

FIRST MARINER BANCORP  
Form 10-Q  
May 10, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES  
EXCHANGE ACT OF 1934.

For the quarterly period ended March 31, 2007.

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

For the transition period from                      to

Commission file number: 0-21815

**FIRST MARINER BANCORP**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State of Incorporation)

1501 South Clinton Street,

**52-1834860**  
(I.R.S. Employer Identification Number)

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

**Baltimore, MD**  
(Address of principal executive offices)

**21224**  
(Zip Code)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to file such report, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The number of shares of common stock outstanding as of May 4, 2007 is 6,429,969 shares.

---

**FIRST MARINER BANCORP AND SUBSIDIARIES  
CONTENTS**

PART I FINANCIAL INFORMATION

<u>Item 1</u>	<u>Financial Statements</u>  <u>Consolidated Statements of Financial Condition at March 31, 2007 (unaudited) and at December 31, 2006</u>  <u>Consolidated Statements of Operations (unaudited) for the Three months Ended March 31, 2007 and 2006</u>  <u>Consolidated Statements of Cash Flows (unaudited) for the Three months Ended March 31, 2007 and 2006</u>  <u>Notes to Consolidated Financial Statements (unaudited)</u>
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
<u>Item 4</u>	<u>Controls and Procedures</u>

PART II OTHER INFORMATION

<u>Item 1</u>	<u>Legal Proceedings</u>
<u>Item 1a</u>	<u>Risk Factors</u>
<u>Item 2</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
<u>Item 3</u>	<u>Defaults Upon Senior Securities</u>
<u>Item 4</u>	<u>Submission of Matters to a Vote of Security Holders</u>
<u>Item 5</u>	<u>Other Information</u>
<u>Item 6</u>	<u>Exhibits</u>
<u>Signatures</u>	

**PART I FINANCIAL INFORMATION****Item 1 Financial Statements**

**First Mariner Bancorp and Subsidiaries**  
**Consolidated Statements of Financial Condition**  
*(dollars in thousands, except per share data)*

	March 31, 2007 (unaudited)	December 31, 2006
<b>ASSETS</b>		
Cash and due from banks	\$ 32,404	\$ 36,734
Federal funds sold and interest-bearing deposits	104,343	6,235
Trading securities, at fair value	40,901	
Securities available for sale, at fair value	55,336	147,290
Loans held for sale	57,273	94,371
Loans receivable	857,051	866,459
Allowance for loan losses	(11,886)	(12,399)
Loans, net	845,165	854,060
Other real estate owned	5,991	2,440
Restricted stock investments	5,983	6,449
Premises and equipment, net	50,836	49,062
Accrued interest receivable	8,577	10,579
Deferred income taxes	7,468	6,806
Bank-owned life insurance	33,827	33,492
Prepaid expenses and other assets	13,719	15,772
<b>Total assets</b>	<b>\$ 1,261,823</b>	<b>\$ 1,263,290</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Noninterest-bearing	\$ 166,826	\$ 186,720
Interest-bearing	747,445	738,218
<b>Total deposits</b>	<b>914,271</b>	<b>924,938</b>
Short-term borrowings	42,477	40,884
Long-term borrowings, at fair value	62,099	
Long-term borrowings	81,519	132,557
Junior subordinated deferrable interest debentures	73,724	73,724
Accrued expenses and other liabilities	10,335	12,558
<b>Total liabilities</b>	<b>1,184,425</b>	<b>1,184,661</b>
<b>Stockholders' equity:</b>		
Common stock, \$.05 par value; 20,000,000 shares authorized; 6,428,469 and 6,427,725 shares issued and outstanding, respectively	321	321
Additional paid-in capital	57,110	57,123
Retained earnings	19,965	22,109
Accumulated other comprehensive income (loss)	2	(924)
<b>Total stockholders' equity</b>	<b>77,398</b>	<b>78,629</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,261,823</b>	<b>\$ 1,263,290</b>

*See accompanying notes to the consolidated financial statements*



**First Mariner Bancorp and Subsidiaries**  
**Consolidated Statements of Operations**  
*(dollars in thousands except per share data)*

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(unaudited)</b>	
<b>Interest income:</b>		
Loans	\$ 19,735	\$ 19,028
Investments and other earning assets	2,244	3,287
Total interest income	21,979	22,315
<b>Interest expense:</b>		
Deposits	6,929	5,047
Short-term borrowings	315	1,997
Long-term borrowings	3,528	3,029
Total interest expense	10,772	10,073
Net interest income	11,207	12,242
Provision for loan losses	537	422
Net interest income after provision for loan losses	10,670	11,820
<b>Noninterest income:</b>		
Gain on sale of mortgage loans	1,593	1,443
Other mortgage-banking revenue	730	625
ATM fees	716	785
Service fees on deposits	1,471	1,679
Trading loss on securities and long-term borrowings	(111	)
Gain on sale of investment securities, net	887	
Commissions on sales of nondeposit investment products	307	94
Income from bank-owned life insurance	335	252
Commissions on sales of other insurance products	587	561
Other	434	559
Total noninterest income	6,949	5,998
<b>Noninterest expense:</b>		
Salaries and employee benefits	9,357	8,432
Occupancy	2,240	1,703
Furniture, fixtures and equipment	863	800
Professional services	350	202
Advertising	511	466
Data processing	429	449
ATM servicing expenses	230	283
Secondary marketing valuation	33	
Service and maintenance	744	538
Other	2,890	2,645
Total noninterest expense	17,647	15,518
Net (loss) income before income taxes	(28	)
Income tax (benefit) expense	(128	)
Net income	\$ 100	\$ 1,660
<b>Net income per share:</b>		
Basic	\$ 0.02	\$ 0.26
Diluted	\$ 0.02	\$ 0.25

See accompanying notes to the consolidated financial statements.

**First Mariner Bancorp and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
*(dollars in thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(unaudited)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 100	\$ 1,660
<b>Adjustments to reconcile net income to net cash from operating activities:</b>		
Stock-based compensation	16	
Depreciation and amortization	1,206	970
Amortization of unearned loan fees and costs, net	(200 )	(306 )
Amortization of premiums and discounts on loans, net	(271 )	(150 )
Amortization of premiums and discounts on mortgage-backed securities, net	5	59
Loss on trading securities	50	
Loss on long-term debt accounted for at fair value	61	
Gain on sale of securities available for sale	(887 )	
Gain on sale of mortgage loans	(1,593 )	(1,443 )
Decrease in accrued interest receivable	2,002	188
Provision for loan losses	537	422
Valuation allowance on other real estate owned	439	
Loss on sale of other real estate owned	21	
Valuation allowance for loans held for sale	33	
Increase in cash surrender value of bank-owned life insurance	(335 )	(252 )
Originations of mortgage loans held for sale	(211,112 )	(288,454 )
Proceeds from mortgage loans held for sale	248,802	281,716
Net decrease in accrued expenses and other liabilities	(2,280 )	(2,638 )
Net decrease (increase) in prepaids and other assets	2,054	(792 )
Net cash provided by (used in) operating activities	38,648	(9,020 )
<b>Cash flows from investing activities:</b>		
Loan repayments, net of principal (disbursements)	4,842	(190 )
Purchases of premises and equipment	(2,980 )	(1,633 )
Redemptions of restricted stock investments	466	1,281
<b>Activity in securities available for sale:</b>		
Sales of securities available for sale	1,301	
Maturities/calls/repayments of securities available for sale	51,665	5,965
Purchase of securities available for sale	(999 )	
Proceeds from sales of other real estate owned	977	866
Net cash provided by investing activities	55,272	6,289
<b>Cash flows from financing activities:</b>		
Net (decrease) increase in deposits	(10,667 )	11,781
Net increase (decrease) in other borrowed funds	10,555	(17,343 )
Proceeds from stock issuance	109	174
Repurchase of common stock, net of costs	(139 )	
Net cash used in financing activities	(142 )	(5,388 )
Increase (decrease) in cash and cash equivalents	93,778	(8,119 )
Cash and cash equivalents at beginning of period	42,969	45,835
Cash and cash equivalents at end of period	\$ 136,747	\$ 37,716
<b>Supplemental information:</b>		
Interest paid on deposits and borrowed funds	\$ 5,354	\$ 9,902
Income taxes paid	\$ 610	\$ 247
Real estate acquired in satisfaction of loans	\$ 4,988	\$
Transfer of loans held for sale to loan portfolio	\$ 1,001	\$

See accompanying notes to the consolidated financial statements.





**First Mariner Bancorp and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
*(Information as of and for the three months*  
*ended March 31, 2007 and 2006 is unaudited)*

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Basis Of Presentation*

The accompanying consolidated financial statements for First Mariner Bancorp (the Company) have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a full presentation of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements should be read in conjunction with the audited financial statements included in our 2006 Annual Report on Form 10-K.

The consolidated financial statements include the accounts of the Company's subsidiaries, First Mariner Bank (the Bank), Finance Maryland LLC (Finance Maryland), and FM Appraisals, LLC (FM Appraisals). All significant intercompany balances and transactions have been eliminated.

The consolidated financial statements as of March 31, 2007 and for the three months ended March 31, 2007 and 2006 are unaudited but include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of financial position and results of operations for those periods. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results that will be achieved for the entire year.

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for credit losses (the allowance), other than temporary impairment of investment securities, accounting for gain on sale of mortgage loans, determination of changes in fair value for the derivative loan commitments, use of derivatives to manage interest rate risk, and deferred tax assets.

Certain reclassifications have been made to amounts previously reported to conform to the classifications made in 2007.

