

TRI COUNTY FINANCIAL CORP /MD/
Form 10-K
March 15, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from _____ to _____

Commission File No. **0-18279**

TRI-COUNTY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of

52-1652138

incorporation or organization)	(I.R.S. Employer Identification No.)
3035 Leonardtown Road, Waldorf, Maryland (Address of principal executive offices)	20601 (Zip Code)

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

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

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

Common Stock, par value \$0.01 per share

(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The aggregate market value of voting stock held by non-affiliates of the registrant was approximately \$36.4 million based on the closing price (\$16.40 per share) at which the common stock was sold on the last business day of the Company's most recently completed second fiscal quarter. For purposes of this calculation only, the shares held by directors, executive officers and the Company's Employee Stock Ownership Plan of the registrant are deemed to be shares held by affiliates.

Number of shares of common stock outstanding as of February 27, 2013: 3,042,510.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the year ended December 31, 2012. (Part II)
2. Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders. (Part III)

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PART I

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

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

Item 1. Business

Tri-County Financial Corporation (the “Company”) is a bank holding company organized in 1989 under the laws of the State of Maryland. It owns all the outstanding shares of capital stock of Community Bank of Tri-County (the “Bank”), a Maryland-chartered commercial bank. The Bank was organized in 1950 as Tri-County Building and Loan Association of Waldorf, a mutual savings and loan association, and in 1986 converted to a federal stock savings bank and adopted the name Tri-County Federal Savings Bank. In 1997, the Bank converted to a Maryland-chartered commercial bank and adopted its current name. The Company engages in no significant activity other than holding the stock of the Bank and operating the business of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Bank and its subsidiaries.

The Bank serves the Southern Maryland counties of Charles, Calvert and St. Mary’s, (the “Tri-County area”) through its main office and nine branches located in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Lusby, Charlotte Hall, Prince Frederick and Lexington Park, Maryland. Additionally, the Bank expanded its footprint during 2012, opening a branch in King George, Virginia. The Bank operates fifteen automated teller machines (“ATMs”) including four stand-alone locations in the Tri-County area. The Bank offers telephone and internet banking services. The Bank is engaged in the commercial and retail banking business as authorized by the banking statutes of the State of Maryland and applicable federal regulations, including the acceptance of deposits, and the origination of loans to individuals, associations, partnerships and corporations. The Bank’s real estate financing consists of residential first and second mortgage loans, home equity lines of credit and commercial mortgage loans. Commercial lending consists of both secured and unsecured loans. The Bank is a member of the Federal Reserve and Federal Home Loan Bank (the “FHLB”) system and its deposits are insured up to applicable limits by the Deposit Insurance Fund administered by the

Federal Deposit Insurance Corporation (the "FDIC").

The Company's executive offices are located at 3035 Leonardtown Road, Waldorf, Maryland. Its telephone number is (301) 645-5601.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on its website, www.cbtc.com, as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission. Information on the website should not be considered a part of this Form 10-K.

Market Area

The Bank considers its principal lending and deposit market area to consist of the Tri-County area and King George County in Virginia. These counties have experienced significant population growth during the past decade due to their proximity to the growing Washington, DC and Baltimore metropolitan areas. Southern Maryland is generally considered to have more affordable housing than many other Washington and Baltimore area suburbs. In addition, the area has experienced rapid growth in the last decade in businesses and federal facilities located in the area. Major federal facilities include the Patuxent Naval Air Station in St. Mary's county. During 2012, the Bank opened its 1st branch in King George, Virginia. King George County, adjacent to Charles County, is demographically similar to the Tri-County area.

In the last several years, residential housing and population growth in the Tri-County area has been constrained by certain government policies designed to limit growth. Growth has also been dampened as the demand for new housing in the Tri-County area has fallen as the overall housing market has fallen. During 2012, real estate values appear to have stabilized and there were positive trends in housing during 2012. However, unemployment levels remained high and uncertainty for small and medium size businesses lessened the demand for lending. The impact on the Southern Maryland economy has been moderated by the presence of federal government agencies and defense facilities, but the possibility of large cuts to the defense budget hampered economic expansion in 2012.

Future regulatory events may adversely affect the Bank's loan growth.

Competition

The Bank faces strong competition in the attraction of deposits and in the origination of loans. Its most direct competition for deposits and loans comes from other banks, savings and loan associations and federal and state credit unions located in its primary market area. There are currently 13 FDIC-insured depository institutions operating in the Tri-County area including subsidiaries of several regional and super-regional bank holding companies. According to statistics compiled by the FDIC, the Bank was ranked first in deposit market share in the Tri-County area as of June 30, 2012, the latest date for which such data is available. The Bank faces additional significant competition for investors' funds from mutual funds, brokerage firms, and other financial institutions. The Bank competes for loans by providing competitive rates, flexibility of terms and service. It competes for deposits by offering depositors a wide variety of account types, convenient office locations and competitive rates. Other services offered include tax deferred retirement programs, brokerage services, cash management services and safe deposit boxes. The Bank has used targeted direct mail, print and online advertising and community outreach to increase its market share of deposits, loans and other services in its market area. It provides ongoing training for its staff in an attempt to ensure high-quality service.

Lending Activities

General. The Bank offers a wide variety of real estate, consumer and commercial loans. The Bank's lending activities include residential and commercial real estate loans, construction loans, land acquisition and development loans, equipment financing and commercial and consumer loans. Most of the Bank's customers are residents of, or businesses located in, the Tri-County area. The Bank's primary market for commercial loans consists of small and medium-sized businesses located in Southern Maryland. The Bank attracts customers for its consumer lending products based upon its ability to offer service, flexibility and competitive pricing and by leveraging other banking relationships such as soliciting deposit customers for loans.

Commercial Real Estate and Other Non-Residential Real Estate Loans. The permanent financing of commercial and other improved real estate projects, including office buildings, retail locations, churches, and other special purpose buildings is the largest component of the Bank's loan portfolio. Commercial real estate loans amounted to \$419.7 million, or 55.5% of the loan portfolio, at December 31, 2012. This portfolio has increased in both absolute size and as a percentage of the loan portfolio in each of the last four years. The primary security on a commercial real estate loan is the real property and the leases or businesses that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank's capital and participates with other lenders on larger projects. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price and have an initial contractual loan payment period ranging from three to 20 years. Virtually all of the Bank's commercial real estate loans are secured by real estate located in the Bank's primary market area. At December 31, 2012, the largest outstanding commercial real estate loan was a \$7.5 million loan, which is secured by a hotel. This loan was performing according to its terms at December 31, 2012.

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

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

The Bank offers fixed-rate residential first mortgages on a variety of terms including loan periods from ten to 30 years and bi-weekly payment loans. Total fixed-rate loan products in our residential first mortgage portfolio amounted to \$157.2 million as of December 31, 2012. Fixed-rate loans may be packaged and sold to investors or retained in the Bank's loan portfolio. Depending on market conditions, the Bank may elect to retain the right to service the loans sold for a payment based upon a percentage (generally 0.25% of the outstanding loan balance). As of December 31, 2012, the Bank serviced \$48.3 million in residential mortgage loans for others.

The Bank also offers mortgages that are adjustable on a one-, three- and five-year basis generally with limitations on upward adjustments of two percentage points per repricing period and six percentage points over the life of the loan. The Bank primarily markets adjustable-rate loans with rate adjustments based upon a United States Treasury Bill Index. As of December 31, 2012, the Bank had \$20.5 million in adjustable-rate residential mortgage loans. The retention of adjustable-rate mortgage loans in the Bank's loan portfolio helps reduce the negative effects of increases in interest rates on the Bank's net interest income. Under certain conditions, however, the annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also unquantifiable credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. In addition, the initial interest rate on adjustable-rate loans is generally lower than that on a fixed-rate loan of similar credit quality and size.

The Bank makes residential first mortgage loans of up to 97% of the appraised value or sales price of the property, whichever is less, to qualified owner-occupants upon the security of single-family homes. Non-owner occupied one-to four-family loans are generally permitted to a maximum 80% loan-to-value of the appraised value depending on the

overall strength of the application. The Bank currently requires that substantially all residential first mortgage loans with loan-to-value ratios in excess of 80% carry private mortgage insurance (“PMI”) to lower the Bank’s exposure to approximately 80% of the value of the property. The Bank had fewer than 10 loans with PMI at December 31, 2012. In certain cases, the borrower may elect to borrow amounts in excess of 80% loan-to-value in the form of a second mortgage. The second mortgage will generally have a higher interest rate and shorter repayment period than the first mortgage on the same property.

