

Howard Bancorp Inc  
Form 10-Q  
August 09, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended June 30, 2018

OR

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

Commission File Number: 001-35489

**HOWARD BANCORP, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of incorporation or organization)

**20-3735949**

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

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

**(410) 750-0020**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

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

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

The number of outstanding shares of common stock outstanding as of July 31, 2018.

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Common Stock, \$0.01 par value – 19,024,640 shares

HOWARD BANCORP, INC.

TABLE OF CONTENTS

	<b>Page</b>
<b><u>PART I</u></b> <b><u>Financial Information</u></b>	<b><u>4</u></b>
<u>Item 1.</u> <u>Financial Statements</u>	<u>4</u>
<u>Consolidated Balance Sheets (Unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Operations (Unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Comprehensive (Loss) Income (Unaudited)</u>	<u>6</u>
<u>Consolidated Statements of Changes in Stockholders' Equity (Unaudited)</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows (Unaudited)</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>8</u>
 <u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	 <u>34</u>
 <u>Item 3.</u> <u>Quantitative and Qualitative Disclosure about Market Risk</u>	 <u>51</u>
 <u>Item 4.</u> <u>Controls and Procedures</u>	 <u>51</u>
 <b><u>PART II</u></b> <b><u>Other Information</u></b>	 <b><u>52</u></b>
<u>Item 1.</u> <u>Legal Proceedings</u>	<u>52</u>
 <u>Item 1A.</u> <u>Risk Factors</u>	 <u>52</u>
 <u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	 <u>52</u>
 <u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	 <u>52</u>
 <u>Item 4.</u> <u>Mine Safety Disclosures</u>	 <u>52</u>
 <u>Item 5.</u> <u>Other Information</u>	 <u>52</u>
 <u>Item 6.</u> <u>Exhibits</u>	 <u>52</u>
 <b><u>Signatures</u></b>	 <b><u>53</u></b>

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

This report contains forward-looking statements, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect,” “will,” “may,” “should” and words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations, particularly with respect to our business plan and strategies, including our planned new branch in Columbia, Maryland, opening of additional branches, expansion into new markets, potential acquisitions, increasing capital, market share, loan, investments and asset growth, revenue and profit growth and expanding client relationships;
- statements with respect to expected benefits and other impacts of our acquisition of First Mariner Bank, including expected increases in non-interest expenses resulting from the merger;
  - impact of recent branch closures and the opening of our anticipated new branch on expenses;
- statements regarding the asset quality of our investment portfolios and anticipated recovery and collection of unrealized losses on securities available for sale;
- expected continued focus on commercial customers as well as continuing to originate residential real estate loans and both maintaining our residential mortgage loan portfolio and continuing to sell loans into the secondary market;
  - the expected impact of the recently enacted Tax Cuts and Jobs Act;
  - expected increases in occupancy and equipment expenses;
- statements with respect to our allowance for credit losses, and the adequacy thereof;
- our expectations regarding the pending sale of OREO properties, including the timing and impact thereof;
  - statement with respect to having adequate liquidity levels and future sources of liquidity;
  - our belief that we will retain a large portion of maturing certificates of deposit;
  - the impact on us of recent changes to accounting standards;
  - future cash requirements relating to commitments to extend credit; and
  - the impact of interest rate changes on our net interest income.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not undertake any obligation to update any forward-looking statements after the date of this report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

Edgar Filing: Howard Bancorp Inc - Form 10-Q

potential problems in connection with the recent acquisition of First Mariner Bank, as further discussed in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on March 15, 2018;

deterioration in general economic conditions, either nationally or in our market area, or a return to recessionary conditions;

competition among depository and other financial institutions;

inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;

adverse changes in the securities markets;

changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;

our ability to enter new markets successfully and capitalize on growth opportunities, and to otherwise implement our growth strategy;

our ability to successfully integrate acquired entities, if any;

changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;

changes in our organization, compensation and benefit plans;

loss of key personnel; and

other risk discussed in this report.

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. You should not put undue reliance on any forward-looking statements.

**PART I****Item 1.****Financial Statements****Howard Bancorp, Inc. and Subsidiary****Consolidated Balance Sheets**

(in thousands, except share data)	Unaudited June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Cash and due from banks	\$ 107,598	\$ 28,856
Federal funds sold	363	116
Total cash and cash equivalents	107,961	28,972
Securities available for sale, at fair value	127,530	74,256
Securities held to maturity, at amortized cost	9,250	9,250
Nonmarketable equity securities	14,485	6,492
Loans held for sale, at fair value	55,956	42,153
Loans and leases, net of unearned income	1,609,978	936,608
Allowance for credit losses	(6,619 )	(6,159 )
Net loans and leases	1,603,359	930,449
Bank premises and equipment, net	51,668	19,189
Goodwill	71,278	603
Core deposit intangible	13,116	1,743
Bank owned life insurance	73,245	28,631
Other real estate owned	4,115	1,549
Deferred tax assets, net	31,023	813
Interest receivable and other assets	19,263	5,850
Total assets	\$2,182,249	\$ 1,149,950
<b>LIABILITIES</b>		
Noninterest-bearing deposits	\$469,832	\$ 218,139
Interest-bearing deposits	1,095,812	645,769
Total deposits	1,565,644	863,908
Short-term borrowings	189,112	130,385
Long-term borrowings	127,575	18,535
Accrued expenses and other liabilities	10,448	4,869
Total liabilities	1,892,779	1,017,697
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock - par value of \$0.01 authorized 20,000,000 shares; issued and outstanding 19,008,960 shares at June 30, 2018 and 9,820,592 at December 31, 2017	190	98
Capital surplus	275,581	110,387

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Retained earnings	14,152	22,105
Accumulated other comprehensive loss	(453 )	(337 )
Total stockholders' equity	289,470	132,253
Total liabilities and stockholders' equity	\$2,182,249	\$ 1,149,950

The accompanying notes are an integral part of these consolidated financial statements.