*Investment Securities*

We designate securities into one of the three categories at the time of purchase. Debt securities that we have the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt and equity securities are classified as trading securities if bought and held principally for the purpose of selling them in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as held to maturity and debt and equity securities not classified as trading securities are considered available for sale and are reported at estimated fair value, with unrealized gains and losses reported as a separate component of stockholders' equity, net of tax effects, in accumulated other comprehensive income. Effective January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*, and designated \$42.000 million in securities as trading securities which were previously designated as available for sale. In accordance with SFAS No. 159, we recorded a cumulative effect of accounting change reduction to retained earnings related to the investments in the amount of \$993,000 (net of deferred tax impact) as of January 1, 2007.

*Borrowings*

In conjunction with our adoption of SFAS No. 159 as of January 1, 2007, we began recording certain of our long-term borrowings at fair value, with corresponding changes in fair values recorded in income. On January 1, 2007, we recorded a cumulative effect of accounting change reduction to retained earnings in the amount of \$1.251 million (net of deferred tax impact) related to \$60.000 million in borrowings that we began recording at fair value.



Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

NOTE 2 COMPREHENSIVE INCOME

The following table shows the Company's comprehensive income for the three months ended March 31, 2007 and 2006:

(dollars in thousands)	Three Months Ended	
	March 31, 2007	2006
Net income	\$ 100	\$ 1,660
Other comprehensive income items:		
Cumulative effect of accounting change for certain investments, net of tax expense of \$625 and \$0, respectively	993	
Unrealized holding gains (losses) arising during the period (net of tax expense (benefit) of \$300 and \$(746), respectively)	477	(1,185 )
Less: reclassification adjustment for gains (net of taxes of \$343 and \$0, respectively) included in net income	(544 )	
Total other comprehensive income (loss)	926	(1,185 )
Total comprehensive income	\$ 1,026	\$ 475

NOTE 3 PER SHARE DATA

Basic earnings per share is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings per share is computed after adjusting the denominator of the basic earnings per share computation for the effects of all dilutive potential common shares outstanding during the period. The dilutive effects of options, warrants and their equivalents are computed using the treasury stock method. For the three month period ended March 31, 2007 and 2006, there were 310,638 and 0 shares, respectively, which were antidilutive and excluded from the computation.

Information relating to the calculation of earnings per common share is summarized as follows:

(dollars in thousands, except for per share data)	Three Months Ended	
	March 31, 2007	2006
Net income - basic and diluted	\$ 100	\$ 1,660
Weighted-average share outstanding - basic	6,420,811	6,264,833
Dilutive securities - options and warrants	210,319	331,828
Adjusted weighted-average shares outstanding - dilutive	6,631,130	6,596,661
Earnings per share - basic	\$ 0.02	\$ 0.26
Earnings per share - diluted	\$ 0.02	\$ 0.25

NOTE 4 STOCK BASED COMPENSATION

We have stock option award arrangements, which provide for the granting of options to acquire common stock to our directors and key employees. Option prices are equal to or greater than the estimated fair market value of the common stock at the date of the grant. As of March 31, 2007, all outstanding options are fully vested and expire ten years after the date of grant. There have been no modifications to the existing plan. We recognized compensation cost of \$16,000 and \$0 for the three months ended March 31, 2007 and 2006, respectively.

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

Information with respect to stock options is as follows for the three months ended March 31, 2007:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at beginning of period	793,022	\$ 12.84		
Granted	2,550	18.94		
Exercised	(1,000 )	11.07		
Forfeited/Cancelled				
Outstanding at end of period	794,572	\$ 12.86	6.0	\$ 1,861,280
Exercisable at end of period	794,572	\$ 12.86	6.0	\$ 1,861,280

The weighted average fair value of our option grants for the three months ended March 31, 2007 was \$6.35 on the dates of grants. We did not grant any options for the three months ended March 31, 2006. The fair value of our options granted was calculated using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions for the three months ended March 31, 2007:

	2007
Dividend yield	0.00%
Expected volatility	14.18%
Risk-free interest rate	4.58%
Expected lives	8 years

The total intrinsic value of options exercised for the three months ended March 31, 2007 and 2006, amounted to \$5,685 and \$32,195, respectively. The related tax benefit during the three months ended March 31, 2007 and 2006 amounted to \$0 and \$12,434, respectively, and proceeds from exercises of stock options amounted to \$11,065 and \$76,174, respectively for the three months ended March 31, 2007 and 2006.

While our employee stock purchase plan provides for a 10% discount from market value at issuance, we do not recognize compensation expense on the discount as: substantially all employees that meet limited employment qualifications may participate in the plan on an equitable basis; the plan incorporates no option features, the purchase price is based solely on the market price of the shares at the date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid and; the discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering.

NOTE 5 COMMITMENTS AND CONTINGENT LIABILITIES

We are party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of customers. These financial instruments include commitments to extend credit, available lines of credit and standby letters of credit. Our exposure to credit risk is represented by the contractual amounts of those financial instruments. We apply the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments. A summary of the financial instruments at March 31, 2007 whose contract amounts represent potential credit risk is as follows:

(dollars in thousands)	March 31, 2007	December 31, 2006
Commitments to extend credit (includes unused lines of credit)	\$ 256,787	\$ 294,227
Standby letters of credit	4,538	4,677

NOTE 6 SEGMENT INFORMATION

We are in the business of providing financial services, and we operate in three business segments commercial and consumer banking, consumer finance and mortgage-banking. Commercial and consumer banking is conducted through the Bank and involves delivering a broad range of financial services, including lending and deposit taking, to individuals and commercial enterprises. This segment also includes our treasury and administrative functions. Consumer finance is conducted through Finance Maryland, and involves originating small direct consumer loans, mortgage loans, and the purchase of retail installment sales contracts. Mortgage-banking is conducted through First Mariner Mortgage, a

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

division of the Bank, and involves originating first- and second-lien residential mortgages for sale in the secondary market and to the Bank. The results of our subsidiary, FM Appraisals, are included in the mortgage-banking segment.

8

---

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

The following table presents certain information regarding our business segments:

**For the three month period ended March 31, 2007:**

(dollars in thousands)	Commercial and Consumer Banking	Consumer Finance	Mortgage- Banking	Total
Interest income	\$ 16,665	\$ 3,930	\$ 1,384	\$ 21,979
Interest expense	8,879	962	931	10,772
Net interest income	7,786	2,968	453	11,207
Provision for loan losses	250	287		537
Net interest income after provision for loan losses	7,536	2,681	453	10,670
Noninterest income	4,110	729	2,110	6,949
Noninterest expense	12,390	2,628	2,629	17,647
Net intersegment income	21		(21	)
Net income before income taxes	\$ (723	) \$ 782	\$ (87	) \$ (28
Total assets	\$ 1,137,015	\$ 67,535	\$ 57,273	\$ 1,261,823

**For the three month period ended March 31, 2006:**

(dollars in thousands)	Commercial and Consumer Banking	Consumer Finance	Mortgage- Banking	Total
Interest income	\$ 17,579	\$ 3,250	\$ 1,486	\$ 22,315
Interest expense	8,413	682	978	10,073
Net interest income	9,166	2,568	508	12,242
Provision for loan losses		422		422
Net interest income after provision for loan losses	9,166	2,146	508	11,820
Noninterest income	3,356	695	1,947	5,998
Noninterest expense	10,573	2,273	2,672	15,518
Net intersegment income	(9	)	9	
Net income before income taxes	\$ 1,940	\$ 568	\$ (208	) \$ 2,300
Total assets	\$ 1,202,193	\$ 52,195	\$ 100,532	\$ 1,354,920

**NOTE 7 RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140*. This statement amends SFAS No. 133 and SFAS No. 140 by: permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; clarifying which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; establishing a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; clarifying that concentrations of credit risk in the form of subordination are not embedded derivatives and; amending SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The statement is effective for fiscal years beginning after September 15, 2006. The adoption of this standard did not have a material impact on our financial condition, results of operations or liquidity.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*. This statement amends SFAS No. 140 with respect to the accounting for separately recognized servicing assets and servicing liabilities. It requires an entity to recognize a servicing asset or servicing liability each time an obligation is undertaken to service a financial asset by entering into a servicing contract in certain situations and requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practicable. The statement permits the choice between the amortization method and the fair value measurement method for the subsequent measurement of the servicing assets or liabilities and allows for a one-time reclassification of available-for-sale securities to trading securities at initial adoption. The statement also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing

liabilities. The statement is effective for fiscal years beginning after September 15, 2006. The adoption of this standard did not have a material impact on our financial condition, results of operations or liquidity.

9

---

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. The interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of this standard did not have a material impact on our financial condition, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We adopted this standard effective January 1, 2007, with no material impact on our financial condition, results of operations or liquidity.

In September 2006, the FASB ratified the consensus reached by the EITF on Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. EITF 06-4 requires the recognition of a liability and related compensation costs for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods as defined in SFAS No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*. The EITF reached a consensus that Bank Owned Life Insurance policies purchased for this purpose do not effectively settle the entity’s obligation to the employee in this regard and, thus, the entity must record compensation costs and a related liability. Entities should recognize the effects of applying this Issue through either, (a) a change in accounting principle through a cumulative-effective adjustment to retained earnings or to other components of equity or net assets in the balance sheet as of the beginning of the year of adoption, or (b) a change in accounting principle through retrospective application to all prior periods. This Issue is effective for fiscal years beginning after December 15, 2007. The adoption of this interpretation is not anticipated to have a material impact on our financial condition, results of operations or liquidity.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115*, which generally permits the measurement of selected eligible financial instruments, including investment securities, at fair value as of specified election dates and the reporting of unrealized gains or losses on those instruments in earnings at each subsequent reporting date. Generally, the fair value option may be applied on an instrument by instrument basis but, once applied, the election is irrevocable and is applied to the entire instrument. The statement is effective for fiscal years beginning after November 15, 2007, with early adoption permitted as of the beginning of a fiscal year that begins on or before November 15, 2007.