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

Construction and Land Development Loans. The Bank offers construction loans to individuals and building contractors for the construction of one-to-four family dwellings. Construction loans totaled \$14.7 million at December 31, 2012. Loans to individuals primarily consist of construction/permanent loans, which have fixed rates, payable monthly for the construction period and are followed by a 30-year, fixed or adjustable-rate permanent loan. The Bank also provides construction financing to home builders. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. Draws are made upon satisfactory completion of predefined stages of construction. The Bank will typically lend up to the lower of 80% of the appraised value or the contract purchase price of the homes to be constructed.

In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals. Land acquisition and development loans totaled \$17.1 million at December 31, 2012. Bank policy requires that zoning and permits must be in place prior to making development loans. The Bank will typically lend up to the lower of 75% of the appraised value or cost.

The Bank's ability to originate residential construction and development loans is heavily dependent on the continued demand for single-family housing construction in the Bank's market areas. As demand for newly constructed housing has fallen, the Bank's investment in these loans has slowed. The construction and land development portfolio decreased \$4.9 million from \$36.7 million at December 31, 2011 to \$31.8 million at December 31, 2012. Additionally, construction and land development loans as a percentage of the total loan portfolio have fallen in every year since 2008 from greater than 10% to 4.2% at December 31, 2012. If the demand for new houses in the Bank's market areas continues to decline, this portion of its loan portfolio may also decline. In addition, a continued decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. The Bank may not be able to grow its construction lending activities in the event of a continued decline. Construction and land development loans have been particularly affected by recent economic factors that have slowed absorption of finished lots and homes.

Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a project having a value that is insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans. The Bank maintains a portfolio of home equity and second mortgage loans. Home equity loans, which totaled \$18.3 million at December 31, 2012, are generally made in the form of lines of credit with minimum amounts of \$5,000, have terms of up to 20 years, variable rates priced at prime or some margin above prime, and require an 80% or 90% loan-to-value ratio (including any prior liens), depending on the specific loan program. Second mortgage loans, which totaled \$3.7 million at December 31, 2012, are fixed and variable-rate loans that have original terms between five and 15 years. Loan-to-value ratios of up to 80% or 95% are allowed depending on the specific loan program.

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

Commercial Loans. The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. While commercial loans remain an important class of the Bank's loan portfolio at 11.65% of total loans, the commercial loan portfolio decreased by \$13.8 million from \$102.0 million at December 31, 2011 to \$88.2 million at December 31, 2012. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business as well the borrower's global cash flows, the viability of the industry in which the consumer operates, the value of the collateral, and the borrower's ability to service the debt. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank. The higher interest rates and shorter loan terms available on commercial lending make these products attractive to the Bank. Commercial business loans, however, entail greater risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral would make full recovery from the sale of collateral problematic. The Bank attempts to control these risks by establishing guidelines that provide for loans with low loan-to-value ratios. At December 31, 2012, the largest outstanding commercial loan was \$12.0 million, which was secured by commercial real estate, cash and investments. This loan was performing according to its terms at December 31, 2012.

Consumer Loans. The Bank has developed a number of programs to serve the needs of its customers with primary emphasis upon loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans totaled \$995,000 at December 31, 2012. Consumer loans entail greater risk than residential mortgage loans, particularly in the case of consumer loans, which are unsecured or secured by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral may not provide an adequate source of repayment of the outstanding loan balance. Further collection efforts may be hampered by the borrower's lack of current income or other assets. In addition, consumer loan collections are dependent on the borrower's continuing financial stability and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans. Such loans may also give rise to claims and defenses by a consumer loan borrower against an assignee such as the Bank, and a borrower may be able to assert against such assignee claims and defenses that it has against the seller of the underlying collateral.

Commercial Equipment Loans. The Bank also maintains a commercial equipment financing portfolio. Commercial equipment loans totaled \$16.3 million, or 2.2% of the total loan portfolio, at December 31, 2012. These loans consist primarily of fixed-rate, short-term loans collateralized by customers' equipment including trucks, cars, construction equipment, and other more specialized equipment. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. The higher interest rates and shorter loan terms available on commercial equipment lending make these products attractive to the Bank. These loans entail greater risk than loans such as residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income and which

are secured by real property whose value tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic. The Bank attempts to control these risks by establishing guidelines that provide for over collateralization of the loans.

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

	At December 31,		2011		2010		2009		2008	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
(Dollars in Thousands)										
Real Estate Loans										
Commercial	\$419,667	55.47 %	\$370,384	51.55 %	\$336,300	50.72 %	\$292,988	46.88 %	\$236,410	43.11 %
Residential first mortgage	177,663	23.48 %	164,543	22.90 %	136,048	20.52 %	116,226	18.59 %	104,607	19.07 %
Construction and land development	31,819	4.21 %	36,745	5.11 %	42,504	6.41 %	62,509	10.00 %	57,565	10.50 %
Home equity and second mortgage	21,982	2.91 %	24,138	3.36 %	24,380	3.68 %	25,133	4.02 %	25,412	4.63 %
Commercial loans	88,158	11.65 %	101,968	14.19 %	104,566	15.77 %	108,658	17.38 %	101,936	18.59 %
Consumer loans	995	0.13 %	1,001	0.14 %	1,273	0.19 %	1,608	0.26 %	2,046	0.37 %
Commercial equipment	16,268	2.15 %	19,761	2.75 %	17,984	2.71 %	17,917	2.87 %	20,458	3.73 %
Total loans	756,552	100.00 %	718,540	100.00 %	663,055	100.00 %	625,039	100.00 %	548,434	100.00 %
Less:										
Deferred loan fees	665		796		936		975		311	
Loan loss reserve	8,247		7,655		7,669		7,471		5,146	
Loans receivable, net	\$747,640		\$710,089		\$654,450		\$616,593		\$542,977	

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

Loan Approvals, Procedures and Authority. Loan approval authority is established by Board policy and delegated as deemed necessary and appropriate. Loan approval authorities vary by individual with the Chief Executive Officer having approval authority up to \$1.25 million, the President \$1.0 million, the Chief Lending Officer \$1.0 million, the Chief Credit Officer \$1.0 million and the Chief Operating Officer \$1.0 million. The individual lending authority of the other lenders is set by management and based on their individual abilities. The loan approval authorities of the Chief Executive Officer, the President, the Chief Lending Officer, the Chief Credit Officer, the Chief Operating Officer and the Senior Credit Officer may be combined and a minimum of at least three of the five need to be present in an officers' loan committee to approve loans up to \$2.0 million. In cases where time is of the essence, the officers' loan committee consisting of any three members may unanimously approve loans to relationships in excess of the \$2.0 million up to the Bank's in house lending limit with a later ratification by the Board Credit Review Committee. A loan committee consisting of at least three members of the Board (the "Directors Loan Committee") ratifies and approves or renews all loans to relationships that exceed \$2.0 million, except for those noted above that exceed the \$2.0 million limit in certain cases. Depending on the loan and collateral type, conditions for protecting the Bank's collateral are specified in the loan documents. Typically these conditions might include requirements to maintain hazard and title insurance and to pay property taxes.

Depending on market conditions, mortgage loans may be originated primarily with the intent to sell to third parties such as Fannie Mae or Freddie Mac. Mortgage loans in the amount of \$14.1 million were sold by the Bank in 2012. To comply with internal and regulatory limits on loans to one borrower, the Bank may sell portions of commercial and commercial real estate loans to other lenders. The Bank sold no participations in 2012. The Bank also buys loans, portions of loans, or participation certificates from other lenders. The Bank only purchases loans or portions of loans after reviewing loan documents, underwriting support, and other procedures, as necessary. The Bank purchased \$4.5 million in fixed commercial mortgage participations in 2012. Purchased participation loans are subject to the same regulatory and internal policy requirements as other loans in the Bank's portfolio.

