HOWARD BANCORP

2011 ANNUAL REPORT

To Our Shareholders

Another year has passed and I want to take the opportunity to provide some perspective to all of our stakeholders - shareholders, customers, and colleagues - on the accomplishments made by Howard Bancorp over the last 15 months as well as the challenges that lie before us. Since the facts of our accomplishments unfold for all of you on at least a quarterly basis when we release our earnings results - and usually more often when we are the recipient of community recognition or quoted as a financial services resource in a local publication, this perspective sharing in our annual letter is more important than just the recitation of facts. We hope that our explanations, our emphases and our reflections can assist you over the course of the coming year not just in having a record of the facts (the what) but more importantly in understanding how and why we have chosen to react to a challenge or to seize an opportunity.

A key element of the perspective that we bring to you today relates to how we view our role in relation to you and your banking company. Our view is today - and has been since our inception almost nine years ago - that of a steward of your funds and, in some respects, your future. Stewardship is a very old concept. The word itself comes from a 10th century old English word that means guardian of the house. The literal contemporary definition is the" careful and responsible management of something entrusted to one's care." And the connotations that have come to be associated with the word are accountability, transparency, unselfishness, integrity. The debates around the word relate to whether the goal of stewardship is to preserve - as is - or to enhance.

At Howard Bancorp we take our role as a steward quite seriously. We allocate significant resources to guarding your and our financial house from the assaults on capital that come with lending to local businesses in trying economic circumstances, from the restrictions on revenue that come from depressed business investment levels as well as from historically low interest rates, from the pressures on cost control that come from seemingly endless waves of regulations and/or misguided legislation and from the technical threats that face all of us who undertake commerce in the age of the Internet. Some days we feel that the list of threats is endless. However, we also feel that the opportunities in a strong and attractive marketplace are just as endless. And so, like business leaders of old, we see opportunities as obligations. And we define our goal as preserving first and then enhancing shareholder wealth. Preservation in isolation is for "things" with permanent limits on supply; wise growth is for "people" and their savings and their company's success. This commitment to growth and enhancement underpins our business strategy.

We have dealt with the challenges better than most in our industry as our earnings, balance sheet growth, and capital levels show. We have done that by focusing on a traditional business model - a back to basics approach that we have discussed with you before. The great grandson of President William Taft wrote a book very recently on the subject of financial stewardship during the most recent financial crisis. While we might not agree with each of Mr. Taft's premises, we find it very compelling when John Taft argues that "financial leaders lost touch at the turn of the century with the mission and purpose of the financial industry: to act as an intermediary between investors and those seeking capital. "At Howard Bancorp, we take great pride in our fundamental role as an intermediary - one of the oldest and most honorable roles in history - and have used our expertise in fulfillment of a core activity - to support our community and its small and medium sized businesses wisely by allocating both the capital provided by our shareholders and the deposits provided by our customers to those companies who can, with our help, enhance their own business and, in the process, pay us back. We have connected local investors with local seekers of loan capital in a way that only community banks can do sustainably. Because we have weathered the major storms well - a few snapped lines and bent rails but no damage to the hull - when candidly many others have not and because we have made it a consistent goal to thrive and many others have been forced to focus on survival, we see the next few years as filled with opportunities to extend our brand of stewardship. In order to prepare for those opportunities, we have continued with our plans to become an SEC registrant and NASDAQ listed stock through the planned initial public offering of our common stock.

As your steward, we are proud of the accomplishments outlined in these financial statements. Earnings rose almost 50% to end the year at $1.38 million - our first "over $1 million" year of operating profits. This net income growth was not predicated on cyclical reductions in provisions and impairment charges but was led by revenue growth - in particular strong (11%) net interest income growth, which in turn was led by strong balance sheet growth. Assets were up 8% as were loans - significant achievements in an environment where many small and medium sized companies are still reluctant to invest in their business (inventories, equipment, and staff) due to ongoing uncertainty about the broader economy. Our funding sources continued to be largely reliant on core customer activities with deposits up 10% and demand deposits (cash operating accounts for businesses and individuals) up 27%. Asset quality was stable with a steady, modest, decline in the ratio of non-performing assets (non-accrual loans as well as other real estate owned) to total assets of 2.32% vs. 2.89% at the end of 2010.

The bank is continually focused on reserves (capital) for protection/ preservation against further economic downturns and the attendant impact on loan performance, as well as for enhancement, to fund our hallmark growth. During 2011, we were one of only four banks in Maryland to be able to participate in the Small Business Lending Fund (SBLF) to fund that anticipated commercial loan growth. Half of the funds $12 million raised in the SBLF program were used to exit from the Capital Purchase Program - a part of the TARP funds used by the Treasury in 2008 and 2009 to ensure that strong banks like Howard Bank could continue to lend in a downturn. Another $6 million represented net new funds and these positioned the bank with Total Risk Based Capital of 13.8% - up from 11.8 % at the end of 2010 and, at the bank level, well in excess of well capitalized thresholds. SBLF capital costs can decline from the initial 5% dividend level as commercial loans grow and represent attractively priced core capital.

As the balance sheet grows, and as revenues increase, we also remain focused on our own investment allocations - how to ensure that we are ready to acquire, retain and expand relationships in the markets where we see opportunities? We have answered that question with selective allocation of resources to a new relationship management/ business development team focused on the Baltimore City and Baltimore County market to complement our Howard County and Anne Arundel County teams, to customer support and credit administration staff to ensure the infrastructure for growth remains strong, and to a new branch location in Annapolis to serve our growing base of customers in the state capital. We believe that the inability or unwillingness, from a capital and or a core competency perspective, of many community banks in the Greater Baltimore marketplace to grow organically over the last three years provides us with an unprecedented opportunity to extend our brand of sophisticated, one on one banking geographically as well as within markets. That extension can be organic. We also believe that some of those small competing community banks may be looking for partners like us to revitalize their own growth stories. We have very intentionally positioned ourselves for those conversations.

We are proud to have served you well as a financial intermediary and fiduciary. We commit to you that we will continue to guard the house - preserve and to enhance - to grow capital through the retention of earnings as well as by tapping our access to outside investors through the SBLF and the announced IPO; to grow revenues by countering the depressing effects of a slowly recovering economy and low interest rates by growing our balance sheet and funding ourselves inexpensively; to control costs through focused and strategic resource allocation rather than short term decisions that could impair our ability to grow. We are grateful for your continued investment with us and look forward to further leveraging our strengths and enhancing your value in this coming year. We remain grateful that you have chosen us to be your financial stewards.

Sincerely,

Mary Ann Scully

Mary Ann Scully

Chairman, President and CEO of Howard Bancorp and Howard Bank

TABLE OF CONTENTS

Page

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, 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 branch expansion, customer, market and asset growth, expanding client relationships, increasing originations of residential mortgage loans, our portfolio of mortgage loans and our selling of loans into the secondary market, and increasing noninterest income and noninterest bearing commercial deposit accounts;

- statements with respect to our intentions to acquire one or more financial institutions, and the impact of such acquisitions on us;

- statements regarding anticipated changes in expenses;

- statements regarding the asset quality of our investment portfolios and anticipated recovery and collection of unrealized losses on securities available for sale;

- statements with respect to our allowance for loan losses, and the adequacy thereof;

- statements regarding our intentions to lease space in the building we own;

- statements with respect to anticipated losses on, resolution of and additional reserves with respect to nonperforming assets; and

- statements with respect to the closing of the private placement, our initial public offering, and the impact of our initial public offering and the private placement on us.

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.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market area, that are worse than expected;

- we may not sell a significant amount of the shares we are offering hereby and/or the private placement may not close, leaving us with insufficient funds to implement our current business plan and less capital than we anticipate for future operations;

- 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;

- 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 Securities and Exchange Commission and the Public Company Accounting Oversight Board;

- changes in our organization, compensation and benefit plans;

- loss of key personnel; and

- other risks discussed in our filings with the Securities & Exchange Commission.

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.

OUR BUSINESS

Business of Howard Bancorp, Inc.

We were incorporated under the laws of the State of Maryland in April 2005 to serve as the bank holding company of Howard Bank (which we sometimes refer to as the "Bank").

On May 18, 2005, the stockholders of Howard Bank approved the reorganization of Howard Bank into a holding company structure. The reorganization became effective on December 15, 2005. In connection with the reorganization, (i) Howard Bank became our wholly-owned subsidiary, (ii) each outstanding share (or fraction thereof) of Howard Bank common stock was converted into two shares (or fraction thereof) of our common stock, and the former holders of Howard Bank common stock became the holders of all our outstanding shares, and (iii) warrants and options to purchase shares of Howard Bank common stock became options and warrants to purchase Howard Bancorp stock and were adjusted to reflect the exchange of two shares of our common stock for each share of the Bank's common stock.

Our primary business is owning all of the capital stock of Howard Bank. In addition to regulation of the Bank, as a bank holding company registered under the Bank Holding Company Act of 1956, we are subject to regulation and review by the Federal Reserve. See "Supervision and Regulation."

Business of Howard Bank

General

Howard Bank is a trust company chartered under Subtitle 2 of Title 3 of the Financial Institutions Article of the Annotated Code of Maryland. The Bank was formed in March 2004 and commenced banking operations on August 9, 2004. Howard Bank has chosen, for the time being, not to seek and exercise trust powers, and our business, powers and regulatory structure is the same as a Maryland-chartered commercial bank. The Bank is subject to regulation, supervision and regular examination by the Maryland Commissioner of Financial Regulation and the Federal Deposit Insurance Corporation, and our deposits are insured by the Federal Deposit Insurance Corporation. The Bank has three operating subsidiaries, two of which hold foreclosed real estate and the other of which owns and manages real estate that we use for one of our branch locations and that also contains office and retail space.

Howard Bank is headquartered in Ellicott City which is located in Howard County, Maryland. It has branches in both Howard County and the adjacent Anne Arundel County. 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 (the "mass affluent").

Our core business strategy involves delivering advice and superior customer service to clients through local decision makers. The specialized focus of the Bank on both local markets and small and medium-sized business related market segments is combined 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, with fees generated by lending, mortgage banking and depository service charges constituting a much smaller share of revenues. We have positioned the balance sheet to hold a high percentage of earning assets and, in turn, to have those earning assets dominated by loans rather than securities investments. Generally speaking, loans earn more attractive returns than investments and are a key source of product cross sales and customer referrals. Certain economic conditions may favor investments over loans, such as poor corporate earnings, downturns in real estate cycles and other general slowing economic conditions. At all times, our loan and investment strategies seek to balance the need to maintain adequate liquidity via excess cash or federal funds sold with opportunities to appropriately leverage our capital.

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. We opened our fourth full service branch location in December 2008 and our fifth branch (which is not full service) in March 2010, and we plan to move and convert our fifth branch to a full service branch during the first half of 2012. We also plan to open additional branches in the counties where we now operate and contiguous counties over the next several years, although we have no definitive plans or agreements in place with respect to any such 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, deposit gathering (especially non interest bearing transactional deposits) 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. Since the Bank's opening in late 2004, we have participated loans and loan commitments to correspondent banking institutions because of our inability to retain 100% of certain loans originated given our legal lending limit.

Competitive Position

We believe that our position as a community bank with over $300 million in assets positions us well to survive the current economic slowdown, market consolidation and heightened regulatory environment. Our formation in 2003 and 2004 has positioned us to take advantage of the ability to outsource certain activities (internal audit, compliance review, information security monitoring) and to source new products and services (check imaging, online banking) in a highly efficient manner and thus avoid the risk of impairment of operating earnings faced by some older small banks who, we believe, are locked into legacy systems and are finding the onslaught of new regulations more shocking. These strategic partnerships include contractual relationships with some of the largest and strongest providers of item processing, data processing, information monitoring and payments 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 believe the current economic and regulatory environment will lead to 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 as we do and offer advice face-to-face, 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 small and medium-sized businesses a very broad and deep array of competitive credit and cash management services through a term of experienced advisors and providing them with access to local policy and decision makers fills a "white space" between the sophisticated but distracted large banks whose best personnel work with the largest companies and the small banks who are very responsive but less capable of being proactive in providing advice. Relationship managers, team leaders and executive management at the Bank 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.

Current Strategy

The following highlights our current business strategy and strategic priorities.

- ***Increase Howard Bank's capital levels through earnings and external capital raises as appropriate***.

- ***Consistently execute on broadening existing customer relationships and attracting target customers***. We believe that it helps a company compete successfully when it chooses activities that are both different from rivals and valued by target customers. And, such activities must be done extraordinarily well. The knowledge and expertise of our team of bankers coupled with agility and speed in responding, flexibility and creativity in developing solutions and access to decision makers positions us well to compete in the financial services industry in our market area.

  While we have been successful in growing loans and gathering noninterest bearing deposits, we plan to focus on expanding our existing relationships with core products and services that enhance our cost of funds and noninterest income and attracting new "target customers" with the intention of acquiring, retaining and continuously developing profitable core relationships with the potential for depth and longevity. This will require extending the culture of consultative sales/cross sales, proactive relationship management, and extraordinary service (internal and external) held by certain key employees across the Bank and coupling this culture extension with greater discipline, thus resulting in greater efficiency and productivity in our execution.

- ***Leverage Howard Bank's attributes that help it compete successfully to expand the Bank's presence*** - first in Anne Arundel County and possibly in contiguous counties in attracting targeted customers. We will consider both organic and acquired expansion.

- ***Increase noninterest income as a significant contributor to operating revenue***. As net interest margins continue to be compressed, Howard Bank must identify and create new sources of noninterest income, diversifying operating revenue from heavy dependence on net interest income.

- ***Develop and acquire a consistent level of talent across the Bank to ensure we continue to compete successfully***. A key element to being able to compete successfully in our markets is the team of bankers, executive management and board of directors. We will cultivate and nurture the necessary talent to ensure that the knowledge, expertise and attitude of every member of our Bank-wide team are aligned with our strategic vision and mission of "providing financial solutions." This will require having the right people in the right positions, appropriate staffing and resources across the Bank, continuous training, development, coaching and mentoring, and a culture of empowerment and accountability.

- ***Ensure that Enterprise Risk Management is appropriately structured and monitored***. Risk management has been a key differentiator of banks throughout this crisis and will continue to be in the future. We will give keen attention to risk management Bank-wide, identifying the right skill sets, processes, procedures and organizational and governance structures.

We will not be able to fully execute our current business strategy, particularly with respect to growth, if we do not close the private placement, discussed below, or sell a significant number of our shares of common stock we are offering in our initial public offering.

Location and Market Area

Our headquarters are located in Ellicott City, Maryland, and we consider our primary market area to be the Maryland counties of Howard and Anne Arundel. Our secondary market area includes the Maryland counties of Baltimore, Carroll and Harford and as well as Baltimore City. We also have loans outside our market areas, in particular in Frederick, Montgomery and Prince George's Counties in Maryland, although we do not actively solicit business outside our market areas. We have four full service branches located Ellicott City, Columbia, Laurel and western Ellicott City, Maryland. In addition, in 2010, we opened a fifth branch in Anne Arundel County in the Annapolis Exchange Building located in Annapolis, Maryland. This fifth branch provides all services except for cash services (for example, customers cannot cash checks or make cash deposits).

Howard County is located in central Maryland, between Baltimore and Washington, D.C. Howard County is a fast growing county with a well-educated and well-compensated labor force. The population of Howard County increased 15.8% during the 2000-2010 period, compared to 9.0% for the state of Maryland as a whole and, according to estimates from the Maryland State Data Center, Department of Planning (May 2011 estimates), is expected to increase another 9.3% by 2020. For the period 2006-2010 the percentage of residents 25 or older with a bachelor's degree or higher was 58.3%, significantly higher than the Maryland average of 35.7%.

Howard County is one of the wealthiest counties in the nation. Based on estimated median annual household income from 2005 through 2009, Howard County was the fifth wealthiest county in the United States, and the wealthiest county in Maryland. Median household income in Howard County during the 2006-2010 period was $103,273, more than 46% higher than the $70,647 statewide median and more than twice the $51,914 median for the U.S. as a whole. The median value of an owner-occupied home in the county during the 2006-2010 period was $456,200, almost 40% higher than the statewide median value of $329,400.

In addition, Howard County has a vibrant business community. According to the Maryland Department of Business and Economic Development (2009-2010), approximately 8,700 businesses operate in Howard County, with over 200 of these having 100 or more employees. Private, non-farm employment increased 10.7% in the county between 2000 and 2009, compared to 3.1% for the state of Maryland as a whole and just .4% for the U.S. as a whole. As reported by the U.S. Bureau of Labor Statistics, as of December 2011 the unemployment rate in Howard County was just 4.7%, slightly lower than a year ago and significantly lower than both the state and national rates of 6.5% and 8.3%, respectively (December 2011 figures are preliminary estimates).

Anne Arundel County, adjacent to Howard County, also has a favorable profile with respect to the provision of financial services and opportunities for growth. The population in Anne Arundel County grew 9.8% during the 2000-2010 period, compared to 9.0% for the state of Maryland as a whole. Expected population growth in Anne Arundel County (according to estimates from the Maryland State Data Center, Department of Planning (May 2011 estimates)), at 5.9% by 2020, is not as robust as Howard County's, however the size of its population is almost double. Median household income of $83,456 during the 2006-2010 period was higher than both the state and national medians. The median value of an owner-occupied home in the county during the 2006-2010 period was $370,100, 12.4% higher than the statewide median value.

Anne Arundel County also has an active business community. According to the Maryland Department of Business and Economic Development (2009-2010), approximately 14,100 businesses operate in Anne Arundel County, with nearly 300 of these having 100 or more employees. Private, non-farm employment increased 8.7% in the county between 2000 and 2009, compared to 3.1% for the state of Maryland as a whole and just .4% for the U.S. as a whole. As reported by the U.S. Bureau of Labor Statistics the unemployment rate in Anne Arundel County as of December 2011 was 5.8% (preliminary figure), higher than that in Howard County but still lower than the Maryland and national unemployment rates.

For the period 2006-2010 the percentage of residents 25 or older with a bachelor's degree or higher in Anne Arundel County was 35.7%, the same as the state-wide average of but higher than the U.S. average of 27.9%.

We also believe that both counties will experience additional capital investment and economic expansion as a result of the implementation of the Department of Defense Base Realignment and Closure (BRAC) and the location of the U.S. Cyber Command headquarters at Fort Meade in Anne Arundel County, which is less than five miles from the Howard County line, as part of BRAC. According to The Fort Meade Regional Growth Management Committee's May 2010 estimates, total job growth at Fort Meade is expected to be over 28,000 jobs, and total Fort Meade-driven job growth, included indirect jobs, is expected to exceed 61,000.

Unless otherwise noted, the source of the above information is the U.S. Census Bureau.

Lending Activities

General. Our primary market focus is on making loans to and gathering deposits from small and medium size 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 Howard and Anne Arundel Counties, Maryland, and the surrounding communities. Our lending activities consist generally of short to medium term commercial lending, commercial mortgage lending for both owner occupied and investor 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, which includes stringent underwriting standards for all types of loans. Our lending staff follows pricing guidelines established periodically by our management team. In an effort to manage risk, very little authority is given to individual loan officers. Most loan officers can approve loans of up to $50,000, although one of our loan officers can approve loans of up to $100,000 and our President and Chief Executive Officer and our Chief Loan Officer can together approve loans of up to $250,000. Loans above these amounts but less than $1.5 million (or up to $2.0 million for renewal of a loan in an amount previously approved) must be reviewed and approved by an officers' loan committee. All credit decisions in excess of the officers' loan committee's lending authority must be approved prior to funding by our board Loan Committee. Under the leadership of our executive management team, we believe that we employ experienced lending officers, secure appropriate collateral and carefully monitor the financial conditions 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.

Howard 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 audit committee of the board and the full board of directors and are available to and used by regulatory examiners when they review the Bank's asset quality. Through 2011 we retained Maryland Financial Advisory to perform this review, and beginning in 2012 we have retained Clifton Gunderson 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. Commercial loans constituted $81 million, or 29.3% of our loan portfolio at December 31, 2011. 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 investor properties (including residential properties). Commercial real estate loans constituted $124 million, or 45% of our loan portfolio, at December 31, 2011. Of these, $47 million, or 38% (and 17% of our total loan portfolio), were loans for owner occupied properties and $77 million, or 62% (28% of our total loan portfolio), were loans for non-owner occupied 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, amortize over 20 – 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. This segment of our loan portfolio constituted $39 million, or 14% of our portfolio, at December 31, 2011. Most of these loans (92%) were commercial construction loans and land loans while the remainder at December 31, 2011 were for residential 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 commercial construction will often convert into a permanent commercial mortgage loans 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 constituted $32 million, or 12% of our loan portfolio at December 31, 2011. Of these, approximately 71% is made up 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. Our residential mortgage loans are generally fixed rate loans with 15- or 30-year terms. We will occasionally, however, originate variable rate loans with a five- to seven-year term, although such loans have a longer amortization schedule.

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 also require title insurance, and borrowers must obtain hazard insurance, and flood insurance if applicable.

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 compensate 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 compensate for 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.

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. However, these loans are not a focus of our lending activities, and constituted only $1 million, or less than 1% of our loan portfolio, at December 31, 2011. 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, although we originate a small number of first lien residential mortgage loans that we sell into the secondary market. We do not retain the servicing rights on such 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. These loans make up less than 5% of our portfolio.

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 the board of directors annually.