We adopted SFAS No. 159 on January 1, 2007. The effect of adopting this statement on existing eligible items at the time of adoption is recorded as a cumulative effect of accounting change through retained earnings in the financial statements and is detailed as follows:

(dollars in thousands)	Balance Sheet January 1, 2007 Prior to Adoption	Net Gain/(Loss) Upon Adoption	Balance Sheet January 1, 2007 After Adoption of Fair Value Option
Investment trading securities	\$ 42,569	\$ (1,618 )	\$ 40,951
Long-term debt	60,000	(2,038 )	62,038
Pre-tax cumulative effect of adoption of the fair value option		(3,656 )	
Increase in deferred tax assets		1,412	
Cumulative effect of adoption of the fair value option (charge to retained earnings)		\$ (2,244 )	

Management believes the adoption was appropriate in order to more closely align the impact of interest rate movements within stockholders’ equity. Prior to adoption, the securities were marked to market through the Company’s stockholders’ equity, with no offsetting impact of any borrowings or other interest-bearing liabilities, which may act as a natural interest rate risk hedge. By treating certain assets and liabilities with similar characteristics as fair value instruments, both positions will be subject to fair value adjustments through earnings and ultimately stockholders’ equity. Management believes the adoption will minimize the volatility in reported stockholders’ equity as the borrowing position will also be subject to fair value treatment.





## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

As a result of our early adoption of SFAS No. 159, we elected to transfer \$42.000 million of investment securities previously held as available for sale to trading securities. These securities were selected based upon their yield (under 5%) and quality of available pricing data. The average life of the bonds selected was 5.22 years. In addition, we elected to record \$60.000 million of our long-term borrowings at fair value. The borrowings selected were fixed rate (6.07%) with an average remaining life of 3.24 years and have a consistent and reliable pricing source. Retained earnings as of January 1, 2007 was reduced by \$2.244 million, net of tax, as a result of the election. This is a permanent adjustment to retained earnings; however, there is no impact to total stockholders' equity from the investment reclassification because the market value adjustment of the available for sale securities was already recorded in accumulated other comprehensive loss. This one-time charge will not be recognized in current earnings based upon application of SFAS No. 159. In addition, a pre-tax loss of approximately \$111,000 was recognized in the first quarter of 2007 due to a net decrease in the fair value of these financial instruments since January 1, 2007.

Interest income on trading securities and interest expense on long-term borrowings at fair value is accrued at the contractual rate based on the principal outstanding. Premiums and discounts related to trading securities are expensed at time of purchase. The interest from trading securities is included in the Statements of Operations in Interest income from investments and other earning assets and the interest on borrowings at fair value is included in the Statements of Operations in Interest expense from long-term borrowings.

The following table shows details of the financial instruments as of March 31, 2007 for which we elected to apply the fair value option:

(dollars in thousands)	Carrying Value (Fair Value)	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Trading Gains and Losses	Total Changes In Fair Values Included In Period Earnings
Trading securities	\$ 40,901	\$ 40,901	\$	\$ (50 )	\$ (50 )
Long-term debt at fair value	62,099		62,099	(61 )	(61 )

### Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read and reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in our Annual Report on Form 10-K for the year ended December 31, 2006.

#### Forward-Looking Statements

This quarterly report on Form 10-Q may contain forward-looking language within the meaning of The Private Securities Litigation Reform Act of 1995. Statements may include expressions about our confidence, policies and strategies, provisions and allowance for loan losses, adequacy of capital levels, and liquidity. All statements included or incorporated by reference in this Quarterly Report on Form 10-Q, other than statements that are purely historical, are forward-looking statements. Statements that include the use of terminology such as anticipates, expects, intends, plans, believes, estimates and similar expressions also identify forward-looking statements. The forward-looking statements are based on our current intent, belief and expectations. Forward-looking statements in this Quarterly Report on Form 10-Q include, but are not limited to, statements of our plans, strategies, objectives, intentions, including, among other statements, statements involving our projected loan and deposit growth, loan collateral values, collectibility of loans, anticipated changes in other operating income, payroll and branching expenses, branch, office and product expansion of the Company and its subsidiaries, and liquidity and capital levels. Such forward-looking statements involve certain risks and uncertainties, including general economic conditions, competition in the geographic and business areas in which we operate, inflation, fluctuations in interest rates, legislation and government regulation. These statements are not guarantees of future performance and are subject to certain risks and uncertainties that are difficult to predict. For a more complete discussion of risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements, see Risk Factors filed as Item 1A of Part I in our Form 10-K for the year ended December 31, 2006. Except as required by applicable laws, we do not intend to publish updates or revisions of any forward-looking statements we make to reflect new information, future events or otherwise.

#### The Company

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



## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

The Company's business is conducted primarily through its wholly owned subsidiaries, First Mariner Bank (the "Bank"), Finance Maryland LLC ("Finance Maryland"), and FM Appraisals, LLC ("FM Appraisals"). The Bank is the largest operating subsidiary of the Company with assets exceeding \$1.1 billion as of March 31, 2007. The Bank was formed in 1995 through the merger of several small financial institutions. The Bank's primary market area for its core banking operations, which consist of traditional commercial and consumer lending, as well as retail and commercial deposit operations, is central Maryland as well as portions of Maryland's eastern shore. The Bank opened its first branch in Pennsylvania during the first quarter of 2007. The Bank is an independent community bank, and its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC").

The Bank is engaged in the general commercial banking business, with particular attention and emphasis on the needs of individuals and small to mid-sized businesses, and delivers a wide range of financial products and services that are offered by many larger competitors. Products and services include traditional deposit products, a variety of consumer and commercial loans, residential and commercial mortgage and construction loans, wire transfer services, non-deposit investment products, and internet banking and similar services. Most importantly, the Bank provides customers with access to local Bank officers who are empowered to act with flexibility to meet customers' needs in an effort to foster and develop long-term loan and deposit relationships.

First Mariner Mortgage, a division of the Bank, engages in mortgage-banking activities, providing mortgages and associated products to customers and selling most of those mortgages on the secondary market. During the first quarter of 2006, First Mariner Mortgage expanded its secondary marketing activities significantly and began hedging the interest rate risk associated with mortgage-banking activities. During 2007, such activity decreased significantly due to decreased loan demand resulting in a decline in originations. In addition, we reduced the types of products that we offer and tightened our underwriting standards.

Finance Maryland engages in traditional consumer finance activities, making small direct loans to individuals, mortgage loans, the purchase of installment loan sales contracts from local merchants and retail dealers of consumer goods, and loans to individuals via direct mail solicitations. Finance Maryland currently operates 18 branches, including a central approval office, in Maryland and four branches in Delaware, which operate under the trade name "Finance Delaware." Finance Maryland had total assets of \$67.5 million as of March 31, 2007.

FM Appraisals is a residential real estate appraisal preparation and management company that is headquartered in Baltimore City. FM Appraisals offers appraisal services for residential real estate lenders, including appraisal preparation, the compliance oversight of sub-contracted appraisers, appraisal ordering and administration, and appraisal review services. FM Appraisals provides these services to First Mariner Mortgage.

### Critical Accounting Policies

The Company's financial statements are prepared in accordance with generally accepted accounting principles ("GAAP") in the United States of America and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. When applying accounting policies in such areas that are subjective in nature, management must use its best judgment to arrive at the carrying value of certain assets and liabilities. Below is a discussion of our critical accounting policies.

#### *Allowance for loan losses*

A variety of estimates impact the carrying value of the loan portfolio including the calculation of the allowance for loan losses, valuation of underlying collateral and the timing of loan charge-offs.

The allowance is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payments on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio. Current trends in delinquencies and charge-offs, the views of the Bank's regulators, changes in the size and composition of the loan portfolio and peer comparisons are also factors. The analysis also requires consideration of the economic climate and direction and change in the interest rate environment, which may impact a borrower's ability to pay, legislation impacting the banking industry and environmental and economic conditions specific to the Bank's service areas. Because the calculation of the allowance for loan losses relies on estimates and judgments relating to inherently uncertain events, results may differ from our estimates.



*Investment securities*

Securities are evaluated periodically to determine whether a decline in their value is other than temporary. The term "other than temporary" is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Management reviews criteria such as the magnitude and duration of the decline, as well as the reasons for the decline, to predict whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

*Deferred income taxes*

Under the liability method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not.

*Loan income recognition*

Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees and certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual loan terms. Accrual of interest is discontinued when its receipt is in doubt, which typically occurs when a loan becomes 90 days past due as to principal or interest. Any interest accrued to income in the year when interest accruals are discontinued is reversed. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the principal balance and accrued interest. Loans are returned to accrual status once the doubt concerning collectibility has been removed and the borrower has demonstrated the ability to pay and remain current. Payments on nonaccrual loans are generally applied to principal.

***Derivative Loan Commitments and Hedging Activities***

In connection with our mortgage-banking activities, we enter into commitments to fund residential mortgage loans at specified times in the future. We enter into these commitments through retail and broker channels and also purchase loan commitments from correspondent lenders. A mortgage loan commitment binds the Company to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 90 days after inception of the rate lock commitment. Such a commitment is referred to as a derivative loan commitment if the loan that will result from exercise of the commitment will be held for sale upon funding under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. As such, loan commitments that are derivatives must be recognized at fair value on the consolidated balance sheets with changes in their fair values recorded as part of income from mortgage-banking operations. For accounting purposes, we value this commitment to zero at inception. Subsequent to inception, we estimate the fair value of the commitment, taking into consideration the probability of funding of the loan, and compare it to the fair value calculated at inception to measure the change in value, which is recorded through current period earnings with a corresponding asset for an increase in value or a liability for a decrease in value.

