TAYLOR CALVIN B BANKSHARES INC
Form 10-K
March 12, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2008
Commission File No. 000-50047

Calvin B. Taylor Bankshares, Inc.

(Exact name of registrant as specified in its Charter)

Maryland

(State of incorporation or organization)

52-1948274

(I.R.S. Employer Identification No.)

24 North Main Street, Berlin, Maryland 21811

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (410) 641-1700

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 $1.00 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes__ No [X]

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes__ No [X]

The aggregate market value of the Common Stock, all of which has voting rights, held by non-affiliates of the registrant on December 31, 2008, was $92,800,447. This calculation is based upon the last price known to the registrant at which its Common Stock was sold as of the last business day of the registrant's most recently completed second fiscal quarter. As of June 30, 2008, the last known sale price was $36.50 per share. There is not an active trading market for the Common Stock and it is not possible to identify precisely the market value of the Common Stock. On February 28, 2009, 3,036,754 shares of the registrant's common stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Proxy Statement for Annual Meeting of Stockholders to be held on May 13, 2009, is incorporated by reference in this Form 10-K in Part III, Item 10, Item 11, Item 12, Item 13, and Item 14.

This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements appear in a number of places in this Report and include all statements regarding the intent, belief or current expectations of the Company, its directors, or its officers with respect to, among other things: (i) the Company's financing plans; (ii) trends affecting the Company's financial condition or results of operations; (iii) the Company's growth strategy and operating strategy; and (iv) the declaration and payment of dividends. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in the Company's filings with the Securities and Exchange Commission.

PART I

Item 1. Business

General

Calvin B. Taylor Bankshares, Inc. (Company) was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of Calvin B. Taylor Banking Company of Berlin, Maryland (Bank). The Bank, which commenced operation in 1890, is a commercial bank incorporated under the laws of the State of Maryland on December 17, 1907, with a main office located in Berlin, Maryland.

Location and Service Area

The Company, through the Bank, is engaged in a general commercial and retail banking business serving individuals, small- to medium-sized businesses, professional organizations, and governmental units. The Bank operates nine branches located throughout Worcester County, Maryland and one branch located in Sussex County, Delaware. The Bank draws most of its customer deposits and conducts most of its lending transactions within the communities in which these branches are located.

Much of the Bank’s service area is located along the shores of the Atlantic Ocean and has grown as both a resort and a retirement community. The principal components of the economy are tourism and agriculture. Berlin has a strong component of health-care related businesses. The tourist businesses of Ocean City, Maryland and Bethany, Delaware and the health-care facilities in Berlin, Maryland (including Berlin Nursing Home and Atlantic General Hospital) are among the largest employers in the counties.

Banking Products and Services

The Bank offers a full range of deposit services including checking, NOW, Money Market, and savings accounts, and time deposits including certificates of deposit. The transaction, savings, and certificate of deposit accounts are tailored to the Bank’s principal market areas at rates competitive to those offered in the area. The Bank also offers Individual Retirements Accounts (IRA), Health Savings Accounts, and Education Savings Accounts. All deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the maximum amount allowed by law. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities. The Bank offers individual customers up to $50 million in FDIC insured deposits through the Certificate of Deposit Account Registry Services® (CDARS).

The Bank also offers a full range of short- to medium-term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. The Bank originates commercial and residential mortgage loans and real estate construction and acquisition loans. These lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank lends to directors and officers of the Company and the Bank under terms comparable to those offered to other borrowers entering into similar loan transactions. The Board of Directors approves all loans to officers and directors and reviews these loans every six months.

Other bank services include cash management services, 24-hour ATM’s, debit cards, safe deposit boxes, travelers’ checks, direct deposit of payroll and social security funds, and automatic drafts for various accounts. The Bank offers bank-by-phone and Internet banking services, including electronic bill-payment, to both commercial and retail customers. Early in 2008, the Bank began offering a remote capture service that enables commercial customers to electronically capture check images and make on-line deposits. Also in 2008, the Bank began offering electronic statement delivery to consumer and commercial customers. The Bank also offers non-deposit products including retail repurchase agreements and discount brokerage services through a correspondent bank.

Competition

The Company and the Bank face strong competition in all areas of operations. The competition comes from entities operating in Worcester County, Maryland and Sussex County, Delaware and neighboring counties and includes branches of some of the largest banks in Maryland, Delaware, and Virginia. Its most direct competition for deposits historically has come from other commercial banks, savings banks, savings and loan associations, and credit unions operating in its service areas. The Bank also competes for deposits with money market mutual funds and corporate and government securities. The Bank competes for loans with the same banking entities, as well as mortgage banking companies and other institutional lenders. The competition for loans varies from time to time depending on certain factors. These factors include, among others, the general availability of lendable funds and credit, general and local economic conditions, current interest rate levels, conditions in the mortgage market, and other factors which are not readily predictable.

The Bank employs traditional marketing media including local newspapers and radio, to attract new customers. Bank officers, directors, and employees are active in numerous community organizations and participate in community-based events. These activities and referrals by satisfied customers result in new business.

Employees

As of December 31, 2008, the Bank employed 94 full-time equivalent employees. The Company's operations are conducted through the Bank. Consequently, the Company does not have separate employees. None of the employees of the Bank are represented by any collective bargaining unit. The Bank considers its relations with its employees to be good.

SUPERVISION AND REGULATION

The Company and the Bank are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on, and provide for general regulatory oversight with respect to, virtually all aspects of operations. These laws and regulations are generally intended to protect depositors, not stockholders. The following is a summary of certain statutes, rules, and regulations affecting the Company and the Bank. To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Proposed legislative changes and the policies of various regulatory authorities may affect the operations of the Company and the Bank and those effects may be material. The Company is unable to predict the nature or the extent of the effect on its business and earnings that fiscal or monetary policies, economic controls, or new federal or state legislation may have in the future.

The Company

Bank Holding Company Act of 1956

The Company is a bank holding company within the meaning of the federal Bank Holding Company Act of 1956 (BHCA). Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require. The Company's and the Bank’s activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its Subsidiary, or engaging in any other activity that the Federal Reserve determines to be so closely related to banking or managing and controlling banks as to be a proper incident thereto.

Investments, Control, and Activities. With certain limited exceptions, the BHCA requires a bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring substantially all the assets of any bank, (ii) acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares), or (iii) merging or consolidating with another bank holding company.

In addition, and subject to certain exceptions, the BHCA and the Change in Bank Control Act, together with regulations thereunder, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring "control" of a bank holding company, such as the Company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Because the Company's Common Stock is registered under the Securities Exchange Act of 1934, under Federal Reserve regulations, control will be rebuttably presumed to exist if a person acquires at least 10% of the outstanding shares of any class of voting securities of the Company. The regulations provide a procedure for challenge of the rebuttable control presumption.

Under the BHCA, the Company is generally prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in non-banking activities, unless the Federal Reserve, by order or regulation, has found those activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Source of Strength; Cross-Guarantee. Under Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which the Company might not otherwise do so. The Federal Reserve may require a bank holding company to terminate an activity or relinquish control of a nonbank subsidiary if the Federal Reserve determines that such activity or control poses serious risk to the financial soundness or stability of a subsidiary bank. Further, federal bank regulatory authorities have discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. The Bank may be required to indemnify, or cross-guarantee, the FDIC against losses it incurs with respect to any other bank controlled by the Company, which in effect makes the Company's equity investments in healthy bank subsidiaries available to the FDIC to assist any failing or failed bank subsidiary of the Company.

Gramm-Leach-Bliley Act

In November 1999, the Gramm-Leach-Bliley Act was signed into law. Among other things, the Act repeals the restriction, contained in the Glass-Steagall Act, on banks affiliating with securities firms. The Act permits bank holding companies to engage in a statutorily provided list of financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities. The Act also authorizes activities that are "complementary" to financial activities. The Act is intended to grant certain powers to community banks that larger institutions have accumulated on an ad hoc basis. One possible consequence of the Act may be increased competition that the Company and the Bank face from larger institutions and other types of companies. It is not possible to determine the full effect that the Act has had on the Company and the Bank.

Securities Exchange Act of 1934

The Company’s common stock is registered with the Securities and Exchange Commission (SEC) under Section 12(g) of the Securities Exchange Act of 1934 (the Act). The Company is, therefore, subject to periodic and ad hoc information reporting, proxy solicitation rules, restrictions on insider trading, and other requirements of the Act.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act (SOX) of 2002 imposed additional disclosure requirements in the Company’s reports filed with the SEC. SOX defines new standards of independence for insiders, provides guidance for certain Board committees including the composition of those committees, and establishes corporate governance requirements.

The Bank

General. The Bank operates as a state nonmember banking association incorporated under the laws of the State of Maryland. It is subject to examination by the FDIC and the state department of banking regulation for each state in which it has a branch. The States and the FDIC regulate or monitor all areas of the Bank’s operations, including security devices and procedures, adequacy of capitalization and loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees on loans, establishment or closure of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The FDIC requires the Bank to maintain certain capital ratios and imposes limitations on the Bank’s aggregate investment in real estate, bank premises, and furniture and fixtures. The Bank is required by the FDIC to prepare quarterly reports on the Bank’s financial condition.

Under provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), all insured institutions must undergo periodic on-site examination by the appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the agency against each institution or affiliate, as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency (and state supervisor when applicable). FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

Transactions With Affiliates and Insiders

The Bank is subject to Section 23A of the Federal Reserve Act, which places limits on the amount of loans or extensions of credit to, or investment in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank’s capital and surplus and, as to all affiliates combined, to 20% of the Bank’s capital and surplus. In addition, each covered transaction must meet specific collateral requirements. The Bank is also subject to Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal stockholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Community Reinvestment Act

The Community Reinvestment Act requires that the Bank shall be evaluated by its primary federal regulator with respect to its record in meeting the credit needs of its local community, including low and moderate income neighborhoods, consistent with safe and sound operations. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. The Bank received a satisfactory rating in its most recent evaluation.

The Bank Secrecy Act and USA Patriot Act

The Bank Secrecy Act of 1970 (BSA) requires financial institutions to assist federal agencies to detect and prevent money laundering by filing and/or maintaining reports of large cash transactions or other suspicious transactions involving cash. BSA is also referred to as anti-money laundering law as it is designed to detect money laundering, tax evasion, or other criminal activities.