Investments and Funding

We balance our liquidity needs based on loan and deposit growth via the investment portfolio and short term borrowings. It is our goal to provide adequate liquidity to support our loan growth. We use the generally short term investments that represent our liquidity to generate additional positive earnings. Howard Bank's primary source of funds is, and will continue to be, core deposits generated from the local marketplace. Additional funding is provided by customer repurchase agreements, FHLB advances, the Board of Governors of the Federal Reserve (the "FRB") Discount Window, and other purchased funds. Other purchased funds may include CDs over $100,000, federal funds purchased, and institutional or brokered deposits. Lines of credit with the Federal Home Loan Bank (the "FHLB") of Atlanta 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. The board of directors has appointed its executive committee to serve as the investment committee, and the executive committee therefore meets at regular intervals (not less than quarterly) and provides a report on the investment portfolio performance to the full board of directors. The investment officer is designated by the President and is responsible for managing the day-to-day activities of the liquidity and investments in accordance with the policies approved by the board of directors. The investment officer is presently our Chief Financial Officer. 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, courier service for non-negotiable deposits, ATM and check cards, automated teller machines at all of our full-service branch locations, safe deposit boxes at all full service locations 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. Our commercial account services include an overnight sweep service and remote deposit capture service.

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 certificates of deposit. 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 certificates of deposits over $100,000, federal funds purchased and institutional or brokered deposits.

Lending Limit

As of December 31, 2011, our legal lending limit for loans to one borrower was approximately $5.3 million. We further monitor our exposure to one borrower through a policy to limit our "in-house" lending limit to $4.5 million, which in-house limit can be waived by our board loan committee. 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. 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 five years have enhanced the Bank's positioning 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 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 community 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 in Howard and Anne Arundel Counties.

Employees

As of March 31, 2012, Howard Bank has 63 full-time employees and four part-time employees. 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.

Recent Completion of Private Placement; Pending Initial Public Offering

We completed a private placement pursuant to which we offered shares of our common stock to certain institutional investors. On March 28, 2012, we entered into separate investment agreements with two institutional investors pursuant to which they have agreed to purchase an aggregate of between 517,354 and 582,815 shares of our common stock (depending on how many of the shares we are offering hereby are sold) at $7.30 per share. Consummation of the investors' purchase of shares of common stock in the private placement is subject, in addition to standard closing conditions, to the following conditions: (i) our raising aggregate gross proceeds in our registered initial public offering and the private placement of at least $6.0 million; (ii) the effectiveness of the registration statement with respect to our initial public offering and the resale of the shares of common stock purchased by one of the private placement investors; (iii) our common stock being approved for listing on the NASDAQ Capital Market; and (iv) closing of the private placement by July 27, 2012. As a result, we cannot assure you that we will ultimately be able to close the private placement and issue the shares subject to the investment agreements.

In addition, the private placement investors will be entitled to preemptive rights for a period of three years that would allow them to maintain their percentage ownership in any subsequent offerings of our common stock or securities convertible into our common stock.

In addition, we expect to begin our initial public offering in late April or early May. We have filed a registration statement on Form S-1 with the Securities and Exchange Commission with respect to our initial public. In our initial public offering, we are offering up to $7.0 million of our common stock in a rights offering directed at our current stockholders, with the shares not purchased by our existing stockholders eligible for purchase by other investors.

Assuming the conditions to closing are satisfied, we expect that the closing of the private placement will take place concurrently with the closing of our registered initial public offering.

Participation in Small Business Lending Fund

On September 22, 2011, we entered into a securities purchase agreement with the Secretary of the Treasury pursuant to which we sold to the Secretary of the Treasury 12,562 shares of our Series AA Preferred Stock, having a liquidation amount per share equal to $1,000, for an aggregate purchase price of $12,562,000. We issued the Series AA Preferred Stock pursuant to Treasury's Small Business Lending Fund. Enacted into law as part of the Small Business Jobs Act of 2010, the SBLF was a $30 billion fund designed to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion at favorable rates. We are pleased to be one of only four banks in the State of Maryland that was approved to participate in this program. The Series AA Preferred Stock qualifies as Tier 1 capital and is generally non-voting. In accordance with the terms of the SBLF program, the Series AA Preferred Stock has an initial annual dividend rate of 5%. The dividend rate will be reduced if our small business lending increases by at least 2.5%; this reduced rate may be as low as 1% if such lending increases by 10% or more. If we increase small business lending by at least 2.5% but by less than 10%, the rate on the Series AA Preferred Stock may fall to between 2% and 4%, but if lending does not increase in the first two and one-half years the annual dividend rate will increase to 7%. After four and one-half years, the dividend rate will increase to 9% if we have not repaid the SBLF funding at such time.

As part of, and as required by, this transaction, we used $6.3 million of the SBLF funds to redeem all of the outstanding shares of Series A and Series B Preferred Stock issued to the Treasury under the TARP Capital Purchase Program, resulting in a net cash payment to us of $6.2 million. This additional capital will allow us to support our continued growth, including our increased lending to small to medium sized businesses. As we no longer have any preferred stock outstanding that was issued under the TARP Capital Purchase Program, we are no longer subject to the corporate governance, compensation and other restrictions and requirements as set forth in EESA and ARRA. Participation in the SBLF does not entail such restrictions and requirements.

Participation in the Troubled Asset Relief Program

On February 27, 2009, we entered into a Letter Agreement and Securities Purchase Agreement with Treasury, pursuant to which we sold to Treasury, for an aggregate purchase price of $5,983,000, (i) 5,983 shares of our Fixed Rate Cumulative Preferred Stock, Series A, having a liquidation amount per share equal to $1,000 and (ii) a warrant to purchase 299 shares of our Fixed Rate Cumulative Perpetual Preferred Stock, Series B, having a liquidation amount per share equal to $1,000, for an exercise price of $0.01 per share, which was immediately exercised.

We issued the shares of Series A Preferred Stock and Series B Preferred pursuant to Treasury's Capital Purchase Program under TARP as authorized by the Emergency Economic Stabilization Act of 2008 ("EESA"), as amended by the American Recovery and Reinvestment Act of 2009 ("ARRA").

We redeemed the Series A and Series B Preferred Stock on September 22, 2011, in connection with our issuance of Series AA Preferred Stock to the Secretary of the Treasury pursuant to the SBLF program, as discussed above.

SUPERVISION AND REGULATION

Howard Bancorp, Inc.

We are a bank holding company under the Bank Holding Company Act of 1956, as amended. We are subject to regulation and examination by the Federal Reserve, and are required to file periodic reports and any additional information that the Federal Reserve may require. The Bank Holding Company Act generally prohibits a bank holding company from engaging in activities other than banking, managing or controlling banks or other permissible subsidiaries, and acquiring or retaining direct or indirect control of any company engaged in any activities closely related to banking or managing or controlling banks.

The status of Howard Bancorp, Inc. as a registered bank holding company under the Bank Holding Company 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 the powers of a commercial bank), and its deposit accounts are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to the maximum legal limits of the FDIC. It is subject to regulation, supervision and regular examination by the Maryland Commissioner of Financial Regulation and the FDIC. The regulations of these various 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 DIF, and not for the purpose of protecting stockholders.

Set forth below is a brief description of the material regulatory requirements that are applicable to Howard Bank and Howard Bancorp, Inc. 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, Inc.

Banking Regulation

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 Maryland Office of the Commissioner of Financial Regulation in its supervision and regulation of state-chartered banking institutions. The Maryland Office of the Commissioner of Financial Regulation may order any banking institution to discontinue any violation of law or unsafe or unsound business practice.

Capital Requirements. Under the FDIC's regulations, federally insured state-chartered banks that are not members of the Federal Reserve System ("state non-member banks"), such as Howard Bank, are required to comply with minimum leverage capital requirements. The minimum leverage capital requirement for a bank is the ratio of Tier 1 (core) capital to total assets of not less than 3.0% if the FDIC determines that the institution is not anticipating or experiencing significant growth and has well-diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and in general is considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System (the CAMELS rating system) established by the Federal Financial Institutions Examination Council. For all other institutions, the minimum leverage capital ratio is not less than 4.0%. Tier 1 capital is the sum of common stockholders' equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other specified items.

In addition, FDIC regulations require state non-member banks to maintain certain ratios of regulatory capital to regulatory risk-weighted assets, or "risk-based capital ratios." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to risk-weighted categories ranging from 0.0% to 200.0%. State non-member banks must maintain a minimum ratio of total capital to risk-weighted assets of at least 8.0%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock and certain other capital instruments, and a portion of the net unrealized gain on equity securities. The includable amount of Tier 2 capital cannot exceed the amount of the institution's Tier 1 capital.

At this time the bank regulatory agencies are more inclined to impose higher capital requirements in order to meet well capitalized standards, 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, Inc. is a legal entity separate and distinct from Howard Bank. Virtually all of Howard Bancorp, Inc.'s revenue available for the payment of dividends on its common stock results from dividends paid to Howard Bancorp, Inc. 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 Maryland Office of the Commissioner of Financial Regulation, 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, cash dividends may not be paid in excess of 90% of net earnings. 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 Howard Bank being in an unsafe and unsound condition. Because Howard Bank has negative retained earnings, it is currently unable to pay dividends to Howard Bancorp, Inc. without first obtaining the approval of the Maryland Bank Commissioner. To date, Howard Bank has received approval from the Maryland Bank Commissioner to issue dividends only with respect to the Series AA Preferred Stock issued under the Small Business Loan Fund Program.

Prompt Corrective Action. Under federal prompt corrective action regulations, the FDIC is authorized and, under certain circumstances required, to take supervisory actions against state non-member banks that are not adequately capitalized. Under these regulations, a bank is considered to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, Tier 1 risk-based capital of 6.0% or more, Tier I leverage capital of 5.0% or more, and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has total risk-based capital of 8.0% or more, Tier I risk-based capital of 4.0% or more and Tier I leverage capital of 4.0% or more (3.0% under certain circumstances), and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has total risk-based capital of less than 8.0%, Tier I risk-based capital of less than 4.0% or Tier I leverage capital of less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has total risk-based capital of less than 6.0%, Tier I risk-based capital less than 3.0%, or Tier I leverage capital of less than 3.0%; and (v) "critically undercapitalized" if its ratio of tangible equity to total assets is equal to or less than 2.0%. Under certain circumstances, the FDIC may reclassify a well capitalized institution as adequately capitalized, and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized). As of December 31, 2011, Howard Bank was "well capitalized" for this purpose.

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

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 based on that institution’s risk classification under an FDIC risk-based assessment system. An institution’s risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. Deposit insurance assessments fund the DIF, which is currently under-funded.

The Dodd-Frank Act changed the way an insured depository institution’s deposit insurance premiums are calculated. The assessment base will no longer be the institution’s deposit base, but rather its average consolidated total assets less its average tangible equity. The legislation also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008, and noninterest bearing transaction accounts have unlimited deposit insurance through December 31, 2012. The Dodd-Frank Act also made changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% percent to 1.35% of the estimated amount of total insured deposits, eliminating the upper limit for the reserve ratio designated by the FDIC each year, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds.

As mandated by the Dodd-Frank Act, in February 2011, the FDIC approved a final rule that changes the deposit insurance assessment system from one that is based on domestic deposits to one that is based on average consolidated total assets minus average tangible equity. In addition, the rule adopts a “scorecard” assessment scheme for larger banks and suspends dividend payments indefinitely if the DIF reserve ratio exceeds 1.5% percent, but provides for decreasing assessment rates when the reserve ratio reaches certain thresholds. Under the new rule, larger insured depository institutions will likely be forced to pay higher assessments than under the old system, which should offset the cost of the assessment increases for institutions with consolidated assets of less than $10 billion, such as Howard Bank. Assessments for the second quarter 2011 were based on this rule, which resulted in an assessment for us of $65,703.25 in September 2011 and $63,258.42 based upon December 31, 2011 call report data, which will be paid on March 30, 2012.

Maryland Regulatory Assessment. The Maryland Office of the Commissioner of Financial Regulation annually assesses state banking institutions to cover the expense of regulating banking institutions. The Commissioner assesses each banking institution the sum of $1,000, plus $0.08 for each $1,000 of assets of the institution over $1,000,000, as disclosed on the banking institution’s most recent financial report.

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 Federal Reserve Regulation D, which applies to all depository institutions with transaction accounts or non-personal time deposits. Amounts in transaction accounts above $11.5 million and up to $71.0 million must have reserves held against them in the ratio of three percent of the amount. Amounts above $71.0 million require reserves of $1,785,000 plus 10% of the amount in excess of $71.0 million. The Maryland reserve requirements may be used to satisfy the requirements of Regulation D. Howard Bank is in compliance with its 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 amount equal to 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.

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 community (including low and moderate income neighborhoods) which 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 applications to open branches. Howard Bank has a CRA rating of “Outstanding.” 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 specified in those statutes. 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 generally 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, Sections 23A of the Federal Reserve Act and the Federal Reserve's Regulation W limit the extent to which the bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10.0% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20.0% of such institution's capital stock and surplus. The term "covered transaction" includes the making of loans, purchase of assets, issuance of guarantees and other similar transactions. In addition, loans or other extensions of credit by the bank to an affiliate are required to be collateralized in accordance with regulatory requirements and 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 institution or subsidiary as those provided to non-affiliates.

Section 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board 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 be 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 anti-money laundering programs that include established internal policies, procedures and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and 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.

The Office of Foreign Assets Control, or OFAC, is responsible for helping to insure 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 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.

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 procedures 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.

The Dodd-Frank Act. On July 21, 2010, President Obama signed the Dodd-Frank Act into law, and many of those laws are now in effect. The Dodd-Frank Act will have a broad impact on the financial services industry, imposing significant regulatory and compliance changes, including the designation of certain financial companies as systemically significant, the imposition of increased capital, leverage, and liquidity requirements, and numerous other provisions designed to improve supervision and oversight of, and strengthen safety and soundness within, the financial services sector.

The following items provide a brief description of certain provisions of the Dodd-Frank Act.

- *Source of strength.* The Dodd-Frank Act extended the Federal Reserve Board's "source of strength" doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress. Under this requirement, Howard Bancorp in the future could be required to provide financial assistance to Howard Bank should Howard Bank experience financial distress.

- *Mortgage loan origination and risk retention.* The Dodd-Frank Act contains additional regulatory requirements that may affect our operations and result in increased compliance costs. For example, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks, in an effort to require steps to verify a borrower's ability to repay. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells or mortgage and other asset-backed securities that the securitizer issues. The risk retention requirement generally will be 5%, but could be increased or decreased by regulation.

- *Consumer Financial Protection Bureau ("CFPB").* The Dodd-Frank Act created a new independent CFPB within the Federal Reserve. The CFPB is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The CFPB has rulemaking authority over many of the statutes governing products and services offered to bank consumers, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. For banking organizations with assets under $10 billion, like Howard Bank, the CFPB has exclusive rulemaking authority, but the FDIC, as Howard Bank's primary federal regulator, will continue to have examination and enforcement authority under federal consumer financial law. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the CFPB. Compliance with any such new regulations would increase our cost of operations.

- *Deposit insurance.* The Dodd-Frank Act made permanent the general $250,000 deposit insurance limit for insured deposits. The Dodd-Frank Act also extends until January 1, 2013, federal deposit insurance coverage for the full net amount held by depositors in noninterest bearing transaction accounts. As discussed above, amendments to the Federal Deposit Insurance Act broadened the assessment base against which an insured depository institution's deposit insurance premiums paid to DIF are calculated. These provisions could increase the FDIC deposit insurance premiums paid by Howard Bank.

- *Enhanced lending limits.* The Dodd-Frank Act strengthened the existing limits on a depository institution's credit exposure to one borrower. Federal banking law limits a depository institution's ability to extend credit to one person (or group of related persons) in an amount exceeding certain thresholds. The Dodd-Frank Act expanded the scope of these restrictions to include credit exposure arising from derivative transactions, repurchase agreements, and securities lending and borrowing transactions.

- *Corporate governance.* The Dodd-Frank Act addressed many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including Howard Bancorp. The Dodd-Frank Act provides the U.S. Securities Exchange Commission ("SEC") with authority to adopt proxy access rules that would allow stockholders of publicly traded companies to nominate candidates for election as a director and have those nominees included in a company's proxy materials and directed the SEC and national securities exchanges to adopt rules that: (1) provide stockholders of U.S. publicly traded companies an advisory vote on executive compensation; (2) will enhance independence requirements for compensation committee members; and (3) will require companies listed on national securities exchanges to adopt incentive-based compensation clawback policies for executive officers.

Many of the requirements of the Dodd-Frank Act will be implemented over time and most will be subject to regulations implemented over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our investors.

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 Federal Reserve's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve affect the levels of bank loans, investments and deposits through its 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.

Bank Holding Company Regulation

As a bank holding company, Howard Bancorp, Inc. is subject to regulation and examination by the Maryland Office of the Commissioner of Financial Regulation and the Federal Reserve. Howard Bancorp, Inc. is required to file with the Federal Reserve an annual report and such additional information as the Federal Reserve may require pursuant to the Bank Holding Company Act of 1956, as amended (the "BHC Act"). Among other things, the BHC Act requires regulatory filings by a stockholder or other party that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution. The determination whether an investor "controls" a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, a party is deemed to control a depository institution or other company if the party owns or controls 25% or more of any class of voting stock. Subject to rebuttal, a party may be presumed to control a depository institution or other company if the investor owns or controls 10% or more of any class of voting stock. Ownership by affiliated parties, or parties acting in concert, is typically aggregated for these purposes. If a party's ownership of Howard Bancorp were to exceed certain thresholds, the investor could be deemed to "control" Howard Bancorp for regulatory purposes. This could subject the investor to regulatory filings or other regulatory consequences.

Pursuant to provisions of the BHC Act and regulations promulgated by the Federal Reserve thereunder, Howard Bancorp, Inc. may only engage in or own companies that engage in activities deemed by the Federal Reserve 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 Federal Reserve 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.

Federal banking regulators have adopted risk-based capital guidelines for bank holding companies. Currently, the required minimum ratio of total capital to risk-weighted assets (including off-balance sheet activities, such as standby letters of credit) is 8%. At least half of the total capital is required to be Tier 1 capital, consisting principally of common stockholders' equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries, less goodwill. The remainder (Tier 2 capital) may consist of a limited amount of subordinated debt and intermediate-term preferred stock, certain hybrid capital instruments and other debt securities, perpetual preferred stock and a limited amount of the general loan loss allowance.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

The above risk-based and leverage ratio guidelines apply on a consolidated basis to any bank holding company with consolidated assets of $500 million or more. These guidelines also apply on a consolidated basis to any bank holding company with consolidated assets of less than $500 million if such holding company (i) is engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) conducts significant off-balance sheet activities or (iii) has a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the SEC. As of December 31, 2011, Howard Bancorp, Inc. had consolidated assets of less than $500 million and did not satisfy the nonbanking, off-balance sheet, or debt requirements that would make it subject to the risk-based or leverage ratio requirements discussed above. However, under the Federal Reserve's Policy for Small Holding Companies it must continue to serve as a source of strength for its subsidiary bank.

The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve'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. The Federal Reserve's policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. Under the prompt corrective action laws, 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, Inc. to pay dividends or otherwise engage in capital distributions.

Federal and State Securities Laws

We have filed with the Securities and Exchange Commission a registration statement under the Securities Act of 1933 (the "Securities Act") for the registration of the shares of common stock to be issued pursuant to our initial public offering offering. Upon completion such offering, our common stock will be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (the "Exchange Act"). We will be subject to the information, proxy solicitation, insider trading restrictions and other requirements under 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. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer will be required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the board of directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting. We will be subject to further reporting and audit requirements under the requirements of the Sarbanes-Oxley Act. We will prepare policies, procedures and systems designed to ensure compliance with these regulations.

MARKET FOR COMMON STOCK, DIVIDEND POLICY AND RELATED STOCKHOLDER MATTERS

Our common stock is quoted on the Over-The-Counter Bulletin Board (the "OTCBB") under the symbol "HBMD." However, there is not an active trading market for our common stock at this time. While we have applied to have our stock listed on The NASDAQ Stock Market in connection with our initial public offering, we cannot assure you that the common stock will be so listed. While we believe there are currently several market makers in our stock, we cannot assure you that these entities will continue to make a market in our stock or that other entities will make a market in our common stock if our current market makers cease to do so. To our knowledge, to date, our common stock has traded only on a very limited basis.

The high and low sales prices of our common stock on the OTCBB for the last two fiscal years are shown below. The quotations shown below are based on information posted on the OTCBB by broker-dealers. These prices may include dealer mark-up, mark-down and/or commission and may not necessarily represent actual transactions.

Sale Price Range

	High	Low
2011		
First Quarter	$ 7.25	$ 5.60
Second Quarter	7.00	6.05
Third Quarter	6.10	5.10
Fourth Quarter	5.30	4.60
2010		
First Quarter	$ 8.00	$ 6.95
Second Quarter	7.30	6.90
Third Quarter	7.50	5.25
Fourth Quarter	6.00	4.75

At March 28, 2012, we had 337 stockholders of record.

Dividend Policy

We have not paid any dividends on our common stock since our inception and we presently do not intend to pay any dividends in the foreseeable future. We expect that we will retain all earnings, if any, for operating capital. Our ability to pay dividends is dependent upon, among other things, restrictions imposed by the reserve and capital requirements of Maryland and federal law and regulations, our income and financial condition, tax considerations, and general business conditions.

In addition, there are restrictions on our ability to pay dividends on our common stock if we are in arrears in the required dividend payment on our Series AA Preferred Stock. So long as the Series AA Preferred Stock remains outstanding, we may declare and pay dividends on our common stock, and any other shares of Junior Stock (as defined below) or Parity Stock (as defined below), only if, after giving effect to the dividend, our Tier 1 capital would be at least equal to the Tier 1 Dividend Threshold (as defined below) and full dividends on all outstanding shares of Series AA Preferred Stock for the most recently completed dividend period have been or are contemporaneously declared and paid.

If a dividend is not declared and paid in full on the Series AA Preferred Stock for any dividend period, then from the last day of that dividend period until the last day of the third dividend period immediately following it, no dividend or distribution may be declared or paid on our common stock or any other shares of Junior Stock (other than dividends payable solely in shares of common stock) or Parity Stock; provided, however, that in any such dividend period in which a dividend is declared and paid on the Series AA Preferred Stock, dividends may be paid on Parity Stock to the extent necessary to avoid any material breach of any covenant to which we are bound.

