Howard Bancorp Inc
Form 10-K
March 15, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2018

Commission file number: 001-35489

HOWARD BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	**20-3735949**
State or other jurisdiction	(I.R.S. Employer
of incorporation or organization	Identification No.)

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

(410) 750-0020

(Registrant's telephone number, including area code)

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes ¨ No 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨

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

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

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

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

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

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

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

Part I

Item 1. Business

Howard Bancorp, Inc.

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

Howard Bank

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

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

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

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

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

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

General Development of the Business

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

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

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

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

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

Our Market Area

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

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

Competitive Position

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

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

Lending Activities

General

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

Credit Policies and Administration

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

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

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

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

Commercial Lending

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

Commercial Mortgage Lending

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

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

Construction Lending

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

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

Residential Mortgage Lending

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

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

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

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

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

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

Consumer Lending

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

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

Loan Originations, Purchases, Sales, Participations and Servicing

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

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

Loan Approval Procedures and Authority

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

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

Mortgage Banking

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

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

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

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

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

Investments and Funding

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

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

Other Banking Products

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

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

Deposit Activities

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

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

Employees

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

Lending Limit

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

Competition

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

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

SUPERVISION AND REGULATION

Howard Bancorp, Inc.

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

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

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

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

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

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

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

Howard Bank

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

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

Financial Institutions Article of the Maryland Annotated Code

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

Capital Requirements

Federal regulations require FDIC-insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to risk-based assets ratio of 4.5%, a Tier 1 capital to risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio. The existing capital requirements were effective January 1, 2015 and are the result of a final rule implementing regulatory amendments based on recommendations of the Basel Committee on Banking Supervision and certain requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”). These requirements may change significantly with the enactment in May 2018 of the Economic Growth, Regulatory Reform, and Consumer Protection Act (“EGRRCPA”), as explained below.

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

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

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

Prompt Corrective Action

Under federal prompt corrective action regulations, the bank regulatory agencies are authorized and, under certain circumstances, required, to take various “prompt corrective actions” to resolve the problems of any bank subject to their jurisdiction that is not adequately capitalized. Depending on their capital levels, every insured depository institution is in one of five capital tiers: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the prompt corrective action regulations, a bank is considered “well capitalized” if it: (i) has a total risk-based capital ratio of 10.0% or greater; (ii) a Tier 1 risk-based capital ratio of 8.0% or greater; (iii) a common equity Tier 1 ratio of 6.5% or greater; (iv) a leverage capital ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. As of December 31, 2018, Howard Bank remained “well capitalized” for this purpose and its capital exceeded all applicable requirements. Well capitalized status is a prerequisite for certain types of favorable regulatory treatment, including expedited processing of applications by the FDIC and the ability to rely on brokered deposits.

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

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

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

Dividends

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

Deposit Insurance Assessments

Howard Bank’s deposit accounts are insured by the FDIC generally up to a maximum of $250,000 per separately insured depositor. FDIC-insured depository institutions are required to pay deposit insurance assessments to the FDIC. The amount of a particular institution’s deposit insurance assessment is determined by an FDIC risk-based assessment system. The assessment is a function of a financial ratios method that takes into account seven financial ratios and the institution's weighted average CAMELS component ratings. The assessment must be within a range that depends on the institution's composite CAMELS rating, and the assessment will be adjusted up or down to come within the range. Assessment rates (inclusive of possible adjustments) currently range from 1.5 to 30 basis points of each institution's total assets less tangible capital. The FDIC may increase or decrease the range of assessments uniformly, except that no adjustment can deviate more than two basis points from the base assessment rate without notice and comment rulemaking. The FDIC's current system represents a change, required by the Dodd-Frank Act, from its prior practice of basing the assessment on an institution's aggregate deposits. The FDIC may terminate insurance of deposits upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The FDIC has recently provided a preliminary notification to banks with less than $10 billion in assets, that they may be eligible for assessment credits as the size of the Deposit Insurance Fund ("DIF") has exceeded predefined levels (a 1.35% DIF ratio). However these credits will not be awarded until the DIF ratio exceeds 1.38%, which as of December 31, 2018 had not yet occurred. Thus, while there exists a chance that FDIC insured institutions may receive credits against future assessments, the triggering event for this has not yet occurred, and there is no assurance that it is likely to occur in the future.