**Consolidated Statements of Operations**

(in thousands, except share data)	Unaudited		For the three months ended	
	For the six months ended June 30, 2018	For the six months ended June 30, 2017	For the three months ended June 30, 2018	For the three months ended June 30, 2017
<b>INTEREST INCOME</b>				
Interest and fees on loans and leases	\$33,366	\$19,742	\$ 19,788	\$ 10,281
Interest and dividends on securities	1,684	626	1,116	340
Other interest income	475	208	261	87
Total interest income	35,525	20,576	21,165	10,708
<b>INTEREST EXPENSE</b>				
Deposits	3,079	1,825	1,729	941
Short-term borrowings	1,407	336	717	195
Long-term borrowings	1,011	167	839	75
Total interest expense	5,497	2,328	3,285	1,211
<b>NET INTEREST INCOME</b>	30,028	18,248	17,880	9,497
Provision for credit losses	2,545	540	1,425	340
Net interest income after provision for credit losses	27,483	17,708	16,455	9,157
<b>NONINTEREST INCOME</b>				
Service charges on deposit accounts	916	454	590	246
Realized and unrealized gains on mortgage banking activity	3,439	5,968	1,623	3,167
Loss on the sale of securities	(139 )	-	-	-
Gain (loss) on the sale of portfolio loans	-	(179 )	-	5
Income from bank owned life insurance	705	345	420	200
Loan fee income	3,925	2,673	2,059	1,412
Other operating income	1,475	490	925	262
Total noninterest income	10,321	9,751	5,617	5,292
<b>NONINTEREST EXPENSE</b>				
Compensation and benefits	17,480	11,620	9,911	6,063
Occupancy and equipment	4,167	2,096	2,617	1,034
Amortization of core deposit intangible	1,222	271	863	136
Marketing and business development	2,109	2,126	1,104	1,185
Professional fees	1,023	840	717	417
Data processing fees	1,648	956	1,047	480
Merger and restructuring expense	15,673	-	5,698	-
FDIC assessment	414	293	261	76
Other real estate owned	19	117	(3 )	93
Loan production expense	2,252	1,880	1,309	950
Other operating expense	2,285	1,516	1,616	781
Total noninterest expense	48,292	21,715	25,140	11,215
<b>(LOSS) INCOME BEFORE INCOME TAXES</b>	(10,488)	5,744	(3,068 )	3,234
Income tax (benefit) expense	(2,535 )	2,140	(791 )	1,196
<b>NET (LOSS) INCOME</b>	<b>\$(7,953 )</b>	<b>\$3,604</b>	<b>\$ (2,277 )</b>	<b>\$ 2,038</b>
<b>NET (LOSS) INCOME PER COMMON SHARE</b>				

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Basic	\$ (0.50	) \$ 0.39	\$ (0.12	) \$ 0.21
Diluted	\$ (0.50	) \$ 0.39	\$ (0.12	) \$ 0.21

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Comprehensive (Loss) Income**

(in thousands)	Unaudited Six months ended		Three months ended	
	June 30, 2018	2017	June 30, 2018	2017
Net (Loss) Income	\$(7,953)	\$3,604	\$(2,277 )	\$2,038
Other comprehensive (loss) income				
Investments available-for-sale:				
Reclassification adjustment for loss	139	-	-	-
Related income tax benefit	(38 )	-	-	-
Unrealized holding (losses) gains	(288 )	48	18	48
Related income tax benefit (expense)	71	(17 )	(69 )	(17 )
Comprehensive (loss) income	\$(8,069)	\$3,635	\$(2,328 )	\$2,069

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Changes in Stockholders' Equity Unaudited**

(dollars in thousands, except share data)	Number of shares	Common stock	Capital surplus	Retained earnings	Accumulated other comprehensive loss	Total
Balances at January 1, 2017	6,991,072	\$ 70	\$71,021	\$ 14,849	\$ (150 )	\$85,790
Net income	-	-	-	3,604	-	3,604
Net unrealized gain on securities	-	-	-	-	31	31
Common stock offering	2,760,000	28	38,355	-	-	38,383
Director stock awards	6,604	-	110	-	-	110
Exercise of options	19,759	-	234	-	-	234
Stock-based compensation	18,668	-	236	-	-	236
Balances at June 30, 2017	9,796,103	\$ 98	\$109,956	\$ 18,453	\$ (119 )	\$128,388
Balances at January 1, 2018	9,820,592	\$ 98	\$110,387	\$ 22,105	\$ (337 )	\$132,253
Net loss	-	-	-	(7,953 )	-	(7,953 )
Net unrealized loss on securities	-	-	-	-	(116 )	(116 )
Acquisition of First Mariner Bank	9,143,222	92	164,486	-	-	164,578
Director stock awards	4,800	-	101	-	-	101
Exercise of options	3,284	-	35	-	-	35
Stock-based compensation	37,062	-	572	-	-	572
Balances at June 30, 2018	19,008,960	\$ 190	\$275,581	\$ 14,152	\$ (453 )	\$289,470

The accompanying notes are an integral part of these consolidated financial statements.

