COMMUNITY FINANCIAL CORP /MD/
Form 10-K
March 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2014

OR

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

For the transition period from _______ to _______

Commission File No. **0-18279**

The Community Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	**52-1652138**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3035 Leonardtown Road, Waldorf, Maryland	20601
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: **(301) 645-5601**

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

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

Common Stock, par value $0.01 per share

(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

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

Large Accelerated Filer ¨ Accelerated Filer x
Non-Accelerated Filer ¨ Smaller Reporting Company x

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

Yes ¨ No x

The aggregate market value of voting stock held by non-affiliates of the registrant was approximately $90.2 million based on the closing price $23.75 per share at which the common stock was sold on the last business day of the Company's most recently completed second fiscal quarter. For purposes of this calculation only, the shares held by directors, executive officers and the Company's Employee Stock Ownership Plan of the registrant are deemed to be shares held by affiliates.

Number of shares of common stock outstanding as of February 27, 2015: 4,731,079.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2015 Annual Meeting of Stockholders. (Part III)

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PART I

This report contains certain "forward-looking statements" within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on The Community Financial Corporation's current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are preceded by terms such as "expects," "believes," "anticipates," "intends" and similar expressions.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors that could affect actual results include interest rate trends, the general economic climate in the market area in which The Community Financial Corporation operates, as well as nationwide, The Community Financial Corporation's ability to control costs and expenses, competitive products and pricing, changes in accounting principles, loan demand, loan delinquency rates, charge-offs and changes in federal and state legislation and regulation. These factors should be considered in evaluating the forward-looking statements and undue reliance should not be placed on such statements. The Community Financial Corporation assumes no obligation to update any forward-looking statement after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Item 1. Business

Business

The Community Financial Corporation is a bank holding company organized in 1989 under the laws of the State of Maryland. It owns all the outstanding shares of capital stock of Community Bank of the Chesapeake, a Maryland-chartered commercial bank. The Bank was organized in 1950 as Tri-County Building and Loan Association of Waldorf, a mutual savings and loan association, and in 1986 converted to a federal stock savings bank and adopted the name Tri-County Federal Savings Bank. In 1997, the Bank converted to a Maryland-chartered commercial bank and adopted the name Community Bank of Tri-County. Effective October 18, 2013, Community Bank changed its name to become Community Bank of the Chesapeake. This new name reflects Community Bank's recent expansion into Virginia. In addition, Tri-County Financial Corporation changed its name to The Community Financial Corporation, to better align the bank name with the parent company.

The Company engages in no significant activity other than holding the stock of the Bank and operating the business of the Bank. Accordingly, the information set forth in this 10-K, including financial statements and related data, relates primarily to the Bank and its subsidiaries.

The Bank maintains its main office and operations center in Waldorf, Maryland, in addition to its branch offices in Lexington Park, Leonardtown, La Plata, Dunkirk, Bryans Road, Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland and Fredericksburg and King George, Virginia. In addition, the Bank maintains five loan production offices ("LPOs") in La Plata, Prince Frederick, Leonardtown and Annapolis, Maryland and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches. The Annapolis LPO opened in October 2014.

The Bank plans to open an additional full-service bank branch in downtown Fredericksburg during 2015.

The Bank operates 16 automated teller machines including four stand-alone locations. The Bank offers telephone and internet banking services. The Bank is engaged in the commercial and retail banking business as authorized by the banking statutes of the State of Maryland and applicable federal regulations, including the acceptance of deposits, and the origination of loans to individuals, associations, partnerships and corporations. The Bank's real estate financing consists of commercial mortgage loans, residential first and second mortgage loans and home equity lines of credit. Commercial lending consists of both secured and unsecured loans. The Bank is a member of the Federal Reserve and Federal Home Loan Bank (the "FHLB") system and its deposits are insured up to applicable limits by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation ("FDIC").

Market Area

The Bank considers its principal lending and deposit market area to consist of the tri-county area in Southern Maryland, King George County and the greater Fredericksburg market in Virginia. As a result of the Bank's expansion into the greater Fredericksburg market in 2013, Stafford County has become part of the Bank's principal lending and deposit market area. The Annapolis LPO opening in October 2014 is expected to provide additional growth opportunities during 2015. Our market area is one of the fastest growing regions in the country and is home to a mix of federal facilities, industrial and high-tech businesses.

The presence of several major federal facilities located within the Bank's footprint and in adjoining counties contribute to economic growth. Major federal facilities include the Patuxent River Naval Air Station in St. Mary's County, the Indian Head Division, Naval Surface Warfare Center in Charles County and the Naval Surface Warfare –Naval Support Facility in King George County. Collectively, these facilities employ over 33,000 people. According to the St. Mary's County Comprehensive Plan, the Patuxent Naval Air Station alone employs approximately 22,000 people and provides an approximate annual economic impact of $2.3 billion. In addition, there are several major federal facilities located in adjoining markets including Andrews Air Force Base and Defense Intelligence Agency & Defense Intelligence Analysis Center in Prince Georges County, Maryland and the U.S. Marine Base Quantico, Drug Enforcement Administration Quantico facility and Federal Bureau of Investigation Quantico facility in Prince William County, Virginia.

The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector. Calvert County is home to the Dominion Power Cove Point Liquid Natural Gas Terminal, which is one of the nation's largest liquefied natural gas terminals and Dominion Power is currently constructing liquefaction facilities for exporting liquefied natural gas.

Southern Maryland is generally considered to have more affordable housing than many other Washington and Baltimore area suburbs. During the recession, growth in the Bank's market area was slowed as the demand for new housing in the tri-county area fell with the overall housing market. According to the Maryland Department of Planning, new housing unit starts fell from 2006 through 2010. However, after 2010, real estate values stabilized and there were positive trends in housing beginning in 2012.

Based on information from the U.S. Bureau of Labor Statistics, unemployment rates at November 2014 remained well below the national average (not seasonally adjusted) of 4.8% for our legacy Southern Maryland market and 4.7% for our new markets of Fredericksburg and Annapolis compared to a 5.8% rate for the United States.

The Bank expanded into the greater Fredericksburg, Virginia market in August 2013. According to the Fredericksburg Regional Alliance, the Fredericksburg Region, including the City of Fredericksburg and the counties of Caroline, King George, Spotsylvania, and Stafford, Virginia, has been the fastest growing region in the Commonwealth of Virginia for the past eight years. Based on information from the Fredericksburg Regional Alliance, this region boasts an impressive array of over 10,000 small businesses and a highly skilled labor force of over one million within a 40-mile commute.

The Bank's primary market area also boasts a strong median household income. According to SNL Financial as of November 2014, the median household income was $94,575 for our legacy Southern Maryland market and $90,097 for our new markets of Fredericksburg and Annapolis compared to $51,579 for the United States.

Competition

The Bank faces strong competition in the attraction of deposits and in the origination of loans. Its most direct competition for deposits and loans comes from other banks, savings and loan associations and federal and state credit unions located in its primary market area. There are currently approximately 40 FDIC-insured depository institutions operating in the Bank's footprint including subsidiaries of several large, regional and national bank holding companies. The Bank also faces additional significant competition for customers' funds from mutual funds, brokerage firms, and other financial service companies. The Bank competes for loans by providing competitive rates and flexibility of terms and service, including customer access to senior decision makers. It competes for deposits by offering depositors a wide variety of account types, convenient office locations and competitive rates. Other services offered include tax deferred retirement programs, brokerage services through an affiliation with Community Wealth Advisors, cash management services and safe deposit boxes. The Bank has used targeted direct mail, print and online advertising and community outreach to increase its market share of deposits, loans and other services in its market area. It provides ongoing training for its staff in an attempt to ensure high-quality service.

Lending Activities

General

The Bank offers a wide variety of real estate and commercial loans. The Bank's lending activities include residential and commercial real estate loans, construction loans, land acquisition and development loans, equipment financing, commercial and consumer loans. Most of the Bank's customers are residents of, or businesses located in the Bank's market area. The Bank's primary targets for commercial loans consist of small and medium-sized businesses with revenues of $5.0 million to $35.0 million located in Southern Maryland, the Annapolis area of Maryland, the Northern Neck region, and the greater Fredericksburg area of Virginia.

Commercial Real Estate and Other Non-Residential Real Estate Loans

The permanent financing of commercial and other improved real estate projects, including office buildings, retail locations, churches, and other special purpose buildings, is the largest component of the Bank’s loan portfolio. Commercial real estate loans amounted to $561.1 million, or 64.3% of the loan portfolio, at December 31, 2014. This portfolio has increased in both absolute size and as a percentage of the loan portfolio in each of the last four years. The primary security on a commercial real estate loan is the real property and the leases or businesses that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank’s capital and participates with other lenders on larger projects. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price and have an initial contractual loan amortization period ranging from three to 20 years. Interest rates and payments on these loans typically adjust after an initial fixed-rate period, which is generally between three and ten years. Interest rates and payments on adjustable-rate loans are adjusted to a rate based on the United States Treasury Bill Index. Almost all of the Bank’s commercial real estate loans are secured by real estate located in the Bank’s primary market area. At December 31, 2014, the largest outstanding commercial real estate loan was $9.9 million, which is secured by which is secured by commercial real estate and was performing according to its terms at December 31, 2014.

Loans secured by commercial real estate are larger and involve greater risks than one- to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. As a result of the greater emphasis that the Bank places on increasing its portfolio of commercial real estate loans, the Bank is increasingly exposed to the risks posed by this type of lending. To monitor cash flows on income properties, the Bank requires borrowers and loan guarantors, if any, to provide annual financial statements on multi-family or commercial real estate loans. In reaching a decision on whether to make a multi-family or commercial real estate loan, the Bank considers the net operating income of the property, the borrower’s expertise, credit history and profitability, and the value of the underlying property, as well as the borrower’s global cash flows. Environmental surveys are generally required for commercial real estate loans over $250,000.

Residential First Mortgage Loans

Residential first mortgage loans made by the Bank are generally long-term loans, amortized on a monthly or bi-weekly basis, with principal and interest due each payment. The initial contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank’s experience indicates that residential real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank originates both fixed-rate and adjustable-rate residential first mortgages.

The Bank offers fixed-rate residential first mortgages on a variety of terms including loan periods from ten to 30 years and bi-weekly payment loans. Total fixed-rate loan products in our residential first mortgage portfolio amounted to $125.5 million as of December 31, 2014. Fixed-rate loans may be packaged and sold to investors or retained in the Bank’s loan portfolio. The Bank generally retains the right to service the loans sold for a payment based upon a percentage (generally 0.25% of the outstanding loan balance). As of December 31, 2014, the Bank serviced $68.7 million in residential mortgage loans for others.

The Bank also offers mortgages that are adjustable on a one-, three- and five-year basis generally with limitations on upward adjustments of two percentage points per re-pricing period and six percentage points over the life of the loan. The Bank primarily markets adjustable-rate loans with rate adjustments based upon a United States Treasury Bill Index. As of December 31, 2014, the Bank had $27.4 million in adjustable-rate residential mortgage loans. At December 31, 2014, the largest outstanding residential first mortgage loan was $2.2 million, which was secured by a residence located in the Bank's market area. The loan was performing according to its terms at December 31, 2014.

The Bank makes residential first mortgage loans of up to 97% of the appraised value or sales price of the property, whichever is less, to qualified owner-occupants upon the security of single-family homes. Non-owner occupied one- to four-family loans are generally permitted to a maximum 80% loan-to-value of the appraised value depending on the overall strength of the application. The Bank currently requires that substantially all residential first mortgage loans with loan-to-value ratios in excess of 80% carry private mortgage insurance to lower the Bank's exposure to approximately 80% of the value of the property. The Bank had fewer than 10 loans with private mortgage insurance at December 31, 2014. In certain cases, the borrower may elect to borrow amounts in excess of 80% loan-to-value in the form of a second mortgage. The second mortgage will generally have a higher interest rate and shorter repayment period than the first mortgage on the same property.

All improved real estate that serves as security for a loan made by the Bank must be insured, in the amount and by such companies as may be approved by the Bank, against fire, vandalism, malicious mischief and other hazards. Such insurance must be maintained through the entire term of the loan and in an amount not less than that amount necessary to pay the Bank’s indebtedness in full.

Construction and Land Development Loans

The Bank offers construction loans to individuals and building contractors for the construction of one- to four-family dwellings. Construction loans totaled $14.5 million at December 31. 2014. Loans to individuals primarily consist of construction/permanent loans, which have fixed rates, payable monthly for the construction period and are followed by a 30-year, fixed or adjustable-rate permanent loan. The Bank also provides construction financing to home builders. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. Draws are made upon satisfactory completion of predefined stages of construction. The Bank will typically lend up to the lower of 80% of the appraised value or the contract purchase price of the homes to be constructed.

In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals. Land acquisition and development loans totaled $21.9 million at December 31, 2014. Bank policy requires that zoning and permits must be in place prior to making development loans. The Bank will typically lend up to the lower of 75% of the appraised value or cost. At December 31, 2014, the largest outstanding construction and land development loan was $4.9 million, which was secured by land in the Bank’s market area.

The Bank’s ability to originate residential construction and development loans is heavily dependent on the continued demand for single-family housing construction in the Bank’s market area. The Bank’s investment in these loans has declined in recent years. The construction and land development portfolio increased $4.4 million from $32.0 million at December 31, 2013 to $36.4 million at December 31, 2014. Construction and land development loans as a percentage of the total loan portfolio have been decreasing since 2008 from greater than 10% as of December 31, 2008 to 4.2% at December 31, 2014. If the demand for new houses being built from smaller builders in the Bank’s market areas continues to decline, this portion of the loan portfolio may continue to decline. In addition, a decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans have been particularly affected by recent economic factors that have slowed absorption of finished lots and homes in Southern Maryland.

Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank’s risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a project having a value that is insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, the Bank may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

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Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. Home equity loans, which totaled $18.7 million at December 31, 2014, are generally made in the form of lines of credit with minimum amounts of $5,000, have terms of up to 20 years, variable rates priced at the then current Wall Street Journal prime rate plus a margin, and require an 80% or 90% loan-to-value ratio (including any prior liens), depending on the specific loan program. Second mortgage loans, which totaled $2.8 million at December 31, 2014, are fixed or variable-rate loans that have original terms between five and 15 years. Loan-to-value ratios of up to 95% are allowed depending on the specific loan program.

These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk has been heightened as the market value of residential property has declined. The Bank monitors the property values of the properties that secure its second mortgages and is lowering credit availability where prudent. The Bank believes that its policies and procedures are sufficient to mitigate the additional risk posed by these loans at the current time.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. The portfolio consists primarily of demand loans and lines of credit. Such loans can be made for terms of up to five years. However, most of the loans are originated for a term of two years or less. The Bank offers both fixed-rate and adjustable-rate loans (typically tied to the then current Wall Street Journal prime rate plus a margin with a floor) under these product lines. While commercial loans remain an important class of the Bank’s loan portfolio at 8.4% of total loans, the commercial loan portfolio decreased by $20.6 million from $94.2 million at December 31, 2013 to $73.6 million at December 31, 2014. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower’s payment history of both corporate and personal debt, the projected cash flows of the business as well the borrower’s global cash flows, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower’s ability to service the debt. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank. The higher interest rates and shorter loan terms available on commercial lending make these products attractive to the Bank.

Commercial business loans, however, entail greater risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower’s ability to make repayment from his or her employment or other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are made on the basis of the borrower’s ability to make repayment from the cash flows of the borrower’s business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral would make full recovery from the sale of collateral problematic. The Bank attempts to control these risks by establishing guidelines that provide for loans with low loan-to-value ratios. At December 31, 2014, the largest outstanding commercial loan was $12.0 million, which was secured by commercial real estate (all of which was located in the Bank's market area), cash and investments. This loan was performing according to its terms at December 31, 2014.

Consumer Loans

The Bank has consumer loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans totaled $613,000 at December 31, 2014. Consumer loans entail greater risk than residential mortgage loans, particularly in the case of consumer loans, which are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral may not provide an adequate source of repayment of the outstanding loan balance. Further collection efforts may be hampered by the borrower's lack of current income or other assets. In addition, consumer loan collections are dependent on the borrower's continuing financial stability and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. Such loans may also give rise to claims and defenses by a consumer loan borrower against an assignee such as the Bank, and a borrower may be able to assert against such assignee claims and defenses that it has against the seller of the underlying collateral.