Loans to One Borrower. Under Maryland law, the maximum amount that the Bank is permitted to lend to any one borrower and his or her related interests may generally not exceed 10% of the Bank's unimpaired capital and surplus, which is defined to include the Bank's capital, surplus, retained earnings and 50% of its reserve for possible loan losses. Under this authority, the Bank would have been permitted to lend up to \$9.2 million to any one borrower at December 31, 2012. By interpretive ruling of the Commissioner of Financial Regulation, Maryland banks have the option of lending up to the amount that would be permissible for a national bank, which is generally 15% of unimpaired capital and surplus (defined to include a bank's total capital for regulatory capital purposes plus any loan loss allowances not included in regulatory capital). Under this formula, the Bank would have been permitted to lend up to \$14.5 million to any one borrower at December 31, 2012. At December 31, 2012, the largest amount outstanding to any one borrower and his or her related interests was \$12.0 million.

Loan Commitments. The Bank does not normally negotiate standby commitments for the construction and purchase of real estate. Conventional loan commitments are granted for a one-month period. The Bank's outstanding commitments to originate loans at December 31, 2012 were approximately \$15.5 million, excluding undisbursed portions of loans in process. It has been the Bank's experience that few commitments expire unfunded.

Maturity of Loan Portfolio. The following table sets forth certain information at December 31, 2012 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less.

	Due within one year after December 31, 2012	Due after one year through five years from December 31, 2012	Due more than five years from December 31, 2012
(Dollars in Thousands)			
Real Estate Loans			
Commercial	\$ 105,356	\$ 154,991	\$ 159,320
Residential first mortgage	41,802	59,052	76,809
Construction and land development	28,568	3,251	-
Home equity and second mortgage	4,290	9,367	8,325
Commercial loans	88,158	-	-
Consumer loans	492	377	126
Commercial equipment	6,779	6,912	2,577
Total loans	\$ 275,445	\$ 233,950	\$ 247,157

The following table sets forth the dollar amount of all loans due after one year from December 31, 2012, which have predetermined interest rates and have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
(Dollars in Thousands)			
Real Estate Loans			
Commercial	\$ 84,045	\$ 230,266	\$ 314,311
Residential first mortgage	119,618	16,243	135,861
Construction and land development	-	3,251	3,251
Home equity and second mortgage	2,290	15,402	17,692
Commercial loans	-	-	-
Consumer loans	503	-	503
Commercial equipment	6,274	3,215	9,489
	\$ 212,730	\$ 268,377	\$ 481,107

Delinquencies. The Bank's collection procedures provide that when a loan is 15 days delinquent, the borrower is contacted by mail and payment is requested. If the delinquency continues, subsequent efforts will be made to contact the delinquent borrower and obtain payment. If these efforts prove unsuccessful, the Bank will pursue appropriate legal action including repossession of the collateral and other actions as deemed necessary. In certain instances, the Bank will attempt to modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his financial affairs.

Impaired Loans. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The Bank evaluates substandard and doubtful classified loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructured loans ("TDRs") to determine whether a loan is impaired (See Notes 1 and 5 of the Consolidated Financial Statements).

Factors considered by management in determining impaired status include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, taking into consideration the circumstances surrounding the loan. These circumstances include the length of the delay, the reasons for the delay, the borrower's payment record and the amount of the shortfall in relation to the principal and interest owed. Loans not impaired are included in the pool of loans evaluated in the general component of the allowance.

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

The Bank considers all TDRs to be impaired and defines TDRs as loans whose terms have been modified to provide for a reduction or a delay in the payment of either interest or principal because of deterioration in the financial condition of the borrower. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR. Once an obligation has been classified as a TDR it continues to be considered a TDR until paid in full or until the loan returns to performing status and yields a market interest rate equal to the current interest rate for new debt with similar risk. TDRs are evaluated for impairment on a loan by loan basis in accordance with the Bank's impairment methodology. The Bank does not participate in any specific government or Company-sponsored loan modification programs. All restructured loan agreements are individual contracts negotiated with a borrower.

Loan loss reserves of \$1.5 million relate to impaired loans at December 31, 2012. The following table sets forth information with respect to the Bank's impaired loans at December 31, 2012. The table includes a breakdown between impaired loans with and without an allowance:

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Recorded investment with no allowance	\$34,718	\$10,621	\$10,020	\$8,947	\$-
Recorded investment with allowance	4,273	10,096	11,368	11,601	1,743
Total impaired loans	\$38,991	\$20,717	\$21,388	\$20,548	\$1,743
Specific allocations of allowance	\$1,548	\$1,997	\$1,998	\$1,837	\$223

Non-Performing Assets. The Bank's non-performing assets include foreclosed real estate and non-performing loans. For a detailed discussion on asset quality see the section captioned "*Management's Discussion and Analysis of Financial Condition and Results of Operations-Asset Quality, Allowance for Loan Losses and Provision for Loan Losses*" in the Company's 2012 Annual Report to Stockholders.

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

market value. Subsequent to foreclosure, the property is carried at the lower of cost or fair value less selling costs. Additional write-downs as well as carrying expenses of the foreclosed properties are charged to expenses in the current period. The Bank had foreclosed real estate with a carrying value of approximately \$6.9 million at December 31, 2012.

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

All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Non-accrual loans include performing loans classified as non-accrual loans due to the customers operating results. Interest on performing non-accrual loans is accounted for on a cash-basis. Non-accrual loans and TDRs are only considered non-performing loans if payments are 90 days or greater delinquent. At December 31, 2012, all TDRs were performing in accordance with the terms of their restructured agreements.

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

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Foreclosed real estate	\$6,891	\$5,029	\$10,469	\$923	\$-
Non-performing loans	8,717	9,511	13,518	19,287	4,936
Total non-performing assets	\$15,608	\$14,540	\$23,987	\$20,210	\$4,936
TDRs	\$4,515	\$11,913	\$16,882	\$11,601	\$-
Performing non-accrual loans	\$4,424	\$-	\$-	\$-	\$-
Non-performing loans (NPLs) to total loans	1.15 %	1.32 %	2.04 %	3.09 %	0.90 %
NPLs and performing non-accrual loans to total loans	1.74 %	1.32 %	2.04 %	3.09 %	0.90 %
Allowance for loan losses to nonperforming loans	94.78 %	80.49 %	56.73 %	38.74 %	104.25 %
Nonperforming assets to total assets	1.59 %	1.48 %	2.71 %	2.48 %	0.69 %
Nonperforming assets, performing non-accrual loans and TDRs to total assets	2.50 %	2.61 %	4.58 %	3.90 %	0.69 %

The below schedule provides the details by loan portfolio of non-performing loans for the dates indicated.

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Non-performing loans:					
Real Estate Loans					
Commercial	\$1,529	\$2,866	\$8,243	\$6,367	\$1,208
Residential first mortgage	3,169	2,439	1,747	339	-
Construction and land development	-	1,414	984	9,504	1,840
Home equity and second mortgage	71	291	233	-	-
Commercial loans	3,732	2,264	2,262	2,192	903

Consumer loans	-	1	1	23	148
Commercial equipment	216	236	48	862	837
Total	\$8,717	\$9,511	\$13,518	\$19,287	\$4,936

The below schedule provides the details by loan portfolio of TDRs for the dates indicated.