6

**Consolidated Statements of Cash Flows**

(in thousands)	Unaudited Six months ended June 30	
	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$(7,953 )	\$3,604
Adjustments to reconcile net (loss) income to net cash from operating activities:		
Provision for credit losses	2,545	540
Deferred income tax	1,852	142
Provision for other real estate owned	-	96
Depreciation	1,200	665
Stock-based compensation	572	346
Net amortization of investment securities	25	30
Net accretion of discount on purchased loans	(628 )	(354 )
Loss on sales of securities	139	-
Net amortization of intangible asset	1,222	271
Loans originated for sale	(337,290)	(326,920)
Proceeds from sale of loans originated for sale	355,115	330,070
Realized and unrealized gains on mortgage banking activity	(3,439 )	(5,968 )
Gain on sales of other real estate owned, net	(45 )	(19 )
Loss on sale of portfolio loans, net	-	179
Cash surrender value of BOLI	(705 )	(345 )
Decrease (increase) in interest receivable	431	(67 )
Increase in interest payable	340	51
Decrease in other assets	2,470	62
Decrease in other liabilities	(355 )	(155 )
Net cash provided by operating activities	15,496	2,228
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities of interest bearing deposits with banks	-	9,880
Purchases of investment securities available-for-sale	(44,535 )	(27,925 )
Purchases of investment securities held-to-maturity	-	(3,000 )
Proceeds from sale/maturities of investment securities available-for-sale	112,039	14,520
Net increase in loans and leases outstanding	(10,662 )	(63,780 )
Purchase of bank owned life insurance	-	(6,500 )
Proceeds from the sale of other real estate owned	954	138
Proceeds from the sale of portfolio loans	-	3,759
Purchase of premises and equipment	(1,773 )	(184 )
Cash acquired in acquisition	29,285	-
Net cash provided by (used in) investing activities	85,308	(73,092 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net (decrease) increase in deposits	(4,699 )	45,975
Net (decrease) increase in short-term borrowings	(126,293)	2,713
Proceeds from issuance of long-term debt	109,041	-
Repayment of long-term debt	-	(13,977 )

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Net proceeds from issuance of common stock, net of cost	136	38,617
Net cash (used in) provided by financing activities	(21,815 )	73,328
Net increase in cash and cash equivalents	78,989	2,464
Cash and cash equivalents at beginning of period	28,972	39,366
Cash and cash equivalents at end of period	\$107,961	\$41,830
SUPPLEMENTAL INFORMATION		
Cash payments for interest	\$4,881	\$2,277
Cash payments for income taxes	-	1,930
Transferred from loans to other real estate owned	174	-
Assets acquired in business combination (net of cash received)	970,709	-
Liabilities assumed in business combination	897,569	-

The accompanying notes are an integral part of these consolidated financial statements.

**Notes to Consolidated Financial Statements** (unaudited)

**Note 1: Summary of Significant Accounting Policies**

**Nature of Operations**

On December 15, 2005, Howard Bancorp, Inc. (“Bancorp”) acquired all of the stock and became the holding company of Howard Bank (the “Bank”) pursuant to the Plan of Reorganization approved by the shareholders of the Bank and by federal and state regulatory agencies. Each share of the Bank’s common stock was converted into two shares of Bancorp common stock effected by the filing of Articles of Exchange on that date, and the shareholders of the Bank became the shareholders of Bancorp. The Bank has seven subsidiaries, six of which are intended to hold foreclosed real estate (three of which are inactive) and the other owns and manages real estate that is used as a branch location and has office and retail space. The accompanying consolidated financial statements of Bancorp and its wholly-owned subsidiary Howard Bank (collectively the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Bancorp was incorporated in April of 2005 under the laws of the State of Maryland and is a bank holding company registered under the Bank Holding Company Act of 1956. Bancorp is a single bank holding company with one subsidiary, Howard Bank, which operates as a state trust company with commercial banking powers regulated by the Maryland Office of the Commissioner of Financial Regulation (the “Commissioner”). The Company is a diversified financial services company providing commercial banking, mortgage banking and consumer finance through banking branches, the internet and other distribution channels to businesses, business owners, professionals and other consumers located primarily in the Greater Baltimore metropolitan area.

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

At the effective time of the Merger, pursuant to the terms of the Agreement, each outstanding share of First Mariner common stock and First Mariner Series A Non-Voting Non-Cumulative Perpetual Preferred Stock issued and

outstanding was cancelled and converted into the right to receive 1.6624 shares of Bancorp common stock. To effect the Merger, Bancorp issued 9,143,222 shares of Bancorp common stock to First Mariner shareholders.

On February 1, 2017, Bancorp closed an underwritten public offering, including the exercise in full by the underwriters of their option to purchase an additional 360,000 shares, at the public offering price of \$15.00 per share. The exercise of the option to purchase additional shares brought the total number of shares of common stock sold by Bancorp to 2,760,000 shares and increased the amount of gross proceeds raised in the offering to approximately \$41.4 million, after underwriting discounts and estimated expenses, net proceeds raised in the offering were \$38.4 million.

The following is a description of the Company's significant accounting policies.

### **Principles of Consolidation**

The consolidated financial statements include the accounts of Bancorp, its subsidiary bank and the Bank's subsidiaries. All significant intercompany accounts and transactions have been eliminated.

### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at 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 changes in the near-term relate to the determination of the allowance for credit losses, other-than-temporary impairment of investment securities, the fair value of loans held for sale, and fair value estimates related to acquisition accounting.



### **Loans Held-For-Sale**

The Company engages in sales of residential mortgage loans originated by the Bank. The Company has elected to measure loans held for sale at fair value. Fair value is based on outstanding investor commitments or, in the absence of such commitments, on current investor yield requirements based on third party models. Gains and losses on sales of these loans are recorded as a component of noninterest income in the Consolidated Statements of Operations. The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no intangible asset recorded for the value of such servicing. Interest on loans held for sale is credited to income based on the principal amounts outstanding.

Upon sale and delivery, loans are legally isolated from the Company and the Company has no ability to restrict or constrain the ability of third party investors to pledge or exchange the mortgage loans. The Company does not have the entitlement or ability to repurchase the mortgage loans or unilaterally cause third party investors to put the mortgage loans back to the Company. Unrealized and realized gains on loan sales are determined using the specific identification method and are recognized through mortgage banking activity in the Consolidated Statements of Operations.

The Company enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e. rate lock commitment). Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 60 days. The Company protects itself from changes in interest rates through the use of best efforts forward delivery commitments, whereby the Company commits to sell a loan at a premium at the time the borrower commits to an interest rate with the intent that the buyer has assumed interest rate risk on the loan.

For purposes of calculating fair value of rate lock commitments, the Bank estimates loan closing and investor delivery rate based on historical experience. The measurement of the estimated fair value of the rate lock commitments is presented as realized and unrealized gains from mortgage banking activities with the corresponding balance sheet amount presented as part of other assets.