Maryland Regulatory Assessment

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

Liquidity

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

Loans-to-One-Borrower Limitation

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

Commercial Real Estate Loans

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

Community Reinvestment Act and Fair Lending Laws

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

Transactions with Related Parties

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

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

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

Standards for Safety and Soundness

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

12

Anti-Money Laundering and OFAC

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

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

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

Consumer Protection Laws

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

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

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

Effect of Governmental Monetary Policies

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

Federal and State Securities Laws

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

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

Sarbanes-Oxley Act of 2002

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

London Inter-Bank Offered Rate ("LIBOR")

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

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

Item 1A. Risk Factors

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

Risk Factors Relating to Our Business and Our Common Stock

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

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

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

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

The small businesses that make up the majority of our commercial borrowers generally do not have the cash reserves to help cushion them from an economic slowdown to the same extent that large borrowers do and thus may be more heavily impacted by an economic downturn. A continued sluggish economy or another economic slowdown may have a negative effect on the ability of our commercial borrowers to make timely repayments of their loans, which could have an adverse impact on our earnings.

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

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

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

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

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

We are subject to certain operational risks including, but not limited to, data processing system failures and errors, inadequate or failed internal processes, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. We rely heavily on data processing, software, communication, and information systems on a variety of computing platforms and networks and over the Internet to conduct our business. Despite instituted safeguards, we cannot be certain that all of our systems are entirely free from vulnerability to attack or other technological difficulties or failures. Information security risks have increased significantly due to the use of online, telephone and mobile banking channels by clients and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties. Our technologies, systems, networks and our clients' devices have been subject to, and are likely to continue to be the target of, cyber-attacks, computer viruses, malicious code, phishing attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our or our clients’ confidential, proprietary and other information, the theft of client assets through fraudulent transactions or disruption of our or our clients’ or other third parties’ business operations. System failure or errors, security breaches in our Internet banking activities or other communication and information systems, or other technology difficulties or failures, could result in information being lost or misappropriated, interrupt of our operations, damage our reputation, result in a loss of customer business, cause us to incur expenses to rectify, subject us to additional regulatory scrutiny or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations. We rely on standard Internet and other security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from damage or compromises or breaches of our security measures. We continue to monitor developments in this area and consider whether additional protective measures are necessary or appropriate, and we have obtained insurance protection intended to cover losses due to network security breaches; there is no guarantee, however, that such insurance would cover all costs associated with any breach, damage or failure of our computer systems and network infrastructure.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As previously mentioned, a key component of our growth strategy is to pursue acquisitions of other financial institutions or branches of other financial institutions. As consolidation of the banking industry continues, the competition for suitable acquisition candidates may increase. We compete with other banking companies for acquisition opportunities, and there are a limited number of candidates that meet our acquisition criteria. Consequently, we may not be able to identify suitable candidates for acquisitions. If we are unable to locate suitable acquisition candidates willing to sell on terms acceptable to us, our net income could decline and we would be required to find other methods to grow our business. We may also open additional branches organically and expand into new markets or offer new products and services. These activities would involve a number of risks, including:

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

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

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

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

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

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

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

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

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

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

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

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

We continually encounter technological change.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our lending and deposit operations are concentrated in the Greater Baltimore Metropolitan Area. Broad geographic diversification is not currently part of our community bank focus. As a result, our success depends in part on economic conditions in our markets. Adverse changes in economic conditions in our primary market area could reduce our deposit base and demand for our services and products and negatively impact growth in our loans and deposits, impair our ability to collect on our outstanding loans, increase credit losses, problem loans and charge-offs, and otherwise negatively affect our performance and financial condition. Declines in real estate values could cause some of our residential and commercial real estate loans to be inadequately collateralized, which would expose us to a greater risk of loss in the event that the recovery on amounts due on defaulted loans is resolved by selling the real estate collateral. In addition, adverse changes in economic conditions in and around our market area may more severely impact our business and financial condition than are our larger, more geographically diverse competitors. Our larger bank competitors, for example, serve more geographically diverse market areas, parts of which may not be affected by the same economic conditions that may exist in our market areas.

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

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

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

Changes in tax laws may negatively impact our financial performance.

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

We are subject to liquidity risks.

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

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

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

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

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

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

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

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

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

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

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

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

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

Our lending limit may limit our growth.

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

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

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

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

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

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

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

The market price for our common stock may be volatile.

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

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

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

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

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

- We may not have sufficient earnings as our primary source of income, the payment of dividends to Howard Bancorp by Howard Bank, is subject to federal and state laws that limit the ability of that bank to pay dividends;
- FRB policy requires bank holding companies to pay cash dividends on common stock only out of net income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition; and
- our board of directors may determine that, even though funds are available for dividend payments, retaining the funds for internal uses, such as expansion of our operations, is a better strategy.