TDRs:	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Real Estate Loans					
Commercial	\$3,097	\$7,697	\$6,848	\$6,706	\$ -
Residential first mortgage	1,418	-	929	394	-
Construction and land development	-	1,717	-	-	-
Commercial loans	-	2,369	8,834	4,441	-
Commercial equipment	-	130	271	60	-
Total	\$4,515	\$11,913	\$16,882	\$11,601	\$ -

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

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Balance at beginning of period	\$7,655	\$7,669	\$7,471	\$5,146	\$4,482
Charge-offs:					
Real Estate Loans					
Commercial	486	1,249	526	-	-
Residential first mortgages	11	49	63	-	-
Construction and land development	141	213	2,249	187	287
Home equity and second mortgage	211	-	71	98	-
Commercial loans	1,004	2,441	569	608	202
Consumer loans	5	3	10	32	67
Commercial equipment	169	150	256	223	83
Total Charge-offs:	2,027	4,105	3,744	1,148	639
Recoveries:					
Residential first mortgages	38	1	-	-	-
Construction and land development	-	-	1	-	-
Consumer loans	1	1	7	-	2
Commercial loans	51	2	-	-	-
Total Recoveries	90	4	8	-	2
Net charge-offs	1,937	4,101	3,736	1,148	637
Provision for Possible Loan Losses	2,529	4,087	3,934	3,473	1,301
Balance at End of Period	\$8,247	\$7,655	\$7,669	\$7,471	\$5,146
Allowance for loan losses to total loans	1.09 %	1.07 %	1.16 %	1.20 %	0.94 %
Net charge-offs to average loans	0.27 %	0.61 %	0.61 %	0.20 %	0.13 %

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

	At December 31, 2012		2011		2010		2009		2008		
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	
	(Dollars in Thousands)										
Real Estate Loans											
Commercial	\$4,090	55.47 %	\$2,525	51.55 %	\$3,314	50.72 %	\$2,660	46.88 %	\$2,009	43.11 %	
Residential first mortgage	1,083	23.48 %	539	22.90 %	204	20.52 %	128	18.59 %	105	19.07 %	
Construction and land development	533	4.21 %	354	5.11 %	1,267	6.41 %	1,696	10.00 %	1,295	10.50 %	
Home equity and second mortgage	280	2.91 %	144	3.36 %	98	3.68 %	131	4.02 %	102	4.63 %	
Commercial loans	1,949	11.65 %	3,850	14.19 %	2,551	15.77 %	2,110	17.38 %	1,248	18.59 %	
Consumer loans	20	0.13 %	20	0.14 %	32	0.19 %	64	0.26 %	43	0.37 %	
Commercial equipment	292	2.15 %	223	2.75 %	203	2.71 %	682	2.87 %	344	3.73 %	
Total allowance for loan losses	\$8,247	100.00 %	\$7,655	100.00 %	\$7,669	100.00 %	\$7,471	100.00 %	\$5,146	100.00 %	

The Bank closely monitors the payment activity of all its loans. The Bank periodically reviews the adequacy of the allowance for loan losses based on an analysis of the size and composition of the loan portfolio, the Bank's historical loss experience, including trends in non-performing and classified loans and charge-offs, economic conditions in the Bank's market area, and a review of selected individual loans. Loan losses are charged off against the allowance when individual loans are deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance. The Bank believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America and is in compliance with appropriate regulatory guidelines. However, the establishment of the level of the allowance for loan losses is highly subjective and dependent on incomplete information as to the ultimate disposition of loans. Accordingly, there can be no assurance that actual losses may not vary from the amounts estimated or that the Bank's regulators will not require the Bank to significantly increase or decrease its allowance for loan losses, thereby affecting the Bank's financial condition and earnings. For a more complete discussion of the allowance for loan losses, see the section captioned "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies*" and Notes 1 and 5 of the Consolidated Financial Statements in the Company's 2012 Annual Report to Stockholders.

Investment Activities

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

The following table sets forth the carrying value of the Company's investment securities portfolio and FHLB of Atlanta and Federal Reserve Bank stock at the dates indicated. At December 31, 2012, 2011, and 2010, their estimated fair value was \$167 million, \$201 million, and \$168 million, respectively.

	At December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Asset-backed securities:			
Freddie Mac and Fannie Mae	\$150,318	\$180,638	\$144,861
Other	4,439	9,839	12,463
Total asset-backed securities	154,757	190,477	157,324
Corporate equity securities	37	37	37
Bond mutual funds	4,281	4,080	3,820
Treasury bills	750	750	753

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Total investment securities	159,825	195,344	161,934
FHLB and Federal Reserve Bank stock	5,476	5,587	6,316
Total investment securities and FHLB and Federal Reserve Bank stock	\$165,301	\$200,931	\$168,250

The maturities and weighted average yields for investment securities available for sale (“AFS”) and held to maturity (“HTM”) at December 31, 2012 are shown below.

	One Year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years	
	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
(Dollars in Thousands)								
AFS Investment securities:								
Asset-backed securities	13,918	1.42 %	20,613	1.37 %	6,486	1.39 %	1,689	1.46 %
Mutual funds	4,013	2.13 %	-	0.00 %	-	0.00 %	-	0.00 %
Total AFS investment securities	\$17,931	1.58 %	\$20,613	1.37 %	\$6,486	1.39 %	\$1,689	1.46 %
HTM Investment securities:								
Asset-backed securities	\$39,331	1.90 %	\$48,166	1.93 %	\$17,128	0.78 %	\$7,244	0.91 %
Treasury bills	750	0.12 %	-	0.00 %	-	0.00 %	-	0.00 %
Other investments	-	0.00 %	-	0.00 %	-	0.00 %	-	0.00 %
Total HTM investment securities	\$40,081	1.87 %	\$48,166	1.93 %	\$17,128	0.78 %	\$7,244	0.91 %

The Bank’s investment policy provides that securities that will be held for indefinite periods of time, including securities that will be used as part of the Bank’s asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors are classified as available for sale and accounted for at fair value. Management’s intent is to hold securities reported at amortized cost to maturity. Certain of the Company’s asset-backed securities are issued by private issuers (defined as an issuer that is not a government or a government-sponsored entity). The Company had no investments in any private issuer’s securities that aggregate to more than 10% of the Company’s equity.

Deposits and Other Sources of Funds

General. The funds needed by the Bank to make loans are primarily generated by deposit accounts solicited from the communities surrounding its main office and nine branches in the Southern Maryland area and the branch in King George, Virginia . Total deposits were \$820.2 million as of December 31, 2012. The Bank uses borrowings and other sources to supplement funding from deposits.

Deposits. The Bank's deposit products include savings, money market, demand deposit, IRA, SEP, Christmas clubs, and time deposit accounts. Variations in service charges, terms and interest rates are used to target specific markets. Ancillary products and services for deposit customers include safe deposit boxes, travelers checks, night depositories, automated clearinghouse transactions, wire transfers, ATMs, and online and telephone banking. The Bank is a member of ACCEL/Exchange, Cirrus, Maestro and Star ATM networks. The Bank has occasionally used deposit brokers to obtain funds. At December 31, 2012 and 2011, the Bank had \$19.0 million in deposits from brokers. In addition the Bank utilizes the Certificate of Deposit Account Registry Service ("CDARS") to provide existing customers with additional access to FDIC insurance. At December 31, 2012, the Bank maintained CDARS deposits of \$27.9 million compared to \$34.9 million at December 31, 2011.

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

	For the Year Ended December 31,					
	2012		2011		2010	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in Thousands)					
Savings	\$32,577	0.17 %	\$31,446	0.35 %	\$30,355	0.41 %
Interest-bearing demand and money market accounts	262,331	0.54 %	217,183	1.00 %	161,494	0.94 %
Certificates of deposit	432,487	1.60 %	434,811	1.94 %	421,525	2.21 %
Total interest-bearing deposits	727,395		683,440		613,374	
Noninterest-bearing demand deposits	74,161		66,105		65,041	
	\$801,556	1.05 %	\$749,545	1.43 %	\$678,415	1.61 %

The following table indicates the amount of the Bank's certificates of deposit and other time deposits of \$100,000 or more and \$250,000 or more by time remaining until maturity as of December 31, 2012.

Time Deposit Maturity Period	\$100,000 or More	\$250,000 or More
	(Dollars in Thousands)	
Three months or less	\$40,024	\$ 14,381
Three through six months	38,677	12,816
Six through twelve months	49,013	15,012
Over twelve months	78,691	28,580
Total	\$206,405	\$ 70,789

Borrowings. Deposits are the primary source of funds for the Bank's lending and investment activities and for its general business purposes. The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 40% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and other commercial banks. Long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. The table below sets forth information about borrowings for the years indicated.