*Loan Repurchases*

Our sales agreements with investors who buy our loans generally contain covenants which may require us to repurchase loans under certain provisions, including delinquencies, or return premiums paid by those investors should the loan be paid off early or be required to be repurchased. These covenants are usual and customary within the mortgage-banking industry and generally apply for the first 90 days after the loan has been purchased by the investor. We maintain a reserve (included in other liabilities) for potential losses relating to these sales covenants, including estimates for the devaluation of loans as a result of their delinquency status.

Cumulative Effect of Accounting Change

We adopted SFAS No. 159 effective January 1, 2007. The effect of adopting this statement on existing eligible items at the time of adoption is recorded as a cumulative effect of accounting change in the financial statements through retained earnings and is detailed as follows:

(dollars in thousands)	Balance Sheet January 1, 2007 Prior to Adoption	Net Gain/(Loss) Upon Adoption	Balance Sheet January 1, 2007 After Adoption of Fair Value Option
Investment trading securities	\$ 42,569	\$ (1,618 )	\$ 40,951
Long-term debt	60,000	(2,038 )	62,038
Pre-tax cumulative effect of adoption of the fair value option		(3,656 )	
Increase in deferred tax assets		1,412	
Cumulative effect of adoption of the fair value option (charge to retained earnings)		\$ (2,244 )	

See Note 7 to the Consolidated Financial Statements above for additional information about our adoption of SFAS No. 159.

Financial Condition

The Company's total assets were \$1.262 billion at March 31, 2007, compared to \$1.263 billion at December 31, 2006, decreasing \$1.467 million or 0.1% for the first three months of 2007. Earning assets remained stable at \$1.121 billion at both March 31, 2007 and December 31, 2006. The decrease in assets was due to decreases in cash and due from banks (-\$4.330 million), investment securities (both trading and available for sale) (-\$51.053 million), loans held for sale (-\$37.098 million), and net loans outstanding (-\$8.895 million), partially offset by increases in short-term investments (+\$98.108 million). We also experienced decreases in deposits (-\$10.667 million), partially offset by increases in short-term (+\$1.593 million) and long-term (+\$11.061 million) borrowings.

*Investment securities available for sale*

We utilize the investment portfolio as part of our overall asset/liability management practices to enhance interest revenue while providing necessary liquidity for the funding of loan growth or deposit withdrawals. Investment securities available for sale declined \$91.954 million due to the transfer of securities available for sale to the trading securities portfolio, security sales of \$1.301 million, normal principal payments on mortgage-backed securities and scheduled maturities of other investments (\$51.665 million). These decreases were offset by an increase in market values and additional purchases of securities of \$999,000. At March 31, 2007, our unrealized gain on securities classified as available for sale totaled \$7,000, compared to a loss of \$1.505 million at December 31, 2006. The improvement resulted from the transfer of certain securities to the trading portfolio and decreases in short-term and long-term interest rates from December 31, 2006 to March 31, 2007, which resulted in higher market valuation of our fixed income investments.

## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

The investment securities available for sale portfolio composition is as follows:

(dollars in thousands)	March 31, 2007		December 31, 2006	
	Balance	Percent of Total	Balance	Percent of Total
Investment securities available for sale:				
Mortgage-backed securities	\$ 19,267	34.8 %	\$ 62,281	42.3 %
Trust preferred securities	26,658	48.2 %	33,028	22.4 %
US government agency notes			39,894	27.1 %
US Treasury securities	1,004	1.8 %	998	0.7 %
Obligations of state and municipal subdivisions	2,962	5.3 %	2,965	2.0 %
Corporate obligations	1,979	3.6 %	1,988	1.3 %
Equity securities	720	1.3 %	1,395	1.0 %
Foreign government bonds	1,750	3.2 %	1,750	1.2 %
Other investment securities	996	1.8 %	2,991	2.0 %
<b>Total investment securities available for sale</b>	<b>\$ 55,336</b>	<b>100.0 %</b>	<b>\$ 147,290</b>	<b>100.0 %</b>

### Loans

Total loans decreased \$9.408 million during the first three months of 2007. The majority of the decline occurred in our commercial real estate portfolio, which decreased by \$17.637 million, and in our consumer residential construction portfolio, which decreased by \$4.348 million. These decreases reflect the softening demand for both residential and commercial real estate development loans. These declines were partially offset by growth in our residential mortgage loan portfolio (+\$7.462 million) (primarily due to repurchased loans), commercial construction portfolio (+\$2.769 million), and consumer loan portfolio (+\$4.772 million). Our loans secured by deposits and other also increased by \$387,000. The total loan portfolio was comprised of the following:

(dollars in thousands)	March 31, 2007		December 31, 2006	
	Balance	Percent of Total	Balance	Percent of Total
Loans secured by first mortgages on real estate:				
Residential	\$ 64,186	7.5 %	\$ 56,724	6.5 %
Commercial	300,599	35.0 %	318,236	36.7 %
Consumer residential construction	93,658	10.9 %	98,006	11.3 %
Commercial / residential construction	140,538	16.4 %	137,769	15.9 %
Commercial	598,981	69.8 %	610,735	70.4 %
Commercial	77,616	9.1 %	79,001	9.1 %
Loans secured by second mortgages on real estate				
Consumer loans	100,657	11.7 %	102,367	11.8 %
Consumer loans	77,962	9.1 %	73,190	8.5 %
Loans secured by deposits and other	2,344	0.3 %	1,957	0.2 %
<b>Total loans</b>	<b>857,560</b>	<b>100.0 %</b>	<b>867,250</b>	<b>100.0 %</b>
Unamortized loan discounts	(163 )		(220 )	
Unearned loan fees, net	(346 )		(571 )	
	<b>\$ 857,051</b>		<b>\$ 866,459</b>	

### Credit Risk Management

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

We provide for loan losses through the establishment of an allowance for loan losses (the allowance) by provisions charged against earnings. Our allowance for loan losses represents an estimated reserve for existing losses in the loan portfolio. We evaluate the adequacy of our allowance for loan losses continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other



loans that we believe require special attention.

15

---

Based upon management's evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The provision for loan losses was \$537,000 for the three months ended March 31, 2007 as compared to \$422,000 for the same period in 2006. The provision for loan losses increased in an amount proportionate to the incremental inherent risk associated with the growth and decline in the various loan types as well as a deterioration in qualitative factors management uses in establishing the unallocated portion of the allowance for loan losses. We recorded net charge-offs of \$1.050 million during the first three months of 2007 compared to net charge-offs of \$296,000 for the same period in 2006. This increase was primarily attributable to increases in net charge-offs of commercial, commercial mortgage and repurchased second mortgages.

The allowance consists of three elements: (1) specific reserves for individual credits; (2) general reserves for types or portfolios of loans based on historical loan loss experience, judgmentally adjusted for current conditions and credit risk concentrations; and (3) unallocated reserves. Combined specific reserves and general reserves by loan type are considered allocated reserves. All outstanding loans are considered in evaluating the adequacy of the allowance.

We deploy a systematic methodology for determining our allowance for loan losses that includes a quarterly review process and adjustment to our allowance. Our process includes updates on all loans that we have rated for risk. Our commercial loans are generally reviewed individually, in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, while large groups of homogeneous loans are reviewed as pools. Our methodology incorporates a variety of risk considerations, both qualitative and quantitative. Quantitative factors include our historical loss experience by loan type, collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are evaluated in connection with our unallocated portion of our allowance for loan losses. We periodically engage outside firms and experts to independently assess our methodology, and perform various loan review functions.

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

The process of establishing the allowance with respect to our commercial and commercial real estate loan portfolios begins when a loan officer initially assigns each loan a risk grade, using established credit criteria. Risk grades are subject to review and validation annually by an independent consulting firm, as well as periodically by our internal credit review function. Management reviews, on a quarterly basis, current conditions that affect various lines of business and may warrant adjustments to reserves for a particular loan. Management also evaluates credit risk concentrations, including trends in large dollar exposures to related borrowers, and industry and geographic concentrations. Economic and environmental factors are also considered. All nonaccrual loans in the commercial and nonresidential real estate portfolios, as well as other loans in the portfolios identified as having the potential for further deterioration, are analyzed individually to confirm the appropriate risk grading and accrual status, and to determine the need for a specific reserve.

Consumer and residential mortgage loans are segregated into homogeneous pools with similar risk characteristics. Trends and current conditions in retail and residential mortgage pools are analyzed and historical loss experience is adjusted accordingly. Adjustment factors for the retail and residential mortgage portfolios are consistent with those for the commercial portfolios.

The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the specific and general portions of the allowance and is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of internal loan examiners, and management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Executive management reviews these conditions quarterly. We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may exist inherently within the loan portfolios. The judgmental aspects involved in applying the risk grading criteria, analyzing the quality of individual loans, and assessing collateral values can also contribute to undetected, but probable, losses.

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

Valuation allowances established in relationship to repurchased loans originated for sale or transfer of loans from loans held for sale to the loan portfolio are in addition to and separate from the allowance for loan losses. The valuation allowance was established for loans already repurchased and in the portfolio and the secondary marketing reserve is for loans that may be required to be repurchased in the future. The valuation allowance (\$1.027 million) and secondary marketing reserve (\$2.471 million) are not part of our allowance for loan losses of \$11.886 million, but are in addition to it.

