward. A return to elevated levels of unemployment, declines in the values of real estate, or other events that negatively affect household and/or corporate incomes may result in higher than expected loan delinquencies, increases in our nonperforming and criticized classified assets and a decline in demand for our products and services. These events may cause us to incur losses and may adversely affect our financial condition and results of operations.

Our profitability depends on interest rates, and changes in interest rates could have an adverse impact on our results of operations and financial condition.

Our results of operations depends to a large extent on our “net interest income,” which is the difference between the interest income received from our interest-earning assets, such as loans and investment securities, and the interest expense incurred in connection with our interest-bearing liabilities, such as interest on deposit accounts. Changes in interest rates can increase or decrease our net interest income, because different types of assets and liabilities may react differently, and at different times, to market interest rate changes. When interest bearing liabilities mature or reprice more quickly than interest earning assets in a period, an increase in interest rates could reduce net interest income. Similarly, when interest earning assets mature or reprice more quickly than interest bearing liabilities, falling interest rates could reduce net interest income. Additionally, an increase in interest rates may, among other things, reduce loan demand and our ability to originate loans (which would also decrease our ability to generate noninterest income through the sale of loans into the secondary market), and make it more difficult for borrowers to repay adjustable-rate loans or otherwise decrease loan repayment rates. A decrease in the general level of interest rates may affect us through, among other things, increased prepayments on our loan and mortgage-backed securities portfolios and increased competition for deposits. Accordingly, changes in the level of market interest rates affect our net yield on interest earning assets, loan origination volume, loan and mortgage-backed securities portfolios, and our overall results. Fluctuations in interest rates are highly sensitive to many factors that are not predictable or controllable. Therefore, while we attempt to manage our risk from changes in market interest rates by adjusting the rates, maturity, repricing, and balances of the different types of interest-earning assets and interest bearing liabilities, we might not be able to maintain a consistent positive spread between the interest that we receive and the interest that we pay. As a result, a rapid increase or decrease in interest rates could have an adverse effect on our net interest margin and results of operations.

In addition, as market interest rates rise, we will have competitive pressures to increase the rates we pay on deposits. Because interest rates we pay on our deposits could be expected to increase more quickly than the increase in the yields we earn on our interest-earning assets, our net interest income would be adversely affected.

Furthermore, the FRB, in an attempt to help the overall economy, has among other things kept interest rates low through its targeted federal funds rate and the purchase of Treasury and mortgage-backed securities. If the FRB continues to increase the federal funds rate in the near term, as is expected, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic growth. If rates remain relatively low it could create deflationary pressures, which while possibly lowering our operating costs, could have a negative impact on our borrowers, especially our commercial borrowers, and the values of collateral securing our loans, which could negatively affect our financial performance.

We also are subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, we are subject to reinvestment risk to the extent that we are unable to reinvest the cash received from such prepayments at rates that are comparable to the interest rates on existing loans and securities.

Reforms to and uncertainty regarding LIBOR may adversely affect our business.

In 2017, a committee of private-market derivative participants and their regulators convened by the Federal Reserve, the ARRC, was created to identify an alternative reference interest rate to replace LIBOR. The ARRC announced SOFR, a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as its preferred alternative to LIBOR. The Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. Subsequently, the FRB announced final plans for the production of SOFR, which resulted in the commencement of its published rates by the Federal Reserve Bank of New York on April 2, 2018. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question and the future of LIBOR at this time is uncertain. The uncertainty as to the nature and effect of such reforms and actions and the political discontinuance of LIBOR may adversely affect the value of and return on our financial assets and liabilities that are based on or are linked to LIBOR, our results of operations or financial condition. In addition, these reforms may also require extensive changes to the contracts that govern these LIBOR based products, as well as our systems and processes.

Requirements to hold more capital could have a material adverse effect on our financial condition and operations.

In July 2013, the bank regulators issued a final rule that revised their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision (“Basel III”) and certain provisions of the Dodd-Frank Act. The final rule, which became effective on January 1, 2016, apply to all depository institutions, top-tier bank holding companies with total consolidated assets of \$1 billion or more and top-tier savings and loan holding companies and substantially amend the regulatory risk-based capital rules applicable to us. The rules apply to Howard Bank and Howard Bancorp. The rules include a capital conservation buffer that phases in over a period of years that began in 2017 and will become fully effective in 2019. Failure to satisfy any of the capital requirements, including with the applicable “buffer” amount, will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. The rules establish a maximum percentage of eligible retained income that could be utilized for such actions if the capital requirements of the buffer are not fully satisfied. Beginning January 1, 2018, Howard Bancorp and the Bank’s risk-based capital requirements, with the applicable buffer, are (i) a common equity Tier 1 ratio of 6.375%, (ii) a Tier 1 capital (common Tier 1 capital plus Additional Tier 1 capital) ratio of 7.875% and (iii) a total capital ratio of 9.875%. The capital conservation buffer does not apply to our leverage ratio requirement, which will remain at 4.0%.

Once the capital conservation buffer is fully phased in on January 1, 2019, the resulting requirements will be a common equity Tier 1 ratio of 7.0%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. These increased capital requirements may have a material adverse impact on our liquidity and results of operations, or the failure to satisfy such requirements may result in our inability to pay dividends on or repurchase shares of our common stock, which could also negatively impact the market price of our stock, and may negatively impact our ability to retain personnel if our ability to pay retention bonuses is compromised.

Our business may be adversely affected by increasing prevalence of fraud and other financial crimes.

As a financial institution, we are subject to risk of loss due to fraud and other financial crimes. Nationally, reported incidents of fraud and other financial crimes have increased. We believe we have controls in place to detect and prevent such losses, but in some cases multi-party collusion or other sophisticated methods of hiding fraud may not be readily detected or detectable, and could result in losses that affect our financial condition and results of operations.

Financial crime is not limited to the financial services industry. Our customers could experience fraud in their businesses, which could materially impact their ability to repay their loans, and deposit customers in all financial institutions are constantly and unwittingly solicited by others in fraud schemes that vary from easily detectable and obvious attempts to high-level and very complex international schemes that could drain an account of millions of dollars and require detailed financial forensics to unravel. While we have controls in place, contractual agreements with our customers partitioning liability, and insurance to help mitigate the risk, none of these are guarantees that we will not experience a loss, potentially a loss that could have a material adverse effect on our financial condition, reputation and results of operations.

Monetary policy and general economic conditions will influence our results of operations.

Governmental economic and monetary policy will influence our results of operations. The rates of interest payable on deposits and chargeable on loans are affected by fiscal policy as determined by various governmental and regulatory authorities, in particular the FRB, as well as by national, state and local economic conditions. In addition, adverse general economic conditions may impair the ability of our borrowers to repay loans.

Because the Bank serves a limited market area, we are susceptible to economic downturns in our market area.

Our lending and deposit operations are concentrated in the Greater Baltimore Metropolitan Area. Broad geographic diversification is not currently part of our community bank focus. As a result, our success depends in part on economic conditions in our markets. Adverse changes in economic conditions in our primary market area could reduce our deposit base and demand for our services and products and negatively impact growth in our loans and deposits, impair our ability to collect on our outstanding loans, increase credit losses, problem loans and charge-offs,

and otherwise negatively affect our performance and financial condition. Declines in real estate values could cause some of our residential and commercial real estate loans to be inadequately collateralized, which would expose us to a greater risk of loss in the event that the recovery on amounts due on defaulted loans is resolved by selling the real estate collateral. In addition, adverse changes in economic conditions in and around our market area may more severely impact our business and financial condition than are our larger, more geographically diverse competitors. Our larger bank competitors, for example, serve more geographically diverse market areas, parts of which may not be affected by the same economic conditions that may exist in our market areas.

Further, unexpected changes in the national and local economy may adversely affect our ability to attract deposits and to make loans. In particular, due to the proximity of our primary and secondary market areas to Washington, D.C., decreases in spending by the Federal government or cuts to Federal government employment could impact us to a greater degree than banks that serve a larger or a different geographical area. Such risks are beyond our control and may have a material adverse effect on our financial condition and results of operations and, in turn, the value of our common stock.

The small- and medium-sized businesses that the Bank lends to may have fewer resources to weather a downturn in the economy, which may impair a borrower's ability to repay a loan to the Bank that could materially harm our operating results.

The Bank targets its business development and marketing strategy primarily to serve the banking and financial services needs of small- and medium-sized businesses. These small- and medium-sized businesses frequently have a smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair their ability to repay a loan. In addition, the success of a small- and medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on its business and its ability to repay a loan. As a result, economic downturns and other events that negatively impact our market areas could cause the Bank to incur substantial credit losses that could negatively affect our results of operations and financial condition.

Changes in tax laws may negatively impact our financial performance.

Changes in tax laws contained in the Tax Cuts and Jobs Act, which was enacted in December 2017, contain a number of provisions that could have an impact on the banking industry, borrowers and the market for single family residential and multifamily residential real estate. Among the changes are: lower limits on the deductibility of mortgage interest on single family residential mortgages; limitations on deductibility of business interest expense; and limitations on the deductibility of property taxes and state and local income taxes. Such changes may have an adverse effect on the market for and valuation of single family residential properties and multifamily residential properties, as well as on the demand for such loans in the future. If home ownership or multifamily residential property ownership become less attractive, demand for mortgage loans would decrease, which could have a material adverse effect on our mortgage banking operations and as a result on our revenues, net income, operating results and financial condition. In addition, the value of the properties securing loans in our portfolio may be adversely impacted as a result of the changing economics of home ownership and multifamily residential ownership, which could require an increase in our provision for credit losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations. Additionally, certain borrowers could become less able to service their debts as a result of higher tax obligations. These changes could adversely affect our business, financial condition and results of operations.

We are subject to liquidity risks.

Market conditions could negatively affect the level or cost of available liquidity, which would affect our ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, and fund asset growth and new business transactions at a reasonable cost, in a timely manner, and without adverse consequences. Core deposits are our primary source of funding, but this is supplemented by overnight unsecured master notes, customer repurchase agreements, FHLB advances, the FRB Discount Window, subordinated debentures and other purchased funds. A significant decrease in our core deposits, an inability to renew FHLB advances or access the Discount Window, an inability to obtain alternative funding to core deposits or our other traditional sources of funds, or a substantial, unexpected, or prolonged change in the level or cost of liquidity could have a negative effect on our business, financial condition and results of operations.

We depend heavily on key employees, Mary Ann Scully and Robert D. Kunisch, Jr., to continue the implementation of our long-term business strategy and the loss of their services could disrupt our operations and result in reduced earnings.

Ms. Scully is our Chairman and Chief Executive Officer, and Mr. Kunisch is our President. We believe that our continued growth and future success will depend in large part on the skills of our senior management team. We believe these two executive officers possess valuable knowledge about and experience in the banking industry and that their knowledge and relationships would be difficult to replicate. We have entered into an employment agreement with each of Ms. Scully and Mr. Kunisch and acquired key-person life insurance on each, but the existence of such agreements and insurance does not assure that we will be able to retain their services or recover losses associated with the loss of their services. The unexpected loss of the services of Ms. Scully or Mr. Kunisch could have a material adverse effect on our business, operations, financial condition and operating results, as well as the value of our common stock.

Federal and state banking agencies periodically conduct examinations of our business, including compliance with laws and regulations, and our failure to comply with any supervisory actions to which we are or become subject as a result of such examinations may adversely affect us.

State and federal banking agencies, including the FRB, the FDIC and the Commissioner, periodically conduct examinations of our business, including compliance with laws and regulations. If, as a result of an examination, a state or federal banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we or our management was in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate the Bank’s deposit insurance. If we become subject to such regulatory actions, our business, results of operations and reputation may be negatively impacted.

Our expansion plans will require regulatory approvals, and failure to obtain them may restrict our growth.

We intend to complement and expand our business by continuing to pursue strategic acquisitions of banks and other financial institutions. We must generally receive regulatory approval before we can acquire an institution or business. Such regulatory approvals may not be granted on terms that are acceptable to us, or at all. We may also be required to sell branches as a condition to receiving regulatory approval, which condition may not be acceptable to us or, if acceptable to us, may reduce the benefit of any acquisition.

In addition to the acquisition of existing financial institutions, as opportunities arise, we plan to continue de novo branching as a part of our internal growth strategy and possibly enter into new markets through de novo branching. De novo branching and any acquisition carries with it numerous risks, including the inability to obtain all required regulatory approvals. The failure to obtain these regulatory approvals for potential future strategic acquisitions and de novo branches may impact our business plans and restrict our growth.

We may be required to raise additional capital in the future, but that capital may not be available when it is needed on attractive terms, or at all.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. Our capital requirements for the foreseeable future are currently satisfied. We may at some point, however, need to raise

additional capital to support our continued growth or if our liquidity is adversely affected by external factors such as worsening economic conditions or continued slow economic growth. Our ability to raise additional capital, if needed, will depend in part on conditions in the capital markets at that time, which are outside our control. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations could be materially impaired, or the failure to raise additional capital could have a material adverse effect on our liquidity, financial condition or results of operations. In addition, if we decide to raise additional equity capital, your interest in Howard Bancorp could be diluted. Furthermore, if we raise additional capital through the issuance of debt securities, there can be no assurance that sufficient revenues or cash flow will exist to service such debt.

Our investment securities portfolio is subject to credit risk, market risk, and liquidity risk.

Our investment securities portfolio is subject to risks beyond our control that may significantly influence its fair value. These include, but are not limited to, rating agency downgrades of the securities, defaults of the issuers of the securities, lack of market pricing of the securities, and instability in the credit markets. Lack of market activity with respect to some securities has, in certain circumstances, required us to base their fair market valuation on unobservable inputs. Any changes in these risk factors, in current accounting principles or interpretations of these principles could impact our assessment of fair value and thus the determination of other-than-temporary impairment of the securities in the investment securities portfolio. Investment securities that previously were determined to be other-than-temporarily impaired could require further write-downs due to continued erosion of the creditworthiness of the issuer. Write-downs of investment securities would negatively affect our earnings and regulatory capital ratios.

Further, most of our securities investment portfolio as of December 31, 2018 has been designated as available for sale pursuant to Statement of Financial Accounting Standards, Accounting Standards Codification (“ASC”) Topic 320 – “Investments.” ASC Topic 320 requires that unrealized gains and losses in the estimated value of the available for sale portfolio be “marked to market” and reflected as a separate item in stockholders’ equity, net of tax. If the market value of the investment portfolio declines, this could cause a corresponding decline in stockholders’ equity.

Our lending limit may limit our growth.

We are limited in the amount we can loan to a single borrower by the amount of our capital. Generally, under current law, we may lend up to 15% of our unimpaired capital and surplus to any one borrower. Based upon our current capital levels, such amount is significantly less than that of many of our competitors and may discourage potential borrowers who have credit needs in excess of our lending limit from doing business with us. We accommodate larger loans by selling participations in those loans to other financial institutions, but this strategy may not always be available.

The failure to maintain our reputation may materially adversely affect our ability to grow and generate revenue.

Our reputation is one of the most valuable components of our business. Damage to our reputation could undermine the confidence of clients and prospects in our ability to serve them and therefore could negatively affect our earnings. Damage to our reputation also could affect the confidence of rating agencies, regulators, stockholders and other parties in a wide range of transactions that are important to our business. Failure to maintain our reputation ultimately would have an adverse effect on our ability to maintain and grow our business. Actions by the financial services industry generally or by other members of or individuals in the financial services industry also could impact our reputation negatively. The considerable expansion in the use of social media over recent years has increased the risk that our reputation could be negatively impacted in a short amount of time. If we are unable to quickly and effectively respond to any incidents negatively impacting our reputation, it could have a material and long-term negative impact on our business and, therefore, our operating results.

Anti-takeover provisions in our corporate documents and in federal and state law may make it difficult and expensive to remove current management.

Anti-takeover provisions in our articles of incorporation and bylaws and federal and state banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire Howard Bancorp, even if doing so would be perceived to be beneficial to our stockholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock. These provisions could also discourage proxy contests and make it more difficult and expensive for holders of our common stock to elect directors other than the candidates nominated by our board of directors or otherwise remove existing directors and management, even if current management is not performing adequately.

Our articles of incorporation limit the liability of our directors and officers and the rights of us and our stockholders to take action against our directors and officers.

Our articles of incorporation eliminates our directors' and officers' liability to us and our stockholders for money damages to the fullest extent permitted by Maryland law. Our articles of incorporation and bylaws also require us to indemnify our directors and officers for liability resulting from actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, we and our stockholders may have more limited rights against our directors and officers than might otherwise exist under common law. In addition, we may be obligated to fund the defense costs incurred by our directors and officers.

The market price for our common stock may be volatile.

The market price of our common stock could be subject to significant fluctuations due to changes in sentiment in the market regarding our operations or business prospects. Factors that may affect market sentiment include:

- operating results that vary from the expectations of our management or of securities analysts and investors;
- developments in our business or in the financial service sector generally;
- regulatory or legislative changes affecting our industry generally or our business and operations in particular;
- operating and securities price performance of companies that investors consider to be comparable to us;
- changes in estimates or recommendations by securities analysts;
- announcements of strategic developments, acquisitions, dispositions, financings and other material events by us or our competitors; and
- changes in financial markets and national and local economies and general market conditions, such as interest rates and stock, commodity, credit or asset valuations or volatility.

While the U.S. and other governments continue efforts to restore confidence in financial markets and promote economic growth, market and economic turmoil could still occur in the near- or long-term, negatively affecting our business, financial condition and results of operations, as well as the price, trading volume and volatility of our common stock.

We may be unable to, or choose not to, pay dividends on our common stock.

We cannot assure you of our ability to pay dividends. Our ability to pay dividends depends on the following factors, among others:

We may not have sufficient earnings as our primary source of income, the payment of dividends to Howard Bancorp by Howard Bank, is subject to federal and state laws that limit the ability of that bank to pay dividends;

FRB policy requires bank holding companies to pay cash dividends on common stock only out of net income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition; and

our board of directors may determine that, even though funds are available for dividend payments, retaining the funds for internal uses, such as expansion of our operations, is a better strategy.

If we fail to pay dividends in the future, capital appreciation, if any, of our common stock may be the sole opportunity for gains on an investment in our common stock. In addition, in the event the Bank becomes unable to pay dividends to Howard Bancorp, we may not be able to service our debt or pay our other obligations or pay dividends on our common stock. Accordingly, Howard Bancorp's inability to receive dividends from Howard Bank could also have a material adverse effect on our business, financial condition and results of operations and the value of your investment in our common stock.

We can sell additional shares of common stock without consulting stockholders and without offering shares to existing stockholders, which would result in dilution of stockholders' interests in Howard Bancorp and could depress our stock price.

Our articles of incorporation currently authorize an aggregate of 20 million shares of common stock, 19,056,736 of which are outstanding as of February 28, 2019. Under Maryland law, our board of directors has the authority to amend our articles of incorporation, without stockholder approval, to increase or decrease the aggregate number of shares of stock or the number of shares of any class of stock that we have the authority to issue. Our board of directors is further authorized to issue additional shares of common stock and preferred stock, at such times and for such consideration as it may determine, without stockholder action. The ability of our board of directors to increase our authorized shares of capital stock, and the existence of authorized but unissued shares of common stock and preferred stock, could have the effect of rendering more difficult or discouraging hostile takeover attempts, or of facilitating a negotiated acquisition and could affect the market for and price of our common stock. Because our common stockholders do not have preemptive rights to purchase shares of our capital stock (that is, the right to purchase a stockholder's pro rata share of

any securities issued by Howard Bancorp), any future offering of capital stock could have a dilutive effect on holders of our common stock.

Item 1B. Unresolved Staff Comments

None

25

Item 2. Properties

Our headquarters are located in Baltimore City, Maryland. As of December 31, 2018, the Bank owns 13 full-service branches and leased the remaining eight branches. See Notes to the Consolidated Financial Statements, "Premises and Equipment," for additional information.

At December 31, 2018, we owned the following properties, which had a book value of \$40.1 million:

Branch Location	Address	Description
Canton	3301 Boston Street Baltimore, MD 21224	Full service branch
Maple Lawn ¹	10985 Johns Hopkins Road Laurel, MD 20723	Full service branch with drive-thru
Centennial	10161 Baltimore National Pike Ellicott City, MD 21042	Full service branch with drive-thru
Aberdeen	3 West Bel Air Avenue Aberdeen, MD 21001	Full service branch with drive-thru
Rising Sun	6 Pearl Street Rising Sun, MD 21911	Full service branch with drive-thru
Elkton ¹	305 Augustine Herman Highway Elkton, MD 21921	Full service branch with drive-thru
Parkville ¹	2028 East Joppa Road Parkville, MD 21235	Full service branch with drive-thru
Hickory ¹	1403 Conowingo Road Bel Air, MD 21014	Full service branch with drive-thru
Bel Air ¹	8 Bel Air South Parkway Bel Air, MD 21015	Full service branch with drive-thru
Pikesville	1013 Reisterstown Road Baltimore, MD 21208	Full service branch
Owings Mills	4800 Painters Mill Road	Full service branch with drive-thru

Edgar Filing: Howard Bancorp Inc - Form 10-K

Owings Mills, MD 21117

White Marsh	10101 Baltimore National Pike Baltimore, MD 21236	Full service branch with drive-thru
Glen Burnie ¹	305 Crain Highway Glen Burnie, MD 21061	Full service branch with drive-thru
Dublin	3535 Conowingo Road Street, MD 21154	Former branch location
Perryville	4871 Pulaski Highway Perryville, MD 21154	Former branch location
Easton	8662 Alicia Drive Easton, MD 21601	Former branch location
Loch Raven	1641 East Joppa Road Baltimore, MD 21234	Former branch location

Office Location	Address	Description
Corporate Office	3301 Boston Street Baltimore, MD 21224	Corporate headquarters
Centennial Regional Office	10161 Baltimore National Pike Ellicott City, MD 21042	Commercial lending office

(1)The premises are owned, but are subject to a ground lease.

We leased the following branches at December 31, 2018:

Branch Location	Address	Description
Snowden River	6011 University Boulevard, Suite 150 Ellicott City, MD 21043	Full service branch
Defense Highway	116 Defense Highway Annapolis, MD 21401	Full service branch with drive-thru
Remington	2700 Remington Avenue, Suite 100 Baltimore, MD 21211	Full service branch
Columbia Towers	10175 Little Patuxent Parkway Columbia, MD 21044	Full service branch
Carroll Island	176 Carroll Island Road Baltimore, MD 21220	Full service branch with drive-thru
Dundalk	7860 Wise Avenue Baltimore, MD 21222	Full service branch with drive-thru
Severna Park	366A Richie Highway Severna Park, MD 21146	Full service branch with drive-thru
Timonium	2129 York Road Timonium, MD 21093	Full service branch with drive-thru

We lease the following facilities unless otherwise noted:

Office Location	Address	Description
Towson Office	22 West Pennsylvania Avenue, Suite 102 Baltimore, MD 21204	Regional headquarters
Annapolis Office	1997 Annapolis Exchange Parkway, Suite 140 Annapolis, MD 21401	Regional banking office and regional mortgage banking office
Parkville ¹	2028 East Joppa Road Parkville, MD 21235	Regional banking office and regional mortgage banking office
Bethesda Mortgage Office	6903 Rockledge Drive Bethesda, MD 20817	Regional mortgage banking office
Timonium Mortgage Office	1954 Greenspring Drive, Suite 165 Timonium, MD 21093	Regional mortgage banking office
Rockville Mortgage Office	1572 Crabb Branch Way, Suite 2D Rockville, MD 20855	Regional mortgage banking office
Salisbury Mortgage Office	601 E Naylor Mill Rd Salisbury, MD 21804	Regional mortgage banking office
Severna Mortgage Office	650 Ritchie Highway Severna Park, MD 21146	Regional mortgage banking office
Newark Office	200 Continental Drive Newark, DE 19713	Commercial lending office

(1) The premises are owned, but are subject to a ground lease.

Item 3. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our normal course of business. As of the date of this report, we are not aware of any material pending litigation matters.

Item 4. Mine Safety Disclosures

Not applicable

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities

Our common stock is listed on The Nasdaq Stock Market under the symbol "HBMD."

At February 28, 2019, we had 414 stockholders of record.

Dividends

We have not declared or paid any dividends on our common stock. We currently intend to retain all of our future earnings, if any, for use in our business and do not anticipate paying cash dividends on our common stock in the foreseeable future; however, our board of directors may decide to declare dividends in the future. Payments of future dividends, if any, will be at the discretion of our board of directors after taking into account various factors, including our business, operating results and financial condition, current and anticipated cash needs, plans for expansion, tax considerations, general economic conditions and any legal or contractual limitations on our ability to pay dividends. We are not obligated to pay dividends on our common stock.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by this section of this Item is incorporated by reference to the information included under the captions "Securities Authorized for Issuance Under Equity Compensation Plans" in the Proxy Statement.

Item 6. Selected Financial Data

(in thousands, except per share data.)	Year ended December 31,				
	2018	2017	2016	2015	2014
Statements of operations data:					
Interest income	\$80,389	\$ 43,026	\$38,741	\$33,349	\$23,360
Interest expense	13,771	5,167	4,562	3,072	2,402
Provision for credit losses	6,091	1,831	2,037	1,836	3,255
Noninterest income	17,860	19,524	14,796	11,935	23,256
Noninterest expense	83,112	45,200	38,699	38,261	23,694
Federal and state income tax expense	(897)	3,152	2,936	973	6,853
Net income (loss)	(3,828)	7,200	5,303	1,142	10,412
Dividends	-	-	166	126	126
Net income available to common shareholders	(3,828)	7,200	5,137	1,016	10,286
Per share data and shares outstanding:					
Net income (loss) per common share, basic	\$(0.22)	\$ 0.75	\$0.74	\$0.16	\$2.53
Net income (loss) per common share, diluted	\$(0.22)	\$ 0.75	\$0.73	\$0.16	\$2.48
Book value per common share at period end	\$15.48	\$ 13.47	\$12.27	\$11.54	\$11.36
Average common shares outstanding	17,556,554	9,555,952	6,975,662	6,160,005	4,073,077
Diluted average common shares outstanding	17,556,554	9,596,804	6,998,982	6,223,496	4,143,101
Shares outstanding at period end	19,039,347	9,820,592	6,991,072	6,962,139	4,145,547
Financial Condition data:					
Total assets	\$2,266,514	\$ 1,149,950	\$1,026,957	\$946,759	\$691,416
Loans receivable (gross)	1,649,751	936,608	821,524	757,002	552,917
Allowance for credit losses	9,873	6,159	6,428	4,869	3,602
Other interest-earning assets	351,917	152,343	152,075	138,137	99,261
Total deposits	1,685,806	863,908	808,734	747,408	554,039
Borrowings	276,653	148,920	127,574	98,828	67,628
Total stockholders' equity	294,683	132,253	85,790	92,899	59,643
Common equity	294,683	132,253	85,790	80,337	47,081
Average assets	1,997,474	1,072,943	970,710	782,441	557,602
Average stockholders' equity	266,075	123,763	86,221	76,143	50,674
Average common stockholders' equity	266,075	123,763	81,896	63,581	38,112
Selected performance ratios:					
Return on average assets	(0.19)%	0.67 %	0.55 %	0.15 %	1.87 %
Return on average common equity	(1.44)%	5.82 %	6.48 %	1.80 %	27.32 %

Edgar Filing: Howard Bancorp Inc - Form 10-K

Net interest margin ¹	3.78	%	3.73	%	3.73	%	4.08	%	3.97	%
Efficiency ratio ²	98.38	%	78.77	%	79.01	%	90.64	%	53.59	%
Asset quality ratios:										
Nonperforming loans to gross loans	1.50	%	1.41	%	1.17	%	1.37	%	0.77	%
Allowance for credit losses to loans	0.60	%	0.66	%	0.78	%	0.64	%	0.65	%
Allowance for credit losses to nonperforming loans	39.94	%	46.70	%	69.24	%	46.95	%	84.69	%
Nonperforming assets to loans and other real estate	1.76	%	1.57	%	1.41	%	1.68	%	1.21	%
Nonperforming assets to total assets	1.28	%	1.28	%	1.16	%	1.35	%	0.97	%
Capital ratios:										
Leverage ratio	8.77	%	11.70	%	8.36	%	9.90	%	8.60	%
Tier I risk-based capital ratio	10.00	%	12.77	%	9.71	%	11.47	%	10.11	%
Total risk-based capital ratio	12.14	%	13.72	%	10.83	%	12.09	%	10.73	%
Average equity to average assets	13.32	%	11.53	%	8.88	%	9.73	%	9.09	%

(1) Net interest margin is net interest income divided by average earning assets.

(2) Efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This section is intended to help current and potential investors understand our financial performance through a discussion of the factors affecting our consolidated financial condition at December 31, 2018 and 2017 and our consolidated results of operations for the years ended December 31, 2018, 2017 and 2016. This section should be read in conjunction with the Consolidated Financial Statements and notes to the consolidated financial statements that appear elsewhere in this report.

Overview

Howard Bancorp, Inc. is the holding company for Howard Bank. Howard Bank was formed in 2004. Howard Bank's business has consisted primarily of originating both commercial and real estate loans secured by property in our market area. Typically, commercial real estate and business loans involve a higher degree of risk and carry a higher yield than one-to four-family residential loans. Although we plan to continue to focus on commercial customers, we intend to continue our origination of one- to four-family residential mortgage loans, maintaining our portfolio of mortgage lending and also selling select loans into the secondary markets.