Commercial Equipment Loans

The Bank also maintains an amortizing commercial portfolio consisting primarily of commercial equipment loans. Commercial equipment loans totaled $26.2 million, or 3.0% of the total loan portfolio, at December 31, 2014. These loans consist primarily of fixed-rate, short-term loans collateralized by customers' equipment including trucks, cars, construction and other more specialized equipment. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. The higher interest rates and shorter loan terms available on commercial equipment lending make these products attractive to the Bank. These loans entail greater risk than loans such as residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic. The Bank assesses the amount of collateral required for a loan based upon the credit worthiness of the borrowers.

Loan Portfolio Analysis

Set forth below is selected data relating to the composition of the Bank's loan portfolio by type of loan on the dates indicated.

	At December 31, 2014			2013			2012			2011			2010		
(dollars in thousands)	Amount	%		Amount	%		Amount	%		Amount	%		Amount	%	
Commercial real estate	$561,080	64.34	%	$476,648	58.97	%	$419,667	55.47	%	$370,384	51.55	%	$336,300	50.72	%
Residential first mtgs.	152,837	17.52	%	159,147	19.69	%	177,663	23.48	%	164,543	22.90	%	136,048	20.52	%
Construction and land dev.	36,370	4.17	%	32,001	3.96	%	31,819	4.21	%	36,745	5.11	%	42,504	6.41	%
Home equity and second mtgs.	21,452	2.46	%	21,692	2.68	%	21,982	2.91	%	24,138	3.36	%	24,380	3.68	%
	73,625	8.44	%	94,176	11.65	%	88,158	11.65	%	101,968	14.19	%	104,566	15.77	%

Commercial loans										
Consumer loans	613	0.07 %	838	0.10 %	995	0.13 %	1,001	0.14 %	1,273	0.19 %
Commercial equipment	26,152	3.00 %	23,738	2.94 %	16,268	2.15 %	19,761	2.75 %	17,984	2.71 %
Total Loans	872,129	100.00 %	808,240	100.00 %	756,552	100.00 %	718,540	100.00 %	663,055	100.00 %
Deferred loan fees	1,239		972		664		796		936	
Allowance for loan losses	8,481		8,138		8,247		7,655		7,669	
Loans receivable, net	$862,409		$799,130		$747,641		$710,089		$654,450	

Loan Originations, Purchases and Sales

The Bank solicits loan applications through marketing by commercial and residential mortgage loan officers, its branch network, and referrals from customers. Loans are processed and approved according to guidelines established by the Bank. Loan requirements such as income verification, collateral appraisal, and credit reports vary by loan type. Loan processing functions are generally centralized except for small consumer loans.

Depending on market conditions, residential mortgage loans may be originated with the intent to sell to third parties such as FHLMC. Mortgage loans in the amount of $13.6 million and $23.3 million were sold by the Bank for the years ended December 31, 2014 and 2013, respectively. To comply with internal and regulatory limits on loans to one borrower, the Bank may sell portions of commercial and commercial real estate loans to other lenders. The Bank sold no participations in 2014 or 2013. The Bank may also buy loans, portions of loans, or participation certificates from other lenders. The Bank only purchases loans or portions of loans after reviewing loan documents, underwriting support, and completing other procedures, as necessary. The Bank purchased no loans during 2014 and 2013. Purchased participation loans are subject to the same regulatory and internal policy requirements as other loans in the Bank’s portfolio as described below.

Loan Approvals, Procedures and Authority

Loan approval authority is established by Board policy. Loan approval authorities vary by individual with the Chief Executive Officer having approval authority up to $1.25 million, the Chief Lending Officer up to $1.0 million, the Chief Risk Officer up to $1.0 million and the Chief Operating Officer up to $1.0 million. The individual lending authority of the other lenders is set by management and based on their individual abilities. The loan approval authorities of the Chief Executive Officer, the Chief Lending Officer, the Chief Risk Officer, the Chief Operating Officer, the Senior Credit Officer and the regional senior loan officers may be combined and a minimum of at least three other individuals (two-thirds of which must be executive level) need to be present in an officers’ loan committee. The officers’ loan committee approves loans up to the Bank’s legal lending limit. The in-house lending guideline is approved by the Credit Risk Committee on an annual basis or as needed if more frequently and is less than the Bank’s legal lending limit. Relationships in excess of the Bank’s in-house lending guideline are reported to the Board of Directors. The Board of Directors approves all loans required to be approved by regulation, such as Regulation O loans.

The Credit Risk Committee of the Bank, consisting of three or more directors, has been delegated by the Board of Directors of the Bank to assist the Board in its oversight responsibilities. The committee reviews the Bank's credit risk management, including the significant policies, procedures and practices employed to manage credit risk, and provides recommendations to the Board on strategic guidance to management on the assumption, management and mitigation of credit risk.

Depending on the loan and collateral type, conditions for protecting the Bank's collateral are specified in the loan documents. Typically these conditions might include requirements to maintain hazard and title insurance and to pay property taxes.

Loans to One Borrower

Under Maryland law, the maximum amount that the Bank is permitted to lend to any one borrower and his or her related interests may generally not exceed 10% of the Bank's unimpaired capital and surplus, which is defined to include the Bank's capital, surplus, retained earnings and 50% of its reserve for possible loan losses. Under this authority, the Bank would have been permitted to lend up to $13.1 million to any one borrower at December 31, 2014. By interpretive ruling of the Maryland Commissioner, Maryland banks have the option of lending up to the amount that would be permissible for a national bank, which is generally 15% of unimpaired capital and surplus (defined to include a bank's total capital for regulatory capital purposes plus any loan loss allowances not included in regulatory capital). Under this formula, the Bank would have been permitted to lend up to $20.3 million to any one borrower at December 31, 2014. At December 31, 2014, the largest amount outstanding to any one borrower and his or her related interests was $12.0 million. This borrower is a AAA-rated university hospital system located within the our market area.

Loan Commitments

The Bank does not normally negotiate standby commitments for the construction and purchase of real estate. Most loan commitments are granted for a one-month period. The Bank's outstanding commitments to originate loans at December 31, 2014 were approximately $36.3 million, excluding undisbursed portions of loans in process. It has been the Bank's experience that few commitments expire unfunded.

Maturity of Loan Portfolio

The following table sets forth certain information at December 31, 2014 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less.

	Due within one	Due after one year	Due more than

(dollars in thousands) Description of Asset	year after December 31, 2014	through five years from December 31, 2014	five years from December 31, 2014
Real Estate Loans			
Commercial	$ 114,300	$ 184,317	$ 262,463
Residential first mortgage	21,110	58,320	73,407
Construction and land development	26,867	9,503	-
Home equity and second mortgage	2,238	6,926	12,288
Commercial loans	73,625	-	-
Consumer loans	303	275	35
Commercial equipment	17,497	5,826	2,829
Total loans	$ 255,940	$ 265,167	$ 351,022

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The following table sets forth the dollar amount of all loans due after one year from December 31, 2014, which have predetermined interest rates and have floating or adjustable interest rates.

(dollars in thousands) Description of Asset	Fixed Rates	Floating or Adjustable Rates	Total
Real Estate Loans			
Commercial	$ 92,367	$ 354,413	$446,780
Residential first mortgage	105,082	26,645	131,727
Construction and land development	3,859	5,644	9,503
Home equity and second mortgage	2,362	16,852	19,214
Commercial loans	-	-	-
Consumer loans	310	-	310
Commercial equipment	6,625	2,030	8,655
	$ 210,605	$ 405,584	$616,189

Asset Classification

Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting on asset quality. We use an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets 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 characterized by the “distinct possibility” that the insured institution 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 classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated “special mention.”

When an insured institution classifies one or more assets, or portions thereof, as “substandard” or “doubtful,” it is required that a general valuation allowance for loan losses be established in an amount deemed prudent by management. General valuation allowances represent loss allowances that have been established to recognize the inherent losses associated with lending activities, but that, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies one or more assets, or portions thereof, as “loss,” it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

The table below sets forth information on our classified assets and assets designated special mention at the dates indicated. Classified and special mention assets include loans, securities and other real estate owned.

(dollars in thousands)	As of December 31, 2014	As of December 31, 2013	As of December 31, 2012
Classified assets			
Substandard	$ 54,022	$ 56,880	$ 58,595
Doubtful	-	-	-
Loss	-	-	-
Total classified assets	54,022	56,880	58,595
Special mention assets	5,460	9,246	6,092
	$ 59,482	$ 66,126	$ 64,687

Delinquencies

The Bank’s collection procedures provide that when a loan is 15 days delinquent, the borrower is contacted by mail and payment is requested. If the delinquency continues, subsequent efforts will be made to contact the delinquent borrower and obtain payment. If these efforts prove unsuccessful, the Bank will pursue appropriate legal action including repossession of the collateral and other actions as deemed necessary. In certain instances, the Bank will attempt to modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his financial affairs. For an analysis of past due loans as of December 31, 2014 and 2013, respectively, refer to Note 6 in the Consolidated Financial Statements.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The Bank evaluates substandard and doubtful classified loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructures (“TDRs”) on an individualized basis to determine whether a loan is impaired (See Notes 1 and 6 of the Consolidated Financial Statements).

Factors considered by management in determining impaired status 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 shortfalls on a case-by-case basis, taking into consideration the circumstances surrounding the loan. These circumstances include the length of the delay, the reasons for the delay, the borrower’s payment record and the amount of the shortfall in relation to the principal and interest owed. Loans not impaired are included in the pool of loans evaluated in the general component of the allowance.

If a specific loan is deemed to be impaired it is evaluated for impairment. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price or the fair value of the collateral, if the loan is collateral dependent. For loans that have an impairment, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than carrying value of that loan.

The Bank considers all TDRs to be impaired and defines TDRs as loans whose terms have been modified to provide for a reduction or a delay in the payment of either interest or principal because of deterioration in the financial condition of the borrower. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR. Once an obligation has been classified as a TDR it continues to be considered a TDR until paid in full or until the debt is refinanced at market rates with no debt forgiveness. TDRs are evaluated for impairment on a loan-by-loan basis in accordance with the Bank’s impairment methodology. The Bank does not participate in any specific government or Bank-sponsored loan modification programs. All restructured loan agreements are individual contracts negotiated with a borrower.

Specific loan loss reserves of $451,000 relate to impaired loans at December 31, 2014. The following table sets forth information with respect to the Bank’s impaired loans at the dates indicated. The table includes a breakdown between impaired loans with and without an allowance:

	December 31,				
(dollars in thousands)	2014	2013	2012	2011	2010
Recorded investment with no allowance	$45,587	$28,220	$34,717	$10,621	$10,020

Recorded investment with allowance	4,122	9,786	4,273	10,096	11,368
Total impaired loans	$49,709	$38,006	$38,990	$20,717	$21,388
Specific allocations of allowance	$451	$985	$1,548	$1,997	$1,998
Interest income recognized	$1,841	$1,608	$1,850	$793	$861

For additional information regarding impaired loans by class at December 31, 2014 and 2013, respectively, refer to Note 6 in the Consolidated Financial Statements.

The Bank closely monitors the payment activity of all its loans. The Bank periodically reviews the adequacy of the allowance for loan losses based on an analysis of the size of and composition of the loan portfolio, the Bank's historical loss experience, including trends in delinquency, non-performing and classified loans and charge-offs, economic conditions in the Bank's market area, and a review of selected individual loans. Loan losses are charged off against the allowance when individual loans are deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance. The Bank believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America and is in compliance with appropriate regulatory guidelines. However, the establishment of the level of the allowance for loan losses is highly subjective and dependent on incomplete information as to the ultimate disposition of loans. Accordingly, actual losses may vary from the amounts estimated. Additionally, our regulators as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase or decrease the allowance for loan losses, thereby affecting the Bank's financial condition and earnings. For a more complete discussion of the allowance for loan losses, see the section captioned *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies"* and Notes 1 and 6 of the Consolidated Financial Statements.

The following table allocates the allowance for loan losses by loan category at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	At December 31,									
	2014		2013		2012		2011		2010	
(dollars in thousands)	Amount	% [1]	Amount	% [1]	Amount	% [1]	Amount	% [1]	Amount	% [1]
Commercial real estate	$4,076	64.34 %	$3,525	58.97 %	$4,092	55.47 %	$2,526	51.55 %	$3,314	50.72 %
Residential first mtgs.	1,092	17.52 %	1,401	19.69 %	1,083	23.48 %	539	22.90 %	204	20.52 %
Construction and land dev.	1,071	4.17 %	584	3.96 %	533	4.21 %	354	5.11 %	1,267	6.41 %
Home equity and second mtgs.	173	2.46 %	249	2.68 %	280	2.91 %	144	3.36 %	98	3.68 %
Commercial loans	1,677	8.44 %	1,916	11.65 %	1,948	11.65 %	3,850	14.19 %	2,551	15.77 %
Consumer loans	3	0.07 %	10	0.10 %	19	0.13 %	19	0.14 %	32	0.19 %
Commercial equipment	389	3.00 %	453	2.94 %	292	2.15 %	223	2.75 %	203	2.71 %
Total allowance for loan losses	$8,481	100.00%	$8,138	100.00%	$8,247	100.00%	$7,655	100.00%	$7,669	100.00%

[1] Percent of loans in each category to total loans

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The following table sets forth an analysis of activity in the Bank's allowance for loan losses for the periods indicated.

	At December 31,				
(dollars in thousands)	2014	2013	2012	2011	2010
Balance at beginning of period	$8,138	$8,247	$7,655	$7,669	$7,471
Charge-offs:					
Commercial real estate	350	140	486	1,249	526
Residential first mtgs.	94	348	11	49	63
Construction and land dev.	992	36	141	213	2,249
Home equity and second mtgs.	59	111	211	-	71
Commercial loans	1,134	480	1,004	2,441	569
Consumer loans	3	12	5	3	10
Commercial equipment	10	35	169	150	256
Total Charge-offs	2,642	1,162	2,027	4,105	3,744
Recoveries:					
Commercial real estate	11	-	-	-	-
Residential first mtgs.	186	11	38	1	-
Construction and land dev.	84	1	-	-	1
Home equity and second mtgs.	10	17	-	-	-
Commercial loans	5	23	51	-	-
Consumer loans	11	3	1	1	7
Commercial equipment	25	58	-	2	-
Total Recoveries	332	113	90	4	8
Net Charge-offs	2,310	1,049	1,937	4,101	3,736
Provision for Loan Losses	2,653	940	2,529	4,087	3,934
Balance at end of period	$8,481	$8,138	$8,247	$7,655	$7,669
Allowance for loan losses to total loans	0.97 %	1.01 %	1.09 %	1.07 %	1.16 %
Net charge-offs to average loans	0.28 %	0.14 %	0.27 %	0.61 %	0.61 %

Non-performing Assets

The Bank's non-performing assets include other real estate owned, non-accrual loans and TDRs. Both non-accrual and TDR loans include loans that are paid current and are performing in accordance with the term of their original or modified contract terms. For a detailed discussion on asset quality see the section captioned *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Asset Quality, Allowance for Loan Losses and Provision for Loan Losses."*

Other Real Estate Owned ("OREO")

Real estate acquired by the Bank as a result of foreclosure or by deed in lieu of foreclosure is classified as foreclosed real estate until such time as it is sold. When such property is acquired, it is recorded at its fair market value.

Subsequent to foreclosure, the property is carried at the lower of cost or fair value less selling costs. Additional write-downs as well as carrying expenses of the foreclosed properties are charged to expenses in the current period. The Bank had foreclosed real estate with a carrying value of approximately $5.9 million at December 31, 2014. For a discussion of the accounting for foreclosed real estate, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Other Real Estate Owned"* and Notes 1 and 8 to the Consolidated Financial Statements.

Non-accrual Loans

Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of additional interest is doubtful. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Consumer loans are typically charged-off no later than 90 days past due. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Non-accrual loans are evaluated for impaired status on a loan by loan basis in accordance with the Company's impairment methodology.

All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Non-accrual loans include certain loans that are current with all loan payments and are placed on non-accrual status due to customer operating results and cash flows. Interest is recognized on non-accrual loans on a cash-basis if the loans are not impaired or there is no impairment. For a discussion of the accounting for non-accrual loans, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Asset Quality, Allowance for Loan Losses and Provision for Loan Losses"* and Notes 1 and 6 to the Consolidated Financial Statements.

The following table sets forth information with respect to the Bank's non-performing assets. There were no loans 90 days or more past due that were still accruing interest at the dates indicated.