In establishing the valuation allowance and secondary marketing reserve, management needed to make significant assumptions concerning the ultimate collectibility of loans currently delinquent, and those expected to be repurchased in the future. Additionally, a portion of these reserves are based upon projected volume of repurchases. While these projections were made with the most current data available to management, actual realized losses could differ due to the changes in the borrowers' willingness or ability to resolve the delinquency status, changes in the actual volume of future repurchases, or changes in market values of those loans which are liquidated. Management will update these assumptions continually as greater experience becomes available.

In response to the trends experienced in our secondary marketing business, management has taken steps to modify underwriting guidelines and strengthen borrower qualification terms. Additionally, management has dramatically reduced its offering of second mortgage products through broker channels and has limited its mortgage lending to investor borrowers.

The allowance at March 31, 2007 is considered by management to be sufficient to address the credit losses inherent in the current loan portfolio. The changes in the allowance are presented in the following table:

(dollars in thousands)	Three Months Ended	
	March 31, 2007	2006
Allowance for loan losses, beginning of year	\$ 12,399	\$ 11,743
Loans charged off:		
Commercial	(67)	
Residential construction - commercial		
Commercial mortgages	(340)	
Residential construction - consumer		(9)
Residential mortgages		
Consumer	(795)	(412)
Total loans charged off	(1,202)	(421)
Recoveries:		
Commercial		
Residential construction - commercial		
Commercial mortgages		
Residential construction - consumer		23
Residential mortgages	29	
Consumer	123	102
Total recoveries	152	125
Net charge-offs	(1,050)	(296)
Provision for loan losses	537	422
Allowance for loan losses, end of period	\$ 11,886	\$ 11,869
Loans (net of premiums and discounts):		
Period-end balance	\$ 857,051	\$ 851,936
Average balance during period	859,389	847,794
Allowance as a percentage of period-end loan balance	1.39	% 1.39
Percent of average loans:		
Provision for loan losses (annualized)	0.25	% 0.20
Net charge-offs (annualized)	0.50	% 0.14

During the first three months of 2007, annualized net charge-offs as compared to average loans outstanding increased to 0.50%, as compared to 0.14% during the same period of 2006, mostly due to a few large charge-offs in the commercial mortgage portfolio (\$340,000) taken in the first quarter of 2007 and increased charge-offs in our consumer portfolio consistent with the increase in our consumer loan portfolio balances and charge offs of previously repurchased second mortgages. Nonperforming assets, expressed as a percentage of total assets, totaled 1.73% at March 31, 2007, 0.52% at December 31, 2006 and 0.27% at March 31, 2006. The increase as compared to March 31, 2006 reflects an increase in both residential real estate acquired by foreclosure and nonaccrual loans. At March 31, 2007, there were a larger percentage of commercial and residential real estate loans classified as nonaccrual as compared to March 31, 2006, when a larger percentage consisted of commercial

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

loans. Loans past due 90 days or more and still accruing totaled \$18.480 million as of March 31, 2007 compared to \$27.274 million at December 31, 2006 and

17

---

## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

\$1.649 million as of March 31, 2006. Of the \$18.480 million total, \$4.057 million is for six commercial construction loans, \$1.370 million is for two commercial mortgage loans, \$88,000 is for one commercial loan, and \$12.963 million is for first-lien position residential mortgages, all of which are well-collateralized and in the process of collection. The remainder of the loans past due 90 days or more of \$2,000 are consumer loans.

The following table summarizes our allocation of allowance by loan type:

(dollars in thousands)	March 31, 2007			December 31, 2006		
	Amount	Percent of Total	Percent of Loans to Total Loans	Amount	Percent of Total	Percent of Loans to Total Loans
Commercial	\$ 561	4.7 %	9.1 %	\$ 926	7.5 %	9.1 %
Residential construction -commercial	2,570	21.6 %	16.3 %	2,749	22.2 %	15.8 %
Commercial mortgages	2,375	20.0 %	35.1 %	3,073	24.8 %	36.7 %
Residential construction -consumer	729	6.1 %	10.9 %	1,068	8.6 %	11.3 %
Residential mortgages	202	1.7 %	7.5 %	28	0.2 %	6.5 %
Consumer	2,807	23.7 %	21.1 %	2,928	23.6 %	20.6 %
Unallocated	2,642	22.2 %		1,627	13.1 %	
Total	\$ 11,886	100.0 %	100.0 %	\$ 12,399	100.0 %	100.0 %

Management applies SFAS No. 114 to determine accrual status for larger loans. Under SFAS No. 114, when it is probable that we will be unable to collect all payments due, including interest, we place the loan on nonaccrual. Management may grant a waiver from nonaccrual status for a 90-day past-due loan that is both well secured and in the process of collection. A loan remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. As a result of our ongoing review of the loan portfolio, we may classify loans as nonaccrual even though the presence of collateral or the borrowers financial strength may be sufficient to provide for ultimate repayment. We recognize interest on nonaccrual loans only when it is received.

The following table provides information concerning nonperforming assets and past-due loans:

(dollars in thousands)	March 31, 2007	December 31, 2006	March 31, 2006
Nonaccrual loans	\$ 15,851	\$ 4,158	\$ 3,653
Real estate acquired by foreclosure	5,991	2,440	65
Total nonperforming assets	\$ 21,842	\$ 6,598	\$ 3,718
Loans past-due 90 days or more and accruing	\$ 18,480	\$ 27,274	\$ 1,649

A loan is determined to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is not considered impaired during a period of delay in payment if we expect to collect all amounts due, including past-due interest. We generally consider a period of delay in payment to include delinquency up to 90 days. Commercial loans are evaluated individually for impairment. Pools of smaller-balance homogeneous loans such as consumer installment, residential first and second mortgage loans and credit card loans are collectively evaluated for impairment. During the first quarter of 2007, management considered two large commercial construction loans (\$9.9 million) to be impaired under this criteria and reclassified these loans as nonaccrual.

**We consider impaired loans to be all commercial nonaccrual loans. As of March 31, 2007, we had impaired loans of \$12.393 million. The valuation allowance for impaired loans was \$1.400 million as of March 31, 2007.**

At March 31, 2007, the allowance for loan losses represented 54.4% of nonperforming assets compared to 187.9% at December 31, 2006. Management believes the allowance for loan losses is adequate as of March 31, 2007.

As of March 31, 2007, we maintained \$19.783 million in delinquent loans that we have repurchased from investors in accordance with a covenant in our sales agreements. We have established a valuation allowance for these loans in the amount of \$1.027 million that is in addition to and separate from the allowance for loan losses. The majority of the loans are 90 days past due. Of the \$19.783 million, \$2.997 million have been placed on nonaccrual.



*Deposits*

Deposits totaled \$914.271 million as of March 31, 2007, decreasing \$10.667 million or 1.2% from the December 31, 2006 balance of \$924.938 million. The decrease in deposits is primarily due to decreased time deposits and noninterest-bearing demand deposits, partially offset by increases in NOW, money market, and regular savings accounts. The mix of deposits has changed somewhat during 2007, with a higher percentage of interest-bearing transaction accounts and regular savings accounts and less noninterest-bearing demand and time deposit accounts as of March 31, 2007 compared to December 31, 2006. The deposit breakdown is as follows:

(dollars in thousands)	March 31, 2007		December 31, 2006	
	Balance	Percent of Total	Balance	Percent of Total
NOW & money market savings deposits	\$ 309,242	33.8 %	\$ 282,871	30.6 %
Regular savings deposits	60,659	6.7 %	58,377	6.3 %
Time deposits	377,544	41.3 %	396,970	42.9 %
Total interest-bearing deposits	747,445	81.8 %	738,218	79.8 %
Noninterest-bearing demand deposits	166,826	18.2 %	186,720	20.2 %
Total deposits	\$ 914,271	100.0 %	\$ 924,938	100.0 %

Core deposits represent deposits that we believe to be less sensitive to changes in interest rates and therefore, will be retained regardless of the movement of interest rates. We consider our core deposits to be all noninterest-bearing, NOW, money market accounts less than \$100,000, and saving deposits, as well as all time deposits less than \$100,000 that mature in greater than one year. As of March 31, 2007, our core deposits were \$489.945 million. The remainder of our deposits could be susceptible to attrition due to interest rate movements.

*Borrowings*

Our borrowings consist of short-term promissory notes issued to certain qualified investors, short-term and long-term advances from the Federal Home Loan Bank at Atlanta ( FHLB ), a mortgage warehouse line of credit, a mortgage loan, a long-term line of credit, and junior subordinated deferrable interest debentures. Our short-term promissory notes are in the form of commercial paper, which reprice daily and have maturities of 270 days or less. Our advances from the FHLB may be in the form of short-term or long-term obligations. Short-term advances have maturities for one year or less and can be paid without penalty. Long-term borrowings through the FHLB have original maturities up to 15 years and generally contain prepayment penalties and call provisions.

Long-term borrowings consist of advances from the FHLB, a mortgage loan on our former headquarters building, and a line of credit and totaled \$143.618 million and \$132.557 million at March 31, 2007 and December 31, 2006, respectively. The long-term line of credit is used to fund Finance Maryland's lending business. As of March 31, 2007, total borrowings under this line were \$47.000 million, up from \$38.000 million at December 31, 2006. In March of 2006, we purchased our former headquarters building and assumed the existing mortgage loan on the property. As of March 31, 2007, the balance on the loan was \$9.519 million compared to \$9.557 million as of December 31, 2006. FHLB long-term advances remained unchanged at \$85.000 million; however, \$60.000 million of the advances are now recorded at fair value (\$62.099 million) in accordance with SFAS No. 159. See more detailed discussion about the advances recorded at fair value under Cumulative Effect of Accounting Change above.

Short-term borrowings consist of short-term promissory notes, short-term advances from the FHLB, and a mortgage warehouse line of credit secured by certain loans held for sale. Short-term borrowings increased \$1.593 million, from \$40.884 million at December 31, 2006 to \$42.477 million at March 31, 2007, as deposit attrition led to the need for additional borrowings.