We are headquartered in Baltimore, Maryland. We consider our primary market area to be the Greater Baltimore Metropolitan Area. We engage in a general commercial banking business, making various types of loans and accepting deposits. We market our financial services primarily to small- and medium-sized businesses and their owners, professionals and executives, and high-net-worth individuals. Our loans are primarily funded by core deposits of customers in our market.

Our results of operations depend mainly on our net interest income, which is the difference between the interest income we earn on our loan and investment portfolios and the interest expense we pay on deposits and borrowings. Results of operations are also affected by provisions for credit losses, noninterest income and noninterest expense. Our noninterest expense consists primarily of compensation and employee benefits, as well as office occupancy, deposit insurance and general administrative and data processing expenses. Our operations are significantly affected by general economic and competitive conditions, particularly with respect to changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect our financial condition and results of operations.

In May 2016, we redeemed all of the 12,562 shares of the Series AA Preferred Stock that we had previously issued to Treasury under its SBLF program for approximately \$12.7 million, including dividends accrued but unpaid through the redemption date. The redemption of the Series AA Preferred Stock was funded with variable rate debt with

Raymond James Bank, N.A.

On February 1, 2017, we closed an underwritten public offering, pursuant to which the Company issued and sold 2,760,000 shares, which included the exercise in full by the underwriters to purchase an additional 360,000 shares, at the public offering price of \$15.00 per share. The amount of gross proceeds raised in this offering was approximately \$41.4 million, after underwriting discounts and estimated expenses, and the amount of net proceeds raised in this offering was \$38.4 million. We used the proceeds of the offering to pay off the loan to Raymond James Bank, N.A. and retained the remainder. This had a positive impact on our liquidity and capital position in 2017 and provided funds that will continue to allow us to grow our loans and investments.

On March 1, 2018, we acquired First Mariner through the completion of our previously announced merger (the “First Mariner merger”) pursuant to the Agreement and Plan of Reorganization dated August 14, 2017, and as amended by Amendment No. 1 on November 8, 2017, by and among the Company, the Bank and First Mariner (as amended, the “Agreement”). At the effective time of the First Mariner merger, First Mariner merged with and into the Bank, with the Bank continuing as the surviving bank of the Merger and a wholly owned subsidiary of the Company. The aggregate merger consideration of \$173.8 million included \$9.2 million of cash and 9,143,222 shares of our common stock, which was valued at approximately \$164.6 million.

On December 6, 2018, the Company entered into Subordinated Note Purchase Agreements with certain Purchasers pursuant to which the Company sold and issued \$25,000,000 in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes due December 6, 2028. The Notes were issued by the Company to the Purchasers at a price equal to 100% of their face amount in reliance on the exemptions from registration available under Section 4(a)(2) of the Securities Act and the provisions of Regulation D thereunder. The Company intends to use the net proceeds for general corporate purposes, to provide for continued growth and to supplement its regulatory capital ratios.

Financial highlights for the year ended December 31, 2018 are as follows:

As a result of the First Mariner merger in March of 2018 we acquired:

Assets - \$1.0 billion, primarily from:

§ Investment securities - \$130.3 million

§ Loans - \$692.5 million

Liabilities - \$897.6 million, primarily from:

§ Deposits - \$706.4 million

§ Borrowings - \$185.0 million

Goodwill recorded - \$70.1 million

Because of the timing of the First Mariner merger closing on March 1, 2018, the 2018 year-to-date operating results only include combined revenues and operating expenses since the First Mariner merger closing;

	§	Net interest income - \$66.6 million
§		Pretax loss of \$4.7 million, after the recording of \$15.5 million in merger related expenses.
§		A loss of \$0.22 per common share for 2018 and earnings per share of \$0.75 for 2017.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a reduced, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any tax net operating loss carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations, but such changes do not currently impact us.

Critical Accounting Policies

Our accounting and financial reporting policies conform to the accounting principles generally accepted in the United States of America (“GAAP”) and general practice within the banking industry. Accordingly, preparation of the financial statements requires management to exercise significant judgment or discretion and make significant assumptions and estimates based on the information available that have, or could have, a material impact on the carrying value of certain assets or on income. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the periods presented. In reviewing and understanding financial information for us, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. The accounting policies we view as critical are those relating to the allowance for credit losses, goodwill and other intangible assets, income taxes and share based compensation.

Allowance for Credit Losses

The allowance for credit losses is established through a provision for credit losses charged against income. Loans are charged against the allowance for credit losses when management believes that the collectability of the principal is

unlikely. Subsequent recoveries are added to the allowance. The allowance is an amount that represents the amount of probable and reasonably estimable known and inherent losses in the loan portfolio, based on evaluations of the collectability of loans. The evaluations take into consideration such factors as changes in the types and amount of loans in the loan portfolio, historical loss experience, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, estimated losses relating to specifically identified loans, and current economic conditions. This evaluation is inherently subjective as it requires material estimates including, among others, exposure at default, the amount and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on our loan portfolios as well as consideration of general loss experience. Based on our estimate of the level of allowance for credit losses required, we record a provision for credit losses to maintain the allowance for credit losses at an appropriate level.

We cannot predict with certainty the amount of loan charge-offs that we will incur. We do not currently determine a range of loss with respect to the allowance for credit losses. In addition, our regulatory agencies, as an integral part of their examination processes, periodically review our allowance for credit losses. Such agencies may require that we recognize additions to the allowance for credit losses based on their judgments about information available to them at the time of their examination. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for credit losses may be required that would adversely impact earnings in future periods.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the sum of the estimated fair values of tangible and identifiable intangible assets acquired less the estimated fair value of the liabilities assumed. Core deposit intangibles represent the estimated value of long-term deposit relationships acquired in a business combination. The core deposit intangible is amortized over the estimated useful lives of the acquired long-term deposits, and the remaining amounts of the core deposit intangible are periodically reviewed for reasonableness. Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. We perform a qualitative assessment annually to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing updated qualitative factors, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it does not have to perform the two step impairment test. Determining the fair value under the first step of the goodwill impairment test and determining the fair value if individual assets and liabilities of a reporting unit under the second step of the goodwill impairment test are judgmental and often involve the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. Estimates of fair value are primarily determined using discounted cash flows, market comparisons and recent transactions. Significant estimates and assumptions include projected future cash flows, discount rates, reflective market rate of return, projected growth rates and determination and evaluation of appropriate market comparables. Future events could cause the Company to conclude that goodwill or other intangible assets have become impaired, which would result in the Company recording an impairment loss. Any resulting impairment loss could have a material impact on the Company's financial condition and results of operations. Based on the results of qualitative assessment, the Company determined that there was not an impairment of the carrying value of either the goodwill or core deposit intangible at December 31, 2018.

Income Taxes

We account for income taxes under the asset/liability method. We recognize deferred tax assets and liabilities for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as operating loss and tax credit carry-forwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We recognize the effect on deferred tax assets and liabilities of a change in tax rates in income in the period indicated by the enactment date. We establish a valuation allowance for deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become realizable. The judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond our control. It is at least reasonably possible that management's judgment about the need for a valuation allowance for deferred tax assets could change in the near term.

Share Based Compensation

We follow the provisions of ASC Topic 718 “Compensation – Stock Compensation,” which requires the expense recognition over the respective service period for the fair value of share based compensation awards, such as stock options, restricted stock, and performance based shares. This standard allows management to establish modeling assumptions as to expected stock price volatility, option terms, forfeiture rates and dividend rates which directly impact estimated fair value. The accounting standard also allows for the use of alternative option pricing models which may impact fair value as determined. Our practice is to utilize reasonable and supportable assumptions that are reviewed with the appropriate board committee.

Balance Sheet Analysis and Comparison of Financial Condition

A comparison between December 31, 2018 and December 31, 2017 balance sheets is presented below.

General

All aspects of our financial condition were greatly impacted by the First Mariner merger. Total assets increased \$1.1 billion, or 97.1%, to \$2.3 billion at December 31, 2018 compared to assets of \$1.1 billion at December 31, 2017. This asset growth consisted primarily of increases in our portfolio loans of \$713.1 million and investment securities of \$149.6 million, cash and cash equivalents of \$72.5 million and \$45.5 million in bank owned life insurance (“BOLI”), partially offset by a decline of \$20.9 million in loans held for sale. The primary source of funding for the asset growth was an increase in deposit balances. Customer deposits increased from \$863.9 million at December 31, 2017 to \$1.7 billion at December 31, 2018, an increase of \$821.9 million or 95.1%. Supplementing this deposit growth, our borrowings increased \$127.7 million, partially due to the issuance of \$25 million of Notes issued in the fourth quarter of 2018. Total stockholders’ equity increased \$162.4 million during 2018 primarily as a result of the shares issued in connection with the First Mariner merger.

Investment Securities

Available for sale

Available for sale securities are reported at fair value. We currently hold U.S. agency and treasury securities and mortgage backed securities in our securities portfolio, which are categorized as available for sale. We use our securities portfolio to provide the required collateral for funding via commercial customer overnight securities sold under agreement to repurchase (“repurchase agreements”) as well as to provide sufficient liquidity to fund our loans and provide funds for withdrawals of deposits.

Held to maturity

Held to maturity securities are reported at amortized cost. The only investments that we have classified as held to maturity are corporate debentures. These investments are intended to be held until maturity.

Nonmarketable equity

At December 31, 2018 and 2017, we held an investment in stock of the Federal Home Loan Bank (“FHLB”) of \$11.8 million and \$6.5 million, respectively. This investment is required for continued FHLB membership and is based partially upon the amount of borrowings outstanding from the FHLB. This FHLB stock is carried at cost.

The following table sets forth the composition of our investment securities portfolio at the dates indicated.

(in thousands)	December 31, 2018		2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for sale						
U.S. Government						
Agencies	\$ 130,088	\$ 130,397	\$ 68,082	\$ 67,740	\$ 34,584	\$ 34,463
Treasuries	-	-	1,505	1,494	1,512	1,504
Mortgage-backed	90,242	90,460	2,541	2,479	1,366	1,298
Other investments	3,011	3,001	2,579	2,543	1,500	1,463
	\$ 223,341	\$ 223,858	\$ 74,707	\$ 74,256	\$ 38,962	\$ 38,728
Held to maturity Corporate debentures	\$ 9,250	\$ 9,253	\$ 9,250	\$ 9,421	\$ 6,250	\$ 6,584

We had available for sale securities of \$223.9 million and \$74.3 million at December 31, 2018 and December 31, 2017, respectively, which were recorded at fair value. This represents an increase of \$149.6 million for the year ended December 31, 2018 from the prior year end. All acquired First Mariner investment securities were classified as available for sale, and were acquired at their fair values. For interest rate sensitivity reasons, we elected to immediately liquidate a portion of acquired securities portfolio. Because we sold these securities acquired within days of the closing of the transaction we did not record any gain or loss on the sale. We sold approximately \$69.7 million of the acquired securities and retained nearly \$51.0 million in our portfolio. Additionally, the Bank took the opportunity to reposition a portion of its pre-acquisition portfolio through the sale of primarily shorter duration agency debenture bonds with maturities over one year. The increase in the size of the portfolio was intended to provide additional collateral for certain funding sources, and to provide additional liquidity for the Bank. Nearly \$39 million of our securities portfolio matures in one year or less, giving us the capacity to fund future loan growth while maintaining an appropriate amount of securities to provide the required collateral under our repurchase agreements. As part of the repositioning of the portfolio we recorded a net loss of \$364 thousand on sales of securities in 2018. We did not sell any securities during 2017, however in 2016 we sold an equity security with a carrying value of \$100

thousand issued by a local small financial institution that resulted in a gain upon sale of \$96 thousand.

We had securities held to maturity of \$9.3 million December 31, 2018 and 2017, which were recorded at amortized cost. This consists of investments in corporate debentures.

With respect to our portfolio of securities available for sale, the portfolio contained 31 securities with unrealized losses of \$275 thousand and 38 securities with unrealized losses of \$451 thousand at December 31, 2018 and 2017, respectively. Changes in the fair value of these securities resulted primarily from interest rate fluctuations. We do not intend to sell these securities nor is it more likely than not that we would be required to sell these securities before their anticipated recovery, and we believe the collection of the investment and related interest is probable. Based on this analysis, we do not consider any of the unrealized losses to be other than temporary impairment losses. One held to maturity security was in a loss position at both December 31, 2018 and 2017.

Portfolio Maturities and Yields

The composition and maturities of the investment securities portfolio (with respect to those securities that have a fixed maturity date) at December 31, 2018 is summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

Edgar Filing: Howard Bancorp Inc - Form 10-K

(in thousands)	As of December 31, 2018									
	One year or less	After one through five years	After five through ten years	After ten years		Total				
	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield	Weighted Amortized Cost	Weighted Average Yield
U.S. Government Agencies	\$38,936	2.12 %	\$88,167	2.84 %	\$2,985	3.48 %	\$-	- %	\$130,088	2.64 %
Mortgage-backed	-	-	8	4.70	4,627	3.14	85,607	3.33	90,242	3.32
Other investments	-	-	-	-	3,011	8.23	-	-	3,011	8.23
	\$38,936	2.12 %	\$88,175	2.84 %	\$10,623	4.68 %	\$85,607	3.33 %	\$223,341	2.99 %
Held to maturity										
Corporate debentures	\$-	-	\$-	-	\$9,250	6.16	\$-	-	\$9,250	6.16 %

Loan and Lease Portfolio

Total loans and leases increased \$713.1 million, or 76.1%, to \$1.6 billion at December 31, 2018 from \$936.6 million at December 31, 2017. The loans acquired of \$581.1 million at December 31, 2018 represented the majority of the growth in 2018, with the remainder attributed to organic growth. Organic growth was primarily due to growth in commercial loans and leases, increasing \$39.7 million and commercial real estate loans, increasing \$44.9 million from December 31, 2017 as we continue to focus on the needs of small- and medium-sized businesses in our market area. Residential real estate loans increased \$17.2 million through organic growth, while consumer loans increased \$16.9 million from December 31, 2017 levels through organic growth, including as a result of a purchase of a \$20 million pool of variable rate student loans in the third quarter of 2018.

The following table sets forth the composition of our loan portfolio at the dates indicated.

(dollars in thousands)	December 31, 2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Real Estate										
Construction and land	\$123,671	7.5 %	\$74,398	7.9 %	\$72,973	8.9 %	\$69,385	9.1 %	\$64,158	11.6 %
Residential - first lien	383,044	23.2	194,896	20.8	195,032	23.7	182,988	24.1	88,293	16.0
Residential - junior lien	89,645	5.4	43,047	4.6	35,009	4.3	27,477	3.6	19,301	3.5
Total residential real estate	472,689	28.6	237,943	25.4	230,041	28.0	210,465	27.7	107,594	19.5
	234,102	14.2	170,408	18.2	134,213	16.3	131,114	17.3	112,826	20.4

Edgar Filing: Howard Bancorp Inc - Form 10-K

Commercial - owner occupied										
Commercial - non-owner occupied	427,747	25.9	260,802	27.8	216,781	26.4	181,361	23.9	123,958	22.4
Total commercial real estate	661,849	40.1	431,210	46.0	350,994	42.7	312,475	41.2	236,784	42.8
Total real estate loans	1,258,209	76.2	743,551	79.3	654,008	79.6	592,325	78.0	408,536	73.9
Commercial loans and leases	336,876	20.5	188,729	20.2	162,715	19.8	160,424	21.4	139,669	25.2
Consumer loans	54,666	3.3	4,328	0.5	4,801	0.6	4,253	0.6	4,712	0.9
Total loans and leases	\$1,649,751	100.0%	\$936,608	100.0%	\$821,524	100.0%	\$757,002	100.0%	\$552,917	100.0%

Loan Portfolio Maturities

The following table summarizes the scheduled repayments of our loan portfolio and sets forth the scheduled repayments of fixed and adjustable rate loans in our portfolio at December 31, 2018.

(dollars in thousands)	At December 31, 2018			
	One year or less	After one through five years	After five years	Total
Real Estate				
Construction and land	\$58,988	\$ 44,266	\$ 20,417	\$123,671
Residential - first lien	390	6,598	376,056	383,044
Residential - junior lien	619	6,342	82,684	89,645
Total residential real estate	1,009	12,940	458,740	472,689
Commercial - owner occupied	22,891	80,636	130,575	234,102
Commercial - non-owner occupied	37,516	179,378	210,853	427,747
Total commercial real estate	60,407	260,014	341,428	661,849
Total real estate loans	120,404	317,220	820,585	1,258,209
Commercial loans and leases	46,221	104,174	186,481	336,876
Consumer loans	415	20,072	34,179	54,666
Total	\$167,040	\$ 441,466	\$ 1,041,245	\$1,649,751
Rate terms:				
Fixed rate	\$84,299	\$ 295,444	\$ 518,898	\$898,641
Adjustable rate	82,741	146,022	522,347	751,110
Total	\$167,040	\$ 441,466	\$ 1,041,245	\$1,649,751

Loans Held for Sale

We sell the majority of the residential mortgage loans originated by the Bank. Outstanding balances for the loans held for sale portfolio decreased \$20.9 million to \$21.3 million at December 31, 2018, from \$42.2 million at December 31, 2017. The decline in balances resulted from the intent to reduce the overall levels of mortgage originations for 2018 and the closing of the national leads-based consumer direct unit of our mortgage division in the second quarter of 2018. Overall for 2018, we had mortgage loan origination volumes of \$586.4 million compared to \$673.4 million originated for the same period of 2017.

Goodwill and Other Intangible Assets

Goodwill represents the consideration paid in excess of the fair value of net assets acquired (including identifiable intangibles) in a business combination. In the First Mariner merger we recorded \$70.1 million of goodwill. This

amount plus the \$603 thousand recorded from previous acquisitions increased our total goodwill at December 31, 2018 to \$70.7 million. In addition we recorded \$12.6 million of core deposit intangibles, which are premiums paid on acquired non-maturity deposits, related to the First Mariner merger. This amount plus the core deposit intangible amounts recorded from previous acquisitions resulted in a net carrying amount of \$11.5 million at December 31, 2018 compared to \$1.7 million at December 31, 2017.

Deposits

We accept deposits primarily from the areas in which our branches and offices are located. We have consistently focused on building broader customer relationships and targeting small business customers to increase our core deposits. We also rely on our customer service to attract and retain deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Customer deposits have historically provided us with a sizeable source of relatively stable and low-cost funds to support asset growth. Our deposit accounts consist of commercial and retail checking accounts, savings accounts, certificates of deposit, money market accounts, and individual retirement accounts. We do not currently accept brokered deposits other than those obtained under Promontory Interfinancial Network's certificate of deposit account registry service program.

We review and update interest rates paid, maturity terms, service fees and withdrawal penalties on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market interest rates, liquidity requirements, anticipated short term loan demand and our deposit growth goals.

Deposits increased from \$863.9 million at December 31, 2017 to \$1.7 billion at December 31, 2018, an increase of \$821.9 million or 95.1%, primarily from the deposits acquired in the First Mariner merger. The largest increase in organic deposits was in CDs, increasing \$145.2 million, or 53.9%, resulting from a promotional campaign during the third quarter 2018. As a result of this CD campaign, money market accounts declined approximately \$20 million primarily due to customers transferring balances out of money market accounts and into CDs. Organic growth of interest bearing deposits increased \$85.4 million, offset by a \$15.1 million decrease in noninterest bearing deposits.

The following table sets forth the distribution of total deposit accounts, by account type, at the dates indicated.

(dollars in thousands)	December 31, 2018			2017			2016		
	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate
Noninterest-bearing demand	\$429,200	26 %	- %	\$218,139	26 %	- %	\$182,880	23 %	- %
Interest-bearing checking	227,322	13	0.35	71,642	8	0.25	62,538	8	0.23
Money market accounts	356,130	21	0.61	252,453	29	0.43	247,858	31	0.46
Savings	134,893	8	0.15	52,078	6	0.14	50,495	6	0.14
Certificates of deposit	538,261	32	1.31	269,596	31	1.05	264,963	32	0.87
Total deposits	\$1,685,806	100 %	0.79 %	\$863,908	100 %	0.63 %	\$808,734	100 %	0.57 %

The following table sets forth the maturity of CDs of \$100,000 and over at December 31, 2018.

(in thousands)	
Three months or less	\$103,242
Over three to six months	78,335
Over six to twelve months	61,671
Over twelve months	120,527
	\$363,775

Borrowings

Customer deposits remain the primary source we utilize to meet funding needs, but we supplement this with short- and long-term borrowings. Borrowings consist of overnight unsecured master notes, customer repurchase agreements, FHLB advances and subordinated debentures. Repurchase agreements consist of overnight electronic sweep products

that move customer excess funds from noninterest-bearing deposit accounts to an interest-bearing repurchase agreement, which is classified as a borrowing. Master notes similarly sweep funds from the Bank's customer accounts to Howard Bancorp but do not require pledged collateral. Repurchase agreements sweep funds within the Bank and are secured primarily by pledges of U.S. Government Agency securities, based upon their fair value, as collateral for 100% of the principal and accrued interest of its repurchase agreements. Borrowings totaled \$276.7 million at December 31, 2018 and \$148.9 million at December 31, 2017.

Subordinated Debt

On December 6, 2018, the Company entered into Subordinated Note Purchase Agreements with certain Purchasers pursuant to which the Company sold and issued \$25,000,000 in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes due December 6, 2028. The Notes were issued by the Company to the Purchasers at a price equal to 100% of their face amount in reliance on the exemptions from registration available under Section 4(a)(2) of the Securities Act and the provisions of Regulation D thereunder. The Company intends to use the net proceeds of this offering for general corporate purposes, to provide for continued growth and to supplement its regulatory capital ratios. The Notes have been structured to qualify initially as Tier 2 capital for regulatory capital purposes. The Notes will initially bear interest at a rate of 6.00% per annum from and including December 6, 2018, to but excluding December 6, 2023, with interest during this period payable semi-annually in arrears. From and including December 6, 2023, to but excluding the maturity date or early redemption date, the interest rate will reset quarterly to an annual floating rate equal to three-month LIBOR, plus 302 basis points, with interest during this period payable quarterly in arrears. The Notes are redeemable by the Company at its option, in whole or in part, on or after December 6, 2023.

Patapsco Statutory Trust I, a Connecticut statutory business trust and an unconsolidated wholly-owned subsidiary of Howard Bancorp (the "Trust"), issued \$5 million of capital trust pass-through securities to investors. The interest rate currently adjusts on a quarterly basis at the rate of the three month LIBOR plus 1.48%. The Trust purchased \$5,155,000 of junior subordinated deferrable interest debentures from Patapsco Bancorp. The debentures are the sole asset of the Trust. Patapsco Bancorp also fully and unconditionally guaranteed the obligations of the Trust under the capital securities, which guarantee became an obligation of Howard Bancorp upon our acquisition of Patapsco Bancorp. The capital securities are redeemable by the Company at par. The capital securities must be redeemed upon final maturity of the subordinated debentures on December 31, 2035.

Short-term borrowings are summarized in the following table:

(dollars in thousands)	December 31,		2017		2016	
	2018	Rate	Amount	Rate	Amount	Rate
Securities Sold Under Agreement to Repurchase & Master Notes						
At period end	16,576	0.21 %	\$14,356	0.12 %	\$11,390	0.13 %
Average for the year	18,927	0.19	13,460	0.13	13,626	0.13
Maximum month-end balance	25,291		16,563		21,764	
Federal Funds Purchased and Short-term Borrowed Funds						
At period end	118,000	2.34 %	\$116,029	1.50 %	\$95,666	1.26 %
Average for the year	127,123	1.80	75,053	1.14	49,831	1.16
Maximum month-end balance	310,023		116,029		95,666	

Short-term borrowings totaled \$134.6 million at December 31, 2018 and \$130.4 million at December 31, 2017, an increase of \$4.2 million, or 3.2%. Short-term borrowings at December 31, 2018 consisted of repurchase agreements of \$15.6 million, master notes totaling \$972 thousand, and six short-term FHLB advances totaling \$118.0 million.

Long-term borrowings totaled \$142.1 million at December 31, 2018, consisting of five long-term fixed rate FHLB advances totaling \$114.0 million and subordinated debt of \$28.1 million, discussed above.

Stockholders' Equity

Total stockholders' equity increased \$162.4 million, or 122.8%, from \$132.3 million at December 31, 2017 to \$294.7 million at December 31, 2018. As disclosed above, this increase was primarily the result of the issuance of 9.1 million shares representing \$165 million in common stock in connection with the First Mariner merger.

Total stockholders' equity at December 31, 2018 represents a capital to asset ratio of 13.0%, compared to 11.5% at December 31, 2017. Book value per share was \$15.48 at December 31, 2018 and \$13.47 at December 31, 2017. Leverage ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio were 8.77%, 10.00% and 12.14%, respectively at December 31, 2018. These ratios decreased dramatically from December 31, 2017 levels 11.70%, 12.77% and 13.72%, respectively. These ratios were negatively impacted by the First Mariner merger due to the higher level of intangible assets and portions of the deferred tax asset which are deducted from capital in calculating regulatory capital, and positively impacted by the issuance in the fourth quarter of 2018 of \$25 million Notes structured to qualify initially as Tier 2 capital for regulatory capital purposes.

Average Balance and Yields

The following tables set forth average balances, average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect thereof was not material. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, and have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense.

(dollars in thousands)	December 31, 2018			2017			2016		
	Average Balance	Income / Expense	Yield / Rate	Average Balance	Income / Expense	Yield / Rate	Average Balance	Income / Expense	Yield / Rate
Earning assets									
Loans and leases: ¹									
Commercial loans and leases	\$320,435	\$16,017	5.00%	\$177,167	\$8,113	4.58%	\$159,230	\$7,738	4.86%
Commercial real estate	610,111	30,328	4.97	373,972	17,584	4.70	323,868	15,506	4.79
Construction and land	107,962	5,917	5.48	79,177	3,813	4.82	72,061	3,369	4.68
Residential real estate	429,986	18,891	4.39	234,429	10,151	4.33	225,054	9,536	4.24
Consumer	44,361	2,289	5.16	4,475	252	5.64	4,561	249	5.45
Total loans and leases	1,512,855	73,442	4.85	869,220	39,913	4.59	784,774	36,398	4.64
Loans held for sale	38,261	1,567	4.09	35,065	1,300	3.71	43,206	1,467	3.40
Other earning assets ²	69,103	1,083	1.57	41,953	397	0.95	36,918	185	0.50
Securities: ³									
U.S. Treasury	1,241	10	0.83	1,494	12	0.84	851	7	0.83
U.S Gov agencies	72,659	1,507	2.07	50,002	581	1.16	41,899	194	0.46
Mortgage-backed	44,748	1,369	3.06	1,439	38	2.63	213	6	2.86
Corporate debentures	9,277	571	6.15	8,750	541	6.18	4,386	288	6.57
Other investments	15,682	840	5.36	6,306	244	3.88	5,162	196	3.79
Total securities	143,607	4,297	2.99	67,991	1,416	2.08	52,511	691	1.32
Total earning assets	1,763,826	80,389	4.56	1,014,229	43,026	4.24	917,409	38,741	4.22
Cash and due from banks	16,928			8,903			7,529		
Bank premises and equipment, net	45,830			19,673			20,569		
Other assets	177,056			35,815			30,704		
Less: allowance for credit losses	(6,166)			(5,677)			(5,501)		
Total assets	\$1,997,474			\$1,072,943			\$970,710		
Interest-bearing liabilities									
Deposits:									

Edgar Filing: Howard Bancorp Inc - Form 10-K

Interest-bearing demand accounts	\$157,523	554	0.35 %	\$68,097	\$168	0.25 %	\$57,846	\$132	0.23 %
Money market	361,101	2,197	0.61	265,927	1,143	0.43	250,118	1,149	0.46
Savings	129,586	197	0.15	52,964	73	0.14	52,351	71	0.14
Time deposits	426,958	5,592	1.31	247,854	2,613	1.05	243,376	2,118	0.87
Total interest-bearing deposits	1,075,168	8,540	0.79	634,842	3,997	0.63	603,691	3,470	0.57
Short-term borrowings	146,023	2,327	1.59	88,513	876	0.99	63,457	595	0.94
Long-term borrowings	101,488	2,904	2.86	8,967	294	3.28	28,285	497	1.76
Total interest-bearing funds	1,322,679	13,771	1.04	732,322	5,167	0.71	695,433	4,562	0.66
Noninterest-bearing deposits	403,656			212,261			182,909		
Other liabilities and accrued expenses	5,064			4,597			6,147		
Total liabilities	1,731,399			949,180			884,489		
Shareholders' equity	266,075			123,763			86,221		
Total liabilities & shareholders' equity	\$1,997,474			\$1,072,943			\$970,710		
Net interest rate spread ⁴		\$66,618	3.52 %		\$37,859	3.53 %		\$34,179	3.56 %
Effect of noninterest-bearing funds			0.26			0.20			0.17
Net interest margin on earning assets ⁵			3.78 %			3.73 %			3.73 %

(1) Loan fee income is included in the interest income calculation, and non-accrual loans are included in the average loan base upon which the interest rate earned on loans is calculated.