At or for the Year Ended December 31,	2011	2010
2012		
(Dollars in Thousands)		

Long-term debt						
Long-term debt						
outstanding at	\$	60,527		\$	60,577	
end of period						\$
end of period						70,624
Weighted						
average rate on						
outstanding		2.80	%		3.33	%
long-term debt at						
end of period						
end of period						
Maximum						
outstanding						
long-term debt of		60,573			60,620	
any month end						70,666
any month end						
Average						
outstanding						
long-term debt,		60,206			61,421	
during period						70,823
during period						
Approximate						
average rate paid						
on long-term		3.02	%		3.32	%
debt during						
period						
period						
Short-term						
borrowings						
Short-term						
borrowings						
outstanding at	\$	1,000		\$	-	
end of period						\$
end of period						816
end of period						
end of period						
Weighted						
average rate on						
short-term		0.36	%		0.00	%
borrowings at						
end of period						
end of period						
Maximum						
outstanding						
short-term						
borrowings at	\$	14,000		\$	15,703	
any month end						\$
any month end						11,322
during						
period						
period						
Average						
outstanding						
short-term		3,639			2,168	
borrowings						2,973
borrowings						
Approximate						
average rate paid						
on short-term		1.40	%		1.91	%
borrowings						
borrowings						

For more information regarding the Bank's borrowings, see Note 10 of Notes to Consolidated Financial Statements.

Subsidiary Activities

In April 1997, the Bank formed a wholly owned subsidiary, Community Mortgage Corporation of Tri-County, to offer mortgage banking, brokerage, and other services to the public. This corporation is currently inactive.

The Company has two direct subsidiaries other than the Bank. In July 2004, Tri-County Capital Trust I was established as a statutory trust under Delaware law as a wholly-owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust I issued \$7.0 million of trust preferred securities on July 22, 2004. In June 2005, Tri-County Capital Trust II was also established as a statutory trust under Delaware law as a wholly owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust II issued \$5.0 million of trust preferred securities on June 15, 2005. For more information regarding these entities, see Note 17 of the Notes to Consolidated Financial Statements in the Company's 2012 Annual Report to Stockholders.

SUPERVISION AND REGULATION

Regulation of the Company

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

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

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

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

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

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

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

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

Stock Repurchases. The Company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption. This requirement does not apply to bank holding companies that are "well capitalized," "well-managed" and are not the subject of any unresolved supervisory issues.

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

Regulation of the Bank

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

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

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

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

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

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

The current risk-based capital guidelines that apply to the Bank are based on the 1988 capital accord of the International Basel Committee on Banking Supervision (“Basel Committee”), a committee of central banks and bank supervisors, as implemented by the Federal Reserve Board. In 2004, the Basel Committee published a new capital accord, which is referred to as “Basel II,” to replace Basel I. Basel II provides two approaches for setting capital standards for credit risk: an internal ratings-based approach tailored to individual institutions’ circumstances and a standardized approach that bases risk weightings on external credit assessments to a much greater extent than permitted in existing risk-based capital guidelines, which became effective in 2008 for large international banks (total assets of \$250 billion or more or consolidated foreign exposure of \$10 billion or more).

In December 2010 and January 2011, the Basel Committee published the final texts of reforms on capital and liquidity, which is referred to as “Basel III.” Although Basel III is intended to be implemented by participating countries for large, internationally active banks, its provisions are likely to be considered by United States banking regulators in developing new regulations applicable to other banks in the United States. Basel III will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. The Federal Reserve and other U.S. government agencies responsible for implementing the Basel III framework announced in November 2012 that they were abolishing the existing deadline without instating a new one. The implementation of the Basel III final framework was to commence January 1, 2013. On that date, banking institutions would have been required to meet the following minimum capital ratios: (i) 3.5% Common Equity Tier 1 (generally consisting of common shares and retained earnings) to risk-weighted assets; (ii) 4.5% Tier 1 capital to risk-weighted assets; and (iii) 8.0% Total capital to risk-weighted assets.

When fully phased-in on January 1, 2019, and if implemented by the U.S. banking agencies, Basel III will require banks to maintain:

- a minimum ratio of Common Equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer,”
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer,
- a minimum ratio of Total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer, and
- a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures.

Basel III also includes the following significant provisions:

- An additional countercyclical capital buffer to be imposed by applicable national banking regulators periodically at their discretion, with advance notice.
- Restrictions on capital distributions and discretionary bonuses applicable when capital ratios fall within the buffer zone.
- Deduction from common equity of deferred tax assets that depend on future profitability to be realized. For capital instruments issued on or after January 13, 2013 (other than common equity), a loss-absorbency requirement that the instrument must be written off or converted to common equity if a triggering event occurs, either pursuant to applicable law or at the direction of the banking regulator. A triggering event is an event that would cause the banking organization to become nonviable without the write off or conversion, or without an injection of capital from the public sector.

Since the Basel III framework is not self-executing, the rules and standards promulgated under Basel III require that the U.S. federal banking regulators adopt them prior to becoming effective in the U.S. Although U.S. federal banking regulators have expressed support for Basel III, the timing and scope of its implementation, as well as any potential modifications or adjustments that may result during the implementation process, are not yet known.

Prompt Corrective Regulatory Action. The Federal Reserve Board classifies state member banks by capital levels and is authorized to take various prompt corrective actions to resolve the problems of any bank that fails to satisfy the capital standards. A well capitalized bank is one that is not subject to any regulatory capital order to meet specific capital levels and has or exceeds the following capital levels: a total risk-based capital ratio of 10%, a Tier 1 risk-based capital ratio of 6%, and a leverage ratio of 5%. An adequately capitalized bank is one that does not qualify as well capitalized but meets or exceeds the following capital requirements: a total risk-based capital ratio of 8%, a Tier 1 risk-based capital ratio of 4%, and a leverage ratio of either (1) 4% or (2) 3% if the bank has the highest composite examination rating. A bank not meeting these criteria is treated as undercapitalized, significantly undercapitalized, or critically undercapitalized depending on the extent to which the bank's capital levels are below these standards. A state member bank that falls within any of the three undercapitalized categories established by the prompt corrective action regulation will be subject to regulatory sanctions. As of December 31, 2012, the Bank was well capitalized as defined by the Federal Reserve Board's regulations.

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

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

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

Insurance of Deposit Accounts. Under the Federal Deposit Insurance Corporation's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned. The initial base assessment rate ranges from five to 35 basis points.

The rate schedules will automatically adjust in the future when the Deposit Insurance Fund reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

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

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

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

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

Reserve Requirements. Under Federal Reserve Board regulations, the Bank currently must maintain average daily reserves equal to 3% on aggregate transaction, plus 10% on the remainder. The first \$10.7 million of transaction accounts are exempt. This percentage is subject to adjustment by the Federal Reserve Board. Because required reserves must be maintained in the form of vault cash or in a noninterest-bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets. At December 31, 2012, the Bank met applicable Federal Reserve Board reserve requirements.

Transactions with Affiliates. A state member bank is limited in the amount of "covered transactions" with any affiliate. All such transactions must also be on terms substantially the same, or at least as favorable, to the Bank or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions. Certain covered transactions, such as loans to affiliates, must meet collateral requirements. At December 31, 2012, we had no transactions with affiliates.

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

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

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

Personnel

As of December 31, 2012, the Bank had 159 full-time employees and 8 part-time employees. The employees are not represented by a collective bargaining agreement. The Bank believes its employee relations are good.

Executive Officers of the Registrant

The executive officers of the Company are as follows:

Michael L. Middleton (65 years old) is Chairman and Chief Executive Officer of the Company and the Bank. Mr. Middleton joined the Bank in 1973 and served in various management positions until 1979 when he became President of the Bank until 2010. He remained as President of the Company until May 2012. Mr. Middleton is a Certified Public Accountant and holds a Masters of Business Administration. From 1996 to 2004, Mr. Middleton served on the Board of Directors of the Federal Home Loan Bank of Atlanta, serving as Chairman of the Board in 2004. Mr. Middleton served on the Board of Directors of the Federal Reserve Bank, Baltimore Branch, from 2004 to 2009. He is Chairman of the Maryland Bankers Association, a trustee for the College of Southern Maryland, and serves on the Federal Reserve's Community Depository Institutions Advisory Council. He also serves on several philanthropic and civic boards.

William J. Pasenelli (54 years old) is President and Chief Financial Officer of the Company and President of the Bank. Mr. Pasenelli joined the Bank as Chief Financial Officer in April 2000 and was named President of the Bank in 2010 and President of the Company in May 2012. Before joining the Bank, Mr. Pasenelli had been Chief Financial Officer of Acacia Federal Savings Bank, Annandale, Virginia, since 1987. Mr. Pasenelli is a member of the American Institute of Certified Public Accountants, the Greater Washington Society of Certified Public Accountants and other civic groups.