"Junior Stock" means our common stock and any other class or series of our stock the terms of which expressly provide that it ranks junior to the Series AA Preferred Stock as to dividend and redemption rights and/or as to rights on our liquidation, dissolution or winding up. Currently, our common stock is the only class of stock outstanding that constitutes Junior Stock.

"Parity Stock" means any class or series of our stock, other than the Series AA Preferred Stock, the terms of which do not expressly provide that such class or series will rank senior or junior to the Series AA Preferred Stock as to dividend rights and/or as to rights upon our liquidation, dissolution or winding up, in each case without regard to whether dividends accrue cumulatively or non-cumulatively. We currently have no outstanding class or series of stock that constitutes Parity Stock.

The "Tier 1 Dividend Threshold" means 90% of $23,536,000, which is Howard Bancorp's consolidated Tier 1 capital as of June 30, 2011, less the $6.3 million in TARP preferred stock then outstanding and repaid on September 22, plus the $12,562,000 in Series AA Preferred Stock issued and minus the net loan charge-offs by the Bank since September 22, 2011. The Tier 1 Dividend Threshold is subject to reduction, beginning on the first day of the 11th dividend period following the date of issuance of the Series AA Preferred Stock, by $1,256,200 (10% of the aggregate liquidation amount of the Series AA Preferred Stock initially issued, without regard to any subsequent partial redemptions) for each 1% increase in QSBL from the Baseline level to the ninth dividend period.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section is intended to help potential investors understand our financial performance through a discussion of the factors affecting our consolidated financial condition at December 31, 2011, 2010 and 2009. 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 is a trust company chartered under Subtitle 2 of Title 3 of the Financial Institutions Article of the Annotated Code of Maryland. The Bank was formed in March 2004 and commenced banking operations on August 9, 2004. Howard Bank does not exercise trust powers, and our regulatory structure is the same as a Maryland-chartered commercial bank. As such, our 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 increase our originations of one- to four-family residential mortgage loans going forward, increasing our portfolio of mortgage lending and also selling select loans into the secondary markets.

We are headquartered in Ellicott City, Maryland and we consider our primary market area to be Howard County, Maryland and Anne Arundel County, Maryland. Our secondary market area, primarily for commercial lending, includes the Maryland counties of Baltimore, Carroll, Frederick, Montgomery and Prince George's as well as Baltimore City. We engage in a general commercial banking business, making various types of loans and accepting deposits. We market our financial services to small to 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 is to deliver superior customer service that is supported by an extremely high level of banking sophistication. Our specialized community banking focus on both local markets and small business related market segments is combined with a broad array of products, new technology and seasoned banking professionals which positions the Bank differently than 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. We call it Hands-On Service.

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 law, regulations or government policies may materially affect our financial condition and results of operations.

During the year ended December 31, 2011, our net interest income increased $1.3 million, or 11%, compared to the year ended December 31, 2010, primarily as a result of lower interest paid on deposits during the 2011 period. We had net income of $1.4 million at December 31, 2011 compared to net income of $933 thousand for the same period in 2010, a $452 thousand or 48% increase. This increase was primarily as a result of the increased net interest income and a decrease in the provision for credit losses, partially offset by an increase in noninterest expenses resulting from increased infrastructure costs to support a growing institution and increased cost associated with Other Real Estate Owned ("OREO") properties. Comparing December 31, 2011 to the same period in 2010, total assets, total loans, and total deposits grew by 8%, 8%, and 10% respectively. While this growth was modest compared to growth in prior years, our noninterest-bearing deposit accounts, which are the most indicative of our growth in overall core relationships, increased by nearly $13.4 million, or 28%.

During the year ended December 31, 2010, our net interest income increased $2.7 million or 31%, compared to the year ended December 31, 2009, due to increased interest income resulting from an increase in average earning assets of $37 million or 15% over 2009, as well as lower interest paid on interest-bearing funds for 2010. Although average interest-bearing funds increased by $37 million for 2010 over 2009, the interest cost of those funds decreased by over $800 thousand or more than 20%. We had net income of $933 thousand in 2010, compared to a net loss of $2.2 million in 2009. In addition to the increase in net interest income, the provision for credit losses decreased from $3.7 million in 2009 to $1.6 million for 2010, and while noninterest income levels were similar for both years, total noninterest expenses decreased by $553 thousand for 2010 compared to 2009 due primarily to a $1.3 million valuation adjustment that we recorded in 2009 on a property we acquired via foreclosure.

Our nonperforming assets totaled $7.8 million, or 2.40% of total assets, at December 31, 2011, compared to $8.7 million, or 2.89% of total assets, at December 31, 2010 and $8.5 million, or 2.97% of total assets, at December 31, 2009. We had one loan totaling $90 thousand delinquent more than 90 days at December 31, 2011 compared to $150 thousand (one loan) and $10 thousand (one loan) of such delinquencies at December 31, 2010 and December 31, 2009, respectively. In addition, we provided $1.2 million for credit losses for the year ended December 31, 2011 compared to $1.6 million for credit losses during the year ended December 31, 2010 and $3.7 million during the year ended December 31, 2009, reflecting a decrease in nonperforming loans and a lower level of required specific reserves for the credit loss provision.

As otherwise discussed in this report, we recently completed a private placement pursuant to which two institutional investors pursuant to which they have agreed to purchase an aggregate of between 517,354 and 582,815 shares of our common stock (depending on how many of the shares we are offering hereby are sold) at $7.30 per share, subject to certain closing conditions. In addition, we expect to begin our initial public offering during late April or early May. In our initial public offering, we are offering up to $7.0 million of our common stock in a rights offering directed at our current stockholders, with the shares not purchased by our existing stockholders eligible for purchase by other investors.

We do not offer "interest only" mortgage loans on one- to four-family residential properties (where the borrower pays interest but no principal for an initial period, after which the loan converts to a fully amortizing loan). We also do not offer loans that provide for negative amortization of principal, such as "Option ARM" loans, where the borrower can pay less than the interest owed on their loan, resulting in an increased principal balance during the life of the loan. We do not offer "subprime loans" (loans that generally are made to borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios) or Alt-A loans (traditionally defined as loans having less than full documentation). We also do not own any private label mortgage-backed securities.

Our Business Strategy

Highlights of our business strategy are as follows:

- ***Increase Howard Bank's capital levels through earnings and external capital raises as appropriate***.

- ***Consistently execute on broadening existing customer relationships and attracting target customers***. We believe that it helps a company compete successfully when it chooses activities that are both different from rivals and valued by target customers. And, such activities must be done extraordinarily well. The knowledge and expertise of our team of bankers coupled with agility and speed in responding, flexibility and creativity in developing solutions and access to decision makers positions us well to compete in the financial services industry in our market area.

While we have been successful in growing loans and gathering noninterest-bearing deposits, we plan to focus on expanding our existing relationships with core products and services that enhance our cost of funds and noninterest income and attracting new "target customers" with the intention of acquiring, retaining and continuously developing profitable core relationships with the potential for depth and longevity. This will require extending the culture of consultative sales/cross sales, proactive relationship management, and extraordinary service (internal and external) held by certain key employees across the Bank and coupling this culture extension with greater discipline, thus resulting in greater efficiency and productivity in our execution.

- ***Leverage Howard Bank's attributes that help it compete successfully to expand the Bank's presence*** - first in Anne Arundel County and possibly in contiguous counties in attracting targeted customers. We will consider both organic and acquired expansion.

- ***Increase noninterest income as a significant contributor to operating revenue***. As net interest margins continue to be compressed, Howard Bank must identify and create new sources of noninterest income, diversifying operating revenue from heavy dependence on net interest income.

- ***Develop and acquire a consistent level of talent across the Bank to ensure we continue to compete successfully***. A key element of being able to compete successfully in our markets is the team of bankers, executive management and board of directors. We will cultivate and nurture the necessary talent to ensure that the knowledge, expertise and attitude of every member of our Bank-wide team are aligned with our strategic vision and mission of "providing financial solutions." This will require having the right people in the right positions, appropriate staffing and resources across the Bank, continuous training, development, coaching and mentoring, and a culture of empowerment and accountability.

- ***Ensure that Enterprise Risk Management is appropriately structured and monitored***. Risk management has been a key differentiator of banks throughout this crisis and will continue to be in the future. We will give keen attention to risk management Bank-wide, identifying the right skill sets, processes, procedures and organizational and governance structures.

Critical Accounting Policies

Our accounting and financial reporting policies conform to the accounting principles generally accepted in the United States of America and general practice within the banking industry. Accordingly, the financial statements require management to exercise significant judgment or discretion or make significant assumptions 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. We consider the allowance for credit losses to be our most significant accounting policy, which is further described in Note 6 of the Notes to the financial statements.

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 impacted 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.

We account for income taxes under the asset/liability method. We recognize deferred tax assets for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, 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.

We follow the provisions of ASC Topic 718 "Compensation," which requires the expense recognition over a 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 which are reviewed with the appropriate Board Committee.

Balance Sheet Analysis and Comparison of Financial Condition

A comparison between December 31, 2011, December 31, 2010 and December 31, 2009 balance sheets is presented below.

Assets

Total assets increased $22.9 million, or 7.6%, to $323.1 million at December 31, 2011 compared to $300.2 million at December 31, 2010. This increase in assets was primarily due to a $20.2 million, or 7.9%, increase in loans, to $276.5 million at December 31, 2011 from $256.3 million at December 31, 2010, and also a $6.5 million, or 56.5%, increase in cash and due from banks. The asset growth was funded primarily from increases in customer deposits, which increased from $239.3 million at December 31, 2010 to $262.6 million at December 31, 2011, an increase of $23.3 million or 9.7%. From a funding perspective, most important was the growth in noninterest-bearing deposits of $13.4 million or 27.5% from $48.7 million at December 31, 2010 to $62.0 million at December 31, 2011. In addition, our total capital levels increased by over $7.3 million or 25.1% year over year, due to both increased levels of earnings and the additional funds we received as a result of our participation in the SBLF program.

Securities Available for Sale

We currently hold both U.S. agency securities and mortgage backed securities in our securities portfolio, all of which are considered as available for sale. Our securities portfolio is used to provide the required collateral for funding via commercial customer repurchase agreements as well as to provide sufficient liquidity to fund our loans and provide funds for withdrawals of deposited funds. At December 31, 2011 and December 31, 2010 we held an investment in stock of the Federal Home Loan Bank of Atlanta (“FHLB”) of $1.3 million and $1.5 million, respectively. This investment, which is required for continued membership, is based partially upon the dollar amount of borrowings outstanding from the FHLB. These investments are carried at cost. We have never held stock in Fannie Mae or Freddie Mac.

The following tables set forth the composition of our investment securities portfolio at the dates indicated.

(in thousands)	December 31, 2011		2010		2009	
	Amortized Cost	**Estimated Fair Value**	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
U.S. Federal agencies	**$ 12,774**	**$ 12,773**	$ 14,037	$ 14,037	$ 13,707	$ 13,709
Mortgage-backed	**568**	**603**	953	1,003	1,614	1,694
Total	**$ 13,342**	**$ 13,376**	$ 14,990	$ 15,040	$ 15,321	$ 15,403

We had securities available for sale of $13.4 million and $15.0 million at December 31, 2011 and December 31, 2010, respectively, which were recorded at fair value. This represents a decrease of $1.7 million, or 11.1%, for the year ended December, 2011 from the prior year end. We did not record any gains or losses on the sales or calls of securities or mortgage backed securities in either the years ended December 31, 2011 or 2010.

With respect to our portfolio of securities available for sale, we held securities with unrealized losses of $2,494 and $2,708 at December 31, 2011 and 2010, respectively. The minimal 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 consider all of the unrealized losses to be temporary impairment losses.

Portfolio Maturities and Yields

The composition and maturities of the investment securities portfolio at December 31, 2011 and 2010 are summarized in the following tables. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

(in thousands)	As of December 31, 2011 One year or less		After one through five years		After five through ten years		After ten years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. Government Agencies	$ 6,000	0.01 %	$ 6,774	0.51 %	$ -	- %	$ -	- %	$ 12,774	0.27 %
Mortgage-backed	-	-	247	5.11	168	4.97	153	4.85	568	5.00
	$ 6,000	0.01 %	$ 7,021	0.67 %	$ 168	4.97 %	$ 153	4.85 %	$ 13,342	0.48 %

(in thousands)	One year or less		After one through five years		After five through ten years		After ten years		Total	
	As of December 31, 2010									
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. Government										
Agencies	$ 12,037	0.25 %	$ 2,000	0.60 %	$ -	- %	$ -	- %	$ 14,037	0.30 %
Mortgage-backed	-	-	424	5.21	-	-	529	5.00	953	5.09
	$ 12,037	0.25 %	$ 2,424	1.41 %	$ -	- %	$ 529	5.00 %	$ 14,990	0.61 %

Loan Portfolio

Total loans increased by $20.2 million or 7.9%, to $276.5 million at December 31, 2011 from $256.3 million at December 31, 2010. At December 31, 2011, total loans were 85.6% of total assets relatively unchanged compared to 85.4% of total assets at December 31, 2010. Loan growth throughout the banking industry has been hampered by decreased loan demand resulting from uncertain economic conditions.

The following table sets forth the composition of our loan portfolio at the dates indicated. We had loans held for sale of $646 thousand at December 31, 2011, and $1.06 million at December 31, 2010.

(dollars in thousands)	2011		2010		2009		2008		2007	
	December 31,									
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Real Estate										
Construction and land	**$ 39,268**	**14.2** %	$ 30,604	11.9 %	$ 33,437	13.2 %	$ 32,230	15.8 %	$ 29,225	16.9 %
Residential - first lien	**22,087**	**8.0**	22,309	8.7	20,202	8.0	18,986	9.3	17,181	10.0
Residential - junior lien	**9,242**	**3.3**	9,889	3.9	10,401	4.1	9,261	4.5	7,237	4.2
Total residential real estate	**31,329**	**11.3**	32,198	12.6	30,603	12.1	28,247	13.8	24,418	14.2
Commercial - owner occupied	**46,588**	**16.8**	46,947	18.3	43,397	17.2	35,366	17.3	33,523	19.4
Commercial - non-owner occupied	**76,880**	**27.8**	58,438	22.8	51,193	20.3	28,758	14.1	20,336	11.8
Total commercial real estate	**123,468**	**44.6**	105,385	41.1	94,590	37.4	64,124	31.4	53,859	31.2
Total real estate loans	**194,065**	**70.2**	168,187	65.6	158,630	62.8	124,601	61.1	107,502	62.3
Commercial loans and leases	**81,243**	**29.4**	86,851	33.9	92,816	36.7	77,436	37.9	62,959	36.5
Consumer loans	**1,223**	**0.4**	1,269	0.5	1,299	0.5	2,053	1.0	2,030	1.2
Total loans	**$ 276,531**	**100.0** %	$ 256,307	100.0 %	$ 252,745	100.0 %	$ 204,090	100.0 %	$ 172,491	100.0 %
Allowance for loan and lease losses	**(3,433)**		(3,523)		(3,508)		(2,659)		(2,671)	
Net loans	**$ 273,098**		$ 252,784		$ 249,237		$ 201,431		$ 169,820	

Loan Portfolio Maturities and Yields

The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2011.

December 31, 2011

(dollars in thousands)	Construction & Land Amount	Construction & Land Weighted Average Rate	Residential Real Estate First Lien Amount	Residential Real Estate First Lien Weighted Average Rate	Residential Real Estate Junior Lien Amount	Residential Real Estate Junior Lien Weighted Average Rate
Due during the twelve months ending December 31,						
2012	$ 30,585	5.22 %	$ -	- %	$ 12	5.82 %
2013	4,398	4.60	-	-	-	-
2014	861	6.00	-	-	40	3.00
2015 to 2016	3,423	6.03	-	-	1,767	3.08
2017 to 2021	-	-	-	-	4,302	3.30
2022 to 2026	-	-	2,476	5.08	482	6.75
2027 and beyond	-	-	19,611	5.54	2,639	5.56
Total	**$ 39,268**	5.24 %	**$ 22,087**	5.49 %	**$ 9,242**	4.09 %

	Commercial Real Estate Owner Occupied Amount	Commercial Real Estate Owner Occupied Weighted Average Rate	Commercial Real Estate Non Owner Occupied Amount	Commercial Real Estate Non Owner Occupied Weighted Average Rate	Commercial Loans & Leases Amount	Commercial Loans & Leases Weighted Average Rate
Due during the twelve months ending December 31,						
2012	$ 4,883	5.94 %	$ 8,152	4.78 %	$ 36,533	4.40 %
2013	1,573	6.15	6,266	5.49	5,478	4.26
2014	6,437	6.41	19,047	6.22	7,423	6.22
2015 to 2016	20,114	6.03	20,644	6.09	10,336	5.88
2017 to 2021	11,169	5.76	22,677	4.68	19,559	6.44
2022 to 2026	2,412	4.88	-	-	1,914	6.09
2027 and beyond	-	-	93	6.50	-	-
Total	**$ 46,588**	5.95 %	**$ 76,880**	5.52 %	**$ 81,243**	5.28 %

	Consumer Loans Amount	Consumer Loans Weighted Average Rate	Total Loans Amount	Total Loans Weighted Average Rate
Due during the twelve months ending December 31,				
2012	$ 236	6.00 %	$ 80,401	4.85 %
2013	650	3.48	18,366	4.89
2014	49	7.29	33,857	6.25
2015 to 2016	222	6.60	56,507	5.94
2017 to 2021	66	8.38	57,773	5.38
2022 to 2026	-	-	7,284	5.39
2027 and beyond	-	-	22,344	5.55
Total	**$ 1,223**	4.95 %	**$ 276,531**	5.43 %

The following table sets forth the scheduled repayments of fixed and adjustable rate loans in our portfolio as of December 31, 2011, that are contractually due after one year, or after December 31, 2012.

	Due After one year		
(in thousands)	**Fixed**	**Adjustable**	**Total**
Real Estate			
Construction & Land	$ 7,271	$ 1,412	$ 8,683
Residential - First Lien	21,729	358	22,087
Residential - Junior Lien	2,104	7,126	9,230
Total Residential Real Estate	23,833	7,484	31,317
Commercial - Owner Occupied	35,419	6,285	41,704
Commercial - Non-owner Occupied	57,850	10,878	68,728
Total Commercial Real Estate	93,270	17,163	110,432
Total Real Estate Loans	124,374	26,059	150,432
Commercial Loans & Leases	37,359	7,352	44,711
Consumer Loans	392	595	987
Total Loans	$ 162,124	$ 34,006	$ 196,130

Premises and Equipment

The composition of our investments in premises and equipment are presented in the following table:

	December 31,		
(in thousands)	**2011**	2010	2009
Land	**2,660**	$ 2,660	$ -
Building and leasehold improvements	**7,141**	6,653	2,282
Furniture and equipment	**1,912**	1,702	1,540
Software	**163**	161	141
	11,876	11,176	3,963
Less: accumulated depreciation and amortization	**2,392**	1,937	1,581
Net premises and equipment	**$ 9,484**	$ 9,239	$ 2,382

For the year ended December 31, 2011, the primary increase in our fixed assets was the purchase of additional furniture and equipment associated with the growth of our operational and administrative infrastructure staff, which has increased to correspond with the increase in assets, deposits and customers. We did not open any new branches during 2011, but we do anticipate the addition of a new branch early in 2012. During 2010, we purchased and now own a property that includes one of our branch locations as well as both office and retail space. In addition to the current branch, we expect to utilize a portion of the center for future Bank expansion and intend to lease the remainder of the space.

Deposits

We accept deposits primarily from the areas in which our 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 (“CDs”), 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 (“CDARS”) 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.

Our deposits increased from $239.3 million at December 31, 2010 to $262.6 million at December 31, 2011, an increase of $23.3 million or 9.7%. The increase resulted primarily from a $13.4 million or 27.5% increase in noninterest-bearing checking accounts, which increased from $48.7 million at December 31, 2010 to $62.0 million at December 31, 2011. In addition, CDs increased from $95.2 million at December 31, 2010 to $111.0 million at December 31, 2011, an increase of $15.8 million or 16.6%. As the growth in noninterest bearing checking and CDs were sufficient to fund the growth in loans and assets, other categories of deposits were not maintained at previous levels and experienced minor declines.

Deposits increased $10.6 million, or 4.6%, to $239.3 million at December 31, 2010 from $228.7 million at December 31, 2009. The increase resulted from a $9.7 million or 24.8% increase in noninterest-bearing checking accounts from $39.0 million at December 31, 2009 to $48.7 million at December 31, 2010. Money market accounts also increased by $19.9 million or 44.4% from December 31, 2009 to December 31, 2010.

The following tables set forth the distribution of total deposits, by account type, at the dates indicated

	December 31,								
(dollars in thousands)	**2011**			2010			2009		
	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate
Noninterest-bearing demand	**62,044**	**24** %	**-** %	$ 48,679	20 %	- %	$ 38,998	17 %	- %
Interest-bearing checking	**17,687**	**7**	**0.43**	17,152	7	0.42	15,901	6	0.46
Money market accounts	**61,267**	**23**	**0.70**	64,637	27	0.76	44,759	20	1.01
Savings	**10,644**	**4**	**0.65**	13,608	6	1.29	15,644	7	1.77
Certificates of deposit $100,000 and over	**79,718**	**30**	**1.21**	68,118	29	1.76	65,340	29	3.01
Certificates of deposit under $100,000	**31,282**	**12**	**1.06**	27,120	11	1.70	48,101	21	2.82
Total deposits	**$ 262,642**	**100** %	**0.91** %	$ 239,314	100 %	1.31 %	$ 228,743	100 %	2.14 %

As of December 31, 2011 and 2010, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to $100,000 was $79.7 million and $68.1 million, respectively. The following table sets forth the maturity of those certificates as of December 31, 2011.