(2) Includes Federal funds sold and interest-bearing deposits with banks.

(3) Available for sale securities are presented at fair value, held to maturity securities are presented at amortized cost.

(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(5) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The following table presents the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The total of the changes set forth in the rate and volume columns are presented in the total column.

(in thousands)	For the year ended December 31,					
	2018 vs. 2017			2017 vs. 2016		
	Due to variances in			Due to variances in		
	Total	Rates	Volumes ¹	Total	Rates	Volumes ¹
Interest earned on:						
Loans and leases:						
Commercial loans and leases	\$7,904	\$741	\$ 7,163	\$375	\$(334)	\$ 709
Commercial real estate	12,744	1,013	11,731	2,078	(208)	2,286
Construction and land	2,104	523	1,581	444	76	368
Residential real estate	8,740	148	8,592	615	157	458
Consumer	2,037	(21)	2,058	3	7	(4)
Loans held for sale	267	135	132	(167)	101	(268)
Securities	2,881	620	2,261	725	301	424
Other earning assets	686	259	427	212	123	89
Total interest income	37,363	3,418	33,945	4,285	223	4,062
Interest paid on:						
Savings deposits	124	6	118	2	1	1
Interest bearing checking	386	69	317	37	8	29
Money market accounts	1,054	475	579	(6)	(55)	49
Time deposits	2,979	644	2,335	494	334	160
Short-term borrowings	1,451	534	917	281	25	256
Long-term borrowings	2,610	(38)	2,648	(203)	323	(526)
Total interest expense	8,604	1,690	6,914	605	636	(31)
Net interest earned	\$28,759	\$1,728	\$ 27,031	\$3,680	\$(413)	\$ 4,093

(1) Change attributed to mix (rate and volume) are included in volume variance.

Comparison of Results of Operations

A comparison of the results of operations for the years ended December 31, 2018 and December 31, 2017 is presented below.

General

We recorded a net loss for the year ended December 31, 2018 of \$3.8 million compared to net income of \$7.2 million for the year ended December 31, 2017. The decrease in net income was primarily driven by \$15.5 million merger-related expenses in 2018 compared to \$567 thousand in 2017.

Because of the 2018 net loss, our earnings per basic common share (“EPS”) for 2018 was a loss of \$0.22 compared to EPS of \$0.75 for 2017. Average common shares outstanding increased 8.0 million when comparing 2018 to 2017 as a result the 9.1 million shares issued March 1, 2018 in connection with the First Mariner merger.

Interest Income

Interest income increased \$37.4 million, or 86.8%, to \$80.4 million for the year ended December 31, 2018 compared to \$43.0 million during the year ended December 31, 2017. \$33.5 million of the increase was in interest and fees on loans and leases (excluding loans held for sale) primarily due to an increase in the average balance of portfolio loans of \$643.6 million, or 80.9%, compared to the average balance for 2017. This asset growth was complimented by a 26 basis point increase in the average yield on our portfolio loans and leases, partially related to the 2018 increases in the prime lending rate. Interest and dividends on investment securities increased \$2.9 million year over year as a result of the average yield on our securities portfolio increasing 91 basis points year over year. Other interest income increased \$686 thousand year over year as a result of increases in both the average balance and the average yield on these assets. Overall, total average earning assets increased by \$749.6 million, or 74%, and the average yield on all interest earning assets during 2018 increased by 32 basis points compared to 2017.

Interest Expense

Interest expense increased \$8.6 million, to \$13.8 million, for the year ending December 31, 2018, from \$5.2 million in 2017. Interest expense on deposits increased by \$4.5 million in 2018 as compared to 2017, with \$3.3 million of the increase resulting from increases in the average volumes and \$1.2 million from increased rates paid on interest-bearing deposits. These increases were due largely to a \$179.1 million increase in the average balances of, and the 26 basis point increase in the rate paid on, time deposits. We increased the interest rates on our time deposits in response to the prevailing competitive rates in the market. In addition, interest expense on borrowings increased \$4.1 million in 2018 as compared to 2017, primarily as a result of increases in the average balance of borrowings increasing \$150.0 million. Average rates paid on our short-term borrowing increased 60 basis points, while average rates paid on our long-term borrowings decreased 42 basis points. Because of the timing of the closing of our Notes offering in December of 2018, the interest expense on this did not have a major impact on the total level of interest expense for 2018.

Net Interest Income

Net interest income is our largest source of operating revenue. Net interest income is affected by various factors including changes in interest rates and the composition of interest-earning assets and interest-bearing liabilities and maturities. Net interest income is determined by the interest rate spread (i.e., the difference between the yields earned on interest-earning assets and the rates paid on interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. Net interest income increased \$28.8 million, or 76.0%, during the year ended December 31, 2018 compared to the year ended December 31, 2017. The increase in net interest income was primarily due to balance sheet growth related to the First Mariner merger, while successfully managing our interest expense even with the sizable growth in deposits and borrowings year over year.

Provision for Credit Losses

We establish a provision for credit losses, which is a charge to earnings, in order to maintain the allowance for credit losses at a level we consider adequate to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. In determining the level of the allowance for credit losses, management considers past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the levels of nonperforming loans. The amount of the allowance is based on estimates and actual losses may vary from such estimates as more information becomes available or economic conditions change. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as circumstances change or more information becomes available. The allowance for credit losses is assessed on at least a quarterly basis and provisions are made for credit losses as required in order to maintain the allowance.

Based on management's evaluation of the above factors, we incurred a provision for credit losses of \$6.1 million for 2018 compared to \$1.8 million during 2017, an increase of \$4.3 million. The provision level for 2018 was impacted by \$2.5 million of additional reserves related to an increase in charge-offs and a specific reserve of \$2.4 million related to a long term relationship recorded in the fourth quarter.

Management analyzes the allowance for credit losses as described in the section entitled "Allowance for Credit Losses." The provision that is recorded is sufficient, in management's judgment, to bring the allowance for credit losses to a level that reflects the losses inherent in our loan portfolio relative to loan mix, economic conditions and historical loss experience. Management believes, to the best of its knowledge, that all known losses as of the balance sheet dates have been recorded. However, although management uses the best information available to make determinations with respect to the provisions for credit losses, additional provisions for credit losses may be required to be established in the future should economic or other conditions change substantially. In addition, as an integral part of their examination process, the Commissioner and the FDIC will periodically review the allowance for credit losses. The Commissioner and the FDIC may require us to recognize additions to the allowance based on their analysis of information available to them at the time of their examination.

Noninterest Income

Noninterest income was \$17.9 million for the year ended December 31, 2018, compared to \$19.5 million for the year ended December 31, 2017. The decrease in noninterest income was primarily driven by reductions in our mortgage banking activities. Soon after the First Mariner merger, management announced the discontinuation of the national leads-based consumer direct unit of our mortgage division and a de-emphasis on mortgage operations to mitigate the inherent volatility of this business line, both of which resulted in a reduction of origination levels for 2018 and the corresponding decrease in mortgage based noninterest income. We account for both our loans held for sale as well as our interest rate locks using the fair value approach, and under this methodology, revenues are negatively impacted when the levels of either of these decline. Because of the overall reduction in the levels of originations and the fair value accounting for loans held for sale and interest rate locks our overall mortgage based revenue declined by \$5.8 million for 2018 compared to 2017.

Service charges on deposit accounts, which consist of account activity fees such as overdraft fees and other traditional banking fees, increased \$1.3 million period over period, primarily as a result of increased overdraft activities resulting from the deposit growth both acquired and organic during 2018.

Earnings on BOLI increased \$854 thousand during 2018 compared to 2017 as a result of the Bank acquiring \$44.8 million of additional BOLI in the First Mariner merger.

Other operating income, which consists mainly of non-depository account fees such as wire, merchant card and ATM services, increased \$2.6 million in 2018 compared to 2017 due to increased transaction volumes primarily from the First Mariner merger.

Partially offsetting the above increases was a \$332 thousand loss on the disposal of certain fixed assets that were part of the exit cost associated the First Mariner merger and reorganization strategies and a \$364 thousand loss on the sales of securities during 2018.

Noninterest Expenses

Noninterest expenses increased \$37.9 million, or 83.9%, to \$83.1 million for the year ended December 31, 2018 compared to \$45.2 million for the year ended December 31, 2017. The First Mariner merger had the most significant impact on noninterest expenses. Merger related expenses of \$15.5 million had the greatest impact on the noninterest expense throughout 2018 compared to \$567 thousand in merger related expenses reflected in 2017. Excluding these merger related expenses, noninterest expenses would have increased \$22.9 million, or 51.4%, year over year.

Compensation and benefits expenses remain the largest component of noninterest expenses. Compensation and benefits expenses grew by \$10.1 million, or 42.9%, for 2018 as compared to 2017. The primary driver of the increase in compensation and benefits was the expanded size of our operational sales and branch staff to support the 2018 growth. Employee insurance costs increased \$562 thousand, employee related tax expense increased \$655 thousand, and other employee benefits increased \$424 thousand.

Occupancy and equipment related costs increased \$6.5 million in 2018 as compared to 2017. As part of the First Mariner merger, the Bank evaluated its retail branch network. This evaluation resulted in the closing of several acquired and/or existing locations that were deemed to be redundant. At the time of the First Mariner merger, the Company operated 14 branches and First Mariner had 13 branch locations. As of December 31, 2018 we operated 21 branches, with one scheduled to close in the first quarter of 2019. In 2018 we incurred \$2.7 million in lease termination and location closing costs for which there were no comparable cost in 2017. We are continuing to evaluate our branch delivery system and plan to optimize the branch locations even more during 2019. General operating expenses (rental, janitorial, maintenance, taxes and depreciation) increased \$3.1 million year over year, and equipment expenses (hardware, maintenance contracts and depreciation) increased \$704 thousand year over year.

In the First Mariner merger, we recorded a \$12.3 million core deposit intangible, which is amortized against noninterest expenses using an accelerated amortization schedule. Because of this, our core deposit intangible amortization expenses increased by \$2.4 million for 2018 compared to 2017.

Data processing fees consist of core system processors and banking network costs. These costs increased \$2.0 million or 98.1% from \$2.0 million in 2017 to \$4.0 million in 2018 resulting from the large growth in loan and deposit accounts in the First Mariner merger. 2018 data processing expenses were also inflated as we were running dual core processing systems from the closing of the First Mariner merger in March 2018 until the conversion and integration onto one consolidated platform in May of 2018.

Other operating expenses consist mainly of a variety of general expenses such as telephone and data lines, supplies and postage and courier services. In aggregate, these expenses increased \$2.1 million, year over year. The costs of supporting our expanding infrastructure increased; software licensing cost by \$687 thousand, telephone and data line cost by \$243 thousand, armored carrier, security and postage expenses by \$203 thousand and general supplies and operating costs by \$222 thousand.

Income Tax Expense

Taking into consideration the above-stated changes in net interest income, the provision for credit losses, and our noninterest income and noninterest expense levels, pretax income decreased \$15.1 million from income of \$10.4 million in 2017 to a loss of \$4.7 million in 2018.

Because of the pretax loss for 2018, we recorded an income tax benefit of \$897 thousand for year ended December 31, 2018 versus an income tax expense \$3.2 million for year ended December 31, 2017. The effective tax rate is influenced by sources of non-taxable income, such as the income from our BOLI program, and also by certain non-deductible expense items. Certain merger and acquisition costs are deemed not deductible for income tax purposes, which impacted the effective tax rate for 2018. As a result of these effects, our effective tax rate on the 2018 pretax loss was 19.0%, while the effective tax rate on our 2017 earnings was 30.4%.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a reduced, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any tax net operating loss carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations, however, such changes do not currently impact us.

A comparison of the results of operations for the years ended December 31, 2017 and December 31, 2016 is presented below.

General

Net income available to common stockholders increased \$2.1 million, or 40%, to \$7.2 million for the year ended December 31, 2017 compared to \$5.1 million for the year ended December 31, 2016. The increase in net income available to common stockholders was driven by increases of \$3.7 million in net interest income and \$4.7 million in noninterest income, partially offset by increases of \$6.5 million in noninterest expense, of which nearly \$600 thousand were merger-related expenses. Much of this revenue growth and the increased expenses are attributable to the balance sheet growth resulting from our continued strategic and organic growth initiatives.

Interest Income

Interest income increased \$4.3 million, or 11.1%, to \$43.0 million for the year ended December 31, 2017 compared to \$38.7 million during the year ended December 31, 2016. The increase was primarily due to a \$3.5 million, or 10.0%, increase in interest and fees on loans and leases (excluding loans held for sale), primarily as a result of an \$84.4 million or 10.8% increase in the average balance of portfolio loans, partially offset by a modest five basis point decrease in the average yield on our portfolio loans and leases, which resulted from decreases in the average rates earned on our commercial loans and leases and, to a lesser extent, commercial real estate loans. Additionally, interest and dividends on investment securities increased \$725 thousand and other interest income increased \$212 thousand year over year as a result of increases in both the average balance and the average yield on these assets; the average yield on our securities portfolio increased 76 basis points and the average yield on our other interest earning assets increased 45 basis points year over year. Partially offsetting these increases was a decrease in income on loans held for sale of \$167 thousand, or 11.4%, as a result of a decrease of \$8.1 million in the average balance of our loans held for sale, partially offset by a 31 basis point increase in the average yield on our loans held for sale. Overall, the average yield on all interest earning assets during 2017 increased by 2 basis points compared to 2016.

Interest Expense

Interest expense increased \$605 thousand, or 13.3%, to \$5.2 million during the year ended December 31, 2017 from \$4.6 million during the prior year. Interest expense on deposits increased by \$527 thousand for 2017 compared to 2016, with \$288 thousand of the increase resulting from increases in the average rates paid on interest-bearing deposits and \$239 thousand of the increase resulting from the growth in the average balances of our interest-bearing deposits. These increase were driven primarily by the \$4.5 million increase in the average balance of, and the 18 basis point increase in the rate paid on, our time deposits. We increased the interest rates on our time deposits in response to the prevailing competitive rates in the market. In addition, interest expense on borrowings increased \$78 thousand in 2017 compared to 2016, primarily as a result of increases in the average balance of our short-term borrowings and in the average rate paid on our long-term borrowings, partially offset by a decrease in the average volume of our long-term borrowings. Average short-term borrowings increased by \$25.1 million year over year while the average interest rate on these borrowings increased five basis points, and the average rate on long-term borrowings increased by 152 basis points as the average balance of our lower cost fixed rate long-term borrowings declined by \$19.3 million, leaving only a small amount of higher cost long-term debt at the end of 2017.

Net Interest Income

Net interest income increased \$3.7 million, or 10.8%, during the year ended December 31, 2017 compared to the year ended December 31, 2016. The increase in net interest income was primarily due to the increase in interest income driven by our continued balance sheet growth, as discussed above, while successfully controlling interest expense even with the sizable growth in deposits and borrowings year over year.

Provision for Credit Losses

Based on management's evaluation of the factors to utilized to determine the level of allowance for credit losses, we incurred a provision for credit losses of \$1.8 million for 2017 compared to \$2.0 million during 2016, a decrease of \$206 thousand, or 10.1%. The provision level for 2016 was impacted by the migration of acquired loans into our allowance for credit losses measurement process, as well as some specific provisions on individual loans. Thus, even though we continued to experience organic loan growth, the mix of specific and general provisions for the two years resulted in a provision for 2017 that was less than the provision in the prior year.

Noninterest Income

Noninterest income was \$19.5 million for the year ended December 31, 2017 compared to \$14.8 million for the year ended December 31, 2016. The primary reason for the increase in noninterest income was our mortgage banking activities. As a result of the origination and subsequent sales of residential mortgage loans, realized and unrealized gains on the sale of loans produced approximately \$11.0 million in noninterest revenues during 2017 compared to \$8.1 million in 2016. Complementing the realized and unrealized gains on sale of mortgage loans was loan fee income derived from mortgage banking processing and underwriting as well as other portfolio loan fees. Loan fees realized in 2017 were \$5.7 million compared to \$3.9 million during 2016 as a result of both an increase in the number of loans originated and a higher fee structure during 2017 compared to 2016.

Partially offsetting these increases was a reduction in gain on the sale of portfolio loans, which for 2016 consisted of the sale of an acquired impaired loan that resulted in a gain of approximately \$675 thousand. The \$86 thousand net gain recorded in 2017 is comprised of a \$222 thousand gain related to the sale of the guaranteed portion of small business loans held in our portfolio, partially offset by a \$136 thousand loss on the sale of residential mortgages held in our portfolio that were carried at fair value. The gain recorded in 2016 benefited from a \$652 thousand gain on the sale of an acquired impaired loan during the second quarter of 2016, partially offset by a \$120 thousand loss on residential loans sold in the fourth quarter of 2016 that were classified as held for investment.

In 2016 we sold stock in a small financial institution, resulting in a gain of \$96 thousand; there were no such securities sales in 2017.

Service charges on deposit accounts, which consist of account activity fees such as overdraft fees and other traditional banking fees, increased \$229 thousand period over period, primarily as a result of increased overdraft fees resulting from the deposit growth we continue to experience

Earnings on BOLI increased \$137 thousand during 2017 compared to 2016 as a result of the Bank purchasing an additional \$6.5 million in BOLI early in 2017.

Other operating income, which consists mainly of non-depository account fees such as wire, merchant card and ATM services, increased \$91 thousand in 2017 compared to 2016 due to increased transaction volumes resulting from our larger customer base.

Noninterest Expenses

The efficiency ratio was 78.77% for the year ended December 31, 2017 compared to 79.01% for the year ended December 31, 2016. Noninterest expenses increased \$6.5 million, or 16.8%, to \$45.2 million for the year ended December 31, 2017 compared to \$38.7 million for the year ended December 31, 2016.

Compensation and benefits expenses grew by \$4.5 million or 23.9% for 2017 versus 2016. The primary driver of the increase in compensation and benefits was the expanded size of our staff, in particular, in our mortgage division, and, to a lesser extent, increased employee insurance cost, primarily health insurance. Insurance cost increased \$462 thousand or 25.0% comparing 2017 with 2016.

Occupancy and equipment related costs decreased slightly, by \$468 thousand, during 2017 compared to 2016. The Bank closed three locations, as digital banking use continues to increase and bank branch transaction levels at these locations had been decreasing. Further, in early 2016, we incurred approximately \$500 thousand in costs to exit lease agreements related to the three closed locations, which increased occupancy costs for 2016 and for which there was no comparable expense in 2017. In late 2017 we opened a new Remington branch location in Baltimore City, Maryland.

Cost increases related to the expansion of our infrastructure, growth initiatives and enhanced delivery strategies year over year include: marketing and business development - \$856 thousand driven by mortgage-related marketing and business development expenses increases; data processing - \$315 thousand relating to normal service provider increases; and merger related expense - \$567 thousand as the result of activities related to the First Mariner merger.

Loan production expense, which includes costs related to originating, closing and securitizing loans, including both loans placed in our portfolio and loans held for sale, increased \$727 thousand to \$3.7 million in 2017 from \$3.0 million during 2016 as a result of the increased number of loans originated, both for sale and to retain in our portfolio, during 2017 compared to 2016.

Other real estate owned (“OREO”) expenses increased \$558 thousand, to \$655 thousand during 2017 from \$97 thousand in 2016. This increase was primarily driven by valuation adjustments of \$581 thousand on OREO properties upon receipt of updated appraisals.

Other operating expenses decreased slightly, by \$170 thousand, year over year. Supporting our expanding infrastructure increased licensing cost by \$202 thousand. This increase was offset by decreases resulting from our eliminating redundancies and controlling costs during 2017, which resulted in year over year decreases of \$26 thousand in materials and supplies, \$94 thousand in phone and data lines and \$22 thousand in bank security and armored carrier services. Additionally, as core deposit intangibles continue to amortize, expenses related to this amortization decreased \$149 thousand year over year.

Nonperforming and Problem Assets

Management performs reviews of all delinquent loans and our loan officers contact customers to attempt to resolve potential credit issues in a timely manner. When in the best interests of Howard Bank and the customer, we will enter into a troubled debt restructuring with respect to a particular loan. When not possible, we seek to aggressively move loans through the legal and foreclosure process within applicable legal constraints.

Loans are placed on non-accrual status when payment of principal or interest is 90 days or more past due and the value of the collateral securing the loan, if any, is less than the outstanding balance of the loan. Loans are also placed on non-accrual status if management has serious doubt about further collectability of principal or interest on the loan, even though the loan is currently performing. When loans are placed on a non-accrual status, unpaid accrued interest is fully reversed, and further income, if any, is recognized only to the extent received. The loan may be returned to accrual status if the loan is brought current, has performed in accordance with the contractual terms for a reasonable period of time and ultimate collectability of the total contractual principal and interest is no longer in doubt.

The table below sets forth the amounts and categories of our nonperforming assets, which consist of non-accrual loans, troubled debt restructurings and OREO (which includes real estate acquired through, or in lieu of, foreclosure), at the dates indicated.

(in thousands)	December 31,									
	2018	2017	2016	2015	2014					
Non-accrual loans:										
Real estate loans:										
Construction and land	\$1,323	\$637	\$-	\$-	\$1,144					
Residential - first lien	12,278	1,722	491	693	719					
Residential - junior lien	1,137	396	37	63	57					
Commercial	6,286	6,375	1,584	1,148	-					
Commercial and leases	2,417	3,438	4,624	5,935	2,015					
Consumer	174	-	167	150	92					
Total non-accrual loans	23,615	12,568	6,903	7,989	4,027					
Accruing troubled debt restructured loans:										
Real estate loans:										
Construction and land	125	125	125	-	-					
Residential - first lien	982	287	294	301	-					
Commercial	-	-	2,073	2,073	226					
Commercial and leases	-	208	183	7	-					
Total accruing troubled debt restructured loans	1,107	620	2,675	2,381	226					
Total non-performing loans	24,722	13,188	9,578	10,370	4,253					
Other real estate owned:										
Land	1,772	956	1,220	964	595					
Residential - first lien	1,062	-	-	-	-					
Commercial	1,558	593	1,130	1,405	1,877					
Total other real estate owned	4,392	1,549	2,350	2,369	2,472					
Total non-performing assets	\$29,114	\$14,737	\$11,928	\$12,739	\$6,725					
Ratios:										
Non-performing loans to total gross loans	1.50	%	1.41	%	1.17	%	1.37	%	0.77	%
Non-performing assets to total assets	1.28	%	1.28	%	1.16	%	1.35	%	0.97	%
Loans past due 90 days still accruing:										
Real estate loans:										
Construction and land	\$351	\$-	\$1	\$15	\$278					
Residential - first lien	570	328	298	941	158					
Residential - junior lien	-	50	-	30	-					
Commercial	-	3,094	2,703	681	150					
Commercial and leases	-	-	-	147	571					
Consumer	-	-	1	2	-					
	\$921	\$3,472	\$3,003	\$1,816	\$1,157					

Included in total non-accrual loans at December 31, 2018 shown above are five troubled debt restructured loans (“TDRs”) totaling \$3.6 million that were not performing in accordance with their modified terms, and the accrual of

interest has ceased. Also included in non-accrual loans are \$11.4 million of purchased credit impaired loans acquired in the First Mariner merger. There was one new residential first restructured in 2018 of \$96.4 thousand. Additionally, we had one restructured residential first loan of \$702 thousand that had been performing in accordance with their modified terms and was returned to an accruing status in 2018. Further, there were three TDRs totaling \$1.1 million performing subject to their modified terms at December 31, 2018, all restructured prior to 2018.

Under GAAP we are required to account for certain loan modifications or restructurings as TDRs. In general, the modification or restructuring of a debt constitutes a TDR if Howard Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession, such as a reduction in the effective interest rate, to the borrower that we would not otherwise consider. However, all debt restructurings or loan modifications for a borrower do not necessarily constitute troubled debt restructurings.

Interest income that would have been recorded during the years ended December 31, 2018, 2017 and 2016 if the non-accrual loans had been current and in accordance with their original terms was \$461 thousand, \$317 thousand and \$198 thousand, respectively. No interest income was recorded on such loans during these periods.

Nonperforming assets amounted to \$29.1 million, or 1.28% of total assets, at December 31, 2018 compared to \$14.7 million, or 1.28% of total assets, at December 31, 2017 and \$11.9 million, or 1.16% of total assets, at December 31, 2016. Total nonperforming assets increased \$14.4 million during 2018 primarily as a result of nonperforming assets acquired.

The composition of our nonperforming loans is further described below:

Non-Accrual Loans:

Two commercial construction and one land loan totaling \$1.3 million.

46 residential first lien loans totaling \$12.3 million.

21 residential junior lien loans totaling \$1.1 million.

Three commercial owner occupied loans totaling \$1.3 million.

Eight commercial non-owner occupied loans totaling \$5.0 million, two with a specific reserve of \$2.2 million and five of which represent two relationships.

19 commercial loans totaling \$2.4 million, four with a Small Business Administration (“SBA”) guarantee and two that include specific reserves totaling \$200 thousand.

Two consumer loans totaling \$174 thousand.

Accruing Troubled Debt Restructured Loans:

One construction and land loan in the amount of \$125 thousand.

Two residential real estate loans totaling of \$982 thousand.

Other Real Estate Owned

Real estate we acquire as a result of foreclosure is classified as OREO. When a property is acquired it is recorded fair value less the anticipated cost to sell at the date of foreclosure. If there is a subsequent decline in the value of real estate owned, we provide an additional allowance to reduce real estate acquired through foreclosure to its fair value less estimated disposal costs. Costs relating to holding such real estate are charged against income in the current period while costs relating to improving such real estate are capitalized until a saleable condition is reached up to the property’s net realizable value, then such costs would be charged against income in the current period.

OREO at December 31, 2018 consisted of:

- . Several parcels of unimproved land.
- . Several lots of non-residential property.
- . Two commercial real estate properties.
- . Seven residential 1-4 family properties.

We had OREO of \$4.4 million at December 31, 2018, \$1.5 million at December 31, 2017 and \$2.4 million at 2016. Included in noninterest expenses were \$352 thousand, \$581 thousand and \$83 thousand valuation allowances recorded for 2018, 2017 and 2016, respectively, as the current appraised value of OREO properties, less estimated cost to sell, was insufficient to cover the recorded OREO amount. Additionally, we sold one commercial building in Sussex County, Delaware and two parcels of land in Baltimore, Maryland recording a net loss of \$64 thousand in 2018.

Classification of Loans

Our policies, consistent with regulatory guidelines, provide for the classification of loans and other assets that are considered to be of lesser quality as Substandard, Doubtful, or Loss assets. An asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Substandard assets include those assets characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all of the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable or improbable. Assets (or portions of assets) classified as Loss are those considered uncollectible and of such little value that their continuance as assets is not warranted. Assets that do not expose us to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve our close attention, are required to be designated as Special Mention.

We maintain an allowance for credit losses at an amount estimated to equal all credit losses incurred in our loan portfolio that are both probable and reasonable to estimate at a balance sheet date. Our determination as to the classification of our assets is subject to review by the Commissioner and the FDIC. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations.

The following table sets forth our amounts of classified loans and criticized loans (classified loans and loans designated as Special Mention) at the dates indicated.

(in thousands)	December 31,		
	2018	2017	2016
Classified loans:			
Substandard	\$24,610	\$6,779	\$3,734
Doubtful	-	6,310	6,903
Total classified loans	24,610	13,089	10,637
Special mention	3,955	1,592	524
Total criticized loans	\$28,565	\$14,681	\$11,161

Allowance for Credit Losses

We provide for credit losses based upon the consistent application of our documented allowance for credit loss methodology. All credit losses are charged to the allowance for credit losses and all recoveries are credited to it. Additions to the allowance for credit losses are provided by charges to income based on various factors that, in our judgment, deserve current recognition in estimating probable losses. We regularly review the loan portfolio and make provisions for credit losses in order to maintain the allowance for credit losses in accordance with GAAP. The allowance for credit losses consists primarily of two components:

Specific allowances are established for loans classified as impaired. For loans classified as impaired, the allowance is established when the net realizable value (collateral value less costs to sell) of the impaired loan is lower than the carrying amount of the loan. The amount of impairment provided for as a specific allowance is represented by the 1) deficiency, if any, between the underlying collateral value and the carrying value of the loan. Impaired loans for which the estimated fair value of the loan, or the loan's observable market price or the fair value of the underlying collateral, if the loan is collateral dependent, exceeds the carrying value of the loan are not considered in establishing specific allowances for credit losses; and

2) General allowances established for credit losses on a portfolio basis for loans that do not meet the definition of impaired loans. The portfolio is grouped into similar risk characteristics, primarily loan type and regulatory

classification. We apply an estimated loss rate to each loan group. The loss rates applied are based upon our loss experience adjusted, as appropriate, for the qualitative factors discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions.

The allowance for credit losses is maintained at a level to provide for losses that are probable and can be reasonably estimated. Management's periodic evaluation of the adequacy of the allowance is based on Howard Bank's past credit loss experience, known and inherent losses in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

A loan is considered past due or delinquent when a contractual payment is not paid on the day it is due. A loan is considered impaired when, based on current information and events, it is probable that Howard Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. The impairment of a loan may be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided by the collateral. Generally, Howard Bank's impairment on such loans is measured by reference to the fair value of the collateral. Interest income on impaired loans is recognized on the cash basis.