The Company elected to measure loans held for sale at fair value to better align reported results with the underlying economic changes in value of the loans on the Company's balance sheet. Loans held for sale that were not ultimately sold, but instead were placed into the Bank's portfolio, are reclassified to loans held for investment and continue to be recorded at fair value.

## **Reclassifications**

Certain items in prior financial statements have been reclassified to conform to the current presentation.

## **Accounting Pronouncements**

The FASB has issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. This ASU's objectives are to 1) improve the transparency and understanding of information conveyed to financial statements users about an entity's risk management activities by better aligning the entity's financial reporting for hedging relationships with those risk management activities; and 2) reduce the complexity of and simplify the application of hedge accounting by preparers. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018; early adoption is permitted. The Company currently does not designate any derivative financial instruments as formal hedging relationships and therefore, does not utilize hedge accounting. However, the Company is currently evaluating this ASU to determine whether its provision will enhance the Company's ability to employ risk management strategies, while improving the transparency and understanding of those strategies for financial statement users.

The FASB has issued ASU 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. This ASU clarifies when changes to the term or conditions of a share-based payment award must be accounted for as a modification. Under this ASU, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: 1) The fair value; 2) the award's vesting conditions; and 3) the award's classification as an equity or liability instrument. Adoption of ASU No. 2017-09 did not have an impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company will evaluate the guidance in this update but does not expect it to have a significant impact on the Company's financial position or result of operations.

The FASB has issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. The amendments in this Update simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. The Company should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. Impairment changes should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value, however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The impairment charge is limited to the amount of goodwill allocated to that reporting unit. The amendments in this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The Company will evaluate the guidance in this update but does not expect it to have a significant impact on the Company's financial position or result of operations.

The FASB has issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendments in this Update provide clarification on the definition of a business and provides criteria to aid in the assessment of whether a transaction should be accounted for as an acquisition or a disposal of assets or business. The amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Adoption of ASU 2017-01 did not have a material impact on the Company's financial position or result of operations.

The FASB has issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*. The main objective of this update is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the guidance in this update replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. The guidance in this update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU 2016-02, *Leases (Topic 842)*. The new guidance requires lessees to recognize lease assets and lease liabilities related to certain operating leases on their balance sheet and disclose key information about leasing arrangements. This guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements. The Company leases certain properties under operating leases that will result in recognition on the Company's consolidated balance sheet.

The FASB has issued ASU No. 2016-01, *Financial Instruments – Recognition and Measurement of Financial Assets and Liabilities*. ASU No. 2016-01 requires equity investments to be measured at fair value with changes in fair value

recognized in net income, excluding equity investments that are consolidated or accounted for under the equity method of accounting. The guidance allows equity investments without readily determinable fair values to be measured at cost minus impairment, with a qualitative assessment required to identify impairment. The guidance also: requires public companies to use exit prices to measure the fair value of financial instruments for disclosure purposes; requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; and eliminates the disclosure requirements related to measurement assumptions for the fair value of instruments measured at amortized cost. In addition, the guidance requires that for liabilities measured at fair value under the fair value option, changes in fair value due to changes in instrument-specific credit risk be presented in other comprehensive income. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. Adoption of ASU 2016-01 did not have a material impact on the Company's Consolidated Financial Statements.

The FASB has issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance in this update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. As allowed by this ASU the Company is permitted to adopt using the full retrospective transition method for all periods presented, or modified retrospective method where the guidance would only be applied to existing contracts in effect at the adoption date and new contracts going forward. The Company's revenue stream within the scope of ASU No. 2014-09 is primarily from service charges on deposit accounts. The Company used a modified retrospective approach to uncompleted contracts at the date of adoption. Periods prior to the date of adoption are not retrospectively revised, but a cumulative effect of adoption is recognized for the impact of the ASU on uncompleted contracts at the date of adoption. The impact of guidance in this update, including method of implementation, did not have a material impact on the Company's Consolidated Financial Statements. See Note 13 for additional information.

**Note 2: Business Combinations**

***First Mariner Acquisition***

On March 1, 2018, Howard Bancorp completed its merger with First Mariner Bank into Howard Bank, a wholly owned subsidiary of Howard Bancorp, pursuant to the Agreement and Plan of Reorganization. At the effective time of the Merger, First Mariner merged with and into Howard Bank, with Howard Bank continuing as the surviving bank of the Merger. At the effective time of the Merger, pursuant to the terms of the Agreement, each outstanding share of First Mariner common stock and First Mariner Series A Non-Voting Non-Cumulative Perpetual Preferred Stock issued and outstanding was cancelled and converted into the right to receive 1.6624 shares of Bancorp common stock. The aggregate merger consideration of \$173.8 million included \$9.2 million of cash and 9,143,222 shares of Howard Bancorp common stock, which was valued at approximately \$164.6 million based on the closing price of Howard Bancorp common stock of \$18.00 on February 28, 2018.

The Company has accounted for the Merger under the acquisition method of accounting in accordance with FASB ASC Topic 805, “*Business Combinations*,” whereby the acquired assets and assumed liabilities were recorded by Bancorp at their estimated fair values as of their acquisition date.

Management made significant estimates and exercised significant judgment in accounting for the acquisition of First Mariner. Management judgmentally assigned risk ratings to loans based on appraisals and estimated collateral values, expected cash flows, prepayment speeds and estimated loss factors to measure fair values for loans. Deposits and borrowings were valued based upon interest rates, original and remaining terms and maturities, as well as current rates for similar funds in the same markets. Premises and equipment was valued based on recent appraised values. Management used quoted or current market prices to determine the fair value of investment securities.