	December 31,				
(dollars in thousands)	2014	2013	2012	2011	2010
Non-accrual loans:					
Commercial real estate	$3,824	$7,930	$5,331	$2,866	$8,243
Residential first mtgs.	533	2,245	3,739	2,439	1,747
Construction and land dev.	3,634	2,968	-	1,414	984
Home equity and second mtgs.	399	115	71	291	233
Commercial loans	1,587	1,935	3,732	2,264	2,262
Consumer loans	-	24	52	1	1
Commercial equipment	286	234	216	236	48
Total non-accrual loans (1)	10,263	15,451	13,141	9,511	13,518
OREO	5,883	6,797	6,891	5,029	10,469
TDRs: (2)					
Commercial real estate	10,438	3,141	3,097	7,697	6,848
Residential first mtgs.	906	1,485	1,418	-	929
Construction and land dev.	4,376	-	-	1,717	-
Commercial loans	2,262	-	-	2,369	8,834
Commercial equipment	154	67	-	130	271
Total TDRs	18,136	4,693	4,515	11,913	16,882
Total Accrual TDRs	13,249	4,364	4,515	11,113	16,585
Total non-accrual loans, OREO and Accrual TDRs	$29,395	$26,612	$24,547	$25,653	$40,572
Interest due at stated rates, but not recognized	$845	$599	$626	$415	$875
Non-accrual loans to total loans	1.18 %	1.91 %	1.74 %	1.32 %	2.04 %
Non-accrual loans and Accrual TDRs to total loans (2)	2.70 %	2.45 %	2.33 %	2.87 %	4.54 %
	2.71 %	2.60 %	2.50 %	2.61 %	4.58 %

Non-accrual loans, OREO and Accrual TDRs to total assets [(2)]

[(1)] Non-accrual loans included loans 90 days or greater delinquent and $4.3 million and $4.4 million in loans paid current at December 31, 2013 and 2012, respectively. There were six loans with one well-secured commercial relationship that were current with all loan payments with no specific reserves due to the Bank's superior credit position and the value of the underlying collateral. These loans were classified as non-accrual due to insufficient cash flow projections of the borrowers. In accordance with the Bank's policy, interest is recognized on these loans on a cash-basis if the loans are not impaired or there is no impairment. Non-accrual loans included only loans greater than 90 days delinquent at December 31, 2014.

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(2) There were $4.9 million, $329,000, $800,000 and $297,000 of non-accrual TDRs at December 31, 2014, December 31, 2013, December 31, 2011 and December 31, 2010, respectively, which appear as both TDRs and non-accrual loans in the table above. The ratios were adjusted to avoid duplicative counting of such amounts.

Investment Activities

The Bank maintains a portfolio of investment securities to provide liquidity as well as a source of earnings. The Bank's investment securities portfolio consists primarily of mortgage-backed and other securities issued by U.S. government-sponsored enterprises ("GSEs"), including FNMA and FHLMC. The Bank also has smaller holdings of privately issued mortgage-backed securities, U.S. Treasury obligations, and other equity and debt securities. As a member of the Federal Reserve and FHLB system, the Bank is required to maintain investments in the Federal Reserve Bank as a condition of membership and the Federal Home Loan Bank based upon levels of borrowings.

The following table sets forth the carrying value of the Company's investment securities portfolio and FHLB of Atlanta and Federal Reserve Bank stock at the dates indicated. HTM securities and FHLB of Atlanta and Federal Reserve Bank stock are carried at amortized cost and AFS securities are carried at fair value. At December 31, 2014, 2013, and 2012, their estimated fair value was $133.3 million, $139.9 million, and $166.9 million, respectively.

	At December 31,		
(dollars in thousands)	2014	2013	2012
Asset-backed securities:			
Freddie Mac and Fannie Mae	$119,762	$126,607	$150,318
Other	1,472	3,120	4,439
Total asset-backed securities	121,234	129,727	154,757
Corporate equity securities	40	41	37
Bond mutual funds	4,321	4,130	4,281
Treasury bills	850	750	750
Total investment securities	126,445	134,648	159,825
FHLB and Federal Reserve Bank stock	6,434	5,593	5,476
Total investment securities	$132,879	$140,241	$165,301

The maturities and weighted average yields for investment securities available for sale ("AFS") and held to maturity ("HTM") at December 31, 2014 are shown below.

	One Year or Less	After One Through Five Years	After Five Through Ten Years	After Ten Years

(dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
AFS Investment securities:								
Asset-backed securities	$ 8,084	1.81 %	$ 19,708	1.82 %	$ 8,671	1.76 %	$ 1,865	1.69 %
Mutual funds	4,198	2.05 %	-	0.00 %	-	0.00 %	-	0.00 %
Total AFS investment securities	$ 12,282	1.89 %	$ 19,708	1.82 %	$ 8,671	1.76 %	$ 1,865	1.69 %
HTM Investment securities:								
Asset-backed securities	$ 20,647	2.02 %	$ 44,575	2.00 %	$ 14,299	1.88 %	$ 4,135	1.57 %
U.S. government obligations	850	0.00 %	-	0.00 %	-	0.00 %	-	0.00 %
Other investments	-	0.00 %	-	0.00 %	-	0.00 %	-	0.00 %
Total HTM investment securities	$ 21,497	1.94 %	$ 44,575	2.00 %	$ 14,299	1.88 %	$ 4,135	1.57 %

The Bank's investment policy provides that securities that will be held for indefinite periods of time, including securities that will be used as part of the Bank's asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors are classified as available for sale and accounted for at fair value. Management's intent is to hold securities reported at amortized cost to maturity. Certain of the Company's asset-backed securities are issued by private issuers (defined as an issuer that is not a government or a government-sponsored entity). The Company had no investments in any private issuer's securities that aggregate to more than 10% of the Company's equity. For a discussion of investments see *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Asset Quality, Allowance for Loan Losses and Provision for Loan Losses"* and Notes 1 and 5 to the Consolidated Financial Statements.

Deposits and Other Sources of Funds

General

The funds needed by the Bank to make loans are primarily generated by deposit accounts solicited from the communities surrounding its ten branches in the tri-county area and its branches in King George County and the Fredericksburg area of Virginia. Total deposits were $869.4 million as of December 31, 2014. The Bank uses borrowings and other sources to supplement funding from deposits.

Deposits

The Bank's deposit products include savings, money market, demand deposit, IRA, SEP, and time deposit accounts. Variations in service charges, terms and interest rates are used to target specific markets. Ancillary products and services for deposit customers include safe deposit boxes, night depositories, automated clearinghouse transactions, wire transfers, ATMs, online and telephone banking, remote deposit capture, merchant card services, investment services, positive pay, payroll services and lockbox. The Bank is a member of ACCEL, Master Card, Allpoint and Star ATM networks. The Bank uses deposit brokers to obtain funds. At December 31, 2014, 2013 and 2012, the Bank had $41.7 million, $27.0 million, and $19.1 million in deposits from brokers, respectively. In addition, the Bank utilizes the Certificate of Deposit Account Registry Service ("CDARS") and insured cash sweeps ("ICS") to provide existing customers with additional access to FDIC insurance. At December 31, 2014, 2013 and 2012, the Bank maintained CDARS and ICS deposits of $41.6 million, $29.3 million and $27.9 million, respectively.

The following table sets forth for the periods indicated the average balances outstanding and average interest rates for each major category of deposits.

	For the Years Ended December 31,								
	2014			2013			2012		
(dollars in thousands)	Average Balance	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate	
Savings	$40,104	0.10	%	$37,540	0.10	%	$32,577	0.17	%
Interest-bearing demand and money market accounts	281,960	0.27	%	268,832	0.33	%	262,331	0.56	%
Certificates of deposit	389,641	0.97	%	392,675	1.19	%	432,487	1.60	%
Total interest-bearing deposits	711,705	0.64	%	699,047	0.80	%	727,395	1.16	%
Noninterest-bearing demand deposits	100,783			87,649			74,161		
	$812,488	0.56	%	$786,696	0.71	%	$801,556	1.05	%

The following table indicates the amount of the Bank's certificates of deposit and other time deposits of $100,000 or more and $250,000 or more by time remaining until maturity as of December 31, 2014.

Time Deposit Maturity Period	At December 31, 2014 $100,000 or More	$250,000 or More
(dollars in thousands)		
Three months or less	$ 57,152	$ 24,445
Three through six months	35,288	13,087
Six through twelve months	51,151	24,790
Over twelve months	72,637	21,610
Total	$ 216,228	$ 83,932

For a discussion of deposits, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Liabilities"* and Notes 1 and 10 to the Consolidated Financial Statements.

Borrowings

Deposits are the primary source of funds for the Bank's lending and investment activities and for its general business purposes. The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and other commercial banks. Long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. For a discussion of borrowing, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations-Liabilities"* and Notes 1, 11 and 19 to the Consolidated Financial Statements.

Subsidiary Activities

In April 1997, the Bank formed a wholly owned subsidiary, Community Mortgage Corporation of Tri-County, to offer mortgage banking, brokerage, and other services to the public. This corporation is currently inactive. The Company has two direct subsidiaries other than the Bank. In July 2004, Tri-County Capital Trust I was established as a statutory trust under Delaware law as a wholly-owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust I issued $7.0 million of trust preferred securities on July 22, 2004. In June 2005, Tri-County Capital Trust II was also established as a statutory trust under Delaware law as a wholly owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust II issued $5.0 million of trust preferred securities on June 15, 2005. For more information regarding these entities, see Note 19 of the Notes to Consolidated Financial Statements.

Supervision and Regulation

Regulation of the Company

General

As a bank holding company, the Company is subject to comprehensive regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the regulations of the Federal Reserve Board. The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders, and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The following discussion summarizes certain of the regulations applicable to the Company but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Acquisition of Control

A bank holding company, with certain exceptions, must obtain Federal Reserve Board approval before (1) acquiring ownership or control of another bank or bank holding company if it would own or control more than 5% of such shares or (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging with another bank holding company. In evaluating such application, the Federal Reserve Board considers factors such as the financial condition and managerial resources of the companies involved, the convenience and needs of the communities to be served and competitive factors. Federal law provides that no person may acquire “control” of a bank holding company or insured bank without the approval of the appropriate federal regulator. Control is defined to mean direct or indirect ownership, control of 25% or more of any class of voting stock, control of the election of a majority of the bank’s directors or a determination by the Federal Reserve Board that the acquirer has or would have the power to exercise a controlling influence over the management or policies of the institution.

Permissible Activities

A bank holding company is limited in its activities to banking, managing or controlling banks, or providing services for its subsidiaries. Other permitted non-bank activities have been identified as closely related to banking. Bank holding companies that are “well capitalized” and “well managed” and whose financial institution subsidiaries have satisfactory Community Reinvestment Act records can elect to become “financial holding companies,” which are permitted to engage in a broader range of financial activities than are permitted to bank holding companies. The Company has not opted to become a financial holding company.

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The Federal Reserve Board has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

The Maryland Financial Institutions Code prohibits a bank holding company from acquiring more than 5% of any class of voting stock of a bank or bank holding company without the approval of the Commissioner of Financial Regulation. The Maryland Financial Institutions Code additionally prohibits any person from acquiring voting stock in a bank or bank holding company without 60 days prior notice to the Commissioner if such acquisition will give the person control of 25% or more of the voting stock of the bank or bank holding company. The Commissioner may deny approval of the acquisition if the Commissioner determines it to be anti-competitive or to threaten the safety or soundness of a banking institution.

Dividend

The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. Under the prompt corrective action regulations adopted by the Federal Reserve Board, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized." See "Regulation of the Bank – Capital Adequacy."

Sources of Strength

The Dodd-Frank Act codified the source of strength doctrine requiring bank holding companies to serve as a source of strength for their depository subsidiaries, by providing capital, liquidity and other support in times of financial stress. The regulatory agencies are required, under the Act, to issue implementing regulations.

Stock Repurchases

The Company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption.

This requirement does not apply to bank holding companies that are "well capitalized," "well-managed" and are not the subject of any unresolved supervisory issues.

Capital Requirement

Bank holding companies are required to maintain on a consolidated basis, specified minimum ratios of capital to total assets and capital to risk-weighted assets. These requirements, which generally apply to bank holding companies with consolidated assets of $500 million or more, are substantially similar to, but somewhat more generous than, those applicable to the Bank. See "– Regulation of the Bank – Capital Adequacy." The Dodd-Frank Act required the Federal Reserve Board to adopt consolidated capital requirements for holding companies that are equally as stringent as those applicable to the depository institution subsidiaries. That means that certain instruments that had previously been includable in Tier 1 capital for bank holding companies, such as trust preferred securities, will no longer be eligible for inclusion. The revised capital requirements are subject to certain grandfathering and transition rules. The Company is currently considered a grandfathered institution under these rules.

Regulation of the Bank

General

The Bank is a Maryland commercial bank and its deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The Bank is a member of the Federal Reserve and FHLB systems. The Bank is subject to supervision, examination and regulation by Commissioner of Financial Regulation of the State of Maryland (the "Commissioner") and the Federal Reserve Board.

The Dodd-Frank Act established the Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. The Consumer Financial Protection Bureau assumed responsibility for implementing federal consumer financial protection and fair lending laws and regulations, a function currently handled by federal bank regulatory agencies. However, institutions of less than $10 billion, such as the Bank, will continue to be examined for compliance with consumer protection or fair lending laws and regulations by, and be subject to enforcement authority of their potential regulators.

The following discussion summarizes certain regulations applicable to the Bank but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Capital Adequacy

The regulations of the Federal Reserve Board require bank holding companies and state member banks, respectively, to maintain a minimum leverage ratio of "Tier 1 capital" (as defined in the risk-based capital guidelines discussed in the following paragraphs) to total assets of 4.0%. The Federal Reserve Board has broad authority to require a higher level of Tier 1 capital.

The risk-based capital rules of the Federal Reserve Board require bank holding companies and state member banks to maintain minimum regulatory capital levels based upon risk weighted assets. Risk-based capital is composed of two elements: Tier 1 capital and Tier 2 capital. Tier 1 capital consists primarily of common stockholders' equity, certain perpetual preferred stock less intangible assets. Tier 2 capital elements include, subject to limitations, the allowance for losses on loans and leases; perpetual preferred stock that does not qualify as Tier 1 capital and long-term preferred stock with an original maturity of at least 20 years from issuance; hybrid capital instruments, subordinated debt and intermediate-term preferred stock and up to 45% of unrealized gains on available for sale equity securities.

The risk-based capital regulations assign balance sheet assets and off-balance sheet obligations to one of four broad risk categories. The assets and off-balance sheet items in the four risk categories are weighted at 0%, 20%, 50% and 100%. These computations result in the total risk-weighted assets. The risk-based capital regulations require all banks and bank holding companies to maintain a minimum ratio of total capital (Tier 1 capital plus Tier 2 capital) to total risk-weighted assets of 8%, with at least 4% as Tier 1 capital. In calculating these ratios: (1) Tier 2 capital is limited to no more than 100% of Tier 1 capital; and (2) the aggregate amount of certain types of Tier 2 capital is limited. In addition, the risk-based capital regulations limit the allowance for loan losses includable as capital to 1.25% of total risk-weighted assets. The Federal Reserve Board also has authority to establish individual minimum capital requirements for an institution.

Basel III

On July 9, 2013, the federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision (“Basel III”) and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more and top-tier savings and loan holding companies.

The rule established a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increased the minimum Tier 1 capital to risk-based assets requirement (from 4.0% to 6.0% of risk-weighted assets) and assigned a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property.

The rule also includes changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes include the phasing-out of certain instruments as qualifying capital. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock will be required to be deducted from capital, subject to a two-year transition period. Finally, Tier 1 capital will include accumulated other comprehensive income (which includes all unrealized gains and losses on available for sale debt and equity securities), subject to a two-year transition period.

The new capital requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and non-residential mortgage loans that are 90 days past due or otherwise on nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital; and increased risk-weights (from 0% to up to 600%) for equity exposures.

Finally, the rule limits capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements.

The final rule became effective on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019.

It is management’s belief that, as of December 31, 2014, the Company and the Bank have met all capital adequacy requirements under Basel III on a fully phased-in basis if such requirements were currently effective.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take “prompt corrective action” with respect to institutions that do not meet minimum capital requirements. For such purposes, the law establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

The Federal Reserve Board has adopted regulations to implement prompt corrective action. Among other things, the regulations define the relevant capital measures for the five capital categories. For the period ended December 31, 2014, an institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater, and a leverage capital ratio of 5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. An institution is deemed to be “adequately capitalized” if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater, and generally a leverage capital ratio of 4% or greater. An institution is deemed to be “undercapitalized” if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 4%, or generally a leverage capital ratio of less than 4%. An institution is deemed to be “significantly undercapitalized” if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 3%, or a leverage capital ratio of less than 3%. An institution is deemed to be “critically undercapitalized” if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%.