In response to the terrorist attacks on September 11, 2001, Congress passed the Patriot Act. The Patriot Act requires that Banks prepare and retain additional records designed to assist the government in an effort to combat terrorism. The Act includes anti-money laundering and financial transparency provisions, and guidelines for verifying customer identification during account opening. The Act promotes cooperation between law enforcement, financial institutions, and financial regulators in identifying persons involved in illegal acts such as money laundering and terrorism.

Other Regulations

Interest and certain other charges collected or contracted for by the Bank are subject to state and federal laws concerning interest rates. The Bank’s loan operations are also subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers, the Real Estate Settlement Procedures Act requiring lenders to provide disclosures to consumers at various times during an applicable transaction and which outlaws kickbacks that increase the cost of settlement services, the Home Mortgage Disclosure Act of 1975 requiring financial institutions in metropolitan statistical areas to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves, the Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed, or other prohibited bases in extending credit, the Fair Credit Reporting Act of 1978 governing the use and provision of information to credit reporting agencies, the Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies, and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank are subject to the Truth in Savings Act which governs disclosures of rate and fee information to consumer deposit customers, the Right to Financial Privacy Act which imposes a duty to maintain confidentiality of customers’ financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Fund Transfers Act as implemented by the Federal Reserve Board’s Regulation E which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Deposit Insurance

The FDIC establishes rates for the payment of deposit insurance premiums by federally insured banks and thrifts. The Deposit Insurance Fund is maintained for commercial banks and thrifts, with insurance premiums from the industry used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like the Bank have paid for deposit insurance under a risk-based premium system. The Federal Deposit Insurance Reform Act of 2005 creates a revised deposit insurance assessment rate structure, effective January 1, 2007. Under this system, assessment rates are based on Risk Categories as determined by a combination of CAMELS component ratings and financial ratios. Banks in Risk Category I, the lowest risk profile, will be assessed at a rate of 5 to 7 basis points. A One-time Assessment Credit for banks that were in existence on December 31, 1996, will be applied to offset assessments dollar-for-dollar until full benefit of the credit is received. In addition to the amount paid for deposit insurance, banks are assessed an additional amount to service the interest on the bond obligations of the Financial Corporation (FICO). Any increase in deposit insurance premiums for the Bank will increase the Bank’s operating expenses, and there can be no assurance that such costs can be passed on to the Bank’s customers.

Dividends

The principal source of the Company's cash revenues comes from dividends received from the Bank. The amount of dividends that may be paid by the Bank to the Company depends on the Bank's earnings and capital position and is limited by federal and state laws, regulations, and policies. The Federal Reserve has stated that bank holding companies should refrain from or limit dividend increases or reduce or eliminate dividends under circumstances in which the bank holding company fails to meet minimum capital requirements or in which earnings are impaired.

The Company's ability to pay any cash dividends to its stockholders in the future will depend primarily on the Bank's ability to pay dividends to the Company. In order to pay dividends to the Company, the Bank must comply with the requirements of all applicable laws and regulations. Under Maryland law, the Bank must pay a cash dividend only from the following, after providing for due or accrued expenses, losses, interest, and taxes: (i) its undivided profits, or (ii) with the prior approval of the Department of Financial Regulation, its surplus in excess of 100% of its required capital stock. Under FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. See "Capital Regulations" below. See Item 5 for a discussion of dividends paid by the Company in the past three years.

In addition to the availability of funds from the Bank, the future dividend policy of the Company is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash needs, and general business conditions. The amount of dividends that might be declared in the future presently cannot be estimated and it cannot be known whether such dividends would continue for future periods.

Capital Regulations

The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance sheet exposure, and minimize disincentives for holding liquid assets. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the regulators have noted that banks and bank holding companies contemplating significant expansion programs should not allow expansion to diminish their capital ratios and should maintain ratios well in excess of the minimums.

Current guidelines require bank holding companies and federally regulated banks to maintain a minimum ratio of total risk-based capital to risk-weighted assets equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common stockholders' equity before the unrealized gains and losses on securities available for sale, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles, and excludes the allowance for loan losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan losses up to 1.25% of risk-weighted assets. Total capital is the sum of Tier 1 plus Tier 2 capital. The federal bank regulatory authorities have also implemented a leverage ratio, which is Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk-based guidelines. The principal objective of the leverage ratio is to place a constraint on the maximum degree to which a bank holding company may leverage its equity capital base. The minimum required leverage ratio for top-rated institutions is 4%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points.

FDICIA established a new capital-based regulatory scheme designed to promote early intervention for troubled banks and requires the FDIC to choose the least expensive resolution of bank failures. The new capital-based regulatory framework contains five categories for compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." To qualify as a "well capitalized" institution, a bank must have a leverage ratio of no less than 5%, a Tier 1 risk-based ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2008, the Company and the Bank were qualified as "well capitalized." For further discussions, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Capital."

Recent Economic and Legislative Developments

During the fourth quarter of 2008, bank failures and near failures were prominent in the news. Securitization of subprime, adjustable rate mortgage loans originated in the United States has been cited as contributing to a global economic recession. Other contributory factors include a pool of investors willing to tolerate the risks attached to high yield mortgage backed securities, complex investment products that were not understood by investors or auditors/examiners, and inadequate oversight. Although neither the Company nor the Bank originated or invested in subprime loans, the economic downturn has affected their ability to invest profitably and the ability of some customers to repay their loans.

The Federal Reserve Open Market Committee reduced the federal funds rate from 4.25% at the beginning of 2008 to a range of 0.00% to 0.25% at year-end. Other short-term investments have experienced similar declines. These rate reductions have not accomplished their goal of stimulating borrowing and lending activity. The impact on the Company is reduced interest revenues and yields on federal funds sold, debt securities, and certificates of deposit in other banks.

Late in 2008, the Troubled Asset Relief Program (TARP) empowered U. S. Department of the Treasury to purchase or insure up to $700 billion of "troubled" mortgages and any securities based on those mortgages. These purchases are subject to the Secretary of Treasury's determination that the action will promote financial market stability. TARP gives Treasury the authority to purchase non-liquid, difficult-to-value assets from banks and other financial institutions. TARP is intended to improve the liquidity of these assets by purchasing them using secondary market mechanisms, thus allowing participating institutions to stabilize their balance sheets and avoid further losses.

Within weeks of the establishment of TARP, Treasury determined that direct asset purchase might not be the most effective use of TARP funds, and announced that some of the funds would be used in the Capital Purchase Program (CaPP). Under CaPP, up to $250 billion in preferred securities could be purchased from major financial institutions on the assumption that stronger equity positions would better equip financial institutions to withstand the impact of troubled asset holdings and would encourage lending. Alternate means for deploying TARP funds and monitoring effectiveness of their distribution are the subject of ongoing debate by policy makers and analysts. The Company and the Bank did not seek this assistance and will not benefit directly from TARP funds.

Late in 2008, to bolster public confidence in the financial system and reduce potential investor losses, deposit insurance levels were raised from $100,000 to $250,000 per depositor in accounts other than certain retirement accounts which are already insured to $250,000. Additional insurance of all noninterest bearing transaction account balances is available to depositors in participating financial institutions. The Company and the Bank elected to participate in the Temporary Liquidity Guarantee Program (TLG), providing this additional insurance. On January 1, 2010, the standard coverage limit will return to $100,000 for all deposit categories except IRAs and certain other retirement accounts, which will continue to be insured up to $250,000 per owner. These actions have contributed to a fourth quarter 2008 increase in deposits in the Bank as investors seek the safety of insured deposits in community banks. Deposit insurance premiums will increase as a result of the higher deposit balances, the higher insurance limits, participation in TLG, and higher insurance rates. Management does not expect to pass all of the additional insurance premium costs on to customers.

In the most stable economic times, the Company cannot reliably predict the effect of changing government policies on earnings, or loan and deposit levels. The impact on future results of operation of the Company and the Bank, of the dramatic developments of 2008 are uncertain. Management expects 2009 to bring lower interest revenues and higher fees associated with loan collection.

Item 1A. Risk Factors

The Company and the Bank are subject to various types of risk during the normal conduct of business. There has been no material increase in any level of risk incurred by the Company or the Bank during the period covered by this report. Following are descriptions of the significant categories of risk most relevant to the Company.

Credit risk

Credit risk is the risk to the bank's earnings or capital from the potential of an obligor to fulfill its contractual commitment to the bank. Credit risk is most closely associated with a bank's lending. It encompasses the potential loss on a particular loan as well as the potential for loss from a group of related loans, i.e., a credit concentration. Credit risk also extends to less traditional bank activities. It includes the credit behind the bank's investment portfolio.

A primary source of revenue for the Bank is lending, which is also the area of greatest credit risk. To ameliorate credit risk, the Board and management have adopted conservative lending practices. Board approved policies provide underwriting guidance. Individual loan authorities are low with no individual officer having a secured loan authority over $200,000. One result of the low individual limits is that the Executive Committee or the full Board approves most mortgage loans and many commercial non-mortgages. The Bank's product offerings are non-complex and no new loan products have been introduced this year.

Credit risk attributable to concentrations relates to the geography in which the Bank operates. There are no other significant concentrations related to an individual borrowing relationship or industry.

Interest-rate risk

Interest rate risk is the risk to earnings or capital from the potential movement in interest rates. It is the sensitivity of the bank's future earnings to interest rate changes. Interest rate risk is generally measured on the basis of duration analysis or gap analysis. Duration analysis measures the degree of risk in a particular instrument or portfolio and gap analysis defines the timing when loss may occur. In a community bank, an adequate interest rate risk measurement can be fairly simplistic.

The Bank controls interest rate risk by keeping both interest-bearing assets and liabilities short-term. As of December 31, 2008, approximately 97.5% of the Bank's loans are either variable rate or written on demand, and investment securities generally mature within three years. The longest term offered on a customer certificate of deposit is 24 months. This strategy has carried the Bank through rate cycles successfully in the past.

Liquidity Risk

Liquidity risk is the risk to earnings or capital from a bank's inability to meet its obligations when they come due without incurring unacceptable losses or costs. An example would be: Depositors withdrawing their deposits when the bank does not have the liquid assets to fund the withdrawals while meeting loan-funding obligations.

The Company's consolidated liquidity ratio was 40.0% in 2008, down from 42.0% in 2007 and 45.6% in 2006. Although this ratio has declined slightly, the Company anticipates that it will be able to fund loan demand and meet deposit withdrawal requests through the reduction of overnight investment in federal funds sold, maturity of investment securities, and, if necessary, borrowing against lines of credit with correspondent banks.