(in thousands)	**December 31, 2011**
Three months or less	**$ 18,400**
Over three to six months	**6,026**
Over six to twelve months	**25,568**
Over one year	**29,724**
	$ 79,718

Borrowings

Customer deposits remain the primary source we use to meet funding needs. Borrowings consist of overnight unsecured master notes, overnight securities sold under agreement to repurchase ("repurchase agreements") and FHLB advances. Our borrowings totaled $23.0 million at December 31, 2011 and $31.0 million and $28.5 million at December 31, 2010 and 2009, respectively. Short-term borrowings are summarized on the following table:

	December 31,					
	2011		2010		2009	
(dollars in thousands)	**Amount**	**Rate**	Amount	Rate	Amount	Rate
Securities Sold Under Agreement to Repurchase & Master Notes						
At period end	$ 6,984	0.62 %	$ 11,024	0.59 %	$ 14,459	0.84 %
Average for the year	$ 12,211	0.39 %	$ 14,983	0.62 %	$ 10,374	0.90 %
Maximum month-end balance	$ 17,379		$ 17,424		$ 15,774	
Federal Funds Purchased and Short-term Borrowed Funds						
At period end	$ 6,000	0.59 %	$ 14,000	0.96 %	$ 6,000	0.49 %
Average for the year	$ 9,629	0.98 %	$ 8,203	1.49 %	$ 11,368	0.89 %
Maximum month-end balance	$ 12,500		$ 14,000		$ 19,000	

Short-term borrowings totaled $13.0 million at December 31, 2011 and $25.0 million at December 31, 2010. Short-term borrowing consist of overnight electronic sweep products that move customer excess funds from non-interest bearing account to interest bearing ones. Master notes sweep funds from the Bank customer accounts to Howard Bancorp. Repurchase agreements sweep funds within the Bank and are secured 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. At December 31, 2011and 2010 there were $5.8 million and $9.0 million, respectively in borrowings under these agreements. Finally we did not utilize any Federal funds purchased at December 31, 2011 and used $4.0 million at December 31, 2010. At December 31, 2011 we had three advances outstanding totaling $6 million and at December 31, 2010 had five advances outstanding totaling $10 million in FHLB advances with a final remaining maturity of less than one year.

Total Shareholders' Equity

Total shareholders' equity increased by $7.3 million or 25.1% from $29.3 million at December 31, 2010 to $36.6 million at December 31, 2011. Over $6 million of the increase represented the net proceeds of our issuance to Treasury of our Series AA Preferred Stock pursuant to the SBLF Program. The remainder of the capital growth represents retention of the previous four quarters of earnings.

Total shareholders' equity at December 31, 2011 represents a capital to asset ratio of 11.34%, while the total shareholders' equity of at December 31, 2010 represents a capital to asset ratio of 9.76%.

Average Balance and Yields

The following tables set forth average balance sheets, 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)	2011 Average Balance	2011 Income / Expense	2011 Yield / Rate	2010 Average Balance	2010 Income / Expense	2010 Yield / Rate	2009 Average Balance	2009 Income / Expense	2009 Yield / Rate
	For the year ended December 31,								
Earning assets									
Loans ans leases: [1]									
Commercial loans and leases	**$ 84,384**	**$ 4,758**	**5.64** %	$ 90,787	$ 4,927	5.43 %	$ 89,285	$ 4,643	5.20 %
Commercial real estate	**108,073**	**6,318**	**5.85**	101,284	5,805	5.73	73,737	4,368	5.92
Construction and land	**34,252**	**1,732**	**5.06**	33,581	1,640	4.88	34,950	1,489	4.26
Residential real estate	**32,880**	**1,646**	**5.01**	31,640	1,664	5.26	30,119	1,614	5.36
Consumer	**1,250**	**62**	**4.97**	1,390	67	4.82	1,327	65	4.87
Total loans	**260,839**	**14,516**	**5.57**	258,682	14,103	5.45	229,418	12,179	5.31
Federal funds sold	**11,891**	**22**	**0.19**	6,508	28	0.43	3,968	71	1.79
Securities: [2]									
U.S Gov agencies	**13,845**	**45**	**0.32**	14,448	49	0.34	8,051	51	0.63
Mortgage-backed	**816**	**40**	**4.86**	1,364	69	5.06	2,317	120	5.18
Other investments	**1,459**	**17**	**1.19**	1,642	6	0.37	1,696	5	0.29
Total securities	**16,120**	**102**	**0.63**	17,454	124	0.71	12,064	176	1.46
Total earning assets	**288,850**	**14,640**	**5.07**	282,644	14,255	5.04	245,450	12,426	5.06
Cash and due from banks	**3,209**			11,200			6,728		
Bank premises and equipment, net	**9,264**			5,526			2,486		
Other assets	**9,136**			6,427			5,537		
Less: allowance for credit losses	**(3,890)**			(3,702)			(2,952)		
Total assets	**$ 306,569**			$ 302,095			$ 257,249		
Interest-bearing liabilities									
Deposits:									
Interest-bearing demand accounts	**$ 15,859**	**68**	**0.43**	$ 16,348	69	0.42	$ 15,854	72	0.45
Money market	**62,448**	**438**	**0.70**	56,818	434	0.76	39,900	404	1.01
Savings	**11,974**	**78**	**0.65**	17,020	219	1.29	5,947	105	1.77
Time deposits $100,000 and over	**58,845**	**714**	**1.21**	58,240	1,023	1.76	40,769	1,226	3.01
Other time deposits	**42,322**	**449**	**1.06**	48,649	827	1.70	58,096	1,636	2.82
Total interest-bearing deposits	**191,448**	**1,748**	**0.91**	197,075	2,572	1.31	160,566	3,443	2.14
Short-term borrowings	**21,840**	**168**	**0.77**	22,337	215	0.96	21,820	195	0.89
Long-term borrowings	**7,666**	**101**	**1.31**	8,225	120	1.46	4,696	106	2.26
Total interest-bearing funds	**220,954**	**2,017**	**0.91**	227,637	2,907	1.28	187,082	3,744	2.00
Noninterest-bearing deposits	**53,040**			44,658			39,300		
Other liabilities and accrued expenses	**826**			796			798		
Total liabilities	**274,820**			273,091			227,180		
Shareholders' equity	**31,749**			29,004			30,069		
Total liabilities & shareholders' equity	**$ 306,569**			$ 302,095			$ 257,249		
Net interest rate spread [3]		**$ 12,623**	**4.16** %		$ 11,348	3.77 %		$ 8,682	3.06 %
Effect of noninterest-bearing funds			**0.21**			0.25			0.48
Net interest margin on earning assets [4]			**4.37** %			4.01 %			3.54 %

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

(2) Available for sale securities are presented at amortized cost

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

(4) 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 column is further broken down to show the impact of changes in either rates or volumes. For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately, based on the changes due to rate and the changes due to volume.

	For the Year ended December 31,					
	2011 vs. 2010			2010 vs. 2009		
	Due to variances in			Due to variances in		
(in thousands)	Total	Rates	Volumes [1]	Total	Rates	Volumes [1]
Interest earned on:						
Loans and leases:						
Commercial loans and leases	$ (169)	$ 192	$ (361)	$ 284	$ 51	$ 233
Commercial real estate	513	116	397	1,437	(36)	1,473
Construction and land	92	58	34	151	55	96
Residential real estate	(18)	(80)	62	49	(8)	57
Consumer	(5)	2	(7)	2	-	2
Taxable securities	(22)	(14)	(8)	(52)	(23)	(29)
Federal funds sold	(6)	(16)	10	(43)	(13)	(30)
Interest-bearing deposits in other banks	-	-	-	-	-	-
Total interest income	385	258	127	1,828	26	1,802
Interest paid on:						
Savings deposits	(141)	(108)	(33)	114	(7)	121
Checking plus interest deposits	(1)	1	(2)	(3)	(1)	(2)
Money market accounts	4	(35)	40	30	(25)	55
Time deposit $100,000 and over	(309)	(316)	7	(204)	(129)	(75)
Other time deposits	(378)	(310)	(67)	(808)	(163)	(645)
Short-term borrowings	(47)	(43)	(4)	20	53	(33)
Long-term borrowing	(19)	(12)	(7)	13	-	13
Total interest expense	(890)	(823)	(67)	(838)	(272)	(566)
Net interest earned	$ 1,275	$ 1,082	$ 193	$ 2,666	$ 298	$ 2,368

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

Comparison of Results of Operations – Years Ended December 31, 2011 and December 31, 2010

General

Net income available to common shareholders increased $327 thousand, or 53.9%, to $934 thousand for the year ended December 31, 2011 compared to net income of $607 thousand for the year ended December 31, 2010. The increase in net income was primarily due to an increase of $1.3 million or 11.2% in net interest income which continued to benefit from overall decreases in the cost of funding and a $469 thousand reduction in the provision for credit losses, partially offset by an increase in noninterest expenses of $1.4 million, of which nearly $777 thousand was due to declines in the values of foreclosed real estate and $427 thousand was due to compensation and benefit increases.

Interest Income

Interest income increased $385 thousand, or 2.7%, to $14.6 million for the year ended December 31, 2011 compared to $14.3 million during 2010. The increase was due to a $413 thousand, or 2.9%, increase in interest income on loans, partially offset by a $22 thousand decrease in interest income earned on investment securities and balances due from depository institutions. The modest increase in interest income on loans was due to a 12 basis point increase in the average loan portfolio yield and an improvement in the mix of loans towards higher-yielding loan products. The decrease in interest income on investment securities was due to a decrease in the average balance of investment securities and, to a lesser extent, an 8 basis point decrease in the average yield earned as short term interest rates continued to decline.

Interest Expense

Interest expense decreased $890 thousand, or 30.6%, to $2.0 million for the year ended December 31, 2011, compared to $2.9 million during 2010. This decrease was primarily attributable to continued decreases in rates paid on interest-bearing deposits and, to a lesser extent, lower volumes of certain deposit products. The decrease in interest expense on interest-bearing deposits was the result of a decrease in the average balance of interest-bearing deposits and a 40 basis point decrease in the average rate paid on interest-bearing deposits, which was due to both a decrease in the reliance on higher-cost certificates of deposit as a funding source, given our growth in noninterest-bearing deposits, and lower rates paid on money market accounts based on lower market rates.

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 $1.3 million, or 11.2%, during the year ended December 31, 2011 compared to the year ended December 31, 2010. The increase in net interest income was primarily due to the $824 thousand, or 32.0%, reduction in interest expense on interest-bearing deposits. In addition, interest income increased by $385 thousand, or 2.7%, for the year ended December 31, 2011 compared to 2010.

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 as more information becomes available. The allowance for credit losses is assessed on 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 had a provision for credit losses of $1.2 million for the 2011 year compared to $1.6 million during 2010, a reduction of $469 thousand, or 28.7%. The $1.2 million provision during 2011 reflects both an improvement in the number and amount of nonperforming loans, as the ratio of nonperforming loans to total loans decreased from 2.20% at December 31, 2010 to 2.12% at December 31, 2011, as well as the additional general provisions that are required given our continued growth in the size of the loan portfolio.

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 Maryland Office of the Commissioner of Financial Regulation and the FDIC will periodically review the allowance for credit losses. The Maryland Office of the Commissioner of Financial Regulation 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 $1.1 million for the year ended December 31, 2011 compared to $741 thousand for the year ended December 31, 2010. Service charges on deposit accounts, which consist of account activity fees such as overdraft fees and other traditional banking fees, had a slight decline of $92 thousand. This decrease of 23.6% is due mainly to a decrease in fees related to overdrafts and non-sufficient fund activities on transaction accounts. Other operating income consists mainly of certain loan fees, non-depository account fees and gains / losses on the sale of mortgage loans originated for sale. The Bank began selling mortgage loans into the secondary market during 2010. In the fourth quarter of 2011, the Bank sold two properties previously held as OREO and recorded a gain on sale of $459 thousand, which is included in noninterest income.

Noninterest Expenses

Noninterest expenses increased $1.4 million or 16.6%, to $10.1 million for the year ended December 31, 2011 compared to the $8.7 million the year ended December 31, 2010. The increase was primarily due to an increase of $1.0 million related to the both valuation adjustments in the carrying value of OREO and taxes and maintenance related costs on the OREO properties that we currently hold and a $427 thousand, or 9.3%, increase in salaries and employee benefits. Salaries and employee benefits increased during 2011 primarily as a result of an increase in the number of staff, and to a lesser extent, normal salary increases along with increases in medical insurance premiums we pay on behalf of employees. .

Occupancy expenses decreased 5.5% from the prior year due to lower rental costs. In July 2010 the Bank purchased the property which housed our Centennial branch location. This purchase reduced rental expense approximately $170 thousand during 2011.

Marketing and business development expenses increased 36.1% during 2011 compared to the prior year to support sales growth and research initiatives in conjunction with ongoing strategic initiatives. Additional professional fees, which consist primarily of legal, accounting and consulting expenses, increased 43.7% over the prior year related to an increase in organizational matters.

Other operating expenses consists mainly of loan related expenses (including legal fees associated with non-performing assets) and a variety of general expenses such as phone and data lines, supplies and postage and courier services. These expenses increased $212 thousand or 18.9% during 2011 compared to 2010. Expenses related to maintaining and servicing operating software and date line increased 16.9% as we continue to provide our customers with the latest technology.

Income Tax Expense

Income tax expense amounted to $1.1 million and $816 thousand for the years ended December 31, 2011 and 2010, respectively, resulting in effective tax rates of 40.4% and 46.6%, respectively. The increase in income tax expense was primarily due to higher income before income tax expense for 2011 compared to 2010. The effective tax rate is influenced by certain non deductible expense items relative to pre-tax income.

Comparison of Results of Operations - Years Ended December 31, 2010 and 2009

General

Net income for the year ended December 31, 2010 was $933 thousand, an increase of $3.1 million from net loss of $2.2 million reported for 2009. The net income in 2010 resulted primarily from a year over year increase in net interest income of $2.7 million, or 31%, a decrease in the provision for credit losses of $2.0 million, or 55%, and a decrease in noninterest expenses of $553 thousand, or 6%.

Net Interest Income

Net interest income increased by $2.7 million, to $11.3 million for the year ended December 31, 2010, up from $8.7 million for the year ended December 31, 2009 as a result of a decrease in interest expense and an increase in interest income. Interest income, which is primarily driven by interest income on loans, was $14.3 million for 2010, up from $12.4 million in 2009, representing an increase of $1.8 million, or 15%. Interest expense for 2010 decreased by $837 thousand, or 22%, from $3.7 million in 2009 to $2.9 million for 2010 primarily as a result of a decrease in the average interest rate paid on deposits and as a result of a shift in the mix of our interest-bearing deposits to lower-cost deposit products. Our net interest margin was 4.01% for the year ended December 31, 2010 compared to 3.54% for the year ended December 31, 2009.

Interest Income

Total interest income increased by $1.8 million, or 15%, to $14.3 million for the year ended December 31, 2010 compared to $12.4 million for the year ended December 31, 2009, due primarily to an increase in the average balance of interest-earning assets. Average interest-earning assets increased by $37.2 million, or 15.2%, to $282.6 million for the year ended December 31, 2010 from $245.4 million for the year ended December 31, 2009. In addition, the aggregate average yield on interest-earning assets decreased to 5.04% for the year ended December 31, 2010 from 5.06% for 2009, and the average yield on loans increased from 5.31% in 2009 to 5.45% for 2010, while the yield on shorter term fed funds and investment securities decreased from the previous year. Please see "—Rate/Volume Analysis" for more detailed information regarding the impact of changes in yield and changes in level of interest earning assets during 2010.

Interest income on loans increased $1.9 million, or 16%, to $14.1 million for the year ended December 31, 2010 compared to $12.2 million for the year ended December 31, 2009. This increase is primarily the result of higher average loans balances during the year ended December 31, 2010, as well as a 14 basis point increase in the average yield on loans. Average loans increased approximately $29.3 million, or 13%, to $259 million during 2010 from $229 million during 2009. This increase was primarily attributable to our increasing emphasis on commercial real estate loans during 2010. The average yield on loans receivable increased slightly to 5.45% for the year ended December 31, 2010 from 5.31% for the year ended December 31, 2009. The increase in average yield was primarily attributable to our introduction of interest rate floors on variable rate loans and successful attempts to obtain higher rates on origination of new loans in the generally low interest rate environment.

Interest Expense

Total interest expense decreased by $837 thousand, or 22%, to $2.9 million for the year ended December 31, 2010 from $3.7 million for the year ended December 31, 2009. This decrease in interest expense was due to decreases in the average cost of interest-bearing liabilities and the shifting mix of our funding into lower cost deposits and other low cost funding alternatives. The lowered costs and the improved mix of deposits led to the average cost of interest-bearing liabilities decreasing to 1.28% during the year ended December 31, 2010 from 2.00% during the year ended December 31, 2009, while average interest-bearing liabilities increased by $40.6 million, or 22%, to $228 million during 2010 from $187 million during 2009.

Interest expense on deposits decreased by $871 thousand, or 25.3%, to $2.6 million for the year ended December 31, 2010 from $3.4 million for the year ended December 31, 2009. This was the result of decreases in the average rate paid on interest-bearing deposits during 2010 compared to 2009, partially offset by a $37 million increase in the average balance of interest-bearing deposits to $197 million during 2010 from $161 million during 2009. The average rate paid on interest-bearing deposits decreased to 1.31% during the year ended December 31, 2010 from 2.14% during the year ended December 31, 2009. The cost of funds decrease is primarily attributable to the improved mix of deposits toward lower cost alternatives, as well as reductions in interest expense on certificates of deposit and, to a lesser extent, on savings accounts. The average rate on certificates of deposit over $100 thousand decreased to 1.76% during the year ended December 31, 2010 from 3.01% during the year ended December 31, 2009, and the average rate on certificates of deposit under $100 thousand decreased to 1.70% during the year ended December 31, 2010 from 2.82% during 2009. In general, a decrease in the level of market interest rates enabled us to reduce the rate of interest paid on all of our deposit products during 2010.

Provision for Credit Losses

The provision for credit losses decreased by $2.0 million, or 55%, to $1.6 million for the year ended December 31, 2010 from $3.7 million for the year ended December 31, 2009. The decrease in the provision for credit losses was due to a lower level of specific reserves during 2010 as a result of our having fewer nonperforming loans for which a provision had not already been taken. The 2009 provision also was impacted by a large amount of charge-offs of loans given some considerable deterioration on several large credit relationships.

Noninterest Income

Noninterest income decreased slightly by $15 thousand, or 2%, to $742 thousand during the year ended December 31, 2010 from $756 thousand for the year ended December 31, 2009. The primary reason for the decrease was a small reduction in service charges on deposit accounts, partially offset by an increase in loan and transaction based fees.

Noninterest Expenses

Noninterest expenses decreased by $553 thousand, or 6%, to $8.7 million for the year ended December 31, 2010 from $9.3 million for the year ended December 31, 2009. 2009 expenses included a $1.3 million valuation adjustment on the carrying value of properties held as OREO. Exclusive of this 2009 valuation adjustment, recurring expenses increased for the year ended December 31, 2010 by $733 thousand, or 9% over 2009. The largest increases were in compensation and employee benefits and collection related expenses on troubled loans. Compensation and employee benefits increased by $463 thousand, or 11%, to $4.6 million for the year ended December 31, 2010 from $4.1 million for the year ended December 31, 2009. The primary reason for this increase is the hiring of additional credit administration and support personnel during 2010, as well as the full year costs of a branch that opened in early 2009 and a regional office that commenced operations in the fourth quarter of 2009. A portion of the increase in compensation and employee benefits was also attributable to normal salary increases and an increase in medical insurance costs.

Loan collection related costs, which are included in other operating costs on our financial statements, increased from $129 thousand, exclusive of the OREO valuation adjustment, in 2009 to $475 thousand for the year ended December 31, 2010, an increase of $346 thousand, or 268%. The 2010 expenses related to the increased emphasis on working out problems with nonperforming loans, and in many cases the legal expenses associated with protecting our collateral position for those loans. In cases where we have taken possession of the collateral either through foreclosure or other means, we have had increased expenses associated with the acquisition of title to such properties.

Most other categories of expenses either reflected smaller increases in expenditure levels, or decrease for 2010 compared to 2009. We anticipate that professional fees will be higher during 2011 and beyond as a result of our common stock offerings, and as a result of increased legal and accounting fees in connection with our ongoing reporting obligations under the Securities Exchange Act of 1934 after the registration statement relating to our initial public offering is declared effective.

Income Tax Expense (Benefit)

The income tax expense for the year ended December 31, 2010 was $816 thousand compared to a tax benefit of $1.3 million in 2009. The increased tax expense for 2010 was based upon pretax income of $1.7 million, while the 2009 benefit is primarily the result of the net loss before income taxes of $3.5 million.

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 do a troubled debt restructure with respect to a particular loan. When not possible, we are aggressively moving 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 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 nonaccrual loans, troubled debt restructurings and OREO (which includes real estate acquired through, or in lieu of, foreclosure), at the dates indicated.

	December 31,				
(in thousands)	2011	2010	2009	2008	2007
Non-accrual loans:					
Real estate loans:					
Commercial	$ 1,988	$ 3,601	$ 3,391	$ 3,100	$ -
Residential - First Lien	368	-	40	47	-
Residential - Junior Lien	44				
Construction & Land	-	-	-		2,825
Commercial	3,229	1,764	1,454	955	-
Consumer	9	-	-	-	-
Total non-accrual loans	5,638	5,365	4,885	4,102	2,825
Trouble debt restructure loans:					
Real estate loans:					
Commercial	-	-	2,765	432	-
Residential - First Lien	240	-	-	-	-
Construction & Land	-	-	-	-	-
Commercial	-	285	-	-	-
Total trouble debt restructure loans	240	285	2,765	432	-
Total non-performing loans	5,878	5,650	7,650	4,534	2,825
Other real estate owned:					
Land	595	877	839	2,116	-
Commercial	1,084	1,941	-	-	-
Residential	206	206	-	-	-
Total other real estate owned	1,885	3,024	839	2,116	-
Total non-performing assets	$ 7,763	$ 8,674	$ 8,489	$ 6,650	$ 2,825
Ratios:					
Non-performing loans to total gross loans	2.12	2.20	3.03	2.22	1.64
Non-performing assets to total assets	2.40	2.89	2.97	2.89	1.48

Included in total non- accrual loans above are five trouble debt restructured loans totaling $751 thousand where that were not performing in accordance with the modified terms, and the accrual of interest has ceased. There was one trouble debt restructured loan for $240 thousand that was performing in accordance with its modified terms, and where interest income is recognized. There was one commercial owner occupied real estate loan for $90 thousand that was 90 days or more past due and still accruing interest at

December 31, 2011 and one residential home equity line of credit with a balance of $150 thousand that was 90 days or more past due and still accruing interest at December 31, 2010. As of December 31, 2009 there was one consumer loan with a balance of $10 thousand that was more than 90 days delinquent.