The following table provides the purchase price as of the acquisition date, the current identifiable assets acquired and liabilities assumed at their estimated fair values, and the resulting goodwill of \$70.7 million recorded from the acquisition:

(in thousands)

Purchase Price Consideration

Cash consideration	\$9,245
Purchase price assigned to shares exchanged for stock	164,578
Total purchase price for First Mariner acquisition	\$ 173,823

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Assets acquired at fair value:		
Cash and cash equivalents	\$38,530	
Interest bearing deposits with banks	3,920	
Investment securities available for sale	130,302	
Loans held for sale	28,189	
Loans	664,338	
Accrued interest receivable	3,023	
Other assets	119,826	
Core deposit intangible	12,588	
Total fair value of assets acquired	\$1,000,717	
Liabilities assumed at fair value:		
Deposits	706,435	
Borrowings	185,020	
Accrued expenses and other liabilities	6,114	
Total fair value of liabilities assumed	\$897,569	
Net assets acquired at fair value:		\$103,148
Transaction consideration paid to First Mariner		173,823
Amount of goodwill recorded from First Mariner Acquisition		\$70,675

*Acquired loans*

The following table outlines the contractually required payments receivable, cash flows we expect to receive, non-accretable credit adjustments and the accretable yield for all First Mariner loans as of the acquisition date.

	Contractually Required Payments Receivable	Non-Accretable Credit Adjustment	Cash Flows Expected to be Collected	Accretable FMV Adjustment	Carring Value of Loans Receivable
Performing loans acquired	\$ 654,621	\$ -	\$ 654,621	\$ 9,054	\$ 645,567
Impaired loans acquired	29,470	9,644	19,826	1,055	18,771
Total loans acquired	\$ 684,091	\$ 9,644	\$ 674,447	\$ 10,109	\$ 664,338

At the merger of First Mariner, all loans acquired were recorded at the estimated fair value on the purchase date with no carryover of the related allowance for loan losses. On the merger date, the loan portfolio was segregated into two loan pools, performing and non-performing loans to be retained in our portfolio.

The Company determined the net discounted value of cash flows on approximately 2,700 performing loans totaling \$654.6 million. The valuation took into consideration the loans' underlying characteristics, including account types, remaining terms, annual interest rates, interest types such as fixed or variable rate, past delinquencies, timing of principal and interest payments, current market rates, loan-to-value ratios, loss exposures, and remaining balances. These performing loans were segregated into pools based on loan and payment type and in some cases, risk grade. The effect of this valuation process was a net accretable discount adjustment of \$9.1 million at merger.

The Company also individually evaluated 57 impaired loans totaling \$29.5 million of contractually required payments, to determine the fair value as of the March 1, 2018 measurement date. In determining the fair value for each individually evaluated impaired loan, the Company considered a number of factors including the remaining life of the acquired loan, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral and net present value of cash flows the Company expect to receive, among others.

The Company established a credit risk related non-accretable difference of \$9.6 million relating to these acquired, credit impaired loans, reflected in the recorded net fair value. The Company further estimated the timing and amount of expected cash flows in excess of the estimated fair value and established an accretable discount adjustment of \$1.1 million at acquisition relating to these impaired loans.

## Edgar Filing: Howard Bancorp Inc - Form 10-Q

In connection with the acquisition, the Company incurred merger-related expenses relating to personnel, professional fees, occupancy and equipment and other costs of integrating and conforming acquired operations. Those expenses consisted largely of costs related to professional and consulting services, employment severance and early retirement charges, termination of contractual agreements and conversion of systems and/or integration of operations, initial communication expenses, printing and filing costs of completing the transaction and investment banking charges.

A summary of merger related costs included in the Consolidated Statements of Operations for the six month period ended June 30, 2018 is summarized as follows:

Compensation related	\$9,860
Equipment disposition	1,918
Legal and consulting	2,005
Contract Terminations	925
Accounting & other	965
Total	\$15,673

### **Pro Forma Condensed Combined Financial Information:**

The following table presents unaudited proforma information as if the merger between Howard Bancorp and First Mariner had been completed on January 1, 2018 and on January 1, 2017. The pro forma information does not necessarily reflect the results of operations that would have occurred had the Company merged with First Mariner at the beginning of 2018 or 2017. Supplemental proforma earnings were adjusted to exclude merger related costs. The expected future amortizations of the various fair value adjustments were included beginning in each year presented. Cost savings are not reflected in the unaudited pro forma amounts for the periods presented. The pro forma financial information does not include the impact of possible business model changes, nor does it consider any potential impacts of current market conditions on revenues, expense efficiencies, or other factors.



	Six months ended		Three months ended	
	June 30, 2018	2017	June 30, 2018	2017
Net interest income after provision	\$32,953	\$32,931	\$17,064	\$16,920
Noninterest income	12,351	16,624	5,617	8,277
Noninterest expense	41,304	45,595	20,190	22,974
Net income	2,899	1,918	1,805	1,082
Net income per share	\$0.15	\$0.13	\$0.10	\$0.07

### Note 3: Investment Securities

The Bank holds securities classified as available for sale and held to maturity.

Because of the composition and remaining duration of the securities portfolio acquired in the First Mariner merger, management deemed it prudent for interest rate risk management purposes to liquidate the majority of the acquired portfolio. Thus, in the first quarter of 2018, the Bank sold nearly \$69.37 million of First Mariner securities, with no gains or losses incurred upon the liquidation, as the sales were executed within days of the merger. In addition the Bank sold \$33.0 million of pre-acquisition investment securities, in the first quarter of 2018 and recorded a loss on the sale of \$139 thousand. Nearly \$51 million of the acquired securities that were retained in the securities portfolio were recorded at fair value and were all classified as available for sale.