Market Risk: Moderate

Market risk is the risk to earnings or capital from changes in the value of portfolios of financial instruments. For most banks market risk is the risk of a decline in market value of its securities portfolio. Because the value of bank securities is driven primarily by interest rates, market risk and interest-rate risk frequently go hand in hand.

The Bank generally invests in short term investment securities of high quality. Market rates influence the fair market value of the portfolio and, therefore, the carrying value of securities classified as available for sale. The impact on the Bank's earnings relates to interest-rates and related risk. Management has not identified any investment securities as being other than temporarily impaired.

The regional, national, and international economic recession which has deepened throughout 2008, has caused borrowers hardships that effect their ability to repay loans, resulting in the Bank experiencing upward moving delinquencies, higher than usual charge-offs, and the prospect of repossession of collateral. Additionally, historically low market rates have reduced earnings on investments, including federal funds sold. Due to conservative investment practices, neither the Company nor the Bank has experienced portfolio value declines of significance. The Company and Bank expect the current adverse market conditions to continue to depress earnings for at least another year and likely longer, causing slower than usual growth in capital. The Company and the Bank have capital well in excess of the regulatory definition of well-capitalized which management expects to remain at that level.

Transaction Risk

Transaction risk is the risk to earnings or capital arising from problems with service or product delivery. Transaction risk is the risk of a failure in a bank's operating processes. It is a risk of failure in a bank's automation, its employee integrity, or its internal controls.

The Company and the Bank are subject to transaction risk. Management believes that a sound system of internal controls along with management and audit oversight control this risk at an acceptable level.

Compliance risk

Compliance risk is the risk to earnings or capital from noncompliance with laws, rules, and regulations. Compliance risk is often the greatest risk a bank faces. Compliance risk weighs heavily in every bank regardless of its size or products.

The Company and the Bank devote significant resources to meeting the challenge of complying with all applicable laws and regulations. Management employs a qualified compliance officer and uses supplementary legal or compliance resources as needed. Additionally, compliance is subject to examination by federal and state bank regulators.

Reputation risk

Reputation risk is the risk to earnings or capital from negative public opinion. Community and customer relations are critical to a bank's success. A bank's reputation is extremely important and anything that would impair that reputation is a significant risk.

Management and the Board consider the Bank's reputation to be one of its most valuable non-financial assets. The Bank has earned a reputation for providing good customer service, exercising safe and sound banking practices, dealing fairly with customers, employees and vendors, and participating as a good neighbor in the community. The maintenance of these qualities requires continued commitment and effort.

Strategic Risk

Strategic risk is the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions. A banks strategic plan is the route it is going to follow based on management's perception of the future. If the plan is wrong or improperly implemented, the bank is at risk.

The Company's Strategic Plan is general in nature, emphasizing customer service and profitability as its mission and profitability as its primary objective. The Plan mentions basic loan underwriting criteria as a foundation for asset quality. It includes sections on management succession and community involvement. The Plan does not include specific measurable goals or timeframes for goal achievement.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company has ten branch locations, all of which are owned by the Company or the Bank. The Bank leases the land on which the East Berlin branch is located. The locations are described as follows:

Office	Location	Square Footage
Main Office, Berlin	24 North Main Street, Berlin, Maryland 21811	24,229
East Berlin Office	10524 Old Ocean City Boulevard, Berlin, Maryland 21811	1,500
20th Street Office	100 20th Street, Ocean City, Maryland 21842	3,100
Ocean Pines Office	11103 Cathell Road, Berlin, Maryland 21811	2,420
Mid-Ocean City Office	9105 Coastal Highway, Ocean City, Maryland 21842	1,984
North Ocean City Office	14200 Coastal Highway, Ocean City, Maryland 21842	2,545
West Ocean City Office	9923 Golf Course Road, Ocean City, Maryland 21842	2,496
Pocomoke Office	2140 Old Snow Hill Road, Pocomoke, Maryland 21851	2,624
Snow Hill Office	108 West Market Street, Snow Hill, Maryland 21863	3,773
Ocean View, Delaware Office	50 Atlantic Avenue, Ocean View, Delaware 19970	4,900

The Berlin office is the centralized location for the Company and the Bank. Executive offices, loan processing, proof, bookkeeping, and the computer department are housed there. Most branches have a manager who also serves as a loan officer. All offices participate in normal day-to-day banking operations. The Company operates automated teller machines in all branches and at one non-branch location in a local hospital.

Item 3. Legal Proceedings

(a) There are no material pending legal proceedings to which the Company or the Bank or any of their properties are subject.

(b) No proceedings were terminated during the fourth quarter of the fiscal year covered by this report.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of the stockholders of the Company during the fourth quarter of the fiscal year covered by this report.

PART II

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

The Company's Articles of Incorporation, as amended, authorize it to issue up to 10,000,000 shares of common stock.

As of February 28, 2009 there were approximately 1,011 stockholders of record and 3,036,754 shares of Common Stock issued and outstanding. There is no established public trading market in the stock, and there is no likelihood that a trading market will develop in the near future. Transactions in the common stock are infrequent and are frequently negotiated privately between the persons involved in those transactions.

All outstanding shares of common stock of the Company are entitled to share equally in dividends from funds legally available, when, as, and if declared by the Board of Directors. The Company paid or declared dividends of $2.15 per share in 2008, $.80 per share in 2007, and $.75 per share in 2006. Included in 2008 is a special cash dividend of $1.30 per share which is not expected to be an annual event.

The following table presents information about the Company’s repurchase of its equity securities during the calendar quarter ended on the date of this Form 10-K.

	(a) Total Number of shares	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of a Publicly Announced Program	(d) Maximum Number of Shares that may yet be Purchased Under the Program
Period				
October	2,590	$36.85	2,590	226,050
November	2,230	$36.75	2,230	223,820
December	2,073	$36.75	2,073	221,747
Totals	6,893	$36.79	6,893	

The Company publicly announced on August 14, 2003, that it would repurchase up to 10% of its outstanding equity stock at that time, which equated to a total of 324,000 common shares available for repurchase. As of January 1, 2005, and again on May 18, 2007, this plan was renewed by public announcement, making up to 10% of the Company’s outstanding equity stock available for repurchase at the time of each renewal. This equated to a total of 314,072 common shares available for repurchase as of May 18, 2007.

There is no expiration date for this program. No other stock repurchase plan or program existed or exists simultaneously, nor has any other plan or program expired during the period covered by this table. Common shares repurchased under this plan are retired.

Item 6. Selected Financial Data

The following table presents selected financial data for the five years ended December 31, 2008.

	2008	2007	2006	2005	2004
	(Dollars in thousands, except for per share data)				
At Year End					
Total assets	$372,603	$369,146	$369,512	$391,054	$395,312
Total deposits	$292,459	$288,944	$290,325	$310,858	$319,772
Total loans, net of unearned income and allowance for loan losses	$241,431	$238,076	$233,231	$206,421	$163,489
Total stockholders' equity	$72,283	$74,476	$71,381	$67,530	$67,909
Common shares issued and outstanding	3,048,397	3,102,510	3,149,356	3,187,556	3,208,478
For the Year					
Average total assets	$366,900	$372,006	$377,211	$399,345	$396,695
Average stockholders' equity	$73,726	$72,569	$69,268	$69,138	$66,160
Net interest income	$15,978	$17,032	$16,963	$15,912	$13,698
Net income	$6,059	$7,297	$7,400	$6,798	$5,613
Cash dividend	$6,566	$2,485	$2,368	$6,694	$2,087
Per share data					
Book value	$23.71	$24.01	$22.67	$21.19	$21.17
Net income	$1.97	$2.33	$2.33	$2.13	$1.74
Cash dividends declared	$2.15	$0.80	$0.75	$2.10	$0.65
Other ratios					
Return on average assets	1.65%	1.96%	1.96%	1.70%	1.41%
Return on average equity	8.22%	10.05%	10.68%	9.83%	8.48%
Dividend payout ratio	109.14%	34.33%	32.19%	98.59%	37.36%
Average equity to average assets ratio	20.09%	19.51%	18.36%	17.31%	16.68%

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

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Company's financial statements and related notes and other statistical information included in this report.

Critical Accounting Policies

The Company's financial condition and results of operations are sensitive to accounting measurements and estimates of inherently uncertain matters. When applying accounting policies in areas that are subjective in nature, management uses its best judgment to arrive at the carrying value of certain assets. One of the most critical accounting policies applied is related to the valuation of the loan portfolio.

The allowance for loan losses (ALLL) represents management's best estimate of inherent probable losses in the loan portfolio as of the balance sheet date. It is one of the most difficult and subjective judgments. The adequacy of the allowance for loan losses is evaluated no less than quarterly. The determination of the balance of the allowance for loan losses is based on management's judgments about the credit quality of the loan portfolio as of the review date. It should be sufficient to absorb losses in the loan portfolio as determined by management's consideration of factors including an analysis of historical losses, specific reserves for non-performing or past due loans, delinquency trends, portfolio composition (including segment growth or shifting of balances between segments, products and processes, and concentrations of credit, both regional and by relationship), lending staff experience and changes, critical documentation and policy exceptions, risk rating analysis, interest rates and the competitive environment, economic conditions in the Bank's service area, and results of independent reviews, including audits and regulatory examinations.

Overview

Consolidated income of the Company is derived primarily from operations of the Bank. Net income for 2008 was $6,059,217 compared to $7,296,587 for 2007, and $7,400,369 for 2006. The Company had a return on average equity of 8.22% and return on average assets of 1.65% for 2008, compared to returns on average equity of 10.05% and 10.68%, and returns on average assets of 1.96% and 1.96%, for 2007 and 2006, respectively.

Results of Operations

The Company's net income of $6,059,217, or $1.97 per share, for the year ended December 31, 2008, was a decrease of $1,237,370 (16.96%) from net income of 7,296,587, or $2.33 per share, for the year ended December 31, 2007. Contributing to this decrease was a $1,053,933 (6.19%) decrease in net interest income, a $617,526 increase in the provision for loan losses, a $390,177 (5.16%) increase in noninterest expense, offset by a $720,012 reduction in income tax expense. These factors are discussed further in the following pages.

The Company's net income of $7,296,587, or $2.33 per share, for the year ended December 31, 2007, was a decrease of $103,782 (1.40%) from net income of 7,400,369, or $2.33 per share, for the year ended December 31, 2006. Contributing to this decrease were a $69,810 (0.41%) increase in net interest income, a $15,808 (0.81%) decrease in noninterest revenue, and a $207,404 (2.82%) increase in noninterest expense.