As a result of Basel III (discussed further above), effective January 1, 2015, an institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a common equity Tier 1 risk-based capital ratio of 6.5% or greater, and a leverage capital ratio of 5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. An institution is deemed to be “adequately capitalized” if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, a common equity Tier 1 risk-based capital ratio of 4.5% or greater and generally a leverage capital ratio of 4% or greater. An institution is deemed to be “undercapitalized” if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a common equity Tier 1 risk-based capital ratio of less than 4.5% or generally a leverage capital ratio of less than 4%. An institution is deemed to be “significantly undercapitalized” if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a common equity Tier 1 risk-based capital ratio of less than 3% or a leverage capital ratio of less than 3%. An institution is deemed to be “critically undercapitalized” if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%.

“Undercapitalized” institutions are subject to growth, capital distribution (including dividend), and other limitations, and are required to submit a capital restoration plan. An institution’s compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the bank’s total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an undercapitalized institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.” Significantly undercapitalized institutions are subject to one or more additional restrictions including, but not limited to, a regulatory order requiring them to sell sufficient voting stock to become adequately capitalized; requirements to reduce total assets, cease receipt of deposits from correspondent banks, or dismiss directors or officers; and restrictions on interest rates paid on deposits, compensation of executive officers, and capital distributions by the parent holding company.

Beginning 60 days after becoming “critically undercapitalized,” critically undercapitalized institutions also may not make any payment of principal or interest on certain subordinated debt, extend credit for a highly leveraged transaction, or enter into any material transaction outside the ordinary course of business. In addition, subject to a narrow exception, the appointment of a receiver is required for a critically undercapitalized institution within 270 days after it obtains such status.

As of December 31, 2014, the Bank was well capitalized as defined by the Federal Reserve Board’s regulations.

Branching

Maryland law provides that, with the approval of the Commissioner, Maryland banks may establish branches within Maryland and may establish branches in other states by any means permitted by the laws of such state or by federal law. The Federal Reserve Board may approve interstate branching by merger by state member banks in any state that did not opt out and *de novo* in states that specifically allow for such branching.

Dividend Limitations

Maryland banks may only pay dividends from undivided profits or, with the prior approval of the Commissioner, their surplus in excess of 100% of required capital stock. Maryland banks are further prohibited from declaring a dividend on its shares of common stock until its surplus fund equals the amount of required capital stock or, if the surplus fund does not equal the amount of capital stock, in an amount in excess of 90% of net earnings.

Without the approval of the Federal Reserve Board, a state member bank may not declare or pay a dividend if the total of all dividends declared during the year exceeds its net income during the current calendar year and retained net income for the prior two years. The Bank is further prohibited from making a capital distribution if it would be undercapitalized after payment of the dividend within the meaning of the prompt corrective action regulations discussed above.

Insurance of Deposit Accounts

Under the Federal Deposit Insurance Corporation’s risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution’s assessment rate depends upon the category to which it is assigned. The initial base assessment rate ranges from five to 35 basis points. The rate schedules will automatically adjust in the future when the Deposit Insurance Fund reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

In February 2011, the Federal Deposit Insurance Corporation adopted new rules that amend its current deposit insurance assessment regulations. The new rules implement a provision in the Dodd-Frank Act that changed the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity.

The Federal Deposit Insurance Corporation imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital, as of June 30, 2009 (capped at ten basis points of an institution's deposit assessment base), to cover losses to the Deposit Insurance Fund. That special assessment was collected on September 30, 2009. The Federal Deposit Insurance Corporation provided for similar assessments during the final two quarters of 2009, if deemed necessary. However, in lieu of further special assessments, the Federal Deposit Insurance Corporation required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which include an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 31, 2009. As of December 31, 2009, and each quarter thereafter, a charge to earnings was recorded for each regular assessment with an offsetting credit to the prepaid asset.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The Federal Deposit Insurance Corporation must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the Federal Deposit Insurance Corporation.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation or its prudential banking regulator. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Reserve Requirements

Under Federal Reserve Board regulations, the Bank is required to maintain non-interest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows for 2014: a 3% reserve ratio was assessed on net transaction accounts up to and including $89.0 million; a 10% reserve ratio is applied above $89.0 million. The first $13.3 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually and, for 2015, will require a 3% ratio for up to $103.6 million and an exemption of $14.5 million. At December 31, 2014, the Bank met applicable Federal Reserve Board reserve requirements.

Transactions with Affiliate

A state member bank is limited in the amount of “covered transactions” with any affiliate. All such transactions must also be on terms substantially the same, or at least as favorable, to the Bank or subsidiary as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions. Certain covered transactions, such as loans to affiliates, must meet collateral requirements. At December 31, 2014, we had no transactions with affiliates.

Loans to directors, executive officers and principal stockholders of a state member bank must be made on substantially the same terms as those prevailing for comparable transactions with persons who are not executive officers, directors, principal stockholders or employees of the bank. Loans to any executive officer, director and principal stockholder together with all other outstanding loans to such person and affiliated interests generally may not exceed 15% of the Bank’s unimpaired capital and surplus and all loans to such persons may not exceed the institution’s unimpaired capital and unimpaired surplus. Loans to directors, executive officers and principal stockholders, and their respective affiliates, in excess of the greater of $25,000 or 5% of capital and surplus, or any loans cumulatively aggregating $500,000 or more, must be approved in advance by a majority of the board of directors of the bank with any “interested” director not participating in the voting. State member banks are prohibited from paying the overdrafts of any of their executive officers or directors unless payment is made pursuant to a written, pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or transfer of funds from another account at the bank. In addition, loans to executive officers may not be made on terms more favorable than those afforded other borrowers and are restricted as to type, amount and terms of credit.

Enforcement

The Commissioner has extensive enforcement authority over Maryland banks. Such authority includes the ability to issue cease and desist orders and civil money penalties and to remove directors or officers. The Commissioner may also take possession of a Maryland bank whose capital is impaired and seek to have a receiver appointed by a court.

The Federal Reserve Board has primary federal enforcement responsibility over state banks under its jurisdiction, including the authority to bring enforcement action against all “institution-related parties,” including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an institution. Formal enforcement action may range from the issuance of capital directive or a cease and desist order for the removal of officers and/or directors, receivership, conservatorship or termination of deposit insurance. Civil money penalties cover a wide range of violations and actions, and range up to $25,000 per day or even up to $1 million per day (in the most egregious cases). Criminal penalties for most financial institution crimes include fines of up to $1 million and imprisonment for up to 30 years.

Other Regulations

The Bank’s operations are also subject to federal laws applicable to credit transactions, including the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; and

- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of the Bank also are subject to laws such as the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check.

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Management

Chief Officers

Our executive officers are elected by the Board of Directors and serve at the Board's discretion. Executive officers of the Bank also serve as executive officers of the Company. The executive officers of the Company are as follows:

Michael L. Middleton, 67, is Executive Chairman of the Company and the Bank. Mr. Middleton joined the Bank in 1973 and served in various management positions until 1979 when he became President of the Bank, which he served as until 2010. He remained President of the Company until May 2012. Mr. Middleton has over 40 years of banking experience. Before joining the Bank, Mr. Middleton was employed by KMPG-Peat Marwick. Mr. Middleton is a member of the Maryland Association of Certified Public Accountants and holds a Masters of Business Administration from the University of Maryland. He also attended the Harvard Business School Program on Negotiation. From 1996 to 2004, Mr. Middleton served on the Board of Directors of the FHLB of Atlanta, serving as Chairman of the Board in 2004. Mr. Middleton served on the Board of Directors of the Federal Reserve Bank, Baltimore Branch, from 2004 to 2009. He completed his term as Chairman of the Maryland Bankers Association in June 2013 and is currently the Chairman of the Board for the College of Southern Maryland, serves on the Advisory Board of the Robert H. Smith School of Business Center for Financial Policy and serves on the Federal Reserve's Community Depository Advisory Council. He also serves on several philanthropic and civic boards.

William J. Pasenelli, 56, is a Director and President and Chief Executive of the Company and Bank. Mr. Pasenelli joined the Bank as Chief Financial Officer in 2000 and was named President of the Bank in 2010 and President of the Company in May 2012. He relinquished the position of Chief Financial Officer of the Bank in March 2013. Before joining the Bank, Mr. Pasenelli had been Chief Financial Officer of Acacia Federal Savings Bank, Annandale, Virginia, since 1987. Mr. Pasenelli has over 20 years of banking experience. Mr. Pasenelli is a member of the American Institute of Certified Public Accountants, the Greater Washington Society of Certified Public Accountants and other civic groups. Mr. Pasenelli is a graduate of the National School of Banking and holds a Bachelor of Arts from Duke University. He also attended the Harvard Business School Program on Negotiation.

Gregory C. Cockerham, 60, joined the Bank in 1988. He serves as the Bank's Executive Vice President—Chief Lending Officer of the Company and the Bank. Before joining the Bank, he was Vice President of Maryland National Bank. Mr. Cockerham has over 35 years of banking experience. Mr. Cockerham serves as former Chairman of the College of Southern Maryland Foundation and is the current Chairman of the Maryland Title Center. He is a Paul Harris Fellow and Foundation Chair with the Rotary Club of Charles County and serves on various civic boards. Mr. Cockerham is a Maryland Bankers School graduate and holds a Bachelors of Science from West Virginia University. He also attended the Harvard Business School Program on Negotiation.

James M. Burke, 47, joined the Bank in 2006. He serves as the Bank's Executive Vice President—Chief Risk Officer of the Company and the Bank. Before his appointment as Executive Vice President in 2007, he served as the Bank's Senior Credit Officer. Before joining the Bank, Mr. Burke served as Executive Vice President and Senior Loan

Officer of Mercantile Southern Maryland Bank. Mr. Burke has over 20 years of banking experience. Mr. Burke is the former Chairman of the Board of Directors of University of Maryland Charles Regional Medical Center and is active in other civic groups. Mr. Burke is a Maryland Bankers School graduate and holds a Bachelor of Arts from High Point College. He is also a graduate of the East Carolina Advanced School of Commercial Lending and attended the Harvard Business School Program on Negotiation.

James F. DiMisa, 55, joined the Bank in 2006. He serves as Executive Vice President—Chief Operating Officer of the Company and the Bank. Before joining the Bank, Mr. DiMisa served as Executive Vice President of Mercantile Southern Maryland Bank. Mr. DiMisa has over 30 years of banking experience. Mr. DiMisa is Chairman of the Board of Trustees for the Maryland Bankers School and a member of several other civic and professional groups. Mr. DiMisa is a Stonier Graduate School of Banking graduate and holds a Masters of Business Administration from Mount St. Mary's College and a Bachelors of Science from George Mason University. He also attended the Harvard Business School Program on Negotiation.

Todd L. Capitani, 48, joined the Bank in 2009. He serves as Executive Vice President—Chief Financial Officer of the Company and the Bank. Before joining the Bank, Mr. Capitani served as a Senior Finance Manager at Deloitte Consulting and as Chief Financial Officer at Ruesch International, Inc. Mr. Capitani has over 25 years of experience in corporate finance, controllership and external audit. Mr. Capitani is a member of the American Institute of Certified Public Accountants and other civic groups. Mr. Capitani is a Certified Public Accountant and holds a Bachelors of Arts from the University of California at Santa Barbara. He also attended the Harvard Business School Program on Negotiation and the Yale School of Management Strategic Leadership Conference.

Christy M Lombardi**, 38**, joined the Bank in 1998. She serves as Executive Vice President—Chief Administrative Officer of the Company and the Bank. Ms. Lombardi is responsible for administrative and corporate governance matters for the Company, and oversees human resources and shareholder relations. Ms. Lombardi has 20 years of banking experience. She serves as Vice Chair for the Calvert County Chamber of Commerce Board of Directors and serves on the Advisory Board of the Maryland Banker's Association Council of Professional Women in Banking and Finance. She is a Maryland Bankers School graduate and holds a Masters in Management from University of Maryland University College. Ms. Lombardi also attended the Harvard Business School Program on Negotiation.

Item 1A. Risk Factors

Risks

An investment in shares of our common stock involves various risks. Our business, financial condition and results of operations could be harmed by any of the following risks or by other risks that have not been identified or that we may believe are immaterial or unlikely. The value or market price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Our increased emphasis on commercial lending may expose us to increased lending risks.

At December 31, 2014, our loan portfolio consisted of $561.1 million, or 64.3%, of commercial real estate loans, $73.6 million, or 8.4%, of commercial business loans and $26.2 million, or 3.0%, of commercial equipment loans. We intend to maintain our emphasis on these types of loans. These types of loans generally expose a lender to greater risk of non-payment and loss and require a commensurately higher loan loss allowance than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances compared to one- to four-family residential mortgage loans. Commercial business and equipment loans expose us to additional risks since they typically are made on the basis of the borrower’s ability to make repayments from the cash flows of the borrower’s business and are secured by non-real estate collateral that may depreciate over time. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. At December 31, 2014, $5.7 million, or 55.5%, of our non-accrual loans of $10.3 million consisted of commercial loans.

Our provision for loan losses has been elevated during the last five years and we may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future. Further, our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

For the years ended December 31, 2014 and 2013, we recorded a provision for loan losses of $2.7 million and $940,000, respectively. We also recorded net loan charge-offs of $2.3 million and $1.0 million for the years ended December 31, 2014 and 2013, respectively. Our non-accrual loans, OREO and accruing TDRs aggregated $29.4 million, or 2.71% of total assets, at December 31, 2014. Additionally, loans that were classified as either special mention and substandard were $52.2 million at December 31, 2014. We had no loans classified as doubtful or loss at December 31, 2014. If the economy and/or the real estate market weakens, more of our classified loans may become non-performing and we may be required to take additional provisions to increase our allowance for loan losses for these assets as the value of the collateral may be insufficient to pay any remaining net loan balance, which could have a negative effect on our results of operations. We maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. We believe that our allowance for loan losses is maintained at a level adequate to absorb probable losses inherent in our loan portfolio as of the corresponding balance sheet date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results.

In evaluating the adequacy of our allowance for loan losses, we consider numerous quantitative factors, including our historical charge-off experience, growth of our loan portfolio, changes in the composition of our loan portfolio and the volume of delinquent, non-accrual and classified loans, TDRs and foreclosed real estate. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Finally, we also consider many qualitative factors, including general and economic business conditions, anticipated duration of the current business cycle, current general market collateral valuations, trends apparent in any of the factors we take into account and other matters, which are, by nature, more subjective and fluid. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses may vary from our current estimates.

Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs. Any such additional provisions for loan losses or charge-offs, as required by our regulators, could have a material adverse effect on our financial condition and results of operations.

If we do not effectively manage our credit risk, we may experience increased levels of non-performing loans, charge-offs and delinquencies, which would require additional increases in our provision for loan losses.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of non-payment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. Our credit risk approval and monitoring procedures may not reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, fails to improve, or even if it does improve, our borrowers may experience difficulties in repaying their loans, and the level of non-performing loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses, which would cause our net income and return on equity to decrease.

Non-performing and classified assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

At December 31, 2014, our non-accrual loans totaled $10.3 million, or 1.18% of our loan portfolio, and our non-accrual loans, OREO and accruing TDRs totaled $29.4 million, or 2.71% of total assets. Our non-performing assets adversely affect our net income in various ways. We do not accrue interest income on non-accrual loans or foreclosed properties, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then fair market value, less estimated selling costs, which may result in a loss. These non-performing loans and foreclosed properties also increase our risk profile and the amount of capital our regulators believe is appropriate to maintain in light of such risks. The resolution of non-performing assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in non-performing loans and non-performing assets, our net interest income will be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

At December 31, 2014 our total classified assets were $54.0 million. While we continue to accrue interest income on classified assets that are performing, these assets may negatively impact profitability by requiring additional management attention and regular monitoring. Increased monitoring of these assets by management may impact our management's ability to focus on opportunistic growth, potentially adversely impacting future profitability.

Our residential mortgage loans and home equity loans expose us to a risk of loss due to declining real estate values.

At December 31, 2014, $152.8 million, or 17.5%, of our total loan portfolio consisted of one- to four-family residential mortgage loans, and $21.5 million, or 2.5%, of our total loan portfolio consisted of home equity loans and lines of credit. Declines in the housing market could result in declines in real estate values in our market area. A decline in real estate values could cause some of our mortgage and home equity loans to be inadequately collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

Negative developments in the financial industry, the domestic and international credit markets, and the economy in general pose significant challenges for our industry and us and could adversely affect our business, financial condition and results of operations.