Interest income that would have been recorded during the year ended December 31, 2011, 2010 and 2009 if nonaccrual loans had been current and in accordance with their original terms was $105 thousand, $183 thousand and $142 thousand, respectively. No interest income was recorded on such loans during these periods.

Under accounting principles generally accepted in the United States of America, we are required to account for certain loan modifications or restructurings as "troubled debt restructurings." In general, the modification or restructuring of a debt constitutes a troubled debt restructuring 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 always constitute troubled debt restructurings.

Nonperforming assets amounted to $7.8 million or 2.40% of total assets, at December 31, 2011 compared to $8.7 million or 2.89% of total assets at December 31, 2010 and $8.5 million or 2.97% of total assets at December 31, 2009. Total nonperforming assets decreased by $910 thousand during 2011 due primarily a $1.1 million or 37.7% decrease in OREO with to the sale of two properties totaling $2.1 million, offset by the addition of $1.0 million in new OREO from three commercial condominiums.

At December 31, 2011, our nonperforming loans consisted mainly of two large owner occupied commercial real estate loans under one customer relationship, one large commercial relationship partially guaranteed by the SBA, several small commercial loans with SBA guarantees, and two residential mortgages. The composition of our nonperforming loans is further described below:

- Two owner occupied commercial real estate loans totaling $2.0 million to a local borrower who also owns a property housing one of his business ventures in Sussex County Delaware. We have received an updated appraisal, and have partially charged off the loans to ensure that our remaining carrying value is fully supported by the appraised value of the property. The owner has listed property for sale, and we do not currently anticipate any additional reserves or further loss on this loan.
- Four commercial loans to a local business totaling $2.0 million. The largest individual loan has a 75% SBA guarantee, and reserves have been taken to reflect the amount expected to be received after claims are submitted to the SBA.
- Twelve commercial loans totaling approximately $1.2 million to borrowers that had a portion of their loans guaranteed by the SBA. In general the amount carried under non-performing loans above represents only the guaranteed portion that we expect to receive from the SBA after claims are filed. The Bank's portion of these loans has already been charged-off, thus no further losses are expected on these loans.
- Two residential first lien mortgages for approximately $412 thousand.

Other Real Estate Owned

Real estate we acquire as a result of foreclosure is classified as OREO. When property is acquired it is recorded at the lower of cost, which is the unpaid balance of the loan plus estimated foreclosure costs, or fair value 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. We had foreclosed real estate of $1.9 million at December 31, 2011, $3.0 million at December 31, 2010 and $839 thousand at December 31, 2009. Foreclosed real estate at December 31, 2011 consisted of seven properties, including one single family home located in Anne Arundel County, Maryland, three pieces of undeveloped land in Baltimore County and three commercial properties, in Prince Georges County Maryland.

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 of 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 and 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 Maryland Commissioner of Financial Regulation 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) as of the periods indicated.

	December 31,		
(in thousands)	**2011**	2010	2009
Classified loans:			
Substandard	**$ 5,881**	$ 5,650	$ 4,913
Doubtful	**-**	-	-
Total classified loans	**5,881**	5,650	4,913
Special mention	**-**	2,017	1,095
Total criticized loans	**$ 5,881**	$ 7,667	$ 6,008

At December 31, 2011, total classified loans consisted of $5.6 million of nonaccrual loans (consisting primarily of $0.4 million in residential real estate, $2.0 million in commercial real estate loans and $3.2 million in commercial business lines and loans) and $0.3 million of performing loans that were considered special mention. At December 31, 2010, total criticized loans consisted of $5.4 million of non-accrual loans (consisting of $3.6 million in commercial real estate loans and $1.8 million in commercial business lines and loans) and $2.0 million of performing loans that were considered special mention.

See "—Allowance for Credit Losses" for a discussion of these substandard loans as they relate to the allowance for credit losses.

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 which, 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 accounting principles generally accepted in the United States ("GAAP"). The allowance for credit losses consists primarily of two components:

1) Specific allowances are established for loans classified as substandard or doubtful. 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 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 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 nonaccrual 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 managements 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. 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, 2011 and 2010, nonperforming loans amounted to $5.9 million and $5.7 million, respectively. The amount of nonperforming loans requiring specific reserves totaled $2.3 million and $2.1 million, respectively, and the amount of nonperforming loans with no specific valuation allowance totaled $3.6 million at both December 31, 2011 and 2010.

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 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 Maryland Office of the Commissioner of Financial Regulation and the FDIC will periodically review the allowance for credit losses. The Maryland Office of the Commissioner of Financial Regulation 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 twelve months ended:

	December 31,				
(in thousands)	**2011**	2010	2009	2008	2007
Balance at beginning of year	**$ 3,523**	$ 3,508	$ 2,659	$ 2,671	$ 1,346
Charge-offs:					
Real estate					
Construction and land loans	**-**	-	-	(709)	-
Residential first lien loans	**-**	-	-	-	-
Residential junior lien loans	**-**	(40)	-	-	-
Commercial owner occupied laons	**(1,033)**	-	-	-	-
Commercial non-owner occupied loans	**-**	(100)	-	-	-
Commercial loans and leases	**(562)**	(1,585)	(2,818)	(453)	-
Consumer loans	**(21)**	(29)	(13)	-	-
	(1,616)	(1,754)	(2,831)	(1,162)	-
Recoveries:					
Real estate					
Construction and land loans	**-**	-	-	-	-
Residential first lien loans	**-**	-	-	-	-
Residential junior lien loans	**-**	-	-	-	-
Commercial owner occupied laons	**-**	-	-	-	-
Commercial non-owner occupied loans	**-**	-	-	-	-
Commercial loans and leases	**361**	135	2	-	-
Consumer loans	**1**	1	8	-	-
	362	136	10	-	-
Net recoveries (charge-offs)	**(1,254)**	(1,618)	(2,821)	(1,162)	-
Provision for credit losses	**1,164**	1,633	3,670	1,150	1,325
Balance at end of year	**$ 3,433**	$ 3,523	$ 3,508	$ 2,659	$ 2,671

For additional information with respect to the portions of the allowance for credit losses attributable to our loan classifications, see "—Allocation of Allowance for Credit Losses." For additional information with respect to nonperforming loans and delinquent loans, see "—Nonperforming and Problem Assets" and "—Nonperforming and Problem Assets—Delinquent Loans."

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.

	December 31,									
	2011		2010		2009		2008		2007	
(dollars in thousands)	**Amount**	**Percent[1]**	Amount	Percent[1]	Amount	Percent[1]	Amount	Percent[1]	Amount	Percent[1]
Real estate										
Construction and land loans	**$ 174**	**14.2 %**	$ 143	11.9 %	$ 515	13.2 %	$ 663	15.8 %	$ 1,096	16.9 %
Residential first lien loans	**111**	**8.0**	16	9.1	30	8.0	89	9.3	57	10.0
Residential junior lien loans	**64**	**3.3**	20	3.8	26	4.1	51	4.5	36	4.2
Commercial owner occupied laons	**611**	**16.8**	892	18.2	903	17.2	287	17.3	325	19.4
Commercial non-owner occupied loans	**197**	**27.8**	124	22.7	358	20.3	288	14.1	248	11.8
Commercial loans and leases	**2,233**	**29.4**	2,294	33.8	1,658	36.7	1,253	37.9	859	36.5
Consumer laons	**43**	**0.5**	34	0.5	18	0.5	28	1.1	50	1.2
Total	**$ 3,433**	**100.0 %**	$ 3,523	100.0 %	$ 3,508	100.0 %	$ 2,659	100.0 %	$ 2,671	100.0 %

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

We measure the historic loss performance based upon the levels of losses incurred in each preceding 24-month period. The increased level of the allowance attributable to construction loans and commercial non-owner occupied loans in 2009 was due to an increased level of losses that occurred in each category over the 24 months preceding December 31, 2009, that did not exist for the other periods represented. Similarly, the increase in the allowance attributable to the commercial loan portfolio at December 31, 2011 and December 31, 2010 was impacted by an increased number of losses in that category for the 24 months preceding each measurement date. See "—Nonperforming and Problem Assets—Classification of 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, principal repayments 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 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, 2011 and December 31, 2010. We will maintain our focus on retaining appropriate liquidity levels following the completion of our initial public offering.

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

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

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

Our most liquid 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, 2011 and 2010, cash and cash equivalents totaled $18.2 million and $11.8 million, respectively.

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, 2011 and 2010, we had $59.5 million and $52.1 million, respectively, in loan commitments outstanding, including commitments issued to originate loans of $31.2 million and $20.9 million at December 31, 2011 and 2010, respectively, and $23.4 million and $26.2 million in unused lines of credit to borrowers at December 31, 2011 and 2010, respectively. In addition to commitments to originate loans and unused line of credits we had $5.0 million in letters of credit at both December 31, 2011 and 2010. Certificates of deposit due within one year of December 31, 2011 and 2010 totaled $67.5 million, or 25.7% of total deposits, and $69.5 million, or $29.0% of total deposits, respectively. If these deposits do not remain with us, 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 certificates of deposit due on or before December 31, 2012. We believe, however, based on historical experience and current market interest rates that we will retain upon maturity a large portion of our certificates of deposit with maturities of one year or less as of December 31, 2011.

Our primary investing activity is originating loans. During the year ended December 31, 2011 and the years ended December 31, 2010 and 2009, cash used to fund net loan growth was $23.3 million, $7.4 million and $51.5 million, respectively. During these periods, we purchased $39.2 million, $53.2 million and $48.6 million of securities, respectively.

Financing activities consist primarily of activity in deposit accounts and FHLB advances. We experienced a net increase in deposits of $23.3 million and $10.6 million, respectively, during the years ended December 31, 2011 and 2010. 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 declined to $16 million in 2011, compared to $20 million in 2010, and were $14 million at December 31, 2009. At December 31, 2011, we had the ability to borrow up to a total of $64.2 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, 2011 and 2010, the Bank exceeded all regulatory capital requirements. The Bank is considered "well capitalized" under regulatory guidelines. See— "Supervision and Regulation—Banking Regulation—Capital Requirements" and Note 17 of the Notes to the Financial Statements.

The net proceeds from our planned stock offerings will significantly increase our liquidity and capital resources. Our financial condition and results of operations will be enhanced by the net proceeds from the offerings, resulting in increased interest-earning assets and net interest income. However, due to the increase in equity resulting from the net proceeds raised in the offerings, our short term return on equity ratio will be adversely affected following the offerings.

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 which would have a material effect on us.

Outstanding loan commitments and lines of credit at December 31, 2011 and December 31, 2010 are as follows:

	December 31,	
(in thousands)	**2011**	2010
Unfunded loan commitments	**$ 31,203**	$ 20,945
Unused lines of credit	**23,424**	26,219
Letters of credit	**4,902**	4,906

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 or lines 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, 2011, December 31, 2010 or December 31, 2009 as a liability for credit loss related to these commitments.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued ASU No. 2011-05, *Presentation of Comprehensive Income*. This guidance requires companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance does not change which items are reported in other comprehensive income or the requirement to report reclassifications of items from other comprehensive income to net income. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011 and will require retrospective application for all periods presented.

In April 2011, the FASB issued ASU No. 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*. ASU No. 2011-03 affects all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The amendments in ASU No. 2011-03 remove from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU No. 2011-03 also eliminates the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. The guidance is effective for our reporting period ended June 30, 2012. The guidance will be applied prospectively to transactions or modifications of existing transaction that occur on or after January 1, 2012.

In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. The provisions of ASU No. 2011-02 provide additional guidance related to determining whether a creditor has granted a concession, include factors and examples for creditors to consider in evaluating whether a restructuring results in a delay in payment that is insignificant, prohibit creditors from using the borrower's effective rate test to evaluate whether a concession has been granted to the borrower, and add factors for creditors to use in determining whether a borrower is experiencing financial difficulties. A provision in ASU No. 2011-02 also ends the FASB's deferral of the additional disclosures about troubled debt restructurings as required by ASU No. 2010-20. The provisions of ASU No. 2011-02 were effective for our reporting period ending September 30, 2011. The adoption of ASU No. 2011-02 did not have a material impact on our statements of income and condition.

In July 2010, the FASB issued ASU 2010-20, Receivables (Subtopic 310) – *Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The main objective of ASU 2010-20 is to provide financial statement users greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. Existing disclosure guidance was amended to require an entity to provide a greater level or disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, the amendments in ASU 2010-20 require an entity to disclose credit quality indicators, past due information, and modification of its financing receivables. These improvements will help financial statement users assess an entity's credit risk exposures and its allowance for credit losses. ASU 2010-20 is effective for interim or annual periods ending on or after December 31, 2010. Since ASU 2010-20 only requires enhanced disclosures, the adoption of this statement did not have a material impact on our financial statements or results of operations.

In March 2010, the FASB issued ASU 2010-11, *Derivatives and Hedging*. ASU 2010-11 provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception in ASC 815-15-15-8. ASU 2010-11 is effective at the beginning of the first fiscal quarter beginning after June 15, 2010. The adoption of this guidance did not have a significant impact on our financial statements.

In January 2010, the FASB issued ASU No. 2010-06*, Fair Value Measurements and Disclosures* (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this guidance did not have a significant impact on our financial statements.

Impact of Inflation and Changing Prices

Our financial statements and related notes have been prepared in accordance with U.S. GAAP. U.S. 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.

MANAGEMENT OF HOWARD BANCORP, INC.

Shared Management Structure

The directors of Howard Bancorp, Inc. are the same individuals who are the directors of Howard Bank and the executive officers of Howard Bank are the executive officers of Howard Bancorp, Inc. We expect that Howard Bancorp, Inc. and Howard Bank will continue to have common executive officers until there is a business reason to establish separate management structures.

There are no family relationships between any of our executive officers and directors.

Executive Officers of Howard Bancorp, Inc. and Howard Bank

The following table sets forth information regarding the individuals who serve as the executive officers of Howard Bank and Howard Bancorp, Inc.

Name	Age	Position(s)
Mary Ann Scully	60	Board Chairman, President, Chief Executive Officer and Chief Risk Officer of Howard Bancorp and Howard Bank
Paul G. Brown	57	Executive Vice President of Howard Bancorp, Executive Vice President, Chief Lending Officer, Chief Client Services Officer and Chief Credit Risk Officer of Howard Bank
Charles E. Schwabe	56	Executive Vice President and Secretary of Howard Bancorp, and Executive Vice President, Chief Administrative Officer, Chief Information Officer, Information Security Officer, Compliance Officer, Chief Operational Risk Officer and Secretary of Howard Bank
George C. Coffman	48	Executive Vice President, Chief Financial Officer and Treasurer of Howard Bancorp, Executive Vice President, Chief Financial Officer, Chief Investment Officer, Treasurer and Chief Interest Rate and Liquidity Risk Officer of Howard Bank

The executive officers of Howard Bancorp, Inc. and Howard Bank are elected annually. The business experience for at least the past five years of each of our executive officers is set forth below.

Mary Ann Scully

Ms. Scully, 60, has served as a director and as the Board Chairperson, President, Chief Executive Officer and Chief Risk Officer of Howard Bancorp since December 2005 and has served as a director and as the Board Chairperson, President, Chief Executive Officer and Chief Risk Officer of Howard Bank since the founding of the Bank in 2004. Ms. Scully is also an organizing director of Howard Bank and the Chair of the Executive Committee of the boards of directors of both Howard Bancorp and Howard Bank. Ms. Scully was employed by Allfirst Bank (formerly known as The First National Bank of Maryland and now known as M&T Bank) from 1973 through April 2003. She served as Executive Vice President for Regional Banking from June 2001 through April 2003, Executive Vice President for Community Banking from January 2000 through June 2001, Senior Vice President for Strategic Planning from 1998 to 2000, Senior Vice President for Mergers and Acquisitions from 1996 to 1998, and Senior Vice President of International Banking from 1984 to 1996.

Ms. Scully has been a Howard County resident since 1995. She is the Chairman of the Maryland Bankers Association and the Immediate Past Chair of the Columbia Foundation. She also serves on the boards of the Howard County General Hospital and Catholic Charities. Ms. Scully was formerly a trustee and served on the Finance Committee and the Capital Campaign Council of the Howard Community College Foundation Board, as a trustee of the United Way of Central Maryland, as a trustee of the Horizon Foundation and as an advisory board member of the Sellinger School of Business.

Paul G. Brown

Mr. Brown, 57, serves as Executive Vice President of Howard Bancorp, and Executive Vice President, Chief Lending Officer, Chief Client Services Officer and Chief Credit Risk Officer of Howard Bank. He has held these positions since the founding of the Bank in 2004 and since December 2005 with respect to Howard Bancorp. Mr. Brown provides direct leadership for the relationship management activities of the Bank’s commercial and consumer lending, branch and client service areas.

Prior to joining the organizing group for Howard Bank, he served from 2001-2003 as the Senior Vice President of Regional Banking for Allfirst Bank (now M&T Bank). Before joining Allfirst Bank, he served as Regional President for Keystone Bank (now

M&T Bank) and Senior Vice President of Retail Banking for SunTrust Bank (1997-2000). Mr. Brown has also held senior management positions at Citizens Bank of Maryland (now SunTrust Bank) and Maryland National Bank (now Bank of America).

Mr. Brown has over 30 years of experience in the commercial banking industry.

Charles E. Schwabe

Mr. Schwabe, 56, serves as Executive Vice President and Secretary of Howard Bancorp, and Executive Vice President, Chief Administrative Officer, Chief Information Officer, Information Security Officer, Compliance Officer, Chief Operational Risk Officer and Secretary of Howard Bank. He has held these positions since the founding of the Bank in 2004 and since December 2005 with respect to Howard Bancorp. Mr. Schwabe provides leadership for the operations, information technology, human resources, loan documentation, deposit management, marketing and other areas of administration including the Bank's strategic partnership outsourcing arrangements. He is also Howard Bank's Community Reinvestment Act Officer.

Prior to joining the organizing group for Howard Bank, he was employed by Allfirst Bank (now M&T Bank) from 1988 through April of 2003. He served as Senior Vice President and Manager for the Customer Relationship Management Program as well as the Strategy and Planning Director for the Technology, eCommerce and Operations Division. At Allfirst Bank, he was also Vice President of Strategic Planning for the Mergers and Acquisitions Division and Vice President and Group Marketing Head for small business and retail product development and management. Prior to working at Allfirst Bank, he was a consultant and senior manager for a marketing firm that specialized in the health care and financial services industries.

Mr. Schwabe has over 20 years of banking management experience and another seven years as a marketing strategy consultant to the banking, retail and business services industries.

George C. Coffman

Mr. Coffman, 48, serves as Executive Vice President, Chief Financial Officer and Treasurer of Howard Bancorp and Executive Vice President, Chief Financial Officer, Chief Investment Officer, Treasurer and Chief Interest Rate and Liquidity Risk Officer of Howard Bank. He has held these positions since the opening of the Bank in 2004 and since December 2005 with respect to Howard Bancorp. Mr. Coffman provides leadership for the financial management and investment operations of Howard Bank. In this role, he directly manages all of the corporate accounting functions, management and regulatory reporting preparation, and compliance with accounting principles and disclosure requirements. Mr. Coffman also is responsible for the management of interest rate risk, budgeting and financial planning, and tax planning and reporting. Other duties include directing the investment portfolio, as well as overall funds management, and investor relations. Mr. Coffman is a Certified Public Accountant. He also serves as the Bank's Chief Investment Officer.

Prior to joining the organizing group of Howard Bank, he held several senior financial management positions at Maryland based financial institutions, including Mercantile Bank in Baltimore (now PNC Bank), Farmers & Mechanics Bank in Frederick (now PNC Bank), Sequoia Bank in Bethesda (now United Bank), and Citizens Bank of Maryland in Laurel (now SunTrust Bank).

Mr. Coffman has more than 23 years of experience in the operations, accounting, investment and finance areas of commercial banks in the central Maryland area.