The Company's net income of $1,087,939 or $.36 per share, for the quarter ended December 31, 2008, was a decrease of $563,477 (34.12%) from the net income of $1,651,416 or $.53 per share, for the quarter ended December 31, 2007. An increased provision for loan loss, the primary reason for the decrease, resulted from management's assessment of the quality of the loan portfolio at the reporting date. See "Loan Quality and the Allowance for Loan Losses" for additional related disclosure and discussion.

The Company's net income of $1,651,416 or $.53 per share, for the quarter ended December 31, 2007, was a decrease of $179,843 (9.82%) from the net income of $1,831,259 or $.58 per share, for the quarter ended December 31, 2006. Lower net interest income, the primary reason for the decrease, resulted from the repricing of deposit accounts initiated in mid-2006. Deposit rate increases were targeted at deposit retention in a highly competitive environment.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between revenue on interest-earning assets, such as investment securities and loans, and interest expense incurred on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balances of interest-earning assets and the Company’s funding sources, and the rate spreads between interest-earning assets and funding sources. Changes in net interest income from period to period result from increases or decreases in the volume of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volume of interest-earning assets and interest-bearing liabilities is affected by the ability to manage the earning-asset portfolio, which includes loans, and the availability of particular sources of funds, such as noninterest-bearing deposits.

The key performance measure for net interest income is the "net margin on interest-earning assets," or net interest income divided by average interest-earning assets. The Company's net interest margin for 2008 on a non-GAAP tax-equivalent basis was 4.77%, compared to 5.07% and 5.00% for 2007 and 2006, respectively. Because most of the Bank’s loans are written with a demand feature, the income of the Bank should not change dramatically as interest rates change. Management of the Company expects to maintain the net margin on interest-earning assets. The net margin may decline, however, if competition increases, loan demand decreases, or the cost of funds rises faster than the return on loans and securities. Although such expectations are based on management's judgment, actual results will depend on a number of factors that cannot be predicted with certainty, and fulfillment of management's expectations cannot be assured.

The following tables present information including average balances of interest-earning assets and interest-bearing liabilities, the amount of related interest income and interest expense, and the resulting yields by category of interest-earning asset and interest-bearing liability. In these tables, dividends and interest on tax-exempt securities and loans are reported on a fully taxable equivalent basis, which is a non-GAAP measure as defined in SEC Regulation G and Item 10 of SEC Regulation S-K. Management believes that these measures provide better yield comparability as a tool for managing net interest income.

Average Balances, Interest, and Yields
(Dollars stated in thousands)

	For the Year Ended December 31, 2008			For the Year Ended December 31, 2007			For the Year Ended December 31, 2006		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets									
Federal funds sold	$ 36,328	$ 732	2.02%	$ 37,826	$ 1,919	5.07%	$ 22,547	$ 1,137	5.04%
Interest-bearing deposits	9,659	325	3.37%	3,494	168	4.82%	2,173	79	3.64%
Investment securities:									
U. S. Treasury	44,359	1,902	4.29%	55,061	2,636	4.79%	71,441	2,614	3.66%
U. S. Government Agency	10,330	468	4.53%	6,568	310	4.73%	13,378	398	2.98%
State and municipal	1,359	65	4.82%	2,397	95	3.97%	7,443	219	2.94%
Other	1,934	109	5.64%	1,927	101	5.27%	1,900	102	5.37%
Total investment securities	57,982	2,544	4.39%	65,953	3,142	4.77%	94,162	3,333	3.54%
Loans:									
Commercial	24,272	1,628	6.71%	23,812	1,691	7.10%	23,804	1,711	7.19%
Mortgage	212,104	14,917	7.03%	208,936	14,870	7.12%	200,588	14,020	6.99%
Consumer	2,497	206	8.23%	2,465	206	8.37%	2,491	206	8.27%
Total loans	238,873	16,751	7.01%	235,213	16,767	7.13%	226,883	15,937	7.02%
Allowance for loan losses	237			199			211		
Total loans, net of allowance	238,636	16,751	7.02%	235,014	16,767	7.13%	226,672	15,937	7.03%
Total interest-earning assets	342,605	20,352	5.94%	342,287	21,996	6.43%	345,554	20,486	5.93%
Noninterest-bearing cash	10,906			16,179			17,694		
Premises and equipment	6,391			6,548			6,605		
Other assets	6,998			6,992			7,358		
Total assets	$366,900			$372,006			$377,211		
Interest-bearing deposits									
NOW	$ 48,624	201	0.41%	$ 51,297	183	0.36%	$ 57,052	141	0.25%
Money market	32,070	305	0.95%	33,590	317	0.94%	41,810	335	0.80%
Savings	41,667	309	0.74%	44,137	327	0.74%	47,812	285	0.60%
Other time	90,596	3,149	3.48%	84,867	3,789	4.46%	68,359	2,414	3.53%
Total interest-bearing deposits	212,957	3,964	1.86%	213,891	4,616	2.16%	215,033	3,175	1.48%
Securities sold under agreements to repurchase	4,792	53	1.11%	4,248	29	0.69%	5,878	40	0.68%
Borrowed funds	85	5	6.14%	109	7	6.10%	145	8	5.52%
Total interest-bearing liabilities	217,834	4,022	1.85%	218,248	4,652	2.13%	221,056	3,223	1.46%
Noninterest-bearing deposits	74,262	-		79,807	-		84,380	-	
	292,096	4,022	1.38%	298,055	4,652	1.56%	305,436	3,223	1.06%
Other liabilities	1,078			1,382			2,507		
Stockholders' equity	73,726			72,569			69,268		
Total liabilities and stockholders' equity	$366,900			$372,006			$377,211		
Net interest spread			4.09%			4.30%			4.47%
Net interest income		$ 16,330			$ 17,344			$ 17,263	
Net margin on interest-earning assets			4.77%			5.07%			5.00%

Tax equivalent adjustment included in:			
Investment income	$ 183	$ 191	$ 231
Loan income	$ 169	$ 121	$ 69

Average Balances, Interest, and Yields
(Dollars stated in thousands)

	For the Year Ended December 31, 2005			For the Year Ended December 31, 2004		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets						
Federal funds sold	$ 34,233	$ 1,078	3.15%	$ 41,762	$ 547	1.31%
Interest-bearing deposits	2,175	56	2.55%	2,201	48	2.16%
Investment securities:						
U. S. Treasury	105,456	2,881	2.73%	116,537	2,442	2.10%
U. S. Government Agency	19,666	525	2.67%	18,844	503	2.67%
State and municipal	16,618	388	2.33%	19,004	407	2.14%
Other	1,882	90	4.79%	1,786	79	4.43%
Total investment securities	143,622	3,884	2.70%	156,171	3,431	2.20%
Loans:						
Commercial	19,134	1,322	6.91%	15,243	1,053	6.91%
Mortgage	165,415	11,485	6.94%	146,121	10,289	7.04%
Consumer	2,083	178	8.56%	2,305	201	8.73%
Total loans	186,632	12,985	6.96%	163,669	11,543	7.05%
Allowance for loan losses	214			209		
Total loans, net of allowance	186,418	12,985	6.97%	163,460	11,543	7.06%
Total interest-earning assets	366,448	18,003	4.91%	363,594	15,569	4.28%
Noninterest-bearing cash	19,946			19,705		
Premises and equipment	6,757			6,968		
Other assets	6,194			6,428		
Total assets	$399,345			$396,695		
Interest-bearing deposits						
Savings and NOW	$122,440	319	0.26%	$117,733	310	0.26%
Money market	50,537	218	0.43%	49,733	198	0.40%
Other time	63,710	1,202	1.89%	72,621	1,028	1.42%
Total interest-bearing deposits	236,687	1,739	0.73%	240,087	1,536	0.64%
Securities sold under agreements to repurchase	6,325	22	0.35%	5,021	8	0.16%
Borrowed funds	151	9	6.17%	171	10	6.06%
Total interest-bearing liabilities	243,163	1,770	0.73%	245,279	1,554	0.63%
Noninterest-bearing deposits	85,526	-		83,498	-	
	328,689	1,770	0.54%	328,777	1,554	0.47%
Other liabilities	1,518			1,758		
Stockholders' equity	69,138			66,160		
Total liabilities and stockholders' equity	$399,345			$396,695		
Net interest spread			4.18%			3.65%
Net interest income		$ 16,233			$ 14,015	
Net margin on interest-earning assets			4.43%			3.85%

Tax equivalent adjustment included in:

Investment income	$ 294	$ 286
Loan income	$ 27	$ 31

Analysis of Changes in Net Interest Income
(Dollars stated in thousands)

	Year ended December 31, 2008 compared with 2007 variance due to			Year ended December 31, 2007 compared with 2006 variance due to		
	Total	Rate	Volume	Total	Rate	Volume
Interest-earning assets						
Federal funds sold	(1,187)	(1,111)	(76)	782	12	770
Interest-bearing deposits	157	(140)	297	89	41	48
Investment securities:						
U. S. Treasury	(734)	(222)	(512)	22	621	(599)
U. S. Government Agency	158	(20)	178	(88)	115	(203)
State and municipals	(30)	11	(41)	(124)	25	(149)
Other	8	8	-	(1)	(2)	1
Loans:						
Commercial	(63)	(96)	33	(20)	(21)	1
Mortgage	47	(178)	225	850	267	583
Consumer	-	(3)	3	-	2	(2)
Total interest revenue	1,644)	(1,751)	107	1,510	1,060	450
Interest-bearing liabilities						
NOW	18	28	(10)	42	56	(14)
Money market	(12)	2	(14)	(18)	48	(66)
Savings	(18)	-	(18)	42	64	(22)
Other time deposits	(640)	(896)	256	1,375	792	583
Other borrowed funds	22	19	3	(12)	-	(12)
Total interest expense	(630)	(847)	217	1,429	960	469
Net interest income	(1,014)	(904)	(110)	81	100	(19)

In the preceding table, the variance that is both rate and volume related is reported with the rate variance.

