FIRST MARINER BANCORP
Form 10-K
March 31, 2003

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C.**

# FORM 10-K

**(Mark One)**

ý **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the fiscal year ended December 31, 2002.**

**or**

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

**For the transition period from ___________**

**Commission file number 0-21815**

# FIRST MARINER BANCORP

(Exact name of registrant as specified in its charter)

| **Maryland** | **52-1834860** |
|---|---|
| (State of incorporation) | (IRS Employer Identification Number) |
| **3301 Boston Street, Baltimore, MD** | **21224** |
| (Address of principal executive offices) | (zip code) |

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

Securities registered under Section 12(b) of the Exchange Act: NONE

Securities registered under Section 12 (g) of the Exchange Act:
COMMON STOCK, par value $0.05 per share
(Title of Class)

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

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and no disclosure will 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. o

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $48 million.

The number of shares of common stock outstanding as of March 17, 2002 is 5,394,586 shares.

Documents incorporated by reference:

Proxy Statement Part III

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# FIRST MARINER BANCORP

**Annual Report on Form 10-K**
**December 31, 2002**

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**FORWARD-LOOKING STATEMENTS**

Part I and Part II of this Annual Report on Form 10-K may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of "forward-looking statements." Statements that are not historical in nature, including the words "anticipate," "estimate," "should," "expect," "believe," "intend," and similar expressions, are based on current expectations, estimates and projections about (among other things) the industry and the markets in which the Company operates; they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this Form 10-K, general economic, market or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in our competitive position or competitive actions by other companies; changes in the quality or composition of loan and investment portfolios; the ability to mange growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond the Company's control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on the Company's business or operations. Except as required by applicable laws, we do not intend to publish updates or revisions of any forward-looking statements we make to reflect new information, future events or otherwise. For a discussion of risks and uncertainties that could cause actual results to differ materially from those contained in the forward looking statements, see "Risk Factors" filed as Exhibit 99.1 to this Form 10-K.

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## PART I

### ITEM 1 BUSINESS

**General**

First Mariner Bancorp (the "Company") is a financial holding company whose business is conducted primarily through its wholly-owned operating subsidiaries, First Mariner Bank (the "Bank") and Finance Maryland LLC ("Finance Maryland"). The Bank, which was formed in 1995 through mergers of several local financial institutions, serves central Maryland, portions of Maryland's Eastern Shore and portions of Virginia. The Bank is headquartered in Baltimore City.

First Mariner Bank, whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"), is an independent community bank engaged in the general commercial banking business, with particular attention and emphasis on the needs of individuals and small to mid-sized businesses. The Bank delivers a wide range of financial products and services that are offered by many larger competitors. Products and services include traditional deposit products, a variety of consumer and commercial loans, residential and commercial mortgage and construction loans, money transfer services, non-deposit investment products, and Internet banking and similar services. Most importantly, the Bank provides customers with access to local Bank officers who are empowered to act with flexibility to meet customers' needs in an effort to foster and develop long-term loan and deposit relationships.

Finance Maryland, formed in July 2002, engages in traditional consumer finance activities, making small direct cash loans to individuals, the purchase of installment loan sales contracts from local merchants and retail dealers of consumer goods, and loans to individuals via direct mail solicitations. Finance Maryland currently operates eight branches in the State of Maryland, and had loan receivables of $9.5 million as of December 31, 2002.

Since the Company's formation in 1995, the business strategy has focused on development of an operational and retail distribution infrastructure to create a platform to support the generation of assets and deposits. At its inception the Bank had 20 employees, four full service branches and two ATM's in the Baltimore region, with total assets of $35.2 million, loans of $20.4 million, and deposits of $24.6 million. Since that time, assets have grown at an average compound annual growth rate of 45%. At December 31, 2002, the Company had 575 employees, 22 full service bank branches, 14 mortgage loan offices, 4 consumer finance offices, and approximately 208 ATMS (47 owned and 161 available to customers through third party agreements) with total assets of $870.2 million, loans of $534.0 million and deposits of $668.1 million. Net income for the twelve month period ending December 31, 2002 was $3.9 million.

The Company is not dependent on any single customer or small group of customers and does not experience any material seasonal variations in its business. The Company has no foreign operations.

The Company's executive offices are located at 3301 Boston Street, Baltimore, Maryland 21224 and its telephone number is (410) 342-2600. The Company maintains an internet site located at www.1stMarinerBank.com. The Company's annual report on Form 10-K and quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available, free of charge, in the investor relations section of the Company's internet site as soon as reasonably practicable after they are filed with the Securities and Exchange Commission.

**Business Strategy**

The Company's initial strategy involved building a network of banking branches, mortgage loan offices, and ATMs to capture market share and build a community franchise for stockholders, customers and employees. Having developed this infrastructure, the focus is now on growing assets and earnings by capitalizing on the broad network of Bank branches, mortgage offices, consumer finance offices and ATMs that were established during the infrastructure expansion phase. The Company



believes its current strategy to grow assets and increase profitability will not require substantial expansion of the existing infrastructure.

To continue asset growth and profitability, the Company's marketing strategy is targeted to:

- Capitalize on a personal relationship approach that the Company believes differentiates itself from its larger competitors;
- Provide customers with access to local executives who make key credit and other decisions;
- Pursue commercial lending opportunities with small to mid-sized businesses that are underserved by larger competitors;
- Develop innovative financial products and services to generate additional sources of revenue;
- Cross-sell products and services to existing customers to leverage relationships and enhance profitability;
- Review branch performance from time to time to evaluate possible consolidations that may increase efficiency; and
- Adhere to rigorous credit standards to maintain the continued quality of assets as the Company implements its growth strategy.

**Financial Services**

*Commercial Banking.* The Bank focuses its commercial loan originations on small and mid-sized businesses (generally up to $20.0 million in annual sales) and such loans are usually accompanied by significant related deposits. Commercial loan products include residential and commercial real estate construction loans; working capital loans and lines of credit; demand, term and time loans; and equipment,

inventory and accounts receivable financing. The Bank offers a range of cash management services and deposit products to its commercial customers. Computerized (on-line) banking is currently available to the Bank's commercial customers.

*Retail Banking.* The Bank's retail banking activities emphasize consumer deposit and checking accounts. An extensive range of these services is offered by the Bank to meet the varied needs of its customers from young persons to senior citizens. In addition to traditional products and services, the Bank offers contemporary products and services, such as debit cards, mutual funds and annuities, and Internet banking and electronic bill payment services. Consumer loan products offered by the Bank include home equity lines of credit, fixed rate second mortgages, new and used auto loans, new and used boat loans, overdraft protection, unsecured personal credit lines and the debit card.

*Mortgage Banking.* The Bank's mortgage banking business is structured to provide a source of fee income largely from the process of originating product for sale on the secondary market, as well as the origination of loans to be held in the Bank's loan portfolio. Mortgage banking capabilities include the Federal Housing Administration ("FHA") and the federal Veterans Administration ("VA"); conventional and nonconforming mortgage underwriting; and construction and permanent financing. The Bank intends to improve its competitive position in this market by streamlining the mortgage underwriting process through the introduction of advanced technology.

*Consumer Finance.* Finance Maryland was formed in July 2002, and is currently focused on building market share by offering competitive products and services, delivered by experienced personnel who provide responsive service. Loan sizes are generally smaller than those originated by the Bank (approximately $2,500).

*Community Reinvestment Act.* The Bank has a strong commitment to its responsibilities under the federal Community Reinvestment Act (the "CRA") and actively searches for opportunities to meet the development needs of all members of the community it serves, including persons of low to moderate



income in a manner consistent with safe and sound banking practices. The Bank currently fulfills this commitment by participating in loan programs sponsored or guaranteed by the United States Small Business Administration, the FHA, the VA, the federal Community Development Act, the Maryland Industrial Development Financing Authority, and the Settlement Expense Loan Program.

**Lending Activities**

*Loan Portfolio Composition.* At December 31, 2002, the Bank's loan portfolio totaled $534.0 million, representing approximately 61.4% of its total assets of $870.2 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the year ended December 31, 2002 for more detailed information concerning the composition of the loan portfolio.

*Commercial Loans.* The Bank originates secured and unsecured loans for business purposes. Less than one percent of all commercial loans are unsecured. Loans are made to provide working capital to businesses in the form of lines of credit, which may be secured by real estate, accounts receivable, inventory, equipment or other assets. The financial condition and cash flow of commercial borrowers are closely monitored by the submission of corporate financial statements, personal financial statements and income tax returns. The frequency of submissions of required financial information depends on the size and complexity of the credit and the collateral which secures the loan. It is the Bank's general policy to obtain personal guarantees from the principals of the commercial loan borrowers.

*Real Estate Development and Construction Loans.* The Bank provides interim real estate acquisition development and construction loans to builders, developers, and persons who will ultimately occupy the single family dwellings. Real estate development and construction loans that provide interim financing on the property are generally made for 80% or less of the appraised value of the property taking into consideration private mortgage insurance. Real estate development and construction loan funds are disbursed periodically at pre-specified stages of completion. The Bank carefully monitors these loans with on-site inspections and control of disbursements.

Loans to individuals for the construction of their primary residences are typically secured by the property under construction, they frequently include additional collateral (such as second mortgage on the borrower's present home), and commonly have maturities of 9 to 12 months.

Loans to residential builders are for the construction of residential homes for which a binding sales contract exists and the prospective buyers have been pre-qualified for permanent mortgage financing. Development loans are made only to developers with a proven track record. Generally, these loans are extended only when the borrower provides evidence that the lots under development will be sold to builders satisfactory to the Bank.

Development and construction loans are secured by the properties under development or construction and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely in the value of the underlying property, the Bank considers the financial condition and reputation of the borrower and any guarantors, the amount of the borrowers' equity in the project, independent appraisals, costs estimates and pre-construction sale information.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the year ended December 31, 2002 for more detailed information concerning real estate development and construction lending.

*Residential Real Estate Mortgage Loans.* The Bank's mortgage division originates adjustable and fixed-rate residential mortgage loans. Such mortgage loans are generally originated under terms, conditions and documentation acceptable to the secondary mortgage market. The Bank will place some of these loans into its portfolio, although the substantial majority are sold to investors.



*Commercial Real Estate Mortgage Loans.* The Bank originates mortgage loans secured by commercial real estate. Such loans are primarily secured by office buildings, retail buildings, warehouses and general purpose business space. Although terms may vary, the Bank's commercial mortgages generally have maturities of five years or less.

The Bank seeks to reduce the risks associated with commercial mortgage lending by generally lending in its market area and obtaining periodic financial statements and tax returns from borrowers. It is also the Bank's general policy to obtain personal guarantees from the principals of the borrowers and assignments of all leases related to the collateral.

*Consumer Loans.* The Bank offers a variety of consumer loans. These loans are typically secured by residential real estate or personal property, including automobiles and boats. Home equity loans (closed-end and lines of credit) are typically made up to 80% of the appraised value, less the amount of any existing prior liens on the property and generally have maximum terms of 10 years, although the Bank does offer a 90% loan to value product. The interest rates on closed-end home equity loans are generally fixed, while interest rates on home equity lines of credit are variable.

**Credit Administration**

The Bank's lending activities are subject to written policies approved by the Board of Directors to ensure proper management of credit risk. Loans are subject to a well defined credit process that includes credit evaluation of borrowers, risk-rating of credits, establishment of lending limits and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances, as well as procedures for on-going identification and management of credit deterioration. Regular portfolio reviews are performed to identify potential underperforming credits, estimate loss exposure, geographic and industry concentrations, and to ascertain compliance with the Bank's policies. For significant problem loans, management review consists of evaluation of the financial strengths of the borrower and the guarantor, the related collateral and the effects of economic conditions.

The Bank's loan approval policy provides for various levels of individual lending authority. The maximum lending authority granted by the Bank to any one individual is $500,000. The loan committee of the Board of Directors is authorized to approve loans up to the Bank's legal lending limit, which currently approximates $10.2 million as of December 31, 2002. The Bank has established an in-house limit of $3.0 million, which is reviewed periodically by the Board of Directors. The loan committee will approve loans in excess of the in-house limit on an exception basis.

The Bank generally does not make loans outside its market area unless the borrower has an established relationship with the Bank and conducts its principal business operations within the Bank's market area. Consequently, the Bank and its borrowers are affected by the economic conditions prevailing in its market area.

Finance Maryland's lending activities are subject to written policies approved by the Board of Directors. Loans are subject to a well-defined credit process that includes a credit evaluation of the borrower and the adequacy of available collateral. Finance Maryland's loan policy provides various levels of individual lending authority. Finance Maryland generally does not make loans outside the Maryland marketplace. Finance Maryland purchases installment sales contracts from dealers applying the same criteria. Dealers are subject to pre-approval due diligence and must have a proven track record with management.

**Competition**

The Company and the Bank operate in a competitive environment, competing for deposits and loans with commercial banks, thrifts, finance companies and other financial entities. Principal competitors include other community commercial banks and larger financial institutions with branches



in the Bank's market area. Numerous mergers and consolidations involving banks in the Bank's market area have occurred recently, requiring the Bank to compete with banks with greater resources.

The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations and office hours. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market funds and other investment alternatives. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services, responsiveness, and personalized services. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions, finance companies and other financial intermediaries. Many of the financial institutions operating in the Company's market area offer certain services such as trust and international banking, which the Company does not offer, and have greater financial resources or have substantially higher lending limits.

To compete with other financial services providers, the Company principally relies upon local promotional activities, personal relationships established by officers, directors and employees with its customers and specialized services tailored to meet its customers' needs. In those instances where the Company is unable to accommodate a customers' needs, it will arrange for those services to be provided by other financial institutions with which it has a relationship.

Current banking laws facilitate interstate branching and merger activity among banks. Since September, 1995, certain bank holding companies are authorized to acquire banks throughout the United States. In addition, on and after June 1, 1997, certain banks are permitted to merge with banks organized under the laws of different states. These changes have resulted in an even greater degree of competition in the banking industry and the Company and the Bank may be brought into competition with institutions with which it does not presently compete. As a result, intense competition in the Company's market area may be expected to continue for the foreseeable future.

**Supervision and Regulations**

The Company and the Bank are extensively regulated under federal and state law. Generally, these laws and regulations are intended to protect depositors, not stockholders. The following is a summary description of certain provisions of certain laws which affect the regulation of financial holding companies and banks. The discussion is qualified in its entirety by reference to applicable laws and regulations. Changes in such laws and regulations may have a material effect on the business and prospects of the Company and the Bank.

*Federal Financial Holding Company Regulation and Structure.* The Company is a financial holding company within the meaning of the Bank Holding Company Act of 1956, as amended, and as such, it is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System. The Company is required to file annual and quarterly reports with the Federal Reserve and to provide the Federal Reserve with such additional information as the Federal Reserve may require. The Federal Reserve may conduct examinations of the Company and its subsidiaries.

With certain limited exceptions, the Company is required to obtain prior approval from the Federal Reserve before acquiring direct or indirect ownership or control of more than 5% of any voting securities or substantially all of the assets of a bank or bank holding company, or before merging or consolidating with another bank holding company. In acting on applications for such approval, the Federal Reserve must consider various statutory factors, including among others, the effect of the proposed transaction on competition in the relevant geographical and product markets, each party's financial condition and management resources and record of performance under the CRA. Additionally, with certain exceptions any person proposing to acquire control through direct or indirect ownership of 25% or more of any voting securities of the Company is required to give 60 days written notice of the acquisition to the Federal Reserve, which may prohibit the transaction, and to publish notice to the public.



With prior approval of the Federal Reserve, the Company may acquire more than 5% of the assets or outstanding shares of a company engaging in nonbank activities determined by the Federal Reserve to be closely related to the business of banking or of managing or controlling

banks. Under current Federal Reserve regulations, such permissible nonbank activities include mortgage banking, equipment leasing, securities brokerage and consumer and commercial finance company operations.

Subsidiary banks of a financial holding company are subject to certain quantitative and qualitative restrictions on extensions of credit to the financial holding company or its subsidiaries, investments in their securities, and the use of their securities as collateral for loans to any borrower. These regulations and restrictions may limit the Company's ability to obtain funds from the Bank for its cash needs including funds for the payment of dividends, interest and operating expenses. Further, a financial holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. For example, the Bank may not generally require a customer to obtain other services from itself or the Company, and may not require that a customer promise not to obtain other services from a competitor as a condition to and extension of credit to the customer. The Federal Reserve has ended the anti-tying rules for financial holding companies and their non-banking subsidiaries. Such rules were retained for banks.

Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to make capital injections into a troubled subsidiary bank, and the Federal Reserve may charge the financial holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. A required capital injection may be called for at a time when the holding company does not have the resources to provide it. In addition, depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by, the FDIC in connection with the default of, or assistance provided to, a commonly controlled FDIC-insured depository institution. Accordingly, in the event that any insured subsidiary of the Company causes a loss to the FDIC, other insured subsidiaries of the Company could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guaranty liabilities generally are superior in priority to the obligations of the depository institution to its stockholders due solely to their status as stockholders and obligations to other affiliates.

*State Bank Holding Company Regulation.* As a Maryland bank holding company, the Company is subject to various restrictions on its activities as set forth in Maryland law, in addition to those restrictions set forth in federal law. Under Maryland law, a bank holding company that desires to acquire a bank or bank holding company that has its principal place of business in Maryland must obtain approval from the Maryland Commissioner of Financial Regulation. Also, a bank holding company and its Maryland chartered bank or trust company cannot directly or indirectly acquire banking or nonbanking subsidiaries or affiliates until the bank or trust company receives the approval of the Maryland Commissioner.

*Federal and State Bank Regulation.* The Company's banking subsidiary is a Maryland chartered trust company, with all the powers of a commercial bank regulated and examined by the Maryland Commissioner and the FDIC. The FDIC has extensive enforcement authority over the institutions it regulates to prohibit or correct activities which violate law, regulation or written agreement with the FDIC. Enforcement powers also regulate activities which are deemed to constitute unsafe or unsound practices. Enforcement actions may include the appointment of a conservator or receiver, the issuance of a cease and desist order, the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution-affiliated parties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the removal of or restrictions on directors, officers, employees and institution-affiliated parties, and the enforcement of any such mechanisms through restraining orders or other court actions.



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In its lending activities, the maximum legal rate of interest, fees and charges which a financial institution may charge on a particular loan depends on a variety of factors such as the type of borrower, the purpose of the loan, the amount of the loan and the date the loan is made. Other laws tie the maximum amount which may be loaned to any one customer and the related interest to a financial institution's capital levels. The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, principal shareholders or any related interest of such persons which generally require that such credit extensions be made on substantially the same terms as are available to third persons dealing with the Bank and not involve more than the normal risk of repayment.

The CRA requires that, in connection with the examination of financial institutions within their jurisdictions, the FDIC evaluate the record of the financial institution in meeting the credit needs of their communities including low and moderate income neighborhoods, consistent with the safe and sound operation of those banks. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank has a CRA rating of "Satisfactory."

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), each federal banking agency is required to prescribe, by regulation, noncapital safety and soundness standards for institutions under its authority. The federal banking agencies, including the FDIC, have adopted standards covering internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. An institution which fails to meet those standards may be required by the agency to develop a plan acceptable to the agency, specifying the steps that the institution will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. The Company, on behalf of the Bank, believes

that it meets substantially all standards which have been adopted. FDICIA also imposed new capital standards on insured depository institutions.

Before establishing new branch offices, the Bank must meet certain minimum capital stock and surplus requirements. With each new branch located outside the municipal area of the Bank's principal banking office, these minimal levels increase by $120,000 to $900,000, based on the population size of the municipal area in which the branch will be located. Prior to establishment of the branch, the Bank must obtain Commissioner and FDIC approval. If establishment of the branch involves the purchase of a bank building or furnishings, the total investment in bank buildings and furnishings cannot exceed, with certain exceptions, 50% of the Bank's unimpaired capital and surplus.

**Financial Services Modernization**

Effective in pertinent part on March 11, 2000, the federal Gramm-Leach-Bliley Act ("GLBA") revises the federal Bank Holding Company Act of 1956 and repeals the affiliation provisions of the federal Glass-Steagall Act of 1933, which, taken together, limited the securities, insurance, and other non-banking activities of any company that controls a FDIC insured financial institution. Under GLBA, bank holding companies can elect, subject to certain qualifications, to become a "financial holding company." The Company made an election to become a financial holding company in 2002 and, as such, the Company may engage in activities that are in addition to the business of banking. The GLBA provides that a financial holding company may engage in a full range of financial activities, including insurance and securities sales and underwriting activities, real estate development, and, with certain exceptions, merchant banking activities, with new expedited notice procedures. GLBA also permits certain qualified national banks to form "financial subsidiaries," which have broad authority to engage in all financial activities except insurance underwriting, insurance investments, real estate investment or development, and merchant banking, and expands the potential activities of subsidiaries of state banks, subject to applicable state law. The GLBA may increase the competition the Company encounters.



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**Deposit Insurance**

As a FDIC member institution, deposits of the Bank are currently insured to a minimum of $100,000 per depositor through the Savings Association Insurance Fund ("SAIF"), administered by the FDIC. Insured financial institutions are members of either SAIF or the Bank Insurance Fund ("BIF"). SAIF members generally are savings and loan associations or savings banks, including banks and trust companies that have converted from a savings and loan association or savings bank to a commercial bank or trust company or bank and trust companies that have acquired SAIF deposits. The Bank is a converted federal savings bank; therefore, its deposits are insured through SAIF. Mergers or transfers of assets between SAIF and BIF members generally are permitted with the assuming or resulting depository institution making payments of SAIF assessments on the portion of liabilities attributable to the SAIF-insured institution.