The amortized cost and estimated fair values of investments are as follows:

(in thousands)	June 30, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale								
U.S. Government								
Agencies	\$75,007	\$ 9	\$ 432	\$74,584	\$68,082	\$ -	\$ 342	\$ 67,740
Treasuries	1,502	-	6	1,496	1,505	-	11	1,494
Mortgage-backed	48,445	12	132	48,325	2,541	-	62	2,479
Other investments	3,077	49	-	3,126	2,579	-	36	2,543
	\$128,030	\$ 70	\$ 570	\$127,530	\$74,707	\$ -	\$ 451	\$ 74,256
Held to maturity								
Corporate debentures	\$9,250	\$ 180	\$ 13	\$9,417	\$9,250	\$ 188	\$ 17	\$9,421

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Gross unrealized losses and fair value by investment category and length of time the individual securities have been in a continuous unrealized loss position at June 30, 2018 and December 31, 2017 are presented below:

Edgar Filing: Howard Bancorp Inc - Form 10-Q

June 30, 2018

(in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
U.S. Government Agencies	\$ 47,237	\$ 236	\$ 15,364	\$ 196	\$ 62,601	\$ 432
Treasuries	-	-	1,496	6	1,496	6
Mortgage-backed	30,528	61	1,092	71	31,620	132
Other investments	3,230	99	-	-	3,230	99
	\$ 80,995	\$ 396	\$ 17,952	\$ 273	\$ 98,947	\$ 669
Held to maturity						
Corporate debentures	\$ 2,750	\$ 13	\$ -	\$ -	\$ 2,750	\$ 13

December 31, 2017

(in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
U.S. Government Agencies	\$ 54,303	\$ 216	\$ 13,437	\$ 126	\$ 67,740	\$ 342
Treasuries	-	-	1,494	11	1,494	11
Mortgage-backed	1,202	12	1,262	50	2,464	62
Other investments	2,500	36	-	-	2,500	36
	\$ 58,005	\$ 264	\$ 16,193	\$ 187	\$ 74,198	\$ 451
Held to maturity						
Corporate debentures	\$ 500	\$ 17	\$ -	\$ -	\$ 500	\$ 17

The unrealized losses that existed were a result of market changes in interest rates since the original purchase. Management systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include the (1) duration and magnitude of the decline in value, (2) financial condition of the issuer or issuers and (3) structure of the security. The portfolio contained 46 securities with unrealized losses and 38 securities with unrealized losses at June 30, 2018 and December 31, 2017, respectively.

An impairment loss is recognized in earnings if any of the following are true: (1) the Company intends to sell the debt security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. In situations where the Company intends to sell or when it is more likely than not that the Company will be required to sell the security, the entire impairment loss must be recognized in earnings. In all other situations, only the portion of the impairment loss representing the credit loss must be recognized in earnings, with the remaining portion being

recognized in shareholders' equity as a component of other comprehensive income, net of deferred tax.

The amortized cost and estimated fair values of investments securities by contractual maturity are shown below:

(in thousands)	June 30, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Amounts maturing:				
One year or less	\$12,520	\$ 12,410	\$35,105	\$ 34,995
After one through five years	64,000	63,681	34,489	34,248
After five through ten years	16,927	17,133	9,257	9,428
After ten years	43,833	43,723	2,526	2,464
	\$137,280	\$ 136,947	\$81,377	\$ 81,135

At June 30, 2018 and December 31, 2017, \$34.8 million and \$28.8 million in fair value of securities were pledged as collateral for repurchase agreements and collateralized deposits, respectively.

#### Note 4: Loans and Leases

The Company makes loans and leases to customers primarily in the Greater Baltimore metropolitan area and surrounding communities. A substantial portion of the Company's loan portfolio consists of loans to businesses secured by real estate and/or other business assets.

The loan portfolio segment balances at June 30, 2018 and December 31, 2017 are presented in the following table:

(in thousands)	June 30, 2018			% of Total	December 31, 2017	
	Legacy	Acquired	Total		Total	% of Total
Real estate						
Construction and land	\$74,136	\$40,767	\$114,903	7.1	% \$74,398	7.9 %
Residential - first lien	190,465	182,214	372,679	23.1	194,896	20.8
Residential - junior lien	45,429	50,439	95,868	6.0	43,047	4.6
Total residential real estate	235,894	232,653	468,547	29.1	237,943	25.4
Commercial - owner occupied	180,482	35,325	215,807	13.4	170,408	18.2
Commercial - non-owner occupied	266,011	162,541	428,552	26.6	260,802	27.8
Total commercial real estate	446,493	197,866	644,359	40.0	431,210	46.0
Total real estate loans	756,523	471,286	1,227,809	76.2	743,551	79.3
Commercial loans and leases	217,649	122,447	340,096	21.2	188,729	20.2
Consumer	3,738	38,335	42,073	2.6	4,328	0.5
Total loans	\$977,910	\$632,068	\$1,609,978	100.0%	\$936,608	100.0 %

Net loan origination fees, which are included in the amounts above, totaled \$106 thousand and \$54 thousand at June 30, 2018 and December 31, 2017, respectively.

#### Acquired Impaired Loans

The following table documents changes in the accretible discount on acquired impaired loans at June 30, 2018 and 2017:

(in thousands)	June 30,	
	2018	2017
Balance at beginning of period	\$-	\$60
Impaired loans acquired	1,055	-
Accretion of fair value discounts	(34 )	(53 )
Balance at end of period	\$1,021	\$7

The table below presents the outstanding balances and related carrying amounts for all acquired impaired loans at the end of the respective periods.