Composition of Loan Portfolio

Because loans are expected to produce higher yields than investment securities and other interest-earning assets (assuming that loan losses are not excessive), the absolute volume of loans and the volume as a percentage of total earning assets is an important determinant of net interest margin. Average loans, net of the allowance for loan losses, were $238,636,000, $235,014,000, and $226,672,000, during 2008, 2007, and 2006, respectively, which constituted 69.65%, 68.66%, and 65.60%, of average interest-earning assets for the periods. The Company’s ratio of net loans to deposits was 82.55%, 82.40%, and 80.33%, at December 31, 2008, 2007, and 2006, respectively. Average net loans to average deposits were 83.09%, 80.02%, and 75.71% for 2008, 2007, and 2006. The slight increase in the loan to deposit ratio from 2007 to 2008 is attributable to 1.54% growth in the average loan portfolio accompanied by a 2.21% reduction in average deposits during 2008. The increase in the loan to deposit ratio from 2006 to 2007 is attributable to 3.68% growth in the average loan portfolio accompanied by a 1.91% reduction in average deposits during 2007.

The Company extends loans primarily to customers located in and near Worcester County, Maryland and Sussex County, Delaware. There are no industry concentrations in the Company's loan portfolio. The Company does, however, have a substantial portion of its loans in real estate and performance will be influenced by the real estate market in the region.

During 2004 through 2006, the Bank experienced rapid growth in construction, land development and land loans as a result of a robust real estate market and favorable competitive conditions. While this type of loan may generally be considered to be more risky than other real estate secured loans, the Bank did not deviate from its conservative underwriting practices relative to these transactions. While increasing the outstanding balances in this type of credit, management did not incur any more than its historically low level of risk. This is consistent with the Company’s philosophy that safe and sound practice, coupled with high earnings, are higher priorities than asset growth. The Bank has not engaged in risky lending practices such as subprime mortgages, high loan-to-value lending, or high volume of loans on condominiums.

Throughout 2007 and 2008, general economic conditions have caused a widespread decline in real estate values and an increase in time to market many properties. The Bank’s conservative underwriting practices have somewhat insulated it from the adverse portfolio effects that are currently receiving public attention. Further, management monitors fluctuations in the value of real estate held as collateral and, if deemed necessary, obtains additional collateral to limit the Bank’s loss exposure. As economic conditions continued to deteriorate through 2008, the adverse effects on many of the Bank’s customers have become apparent in increased loan delinquencies. The Bank has experienced higher than usual losses and nonaccrual classifications of loans during 2008 and expects this trend to continue through 2009.

The following table sets forth the composition of the Company's loan portfolio for each of the five most recent year ends.

Composition of the Loan Portfolio Stated in Dollars and Percentages

	2008	2007	2006	2005	2004
Real estate mortgages					
Construction, land development,					
and land	$ 30,330,261	$ 38,230,033	$ 37,331,256	$ 23,430,345	$ 14,304,860
Residential 1 to 4 family	95,203,258	87,327,448	88,599,071	81,327,154	74,211,899
Second mortgages	2,952,418	3,287,734	2,395,178	2,094,749	1,900,559
Commercial properties	89,302,549	84,568,665	79,484,039	76,103,526	57,252,929
Commercial	21,990,067	22,283,007	23,264,997	21,461,593	14,007,430
Consumer	2,359,513	2,574,916	2,352,660	2,215,299	2,010,406
Total loans	242,138,066	238,271,803	233,427,201	206,632,666	163,688,083
Less allowance for loan losses	707,152	195,525	196,083	211,374	198,591
Loans, net	$ 241,430,914	$ 238,076,278	$ 233,231,118	$ 206,421,292	$ 163,489,492
Real estate mortgages					
Construction, land development,					
and land	12.53%	16.04%	15.99%	11.34%	8.74%
Residential 1 to 4 family	39.32%	36.66%	37.95%	39.36%	45.33%
Second mortgages	1.22%	1.38%	1.03%	1.01%	1.16%
Commercial properties	36.88%	35.49%	34.05%	36.83%	34.98%
Commercial	9.08%	9.35%	9.97%	10.39%	8.56%
Consumer	0.97%	1.08%	1.01%	1.07%	1.23%
Total loans	100.00%	100.00%	100.00%	100.00%	100.00%

The following table sets forth the maturity distribution, classified according to sensitivity to changes in interest rates, for selected components of the Company's loan portfolio as of December 31, 2008.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates
December 31, 2008

	One year or less	Over one through five years	Over five years	Total
Real estate mortgages				
Construction, land development, and land	$ 30,274,660	$ 55,601	$ -	$ 30,330,261
Residential 1 to 4 family	94,985,833	47,192	170,233	95,203,258
Second mortgages	2,952,418			2,952,418
Commercial properties	89,008,680	61,297	232,572	89,302,549
Commercial	19,581,492	1,435,082	973,493	21,990,067
Consumer	1,192,137	1,009,029	158,347	2,359,513
	$ 237,995,220	$ 2,608,201	$ 1,534,645	$ 242,138,066
Fixed interest rate	$ 1,967,273	$ 2,608,201	$ 1,534,645	$ 6,110,119
Variable interest rate (or demand)	236,027,947	-	-	236,027,947
Total	$ 237,995,220	$ 2,608,201	$ 1,534,645	$ 242,138,066

As of December 31, 2008, $236,027,947 or 97.48%, of the total loans were either variable rate loans or loans written on demand.

The Company has the following commitments, lines of credit, and letters of credit outstanding as of December 31, 2008, 2007, and 2006, respectively.

	2008	2007	2006
Construction and land development loans	$ 15,218,812	$ 12,582,162	$ 18,866,083
Other loan commitments	22,245,089	20,941,323	21,557,185
Standby letters of credit	1,921,878	1,582,050	1,682,942
Total	$ 39,385,779	$ 35,105,535	$ 42,106,210

Loan commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest at current market rates, fixed expiration dates, and may require the payment of a fee. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company's exposure to loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment.

Loan Quality and the Allowance for Loan Losses

The allowance for loan losses represents an amount which management believes to be adequate to absorb identified and inherent losses in the loan portfolio as of the balance sheet date. Valuation of the allowance is completed no less than quarterly. The determination of the allowance is inherently subjective as it relies on estimates of potential loss related to specific loans, the effects of portfolio trends, and other internal and external factors.

The ALLL consists of (i) formula-based reserves comprised of potential losses in the balance of the loan portfolio segmented into homogeneous pools, (ii) specific reserves comprised of potential losses on loans that management has identified as impaired, and (iii) unallocated reserves. Unallocated reserves are not associated with a specific portfolio segment or a specific loan, but may be appropriate if properly supported and in accordance with GAAP. Management anticipates having low levels of unallocated reserves in future years, as discussed in conjunction with the table titled Allocation of the Allowance for Loan losses, below.

The Company evaluates loan portfolio risk for the purpose of establishing an adequate allowance for loan losses. In determining an adequate level for the formula-based portion of the ALLL, management considers historical loss experience for major types of loans. Homogenous categories of loans are evaluated based on loss experience in the most recent five years, applied to the current portfolio. This formulation gives weight to portfolio size and loss experience for categories of real-estate secured loans (i.e. real estate – construction and real estate – mortgage), other loans to commercial borrowers, and other consumer loans. However, historical data may not be an accurate predictor of loss potential in the current loan portfolio. Management also evaluates trends in delinquencies, the composition of the portfolio, concentrations of credit, and changes in lending products, processes, or staffing. Management further considers external factors such as the interest rate environment, competition, current local and national economic trends, and the results of recent independent reviews by auditors and banking regulators. The ongoing protracted slow-down in the real-estate market has affected both the price and time to market residential and commercial properties. Management closely monitors such trends and the potential effect on the Company. The impact of the current adverse economic conditions is reflected in increases to both the provision for loan loss and the ALLL during 2008.

Management has also adopted a risk rating system which gives weight to collateral status (secured vs. unsecured), and to the absence or improper execution of critical contract or collateral documents. Unsecured loans and those loans with critical documentation exceptions, as defined by management, are considered to have greater loss exposure. Management incorporates these factors in the formula-based portion of the ALLL. Additionally, consideration is given to those segments of the loan portfolio which management deems to pose the greatest likelihood of loss. In an economic downturn, such as the region has experienced in late 2007 and throughout 2008, management believes the Bank’s greatest likelihood of loss is in unsecured loans - commercial and consumer, and in secured consumer loans. Reserves for these segments of the portfolio are included in the formula-based portion of the ALLL at December 31, 2008. As the real estate market continues to languish, management continually evaluates the adequacy of collateral on loans where is appears the borrower is having difficulty servicing their debt. The Bank expects to initiate foreclosure proceedings on some mortgages during 2009. Foreclosure may result in loan losses, costs to hold real estate acquired in foreclosure, and losses on the sale of real estate acquired in foreclosure. Management is unable to estimate the financial consequence of future foreclosure activity.

In determining an adequate level for the specific reserve portion of the ALLL, management reviews the current portfolio giving consideration to problem loans. The allowance may include reserves for specific loans identified as impaired during management's loan review or the Company’s independent loan review or internal audit functions. For significant problem loans, management's review consists of evaluation of the financial strengths of the borrowers and guarantors, the related collateral, and the effects of economic conditions. Amounts of nonaccruing loans and loans past due 90 days or more and still accruing have increased from December 31, 2007 to 2008. Management prepares a Watch List of troubled loans for review by the Board of Directors at their monthly meeting.

The provision for loan losses is a charge to earnings in the current period to replenish the allowance and maintain it at a level management has determined to be adequate. The allowance is increased by current period provisions and by recoveries of amounts previously charged-off. The allowance is decreased when loans are charged-off as losses, which occurs when they are deemed to be uncollectible. Adjustments are made to bring the balance in the allowance to the level established by application of management’s allowance methodology, and may result in an increase or decrease to expense. A provision for loan losses of $617,526 was recorded in 2008. No provision for loan losses was made in 2007, 2006, 2005, or 2004.

Management considers the December 31, 2008 allowance appropriate and adequate to absorb identified and inherent losses in the loan portfolio. As of December 31, 2008, management has identified one loan with balance of $23,579 which is anticipated to be charged-off within the next 12 months. Management has provided for this loss in the ALLL. However, there can be no assurance that charge-offs in future periods will not exceed the allowance for loan loss or that additional increases in the loan loss allowance will not be required.

The following is a schedule of transactions in the allowance for loan losses for each of the five most recent years ended December 31. The Bank experienced net recoveries in 2005 and net charge-offs in the other four years presented. Management does not detect any meaningful trend in the year-to-year relationship of net recoveries to net charge-offs from 2004 through 2007. Rather, these are natural swings of activity in a loan portfolio that has historically experienced minimal losses. The increased losses in 2008 and the increase in the level of the ALLL as a percentage of the gross loan portfolio, reflect the impact, on the Bank's borrowers, of local, regional, national and global economies troubled by job losses, higher energy prices, lower real estate values, and a generally recognized period of economic recession.