The FDIC is required to establish the semi-annual assessments for BIF- and SAIF-insured depository institutions at a rate determined to be appropriate to maintain or increase the reserve ratio of the respective deposit insurance funds at or above 1.25% of estimated insured deposits or at such higher percentage that the FDIC determines to be justified for that year by circumstances raising significant risk of substantial future losses to the fund.

This recapitalization has lowered the semiannual assessments paid by the Bank as a SAIF member. Assessments are made on a risk-based premium system with nine risk classifications based on certain capital and supervisory measures. Financial institutions with higher levels of capital and involving a low degree of supervisory concern are assessed lower premiums than financial institutions with lower levels of capital or involving a higher degree of supervisory concern.

**Limits on Dividends and Other Payments**

The Company's current ability to pay dividends is largely dependent upon the receipt of dividends from its banking subsidiary. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. Federal law prohibits the payment of a dividend by an uninsured depository institution like the Bank if the depository institution is considered "undercapitalized" or if the payment of the dividend would make the institution "undercapitalized". See "Federal Deposit Insurance Corporation Improvement Act of 1991" below. The Company does not anticipate that such provisions will be applied to the Bank. The Federal Reserve has issued a policy statement which provides that, as a general matter, insured banks and bank holding companies may pay dividends only out of prior operating earnings. For a Maryland chartered bank or trust company, dividends may be paid out of undivided profits or, with the prior approval of the Commissioner, from surplus in excess of 100% of required capital stock. If however, the surplus of a Maryland bank is less than 100% of its required capital stock, cash dividends may not be paid in excess of 90% of net earnings. In addition to these specific restrictions, bank regulatory agencies also have the ability to prohibit proposed dividends by a financial institution which would otherwise be permitted under applicable regulations if the regulatory body determines that such distribution would constitute an unsafe or unsound practice.

**Capital Requirements**

The Federal Reserve and FDIC have adopted certain risk-based capital guidelines to assist in the assessment of the capital adequacy of a banking organization's operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit and recourse arrangements which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. Treasury securities to 100% for assets with relatively high credit risk, such as business loans.



A banking organization's risk-based capital ratio is obtained by dividing its qualifying capital by its total risk adjusted assets. The regulators measure risk-adjusted assets, which include off balance sheet items, against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. "Tier 1", or core capital includes common equity, perpetual preferred stock (excluding auction rate issues), trust preferred securities (subject to certain limitations), and minority interest in equity accounts of consolidated subsidiaries (less goodwill and other intangibles), subject to certain exceptions. "Tier 2", or supplementary capital, includes, among other things limited-life preferred stock, hybrid capital instruments, mandatory convertible securities and trust preferred securities, qualifying and subordinated debt, and the allowance for loan and lease losses, subject to certain limitations and less required deductions. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Banks and bank holding companies, subject to the risk-based capital guidelines are required to maintain a ratio of Tier 1 capital to risk-weighted assets of at least 4% and a ratio of total capital to risk-weighted assets of at least 8%. The appropriate regulatory authority may set higher capital requirements when particular circumstances warrant. In addition to risk-based capital banks and bank holding companies are required to maintain a minimum amount of Tier 1 capital to fourth quarter average assets, referred to as the leverage capital ratio, of at least 4%. The Company and the Bank maintained capital ratios which exceeded these minimum standards. See "Management's Discussion and Analysis of Finance Condition and Results of Operations", for the year ended December 31, 2002 for more detailed information concerning capital adequacy.

Federal banking agencies have adopted regulations specifying that the agencies will include, in their evaluations of a Bank's capital adequacy, an assessment of the Bank's interest rate risk ("IRR") exposure. The standards for measuring the adequacy and effectiveness of a banking organization's interest rate risk management includes a measurement of board of director and senior management oversight, and a determination of whether a banking organization's procedures for comprehensive risk management are appropriate to the circumstances of the specific banking organization. The Bank maintains IRR models that are used to measure and monitor IRR. Additionally, the regulatory agencies have been assessing IRR on an informal basis for several years.

Failure to meet applicable capital guidelines could subject a banking organization to a variety of enforcement actions, including limitations on its ability to pay dividends, the issuance by the applicable regulatory authority of a capital directive to increase capital and, in the case of depository institutions, the termination of deposit insurance by the FDIC, as well as to the measures described under "Federal Deposit Insurance Corporation Improvement Act of 1991" below, as applicable to undercapitalized institutions. In addition, future changes in regulations or practices could further reduce the amount of capital recognized for purposes of capital adequacy. Such a change could affect the ability of the Bank to grow and could restrict the amount of profits, if any, available for the payment of dividends to the Company.

**Federal Deposit Insurance Corporation Improvement Act of 1991**

In December, 1991, Congress enacted FDICIA, which substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Act and made significant revisions to several other federal banking statutes. FDICIA provides for, among other things, (i) publicly available annual financial condition and management reports for financial institutions, including audits by independent accountants, (ii) the establishment of uniform accounting standards by federal banking agencies, (iii) the establishment of a "prompt corrective action" system of regulatory supervision and intervention, based on capitalization levels with more scrutiny and restrictions placed on depository institutions with lower levels of capital, (iv) additional grounds for the appointment of a conservator or receiver, and (v) restrictions or prohibitions on accepting brokered deposits, except for institutions



which significantly exceed minimum capital requirements. FDICIA also provides for increased funding of the FDIC insurance funds and the implementation of risked-based premiums.

A central feature of FDICIA is the requirement that the federal banking agencies take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. Pursuant to FDICIA, the federal bank regulatory authorities have adopted

regulations setting forth a five tiered system for measuring the capital adequacy of the depository institutions that they supervise. Under these regulations, a depository institution is classified in one of the following capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." An institution may be deemed by the regulators to be in a capitalization category that is lower than is indicated by its actual capital position if, among other things, it receives an unsatisfactory examination rating with respect to asset quality, management, earnings or liquidity.

FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a cash dividend) or paying any management fees to its holding company if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. Significantly undercapitalized depository institutions may be subject to a number of other requirements and restrictions including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and stop accepting deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator, generally within 90 days of the date such institution is determined to be critically undercapitalized.

FDICIA provides the federal banking agencies with significantly expanded powers to take enforcement action against institutions which fail to comply with capital or other standards. Such action may include the termination of deposit insurance by the FDIC or the appointment of a receiver or conservator for the institution. FDICIA also limits the circumstances under which the FDIC is permitted to provide financial assistance to an insured institution before appointment of a conservator or receiver.

**Interstate Banking Legislation**

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal") was enacted into law on September 29, 1994. Riegle-Neal authorized federal banking agencies to approve interstate bank merger transactions even if such transactions are prohibited by the laws of a state. An exception to such authorization arises if the home state of one of the banks that is a party to the merger transaction opted out of the merger provisions of Riegle-Neal by adopting a law after the date of the enactment of the Riegle-Neal and prior to June 1, 1997. These laws must apply equally to all out-of-state banks and expressly prohibit merger transactions involving out-of-state banks. Riegle-Neal also permits interstate branch acquisitions if the laws of the state where the branch is located permits interstate branch acquisitions. The interstate merger and branch acquisitions permitted by Riegle-Neal are subject to nationwide and statewide insured deposit limitations as described in Riegle-Neal.

Riegle-Neal also authorizes the federal banking agencies to approve *de novo* interstate branching by national and state banks in states which specifically allow for such branching. To the Company's knowledge, only two states, Texas and Montana, have opted out of the Riegle-Neal provisions relating to interstate mergers, acquisitions of branches and establishment of de novo branches. The Company anticipates that Riegle-Neal may increase competition within the market in which the Company operates, although the Company cannot predict the timing or the extent of such increased competition.



**ITEM 2 PROPERTY**

The principal executive offices of the Company, the main office of the Bank and Finance Maryland, are located at 3301 Boston Street, Baltimore, Maryland. The Company, the Bank and Finance Maryland lease approximately 53,000 square feet of space at this location. Annual rent for this space is approximately $964,000, of which $864,000 is allocated for 56,000 square feet of office and $100,000 is allocated for 3,000 square feet of Bank branch space and drive-up banking and customer parking facilities. The Company maintains an operations facility at 1516 Baylis Street, Baltimore, Maryland. The Bank occupies approximately 23,000 square feet of office space and 4,500 square feet of storage space at this location. Annual rent is approximately $231,000 for the office space.

The Bank operates retail bank branches at the following locations:*

**Annapolis (2)**
161A Jennifer Road
Annapolis, MD 21401-7923

**Loch Raven (1)**
1641 East Joppa Road
Baltimore, MD 21286

**Bel Air (1)**
12 A Bel Air South Parkway
Bel Air, MD 21015

**Lutherville/Timonium (2)**
1738 York Road
Lutherville, MD 21093

**Canton/Headquarters (2)**
3301 Boston Street
Baltimore, MD 21224

**Carroll Island (2)**
176 Carroll Island Road
Baltimore, MD 21220

**Cockeysville (1)**
9840 York Road
Baltimore, MD 21032

**Crofton (1)**
1049 MD Route 3
Gambrills, MD 21087

**Downtown Baltimore (2)**
16 S. Calvert Street
Baltimore, MD 21202-1305

**Dundalk (2)**
7860 Wise Avenue
Baltimore, MD 21222

**Easton (2)**
8133 Elliott Road
Easton, MD 21601

**Ellicott City (1)**
10065 Baltimore National Pike
Ellicott City, MD 21043

**Glen Burnie (2)**
7400 L. Gov. Ritchie Highway
Glen Burnie, MD 21061

**Ocean City (2)**
12505 Coastal Highway
Ocean City, MD 21842

**Owings Mills (2)**
60 Painters Mill Road
Owings Mills, MD 21117

**Perry Hall (1)**
8843 Bel Air Road
Perry Hall, MD 21236

**Pikesville (1)**
1013 Reisterstown Road
Baltimore, MD 21208-4207

**Randallstown (2)**
9833 Liberty Road
Randallstown, MD 21133-2034

**Severna Park (2)**
366A Ritchie Highway
Severna Park, MD 21146

**Towson (1)**
115 East Joppa Road
Baltimore, MD 21286-3113

**White Marsh (1)**
10101 Philadelphia Road
Baltimore, MD 21237

**Woodlawn (2)**
7007 Security Boulevard
Baltimore, MD 21244

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* For branch hours and remote ATM locations, please refer to our website at www.1stmarinerbank.com

(1) Bank owns branch

(2) Bank leases branch



For more information on lease commitments and costs see Note 6 of the notes to the consolidated financial statements.

The Bank operates mortgage offices at the following locations:

**Annadale, VA (2)**
7010 Little River Turnpike, Suite 140
Annadale, VA 22003

**Fredericksburg, VA (2)**
2515 Fall Hill Avenue
Fredericksburg, VA 22401

**Annapolis (2)**
2086 Generals Highway, 2nd Floor
Annapolis, MD 21401

**Canton (VA Mortgage.Com) (2)**
1516 Baylis Street
Baltimore, MD 21224

**Canton/Headquarters (2)**
3301 Boston Street
Baltimore, MD 21224

**Crofton (1)**
1049 MD Route 3
Gambrills, MD 21054

**Easton (2)**
8133 Elliott Road
Easton, MD 21601

**Eldersburg (2)**
1912 Liberty Road, Bldg. 2
Eldersburg, MD 21784

**Ellicott City (1)**
10065 Baltimore National Pike
Ellicott City, MD 21042

**Loch Raven (1)**
1641 East Joppa Road
Baltimore, MD 21286

**Ocean City (2)**
12505 Coastal Highway
Ocean City, MD 21842

**Prince Georges (2)**
7905 Malcolm Road, Suite 101
Clinton, MD 20735

**Salisbury (2)**
309 E. Main Street
Salisbury, MD 21801

**Waldorf (2)**
3200 Crain Highway, Suite 102
Waldorf, MD 20603-4841

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(1) Bank owns branch

(2) Bank leases branch



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Finance Maryland operates offices at the following locations:

**Bel Air (2)**
225 Briarhill Place
Bel Air, MD 21015

**Dundalk (2)**
1770 Merritt Blvd.
Baltimore, MD 21222

**Elkton (2)**
125 Big Elk Mall
Elkton, MD 21921

**Glen Burnie (2)**
7400 Ritchie Highway, Suite D
Glen Burnie, MD 21061

**Laurel (2)**

**Hagerstown (2)**
1423 Dual Hwy
Hagerstown, MD 21740

**Salisbury (2)**
319 B Civic Avenue
Salisbury, MD 21804

**Woodlawn (2)**
6666 Security Blvd., Suite 16
Baltimore, MD 21207

**Canton/Headquarters (2)**
3301 Boston Street
Baltimore, MD 21224

140 City Plaza
Laurel, MD 20702

(2) Finance Maryland leases branch

Bank branches range in total size from 2,000 to 4,000 square feet, mortgage offices from 1,200 to 2,000 square feet and Finance Maryland offices from 800 to 1,600 square feet. All locations are suitable and adequate to conduct business and support growth in customer and transaction volume.

**ITEM 3 LEGAL PROCEEDINGS**

Neither the Company nor the Bank is a party to, nor is any of their property the subject of, any material pending legal proceedings incidental to the business of the Company other than those arising in the ordinary course of business. In the opinion of management no such proceeding will have a material adverse effect on the financial position or results of operations of the Company.

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**ITEM 4A EXECUTIVE OFFICERS OF THE REGISTRANT**

*Edwin F. Hale, Sr.* (age 56) has been Chairman and Chief Executive Officer of the Company and of the Bank since 1995.

*Joseph A. Cicero* (age 58) has been the President of the Company and Chief Operating Officer of the Bank since 1996.

*George H. Mantakos* (age 60) has been Executive Vice President of the Company, and the President of the Bank since 1995.

*Mark A. Keidel* (age 41) has been Senior Vice President and Chief Financial Officer of the Company and the Bank since June 2000. Prior to June 2000, Mr. Keidel was Senior Vice President and Chief Financial Officer of Mason Dixon Bancshares for the preceding five years.



**PART II**

**ITEM 5 MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDERS MATTERS**

**Market for Common Stock**

The Company's common stock trades on The Nasdaq National Market under the symbol "FMAR." The table below sets forth for the periods indicated the low and high market prices of the Company's common stock as reported on The Nasdaq National Market. These over-the-counter market quotations reflect inter-dealer prices and do not include retail mark-up, mark-down or commissions, and they may not necessarily represent actual transactions. The Company currently has approximately 3,700 stockholders of record, and did not pay a cash dividend in 2001 or 2002.

| | Low | High |
|---|---|---|
| 2002 Quarter ended: | | |
| Fourth quarter | $ 8.860 | $ 11.440 |

| | Low | High |
|---|---|---|
| Third quarter | 9.950 | 12.500 |
| Second quarter | 9.700 | 12.930 |
| First quarter | 9.150 | 10.900 |
| 2001 Quarter ended: | | |
| Fourth quarter | 7.100 | 9.430 |
| Third quarter | 5.250 | 10.240 |
| Second quarter | 5.000 | 8.000 |
| First quarter | 4.000 | 7.375 |

**EQUITY COMPENSATION PLANS**

The following table sets forth the securities authorized for issuance under the Company's equity compensation plans as of December 31, 2002:

| Plan category | (A) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (B) Weighted-average exercise price of outstanding options, warrants and rights | (C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A)) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 514,538 | $ 8.58 | 258,014 |
| Equity compensation plans not approved by security holders | | | |
| Total | 514,538 | $ 8.58 | 258,014 |



**ITEM 6    SELECTED FINANCIAL DATA**

| | For the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| | (Dollars in thousands except for per share data) | | | | |
| Net Interest Income | $ 30,988 | $ 25,874 | $ 21,020 | $ 17,739 | $ 12,092 |
| Provision For Loan Losses | 2,175 | 1,625 | 1,105 | 785 | 1,212 |
| Noninterest Income | 14,994 | 10,741 | 8,923 | 7,176 | 5,525 |
| Noninterest Expense | 37,973 | 31,296 | 27,798 | 22,743 | 16,246 |
| Net Income | 3,904 | 2,304 | 640 | 877 | 1,123 |
| Dividends per Common Share | | | 0.02 | 0.06 | |
| Net Income per Common Share-Basic | 0.73 | 0.58 | 0.20 | 0.28 | 0.36 |
| Net Income per Common Share-Diluted | 0.69 | 0.57 | 0.20 | 0.26 | 0.32 |
| Total Assets | 870,192 | 777,865 | 677,449 | 616,072 | 497,487 |
| Loans Receivable, Net | 526,777 | 463,141 | 425,657 | 326,206 | 240,049 |
| Deposits | 668,169 | 600,588 | 476,882 | 368,751 | 262,311 |

| | For the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| Long-term Borrowings and Repurchase Agreements | 85,000 | 85,000 | 75,000 | 145,000 | 125,000 |
| Stockholders' Equity | 51,126 | 44,008 | 27,849 | 21,863 | 28,488 |
| Allowance For Loan Losses | 7,188 | 5,524 | 4,341 | 3,322 | 2,676 |
| Net Chargeoffs | 511 | 442 | 86 | 139 | 150 |
| Nonperforming Assets to Total Assets | 0.41% | 0.56% | 1.00% | 0.90% | 0.63% |
| Return On Average Assets | 0.49% | 0.32% | 0.10% | 0.16% | 0.32% |
| Return On Average Equity | 8.20% | 6.98% | 2.85% | 3.30% | 4.07% |
| Dividend Payout Ratio | | | 10% | 21% | |
| Average Equity to Average Assets | 5.99% | 4.65% | 3.45% | 4.79% | 7.94% |
| Regulatory Ratios | | | | | |
| Leverage | 8% | 8% | 6% | 6% | 8% |
| Tier 1 Capital To Risk Weighted Assets | 10% | 11% | 9% | 10% | 14% |
| Total Capital To Risk Weighted Assets | 13% | 13% | 12% | 15% | 19% |

**ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**About First Mariner Bancorp**

First Mariner Bancorp (the "Company") is a financial holding company incorporated under the laws of Maryland and registered under the federal Bank Holding Company Act of 1956, as amended. The Company was organized in 1994 and changed its name to First Mariner Bancorp in May 1995. Since 1995, the Company's strategy has involved building a network of banking branches and ATMs to capture market share and build a community franchise for stockholders, customers and employees. The Company is focusing on growing assets and earnings by capitalizing on the broad network of Bank branches, mortgage offices, and ATMs established during its infrastructure expansion phase.

Through its operating subsidiaries, First Mariner Bank (the "Bank") and Finance Maryland, LLC, ("Finance Maryland") the Company offers consumer and commercial banking and real estate lending services primarily throughout central Maryland and parts of its Eastern Shore and in portions of Virginia.

The following discussion compares the financial condition of the Company at December 31, 2002 to the financial condition at December 31, 2001 and results of operations for the years ended December 31, 2002, 2001 and 2000. This discussion should be read in conjunction with the



accompanying financial statements and related notes as well as statistical information included in this report.

**Application of Critical Accounting Policies**

The Company's consolidated financial statements are prepared in accordance with accounting principals generally accepted in the United States and follow general practices within the banking and financial services industry. The application of these accounting principles requires management to make estimates, judgments, and assumptions based upon information available at the time the financial statements are prepared, and affect the amounts reported in the financial statements and the accompanying notes.

The most significant accounting policies applied by the Company are discussed in note 1 to the consolidated financial statements of this document. These policies provide details on how certain assets and liabilities are valued in the financial statements and how those values are derived. Management believes that based upon the estimates, judgments and assumptions used to determine the allowance for loan losses, that this accounting estimate requires the most subjective and unpredictable judgments, and as such could be subject to revision as new information is available.

The determination of the amount of the Allowance for Loan Losses is considered by management as a critical accounting estimate, as it represents management's estimate of probable loan losses, and loans outstanding comprise 61.4% of the Company's total assets as of December 31, 2002. The estimates used in the determination of the allowance for loan losses include estimated losses on pools of homogeneous loans, losses estimated on specifically identified loans, and consideration of current economic trends and conditions, all of which may change

significantly over time. Note 1 to the consolidated financial statements describes the methodology used in determining the Allowance for Loan Losses and a detailed discussion of factors influencing possible changes in this critical accounting estimate is included in the Credit Risk Management and the Allowance for Loan Losses sections of Management's Discussion and Analysis of Financial Condition and Results of Operation.

**Performance Overview**

The Company continued to achieve significant growth in loans and deposits while producing a record profit in 2002. The Company began to leverage its infrastructure and slowed the rate of new branch growth in 2002, which reduced the growth rate of expenses and resulted in higher levels of earnings and improved productivity and efficiency measures.

The Company recorded net income of $3,904,000 for 2002 compared to $2,304,000 for 2001, an increase of 69.4%, marking the highest net income for any year since the Company's formation. Diluted earnings per share were also the highest in Company history, totaling $.69 per share for 2002, an increase of 21.1% from $.57 per diluted share in 2001. The growth in net income and earnings per share resulted as gross revenue (net interest income and non interest income) increased $9,367,000 or 25.6%, while noninterest expenses, the provision for loan losses, and income tax expense increased by $7,767,000 or 22.6%.