Directors of Howard Bancorp, Inc. and Howard Bank

The Howard Bancorp board of directors includes 15 directors, 14 non-employee/independent directors and Mary Ann Scully, our President and Chief Executive Officer, who also serves as our Chairman, each of whom is also a director of Howard Bank. Our bylaws provide that directors will serve three-year staggered terms so that approximately one-third of the directors are elected at each annual meeting. Following is certain information about our non-employee directors, including their names, current ages, and recent business experience:

Richard G. Arnold

Mr. Arnold, 50, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Arnold is the Vice President and co-owner of The John E. Ruth Company, Inc., a plumbing and heating firm. He has served in that capacity since 1983. He also maintains ownership in various real estate holdings. Mr. Arnold serves on the Board of Trustees at Mount de Sales High School and serves on several related committees. Mr. Arnold is an organizing director of Howard Bank and is currently a member of the Compensation Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Nasser Basir

Mr. Basir, 57, has served as a director of Howard Bancorp and Howard Bank since 2009. Mr. Basir is the CEO, President, and founder of PSI Pax, Inc., an Information Technology (IT) services business, which he created in 2006 as a spin off from Planned

Systems International, Inc., also an IT services firm which he had co-founded in 1988. Mr. Basir has over 30 years of management and technical experience as an IT consultant to both government and commercial organizations. He is presently on the Board of Trustees of the Glenelg Country School and serves and has served on several not-for-profit boards. Mr. Basir is currently a member of the Audit Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Andrew E. Clark

Mr. Clark, 49, has served as a director of Howard Bancorp since its formation in 2005 and as a director of Howard Bank since 2005. Mr. Clark has been a Managing Principal and Chief Operating Officer of Evergreen Advisors, LLC, which assists closely-held and emerging growth companies in the areas of corporate finance, exit strategies, valuations, and advisory services, since 2009. In addition, since January 2011 Mr. Clark has been the Chairman of Capella Tax Network, LLC, a start-up company providing pre-paid tax compliance and advice, primarily as a pre-tax voluntary employee benefit, through a local network of Certified Public Accountants. Mr. Clark is also Chairman of Wheatfield Ventures, LLC, a private investment firm, and has served in that capacity since 2000. Prior to founding Wheatfield Ventures, LLC, Mr. Clark was a senior executive with Verio, Inc., an international provider of internet and Web hosting services, from 1997 to 2000. In addition, Mr. Clark is a member of the Advisory Board of Spring Capital Partners, L.P., a provider of subordinated mezzanine financing in the Mid-Atlantic region. He is presently on the Board of Trustees of the Glenelg Country School, and is the immediate past President of Cattail Creek Country Club. Mr. Clark is currently the Chair of the Compensation Committee and a member of the Executive Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Arthur D. Ebersberger

Mr. Ebersberger, 65, has served as a director of Howard Bancorp and Howard Bank since 2010. Mr. Ebersberger has been Senior Vice President of CBIZ Insurance Services, Inc. since 2000, which is when he sold to CBIZ the insurance brokerage firm that he had owned since June 1968. In addition, he was Secretary and Treasurer of E-IDC Inc., a software developer, from June 2007 through August 2009. He has served on and chaired the boards of several educational, medical, civic and other non-profit and business associations in Maryland and Anne Arundel County, including current service on the boards of Anne Arundel Community College, ERIS Technologies, LLC and the Professional Liability Agents Network. Mr. Ebersberger is currently a member of the Compensation Committee and the Audit Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Philip W. Gibbs

Mr. Gibbs, 53, has served as a director of Howard Bancorp and Howard Bank since 2009. Mr. Gibbs has been President and Chief Operating Officer of Hamel Builders, Inc. since it was founded in 1998. He was a co-founder and is a co-owner of this full-service building firm that provides construction management, design-build and general contracting services in the Mid-Atlantic region. He is also the Vice President of Hamel Commercial, Inc., also a third party general contractor, and has held this position since 1998. He is currently a member of the Compensation Committee of the boards of directors of both Howard Bancorp and Howard Bank. In 2009 Mr. Gibbs was named Anne Arundel County Philanthropist of the Year for his continued annual contributions to over 50 charities. In addition to gift giving, Mr. Gibbs presently serves on the boards of the Anne Arundel Medical Center Foundation and the Anne Arundel Affordable Housing Coalition. He is current Chairperson for the Archdiocese Capital Campaign and past Parent Chair of the St. Mary's Fleur De Lis Fund. Mr. Gibbs also serves on many community Advisory Committees including: Johns Hopkins National Pediatric Care; Anne Arundel County Boys & Girls Club; and Catholic Charities. Through the Gibbs Family Fund, Mr. Gibbs has endowed student scholarships at East Carolina University and St. Mary's School in Annapolis, Maryland.

Robert J. Hartson

Mr. Hartson, 55, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Hartson is the President of ATEC Industries, Ltd., a multi-disciplined construction company working in both the public and private sectors. Mr. Hartson has held this position since 1987. Mr. Hartson also has been the President of ATEC Shielding Systems since 2003. ATEC Shielding Systems is a specialty subcontractor that designs, manufactures and installs systems that protect mission critical assets from the affects of High Electromagnetic Pulse, Electromagnetic Pulse and other destructive electromagnetic phenomenon, and whose primary customers include the U.S. military and various federal agencies. Mr. Hartson is also managing member of several entities that operate diagnostic medical imaging centers in Maryland, including Howard Radiology, Seven Square Imaging, Howard Open MRI (1998-present) and Olney High Field MRI (2002-present). Mr. Hartson is an organizing director of Howard Bank and is currently a member of the Audit and Executive Committees of the boards of directors of both Howard Bancorp and Howard Bank.

Paul I. Latta, Jr.

Mr. Latta, 68, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Latta serves as Managing Member of ERIS Technologies LLC, a company developing 3-D software solutions for managing emergency situations. Prior to that Mr. Latta served as a Senior Vice President of The Rouse Company, a real estate development firm, from 1968 to 1999, and as President of E-IDC Inc., a software developer, from June 2007 through August 2009. Mr. Latta is an organizing director of Howard Bank, serves as the Lead Independent Director of Howard Bancorp and Howard Bank, and is currently a member of the Executive, the Governance and Nominating, and the Compensation Committees of the boards of directors of both Howard Bancorp and Howard Bank. Mr. Latta also serves as a director of ERIS Technologies, LLC.

Barbara K. Lawson

Ms. Lawson, 65, has served as a director of Howard Bancorp and Howard Bank since 2008. Ms. Lawson is a partner of the Synergies Consulting Group and until 2008 was the president and CEO of the Columbia Foundation. Prior to that she served in a variety of not for profit leadership roles, including the Traditional Acupuncture Foundation, the National Institute of Mental Health and the American Red Cross with the latter including refugee and relief work assignments. She is a graduate of Leadership Howard County, is a founding advisory board member of the Women's Giving Circle, the Howard County Police Foundation and Vision Howard County and has received the Audrey Robbins Humanitarian award and is an inductee in the Howard County Women's Hall of Fame and the 2005 Top Hundred Maryland's Women. Ms. Lawson is currently a member of the Governance and Nominating Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Kenneth C. Lundeen

Mr. Lundeen, 67, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Lundeen is President, Chief Executive Officer, and a co-owner of Environmental Reclamation Company, a diversified environmental services company, and has held this position for more than five years. Mr. Lundeen has also served as the President and Chief Executive Officer of C.J. Langenfelder & Son, Inc., a diversified construction contracting firm (1995-2004), and is Chairman of its successor Conrad Capital Corporation, an asset holding company (2004-present). Mr. Lundeen served on the board of directors of the Baltimore branch of the Federal Reserve Bank of Richmond (2001-2006). He is an attorney and actively practiced in Maryland, specializing in corporate and business law and representing small to medium-sized private and publicly held companies, from 1972 until 1988. Mr. Lundeen is an organizing director of Howard Bank and is currently a member of the Governance and Nominating Committee and the Executive Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Robert N. Meyers

Mr. Meyers, 56, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Meyers is President of Southeast Real Estate Advisors, Inc., a firm providing management, consulting and development services in the commercial real estate industry. Mr. Meyers is also President of Southeast Financial Services, Inc., a firm providing financial and consulting services to individuals and companies. He has held these positions since 1997. He was formerly Vice President and Chief Financial Officer for JHP/Tristar Management Inc., a real estate development and property management company. Prior to joining JHP/Tristar, Mr. Meyers practiced as a certified public accountant with Stegman & Company from 1978 to 1984. Mr. Meyers is an organizing director of Howard Bank and is currently the Chair of the Audit Committee and a member of Executive Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Richard H. Pettingill

Mr. Pettingill, 76, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Pettingill has been the President of Dick Pettingill Commercial Real Estate Brokerage, Inc., a commercial real estate brokerage firm, since 1998. He has had multiple experiences working in commercial real estate in the Baltimore Washington Corridor since 1978, including a ten year assignment as Senior Vice President and partner of Casey & Associates/ONCOR International. He is a past President of the Howard County Chamber of Commerce and the Columbia Rotary Club. Additionally, he was the founding Chairman of the Howard County Economic Development Authority established in 1991 and served on that Board for more than eight years. Mr. Pettingill served on the Board of Maryland Chamber of Commerce and was the Treasurer of their PAC for four years through 2006. Mr. Pettingill served as a director of Commercial & Farmers Bank until its acquisition by Farmers & Mechanics Bank in 1999, and continued on the F&M Advisory Board for many years thereafter. Mr. Pettingill is an organizing director of Howard Bank and is currently a member of the Compensation Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Steven W. Sachs

Mr. Sachs, 65, has served as a director of Howard Bancorp since its formation in 2005 and has served as a director of Howard Bank since 2004. Mr. Sachs is an Executive Vice President and Director, Real Estate and Hotel Practice of Willis, a global insurance brokerage and risk management services company. He has been employed with Willis and its predecessors since 1973. Mr. Sachs is also a founder and Chairman of the Board of Sharbrooke Management Company, the operator of six Honey baked Ham and Café franchise locations in the Baltimore metropolitan area. He served from 1992 to 2000 on the Board of the Self Insurance Education Foundation and the Board of the Self Insurance Institute of America from 1996 until 1999. Mr. Sachs was also on the board of directors of the Howard Chamber of Commerce from 1996 to 2002, was the Chairman of the Board of Howard Community College, and is a two-time Past President of the Columbia Rotary Club. Mr. Sachs presently serves on the boards of A Taste of Home, which supports Maryland National Guard members serving in harm's way as well as their families, the Horizon Foundation and the Columbia Festival of the Arts. Mr. Sachs is an organizing director of Howard Bank and is currently a member of the Governance and Nominating Committee of the boards of directors of both Howard Bancorp and Howard Bank. Mr. Sachs was selected by the Howard

County Chamber of Commerce as Howard County Business Person of the Year for 2005-06 and by Leadership Howard County, an organization that provides programs designed to empower and connect community leaders in Howard County, for its 2011 Leadership Legacy Award.

Donna Hill Staton

Ms. Staton, 54, has served as a director of Howard Bancorp and Howard Bank since December 2009. Ms. Staton is an attorney and member of the Maryland Bar since 1982. Her professional experience includes 13 years with the law firm of Piper & Marbury (now DLA Piper) where she was elected partner in 1993. Her commercial litigation practice included the representation of financial institutions and other businesses in state and federal courts and commercial arbitrations. Following a period of service as a Maryland circuit court judge, Ms. Staton was appointed Deputy Attorney General of the State of Maryland in 1997, a position she held until 2006. As chief deputy, she assisted the Attorney General with supervision of an office of nearly 600 employees, a multi-million dollar budget and responsibility for: the delivery of legal advice, counsel and representation of all branches of Maryland government; enforcement of the state's Securities, Antitrust and Consumer Protection laws; criminal investigations; and representation of the State in all criminal appellate appeals. Since leaving her Deputy Attorney General position, Ms. Staton has served in numerous volunteer capacities including the Maryland State Board of Education (since 2009), the Howard County Bar Foundation, the Client Protection Fund of the Bar of Maryland and the Baltimore Education Scholarship Trust. She also served as an adjunct professor at the University of Maryland Law School during 2008. Ms. Staton is currently a member of the Governance and Nominating Committee of the boards of directors of both Howard Bancorp and Howard Bank.

Richard B. Talkin

Mr. Talkin, 74, has served as a director of Howard Bancorp and Howard Bank since 2007. Mr. Talkin, whose law firm is Talkin & Oh, LLC, has been a practicing attorney in Howard County, Maryland since 1968, concentrating in real estate law, zoning, administrative law, real estate construction and development. He previously served as an Assistant States Attorney for Howard County, Maryland, President of the Howard County Bar Association and on the Board of Directors of the MD Bar Association. He is also actively engaged in real estate development and ownership. Mr. Talkin currently serves on the board of directors of the Maryland Science Center, the Domestic Violence Center of Howard County and Stocks in the Future, an organization that aims to improve school performance of middle school students through the teaching of financial life skills. Mr. Talkin is currently a member of the Audit Committee of the boards of directors of both Howard Bancorp and Howard Bank.

HOWARD BANCORP, INC.
INDEX TO FINANCIAL STATEMENTS

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

STEGMAN
& COMPANY
CERTIFIED PUBLIC ACCOUNTANTS AND
MANAGEMENT CONSULTANTS SINCE 1915

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Howard Bancorp, Inc.
Ellicott City, Maryland

We have audited the accompanying consolidated balance sheets of Howard Bancorp, Inc. (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Howard Bancorp, Inc. as of December 31, 2011 and 2010 and the results of their consolidated operations and cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Stegman & Company

Baltimore, Maryland
March 23, 2012

Howard Bancorp, Inc. and Subsidiary

Consolidated Balance Sheets

(in thousands)	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	**$ 17,926**	$ 11,456
Federal funds sold	**279**	298
Total cash and cash equivalents	**18,205**	11,754
Securities available-for-sale	**13,376**	15,040
Nonmarketable equity securities	**1,313**	1,515
Loans held for sale	**646**	1,063
Loans, net of unearned income	**276,531**	256,307
Allowance for credit losses	**(3,433)**	(3,523)
Net loans	**273,098**	252,784
Bank premises and equipment, net	**9,484**	9,239
Other real estate owned	**1,885**	3,024
Deferred income taxes	**1,679**	2,663
Interest receivable and other assets	**3,396**	3,137
Total assets	**$ 323,082**	$ 300,219
LIABILITIES		
Noninterest-bearing deposits	**$ 62,044**	$ 48,679
Interest-bearing deposits	**200,598**	190,635
Total deposits	**262,642**	239,314
Short-term borrowings	**12,984**	25,024
Long-term borrowings	**10,000**	6,000
Accrued expenses and other liabilities	**826**	593
Total liabilities	**286,452**	270,931
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Preferred stock—par value $0.01 (liquidation preference of $1,000 per share) authorized 5,000,000; shares issued and outstanding 12,562 series AA at December 31, 2011 and 6,282 series A and B at December 31, 2010, net of issuance cost	**12,562**	6,272
Common stock - par value of $0.01 authorized 5,000,000 shares; issued and outstanding 2,640,264 shares at December 31, 2011 and 2,636,837 December 31, 2010	**26**	26
Capital surplus	**28,413**	28,285
Accumulated deficit	**(4,391)**	(5,325)
Accumulated other comprehensive income	**20**	30
Total shareholders' equity	**36,630**	29,288
Total liabilities and shareholders'equity	**$ 323,082**	$ 300,219

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

Consolidated Statements of Operations

(in thousands)	Year ended December 31, 2011	2010	2009
INTEREST INCOME			
Interest and fees on loans	**$ 14,516**	$ 14,103	$ 12,179
Interest and dividends on securities	**102**	124	176
Other interest income	**22**	28	71
Total interest income	**14,640**	14,255	12,426
INTEREST EXPENSE			
Deposits	**1,748**	2,572	3,443
Short-term borrowings	**168**	215	195
Long-term borrowings	**101**	120	106
Total interest expense	**2,017**	2,907	3,744
NET INTEREST INCOME	**12,623**	11,348	8,682
Provision for credit losses	**1,164**	1,633	3,670
Net interest income after provision for credit losses	**11,459**	9,715	5,012
NONINTEREST INCOME			
Service charges on deposit accounts	**298**	390	449
Other operating income	**839**	351	307
Total noninterest income	**1,137**	741	756
NONINTEREST EXPENSE			
Compensation and benefits	**5,020**	4,593	4,130
Occupancy and equipment	**1,436**	1,520	1,398
Marketing and business development	**494**	363	311
Professional fees	**401**	279	352
Data processing fees	**353**	354	539
FDIC Assessment	**332**	476	584
Provision for OREO	**777**	-	1,286
Other operating expense	**1,335**	1,123	660
Total noninterest expense	**10,148**	8,707	9,260
INCOME (LOSS) BEFORE INCOME TAXES	**2,448**	1,749	(3,492)
Income tax expense (benefit)	**1,063**	816	(1,304)
NET INCOME (LOSS)	**$ 1,385**	$ 933	$ (2,188)
Preferred stock dividends and discount accretion	**451**	326	274
Net income (loss) available to common shareholders	**$ 934**	$ 607	$ (2,462)
NET INCOME (LOSS) PER COMMON SHARE AVAILABLE			
Basic	**$ 0.35**	$ 0.23	$ (0.93)
Diluted	**$ 0.35**	$ 0.23	$ (0.93)

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

Consolidated Statements of Changes in Shareholders' Equity

(dollars in thousands, except per share data)	Preferred stock	Number of shares	Common stock	Capital Surplus	Accumulated deficit	Accumulated other comprehensive gain/loss	Total
Balances at January 1, 2009	$ -	2,633,064	$ 26	$ 28,181	$ (3,511)	$ 60	$ 24,756
Comprehensive income:							
Net loss	-	-	-	-	(2,188)	-	(2,188)
Other comprehensive loss net of tax:							
Net unrealized gain/(loss) on securities	-	-	-	-	-	(10)	(10)
Total comprehensive loss							(2,198)
Issuance of Preferred Stock:							
Series A and B	6,272	-	-	(299)	-	-	5,973
Dividends paid on preferred stock	-	-	-	-	(233)	-	(233)
Issuance of Common Stock:							
Stock Awards	-	772	-	6	-	-	6
Stock-based compensation	-	-	-	210	-	-	210
Balances at December 31, 2009	6,272	2,633,836	26	28,098	(5,932)	50	28,514
Comprehensive income:							
Net income	-	-	-	-	933	-	933
Other comprehensive loss net of tax:							
Net unrealized gain/(loss) on securities	-	-	-	-	-	(20)	(20)
Total comprehensive income							913
Dividends paid on preferred stock	-	-	-	-	(326)	-	(326)
Issuance of Common Stock:							
Stock Awards	-	3,001	-	21	-	-	21
Stock-based compensation	-	-	-	166	-	-	166
Balances at December 31, 2010	6,272	2,636,837	26	28,285	(5,325)	30	29,288
Comprehensive income:							
Net income	**-**	**-**	**-**	**-**	**1,385**	**-**	**1,385**
Other comprehensive loss net of tax:							
Net unrealized gain/(loss) on securities	**-**	**-**	**-**	**-**	**-**	**(10)**	**(10)**
Total comprehensive income							**1,375**
Issuance of series AA preferred stock	**12,562**						**12,562**
Dividends paid on preferred stock	**-**	**-**	**-**	**-**	**(451)**	**-**	**(451)**
Repurchase of series A and series B preferred stock	**(6,272)**	**-**	**-**	**-**	**-**	**-**	**(6,272)**
Issuance of Common Stock:							
Stock Awards	**-**	**3,427**	**-**	**22**	**-**	**-**	**22**
Stock-based compensation	**-**	**-**	**-**	**106**	**-**	**-**	**106**
Balances at December 31, 2011	**$ 12,562**	**2,640,264**	**$ 26**	**$ 28,413**	**$ (4,391)**	**$ 20**	**$ 36,630**

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

Consolidated Statements of Cash Flows

(in thousands)	Years Ended December 31, **2011**	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	**$ 1,385**	$ 933	$ (2,187)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Provision for credit losses	**1,164**	1,633	3,670
Deferred income taxes (benefit)	**991**	816	(1,304)
Provision for other real estate owned	**777**	-	1,286
Depreciation	**455**	356	366
Stock-based compensation	**128**	187	216
Net accretion of investment securities	**181**	173	(638)
Loans originated for sale	**(3,298)**	(7,751)	-
Proceeds from loans originated for sale	**3,744**	6,726	-
Gains on sales of loans	**(28)**	(53)	-
Gains on sales of other real estate owned, net	**(459)**	-	-
(Decrease) increase in interest receivable	**(111)**	(128)	72
Decrease in interest payable	**(27)**	(30)	(100)
Decrease (increase) in other assets	**52**	(283)	(2,136)
Increase in other liabilities	**260**	41	42
Net cash provided (used) by operating activities	**5,214**	2,620	(713)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of investment securities available-for-sale	**(39,185)**	(53,221)	(48,594)
Proceeds from maturities of investment securities available-for-sale	**40,652**	53,379	44,002
Net increase in loans outstanding	**(23,283)**	(7,350)	(51,476)
Proceeds from the sale of other real estate owned	**2,626**	-	-
Purchase of premises and equipment	**(700)**	(7,213)	(284)
Net cash used in investing activities	**(19,890)**	(14,405)	(56,352)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in noninterest-bearing deposits	**13,365**	9,681	1,256
Net increase in interest-bearing deposits	**9,963**	890	45,001
Net (decrease) increase in short-term borrowings	**(12,040)**	4,566	529
Proceeds from issuance of long-term debt	**4,000**	-	6,000
Repayment of long-term debt	**-**	(2,000)	-
Net proceeds from issuance of preferred stock, net of cost	**6,290**	-	6,272
Cash dividends on preferred stock	**(451)**	(326)	(234)
Net cash provided by financing activities	**21,127**	12,811	58,824
Net increase in cash and cash equivalents	**6,451**	1,026	1,759
Cash and cash equivalents at beginning of period	**11,754**	10,728	8,969
Cash and cash equivalents at end of period	**$ 18,205**	$ 11,754	$ 10,728
SUPPLEMENTAL INFORMATION			
Cash payments for interest	**$ 1,774**	$ 2,937	$ 3,544
Cash payments for income taxes	**$ 330**	$ -	$ -
Transferred from loans to other real estate owned	**$ 1,805**	$ 2,147	$ -

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") acquired all of the stock and became the holding company of Howard Bank (the "Bank") pursuant to the Plan of Reorganization approved by the shareholders of the Bank and by federal and state regulatory agencies. Each share of the Bank common stock was converted into two shares of Bancorp common stock effected by the filing of Articles of Exchange on that date, and the shareholders of the Bank became the shareholders of Bancorp. The Bank has three subsidiaries, two of which hold foreclosed real estate and the other owns and manages real estate that is used as a branch location and has office and retail space. 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.

Bancorp was incorporated in April of 2005 under the laws of the State of Maryland and is a bank holding company registered under the Bank Holding Company Act of 1956. The Company 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 Division of Financial Regulation.

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 Howard County Maryland, Anne Arundel County Maryland and their contiguous counties.