Our loan policies state that after all collection efforts have been exhausted, and the loan is deemed to be a loss, then the remaining loan balance will be charged to the established allowance for credit losses. All loans are evaluated for loss potential once it has been determined by our Watch Committee that the likelihood of repayment is in doubt. When a loan is past due for at least 90 days or a deterioration in debt service coverage ratio, guarantor liquidity, or loan-to-value ratio has occurred that would cause concern regarding the likelihood of the full repayment of principal and interest, and the loan is deemed not to be well secured, the loan should be moved to non-accrual status and a specific reserve is established if the net realizable value is less than the principal value of the loan balance(s). Once the actual loss value has been determined a charge-off against the allowance for credit losses for the amount of the loss is taken. Each loss is evaluated on its specific facts regarding the appropriate timing to recognize the loss.

The adjustments to historical loss experience are based on our evaluation of several qualitative factors, including:

- changes in lending policies, procedures, practices or personnel;
- changes in the level and composition of construction portfolio and related risks;
 - changes and migration of classified assets;
 - changes in exposure to subordinate collateral lien positions;
- levels and composition of existing guarantees on loans by SBA or other agencies;
- changes in national, state and local economic trends and business conditions;
- changes and trends in levels of loan payment delinquencies; and
- any other factors that management considers relevant to the quality or performance of the loan portfolio.

We evaluate the allowance for credit losses based upon the combined total of the specific and general components. Generally, when the loan portfolio increases, absent other factors, the allowance for credit loss methodology results in a higher dollar amount of estimated probable losses than would be the case without the increase. Generally, when the loan portfolio decreases, absent other factors, the allowance for credit loss methodology results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

Commercial and commercial real estate loans generally have greater credit risks compared to the one- to four-family residential mortgage loans we originate, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment experience on loans secured by income-producing properties typically depends on the successful operation of the related business and thus may be subject to a greater extent to adverse conditions in the real estate market and in the general economy. Actual credit losses may be significantly more than the allowance for credit losses we have established, which could have a material negative effect on our financial results.

Generally, we underwrite commercial loans based on cash flow and business history and receive personal guarantees from the borrowers where appropriate. We generally underwrite commercial real estate loans and residential real estate loans at a loan-to-value ratio of 85% or less at origination. Accordingly, in the event that a loan becomes past

due and, randomly with respect to performing loans, we will conduct visual inspections of collateral properties and/or review publicly available information, such as online databases, to ascertain property values. We will also obtain formal appraisals on a regular basis even if we are not considering liquidation of the property to repay a loan. It is our practice to obtain updated appraisals if there is a material change in market conditions or if we become aware of new or additional facts that indicate a potential material reduction in the value of any individual property collateral.

For impaired loans, we utilize the appraised value in determining the appropriate specific allowance for credit losses attributable to a loan. In addition, changes in the appraised value of multiple properties securing our loans may result in an increase or decrease in our general allowance for credit losses as an adjustment to our historical loss experience due to qualitative and environmental factors, as described above.

As of December 31, 2018 and 2017, nonperforming loans amounted to \$24.7 million and \$13.2 million, respectively. The amount of nonperforming loans requiring specific reserves totaled \$3.0 million and \$6.4 million, respectively, and the amount of nonperforming loans with no specific valuation allowance totaled \$21.7 million and \$6.8 million, respectively, at December 31, 2018 and December 31, 2017.

Nonperforming loans are evaluated and valued at the time the loan is identified as impaired on a case by case basis, at the lower of cost or market value. Market value is measured based on the value of the collateral securing the loan. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by us. Appraised values may be discounted based on management's historical experience, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and the client's business. The difference between the appraised value and the principal balance of the loan will determine the specific allowance valuation required for the loan, if any. Nonperforming loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

We evaluate the loan portfolio on at least a quarterly basis, more frequently if conditions warrant, and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of their examination process, the Commissioner and the FDIC will periodically review the allowance for credit losses. The Commissioner and the FDIC may require us to recognize additions to the allowance based on their analysis of information available to them at the time of their examination.

The following table sets forth activity in our allowance for credit losses for the year ended:

(in thousands)	December 31,				
	2018	2017	2016	2015	2014
Balance at beginning of year	\$6,159	\$6,428	\$4,869	\$3,602	\$2,506
Charge-offs:					
Real estate					
Construction and land loans	(202)	(155)	(216)	-	-
Residential first lien loans	(142)	(133)	-	(23)	-
Residential junior lien loans	(195)	(31)	-	(12)	-
Commercial owner occupied loans	(28)	(235)	(191)	-	-
Commercial non-owner occupied loans	(797)	-	-	(82)	(160)
Commercial loans and leases	(1,092)	(1,605)	(234)	(825)	(2,054)
Consumer loans	(63)	(108)	(20)	(5)	(5)
	(2,519)	(2,267)	(661)	(947)	(2,219)
Recoveries:					
Real estate					
Construction and land loans	-	6	-	-	-
Residential first lien loans	8	-	-	3	1
Residential junior lien loans	10	1	-	1	-
Commercial owner occupied loans	-	6	40	-	-
Commercial non-owner occupied loans	32	6	5	318	4
Commercial loans and leases	88	113	101	52	55
Consumer loans	4	35	37	4	-
	142	167	183	378	60

Edgar Filing: Howard Bancorp Inc - Form 10-K

Net charge-offs	(2,377)	(2,100)	(478)	(569)	(2,159)
Provision for credit losses	6,091	1,831	2,037	1,836	3,255
Balance at end of year	\$9,873	\$6,159	\$6,428	\$4,869	\$3,602
Net charge-offs to average loans and leases	0.16 %	0.24 %	0.06 %	0.09 %	0.48 %

Allocation of Allowance for Credit Losses

The following tables set forth the allowance for credit losses allocated by loan category and the percent of loans in each category to total loans at the dates indicated. The allowance for credit losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

(dollars in thousands)	December 31, 2018		2017		2016		2015		2014	
	Amount	Percent ¹	Amount	Percent ¹	Amount	Percent ¹	Amount	Percent ¹	Amount	Percent ¹
Real estate										
Construction and land loans	\$741	7.5 %	\$735	7.9 %	\$511	8.9 %	\$265	9.1 %	\$174	11.6 %
Residential first lien loans	1,170	23.2	668	20.8	454	23.7	300	24.1	272	16.0
Residential junior lien loans	292	5.4	177	4.6	89	4.3	47	3.6	55	3.5
Commercial owner occupied loans	735	14.2	617	18.2	327	16.3	309	17.3	160	20.4
Commercial non-owner occupied loans	4,057	25.9	1,410	27.8	1,120	26.4	728	23.8	562	22.4
Commercial loans and leases	2,644	20.5	2,529	20.2	3,800	19.8	3,094	21.5	2,366	25.2
Consumer loans	234	3.3	23	0.5	127	0.6	126	0.6	13	0.9
Total	\$9,873	100.0 %	\$6,159	100.0 %	\$6,428	100.0 %	\$4,869	100.0 %	\$3,602	100.0 %

(1) Represents the percent of loans in each category to total loans.

Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations. Our primary sources of funds consist of deposit inflows, loan repayments, advances from the FHLB, and the sale of securities available for sale. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Committee (“ALCO”) is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We believe that we have enough sources of liquidity to satisfy our short- and long-term

liquidity needs as of December 31, 2018 and December 31, 2017.

We regularly monitor and adjust our investments in liquid assets based upon our assessment of:

Expected loan demand;
Expected deposit flows and borrowing maturities;
Yields available on interest-earning deposits and securities; and
The objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits and short-term securities.

The most liquid of all assets are cash and cash equivalents. The level of these assets is dependent on our operating, financing, lending and investing activities during any given period. At December 31, 2018 and 2017, cash and cash equivalents totaled \$101.5 million and \$29.0 million, respectively. The increase at December 31, 2018 from the prior year-end was a result of the issuance of \$25 million in Notes and the proceeds from two large loans that paid off late in December of 2018. We used cash and cash equivalents to provide additional funds needed to fund these assets.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our statements of cash flows included in our financial statements.

At December 31, 2018 and 2017, we had \$387.3 million and \$219.6 million, respectively, in loan commitments outstanding, consisting of commitments issued to originate loans of \$104.5 million and \$81.1 million at December 31, 2018 and 2017, respectively, and \$282.8 million and \$138.5 million in unused lines of credit to borrowers at December 31, 2018 and 2017, respectively. In addition to commitments to originate loans and unused lines of credit, we had \$16.7 million and \$10.8 million in letters of credit at December 31, 2018 and 2017, respectively. CDs due within one year totaled \$325.5 million, or 19.3% of total deposits, and \$195.5 million, or 22.6% of total deposits, at December 31, 2018 and 2017, respectively. If we do not retain these deposits, we may be required to seek other sources of funds, including loan and securities sales and FHLB advances. Depending on market conditions, we may be required to pay higher rates on our deposits or other borrowings than we currently pay on the CDs held in our portfolio as of December 31, 2018. We believe, however, based on historical experience and current market interest rates that we will retain upon maturity a large portion of our CDs with maturities of one year or less as of December 31, 2018.

Our primary investing activity is originating loans. During the years ended December 31, 2018 and December 31, 2017, cash used to fund net loan growth was \$50.0 million and \$120.3 million, respectively. During these periods, we purchased \$193.8 million and \$62.3 million of securities, respectively.

Financing activities consist primarily of activity in deposit accounts and FHLB advances. We experienced a net increase in cash provided from deposits of \$115.5 million and \$55.2 million, respectively, during the years ended December 31, 2018 and 2017. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLB, which provide an additional source of funds. FHLB advances increased to \$232 million at December 31, 2018 compared to \$131 million at December 31, 2017. At December 31, 2018, we had the ability to borrow up to a total of \$345.9 million based upon our credit availability at the FHLB, subject to collateral requirements.

The Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2018 and 2017, the Bank exceeded all regulatory capital requirements. The Bank is considered “well capitalized” under regulatory guidelines. See “Item 1. Business—Supervision and Regulation—Howard Bank—Capital Requirements” and the Notes to our Financial Statements.

Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements

We are party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of our customers. These financial instruments are limited to commitments to originate loans and involve, to varying degrees, elements of credit, interest rate, and liquidity risk. These do not represent unusual risks, and management does not anticipate any losses that would have a material effect on us.

Outstanding loan commitments and lines of credit at December 31, 2018 and December 31, 2017 are as follows:

	December 31,	
(in thousands)	2018	2017

Edgar Filing: Howard Bancorp Inc - Form 10-K

Unfunded loan commitments	\$104,466	\$81,074
Unused lines of credit	282,822	138,526
Letters of credit	16,661	10,839

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. We generally require collateral to support financial instruments with credit risk on the same basis as we do for balance sheet instruments. Management generally bases the collateral required on the credit evaluation of the counterparty. Commitments generally have interest rates at current market rates, expiration dates or other termination clauses and may require payment of a fee. Available credit lines represent the unused portion of lines of credit previously extended and available to the customer so long as there is no violation of any contractual condition. These lines generally have variable interest rates. Since we expect many of the commitments to expire without being drawn upon, and since it is unlikely that all customers will draw upon their lines of credit in full at any one time, the total commitment amount or line of credit amount does not necessarily represent future cash requirements. We evaluate each customer's credit-worthiness on a case-by-case basis. Because we conservatively underwrite these facilities at inception, we have not had to withdraw any commitments. We are not aware of any loss that we would incur by funding our commitments, lines of credit or letters of credit.

The credit risk involved in these financial instruments is essentially the same as that involved in extending loan facilities to customers. No amount has been recognized in the statement of financial condition at December 31, 2018, December 31, 2017 or December 31, 2016 as a liability for credit loss related to these commitments.

We have contractual obligations to make future payments on debt and lease agreements. In the normal course of business, we enter into contractual arrangements whereby we commit to future purchases of products or services from unaffiliated parties. These purchase obligations are legally binding agreements whereby we agree to purchase products or services with a specific minimum quantity at a fixed, minimum or variable price over a specified period of time. Purchase obligations may include vendor contracts, communication services, processing services and software contracts. We also have contractual obligations under real property leases for certain facilities we utilize.

Payments due by period for our contractual obligations at December 31, 2018 are as follows:

(in thousands)	Within one year	One to three years	Three to five years	Over five years	Total
Certificates of deposit	\$325,483	\$ 207,065	\$ 5,713	\$ -	\$538,261
Long-term borrowings	-	114,000	-	28,616	142,616
Estimated interest due on certificate of deposit and long-term borrowings	7,076	3,754	44	-	10,874
Contractual service obligations	3,997	2,732	-	-	6,729
Operating leases	2,129	3,385	2,758	3,074	11,346
	\$338,685	\$ 330,936	\$ 8,515	\$ 31,690	\$709,826

Impact of Inflation and Changing Prices

Our financial statements and related notes have been prepared in accordance with GAAP. GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration of changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Liquidity and Funding

The objective of effective liquidity management is to ensure that the Company can meet customer loan requests, customer deposit maturities/withdrawals, and other cash commitments efficiently under both normal operating conditions as well as under unforeseen and unpredictable circumstances of industry or market stress. To achieve this objective, ALCO establishes and monitors liquidity guidelines requiring sufficient asset based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. The Company manages liquidity at both the parent and subsidiary levels through active management of the balance sheet.

The additional information called for by this item is incorporated herein by reference to the “Liquidity and Capital Resources” section of Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” of this Annual Report on Form 10-K.

Interest Rate Risk

Interest rate risk, one of the more prominent risks in terms of potential earnings impact, is an inevitable part of being a financial intermediary. It can occur for any one or more of the following reasons: (a) assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates are generally falling, the Company's earnings will initially decline); (b) assets and liabilities may re-price at the same time but by different amounts (when the general level of interest rates is falling, the Company may choose for customer management, competitive, or other reasons to reduce the rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market interest rates); (c) short-term and long-term market interest rates may change by different amounts (i.e. the shape of the yield curve may impact new loan yields and funding costs differently); or (d) the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change (for example, mortgage-backed securities held in the securities available for sale portfolio may prepay significantly earlier than anticipated – with an associated reduction in portfolio yield and income – if long-term mortgage rates decline sharply). In addition to the direct impact of interest rate changes on net interest income through these categories, interest rates indirectly impact earnings through their effect on loan demand, credit losses, mortgage origination fees, and other sources of the Company's earnings.

In determining the appropriate level of interest rate risk, the Company considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The Company uses a number of tools to measure interest rate risk including a model to simulate the impact of changes in interest rates on our net interest income, monitoring the sensitivity of the net present value of the balance sheet and monitoring the difference or gap between maturing or rate-sensitive assets and liabilities over various time periods.

Management believes that short term interest rate risk is best measured by simulation modeling. This analysis calculates expected net interest income based upon historical trends, spreads to market rates, historical market relationships, prepayment behavior and current and expected product offerings using base market rates and using a rising and a falling interest rate scenario. For example, if rates were to rise 1.00% or 2.00% over the next 12 months, net interest income might increase respectively. Conversely, if rates were to decline over the next 12 months, net interest income might decline respectively.

These estimates are highly assumption-dependent, and may change regularly as the Company's asset/liability structure and business evolves from one period to the next, results will vary as different interest rate scenarios are used and measured relative to a base net interest income scenario that may change.

For the rising and falling interest rate scenarios, the base market interest rate forecast are decreased 100 and 200 basis points and increased 100, 200, 300, and 400 basis points. At December 31, 2018, our net interest income exposure related to these hypothetical changes in market interest rates was within the majority of the current guidelines established in our governing policies.

The following table presents interest sensitivity position at the dates indicated.

Change in interest rates (basis points)	Percentage change in net interest income	Percentage change in net income	Percentage change in market value of portfolio equity
+400	5.9	% 21.2	% 2.3
+300	4.5	% 15.9	% 2.3
+200	3.0	% 11.1	% 2.0
+100	2.0	% 7.1	% 2.1
0	-	-	-
-100	(3.6))% (14.4))% (5.6)
-200	(10.7))% (44.2))% (18.2)

Edgar Filing: Howard Bancorp Inc - Form 10-K

A summary of the repricing schedule of our interest-earning assets and interest-bearing liabilities as of December 31, 2018 is presented below.

	Interest Rate Sensitivity Period							Total Rate Sensitive
	Less than 30 Days	30-90 Days	91-180 Days	181-365 Days	1-2 Years	2-5 Years	Over 5 Years	
(Dollars in thousands)								
Earning assets								
Other earning assets	\$76,702	\$-	\$-	\$-	\$-	\$-	\$-	\$76,702
Investment securities	11,226	42,328	6,561	10,969	46,638	81,203	45,973	244,898
Loans and leases	248,392	281,427	78,964	146,605	210,539	459,170	226,816	1,651,913
Loans held for sale	20,785	-	-	-	-	-	-	20,785
Total earning assets	357,105	323,755	85,525	157,574	257,177	540,373	272,789	1,994,298
Interest-bearing liabilities								
Interest-bearing checking	\$-	\$-	\$-	\$-	\$-	\$-	\$227,271	\$227,271
Money market accounts	-	356,131	-	-	-	-	-	356,131
Savings	-	-	-	-	-	-	134,099	134,099
Certificates of deposit	54,743	69,937	110,117	90,966	128,409	84,317	(312)	538,177
Short-term borrowings	48,000	-	-	10,000	114,000	-	-	172,000
Long-term borrowings	20,000	40,000	-	-	-	-	-	60,000
Total interest-bearing liabilities	122,743	466,068	110,117	100,966	242,409	84,317	361,058	1,487,678
Interest rate sensitivity gap	\$234,362	\$(142,313)	\$(24,592)	\$56,608	\$14,768	\$456,056	\$(88,269)	\$506,620
Cumulative interest rate sensitivity gap	\$234,362	\$92,049	\$67,457	\$124,065	\$138,833	\$594,889	\$506,620	11
Cumulative sensitivity gap as percent of total assets	20.38 %	8.00 %	5.87 %	10.79 %	12.07 %	51.73 %	44.06 %	11 %

Part II

Item 8. Financial Statements and Supplementary Data

Report Of Independent Registered Public Accounting Firm

Stockholders and the Board of Howard Bancorp, Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Howard Bancorp, Inc. and Subsidiary (the “Company”) as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, change in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2019 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2016.

/s/ Dixon Hughes Goodman LLP

Baltimore, Maryland

March 15, 2019

Report Of Independent Registered Public Accounting Firm

Stockholders and the Board of Directors of Howard Bancorp, Inc.

Opinion on Internal Control Over Financial Reporting

We have audited Howard Bancorp, Inc. and Subsidiary (the “Company”)’s internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, Howard Bancorp, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the consolidated financial statements of Howard Bancorp, Inc. and Subsidiary as of December 31, 2018 and 2017, and for each of the years in the three years ended December 31, 2018, and our report dated March 15, 2019, expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Effectiveness of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Dixon Hughes Goodman LLP

Baltimore, Maryland

March 15, 2019

Howard Bancorp, Inc. and Subsidiary**Consolidated Balance Sheets**

(in thousands, except share data)	December 31,	
	2018	2017
ASSETS		
Cash and due from banks	\$ 100,976	\$ 28,856
Federal funds sold	522	116
Total cash and cash equivalents	101,498	28,972
Securities available for sale, at fair value	223,858	74,256
Securities held to maturity, at amortized cost	9,250	9,250
Nonmarketable equity securities	11,786	6,492
Loans held for sale, at fair value	21,261	42,153
Loans and leases, net of unearned income	1,649,751	936,608
Allowance for credit losses	(9,873)	(6,159)
Net loans and leases	1,639,878	930,449
Bank premises and equipment, net	45,137	19,189
Goodwill	70,697	603
Core deposit intangible	11,482	1,743
Bank owned life insurance	74,153	28,631
Other real estate owned	4,392	1,549
Deferred tax assets, net	35,285	813
Interest receivable and other assets	17,837	5,850
Total assets	\$ 2,266,514	\$ 1,149,950
LIABILITIES		
Noninterest-bearing deposits	\$ 429,200	\$ 218,139
Interest-bearing deposits	1,256,606	645,769
Total deposits	1,685,806	863,908
Short-term borrowings	134,576	130,385
Long-term borrowings	142,077	18,535
Accrued expenses and other liabilities	9,372	4,869
Total liabilities	1,971,831	1,017,697
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock - par value of \$0.01 authorized 20,000,000 shares; issued and outstanding 19,039,347 shares at December 31, 2018 and 9,820,592 at December 31, 2017	190	98
Capital surplus	275,843	110,387
Retained earnings	18,277	22,105
Accumulated other comprehensive (loss) income	373	(337)
Total stockholders' equity	294,683	132,253
Total liabilities and stockholders' equity	\$ 2,266,514	\$ 1,149,950

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

Consolidated Statements of Operations

(in thousands, except share data)	December 31,		
	2018	2017	2016
INTEREST INCOME			
Interest and fees on loans and leases	\$75,009	\$41,213	\$37,865
Interest and dividends on securities	4,297	1,416	691
Other interest income	1,083	397	185
Total interest income	80,389	43,026	38,741
INTEREST EXPENSE			
Deposits	8,540	3,997	3,470
Short-term borrowings	2,327	876	595
Long-term borrowings	2,904	294	497
Total interest expense	13,771	5,167	4,562
NET INTEREST INCOME	66,618	37,859	34,179
Provision for credit losses	6,091	1,831	2,037
Net interest income after provision for credit losses	60,527	36,028	32,142
NONINTEREST INCOME			
Service charges on deposit accounts	2,216	923	694
Realized and unrealized gains on mortgage banking activity	5,245	11,035	8,098
(Loss) gain on the sale of securities	(364)	-	96
Gain on the sale of portfolio loans	-	86	532
Loss on the disposal of bank premises & equipment	(345)	(13)	(70)
Income from bank owned life insurance	1,614	760	623
Loan fee income	5,624	5,722	3,903
Other operating income	3,870	1,011	920
Total noninterest income	17,860	19,524	14,796
NONINTEREST EXPENSE			
Compensation and benefits	33,674	23,573	19,034
Occupancy and equipment	10,650	4,154	4,622
Amortization of core deposit intangible	2,856	505	655
Marketing and business development	3,338	4,231	3,375
Professional fees	2,471	1,968	2,111
Data processing fees	4,037	2,038	1,723
Merger and restructuring expense	15,549	567	-
FDIC assessment	1,268	650	780
Other real estate owned	500	655	97
Loan production expense	3,523	3,743	3,016
Other operating expense	5,246	3,116	3,286
Total noninterest expense	83,112	45,200	38,699
(LOSS) INCOME BEFORE INCOME TAXES	(4,725)	10,352	8,239
Income tax (benefit) expense	(897)	3,152	2,936
NET (LOSS) INCOME	\$(3,828)	\$7,200	\$5,303
Preferred stock dividends	-	-	166
Net income available to common stockholders	\$(3,828)	\$7,200	\$5,137
NET (LOSS) INCOME PER COMMON SHARE			

Edgar Filing: Howard Bancorp Inc - Form 10-K

Basic	\$ (0.22)	\$ 0.75	\$ 0.74
Diluted	\$ (0.22)	\$ 0.75	\$ 0.73

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

Consolidated Statements of Comprehensive Income

(in thousands)	December 31,		
	2018	2017	2016
Net (Loss) Income	\$(3,828)	\$7,200	\$5,303
Other comprehensive (loss) income			
Investments available-for-sale:			
Reclassification adjustment for loss (gain)	364	-	(96)
Related income tax	(100)	-	38
Unrealized holding (losses) gains	602	(217)	(90)
Related income tax benefit (expense)	(156)	30	30
Comprehensive (loss) income	\$(3,118)	\$7,013	\$5,185

Consolidated Statements of Changes in Stockholders' Equity

(dollars in thousands, except share data)	Preferred stock	Number of shares	Common stock	Capital surplus	Retained earnings	Accumulated	Total
						other comprehensive (loss) income	
Balances at January 1, 2016	\$12,562	6,962,139	\$70	\$70,587	\$9,712	\$(32)	\$92,899
Net income	-	-	-	-	5,303	-	5,303
Net unrealized loss on securities	-	-	-	-	-	(118)	(118)
Dividends paid on preferred stock	-	-	-	-	(166)	-	(166)
Redemption of preferred stock	(12,562)	-	-	-	-	-	(12,562)
Director stock awards	-	7,241	-	160	-	-	160
Exercise of options	-	3,020	-	35	-	-	35
Stock-based compensation	-	18,672	-	239	-	-	239
Balances at December 31, 2016	-	6,991,072	70	71,021	14,849	(150)	85,790
Net income	-	-	-	-	7,200	-	7,200
Net unrealized loss on securities	-	-	-	-	-	(187)	(187)
Reclassification of tax effects resulting from the Tax Cuts and Jobs Act	-	-	-	-	56	-	56
Common stock offering	-	2,760,000	28	38,355	-	-	38,383
Director stock awards	-	11,404	-	205	-	-	205
Exercise of options	-	27,113	-	316	-	-	316
Stock-based compensation	-	31,003	-	490	-	-	490
Balances at December 31, 2017	-	9,820,592	98	110,387	22,105	(337)	132,253
Net loss	-	-	-	-	(3,828)	-	(3,828)
Net unrealized gain on securities	-	-	-	-	-	710	710
Acquisition of First Mariner Bank	-	9,143,222	92	164,486	-	-	164,578
Director stock awards	-	11,868	-	217	-	-	217
Exercise of options	-	9,123	-	97	-	-	97
Stock-based compensation	-	54,542	-	656	-	-	656

Edgar Filing: Howard Bancorp Inc - Form 10-K

Balances at December 31, 2018	\$-	19,039,347	\$ 190	\$275,843	\$18,277	\$ 373	\$294,683
-------------------------------	-----	------------	--------	-----------	----------	--------	-----------

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

Consolidated Statements of Cash Flows

(in thousands)	Year Ended December 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	\$(3,828)	\$7,200	\$5,303
Adjustments to reconcile net (loss) income to net cash from operating activities:			
Provision for credit losses	6,091	1,831	2,037
Deferred income tax (benefit)	(3,468)	(1,132)	(1,229)
Provision for other real estate owned	352	581	83
Depreciation and amortization	2,188	1,287	1,241
Stock-based compensation	873	695	399
Net (accretion) amortization of investment securities	(1)	81	(3)
Net accretion of discount on purchased loans	(2,313)	(575)	(714)
Loss (gain) on sales of securities	364	-	(96)
Loss on the sale of property	345	13	70
Net amortization of intangible asset	2,856	505	655
Loans originated for sale	(586,385)	(673,448)	(599,299)
Proceeds from sale of loans originated for sale	640,710	693,384	606,020
Realized and unrealized gains on mortgage banking activity	(5,245)	(11,035)	(8,098)
(Gain) loss on sales of other real estate owned, net	(64)	(12)	14
Gain on sale of portfolio loans, net	-	(86)	(532)
Cash surrender value of BOLI	(1,614)	(760)	(623)
Increase in interest receivable	(452)	(672)	(649)
Increase in interest payable	373	124	5
Decrease (increase) in other assets	5,493	(1,372)	(817)
(Decrease) increase in other liabilities	(1,464)	293	(1,460)
Net cash provided by operating activities	54,811	16,902	2,307
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of interest bearing deposits with banks	-	-	(19,513)
Proceeds from maturities of interest bearing deposits with banks	-	19,513	-
Purchases of investment securities available-for-sale	(193,805)	(59,347)	(84,969)
Purchases of investment securities held-to-maturity	-	(3,000)	(3,250)
Proceeds from sale/maturities of investment securities available-for-sale	169,291	23,520	95,731
Net increase in loans and leases outstanding	(49,995)	(120,321)	(68,273)
Purchase of bank owned life insurance	-	(6,500)	(2,200)
Proceeds from the sale of other real estate owned	1,088	232	178
Proceeds from the sale of portfolio loans	-	3,798	4,263
Purchase of premises and equipment	(1,943)	(409)	(627)
Proceeds from the sale of premises and equipment	5,161	-	-
Cash acquired in acquisition	38,889	-	-
Net cash used in investing activities	(31,314)	(142,514)	(78,660)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in deposits	115,463	55,174	61,327
Net (decrease) increase in short-term borrowings	(180,829)	23,329	37,935
Proceeds from issuance of long-term debt	123,543	15,016	2,810

Edgar Filing: Howard Bancorp Inc - Form 10-K

Repayment of long-term debt	-	(17,000)	(12,000)
Net proceeds from issuance of common stock, net of cost	97	38,699	35
Cash consideration paid in acquisition	(9,245)	-	-
Redemption of preferred stock	-	-	(12,562)
Cash dividends on preferred stock	-	-	(166)
Net cash provided by financing activities	49,029	115,218	77,379
Net increase (decrease) in cash and cash equivalents	72,526	(10,394)	1,026
Cash and cash equivalents at beginning of period	28,972	39,366	38,340
Cash and cash equivalents at end of period	\$ 101,498	\$ 28,972	\$ 39,366
SUPPLEMENTAL INFORMATION			
Cash payments for interest	\$ 13,123	\$ 5,044	\$ 4,557
Cash payments for income taxes	-	3,440	3,145
Transferred from loans to other real estate owned	917	-	256
Assets acquired in business combination (net of cash received)	971,431	-	-
Liabilities assumed in business combination	897,569	-	-

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

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Nature of Operations

On December 15, 2005, Howard Bancorp, Inc. (“Bancorp” or the “Company”) acquired all of the stock and became the holding company of Howard Bank (the “Bank”) pursuant to the Plan of Reorganization approved by the stockholders of the Bank and by federal and state regulatory agencies. Each share of the Bank’s common stock was converted into two shares of Bancorp common stock effected by the filing of Articles of Exchange on that date, and the stockholders of the Bank became the stockholders of Bancorp. The Bank has nine subsidiaries, six of which are intended to hold foreclosed real estate (three of which currently hold properties) and two of the others own and manages real estate that is used as office and branch locations. The accompanying consolidated financial statements of Bancorp and its wholly-owned subsidiary bank (collectively the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Bancorp was incorporated in April 2005 under the laws of the State of Maryland and is a bank holding company registered under the Bank Holding Company Act of 1956. Bancorp is a single bank holding company with one subsidiary, Howard Bank, which operates as a state trust company with commercial banking powers regulated by the Maryland Office of the Commissioner of Financial Regulation (the “Commissioner”).