The largest category of revenue, net interest income, grew $5,114,000 or 19.8% due to growth in average earning assets of 10.9% and an increase in the net interest margin to 4.17% for 2002 from 3.86% in 2001. The increase in the net interest margin resulted as deposit and borrowing rates fell more than the decline in yields on loans, investments and other earning assets. Noninterest income increased $4,253,000 or 39.6% due to higher levels of mortgage banking revenue, increased commissions earned on the sales of non-deposit investment products, and growth in deposit service charges and ATM fees. Gains realized on the sale of investment securities increased $461,000. Core noninterest income (excluding gains on sales of investment securities) increased 35.4% and comprised 31.5% of total revenue compared to 29.2% in 2001.



The increase in total expenses resulted from higher noninterest expenses of $6,677,000, an increase in the provision for loan losses of $550,000 and higher income tax expense totaling $540,000. Non interest expense growth was primarily the result of higher salaries and benefit costs, and increased occupancy and equipment expenses to support the Company's growth as well as costs associated with the formation of Finance Maryland in July of 2002. The Company's efficiency ratio improved to 83.5% for 2002 from 85.6% for 2001. The increase in the provision for loan losses reflects the growth in loans, higher levels of net charge offs, and an increase in the allowance for loan losses to 1.35% of total loans as of December 31, 2002 from 1.18% as of December 31, 2001. Income tax expense increased due to an increase of $2,140,000 in net income before taxes. The effective tax rate for the Company decreased to 33.1% for 2002 compared to 37.6% for 2001. The effective rate decreased due to higher levels of tax- exempt income, primarily higher levels of investment securities exempt from state income taxes, and income from Bank Owned Life Insurance which is tax free.

Total assets increased by $92,327,000 or 11.9%, reflecting significant increases in loans and deposits. Loans outstanding increased by $65,300,000 or 13.9%, while deposits grew by $67,581,000 or 11.3%. Growth statistics for loans and deposits continue to compare favorably to industry averages, and reflect the Company's continued efforts in business development and advertising. Since First Mariner's inception in 1995, total assets, loans, and deposits have increased at an average annual compound growth rate of 45.0%, 46.0%, and 46.6% respectively. Stockholders' equity increased $7,118,000 or, 16.2% reflecting the retention of 2002's earnings, improvements in the market value of the Company's available-for-sale securities portfolio and shares issued under the Company's employee stock purchase plan and option plans of $249,000.

Asset quality was favorable in 2002. The ratio of nonperforming assets to total assets decreased to 0.41% at December 31, 2002 from 0.56% at December 31, 2001. The allowance for loan losses was increased to $7,188,000 and totaled 203.9% of nonperforming assets as of December 31, 2002, compared to 127.4% as of December 31, 2001. The ratio of net chargeoffs to average total loans was .10% in 2002, compared to .10% in 2001.

Capital adequacy levels remained strong, exceeding the levels required for "well-capitalized" status as defined by Banking regulation. December 31, 2002 ratios for capital leverage, Tier 1 capital to risk weighted assets, and total capital to risk weighted assets were 7.8%, 9.9%, and 13.3%, respectively, compared to 8.0%, 10.7%, and 12.9%, respectively, at December 31, 2001.

**Net Interest Income/Margins**

The primary source of earnings for the Company is net interest income, which is the difference between income earned on interest-earning assets, such as loans and investment securities, and interest expense incurred on the interest-bearing sources of funds, such as deposits and

borrowings. The level of net interest income is determined primarily by the average balances ("volume") and the rate spreads between the interest-earning assets and the Company's funding sources.

Net interest income increased to $30,998,000 for 2002, a 19.8% increase from the net interest income of $25,874,000 earned for 2001. The increase was attributable to growth in average earning assets, which increased by $72,985,000 or 10.9% and an increase in the spreads realized between earning assets and interest bearing liabilities. Average loans and loans held for sale increased by 7.2% to $550,688,000 and average investments and other earning assets increased by 22.9% to $192,110,000. The increase in average loans reflects the Company's expansion of its commercial and real estate lending activities among middle market borrowers in the Baltimore Metropolitan area, the growth of the Bank's mortgage banking activities, the Bank's continued emphasis on consumer lending, and consumer finance receivables generated by Finance Maryland. Average earning asset growth was funded by an increase in average deposits of $96,308,000 or 18.7%. The increase in average deposits was due to the continued success of sales and marketing efforts in the Company's retail banking and



commercial banking divisions, and the popularity of the Bank's "Flex CD" products. Average other borrowed funds decreased by $25,680,000 or 16.2%, as the Company repaid a significant portion of outstanding borrowings as deposit growth was more than sufficient to fund earning asset growth.

For 2002, interest income on loans decreased to $42,735,000, which represents a decrease of $886,000 or 2.0% from $43,621,000 for 2001. While average balances on loans increased by $37,214,000 or 7.2%, yields decreased 74 basis points to 7.76%, as the Federal Reserve continued to reduce market interest rates throughout 2002. Interest income on investment securities and other earning assets decreased $45,000 or 0.5% to $9,596,000 from $9,641,000. Average balances increased on investments and other earning assets by 22.9% and yields on these assets decreased by 117 basis points, which contributed to the decline in interest income. Interest expense on deposits decreased to $14,248,000 in 2002, a decrease of $4,136,000 or 22.5% from $18,384,000 for 2001. Growth in average interest bearing deposits of 16.0% was mostly offset by a decline in the average rates paid on interest-bearing deposits of 138 basis points. Interest expense on borrowings declined $1,909,000 to $7,095,000 for 2002, a decrease of 21.2% from $9,004,000 for 2001. The decline in average balances of 16.2%, as well as a decrease in the average rates paid on borrowings of 34 basis points, contributed to the reduction.

The key performance measure for net interest income is the "net interest margin", or net interest income divided by average earning assets. The Company's net interest margin is affected by loan pricing, mix of earning assets, and the distribution and pricing of deposits and borrowings. The Company's net interest margin was 4.17% for the year ended December 31, 2002 as compared to 3.86% for 2001. Yields on average total earning assets decreased by 90 basis points, while the cost of interest bearing deposits decreased by 138 basis points and the cost of other borrowings decreased by 34 basis points. A higher proportion of deposit accounts as a percentage of funding contributed to the increase in the net interest margin.

"Comparative Average Balances Yields and Rates" below indicates the Company's average volume of interest-earning assets and interest-bearing liabilities and average yields and rates. Changes in net interest income from period to period result from increases or decreases in the volume and mix of interest-earning assets and interest-bearing liabilities, increases or decreases in the average rates earned and paid on such assets and liabilities and the availability of particular sources of funds, such as non-interest bearing deposits.



**Comparative Average Balances Yields and Rates**

| | 2002 | | | 2001 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate |
| | (Dollars in thousands) | | | | | |
| Assets: | | | | | | |
| Loans & loans held for sale (net of unearned income)(1) | $ 550,688 | $ 42,735 | 7.76% | $ 513,474 | $ 43,621 | 8.50% |

| | 2002 | | | 2001 | | |
|---|---|---|---|---|---|---|
| Mortgage-backed securities available for sale | 96,649 | 5,262 | 5.44% | 103,938 | 6,562 | 6.31% |
| Interest-bearing deposits | 39,002 | 558 | 1.43% | 19,967 | 511 | 2.56% |
| Treasury notes and U.S. government agency securities | 15,615 | 709 | 4.54% | 3,023 | 208 | 6.88% |
| Trust preferred securities | 26,026 | 2,233 | 8.58% | 21,064 | 1,893 | 8.99% |
| Other earning assets | 14,818 | 834 | 5.62% | 8,347 | 467 | 5.59% |
| Total earning assets | 742,798 | 52,331 | 7.05% | 669,813 | 53,262 | 7.95% |
| Allowance for loan losses | (6,138) | | | (4,940) | | |
| Other assets | 57,896 | | | 44,998 | | |
| Total assets | $ 794,556 | | | $ 709,871 | | |
| Liabilities and stockholders' equity: | | | | | | |
| Deposits: | | | | | | |
| Passbook/Savings | $ 44,202 | 424 | 0.96% | $ 33,578 | 665 | 1.98% |
| NOW/MMDA | 203,969 | 2,589 | 1.27% | 214,708 | 6,916 | 3.22% |
| Certificates | 265,305 | 11,235 | 4.23% | 194,534 | 10,803 | 5.55% |
| Total interest-bearing deposits | 513,476 | 14,248 | 2.77% | 442,820 | 18,384 | 4.15% |
| Other borrowed funds | 132,539 | 7,095 | 5.35% | 158,219 | 9,004 | 5.69% |
| Total interest-bearing liabilities | 646,015 | 21,343 | 3.30% | 601,039 | 27,388 | 4.56% |
| Noninterest-bearing demand deposits | 98,010 | | | 72,358 | | |
| Other liabilities | 2,948 | | | 3,449 | | |
| Stockholders' equity | 47,583 | | | 33,025 | | |
| Total liabilities and stockholders' equity | $ 794,556 | | | $ 709,871 | | |
| Interest rate spread (Average yield less average rate) | | | 3.75% | | | 3.39% |
| Net interest income (Interest income less interest expense) | | $ 30,988 | | | $ 25,874 | |
| Net Interest Margin (Net interest income/total earning assets) | | | 4.17% | | | 3.86% |

(1) Loans on non-accrual status are included in the calculation of average balances. Loans held for sale are included in calculation of average balances, income and yield. Interest income on loans includes amortized loan fees, net of costs, and late fees of $2,382, $1,720, and $905 for 2002, 2001, and 2000 respectively.



| | 2000 | | |
|---|---|---|---|
| | Average Balance | Income/ Expense | Yield/ Rate |

| | 2000 | | |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Assets: | | | |
| Loans and loans held for sale (net of unearned income)(1) | $ 414,765 | $ 37,063 | 8.94% |
| Mortgage-backed securities available for sale | 155,879 | 11,132 | 7.14% |
| Interest-bearing deposits | 7,382 | 435 | 5.89% |
| Treasury notes and U.S. government agency securities | 6,833 | 515 | 7.54% |
| Trust preferred securities | 23,298 | 1,885 | 8.09% |
| Other earning assets | 7,434 | 530 | 7.13% |
| Total earning assets | 615,591 | 51,560 | 8.38% |
| Allowance for loan losses | (3,669) | | |
| Other assets | 37,988 | | |
| Total assets | $ 649,910 | | |
| Liabilities and stockholders' equity: | | | |
| Deposits: | | | |
| Passbook/Savings | $ 27,376 | 760 | 2.78% |
| NOW/MMDA | 178,115 | 8,404 | 4.72% |
| Certificates | 161,904 | 9,024 | 5.57% |
| Total interest-bearing deposits | 367,395 | 18,188 | 4.95% |
| Other borrowed funds | 201,989 | 12,352 | 6.12% |
| Total interest-bearing liabilities | 569,384 | 30,540 | 5.36% |
| Noninterest-bearing demand deposits | 57,377 | | |
| Other liabilities | 702 | | |
| Stockholders' equity | 22,447 | | |
| Total liabilities and stockholders' equity | $ 649,910 | | |
| Interest rate spread (Average yield less average rate) | | | 3.02% |
| Net interest income (Interest income less interest expense) | | $ 21,020 | |
| Net Interest Margin (Net interest income/total earning assets) | | | 3.41% |

(1) Loans on non-accrual status are included in the calculation of average balances. Loans held for sale are included in calculation of average balances, income and yield. Interest income on loans includes amortized loan fees, net of costs, and late fees of $2,382, $1,720, and $905 for 2002, 2001, and 2000 respectively.

"Rate/Volume Analysis" below indicates the changes in the Company's net interest income as a result of changes in volume and rates. Changes in interest income and interest expense that result from variances in both volume and rates has been allocated to rate and volume changes in proportion to the absolute dollar amounts of change in each. The Company has an asset and liability management policy designed to provide a proper balance between rate sensitive assets and rate sensitive liabilities to attempt to optimize interest margins and to provide adequate liquidity for anticipated needs.

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**Rate/Volume Analysis**

| | Year Ended December 31, 2002 Compared to Year Ended December 31, 2001 | | |
|---|---|---|---|
| | Variance due to changes in | | |
| | Average Volume | Average Rate | Net Increase/ (Decrease) |
| | (in thousands) | | |
| Interest Income: | | | |
| Loans and loans held for sale (net of unearned income) | $ 3,037 | $ (3,923) | $ (886) |
| Mortgage-backed securities available for sale | (440) | (860) | (1,300) |
| Interest-bearing deposits | 340 | (293) | 47 |
| Treasury notes and U.S. government agency securities | 595 | (94) | 501 |
| Trust preferred securities | 430 | (90) | 340 |
| Other earning assets | 363 | 4 | 367 |
| Total interest income | 4,325 | (5,256) | (931) |
| Interest Expense: | | | |
| Passbook | 169 | (410) | (241) |
| NOW/MMDA | (329) | (3,998) | (4,327) |
| Certificates | 3,360 | (2,928) | 432 |
| Other borrowed funds | (1,395) | (514) | (1,909) |
| Total interest expense | 1,805 | (7,850) | (6,045) |
| Change in net interest income | $ 2,520 | $ 2,594 | $ 5,114 |

| | Year Ended December 31, 2001 Compared to Year Ended December 31, 2000 | | |
|---|---|---|---|
| | Variance due to changes in | | |
| | Average Volume | Average Rate | Net Increase/ (Decrease) |

| | Year Ended December 31, 2001 Compared to Year Ended December 31, 2000 | | |
|---|---|---|---|
| | (in thousands) | | |
| Interest Income: | | | |
| Loans and loans held for sale (net of unearned income) | $ 8,460 | $ (1,902) | $ 6,558 |
| Mortgage-backed securities available for sale | (3,388) | (1,182) | (4,570) |
| Interest-bearing deposits | 426 | (350) | 76 |
| Treasury notes and U.S. government agency securities | (265) | (42) | (307) |
| Trust preferred securities | (190) | 198 | 8 |
| Other earning assets | 69 | (132) | (63) |
| Total interest income | 5,112 | (3,410) | 1,702 |
| Interest Expense: | | | |
| Passbook | 151 | (246) | (95) |
| NOW/MMDA | 1,506 | (2,994) | (1,488) |
| Certificates | 1,811 | (32) | 1,779 |
| Other borrowed funds | (2,528) | (820) | (3,348) |
| Total interest expense | 940 | (4,092) | (3,152) |
| Change in net interest income | $ 4,172 | $ 682 | $ 4,854 |



**Noninterest Income**

Noninterest income is principally derived from mortgage banking activities, service fees on deposit accounts, ATM fees, commissions on sales of insurance products and income from Bank Owned Life Insurance. Noninterest income for the year ended December 31, 2002 was $14,994,000, as compared to $10,741,000 for the year ended December 31, 2001, an increase of $4,253,000 or 39.6%. Core noninterest income (excluding gains on sales of investment securities) increased 35.4%.

Gains on sales of loans increased by $1,710,000 or 89.4% from the year ended December 31, 2001. Total originations of mortgage loans increased 10.0%, and resulted in more loans being sold into the secondary market than during the prior year, with pricing spreads on loans sold also improving. The increase in mortgage loan origination was the result of successful sales efforts, an increase in the number of mortgage loan offices and lower interest rates. Refinance activity accounted for just under 37% of the total mortgage loan origination activity for 2002. Other mortgage banking income decreased by $159,000 or 8.0%. Origination related income decreased by $48,000, while mortgage servicing revenue decreased by $111,000. Service fees on deposits increased by $737,000 or 20.5% as the Company increased the number of demand deposit accounts by 4,157 or 8.6%. Pricing on most deposit accounts remained unchanged throughout 2002. ATM fees increased by $474,000 or 29.0% due to increased transaction volume, higher transaction fee pricing for noncustomers, and added ATM locations. Net gains of $497,000 were realized on the sale of investment securities in 2002, compared to net gains of $36,000 for 2001. Other increases in non interest income included higher commissions earned on the sale of investment products of $327,000, commissions earned on sales of credit insurance policies of $355,000, and the increases in cash surrender value of Bank Owned Life Insurance of $529,000. The increase in income generated from the sales of investment products resulted from more focused sales training and marketing efforts.

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2002 Amount | 2001 Amount | 2000 Amount |
| | (Dollars in thousands) | | |

| | Years Ended December 31, | | |
|---|---|---|---|
| Gain on sale of loans | $ 3,622 | $ 1,912 | $ 1,576 |
| Service fees on deposits | 4,327 | 3,590 | 3,208 |
| ATM Fees | 2,109 | 1,635 | 1,457 |
| Gain on sale of investment securities | 497 | 36 | 359 |
| Other mortgage banking fees | 1,832 | 1,991 | 1,586 |
| Other | 2,607 | 1,577 | 737 |
| Total noninterest income | $ 14,994 | $ 10,741 | $ 8,923 |

**Noninterest Expense**

Noninterest expense totaled $37,973,000 for the year ended December 31, 2002, compared to $31,296,000 for 2001, an increase of $6,677,000 or 21.3%. This increase reflects management's continued emphasis on growth through bank branching, costs associated with the formation and development of Finance Maryland, as well as significant increases in loans, deposits and mortgage banking operational activities. While bank branch expansion slowed in 2002, four new Finance Maryland locations were opened in 2002. Excluding expenses of Finance Maryland, noninterest expenses increased $5,368,000 or 17.2%

Salaries and benefits increased $5,132,000 or 35.1% primarily due to staffing of Finance Maryland, staffing increases to support loan and deposit growth, higher commissions paid for mortgage and commercial loan production as well as regular salary increases and higher benefit costs. Occupancy costs for 2002 grew $513,000 or 11.5% compared to 2001. The increase was due to the relocation of existing branches and the additional Finance Maryland offices. Furniture, fixtures and equipment

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expense increased for the year ended 2002 by $355,000 or 17.0% due to relocating branches and the addition of Finance Maryland offices.

Professional services increased by $396,000 or 46.2% primarily as a result of increased legal fees associated with the workout of one large nonperforming loan. Advertising expenses decreased by 0.7% and totaled $1,071,000 as the Company maintained most of its advertising campaigns from the prior year. Data processing expenses increased $159,000 as the number of accounts increased. All other noninterest expenses increased $130,000 due to increased ATM costs and higher expenses for printing and office supplies.

**Noninterest expense**

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2002 Amount | 2001 Amount | 2000 Amount |
| | (Dollars in thousands) | | |
| Salaries and employee benefits | $ 19,761 | $ 14,629 | $ 13,367 |
| Net occupancy | 4,991 | 4,478 | 3,903 |
| Furniture, fixtures and equipment | 2,443 | 2,088 | 1,662 |
| Professional services | 1,254 | 858 | 601 |
| Advertising | 1,071 | 1,079 | 1,061 |
| Data processing | 1,746 | 1,587 | 1,645 |
| Service and maintenance | 1,043 | 933 | 915 |
| Office supplies | 550 | 455 | 391 |
| ATM servicing expenses | 831 | 695 | 630 |
| Printing | 459 | 368 | 332 |
| Corporate insurance | 191 | 154 | 121 |
| OREO expense | (131) | 412 | 35 |
| FDIC Premiums | 186 | 391 | 140 |
| Consulting fees | 232 | 221 | 252 |

| | Years Ended December 31, | | |
|---|---|---|---|
| Marketing/promotion | 619 | 459 | 443 |
| Postage | 393 | 319 | 317 |
| Security | 222 | 217 | 79 |
| Other | 2,112 | 1,953 | 1,904 |
| Total noninterest expense | $ 37,973 | $ 31,296 | $ 27,798 |

**Income Tax Expenses**

The Company recorded tax expense of $1,930,000 in 2002 for an effective tax rate of 33.1% compared to income tax expense of $1,390,000 and an effective tax rate of 37.6% for 2001. The effective rate decreased due to higher levels of tax- exempt income, primarily higher levels of investment securities exempt from state income taxes, and income from Bank Owned Life Insurance which is tax free.

The Company has utilized all prior net operating loss carryforwards for federal income tax purposes at December 31, 2002. Net operating loss carryforwards for state income tax purposes approximated $6,967,000 and can be offset by future state taxable income of First Mariner Bancorp only. Management anticipates that it is more likely than not that the future operations of First Mariner Bancorp will not generate sufficient taxable income to realize the potential utilization of the net operating loss carryforward. A valuation allowance equal to the deferred tax asset associated with the net operating loss carryforward of $322,000 has been established to reflect this uncertainty.



**Financial Condition**

At December 31, 2002, the Company's total assets were $870,192,000, as compared to $777,865,000 at December 31, 2001, an increase of 11.9%. This increase occurred as the Company continued to benefit from the development of its bank branching and mortgage loan office network, expansion of commercial and retail business development efforts, formation of Finance Maryland and successful development and marketing of deposit and loan products.

Loans at December 31, 2002 were $533,965,000, as compared to $468,665,000 on December 31, 2001, which represents an increase of $65,300,000 or 13.9%. Increases were realized in commercial mortgage, residential construction, and consumer loans, while residential mortgage loans, commercial construction loans and commercial loans decreased. Loans held for sale increased by $9,822,000 as a result of significant mortgage loan origination volume, particularly in the fourth quarter. Investment securities increased by $7,957,000. Interest bearing deposits increased by $1,514,000 due to growth in deposits and borrowed funds in excess of loan growth, the increase in loans held for sale, and growth in the investment portfolio.

Total deposits increased by $67,581,000, an increase of 11.3% from $600,588,000 at December 31, 2001. Borrowings, repurchase agreements, and trust preferred offerings increased by $16,500,000, and increased overall dependence on borrowed funds to 16.8% of total assets as of December 31, 2002, compared to 16.7% as of December 31, 2001.