Gregory C. Cockerham (58 years old) joined the Bank in 1988. He serves as the Bank's Executive Vice President – Chief Lending Officer. Prior to joining the Company he was retail Vice President of Maryland National Bank. Mr. Cockerham serves as Chairman of the College of Southern Maryland Foundation and the Maryland Title Center. He is a Paul Harris Fellow and Foundation Chair with the Rotary Club of Charles County and serves on various civic boards in Charles County.

James M. Burke (44 years old) joined the Bank in 2006. He serves as the Bank's Executive Vice President – Chief Credit Officer. Before his appointment as Executive Vice President in 2007, he served as the Bank's Senior Credit

Officer. Prior to joining the Bank, Mr. Burke served as Executive Vice President of Mercantile Southern Maryland Bank. Mr. Burke has over 20 years of banking experience. Mr. Burke is the former Chairman of the Board of Directors of Civista Medical Center and is active in other civic groups.

James F. DiMisa (53 years old) joined the Bank in 2006. He serves as Executive Vice President- Chief Operating Officer. Prior to joining the Bank, Mr. DiMisa served as Executive Vice President of Mercantile Southern Maryland Bank. Mr. DiMisa has over 30 years of banking experience. Mr. DiMisa is Chairman of the Board of Trustees for the Maryland Bankers School and a member of several other civic and professional groups. Mr. DiMisa is a Stonier Graduate School of Banking graduate and holds a Masters of Business Administration.

Todd L. Capitani (46 years old) joined the Bank in 2009. He serves as the Bank's Executive Vice President – Chief Financial Officer. Before his appointment as Chief Financial Officer of the Bank in 2012, he served as the Bank's Finance Officer. Prior to joining the Bank, Mr. Capitani served as a Senior Manager at Deloitte Consulting and as Chief Financial Officer at Ruesch International, Inc. Mr. Capitani has over 20 years of experience in corporate finance, controllership and external audit. Mr. Capitani is a member of the American Institute of Certified Public Accountants and other civic groups.

Item 1A. Risk Factors

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

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

For 2012, we recorded a provision for loan losses of \$2.5 million. We also recorded net loan charge-offs of \$1.9 million. Our non-performing assets, performing non-accrual loans and troubled debt restructures were \$24.5 million, or 2.50% of total assets, at December 31, 2012. Additionally, loans that were classified as either special mention, substandard, doubtful or loss were \$54.8 million at December 31, 2012. If the economy and/or the real estate market continue to weaken, more of our classified loans may become non-performing and we may be required to add further reserves to our allowance for loan losses for these assets as the value of the collateral may be insufficient to pay any remaining net loan balance, which could have a negative effect on our results of operations. We maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. We believe that our allowance for loan losses is maintained at a level adequate to absorb probable losses inherent in our loan portfolio as of the corresponding balance sheet date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results.

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

Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged

to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs. Any such additional provisions for loan losses or charge-offs, as required by our regulators, could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

At December 31, 2012, our loan portfolio consisted of \$419.7 million, or 55.5%, of commercial real estate loans, \$88.2 million, or 11.7%, of commercial business loans and \$16.3 million, or 2.2%, of commercial equipment loans. We intend to maintain our emphasis on these types of loans. These types of loans generally expose a lender to greater risk of non-payment and loss and require a commensurately higher loan loss allowance than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances compared to one- to four-family residential mortgage loans. Commercial business and equipment loans expose us to additional risks since they typically are made on the basis of the borrower’s ability to make repayments from the cash flows of the borrower’s business and are secured by non-real estate collateral that may depreciate over time. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

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

At December 31, 2012, \$177.7 million, or 23.48%, of our total loan portfolio consisted of one- to four-family residential mortgage loans, and \$22.0 million, or 2.9%, of our total loan portfolio consisted of home equity loans and lines of credit. Recent declines in the housing market have resulted in declines in real estate values in our market areas. These declines in real estate values could cause some of our mortgage and home equity loans to be inadequately collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

A return of recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which would lead to lower revenue, higher loan losses and lower earnings.

A return of recessionary conditions and/or continued negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Further declines in real estate values and sales volumes and continued high unemployment levels may result in higher than expected loan delinquencies, increases in our levels of non-performing and classified assets and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

The unseasoned nature of our commercial loan portfolio may result in changes in estimating collectability, which may lead to additional provisions or charge-offs, which could hurt our profits.

Our commercial real estate, commercial business and commercial equipment loans increased \$165.3 million, or 46.1%, from \$358.8 million at December 31, 2008 to \$524.1 million at December 31, 2012. A large portion of our commercial loan portfolio is unseasoned and does not provide us with a significant payment history pattern from which to judge future collectability, especially in this period of continued declining and unfavorable economic conditions. As a result, it may be difficult to predict the future performance of this part of our loan portfolio. These loans may have delinquency or charge-off levels above our historical experience, which could adversely affect our future performance. Further, these types of loans generally have larger balances and involve a greater risk than one- to four-family residential mortgage loans. Accordingly, if we make any errors in judgment in the collectability of our commercial loans, any resulting charge-offs may be larger on a per loan basis than those incurred historically with our residential mortgage loan or consumer loan portfolios.

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

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

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

Our future growth may require us to raise additional capital, which will be dilutive to existing shareholders and could dilute our per share book value.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that we have sufficient capital resources to satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth. If we raise capital through the issuance of additional shares of our common stock or other securities, it would dilute the ownership interests of existing shareholders and may dilute the per share book value of our common stock. New investors may also have rights, preferences and privileges senior to our current shareholders, which may adversely impact our current shareholders.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we may not be able to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth could be materially impaired.

The cost of the capital we received from the Series C Preferred Stock will increase significantly if the level of our “Qualified Small Business Lending” does not represent an increase from our “baseline” level.

The dividend rate on the Series C Preferred Stock we issued to the United States Department of Treasury (the “Treasury”) under the Small Business Lending Fund Program can fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL” by the Bank. Based upon the increase in the Bank’s level of QSBL over the baseline level calculated under the terms of the Securities Purchase Agreement entered into in connection with the issuance of the Series C Preferred Stock, the dividend rate for the initial dividend period has been set at one percent. For the second through ninth calendar quarters, the dividend rate may be adjusted to between one percent and five percent per annum, to reflect the amount of change in the Bank’s level of QSBL. If the level of the Bank’s qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than 10%, then the dividend rate payable on the Series C Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed between one percent and seven percent based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent. In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, the Company will be required to pay to the Secretary of the Treasury, on each share of Series C Preferred Stock outstanding, but only out of assets legally available, a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock.

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

We face intense competition both in making loans and attracting deposits. This competition may make it more difficult for us to originate new loans and may force us to offer higher deposit rates than currently. Price competition for loans and deposits might result in lower interest rates earned on our loans and higher interest rates paid on our deposits, which would reduce net interest income. According to the Federal Deposit Insurance Corporation, as of June 30, 2012, we held 20.0% of the deposits in Calvert, Charles and St. Mary's counties, Maryland, which was the largest market share of deposits out of the 13 financial institutions that held deposits in these counties. Our profitability depends upon our continued ability to compete successfully in our market area.

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

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

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

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

A significant portion of the population in our market area is affiliated with or employed by the federal government or at military facilities located in the area. As a result, a downturn in federal government or military employment could have a negative impact on local economic conditions and real estate collateral values, and could also negatively affect

the Company's profitability. During 2012, unemployment levels remained high and uncertainty for small and medium size businesses lessened the demand for lending. The impact on the Southern Maryland economy has been moderated by the presence of federal government agencies and defense facilities, but the possibility of large cuts to the defense budget hampered economic expansion in 2012 and the effect of the sequestration would negatively impact employment and potentially the ability of borrowers to make their required payments on a timely basis.

Increased and/or special FDIC assessments will hurt our earnings.