As an ongoing part of our funding and capital planning, we issue trust preferred securities from statutory trusts ( Trust Preferred Securities ), which are wholly owned by First Mariner Bancorp. The proceeds from the sales of Trust Preferred Securities (\$71.500 million), combined with our equity investment in these trusts (\$2.224 million), are exchanged for subordinated deferrable interest debentures. We currently maintain seven of these trusts with aggregated debentures of \$73.724 million as of both March 31, 2007 and December 31, 2006.

The Trust Preferred Securities are mandatorily redeemable, in whole or in part, upon repayment of their underlying subordinated debt at their respective maturities or their earlier redemption. The subordinated debt is redeemable prior to maturity at our option on or after its optional redemption dates.





## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

The junior subordinated deferrable interest debentures are the sole assets of the trusts. First Mariner has fully and unconditionally guaranteed all of the obligations of the trusts.

Under applicable regulatory guidelines, a portion of the Trust Preferred Securities will qualify as Tier I capital, and the remaining portion will qualify as Tier II capital. Under applicable regulatory guidelines, \$25.799 million of the outstanding Trust Preferred Securities qualify as Tier I capital and the remaining \$45.701 million of the Trust Preferred Securities qualify as Tier II capital at March 31, 2007.

### Capital Resources

Stockholders' equity decreased \$1.231 million in the first three months of 2007 to \$77.398 million from \$78.629 million as of December 31, 2006. Retained earnings grew by the retention of net income of \$100,000 for the first three months of 2007, offset by a net cumulative effect of accounting change adjustment of \$2.244 related to our adoption of SFAS No. 159 effective January 1, 2007.

Common stock and additional paid-in-capital decreased by \$13,000 due to stock repurchases of \$139,000, partially offset by the sale of stock through the exercise of options and warrants (\$10,000), shares issued through the employee stock purchase plan (\$99,000), and stock compensation awards (\$16,000). Accumulated other comprehensive loss improved by \$926,000 due to the increase in estimated fair values of the securities portfolio and the cumulative effect of accounting change adjustment related to investment securities.

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

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

The Company and the Bank have exceeded their capital adequacy requirements to date. We regularly monitor the Company's capital adequacy ratios to assure that the Bank exceeds its regulatory capital requirements. The regulatory capital ratios are shown below:

	March 31, 2007	December 31, 2006	Minimum Regulatory Requirements	
<b>Regulatory capital ratios:</b>				
<b>Leverage:</b>				
Consolidated	8.3	% 7.8	% 4.0	%
The Bank	7.8	% 7.3	% 4.0	%
<b>Tier 1 capital to risk-weighted assets:</b>				
Consolidated	10.0	% 10.0	% 4.0	%
The Bank	9.5	% 9.6	% 4.0	%
<b>Total capital to risk-weighted assets:</b>				
Consolidated	15.7	% 15.6	% 8.0	%
The Bank	11.6	% 11.7	% 8.0	%

### Results of Operations

#### *Net Income*

For the three months ended March 31, 2007, net income totaled \$100,000 compared to \$1.660 million for the three month period ended March 31, 2006. Basic earnings per share for the first three months of 2007 totaled \$0.02 compared to \$0.26 per share for the same period of 2006, while diluted earnings per share totaled \$0.02 for the first three months of 2007 compared to \$0.25 for the first three months of 2006. Earnings for the three months ended March 31, 2007 were impacted by lower net interest income, a higher provision for loan losses and growth in noninterest expenses, partially offset by higher noninterest income.



Return on average assets and return on average equity are key measures of a bank's performance. Return on average assets, the product of net income divided by total average assets, measures how effectively we utilize the Company's assets to produce income. Our return on average assets for the three months ended March 31, 2007 was 0.03% compared to 0.51% for the corresponding period in 2006. Return on average equity, the product of net income divided by average equity, measures how effectively we invest the Company's capital to produce income. Return on average equity for the three months ended March 31, 2007 was 0.51% compared to 9.27% for the corresponding period in 2006. All profitability indicators were negatively affected by the lower net income.

#### *Net Interest Income*

Net interest income, the amount by which interest income on interest-earning assets exceeds interest expense on interest-bearing liabilities, is the most significant component of our earnings. Net interest income is a function of several factors, including changes in the volume and mix of interest-earning assets and funding sources, and market interest rates. While management policies influence these factors, external forces, including customer needs and demands, competition, the economic policies of the federal government and the monetary policies of the Federal Reserve Board, are also determining factors.

Net interest income for the first three months of 2007 totaled \$11.207 million, a decrease of \$1.035 million from \$12.242 million for the three months ended March 31, 2006. The decline in net interest income during 2007 was due to both an increase in the average rate paid on interest-bearing liabilities, from 3.80% for the three months ended March 31, 2006 to 4.41% for the three months ended March 31, 2007, a decrease in the volume of average earning assets, from \$1.225 billion for the three months ended March 31, 2006 to \$1.113 billion as of March 31, 2007, and a significantly higher level of loans moved to nonaccrual status. In addition, we also experienced a decline in non-interest bearing funding sources. The increased average rate paid on interest-bearing liabilities was partially offset by lower average balances of interest-bearing deposits and borrowings, which decreased from \$1.074 billion for the three months ended March 31, 2006 to \$989.640 million for the three months ended March 31, 2007. The yield on average earning assets increased from 7.30% for the three months ended March 31, 2006 to 7.92% for the three months ended March 31, 2007. Rates on earning assets and interest-bearing liabilities increased due to increased market interest rates. The net interest margin increased slightly to 3.99% for the three months ended March 31, 2007, as compared to 3.97% for the comparable period in 2006.

*Interest income.* Total interest income decreased by \$336,000 due to the impact of the additional loans placed on nonaccrual status during the quarter, which reduced interest income approximately \$740,000 and the sale of approximately \$100 million in investment securities during the fourth quarter of 2006, which reduced interest on investments in 2007. Overall earning asset growth has moderated in 2007, as higher interest rates have dampened loan demand, loan principal prepayments have increased, and a flat treasury yield curve has discouraged the purchase of investment securities due to the narrow spread between investment yields and funding sources. Average loans outstanding increased by \$11.595 million, with increases in commercial loans and lines of credit (+\$6.691 million), commercial residential construction (+\$25.788 million), residential mortgages (+\$16.605 million), and consumer loans (+\$23.535 million), offset by decreases in commercial mortgages (-\$32.474 million) and consumer residential construction loans (-\$28.550 million). Average loans held for sale decreased \$7.924 million and average investment securities decreased by \$142.255 million (primarily due to the 2006 balance sheet restructuring in which we sold securities in order to pay down debt). Yields on earning assets for the period increased to 7.92% from 7.30% due primarily to the higher rate environment in 2007. The yield on total loans increased from 8.30% to 8.56%, driven by increased rates on most loan types.

*Interest expense.* Interest expense increased by \$699,000, due primarily to increases in the average rate paid on interest-bearing liabilities, which increased from 3.80% for the three months ended March 31, 2006 to 4.41% for the three months ended March 31, 2007, primarily as a result of the higher interest rate environment in 2007. The increase in the rate paid on deposits from 2.96% for the three months ended March 31, 2006 to 3.81% for the three months ended March 31, 2007 was driven primarily by increases in the rates on money market accounts and time deposits. Average interest-bearing deposits increased by \$45.735 million primarily due to an increase in the volume of money market deposits. A decrease in average borrowings of \$129.915 million was due to primarily to a balance sheet restructuring during the fourth quarter of 2006, in which we sold some securities and paid down borrowings with the proceeds.



Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

The following tables set forth, for the periods indicated, information regarding the average balances of interest-earning assets and interest-bearing liabilities and the resulting yields on average interest-earning assets and rates paid on average interest-bearing liabilities. Average balances are also provided for noninterest-earning assets and noninterest-bearing liabilities.

	For the Three Months Ended March 31, 2007			2006		
	Average Balance (1) (dollars in thousands)	Interest (2)	Yield/ Rate	Average Balance (1)	Interest (2)	Yield/ Rate
<b>ASSETS</b>						
Loans:						
Commercial loans and lines of credit	\$ 73,276	\$ 1,235	6.74%	\$ 66,585	\$ 1,019	6.12%
Residential construction - commercial	138,626	2,612	7.54%	112,838	2,447	8.68%
Commercial mortgages	315,853	5,789	7.33%	348,327	6,173	7.09%
Residential construction - consumer	94,026	2,028	8.73%	122,576	2,248	7.43%
Residential mortgages	58,212	633	4.35%	41,607	574	5.52%
Consumer	179,396	6,054	13.54%	155,861	5,081	13.09%
Total loans	859,389	18,351	8.56%	847,794	17,542	8.30%
Loans held for sale	73,530	1,384	7.53%	81,454	1,486	7.32%
Investment securities, trading and AFS	131,678	1,647	5.00%	273,933	3,022	4.41%
Interest-bearing deposits	41,609	503	4.84%	9,236	97	4.21%
Restricted stock investments, at cost	6,550	94	5.76%	12,479	168	5.39%
Total earning assets	1,112,756	21,979	7.92%	1,224,896	22,315	7.30%
Allowance for loan losses	(12,358 )			(11,778 )		
Cash and other nonearning assets	148,688			116,829		
Total assets	\$ 1,249,086	21,979		\$ 1,329,947	22,315	
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Interest-bearing deposits:						
NOW deposits	\$ 9,525	5	0.23%	\$ 12,147	6	0.21%
Savings deposits	59,135	45	0.31%	70,141	53	0.30%
Money market deposits	281,292	2,591	3.74%	216,246	1,371	2.57%
Time deposits	387,787	4,288	4.48%	393,470	3,617	3.73%
Total interest-bearing deposits	737,739	6,929	3.81%	692,004	5,047	2.96%
Borrowings	251,901	3,843	6.19%	381,816	5,026	5.34%
Total interest-bearing liabilities	989,640	10,772	4.41%	1,073,820	10,073	3.80%
Noninterest-bearing demand deposits	169,908			177,295		
Other noninterest-bearing liabilities	10,561			6,196		
Stockholders equity	78,977			72,636		
Total liabilities and stockholders equity	\$ 1,249,086	10,772		\$ 1,329,947	10,073	
Net interest income/net interest spread		\$ 11,207	3.51%		\$ 12,242	3.50%
Net interest margin			3.99%			3.97%

(1) Nonaccrual loans are included in average loans.