**Loan Portfolio**

The Company's loan portfolio is expected to produce higher yields than investment securities and other interest-earning assets, the absolute volume and mix of loans and the volume and mix of loans as a percentage of total earning assets is an important determinant of net interest margin.

The following table sets forth the composition of the Bank's loan portfolio.

| At December 31, | | | | |
|---|---|---|---|---|
| **2002** | **2001** | **2000** | **1999** | **1998** |
| (in thousands) | | | | |

| | At December 31, | | | | |
|---|---|---|---|---|---|
| Loans: | | | | | |
| Commercial Loans and Lines of Credit | $ 56,760 | $ 64,157 | $ 70,726 | $ 68,215 | $ 62,593 |
| Commercial/Residential Construction | 31,878 | 34,411 | 34,832 | 8,092 | 33,773 |
| Commercial Mortgages | 202,994 | 144,836 | 101,601 | 97,909 | 46,193 |
| Residential Construction-Consumer | 135,189 | 125,954 | 82,318 | 34,419 | 17,706 |
| Residential Mortgages | 46,065 | 54,456 | 98,731 | 85,784 | 63,073 |
| Consumer | 61,079 | 44,851 | 41,790 | 35,109 | 19,387 |
| Total Loans | $ 533,965 | $ 468,665 | $ 429,998 | $ 329,528 | $ 242,725 |

The largest increase in the loan portfolio occurred in the Commercial mortgage category, which increased by $58,158,000 and reflected successful marketing and sales efforts, a strong regional economy, as well as a favorable interest rate environment. Consumer loans increased by $16,228,000 again due successful sales efforts, as well as a favorable economic and interest rate environment, and the formation of Finance Maryland. Residential real estate loans, which consist primarily of 3-year and 5-year adjustable rate mortgages, decreased by $8,391,000. The decrease in this category of loans reflects higher payoffs and lower originations of adjustable rate loans as historically low mortgage interest rates encouraged borrowers to elect fixed rate 15- and 30-year loans which were sold in the secondary market. Commercial loans decreased by $7,397,000 while commercial construction loans decreased by $2,533,000.

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Approximately 25.7% of the Bank's loans have adjustable rates as of December 31, 2002 and approximately 29.5% at December 31, 2001, including adjustable rate first mortgages indexed to U.S. Treasury obligations and variable home equity lines of credit tied to the Prime interest rate. Interest rates on variable rate loans adjust to the current interest rate environment, whereas fixed rates do not allow this flexibility. If interest rates were to increase in the future, the interest earned on the variable rate loans would improve, and if rates were to fall the interest earned would decline, thus impacting the Company's interest income. See also the discussion under "Liquidity and Interest Rate Sensitivity" below. The following table sets forth the maturity distribution, classified according to sensitivity to changes in interest rate, for the Bank's loan portfolio at December 31, 2002. Some of the loans may be renewed or repaid prior to maturity. Therefore, the following table should not be used as a forecast of future cash collections. The scheduled repayments as shown above are reported in the maturity category in which the payment is due.

**Maturity Schedule of Selected Loans**

| | Up to 1 Year | More Than 1 Year to 5 Years | 5 Years to 10 Years | More Than 10 Years | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Total Loans: | | | | | |
| Residential Real Estate | $ 3,864 | $ 3,323 | $ 4,704 | $ 34,174 | $ 46,065 |
| Commercial Construction | 7,715 | 9,085 | 1,355 | 2,350 | 20,505 |
| Residential Construction-Commercial | 6,013 | 4,955 | 358 | 47 | 11,373 |
| Residential Construction-Consumer | 133,525 | 1,071 | 75 | 518 | 135,189 |
| Commercial real estate | 23,984 | 128,896 | 46,381 | 3,733 | 202,994 |
| Commercial | 37,455 | 15,759 | 3,543 | 3 | 56,760 |
| Consumer | 36,660 | 14,111 | 4,362 | 5,946 | 61,079 |
| Total | $ 249,216 | $ 177,200 | $ 60,778 | $ 46,771 | $ 533,965 |
| Fixed Rate Loans: | | | | | |
| Residential Real Estate | $ 3,376 | $ 1,830 | $ 1,908 | $ 8,136 | $ 15,250 |

| | Up to 1 Year | More Than 1 Year to 5 Years | 5 Years to 10 Years | More Than 10 Years | Total |
|---|---|---|---|---|---|
| Commercial Construction | 1,959 | 7,768 | 1,317 | 2,350 | 13,394 |
| Residential Construction-Commercial | 445 | 525 | 358 | 12 | 1,340 |
| Residential Construction-Consumer | 131,816 | 1,040 | 21 | 13 | 132,890 |
| Commercial real estate | 18,090 | 112,050 | 40,490 | 3,542 | 174,172 |
| Commercial | 19,042 | 10,211 | 1,162 | | 30,415 |
| Consumer | 4,604 | 14,111 | 4,362 | 5,946 | 29,023 |
| Total Fixed Rate | 179,332 | 147,535 | 49,618 | 19,999 | 396,484 |
| Variable Rate Loans: | | | | | |
| Residential Real Estate | 488 | 1,493 | 2,796 | 26,038 | 30,815 |
| Commercial Construction | 5,756 | 1,317 | 38 | | 7,111 |
| Residential Construction-Commercial | 5,568 | 4,430 | | 35 | 10,033 |
| Residential Construction-Consumer | 1,709 | 31 | 54 | 505 | 2,299 |
| Commercial real estate | 5,894 | 16,846 | 5,891 | 191 | 28,822 |
| Commercial | 18,413 | 5,548 | 2,381 | 3 | 26,345 |
| Consumer | 32,056 | | | | 32,056 |
| Total Variable Rate | 69,884 | 29,665 | 11,160 | 26,772 | 137,481 |
| Total Fixed And Variable | $ 249,216 | $ 177,200 | $ 60,778 | $ 46,771 | $ 533,965 |

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**Credit Risk Management**

The Bank attempts to manage the risk characteristics of its loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, the Bank seeks to rely primarily on the cash flow of its borrowers' as the principal source of repayment. Although credit policies are designed to minimize risk, management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of the loan portfolio as well as general and regional economic conditions.

The allowance for loan losses represents a reserve for potential losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on nonaccruing, past due and other loans that management believes require special attention.

For significant problem loans, management's review consists of evaluation of the financial strengths of the borrower and the guarantor, the related collateral, and the effects of economic conditions. Specific reserves against the remaining loan portfolio are based on analysis of historical loan loss ratios, loan chargeoffs, delinquency trends, previous collection experience, and the risk rating on each individual loan along with an assessment of the effects of external economic conditions. "Allowance for Loan Loss Allocation," which is set forth below, indicates the specific reserves allocated by loan type and also the general reserves included in the allowance for loan losses.

The provision for loan losses is a charge to earnings in the current period to maintain the allowance at a level management has determined to be adequate based upon factors noted above. The Company provided $2,175,000 for loan losses for the year ended December 31, 2002, as compared to $1,625,000 for the year ended December 31, 2001. The higher provision was primarily the result of an increase in the coverage ratio of the allowance for loan losses to total loans to 1.35% as of December 32, 2002 from 1.18% as of December 31, 2001.

As of December 31, 2002 the allowance for loan losses was $7,188,000, as compared with the December 31, 2001 balance of $5,524,000, an increase of $1,664,000 or 30.1%. Net charge-offs of $511,000 and $442,000 were recognized for 2002 and 2001, respectively. Net charge-offs as a percentage of average loans remained at 0.10% for 2002 as well as 2001.

The following table, "Allowance for Loan Losses" summarizes the allowance activities.

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**Allowance for Loan Losses**

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2002** | **2001** | **2000** | **1999** | **1998** |
| | (Dollars in thousands) | | | | |
| Allowance for loan losses, beginning of year | $ 5,524 | $ 4,341 | $ 3,322 | $ 2,676 | $ 1,614 |
| Loans charged off: | | | | | |
| Commercial | | (347) | (62) | | (88) |
| Commercial/Residential Construction | (65) | (50) | | | (70) |
| Commercial Mortgages | | | | | |
| Residential Construction-Consumer | (200) | | | | |
| Residential Mortgages | | (5) | (24) | | |
| Consumer | (288) | (116) | (12) | (142) | (23) |
| Total loans charged off | (553) | (518) | (98) | (142) | (181) |
| Recoveries | | | | | |
| Commercial | | 69 | | | 9 |
| Commercial/Residential Construction | | | | | |
| Commercial Mortgages | | | | | |
| Residential Construction-Consumer | | | | | |
| Residential Mortgages | 9 | 1 | 4 | | 17 |
| Consumer | 33 | 6 | 8 | 3 | 5 |
| Total recoveries | 42 | 76 | 12 | 3 | 31 |
| Net chargeoffs | (511) | (442) | (86) | (139) | (150) |
| Provision for loan losses | 2,175 | 1,625 | 1,105 | 785 | 1,212 |
| Allowance for loan losses, end of year | $ 7,188 | $ 5,524 | $ 4,341 | $ 3,322 | $ 2,676 |
| Loans (net of premiums and discounts) | | | | | |
| Period-end balance | $ 533,965 | $ 468,665 | $ 429,998 | $ 329,528 | $ 242,725 |
| Average balance during period | 496,486 | 455,780 | 383,719 | 301,108 | 188,156 |
| Allowance as percentage of period-end loan balance | 1.35% | 1.18% | 1.01% | 1.01% | 1.10% |
| Percent of average loans: | | | | | |
| Provision for loan losses | 0.44% | 0.36% | 0.29% | 0.26% | 0.64% |
| Net chargeoffs | 0.10% | 0.10% | 0.02% | 0.05% | 0.08% |

Management's judgment as to the level of future losses on existing loans is based on management's internal review of the loan portfolio, including an analysis of the borrowers' current financial position, the consideration of current and anticipated economic conditions and their potential effects on specific borrowers. In determining the collectibility of certain loans, management also considers the fair value of any underlying collateral. However, management's determination of the appropriate allowance level is based upon a number of assumptions about future events, which are believed to be reasonable, but which may or may not prove valid. Thus, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the allowance for loan losses will not be required.

As a result of management's ongoing review of the loan portfolio, loans are classified as nonaccrual even though the presence of collateral or the borrowers financial strength may be sufficient



to provide for ultimate repayment. Interest on non-accrual residential real estate loans is recognized only when received. The following table summarizes the allocation of allowance by loan type.

**Allocation of Allowance for Loan Losses (dollars in thousands)**

| | December 31, 2002 | | | December 31, 2001 | | | December 31, 2000 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent of Total | Percent of Loans to Total Loans | Amount | Percent of Total | Percent of Loans to Total Loans | Amount | Percent of Total | Percent of Loans to Total Loans |
| Commercial Loans and Lines of Credit | $ 826 | 11.5% | 10.6% | $ 1,141 | 20.7% | 13.7% | $ 1,150 | 26.5% | 16.4% |
| Commercial/Residential Construction | 254 | 3.5% | 6.0% | 81 | 1.5% | 7.3% | 191 | 4.4% | 8.1% |
| Commercial Mortgages | 1,632 | 22.7% | 38.0% | 1,377 | 24.9% | 30.9% | 1,106 | 25.5% | 23.6% |
| Residential Construction-Consumer | 2,128 | 29.6% | 25.3% | 936 | 16.9% | 26.9% | 734 | 16.9% | 19.2% |
| Residential Mortgages | 23 | 0.3% | 8.6% | 99 | 1.8% | 11.6% | 107 | 2.5% | 23.0% |
| Consumer | 640 | 8.9% | 11.5% | 112 | 2.0% | 9.6% | 127 | 2.9% | 9.7% |
| Unallocated | 1,685 | 23.5% | | 1,778 | 32.2% | | 926 | 21.3% | |
| Total | $ 7,188 | 100.0% | 100.0% | $ 5,524 | 100.0% | 100.0% | $ 4,341 | 100.0% | 100.0% |

| | December 31, 1999 | | | December 31, 1998 | | |
|---|---|---|---|---|---|---|
| | Amount | Percent of Total | Percent of Loans to Total Loans | Amount | Percent of Total | Percent of Loans to Total Loans |
| Commercial Loans and Lines of Credit | $ 1,264 | 38.0% | 20.7% | $ 622 | 23.2% | 25.8% |
| Commercial/Residential Construction | 156 | 4.7% | 2.5% | 214 | 8.0% | 13.9% |
| Commercial Mortgages | 892 | 26.9% | 29.7% | 651 | 24.3% | 19.0% |
| Residential Construction-Consumer | 306 | 9.2% | 10.4% | 145 | 5.4% | 7.3% |
| Residential Mortgages | 90 | 2.7% | 26.0% | 62 | 2.3% | 26.0% |
| Consumer | 123 | 3.7% | 10.7% | 68 | 2.5% | 8.0% |
| Unallocated | 491 | 14.8% | | 914 | 34.3% | |
| Total | $ 3,322 | 100.0% | 100.0% | $ 2,676 | 100.0% | 100.0% |

**Nonperforming Assets**

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 | 1998 |
| | (Dollars in thousands) | | | | |
| Loans on nonaccrual basis | $ 1,278 | $ 1,652 | $ 3,172 | $ 4,229 | $ 1,520 |
| Real estate acquired by foreclosure | 2,247 | 2,683 | 3,610 | 1,360 | 1,633 |
| Total non-performing assets | $ 3,525 | $ 4,335 | $ 6,782 | $ 5,589 | $ 3,153 |
| Loans past-due 90 days or more and accruing | $ 9,346 | $ 5,257 | $ 701 | $ 2,062 | $ 126 |

As of December 31, 2002, the Company had approximately $1,278,000 in nonaccrual loans, as compared with $1,652,000 at December 31, 2001. The Company held other real estate owned of $2,247,000 at December 31, 2002, compared to $2,683,000 at December 31, 2001. The decrease in nonaccrual loans resulted primarily from the resolution of one large loan which was placed on accruing status during 2002, while the decline in other real estate owned resulted from increased sales of assets acquired in foreclosure. Nonperforming assets, the total of nonaccrual loans and other real estate owned, decreased to 0.41% of total assets at December 31, 2002 from 0.56% of total assets at



December 31, 2001, reflecting the decline in the level of nonperforming assets coupled with higher total assets.

The allowance for loan losses represented 203.9% of nonperforming assets as of December 31, 2002 compared to 127.4% as of December 31, 2001. At December 31, 2002, the allowance for loan losses represented 562.4% of nonaccruing loans compared to 334.4% at December 31, 2001. Management believes the allowance for loan losses is adequate.

**Capital Resources**

Stockholders' equity totaled $51,126,000 as of December 31, 2002 as compared to $44,008,000 as of December 31, 2001, an increase of $7,118,000 or 16.2%. The increase resulted from the change in accumulated other comprehensive income of $2,965,000, the net retention of earnings of $3,904,000, and the issuance of additional capital of $249,000. The change in accumulated other comprehensive income or (loss) reflects the increase in value of the Company's available for sale securities. As market interest rates declined throughout 2002, the value of securities classified as available-for-sale increased.

Banking regulatory authorities have implemented strict capital guidelines directly related to the credit risk associated with an institution's assets. Banks and financial holding companies are required to maintain capital levels based on their "risk adjusted" assets so that categories of assets with higher "deemed" credit risks will require more capital support than assets with lower risk. Additionally, capital must be maintained to support certain off-balance sheet instruments.

To date, the Company has provided its capital requirements mainly through the funds received for its stock offerings. In the future, the Company may consider raising capital from time to time through an offering of common stock or other securities. As reflected in the table for "Capital Ratios", the Company exceeded its capital adequacy requirements as of December 31, 2002 and 2001 and met the requirement for "well capitalized" under Federal Banking Regulation. The Company continually monitors its capital adequacy ratios to ensure that the Company exceeds regulatory capital requirements.

In December 2002, Mariner Capital Trust II, a wholly owned subsidiary of the Company, issued $10,000,000 of Variable Rate Preferred Securities due in December 2032. The entire amount of this issuance is included as additional total capital as of December 31, 2002. See note 9 of the Consolidated Financial Statements for more information concerning the Company's preferred securities.

Capital is classified as Tier 1 capital (common stockholders' equity less certain intangible assets plus a portion of the trust preferred securities) and Total Capital (Tier 1 plus the allowed portion of the allowance for loan losses and the portion of trust preferred securities not included in Tier 1 capital). Minimum required levels must at least equal 4% for Tier 1 capital and 8% for Total Capital. In addition, institutions must maintain a minimum of 4% leverage capital ratio (Tier 1 capital to average total assets for the previous quarter).

The Company's capital position is presented in the following table:

**Capital Ratios**

| | December 31, | | | Minimum Requirements for Capital Adequacy Purposes | To be Well Capitalized Under Prompt Corrective Action Provision |
|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | | |
| Total capital to risk weighted assets | 13.3% | 12.9% | 12.3% | 8.0% | 10.0% |
| Tier 1 capital to risk weighted assets | 9.9% | 10.7% | 9.0% | 4.0% | 6.0% |
| Tier 1 capital leverage ratio | 7.8% | 8.0% | 6.0% | 4.0% | 5.0% |

The Bank also maintains capital levels which qualify for "Well Capitalized" status under current regulatory guidelines. See note 14 to the consolidated financial statements for more detailed information on the Bank's capital adequacy ratios.



**Interest Rate Sensitivity and Liquidity**

Interest rate sensitivity is an important factor in the management of the composition and maturity configurations of earning assets and funding sources. The primary objective of asset/liability management is to ensure the steady growth of the Company's primary earnings component, net interest income. Net interest income can fluctuate with significant interest rate movements. To lessen the impact of interest rate movements, management endeavors to structure the statement of financial condition so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

The measurement of the Company's interest rate sensitivity, or "gap," is one of the principal techniques used in asset/liability management. Interest sensitive gap is the dollar difference between assets and liabilities which are subject to interest rate pricing within a given time period, including both floating rate or adjustable rate instruments and instruments which are approaching maturity.

The Company's management and the board of directors oversee the asset/liability management function and meet periodically to monitor and manage the statement of financial condition, control interest rate exposure, and evaluate pricing strategies for the Company. The asset mix of the statement of financial condition is continually evaluated in terms of several variables: yield, credit quality, appropriate funding sources and liquidity. Management of the liability mix of the statement of financial condition focuses on expanding the various funding sources.

In theory, interest rate risk can be diminished by maintaining a nominal level of interest rate sensitivity. In practice, this is made difficult by a number of factors including cyclical variation in loan demand, different impacts on interest-sensitive assets and liabilities when interest rates change, and the availability of funding sources. Accordingly, the Company undertakes to manage the interest rate sensitivity gap by adjusting the maturity of and establishing rates on the earning asset portfolio and certain interest-bearing liabilities commensurate with management's expectations relative to market interest rates. Additionally, management may employ the use of off balance sheet instruments, such as interest rate swap or caps, to manage its exposure to interest rate movements. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

The interest rate sensitivity position as of December 31, 2002 is presented in the table, "Rate Sensitivity Analysis" below. Assets and liabilities are scheduled based on maturity or repricing data except for mortgage loans and mortgage backed securities which are based on prevailing prepayments assumptions and core deposits which are based on core deposit studies done for banks in the Mid-Atlantic region. The difference between rate-sensitive assets and rate-sensitive liabilities or the interest rate sensitivity gap, is shown at the bottom of the table. As of December 31, 2002, the Company's interest sensitive assets exceeded interest sensitive liabilities within a one year period by $217,094,000 or 24.9% of total assets. As of December 31, 2001, interest rate sensitive assets exceeded interest-sensitive liabilities by $121,911,000 or 15.7%. The change in the interest rate sensitivity gap occurred due to growth in core deposits which are less rate sensitive, growth in time deposits with maturities in excess of one year, which funded increases in short term investments and interest bearing deposits, and growth in loans with maturities or repricing opportunities less than one year.

In addition to the use of interest rate sensitivity reports, the Company tests its interest rate sensitivity through the deployment of simulation analysis. Earnings simulation models are used to estimate what effect specific interest rate changes would have the Company's net interest income and net income. Simulation analysis provides a more rigorous and dynamic measure of interest sensitivity. Derivative financial instruments, such as interest rate caps, are included in the analysis. Changes in prepayments have been included where changes in behavior patterns are assumed to be significant to the simulation, particularly mortgage related assets. Call features on certain securities and borrowings

are based on their call probability in view of the projected rate change, and pricing features such as interest rate floors are incorporated. At December 31, 2002, the Company's estimated earnings sensitivity profile reflected minimal sensitivity to interest rate changes. Based on an assumed increase of 200 basis points over a one year period, the Company's net interest income would decrease by 4% if rates were to decrease, and it would increase by 0% if rates were to increase.