(in thousands)	Contractually Required	
	Payments Receivable	Carrying Amount
At June 30, 2018	\$ 17,166	\$12,611
At December 31, 2017	1,292	851

**Note 5: Credit Quality Assessment****Allowance for Credit Losses**

The following table provides information on the activity in the allowance for credit losses by the respective loan portfolio segment for the periods ended June 30, 2018 and June 30, 2017:

(in thousands)	June 30, 2018							
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Allowance for credit losses:								
Six months ended:								
Beginning balance	\$ 735	\$ 668	\$ 177	\$ 617	\$ 1,410	\$ 2,529	\$ 23	\$6,159
Charge-offs	(202)	(102)	(149)	(1)	(746)	(912)	(49)	(2,161)
Recoveries	-	1	-	-	2	68	5	76
Provision for credit losses	128	113	185	110	957	982	70	2,545
Ending balance	\$ 661	\$ 680	\$ 213	\$ 726	\$ 1,623	\$ 2,667	\$ 49	\$6,619
Three months ended:								
Beginning balance	\$ 563	\$ 736	\$ 186	\$ 698	\$ 1,470	\$ 2,472	\$ 23	\$6,148
Charge-offs	-	(3)	(60)	-	(212)	(644)	(45)	(964)
Recoveries	-	2	-	-	-	7	1	10
Provision for credit losses	98	(55)	87	28	365	832	70	1,425
Ending balance	\$ 661	\$ 680	\$ 213	\$ 726	\$ 1,623	\$ 2,667	\$ 49	\$6,619
	June 30, 2017							
(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Allowance for credit losses:								
Six months ended:								
Beginning balance	\$ 511	\$ 454	\$ 89	\$ 327	\$ 1,120	\$ 3,800	\$ 127	\$6,428
Charge-offs	-	(132)	(31)	-	-	(1,366)	(108)	(1,637)
Recoveries	-	-	1	-	3	28	22	54
Provision for credit losses	51	221	52	74	53	28	61	540

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Ending balance	\$562	\$ 543	\$ 111	\$ 401	\$ 1,176	\$ 2,490	\$ 102	\$5,385
Three months ended:								
Beginning balance	\$534	\$ 504	\$ 99	\$ 395	\$ 1,098	\$ 2,661	\$ 69	\$5,360
Charge-offs	-	(82 )	(8 )	-	-	(254 )	-	(344 )
Recoveries	-	-	1	-	2	16	10	29
Provision for credit losses	28	121	19	6	76	67	23	340
Ending balance	\$562	\$ 543	\$ 111	\$ 401	\$ 1,176	\$ 2,490	\$ 102	\$5,385



The following table provides additional information on the allowance for credit losses at June 30, 2018 and December 31, 2017:

(in thousands)	June 30, 2018							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	
Allowance allocated to:								
individually evaluated for impairment	\$-	\$-	\$-	\$-	\$-	\$25	\$-	\$25
collectively evaluated for impairment	\$661	\$680	\$213	\$726	\$1,623	\$2,642	\$49	\$6,594
Loans:								
Legacy Loans:								
Ending balance	\$74,136	\$190,465	\$45,429	\$180,482	\$266,011	\$217,649	\$3,738	\$977,910
individually evaluated for impairment	\$560	\$6,483	\$105	\$508	\$6,081	\$2,370	\$-	\$16,107
collectively evaluated for impairment	\$73,576	\$183,982	\$45,324	\$179,974	\$259,930	\$215,279	\$3,738	\$961,803
Acquired Loans:								
Ending balance	\$40,767	\$182,214	\$50,439	\$35,325	\$162,541	\$122,447	\$38,335	\$632,068
purchased credit impaired loans	\$849	\$9,582	\$779	\$1,249	\$-	\$13	\$151	\$12,623
collectively evaluated for impairment	\$39,918	\$172,632	\$49,660	\$34,076	\$162,541	\$122,434	\$38,184	\$619,445

Acquired loans were evaluated for impairment subsequent to the merger. No allowance was required on these loans due to the recently assigned credit marks on these loans.

(in thousands)	December 31, 2017							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	
Allowance allocated to:								
individually evaluated for impairment	\$202	\$-	\$29	\$-	\$11	\$668	\$-	\$910

Edgar Filing: Howard Bancorp Inc - Form 10-Q

collectively evaluated for impairment	\$533	\$668	\$148	\$617	\$1,399	\$1,861	\$23	\$5,249
Loans:								
Ending balance	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608
individually evaluated for impairment	\$761	\$2,009	\$396	\$508	\$5,867	\$3,724	\$-	\$13,265
collectively evaluated for impairment	\$73,637	\$192,887	\$42,651	\$169,900	\$254,935	\$185,005	\$4,328	\$923,343

When potential losses are identified, a specific provision and/or charge-off may be taken, based on the then current likelihood of repayment, that is at least in the amount of the collateral deficiency, and any potential collection costs, as determined by the independent third party appraisal.

All loans that are considered impaired are subject to the completion of an impairment analysis. This analysis highlights any potential collateral deficiencies. A specific amount of impairment is established based on the Bank's calculation of the probable loss inherent in the individual loan. The actual occurrence and severity of losses involving impaired credits can differ substantially from estimates.

Credit risk profile by portfolio segment based upon internally assigned risk assignments are presented below:

	June 30, 2018							
(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Credit quality indicators:								
Legacy Loans:								
Not classified	\$73,701	\$184,265	\$45,324	\$179,974	\$259,845	\$215,125	\$3,738	\$961,972
Special mention	-	-	-	-	-	-	-	-
Substandard	435	6,200	105	508	6,166	2,524	-	15,938
Doubtful	-	-	-	-	-	-	-	-
Total	\$74,136	\$190,465	\$45,429	\$180,482	\$266,011	\$217,649	\$3,738	\$977,910
Acquired Loans:								
Not classified	\$39,839	\$172,632	\$49,660	\$29,584	\$162,339	\$122,434	\$38,184	\$614,672
Special mention	79	-	-	3,935	-	-	-	4,014
Substandard	849	9,582	779	1,806	202	13	151	13,382
Doubtful	-	-	-	-	-	-	-	-
Total	\$40,767	\$182,214	\$50,439	\$35,325	\$162,541	\$122,447	\$38,335	\$632,068
	December 31, 2017							
(in thousands)	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Commercial Consumer loans	Total
Credit quality indicators:								
Not classified	\$73,761	\$193,174	\$42,651	\$169,900	\$253,255	\$184,858	\$4,328	\$921,927
Special mention	-	-	-	-	1,592	-	-	1,592
Substandard	637	1,103	5	508	3,725	801	-	6,779
Doubtful	-	619	391	-	2,230	3,070	-	6,310
Total	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608

**Special Mention** - A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

**Substandard** - Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful** - Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loans classified Special Mention, Substandard, Doubtful or Loss are reviewed at least quarterly to determine their appropriate classification. All commercial loan relationships are reviewed annually. Non-classified residential mortgage loans and consumer loans are not evaluated unless a specific event occurs to raise the awareness of possible credit deterioration.