Negative developments that began in the latter half of 2007 and that have continued since then in the global credit and securitization markets have resulted in unprecedented volatility and disruption in the financial markets, a general economic downturn and a tepid economic recovery, both nationally and in our primary markets. As a result, commercial as well as consumer loan portfolio performances deteriorated at many institutions and have not fully recovered, and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. As a result, we may face the following risks:

• Economic conditions that negatively affect housing prices and the job market may cause the credit quality of our loan portfolios to deteriorate;

• Market developments that affect consumer confidence may cause adverse changes in payment patterns by our customers, causing increases in delinquencies and default rates on loans and other credit facilities;

• The processes that we use to estimate our allowance for loan losses and reserves may no longer be reliable because they rely on judgments, such as forecasts of economic conditions, that may no longer be capable of accurate estimation;

• The value of our securities portfolio may decline; and

• We face increased regulation of our industry, and the costs of compliance with such regulation may increase.

These conditions or similar ones may continue to persist or worsen, causing us to experience continuing or increased adverse effects on our business, financial condition, results of operations and the price of our common stock.

Changes in interest rates could reduce our net interest income and earnings.

Our largest component of earnings is net interest income, which could be negatively affected by changes in interest rates. Changing interest rates impact customer actions and may limit the options available to the Company to maximize earnings or increase the costs to minimize risk. We do not have control over market interest rates and the Company's focus to mitigate potential earnings risk centers on controlling the composition of our assets and liabilities.

Our net interest income is the interest we earn on loans and investments less the interest we pay on our deposits and borrowings. Our net interest margin is net interest income divided by average interest-earning assets. Changes in interest rates could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to increase or decrease. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches up. Changes in the slope of the "yield curve"—or the spread between short-term and long-term interest rates—could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets. Our procedures for managing exposure to falling net interest income involve modeling possible scenarios of interest rate increases and decreases to interest-earning assets and interest-bearing liabilities.

Changes in interest rates also can affect: (1) our ability to originate loans; (2) the value of our interest-earning assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay their loans, particularly adjustable or variable rate loans.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Our financial condition and results of operations could be negatively affected if we fail to effectively execute our strategic plan or manage the growth called for in our strategic plan.

Among other things, our strategic plan currently calls for reducing the amount of our non-performing assets, growing assets through commercial lending and generating transaction deposit accounts to reduce our funding costs and improve our net interest margin. Our ability to increase profitability in accordance with this plan will depend on a variety of factors including the identification of desirable business opportunities, competitive responses from financial institutions in our market area and our ability to manage liquidity and funding sources. While we believe we have the management resources and internal systems in place to successfully manage our strategic plan, opportunities may not be available and that the strategic plan may not be successful or effectively managed.

Although we do not have any current definitive plans to do so, other than what we have already disclosed regarding a planned new branch in Fredericksburg in 2015, in implementing our strategic plan we may expand into additional communities or attempt to strengthen our position in our current markets through opportunistic acquisitions of whole banks or branch locations. To the extent that we undertake acquisitions, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Other effects of engaging in such growth strategies may include potential diversion of our management’s time and attention and general disruption to our business. We may be able to adequately and profitably manage anticipated growth.

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be adversely affected.

Our asset valuation may include methodologies, estimations and assumptions that are subject to differing interpretations and could result in changes to asset valuations that may materially adversely affect our results of operations or financial condition.

We must use estimates, assumptions, and judgments when financial assets and liabilities are measured and reported at fair value. Assets and liabilities carried at fair value inherently result in a higher degree of financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices and/or other observable inputs provided by independent third-party sources, when available. When such third-party information is not available, we estimate fair value primarily by using cash flows and other financial modeling techniques utilizing assumptions such as credit quality, liquidity, interest rates and other relevant inputs. Changes in underlying factors, assumptions, or estimates in any of these areas could materially impact our future financial condition and results of operations.

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain of our assets if trading becomes less frequent and market data becomes less observable. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment. In such cases, certain asset valuations may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation.

Strong competition within our market area could hurt our profits and slow growth.

We face intense competition both in making loans and attracting deposits. Our competition for loans and deposits includes banks, savings institutions, mortgage banking companies, credit unions and non-banking financial institutions. We compete with regional and national financial institutions that have a substantial presence in our market area, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than us. Furthermore, tax-exempt credit unions operate in our market area and aggressively price their products and services to a large portion of the market. This competition may make it more difficult for us to originate new loans and may force us to offer higher deposit rates than we currently offer. Price competition for loans and deposits might result in lower interest rates earned on our loans and higher interest rates paid on our deposits, which would reduce net interest income. Our profitability depends upon our continued ability to compete successfully in our market area.

Regulatory changes allowing the payment of interest on commercial accounts may negatively impact our deposit strategy and our net interest income.

Our current deposit strategy includes continuing to increase our noninterest-bearing commercial accounts to lower our cost of funds. Recent changes effected by the Dodd-Frank Act, however, permit the payment of interest on such accounts, which was previously prohibited. If our competitors begin paying interest on commercial deposit accounts, this may increase competition from other financial institutions for these deposits and negatively affect our ability to continue to increase commercial deposit accounts, may require us to consider paying interest on such accounts, or may otherwise require us to revise our deposit strategy, any of which could increase our interest expense and therefore our cost of funds and, as a result, decrease our net interest income, which would adversely impact our results of operations.

If the value of real estate in our market area were to decline, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

Declines in local economic conditions could adversely affect the value of the real estate collateral securing our loans. A decline in property values would diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

We may be adversely affected by economic conditions in our market area, which is significantly dependent on federal government and military employment, as well as national and international economic conditions.

Our marketplace is primarily in the counties of Charles, Calvert and St. Mary’s, Maryland and neighboring communities, and, to a lesser extent, the Northern Neck region and Fredericksburg area of Virginia. Many, if not most, of our customers live and/or work in those counties or in the greater Washington, DC metropolitan area. Because our services are concentrated in this market, we are affected by the general economic conditions in the greater Washington, DC area. Changes in the economy may influence the growth rate of our loans and deposits, the quality of the loan portfolio and loan and deposit pricing. A significant decline in economic conditions caused by inflation, recession, unemployment or other factors beyond our control could decrease the demand for banking products and services generally and/or impair the ability of existing borrowers to repay their loans, which could negatively affect our financial condition and performance.

A significant portion of the population in our market area is affiliated with or employed by the federal government or at military facilities located in the area. As a result, a downturn in federal government or military employment could have a negative impact on local economic conditions and real estate collateral values, and could also negatively affect the Company’s profitability. The impact on the economy has been moderated by the presence of federal government agencies and defense facilities. However, the possibility of large cuts to the defense budget hampered economic expansion in 2012 and 2013 and the effect of the sequestration negatively impacted employment.

We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.

The Company and the Bank are subject to extensive regulation, supervision and examination as noted in the "*Supervision and Regulation"* section of this report. The regulation and supervision by the Maryland Commissioner, the Federal Reserve and the FDIC are not intended to protect the interests of investors in The Community Financial Corporation common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Regulation of the financial services industry is undergoing major changes and future legislation could increase our cost of doing business or harm our competitive position.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was passed, which imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on our business are:

• Changes to regulatory capital requirements;

• Creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the Consumer Financial Protection Bureau, which develops and enforces rules for bank and non-bank providers of consumer financial products);

• Potential limitations on federal preemption;

• Changes to deposit insurance assessments;

• Regulation of debit interchange fees we earn;

• Changes in retail banking regulations, including potential limitations on certain fees we may charge; and

• Changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies to be implemented, some but not all of which have been proposed or finalized by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until after implementation. Certain 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 investors in our common stock.

In addition to the enactment of the Dodd-Frank Act, the federal regulatory agencies have taken stronger supervisory actions against financial institutions that have experienced increased loan losses and other weaknesses as a result of the recent economic crisis. The actions include entering into written agreements and cease and desist orders that place certain limitations on operations. Federal bank regulators have also been using with more frequency their ability to impose individual minimum capital requirements on banks, which requirements may be higher than those required under the Dodd-Frank Act or that would otherwise qualify a bank as being “well capitalized” under applicable prompt corrective action regulations. If we were to become subject to a regulatory agreement or higher individual minimum capital requirements, such action may have a negative impact on our ability to execute our business plan, as well as our ability to grow, pay dividends or engage in mergers and acquisitions and may result in restrictions in our operations.

The Capital rules that were issued require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

In July 2013, the Federal Reserve adopted a final rule for the Basel III capital framework. These rules substantially amend the regulatory risk-based capital rules applicable to us. The rules phase in over time beginning in 2015 and will become fully effective in 2019. The rules apply to the Company as well as to the Bank. Beginning in 2015, our minimum capital requirements will be (i) a common Tier 1 equity ratio of 4.5%, (ii) a Tier 1 capital (common Tier 1 capital plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement will remain at the 4% level now required. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the common Tier 1, Tier 1 and total capital requirements, resulting in a required common Tier 1 equity ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

We are periodically subject to examination and scrutiny by a number of banking agencies and, depending upon the findings and determinations of these agencies, we may be required to make adjustments to our business that could adversely affect us.

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

The Company is a bank holding company and its sources of funds necessary to meet its obligations are limited.

The Company is a bank holding company, and its operations are primarily conducted by the Bank, which is subject to significant federal and state regulation. Cash available to pay dividends to our common and preferred stockholders, pay our obligations and meet our debt service requirements is derived primarily from our existing cash flow sources, dividends received from the Bank, or a combination thereof. Future dividend payments by the Bank to us will require generation of future earnings by the Bank and are subject to certain regulatory guidelines. If the Bank is unable to pay dividends to us, we may not have the resources or cash flow to pay or meet all of our obligations.

The Bank became subject to increased internal control reporting under FDIC regulations in 2014. If it cannot favorably assess the effectiveness of its internal controls over financial reporting or if its independent registered public accounting firm is unable to provide an unqualified attestation report on the Bank's internal controls, we may be subject to additional regulatory scrutiny.

The Bank's total assets exceeded $1.0 billion at December 31, 2014 and it became subject to further reporting requirements under the rules of the FDIC for fiscal year 2014. Pursuant to these rules, management was required to prepare a report that contained an assessment by management of the Bank's effectiveness of internal control structure and procedures for financial reporting as of the end of such fiscal year. The Bank was also required to obtain an independent public accountant's attestation report concerning its internal control structure over financial reporting. The rules that must be met for management to assess the Bank's internal controls over financial reporting are complex, and require significant documentation, testing and possible remediation. The effort to comply with regulatory requirements relating to internal controls will likely cause us to incur increased expenses. We also may encounter problems or delays in completing the implementation of any changes necessary to make a favorable assessment of the Bank's internal controls over financial reporting. In addition, in connection with the attestation process, the Bank may encounter problems or delays in completing the implementation of any requested improvements or receiving a favorable attestation from its independent registered public accounting firm. If the Bank cannot favorably assess the effectiveness of its internal controls over financial reporting, or if its independent registered public accounting firm is unable to provide an unqualified attestation report on the Bank's internal controls, investor confidence and the price of our common stock could be adversely affected and we may be subject to additional regulatory scrutiny.

Provisions of our articles of incorporation, bylaws and Maryland law, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Provisions in our articles of incorporation and bylaws and Maryland corporate law could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to our board of directors and for proposing matters that shareholders may act on at shareholder meetings. In addition, we are subject to Maryland laws, including one that prohibits us from engaging in a business combination with any interested shareholder for a period of five years from the date the person became an interested shareholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors other than the candidates nominated by our Board.

We rely on other companies to provide key components of our business infrastructure.

Third party vendors provide key components of our business infrastructure such as core data processing systems, internet connections, network access and fund distribution. While we have selected these third party vendors carefully, we cannot control their actions. Any problems caused by these third parties, including those which result from their failure to provide services for any reason or their poor performance of services, could adversely affect our ability to deliver products and services to its customers and otherwise to conduct its business. Replacing these third party vendors could also entail significant delay and expense.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have a material adverse effect on us.

Our business is dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

In addition, we provide our customers with the ability to bank remotely, including over the Internet and the telephone. The secure transmission of confidential information over the Internet and other remote channels is a critical element of remote banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could materially and adversely affect us.

Additionally, financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

The laws that regulate our operations are designed for the protection of depositors and the public, not our shareholders.

The federal and state laws and regulations applicable to our operations give regulatory authorities extensive discretion in connection with their supervisory and enforcement responsibilities, and generally have been promulgated to protect depositors and the Deposit Insurance Fund and not for the purpose of protecting shareholders. These laws and regulations can materially affect our future business. Laws and regulations now affecting us may be changed at any time, and the interpretation of such laws and regulations by bank regulatory authorities is also subject to change. We can give no assurance that future changes in laws and regulations or changes in their interpretation will not adversely affect our business. Legislative and regulatory changes may increase our cost of doing business or otherwise adversely affect us and create competitive advantages for non-bank competitors.

We are subject to a variety of operational risks, environmental, legal and compliance risks, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers and can expose us to litigation and regulatory action. Actual or alleged conduct by the Bank can also result in negative public opinion about our other businesses.

If personal, non-public, confidential or proprietary information of customers in our possession were to be misappropriated, mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, erroneously providing such information to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or the interception or inappropriate acquisition of such information by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in our diminished ability to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition or results of operations, perhaps materially.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including our proprietary business information and that of our customers, suppliers and business partners; and personally identifiable information of our customers and employees. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. We, our customers, and other financial institutions with which we interact, are subject to ongoing, continuous attempts to penetrate key systems by individual hackers, organized criminals, and in some cases, state-sponsored organizations. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such unauthorized access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties; disrupt our operations and the services we provide to customers; damage our reputation; and cause a loss of confidence in our products and services, all of which could adversely affect our business, revenues and competitive position. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses.

To remain competitive, we must keep pace with technological change.

Financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

The amount of interest payable on our 6.25% Fixed to Floating Rate Subordinated Notes due 2025 will vary after February 15, 2020.

The interest rate on our 6.25% Fixed to Floating Rate Subordinated Notes due 2025 will vary after February 15, 2020. From and including the issue date of such notes but excluding February 15, 2020, the notes will bear interest at a fixed rate of 6.25% per year. From and including February 15, 2020, to but excluding the maturity date, the notes will bear interest at an annual floating rate equal to the three-month LIBOR plus 479 basis points for any interest period. If interest rates rise, the cost of our subordinated notes may increase thereby negatively affecting our net income.

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Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Bank maintains its main office and operations center in Waldorf, Maryland, in addition to its branch offices in Lexington Park, Leonardtown, La Plata, Dunkirk, Bryans Road, Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland and Fredericksburg and King George, Virginia. The Bank owns all of its branches except for the Dunkirk, Maryland branch, the Fredericksburg, Virginia branch and the land on which the Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland branches are located. In addition, the Bank maintains five loan production offices ("LPOs") in La Plata, Prince Frederick, Leonardtown and Annapolis, Maryland; and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches. Lease expiration dates range from 2017 to 2028 with renewal options of 5 to 10 years. The total net book value of the properties at December 31, 2014 was $17.8 million which included $12.2 million related to buildings and improvements.

Item 3. Legal Proceedings

Neither the Company, the Bank, nor any subsidiary is engaged in any legal proceedings of a material nature at the present time. From time to time, the Bank is a party to legal proceedings in the ordinary course of business.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5 - Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Price and Dividends on Registrant's and Related Stockholder Matters.

Market Information

The following table sets forth high and low bid quotations reported for the Company's common stock for each quarter during 2014 and 2013 and the dividends declared per share for common stock. These quotes reflect inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

Quarter Ended	High	Low	Dividends Per Share
December 31, 2014	$21.50	$19.56	$ 0.10
September 30, 2014	23.75	20.21	0.10
June 30, 2014	23.96	20.55	0.10
March 31, 2014	24.80	19.38	0.10
December 31, 2013	22.18	18.95	0.10
September 30, 2013	19.20	18.20	0.10
June 30, 2013	18.68	16.71	0.10
March 31, 2013	18.75	15.98	0.10

Holders

The common stock of the Company is traded on the NASDAQ Stock Exchange (Symbol: TCFC). The number of stockholders of record of the Company at February 27, 2015 was 527.

Dividends

The Company paid annual cash dividends on common stock between 1994 and 2012. For fiscal year 2012, the Company paid an annual cash dividend of $0.40 per share. During 2013, the Board of Directors announced its intent to move to a quarterly dividend. During 2013 and 2014, the Company declared and paid four quarters of dividends at $0.10 per share. The Board of Directors considers on a quarterly basis the feasibility of paying a cash dividend to its stockholders. Under the Company's general practice, dividends, if declared during the quarter, are paid prior to the end of the subsequent quarter.