**Rate Sensititivity Analysis**

| | As of December 31, 2002 | | | | | |
|---|---|---|---|---|---|---|
| | 180 Days or Less | 181 Days- One Year | One-Five Years | Five-Ten Years | Longer Than 10 Years or Non-Sensitive | Total |
| | (Dollars in thousands) | | | | | |
| Interest-earning assets: | | | | | | |
| Interest-bearing deposits | $ 40,132 | $ | $ | $ | $ | $ 40,132 |
| Investment securities | 31,725 | 13,334 | 34,937 | 10,887 | 36,927 | 127,810 |
| Loans held for sale | 93,098 | | | | | 93,098 |
| Loans | 271,688 | 76,644 | 139,945 | 40,982 | 4,706 | 533,965 |
| Total interest-earnings assets | $ 436,643 | $ 89,978 | $ 174,882 | $ 51,869 | $ 41,633 | $ 795,005 |
| Interest-bearing liabilities: | | | | | | |
| Savings | $ 2,281 | $ 2,292 | $ 18,755 | $ 24,525 | $ | $ 47,853 |
| NOW accounts | 3,378 | 3,391 | 27,589 | 36,230 | | 70,588 |
| Money market accounts | 117,469 | 3,137 | 25,695 | | | 146,301 |
| Certificates | 56,836 | 80,919 | 148,023 | | | 285,778 |
| Borrowings | 39,824 | | 25,000 | 60,000 | 21,450 | 146,274 |
| Total interest-bearing liabilities | $ 219,788 | $ 89,739 | $ 245,062 | $ 120,755 | $ 21,450 | $ 696,794 |
| Interest rate sensitive gap | $ 216,855 | $ 239 | $ (70,180) | $ (68,886) | $ 20,183 | $ 98,211 |
| Cumulative interest rate gap | $ 216,855 | $ 217,094 | $ 146,914 | $ 78,028 | $ 98,211 | |
| Ratio of rate sensitive assets to rate sensitive liabilities | 199% | 100% | 71% | 43% | 194% | |

Liquidity describes the ability of the Company and the Bank to meet the financial obligations that arise out of the ordinary course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of the Bank's customers and to fund current and planned expenditures. Liquidity is derived from increased customer deposits, the maturity distribution of the investment portfolio, loan repayment and income from earning assets. The Company's loan to deposit ratio was 79.9% and 78.0% for December 31, 2002 and 2001, respectively. Funds received from new and existing depositors, provided a large source of liquidity for the years ended December 31, 2002 and 2001. The Bank seeks to rely primarily on core deposits from customers to provide stable and cost-effective sources of funding to support loan growth. The Bank also seeks to augment such deposits with longer term and higher yielding certificates of deposit. CD's of $100,000 or more are summarized by maturity in the table, "Maturity of Time Deposits $100,000 or More", below. To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term funds market. Longer term funding requirements can be obtained through advances from the Federal Home Loan Bank ("FHLB"). The Bank maintains lines of credit with the FHLB of $130,000,000, with a remaining availability of $70,000,000. The Bank maintains other lines of credit totaling $220,000,000. Most borrowing facilities require the pledging of

certain qualifying assets in order to access funding. As



of December 31, 2002, the Company's borrowing capacity totaled $85,000,000 based upon qualifying assets which are not currently pledged.

The Company maintained short-term interest-bearing deposits totaling $40,132,000 compared to $38,618,000. These deposits have immediate availability to meet short-term funding needs. Also, the Bank's investment securities portfolio includes $73,842,000 of mortgage-backed securities which provide significant cash flow each month. The entire investment portfolio is classified as available for sale, is highly marketable, and available to meet liquidity needs. Loans held for sale, which totaled $93,098,000 at December 31, 2002 are committed to be sold into the secondary market and generally are funded within 60 days. The Bank's residential real estate portfolio includes loans, which are underwritten to secondary market criteria and provide an additional source of liquidity. Additionally, the Bank's residential construction loan portfolio provides a source of liquidity as construction periods generally range from 6-12 months, and these loans are subsequently financed with permanent first mortgages and sold into the secondary market.

In the ordinary course of its business, the Company makes commitments to fund approved loans or make material commitments for capital expenditures such as new facilities or computer systems. As of December 31, 2002, the Company had outstanding loan commitments of $161,660,000 and no commitments for material capital expenditures. At December 31, 2001 unfunded loan commitments were $189,718,000 and commitments for the purchase of capital expenditures were $780,000. Management is not aware of any known trends, demands, commitments, or uncertainties that are reasonably likely to result in material changes in liquidity.

**Deposits**

The Bank uses deposits as the primary source of funding of its loans. The following table describes the maturity of time deposits of $100,000 or more at the dates indicated.

**Maturity of Time Deposits $100,000 or More**

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| | (Dollars in thousands) | | |
| Under 3 months | $ 8,070 | $ 6,557 | $ 7,905 |
| 3 to 6 months | 5,062 | 8,111 | 6,031 |
| 6 to 12 months | 23,653 | 8,632 | 10,371 |
| Over 12 months | 44,843 | 38,032 | 16,038 |
| Total | $ 81,628 | $ 61,332 | $ 40,345 |

The Bank offers individuals and businesses a wide variety of accounts. These accounts include checking, savings, money market and CD's and are obtained primarily from communities which the Bank serves. The Bank holds no brokered deposits. The following table details the average amount, the average rate paid and the percentage of each category to total deposits for the years ended December 31, 2002, 2001 and 2000.



**Average Deposit Composition and Cost**

| | Year Ended December 31, 2002 |
|---|---|

| | Year Ended December 31, 2002 | | |
|---|---|---|---|
| | Average Balance | Average Rate | Percent of Total |
| | (Dollars in thousands) | | |
| NOW and money market savings deposits | $ 203,969 | 1.27% | 33.4% |
| Regular savings deposits | 44,202 | 0.96% | 7.2% |
| Time deposits | 265,305 | 4.23% | 43.4% |
| Total interest-bearing deposits | 513,476 | 2.77% | 84.0% |
| Noninterest-bearing demand deposits | 98,010 | | 16.0% |
| Total deposits | $ 611,486 | 2.33% | 100.0% |

| | Year Ended December 31, 2001 | | |
|---|---|---|---|
| | Average Balance | Average Rate | Percent of Total |
| | (Dollars in thousands) | | |
| NOW and money market savings deposits | $ 214,708 | 3.22% | 41.7% |
| Regular savings deposits | 33,578 | 1.98% | 6.5% |
| Time deposits | 194,534 | 5.55% | 37.8% |
| Total interest-bearing deposits | 442,820 | 4.15% | 86.0% |
| Noninterest-bearing demand deposits | 72,358 | | 14.0% |
| Total deposits | $ 515,178 | 3.57% | 100.0% |

| | Year Ended December 31, 2000 | | |
|---|---|---|---|
| | Average Balance | Average Rate | Percent of Total |
| | (Dollars in thousands) | | |
| NOW & money market savings deposits | $ 178,115 | 4.72% | 41.9% |
| Regular savings deposits | 27,376 | 2.78% | 6.5% |
| Time deposits | 161,904 | 5.57% | 38.1% |
| Total interest-bearing deposits | 367,395 | 4.95% | 86.5% |
| Noninterest-bearing demand deposits | 57,377 | | 13.5% |

| | Year Ended December 31, 2000 | | |
|---|---|---|---|
| Total deposits | $ 424,772 | 4.28% | 100.0% |

Total deposits as of December 31, 2002 were $668,169,000 compared to $600,588,000 as of December 31, 2001, an increase of $67,581,000. Rates paid on deposits decreased significantly with the overall decrease in market interest rates. Most categories of deposits increased, with the largest growth occurring in time deposits and noninterest bearing demand deposits. These increases reflect management's growth strategy, which includes significant marketing and promotion, cross-selling, product development, and the development of a bank branch network.



**Investment Securities**

The following table presents the composition of the Company's securities portfolio as of December 31, 2002, 2001 and 2000:

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| | | (in thousands) | |
| Investment securities available for sale: | | | |
| Mortgage-backed securities | $ 73,842 | $ 87,057 | $ 126,985 |
| Trust preferred securities | 26,399 | 24,594 | 20,140 |
| US Government agency bonds | 12,159 | | 5,008 |
| US Treasury securities | 1,015 | 1,014 | 1,008 |
| Equity securities | 2,824 | 2,624 | 2,994 |
| Foreign Government Bonds | 850 | 600 | 600 |
| Other investment securities | 10,721 | 3,964 | |
| Total investment securities available-for-sale | $ 127,810 | $ 119,853 | $ 156,735 |

The investment portfolio at December 31, 2002, is comprised of highly marketable securities, with over 60% secured by the U.S. Government or U.S. Government agencies. Mortgage-backed securities decreased during 2002 as prepayments of principal on these securities increased significantly. The maturity structure of the investment portfolio is significantly influenced by the level of prepayment activity on mortgage-backed investments. At December 31, 2002, the average duration of the portfolio was 3.33 years reflecting current projections which predict a higher level of prepayments on mortgage-backed investments. Investments in trust preferred securities, corporate obligations and common stocks totaled $39,944,000 as of December 31, 2002. The credit risk associated with these investments is regularly monitored by management and risk is diversified as the maximum exposure to any one issuer is less than 4% of total investment securities.

**Borrowings and Repurchase Agreements**

Borrowings consist of short-term promissory notes issued to certain qualified investors and advances from the Federal Home Loan Bank of Atlanta ("FHLB"). The short-term promissory notes are in the form of commercial paper, which reprice daily and have maturities of 270 days or less. Advances from FHLB may be in the form of short-term or long-term obligations. Short-term advances have maturities for one year or less and can be paid without penalty. Long-term borrowings through the FHLB have original maturities up to ten years and generally contain prepayment penalties.

Total borrowings and repurchase agreements increased by $6,500,000 or 6.0%. The increase resulted from growth in short-term promissory notes. Long-term repurchase agreements and long-term FHLB advances remained unchanged from December 31, 2001.

Repurchase agreements may be short-term or long-term, are priced at origination and cannot be prepaid without penalty. Total repurchase agreements remained unchanged. See note 8 of the consolidated financial statements for more information concerning borrowings and repurchase agreements.

**Impact of Inflation and Changing Prices**

The consolidated financial statements and notes thereto presented elsewhere herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is



reflected in the increased cost of the Company's operations. Unlike most industrial companies, nearly all the assets of the Company are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

**Financial Review 2001/2000**

For the year ended December 31 2001, the Company recorded net income of $2,304,000 or $0.58 per basic share, compared to net income of $640,000 income or $0.20 per basic share in 2000. Results for 2001 reflect the completion of the Company's infrastructure and slowing the rate of branch growth which reduced the growth rate of expenses and resulted in higher levels of earnings.

Net interest income for 2001 increased $4,854,000 or 23.1% from 2000, due to growth in average earning assets of $54,222,000 or 8.8% over the prior year. The net interest margin increased 45 basis points to 3.86% in 2001 compared to 3.41% in 2000.

The provision for loan losses increased to $1,625,000 in 2001 from $1,105,000 in 2000. The allowance for loan losses at December 31, 2001 represented 1.18% of loans outstanding, an increase from December 31, 2000 of 1.01% of loans outstanding. Net chargeoffs were $442,000 in 2001 compared to $86,000 in 2000.

Total noninterest income increased 20.4% to $10,741,000. The increase was mostly due to an increase in service fees on deposits and ATM fees of 12.0% as a result of increases in demand deposit account volume of 20.2% and some pricing increases. Mortgage banking revenue and gains on sales of mortgage loans increased $691,000 due to higher mortgage loan origination volume which increased 95% from 2000 to 2001. Other sources of noninterest income increased due to higher commissions from the sale of non-deposit investment products ($500,000) and higher revenue from sales and issuances of official checks ($233,000).

The Company's noninterest expense growth was 12.6% to $31,296,000 in 2001. Salaries and benefits increased 9.4% to $14,629,000 as a result of additional staffing in the retail branches and mortgage banking offices due to the Bank's expansion programs. Also, additional employees were added to support the loan and deposit growth. Occupancy cost grew by 14.7% or $575,000. This increase was due to the addition of mortgage loan offices and costs to terminate leases of two supermarket branches. Advertising expense grew by $18,000 or 1.7% as most major advertising programs were continued in 2001. The increase in other expenses is primarily due to higher costs of other real estate owned, deposit insurance increases, increase bank security expenses and higher printing and office supplies.

The Company recorded an income tax expense of $1,390,000 in 2001, compared to $400,000 recorded in 2000. The effective income tax rate for 2001 was 37.6% compared to 38.5% for 2000.

**ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

See "Interest Rate Sensitivity and Liquidity" in Item 7 on page 33 of this Form 10-K.

**ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA**

**Independent Auditors' Report**

[STEGMAN & COMPANY LOGO]

Audit Committee of the Board of Directors and Stockholders
First Mariner Bancorp
Baltimore, Maryland

We have audited the accompanying consolidated statements of financial condition of First Mariner Bancorp and subsidiaries (the "Company") as of December 31, 2002 and 2001 and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2001, and the results of their operations and cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

/s/ Stegman & Company

Baltimore, Maryland
February 14, 2003



**FIRST MARINER BANCORP AND SUBSIDIARIES**
**Consolidated Statements of Financial Condition**

| | December 31, | |
|---|---|---|
| | 2002 | 2001 |
| | (Dollars in thousands) | |
| ASSETS | | |
| Cash and due from banks | $ 35,674 | $ 32,764 |
| Interest-bearing deposits | 40,132 | 38,618 |
| Available-for-sale securities, at fair value | 127,810 | 119,853 |
| Loans held for sale | 93,098 | 83,276 |
| Loans receivable | 533,965 | 468,665 |
| Allowance for loan losses | (7,188) | (5,524) |
| Loans, net | 526,777 | 463,141 |
| Other real estate owned | 2,247 | 2,683 |
| Restricted stock investments | 3,290 | 4,000 |
| Property and equipment, net | 17,571 | 14,558 |
| Accrued interest receivable | 4,540 | 4,137 |
| Deferred income taxes | 1,619 | 2,497 |
| Prepaid expenses and other assets | 17,434 | 12,338 |

| | December 31, | |
|---|---|---|
| Total assets | $ 870,192 | $ 777,865 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Liabilities: | | |
| Deposits | $ 668,169 | $ 600,588 |
| Borrowings | 89,824 | 83,324 |
| Repurchase agreements | 25,000 | 25,000 |
| Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company | 31,450 | 21,450 |
| Accrued expenses and other liabilities | 4,623 | 3,495 |
| Total liabilities | 819,066 | 733,857 |
| Stockholders' equity: | | |
| Common stock, $.05 par value; 20,000,000 shares authorized; 5,394,586 and 5,367,270 shares issued and outstanding, respectively | 270 | 268 |
| Accumulated other comprehensive income (loss) | 1,962 | (1,003) |
| Additional paid-in capital | 47,939 | 47,692 |
| Retained earnings (deficit) | 955 | (2,949) |
| Total stockholders' equity | 51,126 | 44,008 |
| Total liabilities and stockholders' equity | $ 870,192 | $ 777,865 |

See accompanying notes to consolidated financial statements.



**FIRST MARINER BANCORP AND SUBSIDIARIES**
**Consolidated Statements of Operations**

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| | (Dollars in thousands, except per share data) | | |
| Interest income: | | | |
| Loans | $ 42,735 | $ 43,621 | $ 37,063 |
| Investment securities and other earning assets | 9,596 | 9,641 | 14,497 |
| Total interest income | 52,331 | 53,262 | 51,560 |
| Interest expense: | | | |
| Deposits | 14,248 | 18,384 | 18,188 |
| Borrowed funds and other | 7,095 | 9,004 | 12,352 |

| | For the Years Ended December 31, | | |
|---|---|---|---|
| Total interest expense | 21,343 | 27,388 | 30,540 |
| Net interest income | 30,988 | 25,874 | 21,020 |
| Provision for loan losses | 2,175 | 1,625 | 1,105 |
| Net interest income after provision for loan losses | 28,813 | 24,249 | 19,915 |
| Noninterest income: | | | |
| Gain on sale of loans | 3,622 | 1,912 | 1,576 |
| Service fees on deposits | 4,327 | 3,590 | 3,208 |
| ATM Fees | 2,109 | 1,635 | 1,457 |
| Gain on sale of investment securities, net | 497 | 36 | 359 |
| Other mortgage banking fees | 1,832 | 1,991 | 1,586 |
| Other | 2,607 | 1,577 | 737 |
| Total noninterest income | 14,994 | 10,741 | 8,923 |
| Noninterest expenses: | | | |
| Salaries and employee benefits | 19,761 | 14,629 | 13,367 |
| Net occupancy | 4,991 | 4,478 | 3,903 |
| Furniture, fixtures and equipment | 2,443 | 2,088 | 1,662 |
| Professional services | 1,254 | 858 | 601 |
| Advertising | 1,071 | 1,079 | 1,061 |
| Data processing | 1,746 | 1,587 | 1,645 |
| Other | 6,707 | 6,577 | 5,559 |
| Total noninterest expenses | 37,973 | 31,296 | 27,798 |
| Income before income taxes | 5,834 | 3,694 | 1,040 |
| Income tax expense | 1,930 | 1,390 | 400 |
| Net income | $ 3,904 | $ 2,304 | $ 640 |
| Net income per common share: | | | |
| Basic | $ 0.73 | $ 0.58 | $ 0.20 |
| Diluted | 0.69 | 0.57 | 0.20 |

See accompanying notes to consolidated financial statements.



**FIRST MARINER BANCORP**
**Consolidated Statements of Changes in Stockholders' Equity**

| | For the Years Ended December 31, 2002, 2001 and 2000 | | | | | |
|---|---|---|---|---|---|---|
| | Number of Shares of Common Stock | Common Stock | Accumulated Other Comprehensive Income (Loss) | Additional Paid-in Capital | Retained Earnings (deficit) | Total Stockholders' Equity |

| | For the Years Ended December 31, 2002, 2001 and 2000 | | | | | |
|---|---|---|---|---|---|---|
| | | | (Dollars in thousands) | | | |
| Balance at January 1, 2000 | 3,166,813 | $ 158 | $ (6,859) | $ 34,394 | $ (5,830) | $ 21,863 |
| Common stock issued, net of costs of issuance | 443,995 | 23 | | 1,709 | | 1,732 |
| Net income | | | | | 640 | 640 |
| Other comprehensive income | | | 3,677 | | | 3,677 |
| Cash dividends ($0.02 per share) | | | | | (63) | (63) |
| Balance at December 31, 2000 | 3,610,808 | 181 | (3,182) | 36,103 | (5,253) | 27,849 |
| Common stock issued, net of costs of issuance | 1,756,462 | 87 | | 11,589 | | 11,676 |
| Net income | | | | | 2,304 | 2,304 |
| Other comprehensive income | | | 2,179 | | | 2,179 |
| Balance at December 31, 2001 | 5,367,270 | 268 | (1,003) | 47,692 | (2,949) | 44,008 |
| Common stock issued, net of costs of issuance | 27,316 | 2 | | 247 | | 249 |
| Net income | | | | | 3,904 | 3,904 |
| Other comprehensive income | | | 2,965 | | | 2,965 |
| Balance at December 31, 2002 | 5,394,586 | $ 270 | $ 1,962 | $ 47,939 | $ 955 | $ 51,126 |

See accompanying notes to consolidated financial statements



**FIRST MARINER BANCORP AND SUBSIDIARIES**
**Consolidated Statements of Cash Flows**

| | For The Year Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| | (Dollars in thousands) | | |
| Cash Flows From Operating Activities: | | | |
| Net income | $ 3,904 | $ 2,304 | $ 640 |
| Adjustments to reconcile net income to net cash used by operating activities: | | | |
| Depreciation and amortization | 3,023 | 2,560 | 2,056 |
| Capitalizated interest | (15) | (25) | (66) |
| Amortization of unearned loan fees and costs, net | (2,005) | (1,496) | (422) |
| Amortization of premiums and discounts on loans | 5 | 16 | 27 |
| Amortization of premiums and discounts on mortgage-backed securities, net | 708 | 434 | 221 |
| Gain on securities | (497) | (36) | (359) |
| Gain on other real estate owned | (310) | (9) | |
| Valuation allowance of other real estate owned | 100 | 342 | |
| Deferred income taxes | (794) | (392) | (137) |
| (Increase) decrease in accrued interest receivable | (403) | 276 | (1,101) |

| | For The Year Ended December 31, | | |
|---|---|---|---|
| Provision for loan losses | 2,175 | 1,625 | 1,105 |
| Increase in mortgage loans held-for-sale | (9,822) | (47,455) | (9,522) |
| Decrease in loan sales received in advance | | | (14,458) |
| Increase in accrued expenses and other liabilities | 1,128 | 434 | 1,077 |
| Net increase in prepaids and other assets | (5,096) | (9,376) | (886) |
| Net cash used in operating activities | (7,899) | (50,798) | (21,825) |
| Cash flows from investing activities: | | | |
| Loan disbursements, net of principal repayments | (63,961) | (38,443) | (102,816) |
| Purchases of property and equipment | (6,021) | (2,830) | (5,953) |
| Sales (purchases) of Federal Home Loan Bank of Atlanta stock | 750 | 539 | (174) |
| Purchase of Atlantic Central Bank stock | (40) | | |
| Purchases of available for sale securities | (80,233) | (22,398) | (18,942) |
| Sales of available for sale securities | 11,845 | 16,197 | 42,549 |
| Principal repayments of available for sale securities | 48,471 | 33,127 | 17,918 |
| Maturities of available for sale securities | 16,386 | 13,000 | |
| Construction disbursements-other real estate owned | (232) | (593) | (237) |
| Sales of other real estate owned | 1,028 | 2,001 | 642 |
| Net cash (used in) provided by investing activities | (72,007) | 600 | (67,013) |
| Cash flows from financing activities: | | | |
| Net increase in deposits | 67,581 | 123,706 | 108,131 |
| Net increase (decrease) in other borrowings | 16,500 | (28,466) | (22,834) |
| Proceeds from advances from Federal Home Loan Bank of Atlanta | 102,000 | 244,500 | 275,275 |
| Repayment of advances from Federal Home Loan Bank of Atlanta | (102,000) | (255,275) | (291,800) |
| Proceeds from stock issuance, net | 249 | 11,676 | 1,732 |
| Cash dividends | | | (63) |
| Net cash provided by financing activities | 84,330 | 96,141 | 70,441 |
| Increase (decrease) in cash and cash equivalents | 4,424 | 45,943 | (18,397) |
| Cash and cash equivalents at beginning of period | 71,382 | 25,439 | 43,836 |
| Cash and cash equivalents at end of period | $ 75,806 | $ 71,382 | $ 25,439 |
| Supplemental information: | | | |
| Interest paid on deposits and borrowed funds | $ 21,410 | $ 27,827 | $ 30,280 |
| Real estate acquired in satisfaction of loans | 150 | 814 | 2,665 |
| Income taxes paid | 2,828 | 1,980 | 483 |

See accompanying notes to consolidated financial statements.