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. Certain reclassifications may have been made to the prior year's consolidated financial statements to conform to current period presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("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, other-than-temporary impairment of investment securities and deferred income taxes.

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

Marketable equity securities and debt securities not classified as held-to-maturity are classified as available-for-sale. 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 shareholders' 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. Declines in the fair value of individual available-for-sale 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 stock. These securities are accounted for at cost.

Loans Held-For-Sale

The Company engages in sales of residential mortgage loans originated by the Bank. Loans held for sale are carried at the lower of aggregate cost or fair value. Fair value is derived from secondary market quotations for similar instruments. 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.

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. As a result, the Company is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates.

The market value 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, no gain or loss occurs on rate lock commitments.

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 ninety 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 ninety days or more past due and they are placed on nonaccrual. 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 (ninety 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 Financial Accounting Standards ("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 regardless of size where the internal credit ratings classify the loan as substandard or lower. Loans that have at any point been classified as Troubled Debt Restructurings (TDRs) are deemed to be impaired, and even if the loan is no longer categorized as a TDR utilizes the specific approach.

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 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 experienced, the other factors that are measured and monitored in the overall determination of the allowance include:

- Changes in lending practices within the underwriting process
- Additional risk presented for construction related loans
- Changes in levels, and migration of classified loans
- Collateral lien positions for real estate based loans
- Amount of loans with SBA guarantees and the related net exposure levels
- The current economic condition of the market and observable trends in the economy
- Level of current delinquency levels and non-performing loans with recent trends of each
- Any other factors which management believes may impose additional risk within each portfolio segment

Each of these qualitative risk factors are 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. Given the overall status of the economy in recent years, the Bank experienced a high level of loan losses in 2009, with declining levels of losses for 2010 and 2011 (see Note 6). Thus, the historic loss factors have been the largest determinant of the overall risk factors assigned to each portfolio segment. The following table summarizes the amounts of the allowance for credit losses that are attributable to each component of the analysis:

	12/31/2011	12/31/2010
Collectively evaluated for impairment		
Based Upon Historic Losses	1,630	2,289
Based upon Qualitative Factors	530	435
Total for loans collectively evaluated	2,160	2,723
Individually evaluated for impairment	1,273	800
Total Allowance for credit losses	3,433	3,523

The above table reflects the composition of the allowance for credit losses, detailing the amount of the allowance attributable to amounts identified for loans that have been individually evaluated for impairment, and also the amount of the allowance for loans that are collectively evaluated by portfolio segment. For the periods represented in this table, the nonspecific portion of the allowance resulting from applying historic loss experience represents approximately 75% in 2011 and 84% in 2010, respectively, of the collectively evaluated total for each period.

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 loan 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 nonaccrual 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 loan 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.

Other Real Estate Owned

Other real estate acquired through, or in lieu of, foreclosure is initially recorded at the lower of book value or 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 3 to 10 years for furniture, fixtures and equipment, 3 to 5 years for computer software and hardware. 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 liability method of accounting for income taxes. Under the 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 all of the deferred tax asset will not be realized. Interest and penalties related to income tax matters are recognized in income tax expense.

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 non-interest expenses. The Company remains subject to examination for income tax returns for the years ending after December 31, 2007.

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted net income (loss) per common share is computed by dividing net income (loss) available to common shareholders 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 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.

Advertising Costs

All advertising costs are expensed as incurred. Advertising expense was $494 thousand in 2011, $363 thousand in 2010 and $311 thousand in 2009.

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 statement of financial condition 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 statement of financial condition, such items, along with net income, are components of comprehensive income.

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.

Note 2: 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 2011, 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 two domestic correspondents as partial compensation for services they provided to the Company.

Note 3: Investments Securities

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

	December 31,							
(in thousands)	**2011**				2010			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Federal agencies	**$ 12,774**	**$ 1**	**$ 2**	**$ 12,773**	$ 14,037	$ 3	$ 3	$ 14,037
Mortgage-backed	**568**	**35**	**-**	**603**	953	50	-	1,003
	$ 13,342	**$ 36**	**$ 2**	**$ 13,376**	$ 14,990	$ 53	$ 3	$ 15,040

There have not been any individual securities with an unrealized loss position for a period greater than one year as of either December 31, 2011 or December 31, 2010. Gross unrealized losses and fair value by investment category and length of time the individual securities have been in a continuous unrealized loss position December 31, 2011 and December 31, 2010:

December 31, 2011

(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**
U.S. Federal agencies	**$ 9,722**	**$ 2**	**$ -**	**$ -**	**$ 9,722**	**$ 2**
Mortgage-backed	**-**	**-**	**-**	**-**	**-**	**-**
	$ 9,722	**$ 2**	**$ -**	**$ -**	**$ 9,722**	**$ 2**

December 31, 2010

(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
U.S. Federal agencies	$ 5,996	$ 3	$ -	$ -	$ 5,996	$ 3
Mortgage-backed	-	-	-	-	-	-
	$ 5,996	$ 3	$ -	$ -	$ 5,996	$ 3

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.

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 shareholders' equity as a component of other comprehensive income, net of deferred tax.

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

	December 31,			
(in thousands)	**2011**		2010	
	Amortized Cost	**Estimated Fair Value**	Amortized Cost	Estimated Fair Value
Amounts maturing:				
One year or less	**$ 6,000**	**$ 6,000**	$ 12,037	$ 12,040
After one through five years	**7,021**	**7,036**	2,424	2,441
After five through ten years	**168**	**177**	-	-
After ten years	**153**	**163**	529	559
	$ 13,342	**$ 13,376**	$ 14,990	$ 15,040

There were no sales of investment securities during 2011, 2010 or 2009. At December 31, 2011 and December 31, 2010, $5.8 million and $9.0 million fair value of securities was pledged as collateral for repurchase agreements, respectively. The outstanding balance of no single issuer, except for U. S. Government and U. S. Government agency securities, exceeded ten percent of shareholders' equity at December 31, 2011.

Note 4: Nonmarketable Equity Securities

At December 31, 2011, December 31, 2010 and 2009, the Company's investment in nonmarketable equity securities consisted of Federal Home Loan Bank of Atlanta stock, which is required for continued membership, of $1.3 million, $1.5 million and $1.7 million, respectively. These investments are carried at cost.

Note 5: Loans and Leases

The Company makes loans 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, 2011and December 31, 2010 are presented in the following table:

(in thousands)	December 31, 2011	% of Total			2010	% of Total	
Real estate							
Construction and land	**39,268**	**14.2**	%	$	30,604	11.9	%
Residential - first lien	**22,087**	**8.0**			22,309	8.7	
Residential - junior lien	**9,242**	**3.3**			9,889	3.9	
Total residential real estate	**31,329**	**11.3**			32,198	12.6	
Commercial - owner occupied	**46,588**	**16.8**			46,947	18.3	
Commercial - non-owner occupied	**76,880**	**27.8**			58,438	22.8	
Total commercial real estate	**123,468**	**44.6**			105,385	41.1	
Total real estate loans	**194,065**	**70.2**			168,187	65.6	
Commercial loans and leases	**81,243**	**29.4**			86,851	33.9	
Consumer	**1,223**	**0.4**			1,269	0.5	
Total loans	**$ 276,531**	**100.0**	%	$	256,307	100.0	%

There were $646 thousand in loans held for sale at December 31, 2011 and there were $1.1 million at December 31, 2010.

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 loan and lease 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 to 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 owned-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.

NOTE 6 – 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 loan and lease 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 to credit losses inherent in the total loan portfolio.

Summary information on the allowance for credit loss activity for the years ended December 31 is provided in the following table:

	December 31,		
(in thousands)	**2011**	2010	2009
Balance at beginning of year	**$ 3,523**	$ 3,508	$ 2,659
Provision for credit losses	**1,164**	1,633	3,670
Loan charge-offs	**(1,616)**	(1,754)	(2,831)
Loan recoveries	**362**	136	10
Balance at end of year	**$ 3,433**	$ 3,523	$ 3,508

The following table provides information on the activity in the allowance for loan and lease losses by the respective loan portfolio segment for the year ended December 31, 2011 and 2010:

(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2011							
Allowance for credit losses:								
Beginning balance	$ 143	$ 16	$ 20	$ 892	$ 124	$ 2,294	$ 34	$ 3,523
Charge-offs	-	-	-	(1,033)	-	(562)	(21)	(1,616)
Recoveries	-	-	-	-	-	361	1	362
Provision for credit losses	31	95	44	752	73	140	29	1,164
Ending balance	$ 174	$ 111	$ 64	$ 611	$ 197	$ 2,233	$ 43	$ 3,433
Ending balance:								
individually evaluated for impairment	-	68	44	-	-	1,161	-	1,273
collectively evaluated for impairment	174	43	20	611	197	1,072	43	2,160
Loans:								
Ending balance	39,268	22,087	9,242	46,588	76,880	81,243	1,223	276,531
Ending balance:								
individually evaluated for impairment	-	611	44	1,988	2,783	3,498	9	8,933
collectively evaluated for impairment	39,268	21,476	9,198	44,600	74,097	77,745	1,214	267,598

(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2010							
Allowance for credit losses:								
Beginning balance	$ 515	$ 30	$ 26	$ 903	$ 358	$ 1,658	$ 18	$ 3,508
Charge-offs	-	-	(40)	-	(100)	(1,585)	(29)	(1,754)
Recoveries	-	-	-	-	-	135	1	136
Provision for credit losses	(372)	(14)	34	(11)	(134)	2,086	44	1,633
Ending balance	$ 143	$ 16	$ 20	$ 892	$ 124	$ 2,294	$ 34	$ 3,523
Ending balance:								
individually evaluated for impairment	-	-	-	800	-	-	-	800
collectively evaluated for impairment	143	16	20	92	124	2,294	34	2,723
Loans:								
Ending balance	30,604	22,309	9,889	46,947	58,438	86,851	1,269	256,307
Ending balance:								
individually evaluated for impairment	-	-	-	4,565	2,814	2,054	-	9,433
collectively evaluated for impairment	30,604	22,309	9,889	42,382	55,624	84,797	1,269	246,874

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 and 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.

All loans that are considered impaired are subject to the completion of an impairment analysis. This analysis highlights any potential collateral deficiencies. If the net realizable value of the collateral, less selling costs, results in a shortfall when compared to the carrying amount of the loan, a specific reserve is established for the amount of the shortfall. If in the future additional information becomes available concerning the value of the collateral, adjustments may be made to the specific reserve. When the impairment analysis indicates that the portion of the loss has been confirmed, a charge-off is taken, the loan is written down to its realizable value and the amount of the charge-off is then included in the historic loss experience and, therefore, impacts the calculation of the allowance for credit losses on the nonspecific portion of the allowance calculation. For a loan with a specific reserve, the total amount of the loan is classified as a non-accrual loan, even though a specific reserve has been taken for that loan. This reserve increases the amount of the allowance, and thus increases the ratio of the allowance to total loans outstanding. However, when this specific reserve is charged off, the loan amount is reduced which reduces the amount of non accrual loans. This also reduces the associated reserve and, therefore, the ratio of the allowance to total loans outstanding is reduced.

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)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2011							
Credit quality indicators:								
Not classified	$ 39,268	$ 21,476	$ 9,198	$ 44,600	$ 76,880	$ 78,014	$ 1,214	$ 270,650
Special mention	-	-	-	-	-	-	-	-
Substandard	-	611	44	1,988	-	3,229	9	5,881
Doubtful	-	-	-	-	-	-	-	-
Total	$ 39,268	$ 22,087	$ 9,242	$ 46,588	$ 76,880	$ 81,243	$ 1,223	$ 276,531

(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2010							
Credit quality indicators:								
Not classified	$ 30,604	$ 22,309	$ 9,889	$ 43,347	$ 58,437	$ 82,785	$ 1,269	$ 248,640
Special mention	-	-	-	-	-	2,017	-	2,017
Substandard	-	-	-	3,601	-	2,049	-	5,650
Doubtful	-	-	-	-	-	-	-	-
Total	$ 30,604	$ 22,309	$ 9,889	$ 46,948	$ 58,437	$ 86,851	$ 1,269	$ 256,307

- **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.

An aged analysis of past due loans are as follows:

(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2011							
Analysis of past due loans:								
Accruing loans current	$ 39,268	$ 21,719	$ 9,198	$ 44,600	$ 75,790	$ 77,951	$ 1,214	$ 269,740
Accruing loans past due:								
31-59 days past due	-	-	-	-	-	-	-	-
60-89 days past due	-	-	-	-	1,000	63	-	1,063
Greater than 90 days past due	-	-	-	-	90	-	-	90
Total past due	$ -	$ -	$ -	$ -	$ 1,090	$ 63	$ -	$ 1,153
Non-accrual loans	-	368	44	1,988	-	3,229	9	5,638
Total loans	$ 39,268	$ 22,087	$ 9,242	$ 46,588	$ 76,880	$ 81,243	$ 1,223	$ 276,531

(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2010							
Analysis of past due loans:								
Accruing loans current	$ 30,604	$ 22,309	$ 9,739	$ 43,347	$ 58,437	$ 85,087	$ 1,269	$ 250,792
Accruing loans past due:								
31-59 days past due	-	-	-	-	-	-	-	-
60-89 days past due	-	-	-	-	-	-	-	-
Greater than 90 days past due	-	-	150	-	-	-	-	150
Total past due	$ -	$ -	$ 150	$ -	$ -	$ -	$ -	$ 150
Non-accrual loans	-	-	-	3,601	-	1,764	-	5,365
Total loans	$ 30,604	$ 22,309	$ 9,889	$ 46,948	$ 58,437	$ 86,851	$ 1,269	$ 256,307

Total loans either in non-accrual status or in excess of ninety days delinquent totaled $5.7 million or 2.07% of total loans outstanding as of December 31, 2011 which represents an increase from the total of $5.5 million or 2.15% of total loans at December 31, 2010.

The impaired loans for the years ended December 31, 2011 and 2010 are as follows:

(in thousands)	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2011							
Impaired loans:								
Recorded investment	-	611	44	1,988	2,783	3,498	9	8,933
With an allowance recorded	-	368	44	-	-	1,884	-	2,296
With no related allowance recorded	-	243	-	1,988	2,783	1,614	9	6,637
Related allowance	-	68	44	-	-	1,161	-	1,273
Un-paid principal	-	611	44	3,021	2,783	3,533	9	10,001
Average balance of impaired loans	-	609	44	3,044	2,778	3,593	9	10,078
Interest income recognized	-	23	2	52	114	157	-	348

(in thousands)	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
	December 31, 2010							
Impaired loans:								
Recorded investment	-	-	-	4,565	2,814	2,054	-	9,433
With an allowance recorded	-	-	-	2,122	-	-	-	2,122
With no related allowance recorded	-	-	-	2,443	2,814	2,054	-	7,311
Related allowance	-	-	-	800	-	-	-	800
Un-paid principal	-	-	-	4,565	2,814	2,439	-	9,818
Average balance of impaired loans	-	-	-	5,857	2,838	2,678	-	11,373
Interest income recognized	-	-	-	130	57	79	-	266

Nonaccrual loans included in impaired loans totaled $5.6 million, $5.4 million and $4.9 million at December 31, 2011, 2010 and 2009 respectively. Interest income that would have been recorded if nonaccrual loans had been current and in accordance with their original terms was $105 thousand, $183 thousand and $142 thousand, respectively.

In 2011, the Company transferred one loan totaling $1.5 million, net of reserves, to other real estate owned ("OREO"). Management routinely evaluates OREO based upon periodic appraisals. The Company recorded an additional valuation allowance of $777 thousand in non-interest expense for several properties whose current appraised value was less than the recorded OREO amount. In 2010, the Company transferred three loans totaling $2.1 million, net of the reserve, to OREO.

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 trouble debt restructured loans ("TDRs") for December 31, 2011 and December 31, 2010 are as follows:

	As of December 31, 2011				
(dollars in thousands)	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDR's
Residential real estate - first lien	-	$ -	1	$ 240	$ 240
Commercial real estate non-owner occupied	-	-	-	-	-
Commercial loans	5	751	-	-	751
	5	$ 751	1	$ 240	$ 991

	As of December 31, 2010				
(dollars in thousands)	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDR's
Residential real estate - first lien	-	$ -	-	$ -	$ -
Commercial real estate non-owner occupied	-	-	-	-	-
Commercial loans	2	529	1	285	814
	2	$ 529	1	$ 285	$ 814

A summary of TDRs modifications outstanding and performance under modified terms are as follows:

	As of December 31, 2011		
(in thousands)	Not Performing to Modified Terms	Performing to Modified Terms	Total TDR's
Residential real estate - first lien			
Interest only payments	$ -	$ -	$ -
Rate modification	-	-	-
Forberance	-	-	-
Extension or other modification	-	240	240
Total residential real estate	-	240	240
Commercial loans			
Interest only payments	$ -	$ -	$ -
Rate modification	-	-	-
Forberance	353	-	353
Extension or other modification	398	-	398
Total commercial	751	-	751
Total TDR's	$ 751	$ 240	$ 991

	As of December 31, 2010		
(in thousands)	Not Performing to Modified Terms	Performing to Modified Terms	Total TDR's
Commercial loans			
Interest only payments	$ -	$ -	$ -
Rate modification		285	285
Forberance	367	-	367
Extension or other modification	162	-	162
Total TDR's	$ 529	$ 285	$ 814

There were recorded losses of $19 thousand on one loan that has been classified as a TDR during 2011, while a loss of $120,000 was recorded in 2010 for one loan classified as a TDR.

Note 7: Premises and Equipment

Premises and equipment include the following at:

(in thousands)	December 31, 2011		2010
Land	**2,660**	$	2,660
Building and leasehold improvements	**7,141**		6,653
Furniture and equipment	**1,912**		1,702
Software	**163**		161
	11,876		11,176
Less: accumulated depreciation and amortization	**2,392**		1,937
Net premises and equipment	**$ 9,484**	$	9,239

The Company occupies banking, land and office space in four locations under noncancellable lease arrangements accounted for as operating leases. The initial lease periods range from 10 to 20 years and provide for one or more 5-year renewal options. Rent expense applicable to operating leases amounted to $800 thousand, $961 thousand and $871 thousand for the year ended December 31, 2011, 2010 and 2009, respectively.

In 2010, the Company purchased and now owns a property which includes one of our branch locations as well as both office and retail units. In addition to the current branch, the Company utilizes the office portion of the center for Bank purposes and intends to lease the remainder of the space in the future.

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)		
2012	$	783
2013		797
2014		468
2015		239
2016		181
Thereafter		1,430
Total minimum lease payments	$	3,898

Note 8: Deposits

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

(dollars in thousands)	December 31, 2011	% of Total		2010	% of Total
Noninterest-bearing demand	**62,044**	**24** %	$	48,679	20 %
Interest-bearing checking	**17,687**	**7**		17,152	7
Money market accounts	**61,267**	**23**		64,637	27
Savings	**10,644**	**4**		13,608	6
Certificates of deposit $100,000 and over	**79,718**	**30**		68,118	29
Certificates of deposit under $100,000	**31,282**	**12**		27,120	11
Total deposits	**$ 262,642**	**100** %	$	239,314	100 %

The contractual maturities of certificates of deposits greater than $100,000 at December 31, 2011 are shown in the following table:

(in thousands)		
Three months or less	$	**18,400**
Over three months through twelve months		**31,594**
Over one year through three years		**26,493**
Over three years		**3,231**
Total	$	**79,718**

Interest expense on deposits for the twelve months ended December 31, 2011, December 31, 2010 and 2009 were as follows:

	December 31,				
(in thousands)	**2011**		2010		2009
Interest-bearing checking	**68**	$	69	$	73
Savings and money market	**517**		653		509
Certificates of deposit $100,000 and over	**756**		1,053		1,156
Certificates of deposit under $100,000	**407**		797		1,705
Total	$ **1,748**	$	2,572	$	3,443

Note 9: Short-Term Borrowings

Short-term borrowings consist of overnight unsecured master notes, overnight securities sold under agreement to repurchase and FHLB advances with a final remaining maturity of less than one year. Information relating to short-term borrowings at December 31, 2011 and for the years ended December 31, 2010 and 2009 is presented below:

	December 31,					
	2011			2010		
(dollars in thousands)		**Amount**	**Rate**		Amount	Rate
At period end	$	**12,984**	**0.68** %	$	25,024	0.91 %
Average for the year	$	**21,840**	**0.65** %	$	23,186	0.93 %
Maximum month-end balance	$	**29,879**		$	28,509	

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, 2011, 2010 and 2009 there were $5.8 million, $9.0 million and $11.0 million, respectively in borrowings under these agreements.

If the Company should need to supplement its liquidity, it could borrow, subject to collateral requirements, up to approximately $64.2 million on a line of credit arrangement with the Federal Home Loan Bank of Atlanta ("FHLB"). At December 31, 2011, 2010 and 2009 there were $16.0 million, $20.0 million and $14.0 million, respectively in advances outstanding under this arrangement.

Note 10: Long-Term Borrowings

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

(in thousands)	December 31, 2011	2010
Federal Home Loan Bank Advances [1]		
1.82% Due 2013	**$ 2,000**	$ 2,000
0.94% Due 2013	**2,000**	
0.55% Due 2013	**2,000**	
1.59% Due 2014	**2,000**	
0.84% Due 2014	**2,000**	
2.18% Due 2012		2,000
1.17% Due 2012	**-**	2,000
Total long-term borrowings	**$ 10,000**	$ 6,000

(1) Fixed rate advances

Note 11: Income Taxes

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

(in thousands)	December 31, 2011	2010	2009
Current federal income tax	**$ 330**	$ -	$ -
Current state income tax	**-**	-	-
Deferred federal income tax expense (benefit)	**511**	645	(1,031)
Deferred state income tax expense (benefit)	**222**	171	(273)
Total income tax expense (benefit)	**$ 1,063**	$ 816	$ (1,304)

A reconciliation of the statutory federal income tax rate to the Company's effective tax rate for the periods ended follows:

(in thousands)	December 31, 2011	2010	2009
Statutory federal income tax rate	**34.0** %	34.0 %	(34.0) %
State income taxes, net of federal income tax expense (benefit)	**5.6**	5.2	(5.1)
Other, net	**0.8**	7.5	1.7
Effective tax rate	**40.4** %	46.6 %	(37.4) %

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

(in thousands)	December, 31 2011	2010
Deferred tax assets:		
Net operating loss carryforwards	**$ -**	$ 1,131
Allowance for credit losses	**686**	872
Valuation on foreclosed real estate	**774**	507
Stock-based compensation	**59**	59
Deferred loan fees and costs, net	**42**	32
Other	**220**	137
Total deferred tax assets	**1,781**	2,738
Deferred tax liabilities:		
Unrealized gain on securities	**13**	20
Depreciation and amortization	**89**	55
Total deferred tax liabilities	**102**	75
Net deferred tax assets	**$ 1,679**	$ 2,663

Based upon the taxable income generated during 2011, all of the tax loss carryforwards at December 31, 2010 were fully utilized, and there were no remaining tax loss carryforwards recorded as of December 31, 2011.