(2) There are no tax equivalency adjustments

A rate/volume analysis, which demonstrates changes in interest income and expense for significant assets and liabilities, appears below. Changes attributable to mix (rate and volume) are allocated to volume and rate based on the relative size of the variance that can be separately identified with each.

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

	For the Three Months Ended March 31, 2007			For the Three Months Ended March 31, 2006		
	Due to Variances in		Total	Due to Variances in		Total
	Rate	Volume		Rate	Volume	
<b>Interest earned on:</b>						
<b>Loans:</b>						
Commercial loans and lines of credit	\$ 109	\$ 107	\$ 216	\$ 64	\$ (76 )	\$ (12 )
Residential construction - commercial	(1,575 )	1,740	165	277	893	1,170
Commercial mortgages	1,130	(1,514 )	(384 )	286	793	1,079
Residential construction - consumer	1,725	(1,945 )	(220 )	49	(130 )	(81 )
Residential mortgages	(616 )	675	59	(50 )	9	(41 )
Consumer	181	792	973	865	652	1,517
Total loans	954	(145 )	809	1,491	2,141	3,632
Loans held for sale	242	(344 )	(102 )	406	318	724
Investment securities, trading and AFS	2,293	(3,668 )	(1,375 )	139	(439 )	(300 )
Interest-bearing deposits	17	389	406	48	(18 )	30
Restricted stock investments, at cost	72	(146 )	(74 )	61	9	70
<b>Total interest income</b>	<b>3,578</b>	<b>(3,914 )</b>	<b>(336 )</b>	<b>2,145</b>	<b>2,011</b>	<b>4,156</b>
<b>Interest paid on:</b>						
<b>Interest-bearing deposits:</b>						
NOW deposits	3	(4 )	(1 )	1		1
Savings deposits	10	(18 )	(8 )			
Money market deposits	734	486	1,220	765	38	803
Time deposits	1,022	(351 )	671	599	136	735
Total interest-bearing deposits	1,769	113	1,882	1,365	174	1,539
Borrowings	4,036	(5,219 )	(1,183 )	1,152	467	1,619
<b>Total interest expense</b>	<b>5,805</b>	<b>(5,106 )</b>	<b>699</b>	<b>2,517</b>	<b>641</b>	<b>3,158</b>
<b>Net interest income</b>	<b>\$ (2,227 )</b>	<b>\$ 1,192</b>	<b>\$ (1,035 )</b>	<b>\$ (372 )</b>	<b>\$ 1,370</b>	<b>\$ 998</b>

*Noninterest Income*

Noninterest income for the three months ended March 31, 2007 was \$6.949 million, an increase of \$951,000 or 15.9% for the comparable period of 2006 primarily due to \$887,000 in gains on sales of investment securities during the first quarter of 2007. Also contributing to the higher noninterest income was an increase in gains on sale of mortgage loans, other mortgage-banking revenue, brokerage fees, BOLI income, and commissions on sales of other insurance products, partially offset by decreased service charges on deposit accounts.

Mortgage-banking revenue increased to \$2.323 million in 2007 compared to \$2.068 million in 2006 due to increased revenue realized on the sale of reverse mortgages. Brokerage commissions increased \$213,000 for the three months ended March 31, 2007, primarily due to increased annuity sales. Deposit service charges declined to \$1.471 million for the three months ended March 31, 2007 from \$1.679 million for the three months ended March 31, 2006 due to reduced overdraft fee income. We also recognized a \$111,000 trading loss related to securities and long-term borrowings that we record at fair value in accordance with SFAS No. 159.

*Noninterest expenses*

For the three months ended March 31, 2007, noninterest expenses increased \$2.129 million or 13.7% to \$17.647 million compared to \$15.518 million for the same period of 2006. Salary and employee benefits expenses increased \$925,000 due to additional personnel costs for staffing hired to support the expansion of the consumer finance company and mortgage activities, and increased cost of employer provided health care. Occupancy expenses increased \$537,000 to \$2.240 million for the three months ended March 31, 2007 from \$1.703 million for the three months ended March 31, 2006 due to additional space for the new executive and administrative offices occupied during the third quarter of 2006. Service and maintenance expense also increased (\$206,000) due to increased locations. We also recorded additional secondary marketing reserves of \$33,000 through other operating expenses to reflect the declines in fair market value incurred during the quarter for certain

residential mortgage loans transferred from loans held for sale during the third quarter and to increase our reserves for potential loan repurchases.

23

---

The following table shows the breakout of noninterest expense:

(dollars in thousands)	Three Months Ended	
	March 31,	
	2007	2006
Salaries and employee benefits	\$ 9,357	\$ 8,432
Occupancy	2,240	1,703
Furniture, fixtures and equipment	863	800
Secondary marketing reserve	33	
Professional services	350	202
Advertising	511	466
Data processing	429	449
Service and maintenance	744	538
Office supplies	197	193
ATM servicing expenses	230	283
Printing	179	159
Corporate insurance	116	104
OREO expense	86	(4 )
Consulting fees	194	160
Marketing/promotion	220	312
Postage	275	251
Overnight delivery/courier	226	216
Security	95	61
Dues and memberships	121	160
Loan collection expenses	176	146
Other	1,005	887
	\$ 17,647	\$ 15,518

### *Income Taxes*

We recorded an income tax benefit of \$128,000 on a loss before taxes of \$28,000, resulting in an effective tax rate of (457.1)% for the three month period ended March 31, 2007 in comparison to income tax expense of \$640,000 on income before taxes of \$2.300 million, resulting in an effective tax rate of 27.8% for the three month period ended March 31, 2006. The effective tax rate decreased due to higher levels of tax-exempt income in 2007 as compared to 2006. There were no changes in the statutory income tax rates in 2007.

### Liquidity

Liquidity describes our ability to meet financial obligations, including lending commitments and contingencies, that arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of our customers, as well as to meet current and planned expenditures. These cash requirements are met on a daily basis through the inflow of deposit funds, and the maintenance of short-term overnight investments, maturities and calls in our investment portfolio and available lines of credit with the FHLB, which requires pledged collateral. Fluctuations in deposit and short-term borrowing balances may be influenced by the interest rates paid, general consumer confidence and the overall economic environment. There can be no assurances that deposit withdrawals and loan fundings will not exceed all available sources of liquidity on a short-term basis. Such a situation would have an adverse effect on our ability to originate new loans and maintain reasonable loan and deposit interest rates, which would negatively impact earnings.

The borrowing requirements of customers include commitments to extend credit and the unused portion of lines of credit (collectively commitments ), which totaled \$256.787 million at March 31, 2007. Historically, many of the commitments expire without being fully drawn; therefore, the total commitment amounts do not necessarily represent future cash requirements. Commitments for real estate development and construction, which totaled \$115.194 million, or 44.9% of the \$256.787 million, are generally short-term in nature, satisfying cash requirements with principal repayments as construction properties financed are generally repaid with permanent financing. Available credit lines represent the unused portion of credit previously extended and available to the customer as long as there is no violation of material contractual conditions. Commitments to extend credit for residential mortgage loans of \$18.862 million, or 7.3% of the \$256.787 million at March 31, 2007, generally expire within 60 days. Commercial commitments to extend credit and unused lines of credit of \$5.635 million, or 2.2% of the \$256.787 million at March 31, 2007, generally do not extend for more than 12 months. Consumer commitments to extend credit and unused lines of credit of \$37.997 million, or 14.8% of the \$256.787 million at March 31, 2007, are generally open ended. At March 31, 2007, available home equity lines totaled \$79.099 million, or 30.8% of the \$256.787 million. Home equity credit lines generally extend for a period of 10 years.





Capital expenditures for various branch locations and equipment can be a significant use of liquidity. As of March 31, 2007, we plan on expending approximately \$3.000 million in the next 12 months on our premises and equipment.

Customer withdrawals are also a principal use of liquidity, but are generally mitigated by growth in customer funding sources, such as deposits and short-term borrowings. While balances may fluctuate up and down in any given period, historically we have experienced a steady increase in total customer funding sources.

The Bank's principal sources of liquidity are cash and cash equivalents (which are cash on hand or amounts due from financial institutions, federal funds sold, money market mutual funds, and interest bearing deposits), trading and available for sale securities, deposit accounts and borrowings. The levels of such sources are dependent on the Bank's operating, financing and investing activities at any given time. Cash and cash equivalents totaled \$136.747 million at March 31, 2007 compared to \$42.969 million as of December 31, 2006. Our loan to deposit ratio stood at 93.7% as of both March 31, 2007 and December 31, 2006.

We also have the ability to utilize established credit lines as additional sources of liquidity. To utilize the vast majority of our credit lines, we must pledge certain loans and/or investment securities before advances can be obtained. As of March 31, 2007, we maintained lines of credit totaling \$559.756 million, with available borrowing capacity of \$157.243 million based upon loans and investments available for pledging.