**FIRST MARINER BANCORP AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**For the Years Ended December 31, 2002, 2001 and 2000**

**(1) Summary of Significant Accounting Policies**

***(a) Organization and Basis of Presentation***

First Mariner Bancorp (the "Company") is a financial holding company incorporated under the laws of the State of Maryland. The Company headquartered in Baltimore, Maryland, was organized as "MarylandsBank Corp." in May 1994. The Company's name was changed to "First Mariner Bancorp" in May 1995. The Company owns 100% of common stock of First Mariner Bank (the "Bank") and Finance Maryland, LLC ("Finance Maryland").

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to amounts previously reported to conform with classifications made in 2002.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses. In connection with these determinations, management evaluates historical trends and ratios and where appropriate obtains independent appraisals for significant properties and prepares fair value analyses. Actual results could differ significantly from those estimates.

***(b) Loans Receivable***

Loans receivable are stated at their principal balance outstanding net of related deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loans are placed in nonaccrual status when they are past due 90 days as to either principal or interest, unless the loan is well secured and in the process of collection or earlier when, in the opinion of management, the collection of principal and interest is in doubt. A loan remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. Loans are charged-off when a loan or a portion thereof is considered uncollectible.

The Company identifies impaired loans and measures impairment (i) at the present value of expected cash flows discounted at the loan's effective interest rate; (ii) at the observable market price, or (iii) at the fair value of the collateral if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, an impairment loss is recognized through a valuation allowance and corresponding charge to provision for loan losses. The Company does not apply these provisions to larger groups of smaller-balance homogeneous loans such as consumer installment, residential first and second mortgage loans and credit card loans. These loans are collectively evaluated for impairment.

A loan is determined to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is not considered impaired during a period of delay in payment if the Company expects to collect all amounts due, including interest past-due. The Company generally considers a period of delay in payment to include delinquency up to 90 days.



When the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent any interest has been foregone, and then they are recorded as recoveries of any amounts previously charged off. When this doubt no longer exists, cash receipts are applied under the contractual terms of the loan agreements. Origination and commitment fees and direct origination costs on loans held for investment are deferred and amortized to income over the contractual lives of the related loans using the interest method. Under certain circumstances, commitment fees are recognized over the commitment period or upon expiration of the commitment. Fees to extend loans three months or less are recognized in income upon receipt. Unamortized loan fees are recognized in income when the related loans are sold or prepaid.

***(c) Loans Held for Sale***

Loans originated for sale are carried at the lower of aggregate cost or market value. Market value is determined based on outstanding investor commitments or, in the absence of such commitments, based on current investor yield requirements. Gains and losses on loan sales are determined using the specific identification method.

***(d) Investment Securities***

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt and equity securities are classified as trading securities if bought and held principally for the purpose of selling them in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as held to maturity and debt and equity securities not classified as trading securities are considered available for sale and are reported at estimated fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of tax effects, in accumulated other comprehensive income.

The Company designates securities into one of the three categories at the time of purchase. If a decline in value of an individual security classified as held to maturity or available for sale is judged to be other than temporary, the cost basis of that security is reduced to its fair value and the amount of the write-down is reflected in earnings. Estimated fair value is determined based on bid prices published in financial newspapers or bid quotations received from securities dealers. Gains or losses on the sales of investments are calculated using a specific identification basis and are determined on a trade-date basis. Premiums and discounts on investment and mortgage-backed securities are amortized over the term of the security using methods that approximate the interest method.

***(e) Other Real Estate Owned***

Other real estate owned is recorded at the lower of cost or estimated fair value on their acquisition dates and at the lower of such initial amount or estimated fair value less selling costs thereafter. Subsequent write-downs are included in noninterest expense, along with operating income net of related expenses of such properties and gains or losses realized upon disposition.

***(f) Property and Equipment***

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are accumulated using straight-line and accelerated methods over the



estimated useful lives of the assets. Additions and betterments are capitalized and charges for repairs and maintenance are expensed when incurred. The cost and accumulated depreciation or amortization is eliminated from the accounts when an asset is sold or retired and the resultant gain or loss is credited or charged to income. Property and equipment have estimated useful lives of 3 to 39 years.

***(g) Allowance for Loan Losses***

The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing loans that may become uncollectible. The allowance for loan losses consists of an allocated component and an unallocated component. The components of the allowance for loan losses represent an estimation done pursuant to either Statement of Financial Accounting Standards ("SFAS") No. 5, *Accounting for Contingencies,* or SFAS No. 114, *Accounting by Creditors for Impairment of a Loan.* The adequacy of the allowance for loan losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of factors as outlined below to establish a prudent level. Loans deemed uncollectible are charged against, while recoveries are credited to, the allowance. Management adjusts the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowance and the unallocated allowance.

The formula allowance is calculated by applying loss factors to corresponding categories of outstanding homogenious loans. Loss factors are based on the Company's historical loss experience. The use of these loss factors is intended to reduce the difference between estimated losses inherent in the portfolio and observed losses.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a loan that leads management to believe the probability that a loss may be incurred in an amount different from the amount determined by formula allowance calculation. Management assigns a grade to each loan in this category based on an evaluation of each individual loan. Loss factors are

set by management to reflect its assessment of the relative level of risk inherent in each grade.

The unallocated allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of internal loan examiners, and management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Executive management reviews these conditions quarterly.

Management believes that the allowance for loan losses is adequate. However, the determination of the allowance requires significant judgment, and estimates of probable losses inherent in the loan portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions to the allowance may be necessary based on changes in the loans comprising the loan and lease portfolio and changes in the financial condition of borrowers which may result from changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's loan portfolio



and allowance for loan losses. Such review may result in recognition of additions to the allowance based on their judgments of information available to them at the time of their examination.

***(h) Comprehensive Income***

Comprehensive income includes all changes in stockholders' equity during a period, except those relating to investments by and distributions to stockholders. The Company's comprehensive income consists of net earnings and unrealized gains and losses on securities available-for-sale and is presented in Note 17. Accumulated other comprehensive income is displayed as a separate component of stockholders' equity.

***(i) Income Taxes***

Deferred income taxes are recognized for the tax consequences of temporary differences between financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income taxes are provided on income and expense items when they are reported for financial statement purposes in periods different from the periods in which these items are recognized in the income tax returns. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based upon consideration of available evidence, including tax planning strategies and other factors.

***(j) Statements of Cash Flows***

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. For reporting purposes assets grouped in the Statement of Condition under the captions "Cash and Due from Banks" and "Interest-bearing deposits" are considered cash or cash equivalents.

***(k) Net Income Per Share***

Basic earnings per share (EPS) is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the year. Diluted EPS is computed after adjusting the denominator of the basic EPS computation for the effect of all dilutive potential common shares outstanding during the period. The dilutive effects of options, warrants and their equivalents are computed under the "treasury stock" method, and are provided in Note 13.

***(l) Stock-Based Compensation***

The Company uses the intrinsic value method to account for stock-based employee compensation plans. Under this method, compensation cost is recognized for awards of shares of common stock to employees only if the quoted market price of the stock at the grant date (or other measurement date, if later) is greater than the amount the employee must pay to acquire the stock. Information concerning the pro forma effects of using an optional fair value-based method to account for stock-based employee compensation plans is provided in note 10.

***(m) Goodwill and Other Intangible Assets***

Goodwill represents the excess of the cost of assets acquired in business combinations accounted for under the purchase method over the fair value of the net assets at dates of acquisition and other identifiable intangible assets. Goodwill is tested for impairment on an annual basis.

***(n) Loan Servicing***

The cost of excess servicing receivables is amortized in proportion to, and over the period of, estimated net servicing revenue. Impairment of mortgage servicing receivables is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate. The amount of the impairment recognized is the amount by which the capitalized excess servicing receivables exceed their fair value.

When participating interests in loans sold have an average contractual interest rate, adjusted for normal servicing fees, that differs from the agreed yield to the purchaser, gains or losses are recognized equal to the present value of such differential over the estimated remaining life of such loans. The resulting "excess servicing receivable" or "deferred servicing revenue" is amortized over the estimated life using a method approximating the interest method.

Quoted market prices are not available for the excess servicing receivables. Thus, the excess servicing receivables and the amortization thereon are periodically evaluated in relation to estimated future servicing revenue, taking into consideration changes in interest rates, current repayment rates, and expected future cash flows. The Company evaluates the carrying value of the excess servicing receivables by estimating the future servicing income of the excess servicing receivables based on management's best estimate of remaining loan lives and discounted at the original discount rate.

***(o) Restricted Stock Investments***

The Bank, as a member of the Federal Home Loan Bank System, is required to maintain an investment in capital stock of the Federal Home Loan Bank of Atlanta ("FHLB") in varying amounts based on balances of outstanding home loans and on amounts borrowed from the FHLB. Because no ready market exists for this stock and it has no quoted market value, the Bank's investment in this stock is carried at cost.

The Bank, as a borrower of Atlantic Central Banker's Bank ("ACBB"), is required to maintain an investment in capital stock of ACBB in varying amounts based on balances of outstanding loans and on amounts borrowed from ACBB. Because no ready market exists for this stock and it has no quoted market value, the Bank's investment in this stock is carried at cost.

***(p) Advertising***

Advertising costs are expensed as incurred. Advertising expenses were $1,071,000, $1,079,000 and $1,061,000 for the years ended December 31, 2002, 2001 and 2000 respectively.

**(2) Recent Accounting Pronouncements**

ACCOUNTING FOR STOCK BASED COMPENSATION: In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 148, Accounting for Stock Based Compensation  Transition and Disclosure, which provides



guidance on how to transition from the intrinsic value method of accounting for stock-based employee compensation under Accounting Principles Board Opinion No. 25 to SFAS 123's fair value method accounting, if a company so elects. The Company is currently reviewing the impact of the various options of accounting for stock options.

ACQUISITIONS OF CERTAIN FINANCIAL INSTITUTIONS: In October 2002, the FASB issued SFAS No. 147, Acquisitions of Certain Financial Institutions, which provides guidance on the accounting for the acquisition of a financial institution and supersedes the specialized accounting guidance provided in SFAS No. 72, Accounting for Certain Acquisitions of Banking or Thrift Institutions. SFAS No. 147 became effective upon issuance and requires companies to cease amortization of unidentified intangible assets associated with certain branch acquisitions and reclassify these assets to goodwill. SFAS No. 147 also modifies SFAS No. 144 to include in its scope long-term customer-relationship intangible assets and thus subject those intangible assets to the same undiscounted cash flow recoverability test and impairment loss recognition and measurement provisions required for other long-lived assets.

SFAS No. 147 had no effect on results on operations, financial position, or liquidity because the Company does not have any assets subject to the specialized accounting guidance provided in SFAS No. 72 or SFAS No. 147.

ACCOUNTING FOR COSTS ASSOCIATED WITH EXIT OR DISPOSAL ACTIVITIES: SFAS No. 146, Accounting for costs associated with Exit or Disposal Activities, was issued in July, 2002 and becomes effective for the Company beginning January 1, 2003. This statement requires a cost associated with an exit or disposal activity, such as the sale or termination of a line of business, the closure of business activities in a particular location, or change in management structure, to be recorded as a liability at fair value when it becomes probable the cost will be incurred and no future economic benefit will be gained by the company for such cost. Applicable costs include employee termination benefits, contract termination costs, and costs to consolidate facilities or relocate employees. SFAS No. 146 supersedes Emerging Issues Task Force ("EITF") Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity, which in some cases required certain costs to be recognized before a liability was actually incurred. The adoption of this standard is not expected to have a material impact on results of operations, financial position, or liquidity.

RESCISSION OF SFAS Nos. 4, 44, AND 64, AMENDMENT OF SFAS No. 13, AND TECHNICAL CORRECTIONS (SFAS No. 145): In April 2002, the FASB issued SFAS No. 145, which updates, clarifies, and simplifies certain existing accounting pronouncements beginning at various dates in 2002 and 2003. The statement rescinds SFAS No. 4 and SFAS No. 64, which required net gains or losses from the extinguishment of debt to be classified as an extraordinary item in the income statement. These gains or losses will now be classified as extraordinary only if they meet the criteria for such classification as outlined in APB Opinion 30, which allows for extraordinary treatment if the item is material and both unusual and infrequent in nature. The statement also rescinds SFAS No. 44 related to the accounting for intangible assets for motor carriers and amends SFAS No. 13 to require certain lease modifications that have economic effects similar to sale-leaseback transactions to be accounted for as such. The changes required by SFAS No. 145 are not expected to have a material impact on results of operations, financial position, or liquidity.

ACCOUNTING FOR LONG-LIVED ASSETS: SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, was issued in August, 2002 and addresses how and when to measure



impairment on long-lived assets and how to account for long-lived assets that an entity plans to dispose of either through sale, abandonment, exchange, or distribution to owners. The statement's provisions supersede SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of, which addressed asset impairment, and disposal of a business segment and requires expected future operating losses from discontinued operations to be recorded in the period in which the losses are incurred rather than the measurement date. Under SFAS No. 144, more dispositions may qualify for discontinued operations treatment in the income statement. The provisions of SFAS No. 144 became effective for the Company on January 1, 2002, and did not have a material impact on results of operations, financial position or liquidity.

ASSET RETIREMENT OBLIGATIONS: In June 2002, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires an entity to record a liability for an obligation associated with the retirement of an asset at the time the liability is incurred by capitalizing the cost as part of the carrying value of the related asset and depreciating it over the remaining useful life of that asset. The standard is effective for the Company beginning January 1, 2003. Management does not expect the impact of SFAS No. 143 to be material to the Company's consolidated financial statements.

**(3) Restrictions on Cash and Due From Banks**

The Bank is required by the Federal Reserve System to maintain certain cash reserve balances based principally on deposit liabilities. At both December 31, 2002 and 2001, the required reserve balances were $275,000.

**(4) Available-for-sale securities**

The composition of available-for-sale securities and maturities, where applicable, are as follows at December 31:

| | 2002 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value | Weighted Average Yield |
| | | | (in thousands) | | |
| Available for sale securities: | | | | | |
| Mortgage-backed securities | $ 71,207 | $ 2,638 | $ 3 | $ 73,842 | 6.80% |
| Trust preferred securities due after 10 years | 26,645 | 867 | 1,113 | 26,399 | 8.41% |
| Equity securities | 2,298 | 619 | 93 | 2,824 | 3.40% |
| U.S. Treasury Securities-due one year | 998 | 17 | | 1,015 | 3.00% |
| Corporate Notes due after one year through five years | 5,898 | 26 | 3 | 5,921 | 5.54% |
| U.S. Government Agency Notes-due after one through five years | 11,982 | 177 | | 12,159 | 4.46% |
| Foreign Government Bonds due one year through five years | 850 | | | 850 | 6.49% |
| Other bonds and annuities due after five years through ten years | 4,800 | | | 4,800 | 6.52% |
| | $ 124,678 | $ 4,344 | $ 1,212 | $ 127,810 | 7.68% |

| | 2001 | | | | |
|---|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value | Weighted Average Yield |
| | | | (in thousands) | | |
| Available for sale securities: | | | | | |
| Mortgage-backed securities | $ 87,387 | $ 217 | $ 547 | $ 87,057 | 6.82% |
| Trust preferred securities due after 10 years | 26,268 | 286 | 1,960 | 24,594 | 8.49% |
| Equity securities | 2,142 | 584 | 104 | 2,622 | 3.50% |
| U.S. Treasury Securities-due one year | 1,000 | 14 | | 1,014 | 6.25% |
| Corporate Notes due after one year through five years | 2,047 | 4 | | 2,051 | 6.30% |
| Foreign Government Bonds due one year through five years | 600 | | | 600 | 6.86% |
| Other bonds and annuities due after five years through ten years | 1,915 | | | 1,915 | 6.75% |
| | $ 121,359 | $ 1,105 | $ 2,611 | $ 119,853 | 7.87% |

Stated maturities may differ from contractual maturities as issuers have the right to call or prepay certain obligations without penalty.

During 2002, 2001 and 2000, the Company recognized gross gains on sale of securities of $497,000, $91,000 and $359,000, respectively and gross losses of $0, $55,000 and $0, respectively.

At December 31, 2002, available for sale securities with an aggregate carrying value (fair value) of approximately $56,074,000 were pledged as collateral for borrowings under repurchase agreements.

**(5) Loans Receivable and Allowance for Loan Losses**

Approximately 90% of the Company's loans receivable are to customers located in the State of Maryland. Loans are extended only after evaluation by management of customers' creditworthiness and other relevant factors on a case-by-case basis. The Company generally does not lend more than 90% of the appraised value of a property and requires private mortgage insurance on residential mortgages with loan-to-value ratios in excess of 80%. In addition, the Company generally obtains personal guarantees of repayment from borrowers and/or others for construction, commercial and multi-family residential loans and disburses the proceeds of construction and similar loans only as work progresses on the related projects.

Residential lending is generally considered to involve less risk than other forms of lending, although payment experience on these loans is dependent to some extent on economic and market conditions in the Company's primary lending area. Commercial and construction loan repayments are generally dependent on the operations of the related properties or the financial condition of its borrower or guarantor. Accordingly, repayment of such loans can be more susceptible to adverse conditions in the real estate market and the regional economy.

Loans receivable are summarized as follows at December 31:

| | 2002 | 2001 |
|---|---|---|
| | (in thousands) | |
| Loans secured by first mortgages on real estate: | | |
| Residential | $ 46,249 | $ 54,625 |
| Commercial | 203,986 | 145,547 |
| Consumer residential construction | 135,339 | 126,246 |
| Construction, net of undisbursed principal | 32,050 | 34,668 |
| | 417,624 | 361,086 |
| Commercial | 56,812 | 64,295 |
| Loans secured by second mortgages on real estate | 35,824 | 28,399 |
| Consumer loans | 23,688 | 14,814 |
| Loans secured by deposits and other | 1,147 | 1,168 |
| Total loans | 535,095 | 469,762 |
| Unamortized loan (discounts) premiums | (175) | 5 |
| Unearned loan fees, net | (955) | (1,102) |
| | $ 533,965 | $ 468,665 |

Nonaccrual loans totaled approximately $1,278,000, $1,652,000 and $3,172,000 at December 31, 2002, 2001 and 2000, respectively. The interest income which would have been recorded in 2002, 2001 and 2000 under the original terms of loans in nonaccrual status was approximately $113,000, $168,000

and $302,000, respectively. The actual interest income recorded on these loans in 2002, 2001 and 2000 was approximately $3,000, $52,000 and $32,000, respectively.

There were no impaired loans at December 31, 2002 compared to $980,000 at December 31, 2001. The valuation allowance for impaired loans was $147,000 at December 31, 2001.

The average recorded investment in impaired loans was approximately $163,000, $2,031,000 and $3,426,000 for the years ended December 31, 2002, 2001 and 2000, respectively, and no income has been accrued or collected on these loans while they have been classified as impaired.

Changes in the allowance for losses on loans are summarized as follows:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |
| Balance at beginning of year | $ 5,524 | $ 4,341 | $ 3,322 |
| Provisions for loan losses | 2,175 | 1,625 | 1,105 |
| Charge-offs, net of recoveries | (511) | (442) | (86) |
| Balance at end of year | $ 7,188 | $ 5,524 | $ 4,341 |

Commitments to extend credit are agreements to lend to customers, provided that terms and conditions established in the related contracts are met. At December 31, 2002 and 2001, the Company had commitments to originate first mortgage loans on real estate of approximately $52,000,000 and $83,342,000, respectively, all of which were committed for sale in the secondary market.

At December 31, 2002 and 2001, the Company also had commitments to loan funds under unused home equity lines of credit aggregating approximately $27,562,000 and $20,453,000, respectively, and unused commercial lines of credit as well as unfunded construction commitments aggregating approximately $82,098,000 and $85,923,000, respectively. Such commitments generally carry a fixed rate of interest.

Commitments for first mortgage loans generally expire within 60 days and are normally funded with loan principal repayments, excess liquidity and deposits. Since certain of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Substantially all of the Company's outstanding commitments at December 31, 2002 and 2001 are for loans which would be secured by real estate with appraised values in excess of the commitment amounts. The Company's exposure to credit loss under these contracts in the event of non-performance by the other parties, assuming the collateral proves to be of no value, is represented by the commitment amounts.

During the ordinary course of business, the Company makes loans to its directors and their affiliates and several policy making officers on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other customers. Loans outstanding, both direct and indirect, to directors, their affiliates, and policy making officers totaled $3,044,000, and $2,957,000 at December 31, 2002, and 2001, respectively. During 2002, $689,000 of new loans were made and repayments totaled $602,000; in 2001, $224,000 of new loans and advances of existing loans were made and repayments totaled $2,279,000.