On May 6, 2016, Bancorp redeemed all of the 12,562 shares of the Series AA Preferred Stock that it had previously issued to the U.S. Department of the Treasury (the “Treasury”) under its Small Business Lending Fund (“SBLF”) program. The aggregate redemption price of the Series AA Preferred Stock was approximately \$12.7 million, including dividends accrued but unpaid through the redemption date. The redemption of the Series AA Preferred Stock was funded with variable rate debt with Raymond James Bank, N.A. This debt matured one year from commencement, with interest only payments based upon 30 day London Inter-Bank Offered Rate (“LIBOR”) plus 300 basis points.

On February 1, 2017, Bancorp closed an underwritten public offering, pursuant to which Bancorp issued and sold 2,760,000 shares, which included the exercise in full by the underwriters to purchase an additional 360,000 shares, at the public offering price of \$15.00 per share. The amount of gross proceeds raised in this offering was approximately \$41.4 million, after underwriting discounts and estimated, and the amount of net proceeds raised in this offering was \$38.4 million.

On March 1, 2018, Bancorp completed its previously announced merger (the “First Mariner merger”) with First Mariner Bank, a Maryland chartered trust company (“First Mariner”), pursuant to the Agreement and Plan of Reorganization dated as August 14, 2017, and as amended by Amendment No. 1 on November 8, 2017, by and among Bancorp, the Bank and First Mariner (as amended, the “First Mariner Merger Agreement”). At the effective time of the First Mariner merger, First Mariner merged with and into the Bank, with the Bank continuing as the surviving bank of the First Mariner merger and a wholly owned subsidiary of the Company. At the effective time of the Merger, each outstanding share of First Mariner common stock and First Mariner Series A Non-Voting Non-Cumulative Perpetual Preferred Stock issued and outstanding was cancelled and converted into the right to receive 1.6624 shares of Bancorp common stock, provided that cash was paid in lieu of any fractional shares. The aggregate merger consideration of \$173.8 million included \$9.2 million of cash and 9,143,222 shares of our common stock, which was valued at approximately \$164.6 million based on Bancorp’s closing stock price of \$18.00 on February 28, 2018.

On December 6, 2018, the Company entered into Subordinated Note Purchase Agreements with certain institutional accredited investors (the “Purchasers”) pursuant to which the Company sold and issued \$25,000,000 in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes due December 6, 2028 (the “Notes”). The Notes were issued by the Company to the Purchasers at a price equal to 100% of their face amount in a private offering in reliance on the exemptions from registration available under Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), and the provisions of Regulation D thereunder. The Company intends to use the net proceeds from this offering for general corporate purposes, to provide for continued growth and to supplement its regulatory capital ratios.

The Company is a diversified financial services company providing commercial banking, mortgage banking and consumer finance through banking branches, the internet and other distribution channels to businesses, business owners, professionals and other consumers located primarily in the Greater Baltimore Metropolitan Area.

The following is a description of the Company's significant accounting policies.

Principles of Consolidation

The consolidated financial statements include the accounts of Bancorp, its subsidiary bank and the Bank's subsidiaries. All significant intercompany accounts and transactions have been eliminated. The parent company only financial statements report investments in the subsidiary bank under the equity method.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near-term relate to the determination of the allowance for credit losses, goodwill, deferred tax assets, other-than-temporary impairment of investment securities and the fair value of loans held for sale.

Segment Information

The Company has one reportable segment, "Community Banking." All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, lending is dependent upon the ability of the Bank to fund itself with deposits and other borrowings and manage interest rate and credit risk. Accordingly, all significant operating decisions are based upon analysis of the Company as one segment or unit.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, cash items in the process of clearing, federal funds sold, and interest-bearing deposits with banks with original maturities of less than 90 days. Generally, federal funds are sold as overnight investments.

Investment Securities

Debt securities not classified as held-to-maturity are classified as available-for-sale. Investments held-to-maturity represents securities that the Company has both intent and ability to hold until maturity. Securities available-for-sale are acquired as part of the Bank's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk and other factors. Securities available-for-sale are carried at estimated fair value, with unrealized gains or losses based on the difference between amortized cost and fair value reported as accumulated other comprehensive income (loss), net of deferred taxes, a separate component of stockholders' equity, when appropriate. Realized gains and losses, using the specific identification method, are included as a separate component of noninterest income. Related interest and dividends are included in interest income. Held-to-maturity investments premiums and discounts are amortized to interest income using the effective interest method. Declines in the fair value of individual securities below their amortized cost that are other than temporary result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or that management would not have the intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value or that management would be required to sell the security before recovery in fair value.

Nonmarketable Equity Securities

Nonmarketable equity securities include equity securities that are not publicly traded or are held to meet regulatory requirements such as Federal Home Loan Bank ("FHLB") stock. These securities are accounted for at cost. As of December 31, 2018 and 2017 none of the non-marketable equity securities were considered impaired. Due to redemptive provisions of the FHLB, cost approximates fair value.

Marketable Equity Securities

Marketable equity securities are carried at estimated fair value based on quoted prices. Effective January 1, 2018, changes in fair value of marketable equity securities are recognized in net income. At December 31, 2018, marketable equity securities amounted to \$3.7 million and are included in interest receivable and other assets caption of the consolidated balance sheet. At December 31, 2017, marketable equity securities totaled \$2.5 million and were included with available-for-sale securities with unrealized losses excluded from net income and reported in accumulated other comprehensive income (loss).

Derivative Instruments and Hedging Activity

The Company's risk management strategy incorporates the use of interest rate swap contracts that help in managing interest rate risk within the loan portfolio. These derivatives not designated as hedges and are not speculative, and result from a service the Company provides to certain customers. During 2018, the Company entered into an interest rate swap transaction. The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions. As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings.

By using derivative instruments, the Company is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the fair value gain in a derivative. When the fair value of a derivative contract is positive, this situation generally indicates that the counterparty is obligated to pay the Company, and, therefore, creates a repayment risk for the Company. When the fair value of a derivative contract is negative, the Company is obligated to pay the counterparty and therefore, has no repayment risk. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by the Company.

The Company's derivative activities are monitored by its Asset-Liability Management Committee as part of that committee's oversight of the Company's asset/liability and treasury functions. The Company's Asset-Liability Management Committee is responsible for implementing various hedging strategies that are developed through its analysis of data from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the overall interest-rate risk management process.

The Company recognizes the fair value of derivatives as assets or liabilities in the financial statements. The accounting for the changes in the fair value of a derivative depends on the intended use of the derivative instrument at inception. The change in fair value of the effective portion of cash flow hedges is accounted for in other comprehensive income rather than net income. Changes in fair value of derivative instruments that are not intended as a hedge are accounted for in the net income in the period of the change (see Derivatives and Hedging Activities footnote for further disclosure).

Loans Held For Sale

The Company engages in sales of residential mortgage loans originated by the Bank. The Company has elected to measure loans held for sale at fair value. Fair value is based on outstanding investor commitments or, in the absence of such commitments, on current investor yield requirements based on third party models. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations. The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing. Interest on loans held for sale is credited to income based on the principal amounts outstanding.

Upon sale and delivery, loans are legally isolated from the Company and the Company has no ability to restrict or constrain the ability of third party investors to pledge or exchange the mortgage loans. The Company does not have the entitlement or ability to repurchase the mortgage loans or unilaterally cause third party investors to put the mortgage loans back to the Company. Unrealized and realized gains on loan sales are determined using the specific identification method and are recognized through mortgage banking activity in the Consolidated Statements of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitment). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 60 days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest rate risk on the loan.

For purposes of calculating fair value of rate lock commitments, the Bank estimates loan closing and investor delivery rate based on historical experience. The measurement of the estimated fair value of the rate lock commitments is presented as realized and unrealized gains from mortgage banking activities with the corresponding balance sheet amount presented as part of other assets.

The Company elected to measure loans held for sale at fair value to better align reported results with the underlying economic changes in value of the loans on the Company's balance sheet. Loans held for sale that were not ultimately sold, but instead were placed into the Bank's portfolio, are reclassified to loans held for investment and continue to be recorded at fair value.

Loans and Leases

Loans are stated at their principal balance outstanding, plus deferred origination costs, less unearned discounts and deferred origination fees. Interest on loans is credited to income based on the principal amounts outstanding. Origination fees and costs are amortized to income over the contractual life of the related loans. Generally, accrual of interest on a loan is discontinued when the loan is delinquent more than 90 days unless the collateral securing the loan is sufficient to liquidate the loan. All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income. Interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are tested for impairment no later than when principal or interest payments become 90 days or more past due and they are placed on non-accrual. Management also considers the financial condition of the borrower, cash flows of the loan and the value of the related collateral. Impaired loans do not include large groups of smaller balance homogeneous loans such as residential real estate and consumer installment loans which are evaluated collectively for impairment. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (90 days or less) provided eventual collection of all amounts due is expected. The impairment of a loan may be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided by the collateral. Generally, the Company's impairment on such loans is measured by reference to the fair value of the collateral. Interest income on impaired loans is recognized on the cash basis.

The segments of the Company's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate ("CRE") loan segment is further disaggregated into two classes; owner occupied loans and non-owner occupied loans. Non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, generally have a greater risk profile than owner occupied CRE loans. The residential mortgage loan segment is further disaggregated into two classes: first lien mortgages and second or junior lien mortgages.

Allowance for Credit Losses

The allowance for credit 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, actual loss experience, current economic events in specific industries and geographic areas including unemployment levels and other pertinent factors including 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 homogenous loans based on historical loss experience and consideration of economic trends, all of which may be susceptible to significant change. Credit losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit 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 credit losses consists of a specific component and a nonspecific component. The components of the allowance for credit losses represent an estimation done pursuant to either the Financial Accounting Standards Board's (the "FASB") Accounting Standards Codification ("ASC") Topic 450 *Contingencies* or ASC Topic 310 *Receivables*. The specific component of the allowance for credit losses reflects expected losses resulting from analysis developed through credit allocations for individual loans. The credit allocations are based on a regular analysis of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The specific component of the allowance for credit losses also includes management's determination of the amounts necessary given concentrations and changes in portfolio mix and volume.

The nonspecific portion of the allowance is determined based on management's assessment of general economic conditions, as well as economic factors in the individual markets in which the Company operates including the strength and timing of economic cycles and concerns over the effects of a prolonged economic downturn in the current cycle. This determination inherently involves a higher risk of uncertainty and considers current risk factors that may not have yet manifested themselves in the Bank's historical loss factors used to determine the nonspecific component of the allowance, and it recognizes knowledge of the portfolio may be incomplete. The Bank's historic loss factors are based upon actual losses incurred by portfolio segment over the preceding 24-month period. In portfolio segments where no actual losses have been incurred within the most recent 24-month period, industry loss data for that portfolio segment, as provided by the Federal Deposit Insurance Corporation ("FDIC"), are utilized. In addition to historic loss factors, the Bank's methodology for the allowance for credit losses also incorporates other risk factors that may be inherent within the portfolio segments. For each portfolio segment, in addition to the historic loss experience, the other factors that are measured and monitored in the overall determination of the allowance include:

- changes in lending policies, procedures, practices or personnel;
- changes in the level and composition of construction portfolio and related risks;
- changes and migration of classified assets;
- changes in exposure to subordinate collateral lien positions;
- levels and composition of existing guarantees on loans by the Small Business Administration or other agencies;
- changes in national, state and local economic trends and business conditions;
- changes and trends in levels of loan payment delinquencies; and
- any other factors that management considers relevant to the quality or performance of the loan portfolio.

Each of these qualitative risk factors is measured based upon data generated either internally, or in the case of economic conditions utilizing independently provided data on items such as unemployment rates, commercial real estate vacancy rates, or other market data deemed relevant to the business conditions within the markets served.

The Company's loan policies state that after all collection efforts have been exhausted, and the loan is deemed to be a loss, then the remaining loan balance will be charged to the Company's established allowance for credit losses. All loans are evaluated for loss potential once it has been determined by the Watch Committee that the likelihood of repayment is in doubt. When a loan is past due for at least 90 days or a deterioration in debt service coverage ratio, guarantor liquidity, or loan-to-value ratio has occurred that would cause concern regarding the likelihood of the full repayment of principal and interest, and the loan is deemed not to be well secured, the loan should be moved to non-accrual status and a specific reserve is established if the net realizable value is less than the principal value of the loan balance(s). Once the actual loss value has been determined a charge-off against the allowance for credit losses for the amount of the loss is taken. Each loss is evaluated on its specific facts regarding the appropriate timing to recognize the loss.

Goodwill, Other Intangible Assets and Long-Lived Assets

Goodwill represents the excess of the purchase price over the sum of the estimated fair values of tangible and identifiable intangible assets acquired less the estimated fair value of the liabilities assumed. Core deposit intangibles represent the estimated value of long-term deposit relationships acquired in a business combination. The core deposit intangible is amortized over the estimated useful lives of the acquired long-term deposits acquired, and the remaining amounts of the core deposit intangible are periodically reviewed for impairment. Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. Long-lived assets are those that provide the company with a future economic benefit beyond the current year or operating period. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset is greater than the fair value of the asset. Assets to be disposed of are reported at the lower of the cost or the fair value, less costs to sell. An impairment analysis is performed annually.

Management has determined that Bancorp has one reporting unit, and based upon the annual impairment analysis, it was determined that there was not an impairment of the carrying value of either the goodwill, core deposit intangible or other long-lived assets for 2018.

Business Combinations

GAAP requires that the acquisition method of accounting, formerly referred to as the purchase method, be used for all business combinations and that an acquirer be identified for each business combination. Under GAAP, the acquirer is the entity that obtains control of one or more businesses in the business combination, and the acquisition date is the date the acquirer achieves control. GAAP requires that the acquirer recognize the fair value of assets acquired, liabilities assumed, and any non-controlling interest in the acquired entity at the acquisition date.

Other Real Estate Owned

Other real estate acquired through, or in lieu of, foreclosure is initially recorded at fair value less estimated cost to sell at the date of acquisition, establishing a new cost basis. Revenues and expenses from operations are included in noninterest income. Additions to the valuation allowance are included in noninterest expense. Subsequent to foreclosure, valuations are periodically performed by management and an allowance for losses is established, if necessary, by a charge to operations if the carrying value of a property exceeds its estimated fair value less estimated costs to sell.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method. Premises and equipment are depreciated over the useful lives of the assets, which generally range from three to 10 years for furniture, fixtures and equipment and three to five years for computer software and hardware. Bank owned premises are depreciated over a range of 20 to 30 years. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are included in noninterest expense.

Income Taxes

The Company uses the asset/liability method of accounting for income taxes. Under the asset/liability method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse.

As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. In addition, deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or the entire deferred tax asset will not be realized.

The Company does not have uncertain tax positions that are deemed material, and did not recognize any adjustments for unrecognized tax benefits. The Company's policy is to recognize interest and penalties on income taxes in other noninterest expenses. The Company remains subject to examination by federal and state taxing authorities for income tax returns for the years ending after December 31, 2015.

Net Income Per Common Share

Basic net income per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the year. Diluted net income per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the year including any potential dilutive effects of common stock equivalents, such as options and warrants.

Share-Based Compensation

Compensation cost is recognized for stock options issued to directors and employees. Compensation cost is measured as the fair value of these awards on their date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period for stock option awards. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. When an award is granted to an employee who is retirement eligible, the compensation cost of these awards is recognized over the period up to when the director or employee first becomes eligible to retire.

Compensation expense for non-vested common stock awards is based on the fair value of the awards, which is generally the market price of the common stock on the measurement date, which, for the Company, is the date of grant, and is recognized ratably over the service period of the award.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated balance sheet when they are funded.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income. The Company's sole component of accumulated other comprehensive income/loss is unrealized gains/losses on available for sale securities.

Transfer 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. In certain cases, the recourse to the Bank to repurchase assets may exist but is deemed immaterial based on the specific facts and circumstances.

Reclassifications

Certain reclassifications to 2017 and 2016 financial presentation were made to conform to the 2018 presentation. These reclassifications did not affect previously reported net income or total stockholders' equity.

New Accounting Pronouncements

The FASB has issued ASU 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate ("SOFR") Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. This ASU permits use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes. Alternative Reference Rates Committee "ARRC" has proposed that the SOFR is the rate that represents best practice as the alternative to derivatives currently indexed to LIBOR. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The amendments should be adopted on a prospective basis for qualifying new or re-designated hedging relationships entered into on or after the date of adoption. The Company has non-designated hedge contracts that are indexed to LIBOR and is monitoring this activity and evaluating the related risks as they relate to derivatives.

The FASB has issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework— Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reason for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. ASU 2018-13 only revises disclosure requirements, it will not have a material impact on the

Company's Consolidated Financial Statements.

The FASB has issued ASU 2018-11, *Lease – Targeted Improvements*. The ASU provide entities with relief from the cost of implementing certain aspects of the new leasing standard, ASU 2016-02. Specifically, under the amendments in ASU 2018-11: (1) Entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate leases and non-leases components when certain conditions are met. The amendments have the same effective date as ASU 2016-02, January 1, 2019. The Company has elected both options. ASU 2018-11 will not have a material impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. This ASU's objectives are to 1) improve the transparency and understanding of information conveyed to financial statements users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities; and 2) reduce the complexity of and simplify the application of hedge accounting by preparers. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as formal hedging relationships and therefore, does not utilize hedge accounting. However, the Company is currently evaluating this ASU to determine whether its provision will enhance the Company's ability to employ risk management strategies, while improving the transparency and understanding of those strategies for financial statement users.

The FASB has issued ASU 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. This ASU clarifies when changes to the term or conditions of a share-based payment award must be accounted for as a modification. Under this ASU, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: 1) The fair value; 2) the award's vesting conditions; and 3) the award's classification as an equity or liability instrument. Adoption of ASU No. 2017-09 did not have an impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. This will not have a significant impact on the Company's financial position or result of operations.

The FASB has issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The amendments in this Update simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The Company should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. Impairment charges should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value, however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The impairment charge is limited to the amount of goodwill allocated to that reporting unit. The amendments in this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company will evaluate the guidance in this update but does not expect it to have a significant impact on the Company's financial position or result of operations.

The FASB has issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendments in this Update provide clarification on the definition of a business and provides criteria to aid in the assessment of whether a transaction should be accounted for as an acquisition or a disposal of assets or business. The amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Adoption of ASU 2017-01 did not have a material impact on the Company's financial position or result of operations.

The FASB has issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*. The main objective of this update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the guidance in this update replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable

and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The guidance in this update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU 2016-02, *Leases (Topic 842)*. The new guidance will, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors. This guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company leases certain properties under operating leases that will result in recognition on the Company's Consolidated Balance Sheet. Upon adoption of ASU 2016-02, on January 1, 2019, we expect to recognize right-of-use assets and related lease liabilities totaling \$15.8 million.

The FASB has issued ASU No. 2016-01, *Financial Instruments – Recognition and Measurement of Financial Assets and Liabilities*. ASU No. 2016-01 requires equity investments to be measured at fair value with changes in fair value recognized in net income, excluding equity investments that are consolidated or accounted for under the equity method of accounting. The guidance allows equity investments without readily determinable fair values to be measured at cost minus impairment, with a qualitative assessment required to identify impairment. The guidance also: requires public companies to use exit prices to measure the fair value of financial instruments for disclosure purposes; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and eliminates the disclosure requirements related to measurement assumptions for the fair value of instruments measured at amortized cost. In addition, the guidance requires that for liabilities measured at fair value under the fair value option, changes in fair value due to changes in instrument-specific credit risk be presented in other comprehensive income. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Adoption of ASU 2016-01 did not have a material impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance in this update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. As allowed by this ASU the Company is permitted to adopt using the full retrospective transition method for all periods presented, or modified retrospective method where the guidance would only be applied to existing contracts in effect at the adoption date and new contracts going forward. The Company's revenue stream within the scope of ASU No. 2014-09 is primarily from service charges on deposit accounts. The Company used a modified retrospective approach to uncompleted contracts at the date of adoption. Periods prior to the date of adoption are not retrospectively revised, but a cumulative effect of adoption is recognized for the impact of the ASU on uncompleted contracts at the date of adoption. The impact of guidance in this update, including method of implementation, did not have a material impact on the Company's Consolidated Financial Statements. See Notes to Consolidated Financial Statements "Revenue Recognition" for additional information.

Note 2: Business Combinations

First Mariner Merger

On March 1, 2018, the Company completed its previously announced Merger with First Mariner pursuant to the First Mariner Merger Agreement. At the effective time of the First Mariner merger, First Mariner merged with and into Howard Bank, with Howard Bank continuing as the surviving bank of the First Mariner merger. At the effective time of the First Mariner merger, pursuant to the terms of the First Mariner Merger Agreement, each outstanding share of First Mariner common stock and First Mariner Series A Non-Voting Non-Cumulative Perpetual Preferred Stock issued and outstanding was cancelled and converted into the right to receive 1.6624 shares of Bancorp common stock, provided that cash was paid in lieu of any fractional shares. The aggregate merger consideration of \$173.8 million included \$9.2 million of cash and 9,143,222 shares of Bancorp common stock, which was valued at approximately \$164.6 million based on the closing price of Bancorp's common stock of \$18.00 on February 28, 2018.

The Company has accounted for the First Mariner merger under the acquisition method of accounting in accordance with FASB ASC Topic 805, "*Business Combinations*," whereby the acquired assets and assumed liabilities were recorded at their estimated fair values as of their acquisition date.

Management made significant estimates and exercised significant judgment in accounting for the acquisition of First Mariner. Management judgmentally assigned risk ratings to loans based on appraisals and estimated collateral values, expected cash flows, prepayment speeds and estimated loss factors to measure fair values for loans. Deposits and borrowings were valued based upon interest rates, original and remaining terms and maturities, as well as current rates for similar funds in the same markets. Premises and equipment was valued based on recent appraised values.

Management used quoted or current market prices to determine the fair value of investment securities.

The following table provides the purchase price as of the acquisition date, the current identifiable assets acquired and liabilities assumed at their estimated fair values, and the resulting goodwill of \$70.1 million recorded from the acquisition:

(in thousands)

Purchase Price Consideration

Cash consideration	\$9,245
Purchase price assigned to shares exchanged for stock	164,578
Total purchase price for First Mariner acquisition	\$173,823
Assets acquired at fair value:	
Cash and cash equivalents	\$38,889
Interest bearing deposits with banks	3,920
Investment securities available for sale	130,302
Loans held for sale	28,189
Loans	664,338
Accrued interest receivable	3,023
Other assets	120,049
Core deposit intangible	12,588
Total fair value of assets acquired	\$1,001,298
Liabilities assumed at fair value:	
Deposits	706,435
Borrowings	185,020
Accrued expenses and other liabilities	6,114
Total fair value of liabilities assumed	\$897,569

Net assets acquired at fair value:	\$103,729
Transaction consideration paid to First Mariner	173,823
Amount of goodwill recorded from First Mariner Acquisition	\$70,094

Acquired loans

The following table outlines the contractually required payments receivable, cash flows we expect to receive, non-accretable credit adjustments and the accretable yield for all First Mariner loans as of the acquisition date.

	Contractually Required Payments Receivable	Non-Accretable Credit Adjustment	Cash Flows Expected to be Collected	Accretable FMV Adjustment	Carring Value of Loans Receivable
Performing loans acquired	\$ 654,621	\$ -	\$ 654,621	\$ 9,054	\$ 645,567

Edgar Filing: Howard Bancorp Inc - Form 10-K

Impaired loans acquired	29,470	9,644	19,826	1,055	18,771
Total loans acquired	\$ 684,091	\$ 9,644	\$ 674,447	\$ 10,109	\$ 664,338

As of the First Mariner Merger date, all loans acquired were recorded at the estimated fair value on the purchase date with no carryover of the related allowance for loan losses. On the First Mariner Merger date, the loan portfolio was segregated into two loan pools, performing and non-performing loans to be retained in our portfolio.

The Company determined the net discounted value of cash flows on approximately 2,700 performing loans totaling \$654.6 million. The valuation took into consideration the loans' underlying characteristics, including account types, remaining terms, annual interest rates, interest types such as fixed or variable rate, past delinquencies, timing of principal and interest payments, current market rates, loan-to-value ratios, loss exposures, and remaining balances. These performing loans were segregated into pools based on loan and payment type and in some cases, risk grade. The effect of this valuation process was a net accretable discount adjustment of \$9.1 million at the First Mariner Merger date.

The Company also individually evaluated 57 impaired loans totaling \$29.5 million of contractually required payments, to determine the fair value as of the March 1, 2018 measurement date. In determining the fair value for each individually evaluated impaired loan, the Company considered a number of factors including the remaining life of the acquired loan, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral and net present value of cash flows the Company expects to receive, among others.

The Company established a credit risk related non-accretable difference of \$9.6 million relating to these acquired, credit impaired loans, reflected in the recorded net fair value. The Company further estimated the timing and amount of expected cash flows in excess of the estimated fair value and established an accretable discount adjustment of \$1.1 million at acquisition relating to these impaired loans.

In connection with the First Mariner merger, the Company incurred merger-related expenses relating to personnel, professional fees, occupancy and equipment and other costs of integrating and conforming acquired operations. Those expenses consisted largely of costs related to professional and consulting services, employment severance and early retirement charges, termination of contractual agreements and conversion of systems and/or integration of operations, initial communication expenses, printing and filing costs of completing the transaction and investment banking charges.

A summary of merger related costs included in the Consolidated Statements of Operations for the year ended December 31, 2018 is summarized as follows:

Compensation related	\$9,871
Equipment disposition	1,918
Legal and consulting	2,005
Contract Terminations	677
Accounting & other	1,078
Total	\$15,549

Pro Forma Condensed Combined Financial Information:

The following table presents unaudited pro forma information as if the First Mariner Merger had been completed on January 1, 2018, January 1, 2017 and January 1, 2016. The pro forma information does not necessarily reflect the results of operations that would have occurred had the First Mariner Merger occurred at the beginning of 2018, 2017 or 2016. Supplemental pro forma earnings were adjusted to exclude merger related costs. The expected future amortizations of the various fair value adjustments were included beginning in each year presented. Cost savings are not reflected in the unaudited pro forma amounts for the periods presented. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions on revenues, expense efficiencies, or other factors.

	December 31,		
	2018	2017	2016
Net interest income after provision	\$66,873	\$59,626	\$58,570
Noninterest income	19,890	29,285	24,557
Noninterest expense	77,699	80,721	74,787
Net income	6,569	1,315	2,732
Net income per share	\$0.35	\$0.09	\$0.18

Note 3: Cash and Due from Banks

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. During 2018 and 2017, the Company maintained balances at the Federal Reserve (in addition to vault cash) to meet the reserve requirements as well as balances to partially compensate for services. Additionally, the Company maintained balances with the Federal Home Loan Bank and other domestic correspondent financial institutions as partial compensation for services they provided to the Company.

Note 4: Investments Securities

The Company holds securities classified as available for sale and held to maturity.

The amortized cost and estimated fair values of investments are as follows:

(in thousands)	December 31, 2018				2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale								
U.S. Government Agencies	\$ 130,088	\$ 428	\$ 119	\$ 130,397	\$ 68,082	\$ -	\$ 342	\$ 67,740
Treasuries	-	-	-	-	1,505	-	11	1,494
Mortgage-backed	90,242	364	146	90,460	2,541	-	62	2,479
Other investments	3,011	-	10	3,001	2,579	-	36	2,543
	\$ 223,341	\$ 792	\$ 275	\$ 223,858	\$ 74,707	\$ -	\$ 451	\$ 74,256
Held to maturity Corporate debentures	\$ 9,250	\$ 45	\$ 42	\$ 9,253	\$ 9,250	\$ 188	\$ 17	\$ 9,421

Gross unrealized losses and fair value by investment category and length of time the individual securities have been in a continuous unrealized loss position at December 31, 2018 and December 31, 2017 are presented below:

December 31, 2018 (in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
U.S. Government Agencies	\$ 3,049	\$ 3	\$ 13,887	\$ 116	\$ 16,936	\$ 119
Mortgage-backed	26,197	54	2,107	92	28,304	146
Other investments	3,001	10	-	-	3,001	10
	\$ 32,247	\$ 67	\$ 15,994	\$ 208	\$ 48,241	\$ 275
Held to maturity Corporate debentures	\$ 2,458	\$ 42	\$ -	\$ -	\$ 2,458	\$ 42

Edgar Filing: Howard Bancorp Inc - Form 10-K

December 31, 2017

(in thousands)

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
U.S. Government						
Agencies	\$ 54,303	\$ 216	\$ 13,437	\$ 126	\$67,740	\$ 342
Treasuries	-	-	1,494	11	1,494	11
Mortgage-backed	1,202	12	1,262	50	2,464	62
Other investments	2,500	36	-	-	2,500	36
	\$ 58,005	\$ 264	\$ 16,193	\$ 187	\$74,198	\$ 451
Held to maturity						
Corporate debentures	\$ 500	\$ 17	\$ -	\$ -	\$500	\$ 17

The unrealized losses that existed were a result of market changes in interest rates since the original purchase. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers and (3) structure of the security. The portfolio contained 31 securities with unrealized losses and 38 securities with unrealized losses at December 31, 2018 and 2017, respectively.