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

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

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

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

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

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

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

	Owings Mills, MD 21117	
White Marsh	10101 Baltimore National Pike Baltimore, MD 21236	Full service branch with drive-thru
Glen Burnie [1]	305 Crain Highway Glen Burnie, MD 21061	Full service branch with drive-thru
Dublin	3535 Conowingo Road Street, MD 21154	Former branch location
Perryville	4871 Pulaski Highway Perryville, MD 21154	Former branch location
Easton	8662 Alicia Drive Easton, MD 21601	Former branch location
Loch Raven	1641 East Joppa Road Baltimore, MD 21234	Former branch location

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

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

We leased the following branches at December 31, 2018:

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

We lease the following facilities unless otherwise noted:

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

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

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable

Part II

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

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

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

Dividends

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

Securities Authorized for Issuance Under Equity Compensation Plans

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

Item 6. Selected Financial Data

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

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

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

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

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

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

Overview

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

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

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

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

Raymond James Bank, N.A.

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

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

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

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

- As a result of the First Mariner merger in March of 2018 we acquired:
  - Assets - $1.0 billion, primarily from:
    - § Investment securities - $130.3 million
    - § Loans - $692.5 million
  - Liabilities - $897.6 million, primarily from:
    - § Deposits - $706.4 million
    - § Borrowings - $185.0 million

31

- Goodwill recorded - $70.1 million

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

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

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

Critical Accounting Policies

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

Allowance for Credit Losses

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

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

Goodwill and Other Intangible Assets

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

Income Taxes

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

Share Based Compensation

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

Balance Sheet Analysis and Comparison of Financial Condition

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

General

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

Investment Securities

<u>Available for sale</u>

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

33

Held to maturity

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

Nonmarketable equity

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

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

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

We had available for sale securities of $223.9 million and $74.3 million at December 31, 2018 and December 31, 2017, respectively, which were recorded at fair value. This represents an increase of $149.6 million for the year ended December 31, 2018 from the prior year end. All acquired First Mariner investment securities were classified as available for sale, and were acquired at their fair values. For interest rate sensitivity reasons, we elected to immediately liquidate a portion of acquired securities portfolio. Because we sold these securities acquired within days of the closing of the transaction we did not record any gain or loss on the sale. We sold approximately $69.7 million of the acquired securities and retained nearly $51.0 million in our portfolio. Additionally, the Bank took the opportunity to reposition a portion of its pre-acquisition portfolio through the sale of primarily shorter duration agency debenture bonds with maturities over one year. The increase in the size of the portfolio was intended to provide additional collateral for certain funding sources, and to provide additional liquidity for the Bank. Nearly $39 million of our securities portfolio matures in one year or less, giving us the capacity to fund future loan growth while maintaining an appropriate amount of securities to provide the required collateral under our repurchase agreements. As part of the repositioning of the portfolio we recorded a net loss of $364 thousand on sales of securities in 2018. We did not sell any securities during 2017, however in 2016 we sold an equity security with a carrying value of $100 thousand issued by a local small financial institution that resulted in a gain upon sale of $96 thousand.

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

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

Portfolio Maturities and Yields

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

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

Loan and Lease Portfolio

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

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

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

Commercial - owner occupied										
Commercial - non-owner occupied	427,747	25.9	260,802	27.8	216,781	26.4	181,361	23.9	123,958	22.4
Total commercial real estate	661,849	40.1	431,210	46.0	350,994	42.7	312,475	41.2	236,784	42.8
Total real estate loans	1,258,209	76.2	743,551	79.3	654,008	79.6	592,325	78.0	408,536	73.9
Commercial loans and leases	336,876	20.5	188,729	20.2	162,715	19.8	160,424	21.4	139,669	25.2
Consumer loans	54,666	3.3	4,328	0.5	4,801	0.6	4,253	0.6	4,712	0.9
Total loans and leases	$1,649,751	100.0%	$936,608	100.0%	$821,524	100.0%	$757,002	100.0%	$552,917	100.

35

Loan Portfolio Maturities

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

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

Loans Held for Sale

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

Goodwill and Other Intangible Assets

Goodwill represents the consideration paid in excess of the fair value of net assets acquired (including identifiable intangibles) in a business combination. In the First Mariner merger we recorded $70.1 million of goodwill. This amount plus the $603 thousand recorded from previous acquisitions increased our total goodwill at December 31, 2018 to $70.7 million. In addition we recorded $12.6 million of core deposit intangibles, which are premiums paid on acquired non-maturity deposits, related to the First Mariner merger. This amount plus the core deposit intangible amounts recorded from previous acquisitions resulted in a net carrying amount of $11.5 million at December 31, 2018 compared to $1.7 million at December 31, 2017.

Deposits

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

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

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

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

	December 31,								
(dollars in thousands)	2018			2017			2016		
	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate	Amount	% of Total	Weighted Average Rate
Noninterest-bearing demand	$429,200	26 %	- %	$218,139	26 %	- %	$182,880	23 %	- %
Interest-bearing checking	227,322								