The Company retains servicing on certain loans it sold into the secondary market. At December 31, 2002 and 2001, the servicing portfolio totaled $10,491,000 and $18,766,000 respectively. Servicing loans for others generally consists of collecting mortgage payments, disbursing payments to investors and foreclosure processing. Loan servicing income is recorded upon receipt and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. Mortgage servicing rights had a carrying value of $107,000 and $258,000 as of December 31, 2002 and 2001, respectively. Estimated fair values of these servicing rights approximate carrying value. Amortization expense and impairment of servicing rights was $152,000 and $136,000 for the years ended December 31, 2002 and 2001, respectively.

**(6) Property and Equipment**

Property and equipment are summarized as follows at December 31:

| | 2002 | 2001 |
|---|---|---|
| | (in thousands) | |
| Land | $ 1,823 | $ 1,777 |
| Buildings and improvements | 6,759 | 4,797 |
| Leasehold improvements | 4,597 | 4,082 |
| Furniture, fixtures and equipment | 13,330 | 10,535 |
| Total at cost | 26,509 | 21,191 |
| Less accumulated depreciation and amortization | 8,938 | 6,633 |
| | $ 17,571 | $ 14,558 |

Rent expense for the years ended December 31, 2002, 2001 and 2000 was approximately $2,615,000, $2,590,000 and $2,191,000, respectively. Rent expense for 2002 including $100,000 for termination of existing leases and 2001 included $300,000 for early terminations of existing supermarket leases.

The Company and the Bank occupy space leased from a company, of which the Chairman and CEO of the Company is the owner. In 2002, this company was paid $904,000 for office and branch space. The original term of the lease is 15 years. Management believes that such terms are at least as favorable as those that could be obtained from a third party lessor.

Minimum lease payments due for each of the next five years are as follows:

| | (in thousands) |
|---|---|
| 2003 | $ 2,401 |
| 2004 | 2,288 |
| 2005 | 2,037 |
| 2006 | 1,943 |
| 2007 | 1,899 |
| Thereafter | 8,204 |
| | $ 18,772 |



**(7) Deposits**

Deposits are summarized as follows (dollars in thousands) at December 31:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Amount | Weighted Average Effective Rate | Amount | Weighted Average Effective Rate |
| Noncertificate: | | | | |
| Passbook and other savings | $ 47,853 | 0.96% | $ 36,839 | 1.98% |
| Interest bearing demand deposits | 70,588 | 0.75% | 47,690 | 1.15% |
| Money market accounts | 146,301 | 1.41% | 187,312 | 3.63% |
| Non-interest bearing demand | 117,649 | | 88,883 | |

| | 2002 | | 2001 | |
|---|---|---|---|---|
| Total noncertificate deposits | 382,391 | | 360,724 | |
| Certificates: | | | | |
| Original maturities: | | | | |
| Under 12 months | 5,475 | 2.16% | 4,853 | 4.72% |
| 12 to 60 months | 260,034 | 4.21% | 220,169 | 5.58% |
| IRA and KEOGH | 20,269 | 5.11% | 14,842 | 6.11% |
| Total certificates of deposit | 285,778 | | 239,864 | |
| Total deposits | $ 668,169 | | $ 600,588 | |

| | Amount | % of Total | Amount | % of Total |
|---|---|---|---|---|
| Scheduled certificate maturities: | | | | |
| Under 6 months | $ 47,236 | 16.53% | $ 51,109 | 21.30% |
| 6 months to 12 months | 90,937 | 31.82% | 41,047 | 17.11% |
| 12 months to 24 months | 81,916 | 28.66% | 126,452 | 52.72% |
| 24 months to 36 months | 17,383 | 6.08% | 16,307 | 6.80% |
| 36 months to 48 months | 9,819 | 3.44% | 1,141 | 0.48% |
| Over 48 months | 38,487 | 13.47% | 3,808 | 1.59% |
| | $ 285,778 | 100.00% | $ 239,864 | 100.00% |

The Bank offers certain certificate products that allow customers to withdraw funds at any time without penalty. As of December 31, 2002, certificates that permitted early withdrawal totaled $156,304,000.

Certificates of deposit of $100,000 or more totaled approximately $81,628,000 and $61,332,000 at December 31, 2002 and 2001, respectively.

**(8) Borrowings and Repurchase Agreements**

Borrowings consist of Federal Home Loan Bank at Atlanta (FHLB) advances, short-term promissory notes and repurchase agreements with callable options. The FHLB advances are available under a specific collateral pledge and security agreement, which allows the Company to borrow up to $130,000,000 and requires the Company to maintain collateral for all of its borrowings in the form of



specific first mortgage loans or commercial mortgages with outstanding principal equal to 133% of the advances, overnight investments equal to 100% of advances or securities equal to 103% of advances.

Certain information regarding borrowings and repurchase agreements are as follows:

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| | (dollars in thousands) | | |

| | December 31, | | |
|---|---|---|---|
| Amount outstanding at year-end: | | | |
| FHLB short-term advances | $ | $ | $ 5,775 |
| Short-term promissory notes | 29,824 | 23,324 | 27,874 |
| Short-term repurchase agreements | | | 38,916 |
| FHLB long-term advances | 60,000 | 60,000 | 65,000 |
| Long-term repurchase agreements | 25,000 | 25,000 | 10,000 |
| Weighted average interest rate at year-end: | | | |
| FHLB short-term advances | | | 6.87% |
| Short-term promissory notes | 1.00% | 1.29% | 4.41% |
| Short-term repurchase agreements | | | 6.63% |
| FHLB long-term advances | 5.99% | 5.99% | 5.89% |
| Long-term repurchase agreements | 5.06% | 5.06% | 6.16% |
| Maximum outstanding at any month-end: | | | |
| FHLB short-term advances | $ | $ 29,000 | $ 64,000 |
| Short-term promissory notes | 41,790 | 39,604 | 29,516 |
| Short-term repurchase agreements | 4,257 | 35,534 | 44,767 |
| FHLB long-term advances | 60,000 | 60,000 | 75,000 |
| Long-term repurchase agreements | 25,000 | 25,000 | 85,000 |
| Average outstanding: | | | |
| FHLB short-term advances | $ 2,409 | $ 16,283 | $ 32,175 |
| Short-term promissory notes | 21,543 | 21,070 | 22,257 |
| Short-term repurchase agreements | 723 | 18,934 | 28,116 |
| FHLB long-term advances | 60,000 | 60,288 | 62,083 |
| Long-term repurchase agreements | 25,000 | 20,217 | 33,750 |
| Weighted average interest rate during the year: | | | |
| FHLB short-term advances | 1.82% | 4.83% | 6.50% |
| Short-term promissory notes | 0.99% | 2.86% | 4.31% |
| Short-term repurchase agreements | 3.30% | 5.20% | 5.95% |
| FHLB long-term advances | 5.99% | 6.07% | 5.70% |
| Long-term repurchase agreements | 5.06% | 5.56% | 6.01% |

Repayments on Long-term FHLB advances and Long-term repurchase agreements are as follows: 2003-$0; 2004-$0; 2005-$10,000,000; 2006-$15,000,000; thereafter-$60,000,000. Long term borrowings totaling $85,000,000 are subject to call provisions beginning in 2003.

The Company has pledged securities with a carrying value (fair value) of $56,074,000 and loans with a carrying value of $80,000,000 as collateral for other borrowings.



**(9) Redeemable Trust Preferred Securities**

The Company has formed two wholly-owned statutory business trusts that have issued redeemable preferred securities. Mariner Capital Trust "(MCT") was formed in 1998 and Mariner Capital Trust II ("MCT II") was formed in 2002.

In June of 1998, MCT issued $21,450,000 - 8.30% (2,145,000 shares-$10 par value) Preferred Securities due in June of 2028. MCT invested the proceeds of the Preferred Securities, combined with $663,000 paid by the Company for MCT's Common Securities, in $22,113,000 of the Company's 8.30% Junior Subordinated Debentures. MCT's sole asset is the Junior Subordinated Debentures that mature in June of 2028. The Company has fully and unconditionally guaranteed all of MCT's obligations under the Preferred Securities. A portion of the Preferred Securities of MCT may qualify for inclusion in Tier 1 Capital under current capital guidelines, and any amount not qualifying as Tier 1 Capital is included in Total Capital. Preferred Securities issued by MCT are subject to call provisions beginning in June of 2003.

In December of 2002, MCT II issued $10,000,000 (10,000 shares-$1,000 par value) Floating Rate Preferred Securities due in December of 2032. These securities bear interest equal to LIBOR plus 3.35%, provided that the applicable interest rate may not exceed 12% through December 2007. MCT II invested the proceeds of the Preferred Securities, combined with $300,000 paid by the Company for MCT II's Common Securities, in $10,300,000 of the Company's Floating Rate Junior Subordinated Debentures. These subordinated securities bear interest equal to LIBOR plus 3.35%, provided that the applicable interest rate may not exceed 12% through December 2007. MCT II's sole asset is the Junior Subordinated Debentures that mature in December of 2032. The Company has fully and unconditionally guaranteed all of MCT II's obligations under the Preferred Securities. A portion of the Preferred Securities of MCT II may qualify for inclusion in Tier 1 Capital under current capital guidelines, and any amount not qualifying as Tier 1 Capital is included in Total Capital. Preferred Securities issued by MCT II are subject to call provisions beginning in December of 2007.

**(10) Employee Benefit Plans**

***(a)***

***Profit Sharing Plan***

The Company established a defined contribution plan in 1997, covering employees meeting certain age and service eligibility requirements. The Plan provides for cash deferrals qualifying under Section 401(k). Matching contributions made by the Company totaled $304,000, $238,000 and $145,000 in 2002, 2001, and 2000, respectively.

**(b)**

***Stock Options***

The Company has stock option award arrangements, which provide for the granting of options to acquire common stock to directors and key employees. Option prices are equal to or greater than the estimated fair market value of the common stock at the date of the grant. Options issued prior to 1996 are exercisable immediately after the date of grant. Beginning in 1996, options granted have a three-year vesting schedule with the first year vested upon issuance. All options expire ten years after the date of grant.



Information with respect to stock options is as follows for the years ended December 31, 2002, 2001 and 2000:

| | 2002 | | 2001 | | 2000 | |
|---|---|---|---|---|---|---|
| | **Number of Shares** | **Weighted Average Exercise Price** | **Number of Shares** | **Weighted Average Exercise Price** | **Number of Shares** | **Weighted Average Exercise Price** |
| Outstanding at beginning of year | 373,170 | $ 7.74 | 270,180 | $ 8.60 | 452,190 | $ 10.57 |
| Granted | 146,200 | 10.65 | 110,150 | 5.63 | 54,250 | 5.73 |
| Exercised | (3,498) | 5.58 | | | | |
| Forfeited/Cancelled | (1,334) | 7.89 | (7,160) | 7.57 | (236,260) | 11.70 |
| Outstanding at end of year | 514,538 | $ 8.58 | 373,170 | $ 7.74 | 270,180 | $ 8.60 |

Options outstanding are summarized as follows at December 31, 2002:

| Options Outstanding | | | |
|---|---|---|---|
| **Exercise Price ($)** | **Shares** | **Weighted Average Remaining Contractual Life (Years)** | **Options Exercisable Shares** |
| $ 4.00 | 1,400 | 8.0 | 933 |

| | Options Outstanding | | |
|---|---|---|---|
| 5.50 | 98,418 | 8.2 | 65,612 |
| 5.63 | 42,750 | 7.2 | 42,750 |
| 6.25 | 3,000 | 7.4 | 3,000 |
| 6.45 | 700 | 8.5 | 467 |
| 7.10 | 6,000 | 8.4 | 4,000 |
| 7.40 | 550 | 8.8 | 367 |
| 8.69 | 10,000 | 6.9 | 10,000 |
| 9.09 | 185,020 | 3.9 | 185,020 |
| 9.16 | 1,250 | 9.0 | 833 |
| 9.86 | 1,850 | 9.8 | 617 |
| 10.45 | 125,000 | 9.2 | 41,667 |
| 10.50 | 3,000 | 6.6 | 3,000 |
| 10.70 | 850 | 9.3 | 283 |
| 11.75 | 16,250 | 6.2 | 16,250 |
| 12.03 | 6,500 | 9.4 | 2,167 |
| 12.10 | 12,000 | 9.4 | 4,000 |
| $ 8.58 | 514,538 | 6.8 | 380,966 |

The option price was equal to the market price of the common stock at the date of grant for all options granted in 2002, 2001 and 2000 and, accordingly, no compensation expense related to options was recognized. If the Company had applied a fair value-based method to recognize compensation cost



for the options granted, net income and net income per share would have been changed to the following pro forma amounts for the years ended December 31, 2002:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | (dollars in thousands) | | |
| Net income-as reported | $ 3,904 | $ 2,304 | $ 640 |
| Deduct: Total stock-based employee Compensation determined under fair Value based method for all awards, Net of related income tax effects | (335) | (159) | (69) |
| Proforma net income | $ 3,569 | $ 2,145 | $ 571 |
| Earnings per share: | | | |
| Basic as reported | 0.73 | 0.58 | 0.20 |
| Basic proforma | 0.66 | 0.54 | 0.18 |
| Diluted as reported | 0.69 | 0.57 | 0.20 |
| Diluted proforma | 0.63 | 0.53 | 0.18 |

The weighted average fair values of options granted during 2002, 2001 and 2000 were $7.03, $4.33 and $3.07, respectively, on the dates of grant. The fair values of options granted were calculated using the Black-Scholes option-pricing model with the following weighted average assumptions:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Dividend yield | 0.00% | 0.00% | 0.00% |
| Expected volatility | 48.22% | 65.00% | 25.00% |
| Risk-free interest rate | 4.98% | 5.29% | 6.35% |
| Expected lives | 10 Years | 10 Years | 10 Years |

***(c) Warrants***

Warrants to acquire 885,302 shares of common stock at $9.09 per share were outstanding and exercisable at December 31, 2002, 2001 and 2000, respectively. These warrants have various expiration dates beginning 2004.

***(d) Stock Purchase***

The Company began a stock purchase plan for employees in 2000 whereby the employees can purchase Company stock through payroll deductions. The Company may provide a discount of up to 10% of the purchase price.

**(11) Income Taxes**

Income tax expense consists of the following for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |
| Current | $ 1,136 | $ 998 | $ 263 |
| Deferred | 794 | 392 | 137 |
| Income tax expense | $ 1,930 | $ 1,390 | $ 400 |



Income tax expense (benefit) are reconciled to the amount computed by applying the federal corporate tax rate of 34% to income before taxes as follows for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |
| Income tax expense at federal corporate rate | $ 1,984 | $ 1,256 | $ 354 |
| Change in valuation allowance | 103 | 63 | 49 |
| Other | (157) | 71 | (3) |
| | $ 1,930 | $ 1,390 | $ 400 |

The tax effects of temporary differences between the financial reporting basis and income tax basis of assets and liabilities relate to the following at December 31:

| | 2002 | 2001 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Allowance for losses on loans | $ 2,589 | $ 2,102 |
| Amortization of intangible assets | 113 | 56 |
| Net operating loss carryforward | 322 | 219 |
| Other | 223 | 114 |
| Total gross deferred tax assets | 3,247 | 2,491 |
| Less valuation allowance | (322) | (219) |

| | 2002 | 2001 |
|---|---|---|
| Net deferred tax assets | 2,925 | 2,272 |
| Deferred tax liabilities: | | |
| Depreciation | 83 | 178 |
| Gain on sales of loans | 53 | 100 |
| Total gross deferred tax liabilities | 136 | 278 |
| Attributable to operations | 2,789 | 1,994 |
| Unrealized loss on investments charged to other comprehensive income | (1,170) | 503 |
| Deferred income taxes | $ 1,619 | $ 2,497 |

The Company has net operating loss carryforwards for state income tax purposes of approximately $6,967,000 which are available to offset future state taxable income of First Mariner Bancorp only. Management anticipates that it is more likely than not that the future operations of First Mariner Bancorp will not generate sufficient taxable income to realize the deferred tax asset in the amount of $322,000 relating to this state net operating loss.



**(12) Other Expenses**

Other expenses are comprised of the following for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |
| Service and maintenance | $ 1,043 | $ 933 | $ 915 |
| Office supplies | 550 | 455 | 391 |
| ATM servicing expenses | 831 | 695 | 630 |
| Printing | 459 | 368 | 332 |
| Corporate insurance | 191 | 154 | 140 |
| OREO expense | (131) | 412 | 35 |
| FDIC Premiums | 186 | 391 | 140 |
| Consulting fees | 232 | 221 | 252 |
| Marketing/promotion | 619 | 459 | 443 |
| Postage | 393 | 319 | 317 |
| Security | 222 | 217 | 79 |
| Other(a) | 2,112 | 1,953 | 1,885 |
| | $ 6,707 | $ 6,577 | $ 5,559 |

(a) No single item included in this category exceeded one percent of total revenues.

**(13) Dividends and Earnings Per Share**

As a depository institution whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC), the Bank may not pay dividends or distribute any of its capital assets while it remains in default on any assessment due the FDIC. The Bank currently is not in default under any of its obligations to the FDIC. As a commercial bank under the Maryland Financial Institution Law, the Bank may declare cash

dividends from undivided profits or, with the prior approval of the Commissioner of Financial Regulation, out of surplus in excess of 100% of its required capital stock, after providing for due or accrued expenses, losses, interest and taxes.

The Company and the Bank, in declaring and paying dividends, are also limited insofar as minimum capital requirements mandated by regulatory authorities. The Company and the Bank comply with such capital requirements.

The Company's current ability to pay dividends is largely dependent upon the receipt of dividends from its banking subsidiary. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. The FRB has issued a policy, which provides that, as a general matter, insured banks and bank holding companies may pay dividends only out of prior operating earnings. For a Maryland state-chartered bank or trust company, dividends may be paid out of undivided profits or, with the prior approval of the Commissioner, from surplus in excess of 100% of required capital stock. Cash dividends may not be paid in excess of 90% of net earnings.



Information relating to the calculations of earnings per common share is summarized as follows for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (dollars in thousands) | |
| Net income-basic and diluted | $ 3,904 | $ 2,304 | $ 640 |
| Weighted-average shares outstanding | 5,377,998 | 3,993,462 | 3,185,186 |
| Dilutive securities-options and warrants | 250,275 | 36,082 | |
| Adjusted weighted-average shares outstanding-dilutive | 5,628,273 | 4,029,544 | 3,185,186 |

**(14) Regulatory Matters**

The Company and Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Management believes, as of December 31, 2002, that the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2002 the Bank was "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events that management believes would change the Bank's category.



Regulatory capital amounts (dollars in thousands) and ratios for the Company and the Bank as of December 31, 2002 and 2001, were:

| | Actual Amount | Minimum Requirements For Capital Adequacy Purposes | To Be Well Capitalized Under Prompt Corrective Action Provision |
|---|---|---|---|

| | | Amount | Ratio | Minimum Requirements For Capital Adequacy Purposes Amount | Ratio | To Be Well Capitalized Under Prompt Corrective Action Provision Amount | Ratio |
|---|---|---|---|---|---|---|---|
| **As of December 31, 2002** | | | | | | | |
| Total capital (to risk weighted assets): | | | | | | | |
| Consolidated | $ | 87,802 | 13.3% | 52,854 | 8.0% | 66,068 | 10.0% |
| The Bank | | 68,155 | 10.6% | 51,569 | 8.0% | 64,461 | 10.0% |
| Tier 1 capital (to risk weighted assets): | | | | | | | |
| Consolidated | | 65,552 | 9.9% | 26,427 | 4.0% | 39,641 | 6.0% |
| The Bank | | 61,450 | 9.5% | 25,784 | 4.0% | 38,676 | 6.0% |
| Tier 1 capital (to average assets): | | | | | | | |
| Consolidated | | 65,552 | 7.8% | 33,540 | 4.0% | 41,925 | 5.0% |
| The Bank | | 61,450 | 7.4% | 33,289 | 4.0% | 41,611 | 5.0% |
| **As of December 31, 2001** | | | | | | | |
| Total capital (to risk weighted assets): | | | | | | | |
| Consolidated | $ | 71,985 | 12.9% | 44,799 | 8.0% | 55,998 | 10.0% |
| The Bank | | 60,622 | 11.0% | 44,167 | 8.0% | 55,210 | 10.0% |
| Tier 1 capital (to risk weighted assets): | | | | | | | |
| Consolidated | | 60,015 | 10.7% | 22,399 | 4.0% | 33,599 | 6.0% |
| The Bank | | 55,098 | 10.0% | 22,083 | 4.0% | 33,126 | 6.0% |
| Tier 1 capital (to average assets): | | | | | | | |
| Consolidated | | 60,015 | 8.0% | 30,204 | 4.0% | 37,755 | 5.0% |
| The Bank | | 55,098 | 7.4% | 30,000 | 4.0% | 37,501 | 5.0% |

The FDIC, through the Savings Association Insurance Fund (SAIF), insures deposits of accountholders up to $100,000. The Bank pays an annual premium to provide for this insurance. The Bank is a member of the Federal Home Loan Bank System and is required to maintain an investment in the stock of the FHLB equal to at least 1% of the unpaid principal balances of residential mortgage loans, 0.3% of total assets or 5% of outstanding advances from the Bank, whichever is greater. Purchases and sales of stock are made directly with the Bank at par value.