Note 12: Related Party Transactions

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 collectibility. Total outstanding balances to the Company's executive officers, directors and their related interests at are presented below. Total outstanding commitments to these parties at December 31, 2011 were $14.7 million.

(in thousands)	December 31, 2011	2010
Balance January 1	**$ 11,673**	$ 14,529
Additions	**2,675**	1,425
Repayments	**1,580**	4,281
Balance December 31	**$ 12,768**	$ 11,673

Note 13: Financial Instruments with Off-Balance Sheet Risk

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, 2011	2010
Unfunded loan commitments	**$ 31,203**	$ 20,945
Unused lines of credit	**23,424**	26,219
Letters of credit	**4,902**	4,906

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.

Note 14: Stock Options, Awards and Warrants

The Company initially raised $4,775,000 of capital by selling to its founders investment units consisting of one share of common stock and a fully detachable warrant equal to .25 shares of common stock per unit. The warrants were issued in recognition of the financial and organizational risk undertaken by the purchasers in the organizational offering. The warrants are immediately exercisable and will expire ten (10) years from the date of issuance August 8, 2014. As of December 31, 2011 there have been no exercises of these warrants and the Company has outstanding warrants to purchase 119,376 shares at the price of $10.00 per share.

The Company's stock incentive plans provide for awards of nonqualified and incentive stock options as well as vested and non-vested common stock awards. 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. 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 options and stock awards may also be granted to non-employee members of the Board of Directors as compensation for attendance and participation at meetings of the Board of Directors and meetings of the various committees of the Board. The Company previously maintained an Advisory Board, for which non-employee members were compensated via stock options for meeting attendance. These nonqualified stock options can be granted with terms up to ten years, vest immediately, and are fully exercisable at time of grant. Stock awards granted to directors are based on the fair value of the awards, which is generally the market price of the common stock on the measurement date, and vest immediately. In 2011 and 2010, the Company's issued 4,663 and 3,001 shares of stock, respectively, to directors as compensation for their service.

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

	December 31,			
	2011		2010	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	**397,911**	**$ 11.16**	408,458	$ 11.16
Granted	**-**	**-**	-	-
Exercised	**-**	**-**	-	-
Forfeited	**(2,560)**	**11.11**	(10,547)	10.84
Outstanding at end of year	**395,351**	**$ 11.16**	397,911	$ 11.16
Exercisable at end of year	**372,201**	**$ 11.08**	345,314	$ 10.98
Weighted average fair value of options granted during the year		**$ -**		$ -

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 $4.60 on December 31, 2011 the options outstanding had no aggregate intrinsic value. There were no options exercised at during 2011, 2010 or 2009.

Share-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

Company recognized additional share-based compensation expense related to stock options of $106 thousand for the year ended December 31, 2011, and $166 thousand and $210 thousand during 2010 and 2009, respectively.

Valuation of Share-Based Compensation: The fair value of the Company'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 was calculated using the Black-Scholes option-pricing model. There were no stock options granted in 2011 and 2010, and the weighted-average fair value of stock options granted was $2.52 for 2009. The Company estimated expected market price volatility and expected term of the options based on historical data and other factors. The weighted-average assumptions used to determine the fair value of options granted are detailed in the table below:

Note 15: 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 $99 thousand, $82 thousand and $84 thousand, respectively for the year ended December 31, 2011, 2010 and 2009. The Company's matching contributions vest immediately.

Note 16: Income (Loss) per Common Share

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

	December 31,		
(dollars in thousands, except per share data)	**2011**	2010	2009
Net income (loss) applicable to common stock (numerator)	**$ 1,385**	$ 933	$ (2,188)
Preferred dividends	**$ (451)**	$ (326)	$ (274)
Net income (loss) available to common shareholders	**$ 934**	$ 607	$ (2,462)
BASIC			
Average common shares outstanding (denominator)	**2,638,443**	2,634,822	2,633,066
Basic income (loss) per common share	**$ 0.35**	$ 0.23	$ (0.94)
DILUTED			
Average common shares outstanding	**2,638,443**	2,634,822	2,633,066
Diluted effect of stock options and warrants	**-**	-	-
Diluted average common shares outstanding (denominator)	**2,638,443**	2,634,822	2,633,066
Diluted income (loss) per common share	**$ 0.35**	$ 0.23	$ (0.94)
Stock options and warrants outstanding that are anti-dilutive and thus excluded from calculation of diluted number of shares presented above	**495,141**	464,689	439,034

Note 17: Risk-Based Capital

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") required that the federal regulatory agencies adopt regulations defining five capital tiers for banks: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

Quantitative measures, established by the regulators to ensure capital adequacy, require that the Bank and Bancorp maintain minimum ratios (set forth below) of capital to risk-weighted assets. There are three categories of capital under the guidelines. Tier 1 capital includes common shareholders' equity, qualifying preferred stock and trust preferred securities, less goodwill and certain other deductions (including the unrealized net gains and losses, after applicable income taxes, on securities available for sale carried at fair value). Tier 2 capital includes preferred stock not qualifying as Tier 1 capital, subordinated debt, the allowance for credit losses and net unrealized gains on marketable equity securities, subject to limitations by the guidelines. Tier 2 capital is limited to the amount of Tier 1 capital (i.e., at least half of total capital must be in the form of Tier 1 capital). Tier 3 capital includes certain qualifying unsecured subordinated debt.

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 four risk weights (0%, 20%, 50% and 100%) 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, 2011 and 2010, the Bank met all capital adequacy requirements to which it is subject.

	Actual		For capital adequacy purposes		To be well capitalized under the FDICIA prompt corrective action provisions	
(dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2011:						
Total capital (to risk-weighted assets)						
Howard Bank	$ 38,172	13.75 %	$ 22,214	8.00 %	$ 27,768	10.00 %
Howard Bancorp	**$40,127**	**14.36 %**	**$22,349**	**8.00 %**	**N/A**	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	$ 34,739	12.51 %	$ 11,107	4.00 %	$ 16,661	6.00 %
Howard Bancorp	**$36,694**	**13.14 %**	**$11,174**	**4.00 %**	**N/A**	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	$ 34,739	10.92 %	$ 12,725	4.00 %	$ 15,907	5.00 %
Howard Bancorp	**$36,694**	**11.52 %**	**$12,737**	**4.00 %**	**N/A**	
As of December 31, 2010:						
Total capital (to risk-weighted assets)						
Howard Bank	$ 30,859	11.83 %	$ 20,875	8.00 %	$ 26,094	10.00 %
Howard Bancorp	$ 32,450	12.39 %	$ 20,951	8.00 %	N/A	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	$ 27,594	10.57 %	$ 10,437	4.00 %	$ 15,656	6.00 %
Howard Bancorp	$ 29,173	11.14 %	$ 10,475	4.00 %	N/A	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	$ 27,594	9.05 %	$ 12,199	4.00 %	$ 15,248	5.00 %
Howard Bancorp	$ 29,173	9.52 %	$ 12,256	4.00 %	N/A	

The Bank is currently prohibited from paying dividends without the prior approval of the State Banking Commissioner.

Note 18: 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.

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within Level 1 or Level 2 of the fair value hierarchy. As required by FASB ASC Topic 820, the Company does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid equities, state, municipal and provincial obligations, and certain physical commodities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

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.

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 as of December 31, 2011 and December 31, 2010.

December 31, 2011 (in thousands)	Carrying Value (Fair Value)	Quoted Price (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Federal agencies	**$ 12,773**	**$ -**	**$ 12,773**	**$ -**
Mortgage-backed securities	**604**	**-**	**604**	**-**

December 31, 2010 (in thousands)	Carrying Value (Fair Value)	Quoted Price (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Federal agencies	$ 14,037	$ -	$ 14,037	$ -
Mortgage-backed securities	1,003	-	1,003	-

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, 2011 and December 31, 2010.

December 31, 2011 (in thousands)	Carrying Value (Fair Value)	Quoted Price (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other real estate owned	**$ 1,885**	**$ -**	**$ -**	**$ 1,885**
Impaired loans:				
Residential - first lien	**611**	**-**	**-**	**611**
Residential - junior lien	**44**	**-**	**-**	**44**
Commercial - owner occupied	**1,988**	**-**	**-**	**1,988**
Commercial - non-owner occupied	**2,783**	**-**	**-**	**2,783**
Commercial loans and leases	**3,498**	**-**	**-**	**3,498**
Consumer	**9**	**-**	**-**	**9**

December 31, 2010 (in thousands)	Carrying Value (Fair Value)	Quoted Price (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other real estate owned	$ 3,024	$ -	$ -	$ 3,024
Impaired loans:				
Commercial - owner occupied	4,565	-	-	4,565
Commercial - non-owner occupied	2,814	-	-	2,814
Commercial loans and leases	2,054	-	-	2,054

The following table provides a reconciliation of all assets measured at fair value on a nonrecurring basis using significant unobservable inputs for the twelve months ended December 31, 2011 and December 31, 2010.

(in thousands)	Foreclosed Properties	Impaired Loans
Balance at December 31, 2010	$ 3,024	$ 9,433
Total net gain (losses) for the year included in:		
Gain on sale of foreclosed properties	**459**	**-**
Other comprehensive gain (loss)	**-**	**-**
Purchase and sales, net	**(2,625)**	**-**
Net transfers in (out)	**1,804**	**218**
Valuation allowance	**(777)**	**(718)**
Balance at December 31, 2011	**$ 1,885**	**$ 8,933**
Balance at December 31, 2009	$ 840	$ 7,649
Total net gain (losses) for the year included in:		
Gain on sale of foreclosed properties	-	-
Other comprehensive gain (loss)	-	-
Purchase and sales, net	-	-
Net transfers in (out)	2,184	1,983
Valuation allowance	-	(199)
Balance at December 31, 2010	$ 3,024	$ 9,433

The following table presents required information in accordance with ASC Topic 825 "Financial Instruments" December 31, 2011 and 2010. 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. These financial assets and liabilities have not been recorded at fair value.

The following methods and assumptions were used to estimate the fair value of financial instruments where it is practical to estimate fair value:

Cash and cash equivalents: The fair value of cash and cash equivalents is estimated to approximate the carrying amounts.

Securities available-for-sale: Based on quoted market prices. If quoted market price is not available fair value is estimated using quoted market prices for similar securities. See Note 3 for additional information.

Nonmarketable equity securities: Because these securities are not marketable, the carrying amount approximates the fair value.

Loans: For variable rate loans the carrying amount approximates the fair value. For fixed rate loans the fair value is calculated 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 estimated cash flows do not anticipate prepayments.

Deposits: The carrying amount of non-maturity deposits such as demand deposits, money market and saving deposits approximates the fair value. The fair value of deposits with predetermined maturity dates such as certificate of deposits is estimated by discounting the future cash flows using current rates of similar deposits with similar remaining maturities.

Short-term borrowing: Variable rate repurchase agreements carrying amounts approximate the fair values at the reporting date.

Long-term borrowing: Because the borrowing is a variable rate instrument, the carrying amount approximates the fair value.

Management has made estimates of fair value discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented for loans would be indicative of the value negotiated in an actual sale.

	December 31,			
	2011		2010	
(in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Cash and cash equivalents	**$ 18,205**	**$ 18,205**	$ 11,754	$ 11,754
Nonmarketable equity securities	**1,313**	**1,313**	1,515	1,515
Loans	**277,177**	**280,653**	256,307	256,698
Financial Liabilities				
Deposits	**262,642**	**262,412**	239,314	238,965
Short-term borrowings	**12,984**	**12,984**	25,024	25,024
Long-term borrowings	**10,000**	**9,948**	6,000	5,953

Note 19: NEW ACCOUNTING PRONOUNCEMENTS

In April 2011, the FASB issued ASU No. 2011-02, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring." The provisions of ASU No. 2011-02 provide additional guidance related to determining whether a creditor has granted a concession, include factors and examples for creditors to consider in evaluating whether a restructuring results in a delay in payment that is insignificant, prohibit creditors from using the borrower's effective rate test to evaluate whether a concession has been granted to the borrower, and add factors for creditors to use in determining whether a borrower is experiencing financial difficulties. A provision in ASU No. 2011-02 also ends the FASB's deferral of the additional disclosures about troubled debt restructurings as required by ASU No. 2010-20. The provisions of ASU No. 2011-02 were effective for the Company's reporting period ending September 30, 2011. The adoption of ASU No. 2011-02 did not have a material impact on the Company's statements of income and condition.

In April 2011, the FASB issued ASU No. 2011-03, "Reconsideration of Effective Control for Repurchase Agreements." ASU No. 2011-03 affects all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The amendments in ASU No. 2011-03 remove from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU No. 2011-03 also eliminates the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. The guidance is effective for the Company's reporting period ended June 30, 2012. The guidance will be applied prospectively to transactions or modifications of existing transaction that occur on or after January 1, 2012.

In June 2011, the FASB issued ASU No. 2011-05, "Presentation of Comprehensive Income." This guidance requires companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance does not change which items are reported in other comprehensive income or the requirement to report reclassifications of items from other comprehensive income to net income. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011 and will require retrospective application for all periods presented.

Note 20: Parent Company Financial Information

The condensed financial statement for Howard Bancorp, Inc. (Parent Only) is presented below:

Howard Bancorp, Inc.

Balance Sheets

(in thousands)	December 31, 2011	2010
ASSETS		
Cash and cash equivalents	**$ 2,932**	$ 2,692
Investment in subsidiaries	**35,142**	28,572
Other assets	**60**	51
Total assets	**$ 38,134**	$ 31,315
LIABILITIES		
Short-term borrowings	**$ 1,178**	$ 1,998
Other Liabilities	**326**	29
Total liabilities	**1,504**	2,027
SHAREHOLDERS' EQUITY		
Preferred stock— par value $0.01 (liquidation preference of $1,000 per share) authorized 5,000,000; shares issued and outstanding 12,562 series AA at December 31, 2011 and 6,282 series A and B at December 31, 2010, net of issuance cost	**12,562**	6,272
Common stock - par value of $0.01 authorized 5,000,000 shares; issued and outstanding 2,640,264 shares at December 31, 2011 and 2,636,837 December 31, 2010	**26**	26
Capital surplus	**28,413**	28,285
Accumulated deficit	**(4,391)**	(5,325)
Accumulated other comprehensive income, net	**20**	30
Total shareholders' equity	**36,630**	29,288
Total liabilities and shareholders'equity	**$ 38,134**	$ 31,315

Statements of Operations

(in thousands)	For the year ended December 31, 2011	2010	2009
INTEREST INCOME			
Interest and fees on loans	**$ -**	$ -	$ 26
INTEREST EXPENSE			
Short-term borrowings	**27**	29	38
NET INTEREST EXPENSE	**(27)**	(29)	(12)
Provision for credit losses	**-**	-	(6)
Net interest expense after provision for credit losses	**(27)**	(29)	(6)
NONINTEREST EXPENSE			
Compensation and benefits	**106**	166	235
Other operating expense	**111**	108	13
Total noninterest expense	**217**	274	248
Loss before income tax and equity in undistributed loss of subsidiary	**(244)**	(303)	(254)
Income tax benefit	**(72)**	(4)	(34)
Loss before equity in undistributed income (loss) of subsidiary	**(172)**	(299)	(220)
Equity in undistributed income (loss) of subsidiary	**1,557**	1,232	(1,968)
Net income (loss)	**$ 1,385**	$ 933	$ (2,188)
Preferred stock dividends	**451**	326	274
Net income (loss) available to common shareholders	**$ 934**	$ 607	$ (2,462)

Statements of Cash Flows

(in thousands)	Year Ended December 31, 2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	**$ 1,385**	$ 933	$ (2,188)
Adjustments to reconcile net income (loss)to net cash provided (used) by operating activities:			
Provision for credit losses	**-**	-	(6)
Deferred income taxes (benefits)	**26**	(4)	(34)
Share-based compensation	**128**	187	216
Equity in undistributed (income) loss of subsidiary	**(1,546)**	(923)	1,978
Increase in other assets	**(44)**	29	(638)
Increase in other liabilities	**295**	-	-
Net cash provided (used) by operating activities	**244**	222	(672)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net decrease in loans outstanding	**-**	-	430
Investment in subsidiary	**(5,024)**	(1,500)	(5,000)
Net cash used by investing activities	**(5,024)**	(1,500)	(4,570)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net (decrease) increase in short-term borrowings	**(819)**	(1,743)	3,698
Net proceeds from issuance of preferred stock, net of cost	**6,290**	-	6,272
Cash dividends on preferred stock	**(451)**	(326)	(234)
Net cash provided by financing activities	**5,020**	(2,069)	9,736
Net increase in cash and cash equivalents	**240**	(3,347)	4,494
Cash and cash equivalents at beginning of period	**2,692**	6,039	1,545
Cash and cash equivalents at end of period	**$ 2,932**	$ 2,692	$ 6,039

NOTE 20 — PREFERRED STOCK

On September 22, 2011, we entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which we issued and sold to the Treasury 12,562 shares of our 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 Treasury's Small Business Lending Fund (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 is 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, which is calculated on the aggregate Liquidation Amount, has been initially set at 5% per annum based upon the current level of "Qualified Small Business Lending" ("QSBL") by the Bank. The dividend rate for future dividend periods will be set based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods, from 1% per annum to 7% per annum for the eleventh through the first half of the nineteenth dividend periods. If the Series AA Preferred Stock remains outstanding for more than four-and-one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Bank's QSBL increases. Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series AA Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series AA Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities. In addition, if (i) we have 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) may designate a representative to attend all meetings of Bancorp's Board of Directors in a nonvoting observer capacity and Bancorp must give such representative copies of all notices, minutes, consents and other materials that Bancorp provide to its directors in connection with such meetings.

We may redeem the shares of Series AA Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the Liquidation Amount per share and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by our primary federal banking regulator.
Simultaneously with the receipt of the SBLF funds, Bancorp redeemed the full balance of $6.3 million of shares of Series A and Series B preferred stock issued to the Treasury under the U S Treasury Capital Purchase Program (the "CPP") in 2009. The resulting net increase of approximately $6.2 million of additional capital will support the Company's continued growth.
On February 27, 2009, the United States Department of the Treasury ("Treasury"), purchased $5,983,000 of Fixed Rate Cumulative Perpetual Preferred Stock, Series A ("Series A Preferred Stock") issued by Bancorp. The dividend rate was 5% for the first five years, rising to 9% thereafter. At the same time Bancorp issued its Series A Preferred Stock, it issued to the Treasury warrants which were immediately exercised to purchase Fixed Rate Cumulative Perpetual Preferred Stock, Series B Preferred Stock ("Preferred B") in the amount of 5% of the Preferred A shares or 299 shares with a par value of $299,003.

Howard Bancorp, Inc.

CORPORATE HEADQUARTERS

Howard Bancorp, Inc.
6011 University Boulevard
Suite 370
Ellicott City, MD 21043

Phone: (410) 750-0020
Fax: (410) 750-8588

Website: www.howardbank.com

COMMON STOCK

Howard Bancorp, Inc.'s Common Stock is currently listed on the NASDAQ Over-the-Counter Bulletin Board (OTCBB) under the symbol HBMD.OB

TRANSFER AGENT

Shareholders seeking information on stock transfer requirements, lost certificates, or other shareholder matters should contact our transfer agent:

Registrar and Transfer Company
10 Commerce Drive
Cranford NJ 07016-3572
(800) 368-5948
E-mail: info@rtco.com
Website: www.rtco.com

MARKET MAKERS

In order to facilitate shareholders or other investors in the purchase or sale our common stock, there are several firms which make a market in our common stock. The Company's market makers can be viewed at the About Us – Investor Relations section of the Bank's website www.howardbank.com

ANNUAL MEETING

The annual meeting of Stockholders of Howard Bancorp, Inc. will be held on Wednesday, May 23, 2012 at 11:30 a.m. at the: Corporate Offices of
Howard Bancorp, Inc.
6011 University Boulevard
Suite 370
Ellicott City, MD 21043

INVESTOR RELATIONS

Howard Bancorp, Inc.'s Annual Report, Regulatory Filings, and other corporate publications are on our website at www.howardbank.com or are available to shareholders upon request, without charge, by writing:

George C. Coffman
Executive Vice President and Chief Financial Officer
Howard Bancorp, Inc.
6011 University Boulevard
Suite 370
Ellicott City, MD 21043

Phone: (410) 750-0020
Fax: (410) 750-8588
E-mail: gcoffman@howardbank.com

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stegman & Company
405 East Joppa Road
Suite 100
Baltimore, MD 21286

Phone: (410) 823-8000
Phone: (800) 686-3883
Website: www.stegman.com

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Philip W. Gibbs	**Mary Ann Scully**
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Richard B. Talkin

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President and Chief Executive Officer

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Executive Vice President and Chief Lending Officer

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6011 University Boulevard
Suite 370
Ellicott City, MD 21043

Phone: (410) 750-0020
Fax: (410) 750-8588
howardbank.com