The recent economic recession caused a high level of bank failures, which has dramatically increased Federal Deposit Insurance Corporation's resolution costs and led to a significant reduction in the balance of the Deposit Insurance Fund. As a result, the Federal Deposit Insurance Corporation has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. Increases in the base assessment rate have increased our deposit insurance costs and negatively impacted our earnings. In addition, in May 2009, the Federal Deposit Insurance Corporation imposed a special assessment on all insured institutions and required all institutions to prepay their assessments for all of 2010, 2011 and 2012, which for us totaled \$2.7 million. Additional increases in the base assessment rate or additional special assessments would negatively impact our earnings.

The trading history of our common stock is characterized by low trading volume and volatility.

Although our common stock trades on OTC Electronic Bulletin Board, it has not been regularly traded. We cannot predict the extent to which investor interest in us will lead to a more active trading market in our common stock or how liquid that market might become. A public trading market having the desired characteristics of depth, liquidity and orderliness depends upon the presence in the marketplace of willing buyers and sellers of our common stock at any given time, which presence is dependent upon the individual decisions of investors, over which we have no control.

The market price of our common stock may be highly volatile and subject to wide fluctuations in response to numerous factors, including, but not limited to, the factors discussed in other risk factors and the following:

Ø actual or anticipated fluctuations in our operating results;

Ø changes in interest rates;

Ø changes in the legal or regulatory environment in which we operate;

Ø press releases, announcements or publicity relating to us or our competitors or relating to trends in our industry;

Ø changes in expectations as to our future financial performance, including financial estimates or recommendations by securities analysts and investors;

Ø future sales of our common stock;

Ø changes in economic conditions in our marketplace, general conditions in the U.S. economy, financial markets or the banking industry; and

Ø other developments affecting our competitors or us.

These factors may adversely affect the trading price of our common stock, regardless of our actual operating performance, and could prevent you from selling your common stock at or above the price you desire. In addition, the stock markets, from time to time, experience extreme price and volume fluctuations that may be unrelated or disproportionate to the operating performance of companies. These broad fluctuations may adversely affect the market

price of our common stock, regardless of our trading performance.

Beginning in 2007 and through the present, the business environment for financial services firms has been extremely challenging. During this period, many publicly traded financial services companies have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance or prospects of such companies. We may experience market fluctuations that are not directly related to our operating performance but are influenced by the market's perception of the state of the financial services industry in general and, in particular, the market's assessment of general credit quality conditions, including default and foreclosure rates in the industry.

While the U.S. and other governments continue efforts to restore confidence in financial markets and promote economic growth, we cannot assure you that further market and economic turmoil will not occur in the near- or long-term, negatively affecting our business, financial condition and results of operations, as well as the price, trading volume and volatility of our common stock.

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

The Company and the Bank are subject to extensive regulation, supervision and examination as noted in the *Supervision and Regulation* section of this Form 10K. The regulation and supervision by the Commissioner of Financial Regulation of the State of Maryland, the Federal Reserve Board and the Federal Deposit Insurance Corporation are not intended to protect the interests of investors in Tri-County Financial Corporation common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Regulatory reform may have a material impact on our operations.

In 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act also creates a new federal agency to administer consumer protection and fair lending laws, a function that is now performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions will be reduced as well, and State Attorneys General will have greater authority to bring a suit against a federally chartered institution for violations of certain state and federal consumer protection laws. The Dodd-Frank Act contains various other provisions designed to enhance the regulation of depository institutions. The full impact of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased regulatory burden and compliance costs.

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

Additionally, on August 30, 2012, the federal banking regulatory agencies issued proposed rules that would implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. If adopted as

proposed, Basel III and regulations proposed by the federal banking regulatory agencies will require holding companies and banks to undertake significant activities to demonstrate compliance with the new and higher capital standards. Compliance with these rules, which are still being analyzed, will impose additional costs on banking entities and their holding companies.

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

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

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Bank maintains its main office and operations center in Waldorf, Maryland, in addition to its branch offices in Lexington Park, Leonardtown, La Plata, Dunkirk, Bryans Road, Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland and King George, Virginia. The Bank owns all of its branches except for the Dunkirk, Maryland branch and the land on which the Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland branches are located. Lease expiration dates range from 2017 to 2028 with renewal options of 5 to 10 years. The total net book value of the properties at December 31, 2012 was \$16.4 million which included \$11.1 million related to buildings and improvements.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Security Holder Matters and Issuer Purchases of Equity Securities

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

The information contained under the section captioned "Market for the Registrant's Common Stock and Related Security Holder Matters" in the Company's Annual Report to Stockholders for the fiscal year ended December 31, 2012 (the "Annual Report") filed as Exhibit 13 hereto is incorporated herein by reference.

Stock Performance Graph.

Not required as the Company is a smaller reporting company.

Recent Sales of Unregistered Securities.

Not applicable.

Purchases of Equity Securities by the Issuer.

On September 25, 2008, the Company announced a repurchase program under which it would repurchase up to 5% of its outstanding common stock or approximately 147,435 shares. The following table presents information regarding the Company's stock repurchases during the three months ended December 31, 2012.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1-31, 2012	-	\$ -	-	98,885
November 1-30, 2012	2,200	14.39	2,200	96,685
December 1-31, 2012	271	16.60	271	96,414
Total	2,471	\$ 14.63	2,471	96,414

Item 6. Selected Financial Data

The information contained under the section captioned "Selected Financial Data" of the Annual Report filed as Exhibit 13 hereto is incorporated herein by reference.

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

The information contained in the section captioned "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" of the Annual Report filed as Exhibit 13 hereto is incorporated herein by reference.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Not applicable as the Company is a smaller reporting company.

Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements, Notes to Consolidated Financial Statements and Report of Independent Registered Public Accounting Firm included in the Annual Report filed as Exhibit 13 hereto are incorporated herein by reference.

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

None.

Item 9A. Controls and Procedures

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management's annual report on internal control over financial reporting is incorporated herein by reference to the Company's audited Consolidated Financial Statements in this Annual Report on Form 10-K.

(c) Changes to Internal Control Over Financial Reporting

Except as indicated herein, there were no changes in the Company's internal control over financial reporting during the three months ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

For information concerning the Company's directors, the information contained under the section captioned "*Items to be voted on by Stockholders- Item 1 – Election of Directors*" in the Company's definitive proxy statement for the Company's 2013 Annual Meeting of Stockholders (the "Proxy Statement") is incorporated herein by reference. For information concerning the executive officers of the Company, see "*Item 1 – Business – Executive Officers of the Registrant*" under Part I of this Annual Report on Form 10-K.

For information regarding compliance with Section 16(a) of the Exchange Act, the cover page of this Annual Report on Form 10-K and the information contained under the section captioned "*Other Information Relating to Directors and Executive Officers Section 16(a) Beneficial Ownership Reporting Compliance*" in the Proxy Statement are incorporated herein by reference.

For information concerning the Company's code of ethics, the information contained under the section captioned "*Corporate Governance – Code of Ethics*" in the Proxy Statement is incorporated by reference. A copy of the code of ethics and business conduct is filed as Exhibit 14 hereto.

For information regarding the audit committee and its composition and the audit committee financial expert, the section captioned “*Corporate Governance – Committees of the Board of Directors – Audit Committee*” in the Proxy Statement is incorporated by reference.

Item 11. Executive Compensation

For information regarding executive compensation, the information contained under the sections captioned “*Executive Compensation*” and “*Directors’ Compensation*” in the Proxy Statement is incorporated herein by reference.

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

(a) Security Ownership of Certain Owners

The information required by this item is incorporated herein by reference to the section captioned “*Principal Holders of Voting Securities*” in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned “*Principal Holders of Voting Securities*” in the Proxy Statement.

(c) Changes in Control

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may, at a subsequent date, result in a change in control of the registrant.

(d) Equity Compensation Plan Information

The Company maintains the Tri-County Financial Corporation 2005 Equity Compensation Plan. This plan covers employees and non-employee directors. The following table sets forth certain information with respect to the Company's Equity Compensation Plan as of December 31, 2012.

Plan Category	(a)	(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity plans approved by security holders	190,047	\$ 19.42	97,333
Equity compensation plans not approved by security holders (1)	46,012	\$ 14.64	-
Total	236,059	\$ 18.49	97,333

Consists of the Company's 1995 Stock Option Plan for Non-Employee Directors, which expired in 2005 and which provided grants of non-incentive stock options to directors who are not employees of the Company or its (1) subsidiaries. Options were granted at an exercise price equal to their fair market value at the date of grant and had a term of ten years. Options are generally exercisable while an optionee serves as a director or within one year thereafter.