An impairment loss is recognized in earnings if any of the following are true: (1) the Company intends to sell the debt security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. In situations where the Company intends to sell or when it is more likely than not that the Company will be required to sell the security, the entire impairment loss must be recognized in earnings. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being recognized in stockholders' equity as a component of other comprehensive income, net of deferred tax.

The amortized cost and estimated fair values of investments by contractual maturity are shown below:

(in thousands)	December 31,		2017	
	2018 Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Amounts maturing:				
One year or less	\$38,936	\$ 38,892	\$35,105	\$ 34,995
After one through five years	88,175	88,513	34,489	34,248
After five through ten years	19,873	19,921	9,257	9,428
After ten years	85,607	85,785	2,526	2,464
	\$232,591	\$ 233,111	\$81,377	\$ 81,135

At December 31, 2018 and December 31, 2017, \$42.3 million and \$28.8 million fair value of securities, respectively, were pledged as collateral for both repurchase agreements and deposits of local government entities that require pledged collateral as a condition of maintaining these deposit accounts. No single issuer of securities, except for Government agency securities, had outstanding balances that exceeded ten percent of stockholders' equity at December 31, 2018.

Note 5: Nonmarketable Equity Securities

At December 31, 2018 and December 31, 2017, the Company's investment in nonmarketable equity securities consisted of Federal Home Loan Bank stock, which is required for continued membership, of \$11.8 million and \$6.5 million, respectively. This investment is carried at cost.

Note 6: Loans and Leases

The Company makes loans and leases to customers primarily in the Greater Baltimore Maryland metropolitan area, and surrounding communities. A substantial portion of the Company's loan portfolio consists of loans to businesses secured by real estate and/or other business assets.

The loan portfolio segment balances at December 31, 2018 and December 31, 2017 are presented in the following table:

<i>(in thousands)</i>	December 31, 2018			% of Total	December 31, 2017	
	Legacy	Acquired ¹	Total		Total	% of Total
Real estate						
Construction and land	\$87,739	\$35,932	\$123,671	7.5 %	\$74,398	7.9 %
Residential - first lien	209,777	173,267	383,044	23.2	194,896	20.8
Residential - junior lien	45,421	44,224	89,645	5.4	43,047	4.6
Total residential real estate	255,198	217,491	472,689	28.6	237,943	25.4
Commercial - owner occupied	187,166	46,936	234,102	14.2	170,408	18.2
Commercial - non-owner occupied	288,927	138,820	427,747	25.9	260,802	27.8
Total commercial real estate	476,093	185,756	661,849	40.1	431,210	46.0
Total real estate loans	819,030	439,179	1,258,209	76.2	743,551	79.3
Commercial loans and leases	228,422	108,454	336,876	20.5	188,729	20.2
Consumer	21,236	33,430	54,666	3.3	4,328	0.5
Total loans	\$1,068,688	\$581,063	\$1,649,751	100.0%	\$936,608	100.0 %

(1) Loans acquired in 2018, previously acquired loans are included in legacy balances

Net loan origination fees, which are included in the amounts above, totaled \$307 thousand and \$54 thousand at December 31, 2018 and 2017, respectively.

Portfolio Segments

The Company currently manages its credit products and the respective exposure to credit losses (credit risk) by the following specific portfolio segments (classes) which are levels at which the Company develops and documents its

systematic methodology to determine the allowance for credit losses attributable to each respective portfolio segment. These segments are:

Commercial business loans & leases – Commercial loans are made to provide funds for equipment and general corporate needs. Repayment of a loan primarily uses the funds obtained from the operation of the borrower's business. Commercial loans also include lines of credit that are utilized to finance a borrower's short-term credit needs and/or to finance a percentage of eligible receivables and inventory. The Company's loan portfolio also includes a small portfolio of equipment leases, which consists of leases for essential commercial equipment used by small- and medium-sized businesses.

Construction and land loans – Commercial acquisition, development and construction loans are intended to finance the construction of commercial and residential properties and include loans for the acquisition and development of land. Construction loans represent a higher degree of risk than permanent real estate loans and may be affected by a variety of factors such as the borrower's ability to control costs and adhere to time schedules and the risk that constructed units may not be absorbed by the market within the anticipated time frame or at the anticipated price. The loan commitment on these loans often includes an interest reserve that allows the lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan.

Commercial owner occupied real estate loans – Commercial owner-occupied real estate loans consist of commercial mortgage loans secured by owner occupied properties where an established banking relationship exists and involves a variety of property types to conduct the borrower's operations. The primary source of repayment for this type of loan is the cash flow from the business and is based upon the borrower's financial health and the ability of the borrower and the business to repay.

Commercial non-owner occupied real estate loans – Commercial non-owner occupied loans consist of properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. This commercial real estate category contains mortgage loans to the developers and owners of commercial real estate where the borrower intends to operate or sell the property at a profit and use the income stream or proceeds from the sale(s) to repay the loan.

Consumer loans – This category of loans includes primarily installment loans and personal lines of credit. Consumer loans include installment loans used by customers to purchase automobiles, boats and recreational vehicles.

Residential first lien mortgage loans – The residential real estate category contains permanent mortgage loans principally to consumers secured by residential real estate. Residential real estate loans are evaluated for the adequacy of repayment sources at the time of approval, based upon measures including credit scores, debt-to-income ratios, and collateral values. Loans may be either conforming or non-conforming.

Residential junior lien mortgage loans – This category of loans includes primarily home equity loans and lines. The home equity category consists mainly of revolving lines of credit to consumers which are secured by residential real estate. These loans are typically secured with second mortgages on the homes.

Acquired Impaired Loans

The following table documents changes in the accretable discount on acquired impaired loans at December 31, 2018 and 2017:

(in thousands)	December 31,	
	2018	2017
Balance at beginning of period	\$-	\$60
Impaired loans acquired	1,055	-
Accretion of fair value discounts	(178)	(60)
Balance at end of period	\$877	\$-

The table below presents the outstanding balances and related carrying amounts for all acquired impaired loans at the end of the respective periods:

(in thousands)	Contractually	Carrying
	Required	
	Payments	Amount
At December 31, 2018	\$ 15,463	\$ 11,446
At December 31, 2017	1,292	851

Note 7: Credit Quality Assessment

Allowance for Credit Losses

Credit risk can vary significantly as losses, as a percentage of outstanding loans, can vary widely during economic cycles and are sensitive to changing economic conditions. The amount of loss in any particular type of loan can vary depending on the purpose of the loan and the underlying collateral securing the loan. Collateral securing commercial loans can range from accounts receivable to equipment to improved or unimproved real estate depending on the purpose of the loan. Home mortgage and home equity loans and lines are typically secured by first or second liens on residential real estate. Consumer loans may be secured by personal property, such as auto loans or they may be unsecured loan products.

To control and manage credit risk, management has an internal credit process in place to determine whether credit standards are maintained along with an in-house loan administration accompanied by oversight and review procedures. The primary purpose of loan underwriting is the evaluation of specific lending risks that involves the analysis of the borrower's ability to service the debt as well as the assessment of the value of the underlying collateral. Oversight and review procedures include the monitoring of the portfolio credit quality, early identification of potential problem credits and the management of the problem credits. As part of the oversight and review process, the Company maintains an allowance for credit losses (the "allowance") to absorb estimated and probable losses in the loan and lease portfolio. The allowance is based on consistent, continuous review and evaluation of the loan and lease portfolio, along with ongoing assessments of the probable losses and problem credits in each portfolio. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available for credit losses inherent in the total loan portfolio.

The following table provides information on the activity in the allowance for credit losses by the respective loan portfolio segment for the years ended December 31, 2018, 2017 and 2016:

(in thousands)	December 31, 2018							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	
Allowance for credit losses:								
Beginning balance	\$ 735	\$ 668	\$ 177	\$ 617	\$ 1,410	\$ 2,529	\$ 23	\$ 6,159
Charge-offs	(202)	(142)	(195)	(28)	(797)	(1,092)	(63)	(2,519)
Recoveries	-	8	10	-	32	88	4	142
Provision for credit losses	208	636	300	146	3,412	1,119	270	6,091
Ending balance	\$ 741	\$ 1,170	\$ 292	\$ 735	\$ 4,057	\$ 2,644	\$ 234	\$ 9,873
Allowance allocated to:								
individually evaluated for impairment	\$-	\$-	\$-	\$-	\$ 2,195	\$ 200	\$-	\$ 2,395
collectively evaluated for impairment	\$ 741	\$ 1,170	\$ 292	\$ 735	\$ 1,862	\$ 2,444	\$ 234	\$ 7,478
Loans:								
Legacy Loans:								
Ending balance	\$ 87,739	\$ 209,777	\$ 45,421	\$ 187,166	\$ 288,927	\$ 228,422	\$ 21,236	\$ 1,068,688
individually evaluated for impairment	\$ 560	\$ 5,184	\$ 100	\$ 45	\$ 5,018	\$ 2,455	\$-	\$ 13,362
collectively evaluated for impairment	\$ 87,179	\$ 204,593	\$ 45,321	\$ 187,121	\$ 283,909	\$ 225,967	\$ 21,236	\$ 1,055,326
Acquired Loans:								
Ending balance	\$ 35,932	\$ 173,267	\$ 44,224	\$ 46,936	\$ 138,820	\$ 108,454	\$ 33,430	\$ 581,063
purchased credit impaired loans	\$ 889	\$ 8,075	\$ 1,037	\$ 1,223	\$-	\$-	\$ 174	\$ 11,398
collectively evaluated for impairment	\$ 35,043	\$ 165,192	\$ 43,187	\$ 45,713	\$ 138,820	\$ 108,454	\$ 33,256	\$ 569,665

Acquired loans were evaluated for impairment subsequent to the merger. No allowance was required on these loans due to the recently assigned credit marks on these loans.

Edgar Filing: Howard Bancorp Inc - Form 10-K

	December 31, 2017							
(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Allowance for credit losses:								
Beginning balance	\$511	\$454	\$89	\$327	\$1,120	\$3,800	\$127	\$6,428
Charge-offs	(155)	(133)	(31)	(235)	-	(1,605)	(108)	(2,267)
Recoveries	6	-	1	6	6	113	35	167
Provision for credit losses	373	347	118	519	284	221	(31)	1,831
Ending balance	\$735	\$668	\$177	\$617	\$1,410	\$2,529	\$23	\$6,159
Allowance allocated to:								
individually evaluated for impairment	\$202	\$-	\$29	\$-	\$11	\$668	\$-	\$910
collectively evaluated for impairment	\$533	\$668	\$148	\$617	\$1,399	\$1,861	\$23	\$5,249
Loans:								
Ending balance	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608
individually evaluated for impairment	\$761	\$2,009	\$396	\$508	\$5,867	\$3,724	\$-	\$13,265
collectively evaluated for impairment	\$73,637	\$192,887	\$42,651	\$169,900	\$254,935	\$185,005	\$4,328	\$923,343

(in thousands)	December 31, 2016							
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Allowance for credit losses:								
Beginning balance	\$265	\$300	\$47	\$309	\$728	\$3,094	\$126	\$4,869
Charge-offs	(216)	-	-	(191)	-	(234)	(20)	(661)
Recoveries	-	-	-	40	5	101	37	183
Provision for credit losses	462	154	42	169	387	839	(16)	2,037
Ending balance	\$511	\$454	\$89	\$327	\$1,120	\$3,800	\$127	\$6,428
Allowance allocated to:								
individually evaluated for impairment	\$-	\$7	\$-	\$-	\$-	\$2,076	\$72	\$2,155
collectively evaluated for impairment	\$511	\$447	\$89	\$327	\$1,120	\$1,724	\$55	\$4,273
Loans:								
Ending balance	\$72,973	\$195,032	\$35,009	\$134,213	\$216,781	\$162,715	\$4,801	\$821,524
individually evaluated for impairment	\$125	\$785	\$37	\$509	\$3,148	\$5,142	\$167	\$9,913
collectively evaluated for impairment	\$72,848	\$194,247	\$34,972	\$133,704	\$213,633	\$157,573	\$4,634	\$811,611

Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific reserve on an impaired credit is warranted. At such time an action plan is agreed upon for the particular loan, an appraisal will be ordered (for real estate based collateral) depending on the time elapsed since the prior appraisal, the loan balance and/or the result of the internal evaluation. The Company's policy is to strictly adhere to regulatory appraisal standards. If an appraisal is ordered, no more than a 45 day turnaround is requested from the appraiser, who is selected from an approved appraiser list. After receipt of the updated appraisal, the Company's Watch Committee will determine whether a specific reserve or a charge-off should be taken based upon an impairment analysis. When potential losses are identified, a specific provision and/or charge-off may be taken, based on the then current likelihood of repayment, that is at least in the amount of the collateral deficiency, and any potential collection costs, as determined by the independent third party appraisal. Any further collateral deterioration may result in either further specific reserves being established or additional charge-offs. The President and the Chief Lending Officer have the authority to approve a specific reserve or charge-off between Watch Committee meetings to ensure that there are no significant time lapses during this process.

The Company's systematic methodology for evaluating whether a loan is impaired begins with risk-rating credits on an individual basis and includes consideration of the borrower's overall financial condition, resources and payment record, the sufficiency of collateral and, in a select few cases, support from financial guarantors. In measuring impairment, the Company looks to the discounted cash flows of the project itself or the value of the collateral as the

primary sources of repayment of the loan. The Company will consider the existence of guarantees and the financial strength and wherewithal of the guarantors involved in any loan relationship as both a secondary source of repayment and for the potential as the primary repayment of the loan.

The Company typically relies on recent third party appraisals of the collateral to assist in measuring impairment.

Management has established a credit process that dictates that structured procedures be performed to monitor these loans between the receipt of an original appraisal and the updated appraisal. These procedures include the following:

- An internal evaluation is updated quarterly to include borrower financial statements and/or cash flow projections. The borrower may be contacted for a meeting to discuss an update or revised action plan which may include a request for additional collateral.
- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.
- At the Watch Committee meeting the loan may be downgraded and a specific reserve may be decided upon in advance of the receipt of the appraisal if it is determined that the likelihood of repayment is in doubt.

The Company generally follows a policy of not extending maturities on non-performing loans under existing terms. The Company may extend the maturity of a performing or current loan that may have some inherent weakness associated with the loan. Maturity date extensions only occur under terms that clearly place the Company in a position to assure full collection of the loan under the contractual terms and/or terms at the time of the extension that may eliminate or mitigate the inherent weakness in the loan. These terms may incorporate, but are not limited to additional assignment of collateral, significant balance curtailments/liquidations and assignments of additional project cash flows. Guarantees may be a consideration in the extension of loan maturities, but the Company does not extend loans based solely on guarantees. As a general matter, the Company does not view extension of a loan to be a satisfactory approach to resolving non-performing credits. On an exception basis, certain performing loans that have displayed some inherent weakness in the underlying collateral values, an inability to comply with certain loan covenants which are not affecting the performance of the credit or other identified weakness may be extended.

Collateral values or estimates of discounted cash flows (inclusive of any potential cash flow from guarantees) are evaluated to estimate the probability and severity of potential losses. A specific amount of impairment is established based on the Company's calculation of the probable loss inherent in the individual loan. The actual occurrence and severity of losses involving impaired credits can differ substantially from estimates.

Credit risk profile by portfolio segment based upon internally assigned risk assignments are presented below:

(in thousands)	December 31, 2018							
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
Credit quality indicators:								
Legacy Loans:								
Not classified	\$87,305	\$205,573	\$45,321	\$187,121	\$283,771	\$225,698	\$21,236	\$1,056,025
Special mention	-	-	-	-	-	-	-	-
Substandard	434	4,204	100	45	5,156	2,724	-	12,663
Doubtful	-	-	-	-	-	-	-	-
Total	\$87,739	\$209,777	\$45,421	\$187,166	\$288,927	\$228,422	\$21,236	\$1,068,688
Acquired Loans:								
Not classified	\$34,965	\$165,193	\$43,186	\$41,287	\$138,820	\$108,454	\$33,256	\$565,161
Special mention	78	-	-	3,877	-	-	-	3,955
Substandard	889	8,074	1,038	1,772	-	-	174	11,947
Doubtful	-	-	-	-	-	-	-	-
Total	\$35,932	\$173,267	\$44,224	\$46,936	\$138,820	\$108,454	\$33,430	\$581,063

(in thousands)	December 31, 2017							
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
Credit quality indicators:								
Not classified	\$73,761	\$193,174	\$42,651	\$169,900	\$253,255	\$184,858	\$4,328	\$921,927
Special mention	-	-	-	-	1,592	-	-	1,592
Substandard	637	1,103	5	508	3,725	801	-	6,779
Doubtful	-	619	391	-	2,230	3,070	-	6,310
Total	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608

Special Mention - A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in

the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard - Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loans classified Special Mention, Substandard, Doubtful or Loss are reviewed at least quarterly to determine their appropriate classification. All commercial loan relationships are reviewed annually. Non-classified residential mortgage loans and consumer loans are not evaluated unless a specific event occurs to raise the awareness of a possible credit deterioration.

Edgar Filing: Howard Bancorp Inc - Form 10-K

An aged analysis of past due loans are as follows:

(in thousands)	December 31, 2018							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	
Analysis of past due loans:								
Legacy Loans:								
Accruing loans current	\$86,788	\$196,769	\$44,580	\$187,121	\$283,601	\$225,649	\$21,227	\$1,045,735
Accruing loans past due:								
30-59 days past due	-	5,993	397	-	308	49	9	6,756
60-89 days past due	166	2,241	344	-	-	307	-	3,058
Greater than 90 days past due	351	570	-	-	-	-	-	921
Total past due	517	8,804	741	-	308	356	9	10,735
Non-accrual loans	434	4,204	100	45	5,018	2,417	-	12,218
Total loans	\$87,739	\$209,777	\$45,421	\$187,166	\$288,927	\$228,422	\$21,236	\$1,068,688
Acquired Loans:								
Accruing loans current	\$35,043	\$164,752	\$42,304	\$45,713	\$138,696	\$108,409	\$33,256	\$568,173
Accruing loans past due:								
30-59 days past due	-	440	540	-	124	45	-	1,149
60-89 days past due	-	-	343	-	-	-	-	343
Greater than 90 days past due	-	-	-	-	-	-	-	-
Total past due	-	440	883	-	124	45	-	1,492
Non-accrual loans ¹	889	8,075	1,037	1,223	-	-	174	11,398
Total loans	\$35,932	\$173,267	\$44,224	\$46,936	\$138,820	\$108,454	\$33,430	\$581,063

(1) First Mariner purchased credit impaired loans where the Company amortizes the accretable discount into interest income, however these loans do not accrue interest based on the terms of the loan.

(in thousands)	December 31, 2017							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	
Analysis of past due loans:								
Accruing loans current	\$73,386	\$185,135	\$42,491	\$169,596	\$251,608	\$185,239	\$4,328	\$911,783

Edgar Filing: Howard Bancorp Inc - Form 10-K

Accruing loans past due:								
30-59 days past due	279	6,381	110	173	-	52	-	6,995
60-89 days past due	96	1,330	-	-	364	-	-	1,790
Greater than 90 days past due	-	328	50	131	2,963	-	-	3,472
Total past due	375	8,039	160	304	3,327	52	-	12,257
Non-accrual loans	637	1,722	396	508	5,867	3,438	-	12,568
Total loans	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608

Total loans either in non-accrual status or in excess of 90 days delinquent totaled \$24.5 million or 1.5% of total loans outstanding at December 31, 2018, which represents an increase from \$16.0 million or 1.7% at December 31, 2017.

Edgar Filing: Howard Bancorp Inc - Form 10-K

The impaired loans for the years ended December 31, 2018 and 2017 are as follows:

(in thousands)	December 31, 2018							
	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
Impaired loans:								
Legacy Loans:								
Recorded investment	\$560	\$ 5,184	\$ 100	\$ 45	\$ 5,018	\$ 2,455	\$ -	\$13,362
With an allowance recorded	-	-	-	-	2,816	200	-	3,016
With no related allowance recorded	560	5,184	100	45	2,202	2,255	-	10,346
Related allowance	-	-	-	-	2,195	200	-	2,395
Unpaid principal	761	5,224	99	45	5,040	3,670	-	14,839
Average balance of impaired loans	761	6,245	91	45	5,085	4,358	-	16,585
Interest income recognized	-	111	2	-	5	124	-	242
Acquired Loans:								
Recorded investment ¹	\$889	\$ 8,075	\$ 1,037	\$ 1,223	\$ -	\$ -	\$ 174	11,398
Unpaid principal	1,112	9,201	1,357	1,524	255	1,198	185	14,832
Average balance of impaired loans	1,112	9,201	1,357	1,524	255	1,198	185	14,832
Interest income recognized	-	363	49	16	-	1	5	434

(1) First Mariner purchased credit impaired loans where the Company amortizes the accretable discount into interest income, however these loans do not accrue interest based on the terms of the loan.

(in thousands)	December 31, 2017							
	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
Impaired loans:								
Recorded investment	\$761	\$ 2,009	\$ 396	\$ 508	\$ 5,867	\$ 3,724	\$ -	\$13,265
With an allowance recorded	637	-	391	-	2,230	2,883	-	6,141
With no related allowance recorded	124	2,009	5	508	3,637	841	-	7,124
Related allowance	202	-	29	-	11	668	-	910
Unpaid principal	762	2,034	403	509	5,884	5,293	-	14,885
Average balance of impaired loans	756	2,100	403	519	5,956	5,988	-	15,722
Interest income recognized	19	60	12	-	132	150	-	373

Included in the total impaired loans above were non-accrual loans of \$23.6 million and \$12.6 million at December 31, 2018 and 2017, respectively. Interest income that would have been recorded if non-accrual loans had been current and in accordance with their original terms, was \$1.2 million, \$898 thousand and \$673 thousand for the years ended December 31, 2018, 2017 and 2016, respectively.

Loans may have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief to a borrower experiencing financial difficulty. Such restructured loans are considered impaired loans that may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from the restructured category in the year subsequent to the restructuring if they have performed based on all of the restructured loan terms.

The troubled debt restructured loans (“TDRs”) at December 31, 2018 and December 31, 2017 are as follows:

(dollars in thousands)	December 31, 2018				
	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDRs
Construction and land	-	\$ -	1	\$ 125	\$ 125
Residential real estate - first lien	2	291	2	982	1,273
Commercial - non-owner occupied	2	2,815	-	-	2,815
Commercial loans and leases	1	514	-	-	514
	5	\$ 3,620	3	\$ 1,107	\$ 4,727

(dollars in thousands)	December 31, 2017				
	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDRs
Construction and land	-	\$ -	1	\$ 125	\$ 125
Residential real estate - first lien	2	886	1	287	1,173
Residential real estate - junior lien	1	398	-	-	398
Commercial - non-owner occupied	2	2,815	-	-	2,815
Commercial loans and leases	2	599	1	208	807
	7	\$ 4,698	3	\$ 620	\$ 5,318

A summary of TDR modifications outstanding and performance under modified terms is as follows:

(in thousands)	December 31, 2018			
	Related Allowance	Not Performing to Modified Terms	Performing to Modified Terms	Total TDRs
Construction and land				
Extension or other modification	\$-	\$ -	\$ 125	\$ 125
Residential real estate - first lien				
Extension or other modification	-	291	982	1,273
Commercial RE - non-owner occupied				
Rate modification	2,195	2,815	-	2,815
Commercial loans				
Forbearance	-	514	-	514
Total troubled debt restructured loans	\$ 2,195	\$ 3,620	\$ 1,107	\$ 4,727

December 31, 2017

Edgar Filing: Howard Bancorp Inc - Form 10-K

(in thousands)	Related Allowances	Not Performing to Modified Terms	Performing to Modified Terms	Total TDRs
Construction and land				
Extension or other modification	\$-	\$ -	\$ 125	\$125
Residential real estate - first lien				
Extension or other modification	-	886	287	1,173
Residential real estate - junior lien				
Forbearance	30	398	-	398
Commercial RE - non-owner occupied				
Rate modification	-	2,815	-	2,815
Commercial loans				
Extension or other modification	-	85	208	293
Forbearance	32	514	-	514
Total troubled debt restructured loans	\$62	\$ 4,698	\$ 620	\$5,318

There was one new loan restructured during 2018, consisting of a residential first lien mortgage loan in the amount of \$96 thousand. The Bank extended the terms of the loan that is currently non-performing.

As a part of the modification of the land development loan restructured during 2016, the Bank agreed to forgive \$215 thousand in debt, and recorded this amount as a loss. The pre-modification principal amount on this loan was \$340 thousand, while the post-modification principal amount was reduced to \$125 thousand. The other modifications consisted of interest rate concessions and payment term extensions, not principal reductions that resulted in a partial charge-off.

Performing TDRs were in compliance with their modified terms and there are no further commitments associated with these loans. During 2018 there were no TDRs that subsequently defaulted within twelve months of their modification dates. Additionally, there was one restructured credit the status of which changed from non-performing to performing during the second quarter 2018.

Management routinely evaluates other real estate owned (“OREO”) based upon periodic appraisals. For the years ended December 31, 2018, 2017 and 2016 there were additional allowances recorded of \$352 thousand, \$581 thousand and \$83 thousand, respectively, as the current appraised value, less estimated cost to sell, was not sufficient to cover the recorded OREO amount. For 2018 there were three residential first lien loan totaling \$917 transferred from loans to OREO, and 2017 there were no new loans transferred from loans to OREO. In 2018, the Company sold two commercial properties with a carrying value of \$611 thousand, recording a \$50 thousand gain from the sale of these properties. Additionally the Company sold two commercial land parcels with a carrying values of \$96 thousand, recording a \$13 thousand gain on the sale. In connection with the First Mariner merger, the Bank’s OREO balances increased \$3.0 million, representing 11 properties. At December 31, 2018, there were four residential first lien loans totaling \$960 thousand, and one residential junior loan of \$22 thousand in the process of foreclosure.

Note 8: Derivatives and Hedging Activities

Non-designated Hedges of Interest Rate Risk

The Company maintains interest rate swap contracts with customers that are classified as non-designated hedges and are not speculative in nature. These agreements are designed to convert customer’s variable rate loans with the Company to fixed rate. These interest rate swaps are executed with loan customers to facilitate a respective risk management strategy and allow the customer to pay a fixed rate interest to the Company. These interest rate swaps are

simultaneously hedged by executing offsetting interest rate swaps with unrelated market counterparties to minimize the net risk exposure to the Company resulting from the transactions and allow the Company to receive a variable rate interest. The interest rate swaps pay and receive interest based on a floating rate based on one month LIBOR plus credit spread with payment being calculated on the notional amount. The interest rate swaps are settled with varying maturities.

As the interest rate swaps associated with this program do not meet the strict hedge accounting requirements changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of December 31, 2018, the interest rate swaps had an aggregate notional amount of approximately \$6.2 million and the fair value of the interest swap derivatives are recorded in other assets and other liabilities. All changes in fair value are recorded through earnings as noninterest income. For 2018, the Company recorded a net loss of \$6 thousand related to the change in fair value of these interest rate swap derivatives.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Balance Sheet as of December 31, 2018.

(dollars in thousands)	Balance Sheet Location	Notional Amount	December 31, 2018	
			Estimated Fair Value Gain	Loss
Not designated hedges of interest rate risk:				
Customer related interest rate contracts:				
Matched interest rate swaps with borrowers	Other assets and other liabilities	\$ 3,061	\$ 100	\$ -
Matched interest rate swaps with counterparty	Other assets and other liabilities	\$ 3,061	\$ -	\$ 106

Note 9: Goodwill and Other Intangible Assets

Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset would more-likely-than-not reduce the fair value below the carrying amount. The Bank has one reporting unit, which is the core banking operation.

On March 1, 2018 the Company initially recorded an additional \$71.4 million in goodwill relating to the First Mariner merger. Based upon updated information the goodwill was adjusted downward in 2018 by \$1.3 million to reflect revised valuations as detailed in Note 2.