The Company’s ability to pay dividends is governed by the policies and regulations of the Federal Reserve Board (the “FRB”), which prohibits the payment of dividends under certain circumstances dependent on the Company’s financial condition and capital adequacy. The Company’s ability to pay dividends is also dependent on the receipt of dividends from the Bank.

Federal regulations impose certain limitations on the payment of dividends and other capital distributions by the Bank. The Bank’s ability to pay dividends is governed by the Maryland Financial Institutions Code and the regulations of the FRB. Under the Maryland Financial Institutions Code, a Maryland bank (1) may only pay dividends from undivided profits or, with prior regulatory approval, its surplus in excess of 100% of required capital stock and, (2) may not declare dividends on its common stock until its surplus funds equals the amount of required capital stock, or if the surplus fund does not equal the amount of capital stock, in an amount in excess of 90% of net earnings.

Without the approval of the FRB, a state member bank may not declare or pay a dividend if the total of all dividends declared during the year exceeds its net income during the current calendar year and retained net income for the prior two years. The Bank is further prohibited from making a capital distribution if it would not be adequately capitalized thereafter. In addition, the Bank may not make a capital distribution that would reduce its net worth below the amount required to maintain the liquidation account established for the benefit of its depositors at the time of its conversion to stock form.

On September 22, 2011, the U.S. Department of Treasury purchased $20.0 million of the Company's Series C Preferred Stock under the Small Business Lending Fund. For the year ended December 31, 2014, the Company's dividend rate on the SBLF funds was 1%. See Notes 20 and 23 to the Consolidated Financial Statements. During 2013, the Company had increased its Qualified Small Business Lending ("QSBL") so that the dividend rate would remain at 1% through four and one half years from issuance. After four and one half years from issuance, the dividend rate would have increased to 9%. On February 13, 2015, the Company's federal banking regulator approved the repayment of SBLF by the Company. The Company used proceeds from a $23 million dollar subordinated debt offering closed on February 6, 2015 to redeem all $20 million of the Company's outstanding preferred stock issued under the SBLF program.

Stock Performance Graph

Not required as the Company is filing as a smaller reporting company.

Recent Sales of Unregistered Securities

Not applicable.

Purchases of Equity Securities by the Issuer

On September 25, 2008, the Company announced a repurchase program under which it would repurchase up to 5% of its outstanding common stock or approximately 147,435 shares. The program will continue until it is completed or terminated by the Company's Board of Directors. As of December 31, 2014, 66,046 shares were available to be repurchased under the repurchase program. There were no repurchases during the three months ended December 31, 2014.

Item 6 - Selected Financial Data

SUMMARY OF SELECTED FINANCIAL DATA

The following table shows selected historical consolidated financial data for the Company as of and for each of the five years ended December 31, 2014, which has been derived from our audited consolidated financial statements. You should read this table together with our consolidated financial statements and related notes included elsewhere in this Annual 10-K report.

	At or for the Years Ended December 31,				
(dollars in thousands, except per share amounts)	2014	2013	2012	2011	2010
FINANCIAL CONDITION DATA					
Total assets	$1,082,878	$1,023,824	$981,639	$983,480	$885,936
Loans receivable, net	862,409	799,130	747,641	710,089	654,450
Investment securities	126,445	134,648	159,825	195,344	161,935
Deposits	869,384	821,295	820,231	827,253	724,582
Borrowings	76,672	70,476	61,527	60,577	71,440
Junior subordinated debentures	12,000	12,000	12,000	12,000	12,000
Stockholders' equity—preferred	20,000	20,000	20,000	20,000	16,317
Stockholders' equity—common	96,559	90,730	59,047	55,454	54,788
OPERATING DATA					
Interest and dividend income	$41,759	$39,678	$40,293	$39,959	$39,537
Interest expenses	6,698	7,646	10,604	13,121	13,580
Net interest income (NII)	35,061	32,032	29,689	26,838	25,957
Provision for loan losses	2,653	940	2,529	4,087	3,933
NII after provision for loan losses	32,408	31,092	27,160	22,751	22,024
Noninterest income	4,093	4,174	4,410	4,193	3,580
Noninterest expenses	26,235	24,844	23,804	22,249	18,195
Income before income taxes	10,266	10,422	7,766	4,695	7,409
Income taxes	3,776	3,771	2,776	1,534	2,643
Net income	6,490	6,651	4,990	3,161	4,766
Preferred stock dividends declared	200	200	200	672	847
Income available to common shares	$6,290	$6,451	$4,790	$2,489	$3,919
COMMON SHARE DATA					
Basic earnings per common share	$1.35	$1.90	$1.57	$0.83	$1.31
Diluted earnings per common share	1.35	1.88	1.57	0.82	1.30
Dividends declared per common share	0.40	0.40	0.40	0.40	0.40
Book value per common share (1)	20.53	19.52	19.34	18.32	18.25
Common shares outstanding at end of period	4,702,715	4,647,407	3,052,416	3,026,557	3,002,616
Basic weighted average common shares	4,646,424	3,402,432	3,043,039	3,016,286	2,985,080
Diluted weighted average common shares	4,655,127	3,426,793	3,055,362	3,052,810	3,008,279

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	At or for the Years Ended December 31,				
(dollars in thousands, except per share amounts)	2014	2013	2012	2011	2010
KEY OPERATING RATIOS					
Return on average assets	0.63 %	0.69 %	0.52 %	0.35 %	0.57 %
Return on average total equity	5.69	7.49	6.42	4.33	6.76
Return on average common equity	6.69	9.38	8.29	4.47	7.24
Interest rate spread	3.54	3.44	3.18	3.05	3.12
Net interest margin	3.68	3.56	3.31	3.21	3.32
Efficiency ratio (2)	67.00	68.62	69.81	71.70	61.60
Common dividend payout ratio	29.63	21.05	25.48	48.78	30.77
Non-interest expense to average assets	2.56	2.56	2.47	2.46	2.16
Avg. int-earning assets to avg. int-bearing liabilities	118.83	114.57	111.56	110.11	111.80
SELECTED ASSET QUALITY RATIOS					
Average total equity to average total assets	11.11	9.16	8.07	8.06	8.39
Allowance for loan losses to total loans at end of period	0.97	1.01	1.09	1.07	1.16
Allowance for loan losses to nonperforming loans	82.64	72.86	94.78	80.49	56.73
Net charge-offs to avg. outstanding loans	0.28	0.14	0.27	0.61	0.61
Nonperforming loans to total loans (3)	1.18	1.38	1.15	1.32	2.04
Non-accrual loans to total loans (4)	1.18	1.91	1.74	1.32	2.04
Non-accrual loans and TDRs to total loans (5)	2.70	2.45	2.33	2.87	4.54
Non-accrual loans and OREO to total assets	1.49	2.17	2.04	1.48	2.71
Non-accrual loans, OREO and TDRs to total assets (5)	2.71	2.60	2.50	2.61	4.58
OTHER DATA					
Number of:					
Full-time equivalent employees	172	165	160	143	131
Full-service offices	12	11	11	10	10
Loan Production Offices	5	4	n/a	n/a	n/a
REGULATORY CAPITAL RATIOS (consolidated)					
Tier 1 capital to average assets	12.24 %	12.50 %	9.39 %	9.17 %	9.44 %
Tier 1 capital to risk-weighted assets	14.26	14.66	11.76	11.65	11.84
Total risk-based capital	15.21	15.62	12.84	12.69	12.94

(1) The Company had no intangible assets as of the dates indicated. Thus, tangible book value per share is the same as book value per share for each of the periods indicated.

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

(3) Nonperforming loans include all loans that are 90 days or more delinquent.

(4) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer. Non-accrual loans can include loans that are current with all loan payments. Interest and principal are recognized on a cash-basis in accordance with the Bank's policy if the loans are not impaired or there is no impairment. At December 31, 2013, non-accrual loans included $4.3 million of current loans. These non-accrual loans represented six loans of one well-secured commercial relationship with no specific reserves in the allowance due to the Bank's superior credit position with underlying collateral, which consists primarily of commercial real estate. The Bank had received all scheduled interest and principal payments on this relationship.

(5) At December 31, 2014, the Bank had total TDRs of $18.1 million with two TDR relationships totaling $4.9 million in non-accrual status. One TDR customer relationship of $3.9 million dollars has terms that defer the payment of principal and interest for a period of time. These loans will be classified as non-accrual loans during the entire concession period. Additionally at December 31, 2014, the Bank has one TDR loan of $1.0 million that is 90 days delinquent. These loans are classified as non-accrual loans for the calculation of financial ratios. There were $329,000, $800,000 and $297,000 of non-accrual TDRs at December 31, 2013, December 31, 2011 and December 31, 2010, respectively.

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

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of The Community Financial Corporation (the “Company”) and Community Bank of the Chesapeake (the “Bank”). These forward-looking statements are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions.

The Company and the Bank’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company and the Bank’s market area, changes in real estate market values in the Company and the Bank’s market area and changes in relevant accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties and could potentially result in materially different results under different assumptions and conditions. The Company considers its determination of the allowance for loan losses, the determination of other-than-temporarily impaired securities, the valuation of foreclosed real estate and the valuation of deferred tax assets to be critical accounting policies.

The Company’s Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and the general practices of the United States banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements. Accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When these sources are not available, management makes estimates based upon what it considers to be the best available information.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that exist in the loan portfolio. The allowance is based on two principles of accounting: (1) Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 450 “Contingencies,” which requires that losses be accrued when they are probable of occurring and are estimable and (2) FASB ASC 310 “Receivables,” which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, is determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows and values observable in the secondary markets.

The allowance for loan loss balance is an estimate based upon management's evaluation of the loan portfolio. The allowance is comprised of a specific and a general component. The specific component consists of management's evaluation of certain classified and non-accrual loans and their underlying collateral. Management assesses the ability of the borrower to repay the loan based upon all information available. Loans are examined to determine a specific allowance based upon the borrower's payment history, economic conditions specific to the loan or borrower and other factors that would impact the borrower's ability to repay the loan on its contractual basis. Depending on the assessment of the borrower's ability to pay and the type, condition and value of collateral, management will establish an allowance amount specific to the loan.

Management uses a risk scale to assign grades to commercial real estate, construction and land development, commercial loans and commercial equipment loans. Commercial loan relationships with an aggregate exposure to the Bank of $750,000 or greater are risk rated. Residential first mortgages, home equity and second mortgages and consumer loans are monitored on an ongoing basis based on borrower payment history. Consumer loans and residential real estate loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned or higher risk rating due to a delinquent payment history.

The Company's commercial loan portfolio is periodically reviewed by regulators and independent consultants engaged by management.

In establishing the general component of the allowance, management analyzes non-impaired loans in the portfolio including changes in the amount and type of loans. This analysis reviews trends by portfolio segment in charge-offs, delinquency, classified loans, loan concentrations and the rate of portfolio segment growth. Qualitative factors also include an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends. Based upon this analysis a loss factor is applied to each loan category and the Bank adjusts the loan loss allowance by increasing or decreasing the provision for loan losses.

Management has significant discretion in making the judgments inherent in the determination of the allowance for loan losses, including the valuation of collateral, assessing a borrower's prospects of repayment and in establishing loss factors on the general component of the allowance. Changes in loss factors have a direct impact on the amount of the provision and on net income. Errors in management's assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions. At December 31, 2014, the allowance for loan losses was $8.5 million or 0.97% of total loans. An increase or decrease in the allowance could result in a charge or credit to income before income taxes that materially impacts earnings. For additional information regarding the allowance for loan losses, refer to Notes 1 and 6 to the Consolidated Financial Statements and the discussion under the caption "Provision for Loan Losses" below.

Other-Than-Temporary-Impairment ("OTTI")

Debt securities are evaluated quarterly to determine whether a decline in their value is other-than-temporary. The term “other-than-temporary” is not necessarily intended to indicate a permanent decline in value. It means that the prospects for near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Accounting guidance indicates that the amount of other-than-temporary impairment that is recognized through earnings for debt securities is determined by comparing the present value of the expected cash flows to the amortized cost of the security. The discount rate used to determine the credit loss is the expected book yield on the security.

Other Real Estate Owned (“OREO”)

The Company maintains a valuation allowance on its other real estate owned. As with the allowance for loan losses, the valuation allowance on OREO is based on FASB ASC 450 “Contingencies,” as well as the accounting guidance on impairment of long-lived assets. These statements require that the Company establish a valuation allowance when it has determined that the carrying amount of a foreclosed asset exceeds its fair value. Fair value of a foreclosed asset is measured by the cash flows expected to be realized from its subsequent disposition. These cash flows are reduced for the costs of selling or otherwise disposing of the asset.

In estimating the cash flows from the sale of OREO, management must make significant assumptions regarding the timing and amount of cash flows. For example, in cases where the real estate acquired is undeveloped land, management must gather the best available evidence regarding the market value of the property, including appraisals, cost estimates of development and broker opinions. Due to the highly subjective nature of this evidence, as well as the limited market, long time periods involved and substantial risks, cash flow estimates are highly subjective and subject to change. Errors regarding any aspect of the costs or proceeds of developing, selling or otherwise disposing of foreclosed real estate could result in the allowance being inadequate to reduce carrying costs to fair value and may require an additional provision for valuation allowances.

Deferred Tax Assets

The Company accounts for income taxes in accordance with FASB ASC 740, “Income Taxes,” which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FASB ASC 740 requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

The Company periodically evaluates the ability of the Company to realize the value of its deferred tax assets. If the Company were to determine that it was not more likely than not that the Company would realize the full amount of the deferred tax assets, it would establish a valuation allowance to reduce the carrying value of the deferred tax asset to the amount it believes would be realized. The factors used to assess the likelihood of realization are the Company’s forecast of future taxable income and available tax-planning strategies that could be implemented to realize the net deferred tax assets.

Failure to achieve forecasted taxable income might affect the ultimate realization of the net deferred tax assets. Factors that may affect the Company’s ability to achieve sufficient forecasted taxable income include, but are not limited to, the following: increased competition, a decline in net interest margin, a loss of market share, decreased demand for financial services and national and regional economic conditions.

The Company’s provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of management judgment and are based on the best information available at the time. The Company operates within federal and state taxing jurisdictions and is subject to audit in these jurisdictions. For additional information regarding the deferred tax assets, refer to Note 12 to the Consolidated Financial Statements.

OVERVIEW

Community Bank of the Chesapeake (the “Bank”) is headquartered in Southern Maryland with branches located in Maryland and Virginia. The Bank is a wholly owned subsidiary of The Community Financial Corporation. The Bank conducts business through its main office in Waldorf, Maryland, and 11 branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and King George and Fredericksburg, Virginia. The Company opened a branch in Fredericksburg, Virginia on July 15, 2014. The Company plans to open a second full-service branch in downtown Fredericksburg in the next 12 months. In addition, the Company maintains five loan production offices (“LPOs”) in La Plata, Prince Frederick, Leonardtown and Annapolis, Maryland; and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches.

The Bank opened a commercial loan production office (“LPO”) in Fredericksburg, Virginia during August 2013 and a branch in July 2014. The Fredericksburg Virginia area market is comparable in size to our legacy Southern Maryland footprint. During the second quarter of 2014, we continued to execute the Bank’s growth strategy and added seasoned lenders and support staff to expand into the city of Annapolis and surrounding Anne Arundel County. We opened the Annapolis LPO in October 2014. We are optimistic that our returns on these investments will continue to increase shareholder value during 2015.

In October 2013, the Company issued 1,591,300 shares of common stock at a price of $18.75 per share resulting in net proceeds of $27.4 million after commissions and related offering expenses. In addition, the Company listed its stock on the NASDAQ Stock Exchange and began trading on the exchange September 27, 2013 under the ticker symbol “TCFC.”

Effective October 18, 2013, Community Bank of Tri-County changed its name to Community Bank of the Chesapeake. This new name reflects the Bank's recent expansion into the Northern Neck of Virginia and Fredericksburg, Virginia. The name of the holding company changed from Tri-County Financial Corporation to The Community Financial Corporation, to better align the parent company name with that of the Bank.

The Bank has increased assets through loan production. The Bank believes that its ability to offer fast, flexible, local decision-making will continue to attract significant new business relationships. The Bank focuses its commercial business generation efforts on targeting small and medium sized businesses with revenues between $5.0 million and $35.0 million. The Bank’s marketing is also directed towards increasing its balances of transaction deposit accounts. The Bank believes that increases in these account types will lessen the Bank’s dependence on higher-cost funding, such as certificates of deposit and borrowings. Although management believes that this strategy will increase financial performance over time, increasing the balances of certain products, such as commercial lending and transaction accounts, may also increase the Bank’s noninterest expense. The Bank recognizes that certain lending and deposit products increase the possibility of losses from credit and other risks.