Item 13. Certain Relationships, Related Transactions and Director Independence

The information regarding certain relationships and related transactions, the section captioned “*Other Information Relating to Directors and Executive Officers – Policies and Procedures for Approval and Related Parties Transactions and Relationships and Transactions with the Company and the Bank*” in the Proxy Statement is incorporated herein by reference.

For information regarding director independence, the section captioned “*Proposal 1 – Election of Directors*” in the Proxy Statement is incorporated by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated herein by reference to the section captioned “*Audit Related Matters – Audit Fees*” and “*— an Pre-Approval of Services by the Independent Registered Public Accounting Firm*” in the Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) List of Documents Filed as Part of this Report

(1) *Financial Statements.* The following consolidated financial statements and notes related thereto are incorporated by reference from Item 8 hereof:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2012 and 2011

Consolidated Statements of Income and Comprehensive Income for the Years Ended December 31, 2012 and 2011

Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2012 and 2011

Consolidated Statements of Cash Flows for the Years Ended December 31, 2012 and 2011

Notes to Consolidated Financial Statements

(2) ***Financial Statement Schedules.*** All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) ***Exhibits.*** The following is a list of exhibits filed as part of this Annual Report on Form 10-K and is also the Exhibit Index.

Exhibit No	Description	Incorporated by Reference to
3.1	Articles of Incorporation of Tri-County Financial Corporation	Form S-4 (Registration No. 333-31287).
3.2	Articles of Amendment to Articles of Incorporation of Tri-County Financial Corporation	Form 8-K as filed on May 14, 2012
3.3	Amended and Restated Bylaws of Tri-County Financial Corporation	Form 8-K as filed on August 27, 2010
4.1	Amended and Restated Articles Supplementary establishing Senior Non-cumulative Perpetual Preferred Stock, Series C, of Tri-County Financial Corporation	Form 8-K as filed on September 23, 2011

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10.1*	Tri-County Financial Corporation 1995 Stock Option and Incentive Plan, as amended	Form 10-K for the year ended December 31, 2000 as filed on March 30, 2001.
10.2*	Tri-County Financial Corporation 1995 Stock Option Plan for Non-Employee Directors, as amended	Form 10-K for the year ended December 31, 2000 as filed on March 30, 2001.
10.3*	Employment Agreement with Michael L. Middleton	Form 10-Q for the quarter ended September 30, 2006 as filed on November 14, 2006.
10.4*	Amended and Restated Executive Incentive Compensation Plan	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.5*	Retirement Plan for Directors	Form 10-K for the year ended December 31, 2006 as filed on March 27, 2007.
10.6*	Split Dollar Agreements with Michael L. Middleton	Form 10-K for the year ended December 31, 2000 as filed on March 30, 2001.
10.7*	Split Dollar Agreement with William J. Pasenelli	Form 10-K for the year ended December 31, 2001 as filed on April 1, 2002.
10.8*	Salary Continuation Agreement with Michael L. Middleton, dated September 6, 2003	Form 10-K for the year ended December 31, 2003 as filed on March 26, 2004.
10.9*	First Amendment to the Salary Continuation Agreement, dated September 6, 2003, with Michael L. Middleton	Form 10-K for the year ended December 31, 2008 as filed on March 9, 2009.
10.10*	Tri-County Financial Corporation 2005 Equity Compensation Plan	Definitive Proxy Statement as filed on April 11, 2005
10.11*	Amendment No. 1 to the Tri-County Financial Corporation 2005 Equity Compensation Plan	Form 10-Q for the quarter ended September 30, 2007 as filed on November 13, 2007.
10.12*	Community Bank of Tri-County Executive Deferred Compensation Plan	Form 10-K for the year ended December 31, 2006 as filed on March 27, 2007.

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| 10.13* | Amended and Restated Employment Agreement by and among
Community Bank of Tri-County, William J. Pasenelli and Tri-County
Financial Corporation, as guarantor | Form 10-Q for the quarter ended
March 31, 2007 as filed on May 11,
2007. |
| 10.14* | Amended and Restated Employment Agreement by and among
Community Bank of Tri-County, Gregory C. Cockerham and
Tri-County Financial Corporation, as guarantor | Form 10-Q for the quarter ended
March 31, 2007 as filed on May 11,
2007. |

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| 10.15* | Salary Continuation Agreement with Gregory C. Cockerham, dated August 21, 2006 | Form 10-Q for the quarter ended September 30, 2006 as filed on November 14, 2006. |
| 10.16* | First Amendment to the Salary Continuation Agreement, dated August 21, 2006, with Gregory C. Cockerham | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 10.17* | Second Amendment to the Salary Continuation Agreement, dated August 21, 2006, with Gregory C. Cockerham | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 10.18* | Salary Continuation Agreement with William J. Pasenelli, dated August 21, 2006 | Form 10-Q for the quarter ended September 30, 2006 as filed on November 14, 2006. |
| 10.19* | First Amendment to the Salary Continuation Agreement, dated August 21, 2006, with William J. Pasenelli | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 10.20* | Second Amendment to the Salary Continuation Agreement, dated August 21, 2006, with William J. Pasenelli | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 10.21* | Securities Purchase Agreement dated September 22, 2011, between Tri-County Financial Corporation and the Secretary of the United States Department of the Treasury | Form 8-K as filed on September 23, 2011 |
| 10.22* | Repurchase Letter dated September 22, 2011 between Tri-County Financial Corporation and the United States Department of the Treasury with respect to the Series A Preferred Stock and Series B Preferred Stock | Form 8-K as filed on September 23, 2011 |
| 10.23* | Form of Letter Agreement between Tri-County Financial Corporation and each of Michael L. Middleton, Gregory C. Cockerham and William J. Pasenelli | Form 8-K as filed on September 23, 2011 |
| 10.24* | Salary Continuation Agreement between Gregory C. Cockerham and Community Bank of Tri-County, dated September 6, 2003, as amended on December 22, 2008 | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 10.25* | Salary Continuation Agreement between William J. Pasenelli and Community Bank of Tri-County, dated September 6, 2003, as amended on June 11, 2004 and December 22, 2008 | Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009. |
| 13.0 | Annual Report to Stockholders for the year ended December 31, 2012 | |
| 14.0 | Code of Ethics | |

Form 10-K for the year ended
December 31, 2005 as filed on
March 30, 2006.

- 21.0 List of Subsidiaries
- 23.1 Consent of Stegman & Company
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
- 32.0 Section 1350 Certification of Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer

101.0** The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Changes In Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements.

(*)

Management contract or compensating arrangement.

(**)Furnished not filed.

(b) **Exhibits.** The exhibits required by Item 601 of Regulation S-K are either filed as part of this Annual Report on Form 10-K or incorporated by reference herein.

(c) **Financial Statements and Schedules Excluded From Annual Report.** There are no other financial statements and financial statement schedules which were excluded from this Annual Report pursuant to Rule 14a-3(b)(1) which are required to be included herein.

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.

TRI-COUNTY FINANCIAL CORPORATION

Date: March 15, 2013 By: /s/ Michael L. Middleton
Michael L. Middleton
Chief Executive Officer
(Duly Authorized Representative)

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

By: /s/ Michael L. Middleton
Michael L. Middleton
Director, Chief Executive Officer
(Principal Executive Officer)

By: /s/ William J. Pasenelli
William J. Pasenelli
Director, President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: March 15, 2013

Date: March 15, 2013

By: /s/ H. Beaman Smith
H. Beaman Smith
Director

By: /s/ Austin J. Slater, Jr.
Austin J. Slater, Jr.
Director

Date: March 15, 2013

Date: March 15, 2013

By: /s/ Louis P. Jenkins, Jr.
Louis P. Jenkins, Jr.
Director

By: /s/ James R. Shepherd
James R. Shepherd
Director

Date: March 15, 2013

Date: March 15, 2013

By: /s/ Philip T. Goldstein
Philip T. Goldstein
Director

By: /s/ Joseph V. Stone, Jr.
Joseph V. Stone, Jr.
Director

Date: March 15, 2013

Date: March 15, 2013

By: /s/ Mary Todd Peterson
Mary Todd Peterson
Director

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