#### Inflation

Inflation may be expected to have an impact on our operating costs and thus on net income. A prolonged period of inflation could cause interest rates, wages, and other costs to increase and could adversely affect our results of operations unless the fees we charge could be increased correspondingly. However, we believe that the impact of inflation was not material for 2007 or 2006.

#### Off-Balance Sheet Arrangements

We enter into off-balance sheet arrangements in the normal course of business. These arrangements consist primarily of commitments to extend credit, lines of credit and letters of credit. In addition, the Company has certain operating lease obligations.

Credit 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 rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Our exposure to credit loss in the event of nonperformance by the borrower is the contract amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. We are not aware of any accounting loss we would incur by funding our commitments.

#### *Notional Amount of Derivatives*

The Bank, through First Mariner Mortgage, enters into interest rate lock commitments, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Bank also has corresponding forward sales commitments related to these interest rate lock commitments. The market value of rate lock commitments and best efforts contracts is not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded in stand-alone markets. The Bank determines the fair value of rate lock commitments and best efforts contracts by measuring the change in the value of the underlying asset, while taking into consideration the probability that the rate lock commitments will close.

During the first quarter of 2007, we curtailed our forward loan commitments and the corresponding hedging using forward contracts to sell securities due to the significantly lower production volume of loans during that time. Most of the loans sold during the first quarter of 2007 were done so on a best efforts basis. It is probable that we will resume selling loans on a mandatory delivery basis later in the year and at that time will also resume our hedging of the transactions.

As of March 31, 2007, we had no forward contracts to sell any securities.



Information pertaining to the notional amounts of our derivative financial instruments follows as of March 31, 2007. These derivative financial instruments are recorded in our consolidated balance sheet at fair value.

(dollars in thousands)	Notional Amount	Estimated Fair Value
Interest rate lock commitments	\$ 25,819	\$ 25,761
Open hedge positions:		
Forward sales commitments on loan pipeline and funded loans	\$ 80,875	\$ 80,933
Forward contracts to sell mortgage-backed securities and Eurodollars	\$	\$

The net effect on our income statement from marking to market the forward contracts, the interest rate lock commitments and mortgage loans held for sale are not considered material to the overall operations of the consolidated company.

Changes in interest rates could materially affect the fair value of derivative loan commitments on our consolidated financial statements. In reality, one would not expect all other assumptions to remain constant. Changes in one factor may result in changes in another (for example, changes in interest rates could result in changes in the fallout factor), which might magnify or counteract the sensitivities. This is because the impact of an interest rate shift on the fallout ratio is non-symmetrical and non-linear.

### Item 3 Quantitative and Qualitative Disclosures About Market Risk

Results of operations for financial institutions, including ours, may be materially and adversely affected by changes in prevailing economic conditions, including declines in real estate values, rapid changes in interest rates and the monetary and fiscal policies of the federal government. Our loan portfolio is concentrated primarily in central Maryland and portions of Maryland's eastern shore and is, therefore, subject to risks associated with these local economies.

#### Interest Rate Risk

Our profitability is in part a function of the spread between the interest rates earned on assets and the interest rates paid on deposits and other interest-bearing liabilities (net interest income), including advances from the FHLB and other borrowings. Interest rate risk arises from mismatches (i.e., the interest sensitivity gap) between the dollar amount of repricing or maturing assets and liabilities and is measured in terms of the ratio of the interest rate sensitivity gap to total assets. More assets repricing or maturing than liabilities over a given time period is considered asset-sensitive and is reflected as a positive gap, and more liabilities repricing or maturing than assets over a given time period is considered liability-sensitive and is reflected as negative gap. An asset-sensitive position (i.e., a positive gap) will generally enhance earnings in a rising interest rate environment and will negatively impact earnings in a falling interest rate environment, while a liability-sensitive position (i.e., a negative gap) will generally enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable. We have attempted to structure our asset and liability management strategies to mitigate the impact on net interest income of changes in market interest rates. However, there can be no assurance that we will be able to manage interest rate risk so as to avoid significant adverse effects on net interest income. At March 31, 2007, we had a one year cumulative positive gap of approximately \$229.593 million.

## Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

In addition to the use of interest rate sensitivity reports, we test our interest rate sensitivity through the deployment of a simulation analysis. Earnings simulation models are used to estimate what effect specific interest rate changes would have on our projected net interest income. Derivative financial instruments, such as interest rate caps, are included in the analysis. Changes in prepayments have been included where changes in behavior patterns are assumed to be significant to the simulation, particularly mortgage related assets. Call features on certain securities and borrowings are based on their call probability in view of the projected rate change. At March 31, 2007, the simulation model provided the following profile of our interest rate risk measured over a one-year time horizon, assuming a parallel shift in a yield curve based off the U.S. dollar forward swap curve adjusted for certain pricing assumptions:

	<b>Immediate Rate Change</b>	
	<b>+200BP</b>	<b>-200BP</b>
Net interest income	2%	-2%

Both of the above tools used to assess interest rate risk have strengths and weaknesses. Because the gap analysis reflects a static position at a single point in time, it is limited in quantifying the total impact of market rate changes which do not affect all earning assets and interest-bearing liabilities equally or simultaneously. In addition, gap reports depict the existing structure, excluding exposure arising from new business. While the simulation process is a powerful tool in analyzing interest rate sensitivity, many of the assumptions used in the process are highly qualitative and subjective and are subject to the risk that past historical activity may not generate accurate predictions of the future. The model also assumes parallel movements in interest rates, which means both short-term and long-term rates will change equally. Nonparallel changes in interest rates (short-term rates changing differently from long-term rates) could result in significant differences in projected income amounts when compared to parallel tests. Both measurement tools taken together, however, provide an effective evaluation of our exposure to changes in interest rates, enabling management to better control the volatility of earnings.

We are party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed (locked) by both us and the borrower for specified periods of time. When the borrower locks an interest rate, we effectively extend a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but we must honor the interest rate for the specified time period. We are exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. We utilize either a best efforts sell forward commitment or a mandatory sell forward commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Failure to effectively monitor, manage and hedge the interest rate risk associated with the mandatory commitments subjects us to potentially significant market risk.

Throughout the lock period the changes in the market value of interest rate lock commitments, mandatory sell forward commitments are recorded as unrealized gains and losses and are included in the statement of operations in mortgage-banking revenue. Management has made complex judgments in the recognition of gains and losses in connection with this activity. We utilize a third party and its proprietary simulation model to assist in identifying and managing the risk associated with this activity.

### Item 4 Controls and Procedures

(a) Evaluation of disclosure controls and procedures. The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls, as of the end of the period covered by this Quarterly Report on Form 10-Q, was carried out under the supervision and with the participation of the Company's management, including the CEO and CFO. Based on that evaluation, the Company's management, including the CEO and CFO, has concluded that the Company's disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

(b) Changes in Internal Control Over Financial Reporting. There were no significant changes in our internal control over financial reporting or in other factors during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1 Legal Proceedings**

We are party to legal actions that are routine and incidental to our business. In management's opinion, the outcome of these matters, individually or in the aggregate, will not have a material effect on our results of operations or financial position.

27

---

**Item 1a Risk Factors**

There have been no material changes from the Risk Factors previously disclosed in Item 1A of Part I of our Form 10-K for the year ended December 31, 2006.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Plan</b>	<b>Maximum Number of Shares Yet to Purchase Under Plan</b>
January 2007	7,500	\$ 18.63	170,825	129,175
February 2007			170,825	129,175
March 2007			170,825	129,175

(1) On July 18, 2006, the Company announced that its Board of Directors approved an extension to its share repurchase program, originally approved on July 20, 2004, of up to 300,000 shares (approximately 5%) of our outstanding common stock, which provides for open market or private purchases of stock over the next 24 months.

**Item 3 Defaults Upon Senior Securities**

None

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

At the Company's Annual Meeting of Stockholders held May 1, 2007, the following directors were elected to serve a three-year term expiring upon the date of the Company's 2010 Annual Meeting or until their respective successors are elected and qualified:

	<b>Votes For</b>	<b>Votes Against</b>
Edith B. Brown	5,278,295	691,832
George H. Mantakos	5,279,830	690,297
Michael R. Watson	5,266,846	703,281
Hector Torres	5,276,373	693,754

In addition to the election of four directors at the annual meeting, the terms of nine directors continued after the meeting. The continuing directors were: Edwin F. Hale Sr., Barry B. Bondroff, Patricia Schmoke, MD, John Brown III, Joseph A. Cicero, Howard Friedman, John J. Oliver, Jr., John McDaniel and Robert Caret.

Also, at the Company's Annual Meeting of Stockholders held May 1, 2007, a shareholder proposal regarding the separation of the positions of Chairman of the Board and Chief Executive Officer was voted upon and was defeated as follows:

<b>Votes For</b>	<b>Votes Against</b>	<b>Abstain</b>	<b>Broker Nonvotes</b>
1,725,343	2,838,958	22,722	1,383,104

**Item 5 Other Information**

None

**Item 6 Exhibits**

31.1 Certifications of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended, filed herewith

Edgar Filing: FIRST MARINER BANCORP - Form 10-Q

- 31.2 Certifications of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended, filed herewith
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith

28

---



SIGNATURES

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

FIRST MARINER BANCORP

Date: 5/10/07

By: /s/ Edwin F. Hale Sr.  
Edwin F. Hale Sr.  
Chairman and Chief Executive Officer

Date: 5/10/07

By: /s/ Mark A. Keidel  
Mark A. Keidel  
Chief Financial Officer

29

---

Exhibit Index

- 31.1 Certifications of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended, filed herewith
  - 31.2 Certifications of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended, filed herewith
  - 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith
  - 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith
-