During the fourth quarter of 2013, the Company began to leverage the $27.4 million in additional capital from the October 2013 capital raise to increase interest-earning assets. The Bank has successfully grown its loan portfolio $103.2 million from $768.9 million at September 30, 2013 to $872.1 million at December 31, 2014.

On February 6, 2015 the Company closed a public offering of $23.0 million of its unsecured 6.25% fixed to floating rate subordinated notes due 2025. On February 13, 2015, the Company used proceeds of the offering to redeem all $20 million of the Company's outstanding preferred stock issued under the Small Business Lending Fund ("SBLF") program. The subordinated notes qualify as tier 2 regulatory capital and replaced SBLF tier 1 capital. The balance of the net proceeds will be used for general corporate purposes, including, but not limited to, contributing capital to Community Bank of the Chesapeake, supporting organic growth, possible acquisitions of branches or other financial institutions should accretive acquisition opportunities arise and the payment of dividends.

Economy

The U.S. economy grew slowly throughout 2013 and 2014. Beginning in 2012, local real estate values stabilized and housing prices began to recover. However, uncertainty for small and medium size businesses has lessened the demand for lending. The impact of slower economic growth on the Southern Maryland economy has been moderated by the presence of federal government agencies and defense facilities, but the ongoing possibility of large cuts to the defense budget have hampered economic expansion. The Bank's market expansion has enabled the Company to grow the loan portfolio in the present environment. Even through the difficult economic environment, the Bank's capital levels and asset quality have remained strong.

For additional information regarding the local economy and its impact on the Company's business refer to the Business Section in this 10-K under the caption "Market Area" (*Part I. Item 1. Business Section – Market Area).*

COMPARISION OF RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

Earnings Summary

Net income available to common shareholders for 2014 was stable compared to the prior year decreasing $161,000 to $6.3 million or 2.5% compared to 2013. Diluted earnings per share ("EPS") were $1.35 in 2014, a decrease of $0.53 compared to 2013. The decrease in EPS was the result of the fourth quarter 2013 capital raise previously discussed. The Company's return on average assets was 0.63% in 2014, a decrease of 6 basis points from 2013. The Company's return on average common stockholders' equity was 6.69% in 2014, a decrease of 269 basis points from 2013.

Pretax operating income decreased $156,000 to $10.3 million in 2014 compared to 2013.

The decreased income in 2014 was primarily due to the following:

- The provision for loan losses increased $1.7 million to $2.7 million in 2014 due primarily to increases related to specific credits and increased average loan balances. The overall credit quality of our loan portfolio improved after charge-offs were taken and other workout strategies were exercised for challenging credits. At year end, this resulted in lower levels of classified loans and assets compared to the prior year. The general allowance as a percentage of gross loans increased in 2014 to 0.92% from 0.89% in 2013. During the same time frame the specific allowance decreased 7 basis point to 0.05% as a result of charge-offs and specific work out strategies.

- Noninterest income decreased $81,000 to $4.1 million for 2014 compared to 2013. Lower gains on mortgage loans sales and service charge income were partially offset by increases in gains on the sale of OREO.

- Noninterest expense increased $1.4 million or 5.6% to $26.2 million for 2014 compared to 2013. Employee compensation, occupancy expense and data processing increased to support the growth of the Bank and increased compliance costs. These increases were partially offset by a decrease in costs for FDIC insurance and OREO. The Company’s efficiency ratio improved from 68.62% for 2013 to 67.00% for 2014 and non-interest expense as a percentage of average assets remained flat at 2.56% for both years.

The increased expenses were partially offset by the following positive trends:

- Net interest income was $35.1 million in 2014, an increase of $3.0 million or 9.5% compared to 2013.

  - Interest income increased $2.1 million. The increase was driven by increased loan average balances. The Bank increased average net loan balances $72.7 million to $838.1 million for the fourth quarter of 2014 from $765.4 million for the fourth quarter of 2013. Loan volume was partially offset by yield declines. Average loan yields decreased 20 basis points from 5.02% for 2013 to 4.82% for 2014.

  - Interest expense decreased $948,000. This was primarily due to a decrease in the cost of funds compared to the prior year. The Bank continued to develop core deposit relationships and increased transaction deposits as it re-priced maturing time deposits. Higher cost time deposits were partially replaced with lower cost transaction and time deposits. In addition, the Bank continued to decrease its deposit costs on transaction accounts. The Bank completed the year with a $48.1 million increase in total deposits to $869.4 million. Transaction accounts increased to 56% at December 31, 2014 from 53% and 51% at December 31, 2013 and 2012, respectively.

A more detailed analysis comparing the results of operations for the years ended December 31, 2014 and 2013 follows.

Net Interest Income

The primary component of the Company’s net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company’s interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company’s net interest margin.

Net interest income increased to $35.1 million for the year ended December 31, 2014 compared to $32.0 million for the year ended December 31, 2013. The net interest margin was 3.68% for the year ended December 31, 2014, a 12 basis point increase from 3.56% for the year ended December 31, 2013. The increase was largely the result of an increase in loan average balances during 2014 compared to 2013. The growth in loan balances is directly attributable to the Bank continuing to be an important commercial lender in our legacy Southern Maryland footprint while adding greater than $80 million in new loans in the newer Fredericksburg, Virginia market. In addition, the Company’s cost of funds decreased in 2014. This decrease began during 2012 as certificates of deposit re-priced and rates declined on money market accounts. The average cost of total interest-bearing liabilities decreased 14 basis points from 0.97% for 2013 to 0.83% for 2014. Lastly, cost of deposits has decreased over the last several years because the composition of deposits has changed from reliance upon time deposits to lower cost transaction, both interest-bearing and noninterest bearing, demand deposits. Changes in the components of net interest income due to changes in average balances of assets and liabilities and to changes caused by changes in interest rates are presented in the rate volume analysis included below.

The following table shows the components of net interest income and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	2014	2013	$ Change	% Change
Interest and Dividend Income				
Loans, including fees	$ 39,475	$ 37,196	$ 2,279	6.1 %
Taxable interest and dividends on investment securities	2,270	2,466	(196)	(7.9)%
Interest on deposits with banks	14	16	(2)	(12.5)%
Total Interest and Dividend Income	41,759	39,678	2,081	5.2 %
Interest Expenses				
Deposits	4,586	5,581	(995)	(17.8)%
Short-term borrowings	12	14	(2)	(14.3)%
Long-term debt	2,100	2,051	49	2.4 %
Total Interest Expenses	6,698	7,646	(948)	(12.4)%
Net Interest Income (NII)	$ 35,061	$ 32,032	$ 3,029	9.5 %

Interest and dividend income increased by $2.1 million to $41.8 million for the year ended December 31, 2014, compared to $39.7 million for the year ended December 31, 2013. Growth in the average balance of loans and, to a lesser extent, investment yields were partially offset by decreases in yields on loans and average investment balances. Interest and dividend income increased $3.8 million due to growth of $78.0 million in the average balance of loans from $741.4 million to $819.4 million and $187,000 due to higher investment yields. This increase was partially offset by a decrease of $1.5 million in interest income from a reduction in loan yields. Average loan yields declined 20 basis points from 5.02% for the year ended December 31, 2013 to 4.82% for the year ended December 31, 2014. Interest and dividend income was further reduced $385,000 as average interest-earning investment balances decreased $22.6 million from $157.2 million for the year ended December 31, 2013 to $134.6 million for the year ended December 31, 2014.

The cost of funds continued to decrease as certificates of deposit re-price and lower rates are offered on money market accounts. The average cost of total interest-bearing liabilities decreased 14 basis points from 0.97% for year ended December 31, 2013 to 0.83% for the year ended December 31, 2014. Deposit costs decreased 15 basis points from 0.71% to 0.56% during the same timeframe. Additionally, the increase in average noninterest bearing demand deposits of $13.2 million contributed to the decline in funding costs with average balances increasing from $87.6 million for the year ended December 31, 2013 to $100.8 million for the year ended December 31, 2014.

Interest expense decreased $948,000 to $6.7 million for the year ended December 31, 2014 compared to $7.6 million for the year ended December 31, 2013 due primarily to a reduction in the cost of funds on interest-bearing liabilities; as interest expense decreased $1.1 million due to a decrease in rates. This was principally achieved by a decrease in the average rates paid on certificates of deposits and money market accounts, which declined from 1.19% and 0.33%, respectively, for the year ended December 31, 2013 to 0.97% and 0.27%, respectively, for the year ended December 31, 2014. The Company has been successful in increasing its core deposits and reducing its cost of funds in the low interest rate environment over the last several years. In addition, the average rate paid on debt, which includes long-term debt, subordinated debentures and short-term borrowings, decreased from 2.42% to 2.32% for the comparable period. Interest expense was also reduced $30,000 due to a decline in average certificate of deposit balances of $3.1 million from $392.7 million for the year ended December 31, 2013 to $389.6 million for the year ended December 31, 2014. These reductions were partially offset by increases in interest expense due to larger average balances for interest-bearing transaction accounts and debt. Interest expense increased $38,000 due to a $15.7 million increase in average interest-bearing transaction accounts from $306.4 million for the year ended December 31, 2013 to $322.1 million for the year ended December 31, 2014. Interest expense increased $137,000 due to a $5.8 million increase in average debt balances from $85.3 million for the year ended December 31, 2013 to $91.1 million for the year ended December 31, 2014.

The table below presents information on average balances and rates for deposits

	For the Years Ended December 31,			
	2014		2013	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$40,104	0.10 %	$37,540	0.10 %
Interest-bearing demand and money market accounts	281,960	0.27 %	268,832	0.33 %
Certificates of deposit	389,641	0.97 %	392,675	1.19 %
Total interest-bearing deposits	711,705	0.64 %	699,047	0.80 %
Noninterest-bearing demand deposits	100,783		87,649	
	$812,488	0.56 %	$786,696	0.71 %

The table below sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

	Year Ended December 31, 2014 compared to Year Ended December 31, 2013		
	Due to		
dollars in thousands	Volume	Rate	Total
Interest income:			
Loan portfolio (1)	$ 3,758	$ (1,479)	$ 2,279
Investment securities, federal funds sold and interest bearing deposits	(385)	187	(198)
Total interest-earning assets	$ 3,373	$ (1,292)	$ 2,081
Interest-bearing liabilities:			
Savings	3	(1)	2
Interest-bearing demand and money market accounts	35	(166)	(131)
Certificates of deposit	(30)	(836)	(866)
Long-term debt	137	(95)	42
Short-term debt	-	(2)	(2)
Guaranteed preferred beneficial interest in junior subordinated debentures	-	7	7
Total interest-bearing liabilities	$ 145	$ (1,093)	$ (948)
Net change in net interest income	$ 3,228	$ (199)	$ 3,029

(1) Average balance includes non-accrual loans

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The following table presents information on the average balances of the Company’s interest-earning assets and interest-bearing liabilities and interest earned or paid thereon for the past two fiscal years. There are no tax equivalency adjustments.

	For the Years Ended December 31,							
	2014				2013			
dollars in thousands	Average Balance	Interest	Average Yield/ Cost		Average Balance	Interest	Average Yield/ Cost	
Assets								
Interest-earning assets:								
Loan portfolio (1)	$819,381	$39,475	4.82	%	$741,369	$37,196	5.02	%
Investment securities, federal funds sold and interest-bearing deposits	134,552	2,284	1.70	%	157,211	2,482	1.58	%
Total Interest-Earning Assets	953,933	41,759	4.38	%	898,580	39,678	4.42	%
Cash and cash equivalents	11,979				13,028			
Other assets	60,530				57,455			
Total Assets	$1,026,442				$969,063			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities:								
Savings	$40,104	$40	0.10	%	$37,540	$38	0.10	%
Interest-bearing demand and money market accounts	281,960	755	0.27	%	268,832	886	0.33	%
Certificates of deposit	389,641	3,791	0.97	%	392,675	4,657	1.19	%
Long-term debt	74,714	1,788	2.39	%	68,996	1,746	2.53	%
Short-term debt	4,344	12	0.28	%	4,278	14	0.33	%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	312	2.60	%	12,000	305	2.54	%
Total Interest-Bearing Liabilities	802,763	6,698	0.83	%	784,321	7,646	0.97	%
Noninterest-bearing demand deposits	100,783				87,649			
Other liabilities	8,898				8,318			
Stockholders' equity	113,998				88,775			
Total Liabilities and Stockholders' Equity	$1,026,442				$969,063			
Net interest income		$35,061				$32,032		
Interest rate spread			3.54	%			3.44	%
Net yield on interest-earning assets			3.68	%			3.56	%
Ratio of average interest-earning assets to average interest bearing liabilities			118.83	%			114.57	%
Cost of funds			0.74	%			0.88	%
Cost of deposits			0.56	%			0.71	%

(1) Average balance includes non-accrual loans

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	2014	2013	$ Change	% Change
Provision for loan losses	$ 2,653	$ 940	$ 1,713	182.2 %

The provision for loan losses increased $1.7 million from the comparable period in 2013 to $2.7 million for the year ended December 31, 2014 and reflected an increase in net-charge-offs offset by a decrease in the specific allowance of nonperforming loans. The provision for loan losses increased in 2014 due primarily to increases related to specific credits and increased average loan balances. The specific allowance is based on management's estimate of realizable value for particular loans and has decreased as specific credits have been resolved through a return to performance, charge-offs, additions to other real estate owned, or the sale of non-performing and classified loans. Net charge-offs increased $1.3 million from $1.0 million for the year ended December 31, 2013 to $2.3 million for the year ended December 31, 2014, primarily due to the two loan relationships discussed below.

In the fourth quarter of 2014, the Bank granted concessions on two loan relationships, each of which was classified as substandard. As a result of these concessions, the Bank determined that the loans were troubled debt restructurings ("TDRs"). As such, the loans became impaired and were evaluated for impairment in accordance with Bank policy. The first loan relationship, which totaled $8.6 million, consisted of commercial real estate and construction loans. The borrower agreed to provide additional collateral to cover most of the deficiency determined as a result of the impairment analysis and the Bank charged-off $500,000 in principal. The carrying value of the loans at December 31, 2014 was $8.2 million. The second loan relationship, which totaled approximately $3.8 million, consisted of construction and land development and commercial loans. As a result of the concessions granted and the impairment analysis, the Bank charged-off $843,000 and took 11 finished residential lots into other real estate owned ("OREO"). At December 31, 2014, the carrying value of the loans and the OREO was $1.9 million and $757,000, respectively. Both loan relationships were current and making payments in accordance with their original contract terms before the restructuring occurred. Accordingly, the two loan relationships remained on accrual status at December 31, 2014. As a result of these classifications, total accruing TDRs increased to $13.2 million at December 31, 2014 from $4.4 million at December 31, 2013. Total nonaccrual loans and OREO at December 31, 2014 were $10.3 million and $5.9 million, respectively, as compared to $15.5 million and $6.8 million, respectively, at December 31, 2013, representing a decrease of $5.2 million and $0.9 million, respectively. Additionally, total classified assets declined $2.9 million from $56.9 million at December 31, 2013 to $54.0 million at December 31, 2014.

See further discussion of the provision under the caption "Asset Quality, Allowance for Loan Losses and Provision for Loan Losses" in the Comparison of Financial Condition section of Management's Discussion and Analysis.

Noninterest Income

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	2014	2013	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 368	$ 391	$ (23)	(5.9)%
Gain on sale of asset	7	11	(4)	(36.4)%
Net gains on sale of OREO	322	179	143	79.9 %
Net gains on sale of investment securities	19	-	19	n/a
Income from bank owned life insurance	671	620	51	8.2 %
Service charges	2,213	2,346	(133)	(5.7)%
Gain on sale of loans held for sale	493	627	(134)	(21.4)%
Total Noninterest Income	$ 4,093	$ 4,174	$ (81)	(1.9)%

Noninterest income decreased slightly during 2014 compared to the prior year as reductions in gains on the sale of loans held for sale and service charge income were partially offset by increased gains on sales of other real owned.

Service charge income decreased due to the Bank’s focus on transaction account acquisition. The Bank is providing more products and services to attract and retain commercial customers. In addition, the Bank continued to see a reduction in service fees due to increased regulation.

During the year ended December 31, 2014, the Bank recognized $322,000 in gains on the sale of OREO which consisted of the sale of eight properties for net proceeds of $3.7 million, which included the financing of $1.0 million dollars on a residential subdivision that was transferred from OREO to loans during the fourth quarter of 2014. The contracted sales price of $1.4 million on the residential subdivision qualified for full accrual sales treatment under ASC Topic 360-20-40 “Property Plant and Equipment – Derecognition”.