Allowance for Loan Losses

	2008	2007	2006	2005	2004
Balance at beginning of year	$ 195,525	$ 196,083	$ 211,374	$ 198,591	$ 207,942
Loans charged-off:					
Real estate - construction and land	-	-	-	-	-
Real estate - mortgage	-	-	-	-	-
Commercial	76,383	-	5,357	-	-
Consumer	34,532	6,263	10,029	8,131	13,874
Total loan losses	110,915	6,263	15,386	8,131	13,874
Recoveries on loans previously charged off:					
Real estate - construction and land	-	-	-	-	-
Real estate - mortgage	-	-	-	15,263	-
Commercial	3,785	-	-	-	2,577
Consumer	1,231	5,705	95	5,651	1,946
Total loan recoveries	5,016	5,705	95	20,914	4,523
Net loan charge-offs (recoveries)	105,899	558	15,291	(12,783)	9,351
Provision for loan losses charged to expense	617,526	-	-	-	-
Balance at end of year	$ 707,152	$ 195,525	$ 196,083	$ 211,374	$ 198,591
Allowance for loan losses to loans outstanding at end of year	0.29%	0.08%	0.08%	0.10%	0.12%
Net charge-offs to average gross loans	0.04%	0.00%	0.01%	-0.01%	0.01%

The following table details the allocation of the allowance for loan losses to major categories of loans and the percentage of loans in each category relative to total loans at the five most recent year-ends. The loan portfolio is divided into homogeneous categories of loans for the purpose of calculating formula-based reserves. The categories of real estate – construction and real estate – mortgage loans share similar risks of potential collateral deterioration or devaluation. However, these loans tend to be more adequately secured than those commercial and consumer loans that are not real estate secured. The Bank has not incurred a mortgage loan loss since 1997, and therefore no reserves were allocated to the real estate – construction or real estate – mortgage portions of the loan portfolio in determining the ALLL for 2007, 2006, 2005 or 2004. In 2008, reserves of $475,098 have been provided related to impaired real estate loans. Non-real estate secured loans, commercial and consumer, pose a greater risk of loss due to erosion of the borrower's ability to repay the loan in a timely manner. Collateral on these loans is generally, although not always, less reliable than real estate as a source of recovery if default occurs. The Bank's loan losses in the five years ended December 31, 2008, have been consumer and commercial loans which were unsecured or secured with collateral other than real estate.

Allocation of Allowance for Loan Losses

	December 31, 2008		December 31, 2007		December 31, 2006	
	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans
Real estate - construction and land						
Formula-based	$ -		$ -		$ -	
Specific reserves	370,000		-		-	
Total real estate - construction and land	370,000	12.53 %	-	16.04 %	-	15.99 %
Real estate - mortgage						
Formula-based	125		-		-	
Specific reserves	104,973		-		-	
Total real estate - mortgage	105,098	77.42 %	-	73.53 %	-	73.03 %
Commercial						
Formula-based	73,694		34,952		10,556	
Specific reserves	128,521		109,200		-	
Total commercial	202,215	9.08 %	144,152	9.35 %	10,556	9.97 %
Consumer						
Formula-based	27,929		21,636		24,347	
Specific reserves	1,910		29,314		-	
Total consumer	29,839	0.97	50,950	1.08	24,347	1.01
Subtotal	707,152	100.00 %	195,102	100.00 %	34,903	100.00 %
Unallocated	-		423		161,180	
Total	$ 707,152		$ 195,525		$ 196,083	

December 31, 2005		December 31, 2004	
Amount	% of Loans	Amount	% of Loans

Real estate - construction and land						
Total real estate -						
construction and land	$ -	11.34		$ -	8.74	
Real estate - mortgage						
Total real estate - mortgage	-	77.20		-	81.47	
Commercial						
Formula-based	9,738			47,218		
Specific reserves	-			-		
Total commercial	9,738	10.39	%	47,218	8.56	%
Consumer						
Formula-based	22,926			20,805		
Specific reserves	-			-		
Total consumer	22,926	1.07		20,805	1.23	
Subtotal	32,664	100.00	%	68,023	100.00	%
Unallocated	178,710			130,568		
Total	$ 211,374			$ 198,591		

Unallocated reserves are not associated with a specific portfolio segment or a specific loan, but may be appropriate if properly supported and in accordance with GAAP. Because no portion of the ALLL is calculated on a total loan portfolio basis, management anticipates having low levels of unallocated reserves in future periods. The unallocated portion in the preceding table appears higher in years prior to 2007, the year in which management adopted a revised methodology. Management believes that the ALLL reflected in this table for years prior to 2007 does not materially differ from the balance that would have been calculated at each of those year-ends had current methodology been applied then.

The accrual of interest on a loan is discontinued when principal or interest is ninety days past due or when the loan is determined to be impaired, unless collateral is sufficient to discharge the debt in full and the loan is in process of collection. When a loan is placed in nonaccruing status, any interest previously accrued but unpaid, is reversed from interest income. Interest payments received on nonaccrual loans may be recorded as cash basis income, or as a reduction of principal, depending on management's judgment on a loan by loan basis. Accrual of interest may be restored when all principal and interest are current and management believes that future payments will be received in accordance with the loan agreement.

Nonperforming loans are loans past due 90 or more days and still accruing plus nonaccrual loans. Nonperforming assets are comprised of nonperforming loans combined with real estate acquired in foreclosure and held for sale. There were no nonperforming assets other than nonperforming loans as of December 31, 2008, 2007, 2006, 2005, or 2004, as shown in the following table.

	2008	2007	2006	2005	2004
Loans 90 days or more past due and still accruing	$ 4,647,792	$ 9,100	$ 239,620	$ 131,717	$ 391,676
Nonaccruing loans	199,724	40,916	-	-	-
Total nonperforming loans	$ 4,847,516	$ 50,016	$ 239,620	$ 131,717	$ 391,676
Interest not accrued on nonaccruing loans	$ 6,797	$ 1,509	$ -	$ -	$ -
Interest included in net income on					
nonaccruing loans	$ -	$ -	$ -	$ -	$ -

Included in amounts past due 90 days or more and still accruing at December 31, 2008, is a loan with a principal balance of $4,500,000. The Bank has been notified that there is a lien on the property securing this loan that is superior to the Bank's liens. The Bank was not aware of the lien at the time the loan was originated, and the Bank's settlement agent did not discover the lien during the title examination process. The Bank has filed a claim with the title company that has insured its liens. The Bank believes the title company will indemnify the Bank for any losses resulting from the superior lien, although there is no guarantee that this will be the case. The Bank will review the accrual status of this loan as it learns more information regarding its claim. As of December 31, 2008, there is $86,103 of accrued interest on this loan that was included in interest income in 2008.

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued, although management may categorize a performing loan as impaired based on knowledge of the borrower's financial condition, devaluation of collateral, or other circumstances that are deemed relevant to loan collection. Impaired loans may have specific reserves, or valuation allowances, allocated to them in the ALLL. Estimates of loss reserves on impaired loans are determined based on two of the measurement methods described in Financial Accounting Standard 114 (FAS 114): (1) the loan's observable fair price, or (2) the fair value of collateral, if repayment of the loan is expected to be provided by underlying collateral. Loans determined to be impaired, but for which no specific valuation allowance is made because management believes the loan is secured with adequate collateral or the Bank will not take a loss on such loan, are grouped with other homogeneous loans for evaluation under formula-based criteria described previously.

The following table sets forth principal balances of impaired loans and the related valuation allowances as of December 31, 2008. Included in principal balances of impaired loans as of December 31, 2008 and 2007, was $419,770 and $436,802 which was guaranteed by a government agency. Management had identified no impaired loans as of December 31, 2006, 2005, or 2004.

	2008	2007
Impaired loans with valuation allowances,		
including nonaccruing loans	$ 4,328,618	$ 595,774
Valuation allowances on impaired loans	$ 605,405	$ 138,514

Impaired loans with no valuation allowances	$ 4,559,582	$ -

Liquidity and Interest Rate Sensitivity

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary source of earnings, net interest income. Net interest income can fluctuate with significant interest rate movements. To lessen the impact of these margin swings, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to provide sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. These funds can be obtained by converting assets to cash or by attracting new deposits. Average liquid assets (cash and amounts due from banks, interest-bearing deposits in other banks, federal funds sold, and investment securities) were 40.00% of average deposits for 2008, compared to 42.03% and 45.61% for 2007 and 2006, respectively.

Average net loans to average deposits were 83.09%, 80.02%, and 75.71% for 2008, 2007, and 2006. The increase in the loan to deposit ratio from 2007 to 2008 is attributable to 1.54% growth in the average loan portfolio accompanied by a 2.21% reduction in average deposits during 2008. Funding for loan growth in 2008 was provided by reduction of noninterest-bearing cash. This shift has a positive effect on earnings. The increase in the loan to deposit ratio from 2006 to 2007 is attributable to 3.68% growth in the average loan portfolio accompanied by a 1.91% reduction in average deposits during 2007. The increase in loans does not negatively impact the Company’s ability to meet liquidity demands.

As of December 31, 2008, $30,967,770 (49.35%) of total debt securities mature in one year or less, of which, $17,201,296 are classified as "available-for-sale." Federal funds sold provide additional liquidity. Other sources of liquidity include letters of credit, overnight federal funds, and reverse repurchase agreements available from correspondent banks. The total lines and letters of credit available from correspondent banks were $27,000,000 as of December 31, 2008, and $21,000,000 as of December 31, 2007 and 2006.

The following table shows a distribution of investment securities by their contractual maturities and their yields for the various maturity timeframes. In this schedule, investment securities classified as available for sale are presented at fair value and investments classified as held to maturity are presented at amortized cost.