**(15) Fair Value of Financial Instruments**

Fair value estimates, methods, and assumptions are set forth below for the Company's financial instruments as of December 31, 2002 and 2001.

The carrying value and estimated fair value of financial instruments is summarized as follows:

| | 2002 | | 2001 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| | (in thousands) | | | |
| Assets: | | | | |
| Cash and interest-bearing deposits | $ 75,806 | $ 75,806 | $ 71,382 | 71,382 |
| Investment securities | 127,810 | 127,810 | 119,853 | 119,853 |
| Loans receivable | 533,965 | 544,121 | 468,665 | 494,588 |
| Loans held for sale | 93,098 | 93,480 | 83,276 | 83,554 |

| | 2002 | | 2001 | |
|---|---|---|---|---|
| Mortgage loan servicing rights | 107 | 107 | 258 | 258 |
| Restricted stock investments | 3,290 | 3,290 | 4,000 | 4,000 |
| Liabilities: | | | | |
| Deposit accounts | 668,169 | 674,193 | 600,588 | 604,175 |
| Borrowings | 89,824 | 99,476 | 83,627 | 88,752 |
| Repurchase agreements | 25,000 | 27,241 | 25,000 | 25,832 |
| Company-obligated manditorily redeemable preferred securities of subsidiary trust holding solely debentures of the company | 31,450 | 31,986 | 21,450 | 21,445 |
| Off balance sheet instruments: | | | | |
| Interest Rate Cap | | | | |
| Commitments to extend credit | | | | |
| Loans sold with recourse | | | | |
| Unused lines of credit | | | | |

***(a) Cash and interest-bearing deposits***

The carrying amount for cash and interest-bearing deposits approximates fair value due to the short maturity of these instruments.

***(b) Investment Securities***

The fair value of investment securities is based on bid prices received from an external pricing service or bid quotations received from securities dealers.

***(c) Loans***

Loans were segmented into portfolios with similar financial characteristics. Loans were also segmented by type such as residential, multifamily and nonresidential, construction and land, second mortgage loans, commercial, and consumer. Each loan category was further segmented by fixed and adjustable rate interest terms and performing and nonperforming categories. The fair value of each



loan category was calculated by discounting anticipated cash flows based on weighted-average contractual maturity, weighted-average coupon, and discount rate.

The fair value for nonperforming loans was determined by reducing the carrying value of nonperforming loans by the Company's historical loss percentage for each specific loan category.

***(d) Loans Held for Sale***

The fair value of loans held for sale is based on commitments to sell loans classified as held for sale in the secondary market.

***(e) Mortgage Loan Servicing Rights***

The fair of mortgage loan servicing rights was calculated by discounting anticipated cash flows of net servicing income based on assumptions involving interest rates and current repayment rates.

***(f) Restricted Stock Investments***

The carrying value of restricted stock investments is a reasonable estimate of fair value as these investments do not have a readily available market and can only be sold back to the issuer at its par value of $100 per share.

***(g) Deposits***

The fair value of deposits with no stated maturity, such as noninterest bearing deposits, interest bearing now accounts, money market and statement savings accounts, is deemed to be equal to the carrying amounts. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate for certificates of deposit was estimated using the rate currently offered for deposits of similar remaining maturities.

***(h) Borrowings and Repurchase Agreements***

Borrowings were segmented into categories with similar financial characteristics. Carrying values were discounted using a cash flow approach based on market rates as of December 31, 2002.

***(i) Company-obligated manditorily redeemable preferred securities of subsidiary trust holding solely debentures of the Company***

The fair value of obligations issued by Mariner Capital Trust is based on the bid price on the NASDAQ National Market for securities issued by Mariner Capital Trust. Preferred securities issued by Mariner Capital Trust II are variable rate and carrying values are assumed to equal fair values.

***(j) Off-Balance Sheet Financial Instruments***

The Company's adjustable rate commitments to extend credit move with market rates and are not subject to interest rate risk. The rates and terms of the Company's fixed rate commitments to extend credit are competitive with others in the various markets in which the Company operates. It is impractical to assign fair values to these instruments.



The disclosure of fair value amounts does not include the fair values of any intangibles, including core deposit intangibles. Core deposit intangibles represent the value attributable to total deposits based on an expected duration of customer relationships.

***Limitations***

Fair value estimates are made at a specific point in time, based on relevant market information and information about financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect estimates.

**(16) Segment Information**

The Company is in the business of providing financial services, and operates in three business segments-commercial and consumer banking, mortgage banking and consumer finance. Commercial and consumer banking is conducted through the Bank and involves delivering a broad range of financial products and services, including lending and deposit taking, to individuals and commercial enterprises. Mortgage banking is conducted through First Mariner Mortgage, a division of the Bank, and involves originating residential single family mortgages for sale in the secondary market and to the Bank. Consumer finance is conducted through Finance Maryland, and involves originated making small direct consumer loans and the purchase of retail installment sales contracts.



The following table presents certain information regarding these business segments:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Total revenue: | | | |
| Commercial and consumer banking | $ 37,507 (1) | $ 31,522 (1) | $ 25,322 (1) |
| Consumer Finance | 1,099 (4) | (4) | (4) |
| Mortgage banking | 9,824 | 7,484 | 5,369 |
| Less related party transactions | 2,448 (3) | 2,391 (3) | 748 (3) |
| | 7,376 (2) | 5,093 (2) | 4,621 (2) |
| Consolidated revenue | $ 45,982 | $ 36,615 | $ 29,943 |
| Income before income taxes: | | | |
| Commercial and consumer banking | $ 7,261 (1) | $ 3,279 (1) | $ 1,639 (1) |
| Consumer Finance | (890)(4) | (4) | (4) |
| Mortgage banking | 1,911 | 2,806 | 149 |
| Less related party transactions | 2,448 (3) | 2,391 (3) | 748 (3) |
| | (537)(2) | 415 (2) | (599)(2) |
| Consolidated income before income taxes | $ 5,834 | $ 3,694 | $ 1,040 |
| Identifiable assets: | | | |
| Commercial and consumer banking | $ 766,643 | $ 694,589 | $ 652,580 |
| Consumer Finance | 10,451 | | |
| Mortgage banking | 93,098 | 83,276 | 24,869 |
| Consolidated total assets | $ 870,192 | $ 777,865 | $ 677,449 |

(1) Includes net interest income of $30,988, $25,874 and $21,020 for 2002, 2001 and 2000 respectively.

(2) Includes net interest income of $1,778, $1,274 and $1,757 for 2002, 2001 and 2000 respectively.

(3) Management's policy for the mortgage banking segment is to recognize a gain for loans sold to the Bank at market prices determined on an individual loan basis.

(4) Includes net interest income of $881, $0 and $0 for 2002, 2001 and 2000, respectively.

**(17) Comprehensive Income**

The Company's components of comprehensive income are as follows (in thousands) for the years ended December 31:

| | 2002 | 2001 | 2000 |
|---|---|---|---|

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | (dollars in thousands) | | |
| Net income | $ 3,904 | $ 2,304 | $ 640 |
| Other comprehensive income items: | | | |
| Unrealized holding gains arising during the period (net of tax of $1,673, $1,263, and $2,452, respectively) | 3,270 | 2,199 | 3,897 |
| Less: reclassification adjustment for gains (net of taxes of $192, $16 and $139, respectively) included in net income | 305 | 20 | 220 |
| Total other comprehensive income | 2,965 | 2,179 | 3,677 |
| Total comprehensive income | $ 6,869 | $ 4,483 | $ 4,317 |

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**(18) Quarterly Results of Operations**

The following is a summary of unaudited quarterly results of operations for the years ended December 31, 2002 and 2001:

| | Three months ended | | | |
|---|---|---|---|---|
| | December 31, 2002 | September 30, 2002 | June 30, 2002 | March 31, 2002 |
| | (dollars in thousands, except per share data) | | | |
| Interest income | $ 13,529 | $ 13,500 | $ 12,931 | $ 12,371 |
| Interest expense | 5,294 | 5,345 | 5,292 | 5,412 |
| Net interest income | 8,235 | 8,155 | 7,639 | 6,959 |
| Provision for loan losses | 900 | 640 | 335 | 300 |
| Other operating income | 4,641 | 3,759 | 3,053 | 3,044 |
| Gain on sale of securities | 59 | 344 | 94 | |
| Operating expenses | 10,358 | 10,139 | 9,113 | 8,363 |
| Income before taxes | 1,677 | 1,479 | 1,338 | 1,340 |
| Income tax expense | 552 | 471 | 430 | 477 |
| Net income | $ 1,125 | $ 1,008 | $ 908 | $ 863 |
| Net income per common share (Basic) | 0.21 | 0.19 | 0.17 | 0.16 |
| Net income per common share (Diluted) | 0.19 | 0.18 | 0.16 | 0.16 |

| | Three months ended | | | |
|---|---|---|---|---|
| | December 31, 2001 | September 30, 2001 | June 30, 2001 | March 31, 2001 |
| | (dollars in thousands, except per share data) | | | |
| Interest income | $ 13,074 | $ 13,380 | $ 13,630 | $ 13,178 |
| Interest expense | 6,064 | 6,544 | 7,098 | 7,682 |
| Net interest income | 7,010 | 6,836 | 6,532 | 5,496 |

| | Three months ended | | | |
|---|---|---|---|---|
| Provision for loan losses | 450 | 425 | 375 | 375 |
| Other operating income | 2,758 | 2,891 | 2,499 | 2,557 |
| Gain on sale of securities | (1) | 23 | (51) | 65 |
| Operating expenses | 7,963 | 8,271 | 7,814 | 7,248 |
| Income before taxes | 1,354 | 1,054 | 791 | 495 |
| Income tax expense | 524 | 393 | 290 | 183 |
| Net income | $ 830 | $ 661 | $ 501 | $ 312 |
| Net income per common share (Basic) | 0.17 | 0.18 | 0.14 | 0.09 |
| Net income per common share (Diluted) | 0.16 | 0.18 | 0.14 | 0.09 |



**(19) Financial Information of Parent Company**

The following is financial information of First Mariner Bancorp (parent company only):

**Statements of Financial Condition as of December 31,**

| | 2002 | 2001 |
|---|---|---|
| | (in thousands) | |
| Assets: | | |
| Cash and interest bearing deposits | $ 4,214 | $ 6,002 |
| Loans receivable | 9,650 | 2,650 |
| Available-for-sale securities | 2,824 | 2,622 |
| Investment in subsidiaries | 66,422 | 54,399 |
| Other assets | 1,261 | 972 |
| Total assets | $ 84,371 | $ 66,645 |
| Liabilities and Stockholders' Equity: | | |
| Other liabilities | $ 895 | $ 587 |
| Junior subordinated debentures | 32,350 | 22,050 |
| Stockholders' equity | 51,126 | 44,008 |
| Total liabilities and stockholders' equity | $ 84,371 | $ 66,645 |

**Statement of Income for the years ended December 31,**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | (in thousands) | | |
| Income: | | | |
| Interest income on investments and interest bearing deposits | $ 193 | $ 267 | $ 310 |
| Interest income on loans | 148 | 228 | 402 |

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Gain (loss) on sale of securities | 103 | (12) | 119 |
| Other income | 525 | 551 | 422 |
| Total income | 969 | 1,034 | 1,253 |
| Expenses: | | | |
| Interest expense | 1,884 | 1,880 | 1,880 |
| Professional expenses | 188 | 231 | 161 |
| Other expenses | 233 | 243 | 208 |
| Total expenses | 2,305 | 2,354 | 2,249 |
| Loss before income tax benefit | (1,336) | (1,320) | (996) |
| Income tax benefit | (473) | (469) | (339) |
| Loss before equity in undistributed net income of the subsidiaries | (863) | (851) | (657) |
| Equity in undistributed net income in subsidiaries | 4,767 | 3,155 | 1,297 |
| Net income | $ 3,904 | $ 2,304 | $ 640 |



**Statement of Cash Flows for the years ended December 31,**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (in thousands) | |
| Cash flows from operating activities: | | | |
| Loss before undistributed net income of subsidiaries | $ (863) | $ (851) | $ (657) |
| (Gain) loss on sale of securities | (103) | 12 | (119) |
| Increase (decrease) in other liabilities | 308 | 268 | (172) |
| (Increase) decrease in other assets | (306) | 246 | 3,563 |
| Net cash (used in) provided by operating activities | (964) | (325) | 2,615 |
| Net cash flows from investing activities: | | | |
| Investment in subsidiaries | (4,320) | (10,500) | (4,737) |
| Loans (disbursements) repayments, net | (7,000) | 500 | 1,660 |
| Purchase of available for sale securities | (460) | | (76) |
| Sale of available for sale securities | 407 | 495 | 771 |
| Net cash used in investing activities | (11,373) | (9,505) | (2,382) |
| Net cash flows from financing activities: | | | |
| Proceeds from stock issuance, net | 249 | 11,676 | 1,732 |
| Proceeds from issuance of long-term debt | 10,300 | | |
| Dividends paid | | | (63) |

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Net cash provided by financing activities | 10,549 | 11,676 | 1,669 |
| Net (decrease) increase in cash and interest bearing deposits | (1,788) | 1,846 | 1,902 |
| Cash and short-term investments at beginning of year | 6,002 | 4,156 | 2,254 |
| Cash and short-term investments at end of year | $ 4,214 | $ 6,002 | $ 4,156 |



**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES**

None

## PART III

**ITEM 10 DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Certain information relating to directors and executive officers of the Company and Section 16(a) beneficial ownership reporting compliance is incorporated by reference herein from the Company's proxy statement in connection with its Annual Meeting of Stockholders to be held May 6, 2003, which proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year.

**ITEM 11 EXECUTIVE COMPENSATION**

Certain information relating to directors and executive officers compensation, the Compensation Committee Report on Executive Compensation, and stock performance is incorporated by reference herein from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on May 6, 2003, which proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year.

**ITEM 12 SECURITIES OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Certain information relating to security ownership of certain directors, 5% beneficial owners and management is incorporated by reference herein from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on May 6, 2003, which proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year. With respect to equity compensation plan information, please refer to the section titled "Equity Compensation Plans" appearing in Item 5 of this Form 10-K on page 17.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Certain information relating to certain relationships and related transactions is incorporated by reference herein from the Company's definitive proxy statement in connection with its Annual Meeting of Stockholders to be held on May 6, 2003, which proxy statement will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year.

**ITEM 14 CONTROLS AND PROCEDURES**

a.

Evaluation of disclosure controls and procedures. Within the 90 days prior to the date of this report, the Company carried out an evaluation (the "Evaluation"), under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer ("CEO") along with the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of the Company's "disclosure controls and procedures" ("Disclosure Controls") and its "internal controls and procedures for financial reporting" ("Internal Controls").

Disclosure Controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities and Exchange Act of 1934 ("Exchange Act"), such as this Annual Report, is recorded, processed, summarized and reported with in the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms. Disclosure Controls are also designed with the



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objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Internal Controls are procedures which are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

b.

CEO and CFO certifications. Appearing immediately following the Signatures section of this Annual Report there are "Certifications" of the CEO and the CFO. The Certifications are required in accordance with Section 302 of the Sarbanes-Oxley Act of 2002. This section of the Annual Report which you are currently reading is the information concerning the Evaluation referred to in the certifications and this information should be read in conjunction with the Certifications for a more complete understanding of the topics presented.

c.

Limitations on the effectiveness of controls. The Company's management including the CEO and CFO, does not expect that our Disclosure Controls or our Internal Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls much be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control systems, misstatements due to error or fraud may occur and not be detected.

d.

Conclusions. Based upon the Evaluation, the Company's CEO along with the CFO concluded that the Company's Disclosure Controls are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings, and that our Internal Controls are effective to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

e.

Changes in Internal Controls. There were no significant changes in the Company's Internal Controls or in other factors that could significantly affect those Internal Controls, including any corrective actions with regard to significant deficiencies and material weaknesses.



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## PART IV

### ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1), (2) Financial Statements

Independent Auditors' Reports

Consolidated Statements of Financial Condition as of December 31, 2002 and 2001

Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2002, 2001 and 2000

Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000

Notes to Consolidated Financial Statements for the years ended December 31, 2002, 2001 and 2000

(a)(3) Exhibits Required to be filed by Item 601 of Regulations 8-K.

See Exhibit Index following Signatures

(b) Reports on Form 8-K

None

(c) Exhibits required by Item 601 of Regulation 8-K

See the Exhibit Index following the Signatures



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## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST MARINER BANCORP

Date: March 31, 2003 By: /s/ EDWIN F. HALE SR.

Edwin F. Hale Sr.
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following person on behalf of the registrant in their capacities as indicated on the 31st day of March, 2003

| | |
|---|---|
| /s/ EDWIN F. HALE SR. | /s/ MARK A. KEIDEL |
| Edwin F. Hale Sr., Chief Executive Officer and Director | Mark A. Keidel, Chief Financial Officer |
| /s/ JOSEPH A. CICERO | /s/ GEORGE H. MANTAKOS |

Joseph A. Cicero, President and Director

George H. Mantakos, Executive Vice President and Director

/s/ BARRY B. BONDROFF

Barry B. Bondroff, Director

/s/ BRUCE H. HOFFMAN

Bruce H. Hoffman, Director

/s/ JOHN BROWN III

John Brown III, Director

/s/ JAY J. MATRICCIANI

Jay J. Matricciani, Director

/s/ THOMAS L. BROMWELL

Thomas L. Bromwell, Director

/s/ JAMES P. O'CONOR

James P. O'Conor, Director

/s/ EDITH B. BROWN

Edith B. Brown, Director

/s/ JOHN J. OLIVER

John J. Oliver, Director

/s/ STEPHEN A. BURCH

Stephen A. Burch, Director

/s/ PATRICIA SCHMOKE

Patricia Schmoke, Director

/s/ ROSE M. CERNAK

Rose M. Cernak, Director

/s/ HANAN Y. SIBEL

Hanan Y. Sibel, Director

/s/ HOWARD FRIEDMAN

Howard Friedman, Director

/s/ LEONARD STOLER

Leonard Stoler, Director

/s/ MICHAEL R. WATSON

Michael R. Watson, Director

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Edwin F. Hale, Sr., certify that:

(1) I have reviewed this annual report on Form 10-K of First Mariner Bancorp;

(2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

(3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

(4) The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a.

Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b.

Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date");

c.

Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

(5)

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

(6)

The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003 By: /s/ EDWIN F. HALE, SR.

Edwin F. Hale., Sr.
Chairman and Chief Executive Officer

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CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Mark A. Keidel, certify that:

(1)

I have reviewed this annual report on Form 10-K of First Mariner Bancorp;

(2)

Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

(3)

Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

(4)

The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date");

c. Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

(5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

(6) The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 31, 2003 By: /s/ MARK A. KEIDEL

Mark A. Keidel
Chief Financial Officer

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**EXHIBIT INDEX**

| | |
|---|---|
| 3.1 | Amended and Restated Articles of Incorporation of First Mariner Bancorp (Incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form SB-2, as amended, file no. 333-16011 (the "1996 Registration Statement")) |
| 3.2 | Amended and Restated Bylaws of First Mariner Bancorp (Incorporated by reference to Exhibit 3.2 of the Company's Form 10-Q for the quarter ended September 30, 2002) |
| 10.1 | 1996 Stock Option Plan of First Mariner Bancorp (Incorporated by reference to Exhibit 10.1 of the Registration Statement) |
| 10.2 | Employment Agreement dated May 1, 1995 between First Mariner Bancorp and First Mariner Bank |

and George H. Mantakos (Incorporated by reference to Exhibit 10.2 of the 1996 Registration Statement)

| | |
|---|---|
| 10.3 | Lease Agreement dated March 1, 1996 between First Mariner Bank and Mars Super Markets, Inc. (Incorporated by reference to Exhibit 10.3 of the 1996 Registration Statement) |
| 10.4 | Lease Agreement dated November 1, 1997 between Edwin F. Hale, Sr. and First Mariner Bank (Incorporated by reference to Exhibit 10.4 of Pre-Effective Amendment Number 1 to Form S-1, file no. 333-53789-01) |
| 10.5 | 1998 Stock Option Plan of First Mariner Bancorp (Incorporated by reference to Exhibit 10.5 of Pre-Effective Amendment Number 1 to Form S-1, file no. 333-53789-01) |
| 10.6 | Employee Stock Purchase Plan of First Mariner Bancorp (Incorporated by reference to Exhibit 10.6 of Pre-Effective Amendment Number 1 to Form S-1, file no. 333-53789-01) |
| 10.7 | Lease Agreement dated as of June 1, 1998 between Building #2, L.L.C. and First Mariner Bank (Incorporated by reference to Exhibit 10.7 of Pre-Effective Amendment Number 1 to Form S-1, file no. 333-53789-01) |
| 10.8 | Lease Agreement dated June 18, 2002 between Hale Properties, LLC and First Mariner Bank (Incorporated by reference to Exhibit 10.8 to the Company's Form 10-Q for the quarter ended June 30, 2002.) |
| 10.9 | First Mariner Bancorp 2002 Stock Option Plan (Incorporated by reference to Attachment A to the Company's Definitive Proxy Statement filed on 4/5/02) |
| 21 | Subsidiaries of Registrant filed herewith |
| 23.1 | Consent of Stegman & Company filed herewith |
| 99 | Risk Factors filed herewith |