During the year ended December 31, 2013, the Bank recognized $179,000 in gains on the sale of OREO which consisted of the sale of six properties for net proceeds of $1.3 million and net losses of $46,000 and the recognition of $225,000 of previously deferred gain from an OREO property that the Bank financed during 2011 that did not initially qualify for full accrual sales treatment. The Bank utilized the cost recovery method (ASC Topic 360-20-40 “Property Plant and Equipment – Derecognition”) to account for the sale.

Gains on loans originated for sale in the secondary market decreased in 2014 compared to the prior year. Secondary market sales slowed during the third quarter of 2013 as a result of rising residential mortgage interest rates. The refinance market rebounded slightly during the second half of 2014 due a decrease in rates. The Bank recognized $349,000, or 70.8% of 2014 gains on loan sales, in the last six months of 2014. In 2013, secondary market sales were concentrated during the first six months of 2013, as residential mortgage refinancing slowed during the third and fourth quarters of 2013 due to rising market interest rates. The Bank recognized $516,000, or 82.3% of 2013 gains on loan sales, in the six months ended June 30, 2013.

Noninterest Expense

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	2014	2013	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 15,851	$ 14,521	$ 1,330	9.2 %
Occupancy expense	2,371	2,139	232	10.8 %
Advertising	545	477	68	14.3 %
Data processing expense	1,556	1,289	267	20.7 %
Professional fees	1,129	1,095	34	3.1 %
Depreciation of furniture, fixtures, and equipment	753	765	(12)	(1.6)%
Telephone communications	185	200	(15)	(7.5)%
Office supplies	204	226	(22)	(9.7)%
FDIC Insurance	709	1,115	(406)	(36.4)%
OREO valuation allowance and expenses	386	787	(401)	(51.0)%
Other	2,546	2,230	316	14.2 %
Total Noninterest Expense	$ 26,235	$ 24,844	$ 1,391	5.6 %

	Years Ended December 31,			
(dollars in thousands)	2014	2013	$ Change	% Change
Compensation and Benefits	$ 15,851	$ 14,521	$ 1,330	9.2 %
OREO Valuation Allowance and Expenses	386	787	(401)	(51.0)%
Other Operating Expenses	9,998	9,536	462	4.8 %
Total Noninterest Expense	$ 26,235	$ 24,844	$ 1,391	5.6 %

For the year ended December 31, 2014, noninterest expense increased 5.6%, or $1.4 million, to $26.2 million from $24.8 million for the comparable period in 2013. The increase was primarily due to growth in salary and employee benefits of $1.3 million to $15.9 million as the Bank added employees in 2014 to support its expansion in Fredericksburg, Virginia and Annapolis, Maryland and the surrounding markets. Occupancy and advertising expense increased compared to the same period of the prior year primarily as a result of the Company’s entrance into new markets. Additionally, salary and benefits, data processing and other expenses were impacted by the increased cost of compliance and regulation. These increased costs were partially offset by a reduction in FDIC insurance premiums and OREO related expenses. The Company’s efficiency ratio and noninterest expense as a percentage of average assets for the year ended December 31, 2014 were 67.00% and 2.56%, respectively, compared to 68.62% and 2.56%, respectively, for the year ended December 31, 2013.

Income Tax Expense

For the years ended December 31, 2014 and 2013, the Company recorded income tax expense of $3.8 million. The Company's effective tax rates for the years ended December 31, 2013 and 2012 were 36.78% and 36.18%, respectively. The increase in the effective tax rate was the result of tax exempt income being relatively lower to total income in 2014 than in 2013.

COMPARISION OF FINANCIAL CONDITON AT DECEMBER 31, 2014 AND 2013

Assets

The following table shows the Company's assets and the dollar and percentage changes for the periods presented.

(dollars in thousands)	December 31, 2014	2013	$ Change	% Change
Cash and due from banks	$17,275	$11,408	$5,867	51.4 %
Federal funds sold	965	8,275	(7,310)	(88.3)%
Interest-bearing deposits with banks	3,133	4,836	(1,703)	(35.2)%
Securities available for sale (AFS), at fair value	41,939	48,247	(6,308)	(13.1)%
Securities held to maturity (HTM), at amortized cost	84,506	86,401	(1,895)	(2.2)%
FHLB and FRB stock - at cost	6,434	5,593	841	15.0 %
Loans receivable - net of ALLL of $8,481 and $8,138	862,409	799,130	63,279	7.9 %
Premises and equipment, net	20,586	19,543	1,043	5.3 %
Other real estate owned (OREO)	5,883	6,797	(914)	(13.4)%
Accrued interest receivable	3,036	2,974	62	2.1 %
Investment in bank owned life insurance	27,021	19,350	7,671	39.6 %
Other assets	9,691	11,270	(1,579)	(14.0)%
Total Assets	$1,082,878	$1,023,824	$59,054	5.8 %

The differences in allocations between the cash and investment categories reflect operational needs. Net loans increased $63.3 million from $799.1 million at December 31, 2013 to $862.4 million at December 31, 2014, due primarily to increases in loans for commercial real estate.

The Company has grown its loan portfolio $102.6 million between September 30, 2013 and December 31, 2014. The Bank opened a LPO in Fredericksburg, Virginia during August 2013. The increase in the commercial loan portfolio reflects increased volume in our established Southern Maryland footprint and over $80 million in new loans as a result of the opening of the Fredericksburg LPO. The Company opened its Annapolis, Maryland LPO in October 2014 and is optimistic about its prospects in this market.

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Details of the Company's loan portfolio are presented below:

(dollars in thousands)	December 31, 2014	%	December 31, 2013	%
Commercial real estate	$ 561,080	64.34 %	$ 476,648	58.97 %
Residential first mortgages	152,837	17.52 %	159,147	19.69 %
Construction and land development	36,370	4.17 %	32,001	3.96 %
Home equity and second mortgages	21,452	2.46 %	21,692	2.68 %
Commercial loans	73,625	8.44 %	94,176	11.65 %
Consumer loans	613	0.07 %	838	0.10 %
Commercial equipment	26,152	3.00 %	23,738	2.94 %
	872,129	100.00 %	808,240	100.00 %
Less:				
Deferred loan fees	1,239	0.14 %	972	0.12 %
Allowance for loan losses	8,481	0.97 %	8,138	1.01 %
	9,720		9,110	
	$ 862,409		$ 799,130	

Asset Quality, Allowance for Loan Losses and Provision for Loan Losses

<u>Provision for Loan Losses and the Allowance for Loan Losses</u>

The allowance for loan losses decreased from 1.01% of gross loans at December 31, 2013 to 0.97% of gross loans at December 31, 2014 due to changes to general allowance factors that reflect changes in historical loss, delinquency rates and general economic conditions and a reduction in specific reserves on impaired loans. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to: overall loss experience; current economic conditions; size, growth and composition of the loan portfolio; financial condition of the borrowers; current appraised values of underlying collateral and other relevant factors that, in management's judgment, warrant recognition in determining an adequate allowance. The specific allowance is based on management's estimate of realizable value for particular loans. Management believes that the allowance is adequate.

During the year ended December 31, 2014, net charge-offs were $2.3 million. During the second quarter of 2014, the Bank charged off $650,000 related to $3.4 million in commercial loans to one customer as a result of a sale of the loans to a third party. The sale of the loans decreased the Bank's specific allowance and classified loans. As discussed previously, during the fourth quarter of 2014, the Bank charged off $1.3 million on two customer loan relationships after concessions granted resulted in the relationships being classified as TDRs and therefore subject to impairment analysis. The charge-offs on the TDR loans decreased the Bank's specific allowance. The allowance for loan losses increased $343,000 from December 31, 2013 to December 31, 2014. The increase in the allowance reflects an increase in the general allowance of $877,000 partially offset by a decrease in specific reserves of $534,000. The Bank has increased its general allowance as a percentage of gross loans 3 basis points from 0.89% at December 31, 2013 to

0.92% at December 31, 2014. The following is a breakdown of the Company's general and specific allowances as a percentage of gross loans at December 31, 2014 and December 31, 2013, respectively.

(dollar in thousands)	December 31, 2014	% of Gross Loans	December 31, 2013	% of Gross Loans
General Allowance	$ 8,030	0.92 %	$ 7,153	0.89 %
Specific Allowance	451	0.05 %	985	0.12 %
Total Allowance	$ 8,481	0.97 %	$ 8,138	1.01 %

The aggregate amount of specific allowances has decreased principally due to an overall improvement in the credit quality of our loan portfolio as charge-offs were taken and other workout strategies were exercised for challenging credits. Non-performing loans were resolved with workouts, charge-offs and transfers to OREO. Classified loans of the commercial portfolio, which include commercial real estate, commercial, commercial equipment and construction and land development loans have decreased from $62.8 million at December 31, 2011 to $44.5 million at December 31, 2014 and $45.2 million at December 31, 2013 (see Note 6 to the Consolidated Financial Statements). Total classified loans decreased $1.1 million from $47.6 million at December 31, 2013 to $46.7 million at December 31, 2014.

The following table provides the five-year trend of net charge-offs as a percentage of average loans.

	For the Years Ended December 31,				
(dollars in thousands)	2014	2013	2012	2011	2010
Average loans	$819,381	$741,369	$719,798	$671,242	$615,887
Net charge-offs	2,309	1,049	1,937	4,101	3,736
Net charge-offs to average loans	0.28 %	0.14 %	0.27 %	0.61 %	0.61 %

Asset Quality

The following tables show selected asset quality ratios for the years ended December 31, 2014 and 2013.

(dollars in thousands)	December 31, 2014	December 31, 2013	$ Change	% Change
ASSET QUALITY				
Total assets	$ 1,082,878	$ 1,023,824	$ 59,054	5.77 %
Gross loans	872,129	808,240	63,889	7.90
Allowance for loan losses	8,481	8,138	343	4.21
Past due loans (PDLs) (31 to 89 days)	1,820	8,060	(6,240)	(77.42)
Nonperforming loans (NPLs) (>=90 days)	10,263	11,170	(907)	(8.12)
Non-accrual loans (NPLs + non-accrual only loans) [(a)]	10,263	15,450	(5,187)	(33.57)
Accruing troubled debt restructures (TDRs) [(b)]	13,249	4,364	8,885	203.60
Other real estate owned (OREO)	5,883	6,797	(914)	(13.45)
ASSET QUALITY RATIOS				
Allowance for loan losses to total loans	0.97 %	1.01 %		
Allowance for loan losses to nonperforming loans	82.64	72.86		
Past due loans (PDLs) to total loans	0.21	1.00		
Nonperforming loans (NPLs) to total loans	1.18	1.38		
Loan delinquency (PDLs + NPLs) to total loans	1.39	2.38		
Non-accrual loans to total loans	1.18	1.91		
Non-accrual loans and TDRs to total loans	2.70	2.45		
Non-accrual loans and OREO to total assets	1.49	2.17		
Non-accrual loans, OREO and TDRs to total assets	2.71	2.60		

[(a)] Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer. Non-accrual loans can include loans that are current with all loan payments. Interest and principal are recognized on a cash-basis in accordance with the Bank's policy if the loans are not impaired or there is no impairment. At December 31, 2013, non-accrual loans included $4.3 million of current loans. These non-accrual loans represented six loans of one well-secured commercial relationship with no specific reserves in the allowance due to the Bank's superior credit position with underlying collateral, which consists primarily of commercial real estate. As of December 31, 2013, the Bank had received all scheduled interest and principal payments on this relationship.

(b) At December 31, 2014, the Bank had total TDRs of $18.1 million with two TDR relationships totaling $4.9 million in non-accrual status. One TDR customer relationship of $3.9 million dollars has terms that defer the payment of principal and interest for a period of time. These loans will be classified as non-accrual loans during the entire concession period. When the customer is current and paying down the loans, the arrangement will be reported as TDRs in accordance with the Bank's ALLL policy. Additionally at December 31, 2014, the Bank has one TDR loan of $1.0 million that is 90 days delinquent. These loans are classified as non-accrual loans for the calculation of financial ratios.

Classified Assets and Special Mention Assets

(dollars in thousands)	As of December 31, 2014	As of December 31, 2013	As of December 31, 2012	As of December 31, 2011
Classified loans				
Substandard	$ 46,735	$ 47,645	$ 48,676	$ 68,515
Doubtful	-	-	-	-
Loss	-	-	-	37
Total classified loans	46,735	47,645	48,676	68,552
Special mention loans	5,460	9,246	6,092	-
Total classified and special mention loans	$ 52,195	$ 56,891	$ 54,768	$ 68,552
Classified loans	46,735	47,645	48,676	68,552
Classified securities	1,404	2,438	3,028	6,057
Other real estate owned	5,883	6,797	6,891	5,029
Total classified assets	$ 54,022	$ 56,880	$ 58,595	$ 79,638

During 2014, classified assets (which include loans classified as substandard, doubtful or loss, OREO assets and classified securities) decreased $2.9 million. The Bank’s asset quality has improved over the last several years. Classified assets decreased $25.7 million from $79.7 million at December 31, 2011 to $54.0 million at December 31, 2014.

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) decreased $5.2 million from $15.5 million or 1.91% of total loans at December 31, 2013 to $10.3 million or 1.18% of total loans at December 31, 2014. Non-accrual only loans are loans classified as non-accrual due to customer operating results or payment history. In accordance with the Company’s policy, interest income is recognized on a cash basis for these loans. There were no non-accrual only loans at December 31, 2014. At December 31, 2013, non-accrual only loans were $4.3 million, representing one well-secured commercial relationship with no specific reserves due to the Bank's superior credit position with underlying collateral, which consists primarily of commercial real estate.

Nonperforming loans (loans 90 days or greater delinquent) decreased $907,000 from $11.2 million at December 31, 2013 to $10.3 million at December 31, 2014. Nonperforming loans as a percentage of total loans decreased to 1.18% at December 31, 2014 compared to 1.38% at December 31, 2013. The Bank had 31 nonperforming loans at December 31, 2014 compared to 28 nonperforming loans at December 31, 2013. Nonperforming loans at December 31, 2014 included $8.8 million, or 86% of nonperforming loans, attributed to 16 loans representing six customer relationships classified as substandard. Of these loans, $3.9 million represented a stalled residential development project. During the second quarter of 2014, the Bank deferred the collection of principal and interest for one year to enable the project to use available funds to build units and complete the project. At December 31, 2014, the stalled development project loans are considered both TDRs and non-accrual loans. Additionally at December 31, 2014, the Bank has one TDR commercial real estate loan of $1.0 million that is 90 days delinquent. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Loan delinquency decreased $7.1 million from $19.2 million, or 2.38% of loans, at December 31, 2013 to $12.1 million, or 1.39% of loans, at December 31, 2014. Loans 31-89 days delinquent decreased $6.2 million from $8.1 million, or 1.00% of total loans, at December 31, 2013 to $1.8 million, or 0.21% of total loans, at December 31, 2014. Management believes the 31-89 day past due delinquency rate is a leading indicator of the health of the loan portfolio.

The Bank's TDRs increased $13.4 million to $18.1 million at December 31, 2014 compared to $4.7 million at December 31, 2013. The Bank added 19 new TDRs during the year ended December 31, 2014 compared to three TDRs during the year ended December 31, 2013. The Bank added 12 TDR loans totaling $11.1 million during the fourth quarter of 2014, of which 11 TDRs or $10.1 million related to the concessions granted on two substandard customer loan relationships previously discussed. The Bank had specific reserves of $251,000 on five TDRs totaling $2.5 million at December 31, 2014 and $79,000 on two TDRs totaling $1.8 million at December 31, 2013. Interest income in the amount of $563,000 and $214,000 was recognized on outstanding TDR loans for the years ended December 31, 2014 and 2013, respectively. TDRs as of December 31, 2014 and 2013 were as follows:

	December 31, 2014		December 31, 2013	
(dollars in thousands)	Dollars	Number of Loans	Dollars	Number of Loans
Commercial real estate	$ 10,438	9	$ 3,141	8
Residential first mortgages	906	3	1,485	4
Construction and land development	4,376	4	-	-
Commercial loans	2,262	6	-	-
Commercial equipment	154	2	67	1
Total TDRs	$ 18,136	24	$ 4,693	13
Less: TDRs included in non-accrual loans	(4,887)	(5)	(329)	(1)
Total accrual TDR loans	$ 13,249	19	$ 4,364	12

The OREO balance was $5.9 million at December 31, 2014, a decrease of $914,000 compared to $6.8 million at December 31, 2013. This decrease consisted of valuation allowances of $234,000 to adjust properties to current appraised values and $3.4 million in disposals, partially offset by additions of $2.7 million. OREO carrying amounts reflect management's estimate of the realizable value of the