	December 31,	
(in thousands)	2018	2017
Goodwill		
Banking	\$70,697	\$603

Core deposit intangible is premiums paid for the acquisitions of core deposits, and are amortized based upon the estimated economic benefits received. The gross carrying amount and accumulated amortization of other intangible assets are as follows:

	December 31, 2018		Net	Weighted
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Carrying Amount	Average Remaining Life (Years)
Amortizing intangible assets:				
Core deposit intangible	\$16,135	\$ 4,653	\$ 11,482	4.7

	December 31, 2017		Net	Weighted
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Carrying Amount	Average Remaining Life (Years)
Amortizing intangible assets:				
Core deposit intangible	\$3,540	\$ 1,797	\$ 1,743	5.6

Estimated future amortization expense for amortizing intangibles for the years ending December 31, is as follows:

(in thousands)

2019	\$3,012
2020	2,674
2021	2,326
2022	1,915
2023	1,298
Thereafter	257
Total amortizing intangible assets	\$11,482

Based upon an annual impairment analysis performed in 2018, it was determined that there was not an impairment of the carrying value of either the goodwill or core deposit intangible.

Note 10: Bank Premises and Equipment

Premises and equipment include the following at:

(in thousands)	December 31,	
	2018	2017
Land	\$10,239	\$4,334
Building and leasehold improvements	35,571	16,384
Furniture and equipment	6,686	5,015
Software	419	345
	52,915	26,078
Less: accumulated depreciation and amortization	7,778	6,889
Net premises and equipment	\$45,137	\$19,189

Depreciation and amortization expense for premises and equipment were \$2.1 million, \$1.3 million and \$1.2 million for the years ended December 31, 2018, 2017 and 2016, respectively.

The Company occupies banking and office space in 29 locations, 16 of which are under noncancellable lease arrangements accounted for as operating leases. The initial lease periods range from 5 to 20 years and provide for one or more renewal options. Rent expense applicable to operating leases amounted to \$3.7 million, \$2.0 million and \$2.3 million for the years ended December 31, 2018, 2017 and 2016, respectively. Rental income from owned properties and subleases totaled \$554 thousand, \$387 thousand and \$290 thousand for the years ended December 31, 2018, 2017 and 2016, respectively.

Future minimum lease payments under noncancellable operating leases within the years ending December 31, having an initial term in excess of one year are as follows:

(in thousands)	
2019	\$2,129
2020	1,772
2021	1,613
2022	1,462
2023	1,296
Thereafter	3,074

Total minimum lease payments \$11,346

Note 11: Deposits

The following table details the composition of deposits and the related percentage mix of total deposits, respectively:

(dollars in thousands)	December 31,			
	2018	% of	2017	% of
	Amount	Total	Amount	Total
Noninterest-bearing demand	\$429,200	26 %	\$218,139	26 %
Interest-bearing checking	227,322	13	71,642	8
Money market accounts	356,130	21	252,453	29
Savings	134,893	8	52,078	6
Certificates of deposit \$250 and over	82,511	5	9,950	1
Certificates of deposit under \$250	455,750	27	259,646	30
Total deposits	\$1,685,806	100 %	\$863,908	100 %

The following table presents the maturity schedule for time deposits maturing within years ending December 31:

(in thousands)	
2019	\$325,483
2020	128,452
2021	65,228
2022	13,385
2023	5,713
Total time deposits	\$538,261

Interest expense on deposits for the twelve months ended December 31, 2018, December 31, 2017 and December 31, 2016 was as follows:

(in thousands)	December 31,		
	2018	2017	2016
Interest-bearing checking	\$554	\$168	\$132
Savings and money market	2,393	1,217	1,220
Certificates of deposit	5,593	2,612	2,118
Total	\$8,540	\$3,997	\$3,470

Note 12: Short-Term Borrowings

Short-term borrowings consist of overnight unsecured master notes, overnight securities sold under agreement to repurchase and fixed term borrowings with a final remaining maturity of less than one year. Information relating to short-term borrowings at December 31, 2018 and December 31, 2017 is presented below:

(dollars in thousands)	December 31,			
	2018	2017	Amount	Rate
At period end	134,576	2.08 %	\$130,385	1.35 %
Average for the year	146,050	1.59	88,513	0.99
Maximum month-end balance	322,403		130,385	

The Company pledges U.S. Government Agency securities, based upon their fair value, as collateral for 100% of the principal and accrued interest of its repurchase agreements. At December 31, 2018 and 2017 there were \$16.6 million and \$14.4 million, respectively, in investment securities pledged under these agreements.

If the Company should need to supplement its liquidity, it could borrow, subject to collateral requirements, up to approximately \$345.9 million on a line of credit arrangement with the Federal Home Loan Bank of Atlanta (the “FHLB”). At December 31, 2018 and 2017 there were \$118.0 million and \$116.0 million, respectively, in advances outstanding under this arrangement. Total loans pledged as collateral towards short and long term borrowing was \$518.0 million and \$330.8 million at December 31, 2018 and 2017, respectively.

Note 13: Long-Term Borrowings

Long-term borrowings for the periods consisted of the following:

(in thousands)	December 31,	
	2018	2017
Federal Home Loan Bank Advances		
1.99% Due 2019 ¹	\$-	\$15,000
2.48% Due 2020 ²	14,000	-
2.53% Due 2020 ²	15,000	-
2.67% Due 2020 ²	30,000	-
2.62% Due 2020 ²	30,000	-
2.71% Due 2020 ²	25,000	-
Subordinated debentures		
2.48% Due 2035 ³	5,000	5,000
6.00% Due 2028 ⁴	25,000	-
Total principal of long-term borrowings	144,000	20,000
Purchase accounting adjustment on acquired debt ³	(1,384)	(1,465)
Cost of issuance of subordinated debt ⁴	(539)	-
Total long-term borrowings	\$142,077	\$18,535

(1) Fixed rate advances

(2) Fixed rate hybrid advances

(3) Subordinated debt acquired in 2015. Carrying value after purchase accounting adjustments of \$3.6 million at December 31, 2018. Interest adjusts quarterly at the rate of three month LIBOR plus 1.48%

(4) Issued subordinated debt. Carrying value net of issuance costs of \$24.5 million at December 31, 2018. Initial rate of 6.00% per annum. Subsequent rate adjusts quarterly at the rate of three month LIBOR plus 3.02%

On December 6, 2018, the Company entered into Subordinated Note Purchase Agreements with certain Purchasers pursuant to which the Company sold and issued \$25,000,000 in aggregate principal amount of 6.00% Fixed-to-Floating Rate Subordinated Notes due December 6, 2028. The Notes were issued by the Company to the Purchasers at a price equal to 100% of their face amount in reliance on the exemptions from registration available

under Section 4(a)(2) of the Securities Act and the provisions of Regulation D thereunder. The Company intends to use the net proceeds of this offering for general corporate purposes, to provide for continued growth and to supplement our its regulatory capital ratios.

The Notes have been structured to qualify initially as Tier 2 capital for regulatory capital purposes. The Note will initially bear interest at a rate of 6.00% per annum from an including December 6, 2018, to but excluding December 6, 2023, with interest during this period payable semi-annually in arrears. From an including December 6, 2023, to but excluding the maturity date or early redemption date, the interest rate will reset quarterly to an annual floating rate equal to three-month LIBOR, plus 302 basis points, with interest during this period payable quarterly in arrears. The Notes are redeemable by the Company at its option, in whole or in part, on or after December 6, 2023.

As a part of the acquisition of Patapsco Bancorp, Inc. (“Patapsco Bancorp”) in 2015, Bancorp assumed debt originally issued by Patapsco Bancorp. In 2005 Patapsco Statutory Trust I, a Connecticut statutory business trust and an unconsolidated wholly-owned subsidiary of Patapsco Bancorp and now of Bancorp (the “Trust”), issued \$5 million of capital trust pass-through securities to investors. The interest rate currently adjusts on a quarterly basis at the rate of the three month LIBOR plus 1.48%. The Trust purchased \$5,155,000 of junior subordinated deferrable interest debentures from Patapsco Bancorp. The debentures are the sole asset of the Trust. Patapsco Bancorp also fully and unconditionally guaranteed the obligations of the Trust under the capital securities, which guarantee became an obligation of Bancorp upon its acquisition of Patapsco Bancorp. The capital securities are redeemable by Bancorp at par. The capital securities must be redeemed upon final maturity of the subordinated debentures on December 31, 2035.

Note 14: Income Taxes

Federal and state income tax expense (benefit) consists of the following for the years ended:

(in thousands)	December 31,		
	2018	2017	2016
Current federal income tax	\$-	\$3,243	\$4,171
Current state income tax	-	1,038	(6)
Deferred federal income tax	(627)	(968)	(1,153)
Deferred state income tax	(270)	(161)	(76)
Total income tax expense (benefit)	\$(897)	\$3,152	\$2,936

A reconciliation of the statutory federal income tax (benefit) expense to the Company's effective tax (benefit) rate for the years ended follows:

(in thousands)	December 31,		
	2018	2017	2016
Statutory federal income tax (benefit) expense	\$(992)	\$3,520	\$2,801
State income taxes, net of federal income tax expense	(213)	579	511
Bank owned life insurance	(162)	(258)	(212)
Acquisition related costs	316	115	-
Revalue of deferred taxes	-	268	-
Correction of error	-	(675)	-
Other, net	154	(397)	(164)
Total income tax (benefit) expense	\$(897)	\$3,152	\$2,936

The Company's income tax benefit for 2018 was the result of the loss incurred for the year in contrast to the reported pre-tax book income and the associated income tax expense recognized for 2017. The benefit for 2018 was reduced by the impact of various merger-related non-deductible costs.

Income tax expense for 2017 was adversely impacted by the adjustment of the Company's deferred tax assets and liabilities related to the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act. As a result of the new law, which is more fully discussed below, we recognized a net tax expense totaling \$268 thousand. Income tax expense for 2017 was also impacted by a correction of an overstatement of taxes that resulted from incorrectly classifying certain acquired loan fair value adjustments on purchased credit impaired loans. As a

result, for the year 2017, the Company recognized tax benefits totaling \$675 thousand related to the 2015 through 2016 tax years.

The following table is a summary of the tax effect of temporary differences that give rise to a significant portion of deferred tax assets and liabilities:

(in thousands)	December, 31	
	2018	2017
Deferred tax assets:		
Net operating losses	\$35,415	\$700
Allowance for credit losses	2,717	1,695
Valuation on foreclosed real estate	617	851
Supplemental executive benefit plans	782	372
Stock-based compensation	29	74
Deferred loan fees and costs, net	576	15
Unrealized loss on securities	-	124
Net fair value of acquired assets	4,007	-
Depreciation and amortization	276	-
Other assets	605	283
Total deferred tax assets	45,024	4,114
Deferred tax liabilities:		
Other net liabilities acquired	4,827	2,443
Bank owned life insurance	4,802	-
Unrealized gain on securities	110	-
Net fair value of acquired liabilities	-	629
Depreciation and amortization	-	229
Total deferred tax liabilities	9,739	3,301
Net deferred tax assets	\$35,285	\$813

Based on management's belief that it is more likely than not that all net deferred tax assets will be realized, there was no valuation allowance at either December 31, 2018 or 2017.

The Company's operating loss for the year ended December 31, 2018 generated a federal tax net operating loss of \$8.5 million which may be carried forward indefinitely subject to a maximum annual limitation of 80% of taxable income.

As part of the Company's recent acquisitions, the Company assumed federal tax net operating loss carryforwards. As of December 31, 2018 and 2017, the remaining balance of those net operating loss carryforwards totaled approximately \$123.8 million and \$2.5 million, respectively. The acquired loss carryforwards can be deducted annually from future taxable income through 2038, subject to various annual limitations.

Currently, tax years ending after December 31, 2014 are considered as open for examination by federal and state taxing authorities.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) established a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminated the corporate alternative minimum tax and allows the use of any tax net operating loss carryforwards to offset regular tax liability for any subsequent taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums for banks with \$10 billion or more in assets. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations, however, such changes do not currently impact us.

As stated above, as a result of the enactment of the Tax Cuts and Job Act, we re-measured our deferred tax assets and liabilities based upon the newly enacted U.S. statutory federal income tax rate of 21%, which is the tax rate at which assets and liabilities are expected to reverse in the future. Nonetheless, for the year 2017 we recognized a tax expense related to the re-measurement of our deferred tax asset and liabilities totaling \$268 thousand.

Note 15: Related Party Loans and Deposits

In the normal course of business, loans are made to officers and directors of the Company, as well as to their related interests. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations and do not involve more than the normal risk of collectability.

Total outstanding balances to the Company's executive officers, directors and their related interests are presented below.

(in thousands)	December 31,	
	2018	2017
Balance January 1	\$19,297	\$20,260
Additions	9,347	9,097
Change in status	(11,412)	(747)
Repayments	(10,014)	(9,313)
Balance December 31	\$7,218	\$19,297

In addition to the outstanding balances above, total unfunded commitments to these parties at December 31, 2018 and December 31, 2017 were \$21.7 million and \$18.5 million, respectively. The Bank also routinely enters into deposit relationships with its officers and directors in the normal course of business. These deposit accounts bear the same terms and conditions for comparable deposit accounts of unrelated parties and totaled \$52.0 million at December 31, 2018 and \$12.2 million at December 31, 2017.

Note 16: Financial Instruments with Off-Balance Sheet Risk and Contingencies

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments may include commitments to extend credit, standby letters of credit and purchase commitments. The Company uses these financial instruments to meet the financing needs of its customers. Financial instruments involve, to varying degrees, elements of credit, interest rate, and liquidity risk. These do not represent unusual risks, and management does not anticipate any losses which would have a material effect on the accompanying financial statements.

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

(in thousands)	December 31,	
	2018	2017
Unfunded loan commitments	\$104,466	\$81,074
Unused lines of credit	282,822	138,526
Letters of credit	16,661	10,839

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Company generally requires collateral to support financial instruments with credit risk on the same basis as it does for on-balance sheet instruments. The collateral is based on management's credit evaluation of the counterparty. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Each customer's credit-worthiness is evaluated on a case-by-case basis.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party.

In the normal course of its business, the Company is involved in litigation arising from banking, financial, and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Note 17: Stock Options and Stock Awards

Bancorp's equity incentive plan provides for awards of nonqualified and incentive stock options as well as vested and non-vested common stock awards. As of December 31, 2018, 621,766 shares are reserved for issuance pursuant to future grants under our stock incentive plan. Employee stock options can be granted with exercise prices at the fair market value (as defined within the plan) of the stock at the date of grant and with terms of up to ten years and typically vest over a three year period. Except as otherwise permitted in the plan, upon termination of employment for reasons other than retirement, permanent disability or death, the option exercise period is reduced or the options are canceled.

Stock awards may also be granted to non-employee members of the Company's board of directors (the "Board of Directors" or "Board") as compensation for attendance and participation at meetings of the Board of Directors and meetings of the various committees of the Board. In 2018, 2017 and 2016, Bancorp issued 11,868, 11,404 and 7,241 shares of common stock, respectively, to directors as compensation for their service.

The fair value of Bancorp's stock options granted as compensation is estimated on the measurement date, which, for the Company, is the date of grant. The fair value of stock options is calculated using the Black-Scholes option-pricing model under which the Company estimates expected market price volatility and expected term of the options based on historical data and other factors. There were no stock options granted in 2018, 2017 or 2016. The valuation of Bancorp's restricted stock and restricted stock units is the closing price per share of Bancorp's common stock on the date of grant.

The following table summarizes Bancorp's stock option activity and related information for the years ended:

	December 31, 2018		2017		2016	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Balance at January 1,	30,991	\$ 9.69	123,593	\$ 12.36	137,463	\$ 12.30
Granted	-	-	-	-	-	-
Exercised	(9,123)	10.63	(27,113)	11.67	(3,020)	11.64
Forfeited	(6,600)	10.52	(65,489)	13.92	(10,850)	11.77
Balance at period end	15,268	\$ 8.76	30,991	\$ 9.69	123,593	\$ 12.36
Exercisable at period end	15,268	\$ 8.76	30,991	\$ 9.69	123,593	\$ 12.36
		\$ -		\$ -		\$ -

Weighted average fair value of options granted during the year

The cash received from the exercise of stock options during 2018, 2017 and 2016 was \$97 thousand, \$316 thousand and \$35 thousand, respectively. The intrinsic value of a stock option is the amount that the market value of the underlying stock exceeds the exercise price of the option. Based upon a fair market value of \$14.30 on December 31, 2018 the options outstanding had an aggregate intrinsic value of \$85 thousand. At December 31, 2017, based upon fair market value of \$22.00, the outstanding options outstanding had an aggregate intrinsic value of \$382 thousand. At December 31, 2016, based upon fair market value of \$15.10, the outstanding options outstanding had an aggregate intrinsic value of \$338 thousand. The outstanding stock options as of December 31, 2018 have contractual terms that permit exercise of the options through 2019.

Restricted Stock Units

Restricted stock units (“RSUs”) are similar to restricted stock, except the recipient does not receive the stock immediately, but instead receives it according to a vesting plan and distribution schedule after achieving required performance milestones or upon remaining with the employer for a particular length of time. Each RSU that vests entitles the recipient to receive one share of Bancorp common stock on a specified issuance date. The recipient does not have any stockholder rights, including voting, dividend or liquidation rights, with respect to the shares underlying awarded RSUs until the recipient becomes the record holder of those shares.

Bancorp granted 20,732 RSUs during 2018, subject to a three-year vesting schedule. During 2017, 18,500 RSUs were granted, all of which are subject to a three-year vesting schedule. The 27,000 RSUs awarded in 2016 also are subject to a three-year vesting schedule; they only vest, however, if certain annual performance measures are satisfactorily achieved.

A summary of the activity for Bancorp's RSUs for the periods indicated is presented in the following table:

	December 31, 2018		2017		2016	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Balance at January 1,	52,155	\$ 15.09	65,491	\$ 13.23	74,828	\$ 13.21
Granted	20,732	19.90	18,500	17.41	27,000	12.91
Vested	(54,542)	16.63	(31,836)	12.60	(17,838)	12.95
Forfeited	(8,614)	14.41	-	-	(18,499)	12.96
Balance at period end	9,731	\$ 17.29	52,155	\$ 15.09	65,491	\$ 13.23

At December 31, 2018, based on RSU awards outstanding at that time, the total unrecognized pre-tax compensation expense related to unvested RSU awards was \$114 thousand. Based upon the contractual terms, this expense is expected to be recognized as follows:

(in thousands)	
2019	\$84
2020	30
	\$114

Stock-Based Compensation Expense: Stock-based compensation is recognized as compensation cost in the statement of operations based on their fair values on the measurement date, which, for the Company, is the date of the grant. The amount that the Company recognized in stock-based compensation expense related to the issuance of restricted stock and RSUs and for director compensation paid in stock is presented in the following table:

(in thousands)	For the year ended December 31,		
	2018	2017	2016
Stock-based compensation expense			
Related to the issuance of restricted stock and RSUs	\$ 656	\$ 490	\$ 239
Director compensation paid in stock	\$ 217	\$ 205	\$ 160

Note 18: Benefit Plans

Profit Sharing Plan

The Company sponsors a defined contribution retirement plan through a Section 401(k) profit sharing plan. Employees may contribute up to 15% of their pretax compensation. Participants are eligible for matching Company contributions up to 4% of eligible compensation dependent on the level of voluntary contributions. Company matching contributions totaled \$1.1 million, \$766 thousand and \$575 thousand, respectively, for the years ended December 31, 2018, 2017 and 2016. The Company's matching contributions vest immediately.

Supplemental Executive Retirement Plan ("SERP")

In 2014, the Bank created a SERP for the Chief Executive Officer. This plan was amended in 2016. Under defined benefit SERP, Mary Ann Scully will receive \$150,000 each year for 15 years after attainment of the Normal Retirement Age (as defined in the SERP). Ms. Scully will earn vesting on a graduated schedule in which she will become fully vested on August 25, 2019, which has been established for purposes of the SERP as her retirement date. Expense related to this SERP totaled \$279 thousand, \$275 thousand and \$243 thousand for 2018, 2017 and 2016, respectively. The accrued liability recorded for this SERP was \$1.5 million and \$1.2 million as of December 31, 2018 and December 31, 2017, respectively.

Employee Stock Purchase Plan

The 2017 Employee Stock Purchase Plan (the "Plan") provides eligible employees of the Company and certain of its subsidiaries with opportunities to purchase shares of the Company's common stock. The Plan was approved by the Company's shareholders on December 27, 2017. An aggregate of 250,000 shares of the Company's common stock was approved for issuance under the Plan. The Plan is intended to qualify as an "employee stock purchase plan" as defined in Section 423 of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder, and shall be interpreted consistent therewith. The first offering period under this plan commenced on October 01, 2018, and the expense related to the Plan totaled \$11 thousand for 2018.

Note 19: Income per Common Share

The table below shows the presentation of basic and diluted income per common share for the years ended:

(dollars in thousands, except per share data)	December 31,		
	2018	2017	2016
Net (loss) income	\$ (3,828)	\$ 7,200	\$ 5,303
Preferred stock dividends	-	-	(166)
Net income available to common stockholders (numerator)	\$ (3,828)	\$ 7,200	\$ 5,137
BASIC			
Basic average common shares outstanding (denominator)	17,556,554	9,555,952	6,975,662
Basic (loss) income per common share	\$ (0.22)	\$ 0.75	\$ 0.74
DILUTED			
Average common shares outstanding	17,556,554	9,555,952	6,975,662
Dilutive effect of common stock equivalents	-	40,852	23,320
Diluted average common shares outstanding (denominator)	17,556,554	9,596,804	6,998,982
Diluted (loss) income per common share	\$ (0.22)	\$ 0.75	\$ 0.73

Because the Company reported a loss for 2018 common stock equivalents were excluded from the calculation of diluted average shares outstanding, as their inclusion would have resulted in a lower diluted loss per share	14,740	-	-
Common stock equivalents outstanding that are anti-dilutive and thus excluded from calculation of diluted number of shares presented above	-	-	74,051

Note 20: Regulatory Matters

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that revised their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision (“Basel III”) and certain provisions of the Dodd-Frank Act. The final rule, which became effective on January 1, 2016, applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$1 billion or more and top-tier savings and loan holding companies. The rules apply to Howard Bank and Howard Bancorp. The final rule created a new common equity Tier 1 (“CET1”) minimum capital requirement (4.5% of risk-weighted assets), increased the minimum Tier 1 capital ratio (from 4% to 6% of risk-weighted assets), imposed a minimum leverage ratio of 4.0%, and changed the risk-weight of certain assets to better reflect credit risk and other risk exposures. These include, among other things, a 150% risk weight for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in non-accrual status, and a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable. The final rule also requires unrealized gains and losses on certain “available for sale” securities holdings to be included for purposes of calculating regulatory capital unless the Company elects to opt-out

from this treatment. The Company has elected to permanently opt out of this treatment in the Company's capital calculations, as permitted by the final rule.

Additionally, the rules include a capital conservation buffer that phases in over a period of years that began in 2017 and will become fully effective in 2019. Failure to satisfy any of the capital requirements, including with the applicable "buffer" amount, will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. The rules establish a maximum percentage of eligible retained income that could be utilized for such actions if the capital requirements of the buffer are not fully satisfied.

In addition, under revised prompt corrective action requirements, in order to be considered "well-capitalized," Bancorp and the Bank must have a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a common equity Tier 1 ratio of 6.5% or greater, a leverage capital ratio of 5.0% or greater, and not be subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

There are three main categories of capital under the regulatory capital guidelines. Common equity tier 1 capital consists of paid-in common stock, retained earnings and certain common equity Tier 1 minority interests. Various items, including certain amounts of goodwill, intangible assets, deferred tax assets, must be deducted from common equity Tier 1 before capital ratios are calculated. Tier 1 capital (which, together with common equity tier 1 capital, makes up Tier 1 capital) generally consists of perpetual preferred stock and, in certain circumstances and subject to certain limitations, minority investments in certain subsidiaries, less goodwill and other non-qualifying intangible assets, and certain other deductions. Tier 2 capital consists of perpetual preferred stock that is not otherwise eligible to be included as Tier 1 capital, hybrid capital instruments, term subordinated debt and intermediate-term preferred stock and, subject to limitations, general allowances for credit losses. At least half of total capital must consist of Tier 1 capital. Accumulated other comprehensive income (positive or negative) must be reflected in regulatory capital. Under the guidelines, capital is compared to the relative risk related to the balance sheet. To derive the risk included in the balance sheet, one of several risk weights is applied to the different balance sheet and off-balance sheet assets, primarily based on the relative credit risk of the counterparty. For example, claims guaranteed by the U.S. government or one of its agencies are risk-weighted at 0%. Off-balance sheet items, such as loan commitments, are also applied a risk weight after calculating balance sheet equivalent amounts. One of four credit conversion factors (0%, 20%, 50% and 100%) is assigned to loan commitments based on the likelihood of the off-balance sheet item becoming an asset. For example, certain loan commitments are converted at 50% and then risk-weighted at 100%. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Management believes that, as of December 31, 2018 and December 31, 2017, Bancorp and the Bank met all capital adequacy requirements to which they are subject.

The following table reflects Bancorp's and the Bank's capital as of December 31, 2018 and December 31, 2017:

(dollars in thousands)	Actual		For capital adequacy purposes		To be well capitalized under the FDICIA prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Total capital (to risk-weighted assets)						
Howard Bank	\$212,099	11.80%	\$143,810	8.00%	\$179,762	10.00%
Howard Bancorp	\$218,425	12.14%	\$143,889	8.00%	N/A	
Common equity tier 1 capital (to risk-weighted assets)						
Howard Bank	\$202,226	11.25%	\$80,893	4.50%	\$116,846	6.50%
Howard Bancorp	\$179,935	10.00%	\$80,938	4.50%	N/A	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	\$202,226	11.25%	\$107,857	6.00%	\$143,810	8.00%

Edgar Filing: Howard Bancorp Inc - Form 10-K

Howard Bancorp	\$ 179,935	10.00 %	\$ 107,917	6.00 %	N/A	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	\$ 202,226	9.84 %	\$ 82,212	4.00 %	\$ 102,765	5.00 %
Howard Bancorp	\$ 179,935	8.77 %	\$ 82,046	4.00 %	N/A	
As of December 31, 2017:						
Total capital (to risk-weighted assets)						
Howard Bank	\$ 125,019	12.39 %	\$ 80,720	8.00 %	\$ 100,900	10.00 %
Howard Bancorp	\$ 139,673	13.72 %	\$ 81,456	8.00 %	N/A	
Common equity tier 1 capital (to risk-weighted assets)						
Howard Bank	\$ 118,860	11.78 %	\$ 45,405	4.50 %	\$ 65,585	6.50 %
Howard Bancorp	\$ 129,979	12.77 %	\$ 45,819	4.50 %	N/A	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	\$ 118,860	11.78 %	\$ 60,540	6.00 %	\$ 80,720	8.00 %
Howard Bancorp	\$ 129,979	12.77 %	\$ 61,092	6.00 %	N/A	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	\$ 118,860	10.70 %	\$ 44,438	4.00 %	\$ 55,547	5.00 %
Howard Bancorp	\$ 129,979	11.70 %	\$ 44,439	4.00 %	N/A	

Note 21: Preferred Stock

On September 22, 2011, Bancorp entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which Bancorp issued and sold to the Treasury 12,562 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series AA, having a liquidation preference of \$1,000 per share, for aggregate proceeds of \$12,562,000. The issuance was pursuant to the SBLF program, a \$30 billion fund established under the Small Business Jobs Act of 2010, which encourages lending to small businesses by providing capital to qualified community banks with assets of less than \$10 billion. The Series AA Preferred Stock holders were entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate was initially set at 5% per annum and thereafter was set based upon the percentage change in qualified lending between each dividend period and the baseline “Qualified Small Business Lending” level established at the time the agreement was entered into. Such dividend rate could vary from 1% per annum to 5% per annum for the second through tenth dividend periods and from 1% per annum to 7% per annum for the eleventh through the eighteenth dividend periods and through March 22, 2017 with respect to the nineteenth dividend period. If the Series AA Preferred Stock remained outstanding for more than four-and-one-half years, the dividend rate was fixed at 9%. As of March 22, 2016, the dividend rate was fixed at 9%. Such dividends were not cumulative, but Bancorp could only declare and pay dividends on its common stock (or any other equity securities junior to the Series AA Preferred Stock) if it had declared and paid dividends for the current dividend period on the Series AA Preferred Stock, and was subject to other restrictions on its ability to repurchase or redeem other securities. In addition, if Bancorp had not timely declared and paid dividends on the Series AA Preferred Stock for six dividend periods or more, whether or not consecutive, the Treasury (or any successor holder of Series AA Preferred Stock) could have designated a representative to attend all meetings of the Board of Directors in a nonvoting observer capacity and Bancorp would have been required to give such representative copies of all notices, minutes, consents and other materials that Bancorp provided to its directors in connection with such meetings.

On May 6, 2016, after receiving all required regulatory approvals, Bancorp redeemed the 12,562 shares of Series AA Preferred Stock for \$12,562,000 in accordance with its terms. Bancorp used the proceeds of a \$12,562,000 term loan with Raymond James Bank, N.A. to fund the redemption of the Series AA Preferred Stock. This debt was repaid on February 1, 2017.

Note 22: Fair Value

FASB ASC Topic 820 “Fair Value Measurements” 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. FASB ASC Topic 820 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 Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities 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 the fair value. These hierarchy 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 active 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.