Investment Securities Maturity Distribution and Yields

	December 31, 2008		December 31, 2007		December 31, 2006	
	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Treasury						
One year or less	$ 28,997,415	3.03%	$ 32,430,184	4.51%	$ 37,408,625	4.04%
Over one through five years	22,278,930	3.30%	19,979,251	4.60%	18,479,455	4.69%
Over ten years	2,961,875	7.28%	2,567,812	7.28%	2,524,375	7.28%
Total U.S. Treasury securities	54,238,220	3.37%	54,977,247	4.67%	58,412,455	4.38%
U.S. Government Agencies						
One year or less	1,000,000	3.00%	-	0.00%	8,749,280	3.11%
Over one through five years	5,999,443	3.13%	10,000,000	5.07%	-	-
Total U. S. Government Agencies	6,999,443	3.11%	10,000,000	5.07%	8,749,280	3.11%
State, county, and municipal						
One year or less	970,355	2.71%	960,132	2.76%	2,788,056	2.43%
Over one through five years	537,026	3.34%	647,294	3.68%	1,062,744	2.82%
Total state, county, and municipal	1,507,381	2.93%	1,607,426	3.13%	3,850,800	2.54%
Total debt securities						
One year or less	30,967,770	3.02%	33,390,316	4.46%	48,945,961	3.78%
Over one through five years	28,815,399	3.27%	30,626,545	4.73%	19,542,199	4.59%
Over ten years	2,961,875	7.28%	2,567,812	7.28%	2,524,375	7.28%
Total debt securities	62,745,044	3.33%	66,584,673	4.69%	71,012,535	4.13%
Equity securities	3,852,024	3.87%	4,177,279	3.64%	4,113,288	3.72%
Total securities	$ 66,597,068	3.36%	$ 70,761,952	4.63%	$ 75,125,823	4.11%

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to changes in market interest rates. The rate-sensitive position, or gap, is the difference in the volume of rate-sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate-sensitive assets and liabilities to reduce the impact of interest rate fluctuations on the net interest margin. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Interest rate sensitivity may be controlled on either side of the balance sheet. On the asset side, management exercises some control over maturities. Also, loans are written to provide repricing opportunities on fixed rate notes. The Company's investment portfolio, including federal funds sold, provides the most flexible and fastest control over rate sensitivity since it can generally be restructured more quickly than the loan portfolio.

On the liability side, deposit products are structured to offer incentives to attain the maturity distribution desired. Competitive factors sometimes make control over deposits more difficult and, therefore, less effective as an interest rate sensitivity management tool.

The asset mix of the balance sheet is continually evaluated in terms of several variables: yield, credit quality, appropriate funding sources, and liquidity. Management of the liability mix of the balance sheet focuses on expanding the various funding sources.

As of December 31, 2008, the Company was cumulatively asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Interest Sensitivity Analysis

December 31, 2008

	Within three months	After three but within twelve months	After one but within five years	After five years	Total
Assets					
Earning assets					
Federal funds sold	$ 26,460,842	$ -	$ -	$ -	$ 26,460,842
Interest-bearing deposits	12,840,039	2,125,000	552,076	-	15,517,115
Investment debt securities	13,999,913	16,967,857	28,815,399	2,961,875	62,745,044
Loans	236,376,775	1,618,444	2,608,202	1,534,645	242,138,066
Total earning assets	$ 289,677,569	$ 20,711,301	$ 31,975,677	$ 4,496,520	$ 346,861,067
Liabilities					
Interest-bearing deposits					
NOW	$ 48,043,193	$ -	$ -	$ -	$ 48,043,193
Money market	32,039,678	-	-	-	32,039,678
Savings	43,064,214	-	-	-	43,064,214
Certificates $100,000 and over	17,948,047	16,465,925	2,961,244	-	37,375,216
Certificates under $100,000	29,077,215	25,063,184	7,144,481	-	61,284,880
Securities sold under agreements					-
to repurchase	5,742,765	-	-	-	5,742,765
Note payable	6,239	19,288	48,519	-	74,046
Total interest-bearing liabilities	$ 175,921,351	$ 41,548,397	$ 10,154,244	$ -	$ 227,623,992
Period gap	$ 113,756,218	$ (20,837,096)	$ 21,821,433	$ 4,496,520	$ 119,237,075
Cumulative gap	$ 113,756,218	$ 92,919,122	$ 114,740,555	$ 119,237,075	

Ratio of cumulative gap to total earning assets	32.80%	26.79%	33.08%	34.38%

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities decreased $414,000 (0.19%) from $218,248,000 in 2007, to $217,834,000 in 2008. Average interest-bearing deposits decreased $934,000 (0.44%) from $213,891,000 in 2007 to $212,957,000 in 2008, while average noninterest-bearing demand deposits decreased $5,545,000 (6.95%) from $79,807,000 in 2007 to $74,262,000 in 2008. At December 31, 2008, total deposits were $292,459,213, compared to $288,943,547 at December 31, 2007, an increase of 1.22%. While annual average deposits were lower in 2008 than in 2007, the Bank experienced an increase in deposits during the last quarter of the year. Based in a summer resort area, it is atypical for the Bank's deposits to increase in the fourth quarter of the year. Management attributes the deposit influx to a flight of investors from the troubled stock market to the safety of insured bank deposits.

Average interest-bearing liabilities decreased $2,808,000 (1.27%) to $218,248,000 in 2007, from $221,056,000 in 2006. Average interest-bearing deposits decreased $1,142,000 (.53%) to $213,891,000 in 2007 from $215,033,000 in 2006, while average noninterest-bearing demand deposits decreased $4,573,000 (5.42%) to $79,807,000 in 2007 from $84,380,000 in 2006. At December 31, 2007, total deposits were $288,943,547, compared to $290,324,760 at December 31, 2006, a decrease of .48%. Deposit balances were stable in 2007 with only modest balance reductions relative to the previous year. During 2007, non-deposit investment products became less attractive as the stock market experienced a downturn. Competition for deposits continued although banks began to lower the high rates on time deposits that were offered in 2006.

The following table sets forth the deposits of the Company by category as of December 31, 2008, 2007, and 2006, respectively.

	December 31, 2008		2007		2006	
	Amount	Percent of deposits	Amount	Percent of deposits	Amount	Percent of deposits
Non-interest bearing	$ 70,652,032	24.15%	$ 73,357,578	25.38%	$ 79,625,853	27.43%
NOW	48,043,193	16.43%	51,218,087	17.73%	54,458,814	18.76%
Money market	32,039,678	10.96%	31,719,473	10.98%	36,413,676	12.54%
Savings	43,064,214	14.72%	41,698,409	14.43%	45,844,558	15.79%
Time deposits less than $100,000	61,284,880	20.96%	55,089,053	19.07%	46,020,077	15.85%
Core deposits	255,083,997		253,082,600		262,362,978	
Time deposits of $100,000 or more	37,375,216	12.78%	35,860,947	12.41%	27,961,782	9.63%
Total deposits	$ 292,459,213	100.00%	$ 288,943,547	100.00%	$ 290,324,760	100.00%

Core deposits, which exclude certificates of deposit of $100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits increased $2,001,397 during 2008 following core deposit decreases of $9,280,378 during 2007, and $30,616,403 during 2006. During 2005 and 2006, management believes that market conditions lead to a reversal of some of the deposit influx that occurred in 2001 through 2004 as funds migrated from the stock market into insured deposits. During 2007, deposits continued to shift from more liquid demand and savings products to higher rate time deposits. This shift continued through 2008, as investors again fled the stock market and sought to preserve their invested funds in insured bank deposits.

Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet both its short-term and long-term liquidity needs. Management anticipates that while such deposits will continue to be the Company's primary source of funding in the future, continued reductions in deposit levels, if coupled with growth in the Company’s loan portfolio, could require periodic borrowing of funds. In this event, it is likely that Management would liquidate investment securities from the available for sale portfolio or purchase overnight federal funds as needed.

The maturity distribution of the Company's time deposits of $100,000 or more at December 31, 2008, is shown in the following table.

Maturities of Certificates of Deposit of $100,000 or More

December 31, 2008

	Within three months	After three through six months	After six through twelve months	After twelve months	Total
Time deposits of $100,000 or more	$ 17,948,047	$ 6,444,091	$ 10,021,834	$ 2,961,244	$ 37,375,216

Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Some financial institutions partially fund their balance sheets using large certificates of deposit obtained through brokers. These brokered deposits are generally expensive and are unreliable as long-term funding sources. Accordingly, the Company does not accept brokered deposits under these conditions. Since 2007, the Bank has been a member of the Certificate of Deposit Account Registry Service (CDARS). This service allows the Bank to offer depositors up to $50 million in FDIC insurance through a network of member banks. While CDARS deposits are considered to be brokered deposits for regulatory reporting, they are not considered volatile as they typically remain in the program until maturity. Included in time deposits less than $100,000 at December 31, 2008, are balances of $2,625,410 issued to customers of other CDARS member banks under the reciprocal program.

Noninterest revenue

Noninterest revenue for 2008 increased $104,254 (5.39%) from the previous year. Service charges on deposit accounts increased by $70,427 (6.89%) due to a mid-year increase in the fee for items presented against insufficient funds, coupled with reductions in fee waivers. ATM and debit card revenue increased $13,713 (2.71%) due to increased card usage. Miscellaneous revenues exceed the previous year by $16,585 (7.72%) which includes an increase of $8,651 (35.98%) in wire transfer fees.

Noninterest revenue for 2007 decreased $15,808 (.81%) from the previous year. Service charges on deposit accounts dropped by $96,686 (8.64%) due to reduced volume of fees for items presented against insufficient funds and overdrafts. ATM and debit card revenue increased $56,944 (12.70%) due to increased card usage. Cash surrender value of bank owned life insurance increased $27,996 (17.23%).

The following table presents the principal components of noninterest revenue for the years ended December 31, 2008, 2007, and 2006, respectively.

Noninterest revenue	2008	2007	2006
Service charges on deposit accounts	$ 1,092,899	$ 1,022,472	$ 1,119,158
ATM and debit card revenue	518,859	505,146	448,202
Increase in cash surrender value of bank owned life insurance	194,040	190,511	162,515

Miscellaneous revenue	231,392	214,807	218,869
Total noninterest revenue	$ 2,037,190	$ 1,932,936	$ 1,948,744
Noninterest revenue as a percentage of average total assets	0.56%	0.52%	0.52%

Noninterest Expense

Noninterest expense increased $390,177 (5.16%) from 2007 to 2008. Increased personnel costs of $137,791(3.04%) are attributable to salary increases and related payroll taxes. Occupancy expense increased $53,513 (7.64%), including a $28,404 (20.17%) increase in utilities and a $26,000 (16.36%) increase in real estate taxes. Other operating expense increased $197,896 (10.61%). Significant variances occurred in several areas. Advertising increased $33,489 (18.86%) as the Bank conveyed to the public through the media its safety and soundness in a time of economic turmoil. Expense related to ATM and debit card activities increased $32,258 (11.84%) due to a growing volume of card transactions and the addition of a fraud monitoring system implemented in mid-2008. Annual maintenance contracts for computer software systems increased $20,139 (15.74%) as the Bank offered more products to customers and continued with an equipment replacement program designed to support increasing demands on our processing systems. Correspondent bank fees are up $42,498 (233.92%) due to carrying lower balances at Federal Reserve which results in lower earnings credits. Courier service declined by $23,818 (40.65%) as a result of the conversion in May 2007, to branch-based electronic image capture. Professional fees increased $34,442 (72.96%) as the Bank engaged legal representation for loan collection and to assist with Securities and Exchange Commission compliance.