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.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Recurring Fair Value Measurements

Except for one privately held equity investment, all other classes of investment securities available for sale are recorded at fair value using an industry-wide valuation service and therefore fall into a Level 2 of the fair value hierarchy. The service uses evaluated pricing models that vary based on asset class and include available trade, bid and other market information. Various methodologies include broker quotes, proprietary models, descriptive terms and conditions databases, and quality control programs. The privately held equity investment utilizes peer market information to estimate the unobservable inputs and then these inputs are applied to the asset.

Fair value of loans held for sale is based upon outstanding investor commitments or, in the absence of such commitments, based on current investor yield requirements or third party pricing models and are considered Level 2. Gains and losses on loan sales are determined using specific identification method. Changes in fair value are recognized in the Consolidated Statement of Operations as part of realized and unrealized gain on mortgage banking activities.

Interest rate lock commitments are recorded at fair value determined as the amount that would be required to settle each of these derivatives at the balance sheet date. In the normal course of business, the Company enters into contractual interest rate lock commitments to extend credit to borrowers with fixed expiration dates. The commitment becomes effective when the borrowers lock in a specified interest rate within the time frames established by the mortgage division. All borrowers are evaluated for credit worthiness prior to the extension of the commitment. Market risk arises if interest rates move adversely between the time interest rate is locked by the borrower and the sale date of the loan to an investor. To mitigate this interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into best effort forward sales contracts to sell loans to investors. The forward sales contracts lock in an interest rate price for the sale of loans similar to the specific rate lock commitment. Rate lock commitments to the borrowers through to the date the loan closes are undesignated derivatives and accordingly, are marked to fair value in earnings. These valuations fall into a Level 3 of the fair value hierarchy. The rate lock commitments are deemed as Level 3 inputs because the Company applies an estimated pull-through rate, which is deemed an unobservable measure. The pull-through rate utilized is based upon historic pull-through rates that ranged from 80 percent to 90 percent.

For loans held for investment that were originally intended to be sold and previously included as loans held for sale, fair value is determined by discounting estimated cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

The following table sets forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a recurring basis at December 31, 2018 and December 31, 2017.

Edgar Filing: Howard Bancorp Inc - Form 10-K

December 31, 2018	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	Carrying Value (Fair Value)		
Assets			
Available for sale securities:			
U.S. Government agencies	\$ 130,397	\$ -	\$ 130,397
Mortgage-backed securities	90,460	-	90,460
Other investments	3,001	-	3,001
Loans held for sale	21,261	-	21,261
Loans held for investment	1,303	-	1,303
Rate lock commitments	126	-	-
Interest rate swap assets	100	-	100
Liabilities			
Interest rate swap liabilities	106	-	106

December 31, 2017	Carrying Value (Fair Value)	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities:				
U.S. Government agencies	\$67,740	\$ -	\$ 67,740	\$ -
U.S. Government treasuries	1,494	-	1,494	-
Mortgage-backed securities	2,479	-	2,479	-
Other investments	2,543	-	2,464	79
Loans held for sale	42,153	-	42,153	-
Loans held for investment	1,509	-	1,509	-
Rate lock commitments	451	-	-	451

The following table presents a reconciliation of the assets that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the periods presented:

	December 31, 2018	December 31, 2017
Balance, beginning of period	\$ 530	\$ 528
Privately held equity investment	(72)	79
Net gains (losses) included in realized and unrealized gains on mortgage banking activity in noninterest income	(332)	(77)
Balance, end of period	\$ 126	\$ 530

Assets under fair value option:

December 31, 2018	Carrying Fair Value Amount	Aggregate Unpaid Principal	Difference
(in thousands)			
Loans held for sale	\$ 21,261	\$ 20,785	\$ 476
Loans held for investment	1,303	1,342	(39)

December 31, 2017	Carrying Fair Value	Aggregate Unpaid
-------------------	---------------------	------------------

Edgar Filing: Howard Bancorp Inc - Form 10-K

(in thousands)	Amount	Principal	Difference
Loans held for sale	\$ 42,153	\$ 40,990	\$ 1,163
Loans held for investment	1,509	1,476	33

The Company elected to measure the loans held for sale and the loans held for investment that were originally intended for sale, but instead were added to the Bank's portfolio at fair value to better align reported results with the underlying economic changes in value of the loans on the Company's balance sheet.

Non-recurring Fair Value Measurements

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or market value. Market value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of real estate collateral is determined based on appraisal by qualified licensed appraisers hired by the Company. The value of business equipment, inventory and accounts receivable collateral is based on the net book value on the business' financial statements and, if necessary, discounted based on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Other real estate owned acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for credit losses. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. There were valuation losses of \$352 thousand recognized for the year ended December 31, 2018 and \$581 thousand recognized for the year ended December 31, 2017. These charges were for declines in the value of OREO subsequent to foreclosure. OREO is classified within Level 3 of the hierarchy.

Net (loss)/gain from the changes included in earnings in fair value of loans held for sale was \$(181) thousand, \$62 thousand, and \$69 thousand at December 31, 2018, 2017 and 2016, respectively. Net (loss)/gain from the changes included in earnings in fair value of loans held for investment was \$(71) thousand and \$247 thousand at December 31, 2018 and 2017 respectively. There were no loans held for investment in 2016 accounted for at fair value.

The following table sets forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a nonrecurring basis as of December 31, 2018 and December 31, 2017.

December 31, 2018	Carrying Value (Fair Value)	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
Other real estate owned	\$ 4,392	\$ -	\$ -	\$ 4,392
Impaired loans:				
Construction and land	1,449	-	-	1,449
Residential - first lien	13,259	-	-	13,259
Residential - junior lien	1,137	-	-	1,137
Commercial - owner occupied	1,268	-	-	1,268
Commercial - non-owner occupied	2,823	-	-	2,823
Commercial loans and leases	2,255	-	-	2,255
Consumer	174	-	-	174

December 31, 2017	Carrying Value (Fair Value)	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
Other real estate owned	\$ 1,549	\$ -	\$ -	\$ 1,549

Impaired loans:

Construction and land	559	-	-	559
Residential - first lien	2,009	-	-	2,009
Residential - junior lien	367	-	-	367
Commercial - owner occupied	508	-	-	508
Commercial - non-owner occupied	5,856	-	-	5,856
Commercial loans and leases	3,056	-	-	3,056
Consumer	-	-	-	-

At December 31, 2018 OREO consisted of an outstanding balance of \$6.6 million, less valuation allowance of \$2.2 million. At December 31, 2017, OREO consisted of an outstanding balance of \$4.6 million, less valuation allowance of \$3.1 million. Related allowance on impaired loans for the years ended December 31, 2018 and 2017 were \$2.4 million and \$910 thousand, respectively.

Various techniques are used to value OREO and impaired loans. All loans where the underlying collateral is real estate, either construction, land, commercial, or residential, an independent appraisal is used to identify the value of the collateral. The approaches within the appraisal report include sales comparison, income, and replacement cost analysis. The resulting value will be adjusted by a selling cost of 9.5% and the residual value will be used to determine if there is an impairment. Commercial loans and leases and consumer loans utilize a liquidation approach to the impairment analysis.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are based on quoted market prices where available or calculated using present value techniques. Since quoted market prices are not available on many of our financial instruments, estimates may be based on the present value of estimated future cash flows and estimated discount rates.

The following table presents the estimated fair value of the Company's financial instruments at the dates indicated:

	December 31, 2018		Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value			
<i>(in thousands)</i>					
Financial Assets					
Available for sale securities	\$223,858	\$223,858	\$ -	\$223,858	\$ -
Held to maturity securities	9,250	9,253	-	-	9,253
Nonmarketable equity securities	11,786	11,786	-	11,786	-
Loans held for sale	21,261	21,261	-	21,261	-
Loans held for investment	1,303	1,303	-	1,303	-
Rate lock commitments	126	126	-	-	126
Loans and leases ¹	1,638,575	1,613,506	-	-	1,613,506
Interest rate swap	100	100	-	100	-
Financial Liabilities					
Deposits	1,685,806	1,681,295	-	1,681,295	-
Short-term borrowings	134,576	134,576	-	134,576	-
Long-term borrowings	142,077	142,296	-	142,296	-
Interest rate swap	106	106	-	106	-

December 31, 2017

	Quoted Price in Active Markets for Identical	Significant Other Observable	Significant Unobservable
--	--	------------------------------------	-----------------------------

Edgar Filing: Howard Bancorp Inc - Form 10-K

(in thousands)	Carrying Amount	Fair Value	Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
Financial Assets					
Available for sale securities	\$74,256	\$74,256	\$ -	\$ 74,177	\$ 79
Held to maturity securities	9,250	9,421	-	-	9,421
Nonmarketable equity securities	6,492	6,492	-	6,492	-
Loans held for sale	42,153	42,153	-	42,153	-
Loans held for investment	1,509	1,509	-	1,509	-
Rate lock commitments	451	451	-	-	451
Loans and leases ¹	928,940	925,510	-	-	925,510
Financial Liabilities					
Deposits	863,908	865,182	-	865,182	-
Short-term borrowings	130,385	130,385	-	130,385	-
Long-term borrowings	18,535	18,538	-	18,538	-

Carrying amount is net of unearned income and allowance for loan and lease losses. In accordance with the (1)prospective adoption of ASU No. 2016-01, the fair value of loans as of December 31, 2018 was measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entry price notion.

Note 23: Revenue Recognition*Service Charges on Deposit Accounts*

Service charges on deposit accounts consist of account analysis fees, monthly service fees, check orders, and other deposit account related fees. The Banks's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Banks's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Other Operating Income

Other operating income is primarily comprised of debit and credit card income, ATM fees, merchant services income, revenue streams such as safety deposit box rental fees, and other miscellaneous service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Banks's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Bank's cardholder uses a non-Bank ATM or a non-Bank cardholder uses a Bank ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Bank determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Bank's performance obligation for fees, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

The following presents noninterest income, segregated by revenue streams in scope and out of scope of Topic 606, for the twelve months ended:

(in thousands)	December 31,		
	2018	2017	2016
NONINTEREST INCOME			
Service charges on deposit accounts	\$595	\$239	\$165
Fees and other services charges	2,404	954	813
Other	70	57	58
Noninterest income in scope of Topic 606	3,069	1,250	1,036
Noninterest income out of scope of Topic 606	14,791	18,274	13,760
Total noninterest income	\$17,860	\$19,524	\$14,796

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Bank's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals. Consideration is often received immediately or shortly after the Bank satisfies its performance obligation and revenue is recognized. The Bank does not typically enter into long term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2018 and December 31, 2017, the Bank did not have any significant contract balances.

Contract Acquisition Costs

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Bank did not capitalize any contract acquisition cost.

Note 24: Parent Company Financial Information

The condensed financial statements for Bancorp (Parent Only) are presented below:

Howard Bancorp, Inc.**Balance Sheets**

(in thousands)	December 31,	
	2018	2017
ASSETS		
Cash and cash equivalents	\$6,843	\$15,699
Investment in subsidiaries	316,771	121,374
Other assets	293	-
Total assets	\$323,907	\$137,073
LIABILITIES		
Short-term borrowings	\$972	\$817
Long-term borrowings	28,077	3,535
Other liabilities	175	468
Total liabilities	29,224	4,820
SHAREHOLDERS' EQUITY		
Common stock-par value of \$0.01 authorized 20,000,000 shares; issued and outstanding 19,039,347 shares at December 31, 2018 and 9,820,592 at December 31, 2017	190	98
Capital surplus	275,843	110,387
Retained earnings	18,277	22,105
Accumulated other comprehensive income (loss)	373	(337)
Total shareholders' equity	294,683	132,253
Total liabilities and shareholders' equity	\$323,907	\$137,073

Statements of Operations

(in thousands)	December 31,		
	2018	2017	2016
INTEREST INCOME			
Interest on securities	\$-	\$-	\$1
Other interest income	1	-	-
INTEREST EXPENSE			
Short-term borrowings	6	49	300
Long-term borrowings	376	216	196
NET INTEREST EXPENSE	(381)	(265)	(495)
NONINTEREST INCOME			
Gain on the sale of securities	-	-	96
NONINTEREST EXPENSE			
Compensation and benefits	268	490	306
Other operating expense	42	73	192
Total noninterest expense	310	563	498
Loss before income tax and equity in undistributed income of subsidiary	(691)	(828)	(897)
Income tax benefit	(176)	(349)	(305)
Loss before equity in undistributed income of subsidiary	(515)	(479)	(592)
Equity in undistributed income (loss) of subsidiary	(3,313)	7,679	5,895
Net income (loss)	\$(3,828)	\$7,200	\$5,303
Preferred stock dividends	-	-	166
Net income available to common shareholders	\$(3,828)	\$7,200	\$5,137

Statements of Cash Flows

(in thousands)	Year Ended December 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$(3,828)	\$7,200	\$5,303
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Deferred income taxes (benefits)	(117)	(115)	(60)
Share-based compensation	873	695	399
Gain on sales of securities		-	(96)
Equity in undistributed loss (income) of subsidiary	3,313	(7,679)	(5,895)
(Increase) decrease in other assets	(293)	40	101
Increase (decrease) in other liabilities	(176)	84	(2)
Net cash (used in) provided by operating activities	(228)	225	(250)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of investment securities available-for-sale	-	-	196
Cash paid for acquisition	(9,245)	-	-
Investment in subsidiary	(24,177)	(23,000)	-
Net cash (used in) provided by investing activities	(33,422)	(23,000)	196
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase increase in short-term borrowings	155	(12,542)	12,468
Proceeds from issuance of long-term debt	24,542	82	82
Net proceeds from issuance of common stock, net of cost	97	38,699	35
Redemption of preferred stock	-	-	(12,562)
Cash dividends on preferred stock	-	-	(166)
Net cash provided by (used in) financing activities	24,794	26,239	(143)
Net increase (decrease) in cash and cash equivalents	(8,856)	3,464	(197)
Cash and cash equivalents at beginning of period	15,699	12,235	12,432
Cash and cash equivalents at end of period	\$6,843	\$15,699	\$12,235

Note 25: Quarterly Financial Results (unaudited)

The following table provides a summary of selected consolidated quarterly financial data for the years ended December 31, 2018 and December 31, 2017:

	2018			
	Fourth	Third	Second	First
(in thousands, except share data.)	Quarter	Quarter	Quarter	Quarter
Interest income	\$22,428	\$22,436	\$21,165	\$14,360
Interest expense	4,485	3,789	3,285	2,212
Net interest income	17,943	18,647	17,880	12,148
Provision for loan losses	2,850	696	1,425	1,120
Noninterest income	3,683	3,856	5,617	4,704
Noninterest expense	18,425	16,396	25,140	23,151
Net income before income taxes	351	5,411	(3,068)	(7,419)
Income (benefit) tax expenses	206	1,432	(791)	(1,744)
Net income available to common shareholders	\$145	\$3,979	\$(2,277)	\$(5,675)
Net income per common share, basic	\$0.01	\$0.21	\$(0.12)	\$(0.43)
Net income per common share, diluted	\$0.01	\$0.21	\$(0.12)	\$(0.43)
Average common shares outstanding	19,035,316	19,025,855	19,002,851	13,080,614
Diluted average common shares outstanding	19,041,880	19,035,192	19,002,851	13,080,614
	2017			
	Fourth	Third	Second	First
(in thousands, except share data.)	Quarter	Quarter	Quarter	Quarter
Interest income	\$11,338	\$11,112	\$10,708	\$9,868
Interest expense	1,482	1,357	1,211	1,117
Net interest income	9,856	9,755	9,497	8,751
Provision for loan losses	800	491	340	200
Noninterest income	4,669	5,085	5,311	4,459
Noninterest expense	11,848	11,618	11,234	10,500
Net income before income taxes	1,877	2,731	3,234	2,510
Income tax expenses	(6)	1,018	1,196	944
Net income available to common shareholders	\$1,883	\$1,713	\$2,038	\$1,566
Net income per common share, basic	\$0.19	\$0.17	\$0.21	\$0.18
Net income per common share, diluted	\$0.19	\$0.17	\$0.21	\$0.18
Average common shares outstanding	9,815,228	9,808,542	9,779,772	8,806,404
Diluted average common shares outstanding	9,858,809	9,854,822	9,822,165	8,856,763

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None

Item 9A. Controls and Procedures

As required by SEC rules, the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this annual report on Form 10-K. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of December 31, 2018. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report On Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) for the Company. The Company's internal control over financial reporting is a process designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America, as well as provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements. Management evaluates the effectiveness of internal control over financial reporting and tests for reliability through an internal audit process with actions taken to correct potential deficiencies as they are identified. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management evaluated the effectiveness of the Company's internal control over financial reporting as of December 31, 2018 using the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework (2013)*. Based on that evaluation, management concluded that, as of December 31, 2018, the Company's internal control over financial reporting is effective. Dixon Hughes Goodman LLP, the registered public accounting firm that audited the Company's financial statements included in this report has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2018 that is included elsewhere in this report.

Item 9B. Other Information

None

Part III

Item 10. Directors, Executive Officers and Corporate Governance

The Company has adopted a code of ethics (conduct) that applies to all of its employees and a separate code of ethics (conduct) that applies to its non-employee directors. These codes of conduct are available on the Company's website at www.howardbank.com. There have been no material changes in the procedures previously disclosed by which stockholders may recommend nominees to the Company's Board of Directors.

The remainder of the information required by this Item is incorporated by reference to the information included under the captions "Item 1. Election of Directors," "Committees of the Board of Directors" "Corporate Governance," "Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive proxy statement for its Annual Meeting of Stockholders to be held on May 22, 2019 (the "Proxy Statement").

Item 11. Executive Compensation

The information required by this Item is incorporated by reference to the information included under the captions “Director Compensation” and “Executive Compensation” in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated by reference to the information included under the captions “Securities Authorized for Issuance Under Equity Compensation Plans” and “Security Ownership of Directors, Officers and Certain Beneficial Owners” in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated by reference to the information included under the captions “Election of Directors” and “Certain Relationships and Related Transactions” in the Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by this Item is incorporated by reference to the information included under the captions “Fees to Independent Registered Public Accounting Firm” and “Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of Independent Registered Public Accounting Firm” in the Proxy Statement.

Item 15. Exhibits, Financial Statement Schedules

The following financial statements are included in this report

Consolidated Balance Sheets at December 31, 2018 and 2017

57

Edgar Filing: Howard Bancorp Inc - Form 10-K

<u>Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016</u>	<u>58</u>
<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016</u>	<u>59</u>
<u>Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2018, 2017 and 2016</u>	<u>59</u>
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016</u>	<u>60</u>
<u>Notes to the Consolidated Financial Statements</u>	<u>61</u>
<u>Reports of Independent Registered Public Accounting Firms</u>	<u>55</u>

All financial statement schedules have been omitted as the required information is either inapplicable or included in the consolidated financial statements or related notes.

Exhibit No.	Description	Incorporated by Reference to:
2.1	<u>Agreement and Plan of Merger, dated as of March 2, 2015, by and between Howard Bancorp, Inc. and Patapsco Bancorp, Inc. (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Howard Bancorp undertakes to furnish supplemental copies of any of the omitted schedules or exhibits upon request by the Securities and Exchange Commission.)</u>	<u>Exhibit 2.1 of the Company's Form 8-K filed on March 3, 2015</u>
2.2	<u>Agreement and Plan of Reorganization, dated August 14, 2017 by and among Howard Bancorp, Inc., Howard Bank and First Mariner Bank (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Howard Bancorp undertakes to furnish supplemental copies of any of the omitted schedules or exhibits upon request by the Securities and Exchange Commission.)</u>	<u>Exhibit 2.1 of the Company's Form 8-K filed on August 18, 2017</u>
3.1	<u>Articles of Incorporation of Howard Bancorp, Inc.</u>	<u>Exhibit 3.1 of the Company's Form S-1 filed November 28, 2011</u>
3.2	<u>Articles of Amendment to Articles of Incorporation of Howard Bancorp, Inc.</u>	<u>Exhibit 3.2 of the Company's Form S-1 filed November 28, 2011</u>
3.3	<u>Amended and Restated Articles Supplementary of Senior Non-Cumulative Perpetual Preferred Stock, Series AA</u>	<u>Exhibit 3.3 of the Company's Form S-1 filed November 28, 2011</u>
3.4	<u>Articles of Amendment to Articles of Incorporation of Howard Bancorp, Inc.</u>	<u>Exhibit 3.3 of the Company's Form 8-K filed January 24, 2017</u>
3.5	<u>Amended and Restated Bylaws of Howard Bancorp, Inc.</u>	<u>Exhibit 3.1 of the Company's Form 8-K filed January 25, 2018</u>
4.1	<u>Form of Common Stock Certificate of Howard Bancorp, Inc.</u>	<u>Exhibit 4.1 of the Company's Form S-1 filed November 28, 2011</u>
10.1*	<u>Amended and Restated Employment Agreement between Howard Bank and Mary Ann Scully dated December 18, 2008</u>	<u>Exhibit 10.1 of the Company's Form S-1 filed November 28, 2011</u>
10.3*	<u>Amended and Restated Employment Agreement between Howard Bank and George C. Coffman dated December 18, 2008</u>	<u>Exhibit 10.3 of the Company's Form S-1 filed November 28, 2011</u>
10.4*	<u>Amended and Restated Employment Agreement between Howard Bank and Charles E. Schwabe dated December 18, 2008</u>	<u>Exhibit 10.4 of the Company's Form S-1 filed November 28, 2011</u>
10.5*	<u>Howard Bancorp 2004 Stock Incentive Plan</u>	

		<u>Exhibit 4.2 of the Company's Form S-8 filed April 4, 2013</u>
<u>10.6*</u>	<u>Form of Nonstatutory Stock Option Certificate and Grant Agreement under the 2004 Stock Incentive Plan</u>	<u>Exhibit 10.6 of the Company's Form S-1 filed November 28, 2011</u>
<u>10.7*</u>	<u>Howard Bancorp 2004 Incentive Stock Option Plan</u>	<u>Exhibit 4.5 of the Company's Form S-8 filed April 4, 2013</u>
<u>10.8*</u>	<u>Form of Incentive Stock Option Certificate and Grant Agreement under the 2004 Incentive Stock Option Plan</u>	<u>Exhibit 10.8 of the Company's Form S-1 filed November 28, 2011</u>
<u>10.20*</u>	<u>Howard Bancorp, Inc. 2013 Equity Incentive Plan</u>	<u>Exhibit 10.20 to the Company's Form 10-K filed March 27, 2014</u>
<u>10.21*</u>	<u>Form of Restricted Stock Unit Award Agreement under Howard Bancorp, Inc. 2013 Equity Incentive Plan</u>	<u>Exhibit 4.6 to the Company's Form S-8 filed October 28, 2013</u>
<u>10.22*</u>	<u>Form of Restricted Stock Grant Agreement under Howard Bancorp, Inc. 2013 Equity Incentive Plan</u>	<u>Exhibit 4.3 of the Company's Form S-8 filed October 28, 2013</u>
<u>10.23*</u>	<u>Form of Nonstatutory Stock Option Grant Agreement under the 2013 Equity Incentive Plan</u>	<u>Exhibit 4.4 of the Company's Form S-8 filed October 28, 2013</u>
<u>10.24*</u>	<u>Form of Incentive Stock Option Grant Agreement under the 2013 Equity Incentive Plan</u>	<u>Exhibit 4.5 of the Company's Form S-8 filed October 28, 2013</u>
<u>10.25*</u>	<u>Form of Restricted Stock Grant Agreement under the 2004 Stock Incentive Plan</u>	<u>Exhibit 4.3 of the Company's Form S-8 filed April 4, 2013</u>
<u>10.27*</u>	<u>Supplemental Executive Retirement Plan of Howard Bank, effective December 1, 2014</u>	<u>Exhibit 10.27 of the Company's Form 8-K filed January 6, 2015</u>
<u>10.28*</u>	<u>Supplemental Executive Retirement Plan of Howard Bank, effective December 1, 2014 amended January 19, 2016</u>	<u>Exhibit 10.28 of the Company's Form 10-K filed March 30, 2016</u>
<u>10.29*</u>	<u>Amended and Restated Employment Agreement between Howard Bank and Robert A. Altieri dated September 30, 2014</u>	<u>Exhibit 10.29 of the Company's Form 10-K filed March 30, 2016</u>
<u>10.30*</u>	<u>Employment Agreement between Howard Bank and James D. Witty dated April 29, 2016</u>	<u>Exhibit 10.30 of the Company's Form 10-K filed March 16, 2017</u>
<u>10.32*</u>	<u>Employment Agreement between Howard Bank and Steven M. Poynot dated as of March 12, 2017</u>	<u>Exhibit 10.2 of the Company's Form 10-Q filed November 7, 2017</u>
<u>10.33*</u>	<u>First Amendment to Employment Agreement between Howard Bank and Steven M. Poynot dated as of May 24, 2017</u>	<u>Exhibit 10.3 of the Company's Form 10-Q filed November 7, 2017</u>

<u>10.34*</u>	<u>First Amendment to Employment Agreement between Howard Bank and Robert A. Altieri dated as of May 24, 2017</u>	<u>2017</u> <u>Exhibit 10.4 of the</u> <u>Company's Form 10-Q</u> <u>filed November 7,</u> <u>2017</u>
<u>10.35*</u>	<u>First Amendment to Employment Agreement between Howard Bank and James D. Witty dated as of May 24, 2017</u>	<u>Exhibit 10.5 of the</u> <u>Company's Form 10-Q</u> <u>filed November 7,</u> <u>2017</u>
<u>10.36*</u>	<u>Letter Agreement, dated August 14, 2017, by and between Jack E. Steil and Howard Bank</u>	<u>Exhibit 10.1 of the</u> <u>Company's Form 8-K</u> <u>filed March 1, 2018</u>
<u>10.37*</u>	<u>Employment Agreement, dated August 14, 2017, by and between Robert Kunisch, Jr. and Howard Bank</u>	<u>Exhibit 10.2 of the</u> <u>Company's Form 8-K</u> <u>filed March 1, 2018</u>
<u>10.38*</u>	<u>Howard Bank Executive Incentive Plan</u>	<u>Exhibit 10.3 of the</u> <u>Company's Form 8-K</u> <u>filed March 1, 2018</u>
<u>10.39*</u>	<u>Separation Agreement and General Release, dated June 15, 2018, by and between Robert A. Altieri and Howard Bank</u>	<u>Exhibit 10.1 of the</u> <u>Company's Form 8-K</u> <u>filed June 15, 2018</u>
<u>10.41</u>	<u>Form of Subordinated Note Purchase Agreement, dated December 6, 2018, by and between Howard Bancorp, Inc. and certain institutional accredited investors</u>	<u>Exhibit 10.1 of the</u> <u>Company's Form 8-K</u> <u>filed December 6,</u> <u>2018</u>

Exhibit No.	Description	Filed herewith:
<u>10.40*</u>	<u>Separation Agreement and General Release between Howard Bank and James D. Witty dated as of November 13, 2018</u>	
<u>21</u>	<u>Subsidiaries of the Registrant</u>	
<u>23</u>	<u>Consent of Dixon Hughes Goodman LLP</u>	
<u>31(a)</u>	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	
<u>31(b)</u>	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	
<u>32</u>	<u>Certifications pursuant to 18 U.S.C. Section 1350, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	
101	Extensible Business Reporting Language (“XBRL”)	
	101.INS XBRL Instance File	
	101.SCH XBRL Schema File	
	101.CAL XBRL Calculation File	
	101.DEF XBRL Definition File	
	101.LAB XBRL Label File	
	101.PRE XBRL Presentation File	

* Management compensatory plan, contract or arrangement

Item 16. Form 10-K Summary

None.

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.

Howard Bancorp, Inc.

Date: March 15, 2019 By: /s/ Mary Ann Scully
 Mary Ann Scully
 Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and dates indicated.

Name	Capacities	Date
/s/ Mary Ann Scully Mary Ann Scully	Chief Executive Officer, Chairman (Principal Executive Officer)	March 15, 2019
/s/ George C. Coffman George C. Coffman	Chief Financial Officer (Principal Accounting and Financial Officer)	March 15, 2019
/s/ Richard G. Arnold Richard G. Arnold	Director	March 15, 2019
/s/ W. Gary Dorsch W. Gary Dorsch	Director	March 15, 2019
/s/ James T. Dresher, Jr. James T, Dresher, Jr.	Director	March 15, 2019
/s/ Howard P. Feinglass Howard P. Feinglass	Director	March 15, 2019
/s/ Michael B. High Michael B. High	Director	March 15, 2019
/s/ John J. Keenan John J. Keenan	Director	March 15, 2019

Edgar Filing: Howard Bancorp Inc - Form 10-K

/s/ Robert D. Kunisch, Jr. Robert D. Kunisch, Jr.	Director	March 15, 2019
/s/ Paul I. Latta, Jr. Paul I. Latta, Jr.	Director	March 15, 2019
/s/ Kenneth C. Lundeen Kenneth C. Lundeen	Director	March 15, 2019
/s/ Thomas P. O'Neill Thomas P. O'Neill	Director	March 15, 2019
/s/ Robert W. Smith, Jr. Robert W. Smith, Jr.	Director	March 15, 2019
/s/ Donna Hill Staton Donna Hill Staton	Director	March 15, 2019
/s/ Jack E. Steil Jack E. Steil	Director	March 15, 2019