Noninterest expense increased $207,404 (2.82%) from 2006 to 2007. Increased personnel costs of $275,975 include a $102,262 (28.96%) increase in group insurance expense. Occupancy expense decreased $9,527, including a $32,313 (30.69%) decrease in building maintenance related to non-recurring repairs to branches in 2006. Furniture and equipment expense is down $14,969, which is attributable to lower service contract costs. Other operating expense decreased $44,075, which includes a $50,367 (46.22%) reduction in courier costs resulting from the Bank's implementation of branch-based electronic image capture.

The following table presents the principal components of noninterest expense for the years ended December 31, 2008, 2007, and 2006, respectively.

Noninterest expense

	2008	2007	2006
Salaries and employee benefits	$ 4,670,951	$ 4,533,160	$ 4,257,185
Occupancy expense	753,605	700,092	709,619
Furniture and equipment expense	464,559	463,582	478,551
Advertising	211,056	177,567	166,441
Armored car service	66,003	64,710	52,513
ATM and debit card	304,737	272,479	234,409
Business and product development	78,757	78,703	79,623
Computer software amortization	78,364	79,768	111,765
Computer software maintenance	148,098	127,959	111,777
Correspondent bank fees	60,666	18,168	19,195
Courier service	34,776	58,594	108,961
Deposit insurance	43,186	33,831	36,275
Director fees	151,900	149,400	140,200
Dues, donations, and subscriptions	84,872	85,179	88,255
Liability insurance	29,358	36,294	39,402
Postage	165,249	161,595	149,262
Professional fees	81,648	47,206	41,337
Stationery and supplies	95,945	95,854	123,652

Telephone	159,065	152,855	170,960
Miscellaneous	269,473	225,095	235,305
Total noninterest expense	$ 7,952,268	$ 7,562,091	$ 7,354,687
Noninterest expense as a percentage of average total assets	2.17%	2.03%	1.95%

Capital

Under capital guidelines adopted by the Federal Reserve Board and the FDIC, the Company and the Bank are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common stockholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. In addition, the Company and the Bank must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 4%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

At December 31, 2008, 2007, and 2006, the Company and the Bank were well-capitalized, exceeding all minimum requirements, as set forth in the following table.

	Analysis of Capital			
	Consolidated Company	Bank	To be well capitalized	Required minimums
2008				
Total risk-based capital ratio	32.5%	30.8%	10.0%	8.0%
Tier 1 risk-based capital ratio	31.8%	30.4%	6.0%	4.0%
Tier 1 leverage ratio	18.7%	17.8%	5.0%	4.0%
2007				
Total risk-based capital ratio	33.7%	32.0%	10.0%	8.0%
Tier 1 risk-based capital ratio	33.1%	31.9%	6.0%	4.0%
Tier 1 leverage ratio	19.5%	18.6%	5.0%	4.0%
2006 Restated				
Total risk-based capital ratio	33.4%	31.7%	10.0%	8.0%
Tier 1 risk-based capital ratio	32.8%	31.6%	6.0%	4.0%
Tier 1 leverage ratio	18.6%	17.8%	5.0%	4.0%

Website Access to Securities and Exchange Commission Reports

The Bank maintains an Internet website at www.taylorbank.com. The Company's periodic SEC reports, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, are accessible through this website. Access to these filings is free of charge. The reports are available as soon as practicable after they are filed electronically with the SEC.

Accounting Rule Changes

The following accounting pronouncements have been approved by the Financial Accounting Standards Board but have not become effective as of December 31, 2008. These pronouncements would apply to the Company if the Company or the Bank entered into an applicable activity.

In December 2007, the FASB issued SFAS 141, Revised 2007 (SFAS 141R), *Business Combinations.* SFAS 141R's objective is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after December 31, 2008. The Company does not expect the implementation of SFAS 141R to have a material impact on its consolidated financial statements.

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. Management does not expect SFAS No. 160 to have a material impact on the Company's consolidated financial statements.

FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133* expands disclosure requirements to provide greater transparency about how and why an entity uses derivative instruments, and the accounting for those instruments and related hedge items. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Management does not expect SFAS No. 161 to have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The implementation of SFAS 162 did not have a material impact on its consolidated financial statements.

FASB Statement No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities. This Statement also requires expanded disclosures about financial guarantee insurance contracts. SFAS No. 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Management does not expect SFAS No. 160 to have a material impact on the Company’s consolidated financial statements.

The accounting policies adopted by management are consistent with accounting principles generally accepted in the United States of America and are consistent with those followed by peer Banks.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the Bank are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation. See "Liquidity and Interest Rate Sensitivity" above.

Item 8. Financial Statements and Supplementary Data

In response to this Item, the information included on pages 1 through 22 of the Company's Annual Report to Stockholders for the year ended December 31, 2008, is incorporated herein by reference.

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

There have been no changes in or disagreements with accountants on accounting or financial disclosure during the fiscal year covered by this report.

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Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

Disclosure controls and procedures are designed and maintained by the Company to ensure that information required to be disclosed in the Company’s publicly filed reports is recorded, processed, summarized and reported in a timely manner. Such information must be available to management, including the Chief Executive Officer (CEO) and Treasurer, to allow them to make timely decisions about required disclosures. Even a well-designed and maintained control system can provide only reasonable, not absolute, assurance that its objectives are achieved. Inherent limitations in any system of controls include flawed judgment, errors, omissions, or intentional circumvention of controls.

The Company’s management, including the CEO and Treasurer, performed an evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of December 31, 2008. Based on that evaluation, the Company’s management, including the CEO and Treasurer, has concluded that the Company’s disclosure controls and procedures are effective. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

Internal Control Over Financial Reporting

Management Report on Internal Control over Financial Reporting

Calvin B. Taylor Bankshares, Inc. maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance to the Company’s management and board of directors regarding the preparation of reliable published financial statements. The system includes an organizational structure and division of responsibility, established policies and procedures including a code of conduct to foster a strong ethical climate, and the careful selection, training and development of our staff. The system contains self-monitoring mechanisms, and an internal auditor monitors the operation of the internal control system and reports findings and recommendations to management and the board of directors. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The board, operating through its audit committee, which is composed entirely of directors who are not officers or employees of the Company, provides oversight to the financial reporting process.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system may vary over time and with circumstances.

The Company assessed its internal control system as of December 31, 2008 in relation to criteria for effective internal control over financial reporting as described in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Company believes that, as of December 31, 2008, its system of internal control over financial reporting met those criteria.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 11, 2009 By: /s/ Raymond M. Thompson
Chief Executive Officer

Date: March 11, 2009 By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer

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Attestation Report of the Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Calvin B. Taylor Bankshares, Inc.
Berlin, Maryland

We have audited Calvin B. Taylor Bankshares, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Calvin B. Taylor Bankshares, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America, the balance sheets and the related statements of income, changes in stockholders' equity and cash flows of Calvin B. Taylor Bankshares, Inc. and Subsidiary, and our report dated March 11, 2009, expressed an unqualified opinion.

/s/ Rowles & Company, LLP

Baltimore, Maryland
March 11, 2009

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Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company’s internal controls over financial reporting that have had or are reasonably likely to have a material affect on the Company’s internal control over financial reporting. As of December 31, 2008, the Company’s management, including the CEO and Treasurer, has concluded that the Company’s internal controls over financial reporting are effective.

Audit Committee and Financial Expert

The Board of Directors has adopted a written Audit Policy, which serves as a charter for the Audit Committee. The Audit Committee is comprised of seven independent directors, including Chairman James R. Bergey, Jr. who serves as the financial expert. The Audit Committee is scheduled to meet quarterly and held four meetings in 2008.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2009 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2009 Annual Meeting of Stockholders, and is incorporated herein by reference.

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

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2009 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2009 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2009 Annual Meeting of Stockholders, and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Exhibits
(a)(1), (2) Annual Report to Stockholders for the year ended December 31, 2008
3.1 Articles of Incorporation of the Company, incorporated by reference to Exhibit 3.1 of Registration Statement Form S-4, File No. 33-99762.
3.2 Bylaws of the Company, incorporated by reference to Exhibit 3.2 of Registration Statement Form S-4, File No. 33-99762.

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SIGNATURES

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

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 11, 2009 By: /s/ Raymond M. Thompson
Chief Executive Officer

Date: March 11, 2009 By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer

Pursuant to the requirements 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.

Date: March 11, 2009 By: /s/ James R. Bergey, Jr., Director

Date: March 11, 2009 By: /s/ John H. Burbage, Jr., Director

Date: March 11, 2009 By: /s/ Todd E. Burbage, Director

Date: March 11, 2009 By: /s/ Charlotte K. Cathell, Director

Date: March 11, 2009 By: /s/ Reese F. Cropper, Jr.
Chairman of the Board of Directors

Date: March 11, 2009 By: /s/ Reese F. Cropper, III, Director

Date: March 11, 2009 By: /s/ Hale Harrison, Director

Date: March 11, 2009 By: /s/ Gerald T. Mason, Director

Date: March 11, 2009 By: /s/ William H. Mitchell, Director
Vice President

Date: March 11, 2009 By: /s/ Joseph E. Moore, Director

Date: March 11, 2009 By: /s/ Michael L. Quillin, Sr., Director

Date: March 11, 2009 By: /s/ Raymond M. Thompson, Director
President and Chief Executive Officer

Certification - Pursuant to 18 U.S.C. 1350
Section 906 of the Sarbanes-Oxley Act of 2002

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Annual Report on Form 10-K for the period ended December 31, 2008 of the Registrant (the "Report"):

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 11, 2009 By: /s/ Raymond M. Thompson
Chief Executive Officer

Date: March 11, 2009 By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Raymond M. Thompson, certify that:

I have reviewed this annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;

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

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

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 11, 2009

By: /s/ Raymond M. Thompson
Chief Executive Officer

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jennifer G. Hawkins, certify that:

I have reviewed this annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;

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

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

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 11, 2009

By: /s/ Jennifer G. Hawkins
Treasurer / Principal Financial Officer