Edgar Filing: Howard Bancorp Inc - Form 10-Q

An aged analysis of past due loans are as follows:

(in thousands)	June 30, 2018							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	
Analysis of past due loans:								
Legacy Loans:								
Accruing loans current	\$73,701	\$182,916	\$44,771	\$179,974	\$259,930	\$215,125	\$3,730	\$960,147
Accruing loans past due:								
30-59 days past due	-	-	140	-	-	404	3	547
60-89 days past due	-	1,195	413	-	-	-	5	1,613
Greater than 90 days past due	-	154	-	-	-	-	-	154
Total past due	-	1,349	553	-	-	404	8	2,314
Non-accrual loans	435	6,200	105	508	6,081	2,120	-	15,449
Total loans	\$74,136	\$190,465	\$45,429	\$180,482	\$266,011	\$217,649	\$3,738	\$977,910
Acquired Loans:								
Accruing loans current	\$39,918	\$169,818	\$48,254	\$34,076	\$162,541	\$122,434	\$37,915	\$614,956
Accruing loans past due:								
30-59 days past due	-	-	717	-	-	-	216	933
60-89 days past due	-	2,247	430	-	-	-	37	2,714
Greater than 90 days past due	-	567	259	-	-	-	16	842
Total past due	-	2,814	1,406	-	-	-	269	4,489
Non-accrual loans <sup>1</sup>	849	9,582	779	1,249	-	13	151	12,623
Total loans	\$40,767	\$182,214	\$50,439	\$35,325	\$162,541	\$122,447	\$38,335	\$632,068

(1) Included are purchased credit impaired loans where the Company amortizes the accretable discount into interest income, however these loans do not accrue interest based on the terms of the loan.

(in thousands)	December 31, 2017							Total
	Construction and land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	
Analysis of past due loans:								
Accruing loans current	\$73,386	\$185,135	\$42,491	\$169,596	\$251,608	\$185,239	\$4,328	\$911,783

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Accruing loans past due:								
30-59 days past due	279	6,381	110	173	-	52	-	6,995
60-89 days past due	96	1,330	-	-	364	-	-	1,790
Greater than 90 days past due	-	328	50	131	2,963	-	-	3,472
Total past due	375	8,039	160	304	3,327	52	-	12,257
Non-accrual loans	637	1,722	396	508	5,867	3,438	-	12,568
Total loans	\$74,398	\$194,896	\$43,047	\$170,408	\$260,802	\$188,729	\$4,328	\$936,608

Total loans either in non-accrual status or in excess of 90 days delinquent totaled \$29.1 million or 1.8% of total loans outstanding at June 30, 2018, which represents an increase from \$16.0 million or 1.7% at December 31, 2017.

Edgar Filing: Howard Bancorp Inc - Form 10-Q

The impaired loans at June 30, 2018 and December 31, 2017 are as follows:

(in thousands)	June 30, 2018							
	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total
Impaired loans:								
Legacy Loans:								
Recorded investment	\$560	\$ 6,483	\$ 105	\$ 508	\$ 6,081	\$ 2,370	\$ -	\$16,107
With an allowance recorded	-	-	-	-	-	514	-	514
With no related allowance recorded	560	6,483	105	508	6,081	1,856	-	15,593
Related allowance	-	-	-	-	-	25	-	25
Unpaid principal	762	6,610	105	508	6,837	3,660	-	18,482
Six months ended:								
Average balance of impaired loans	762	6,689	107	508	8,872	3,182	-	20,120
Interest income recognized	-	51	2	-	2	22	-	77
Three months ended:								
Average balance of impaired loans	762	6,694	106	508	6,878	4,759	-	19,707
Interest income recognized	-	32	1	-	1	11	-	45
Acquired Loans:								
Recorded investment <sup>1</sup>	\$849	\$ 9,582	\$ 779	\$ 1,249	\$ -	\$ 13	\$ 151	12,623
Unpaid principal	1,118	11,082	1,235	1,552	305	1,236	163	16,691
Six months ended:								
Average balance of impaired loans	1,118	12,806	1,235	1,552	305	1,236	166	18,418
Interest income recognized	-	217	21	-	-	-	2	240
Three months ended:								
Average balance of impaired loans	1,118	12,744	1,235	1,552	305	1,236	166	18,356
Interest income recognized	-	174	11	-	-	-	2	187

(1) Included are purchased credit impaired loans where the Company amortizes the accretable discount into interest income, however these loans do not accrue interest based on the terms of the loan.

(in thousands)	December 31, 2017							
	Construction & land	Residential first lien	Residential junior lien	Commercial owner occupied	Commercial non-owner occupied	Commercial loans and leases	Consumer loans	Total

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Impaired loans:								
Recorded investment	\$ 761	\$ 2,009	\$ 396	\$ 508	\$ 5,867	\$ 3,724	\$ -	\$ 13,265
With an allowance recorded	637	-	391	-	2,230	2,883	-	6,141
With no related allowance recorded	124	2,009	5	508	3,637	841	-	7,124
Related allowance	202	-	29	-	11	668	-	910
Unpaid principal	762	2,034	403	509	5,884	5,293	-	14,885
Average balance of impaired loans	756	2,100	403	519	5,956	5,988	-	15,722
Interest income recognized	19	60	12	-	132	150	-	373

Included in the total impaired loans above were non-accrual loans of \$28.1 million and \$12.6 million at June 30, 2018 and December 31, 2017, respectively. Interest income that would have been recorded if non-accrual loans had been current and in accordance with their original terms was \$1.0 million and \$258 thousand for the first six months of 2018 and 2017, respectively.

Loans may have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief to a borrower experiencing financial difficulty. Such restructured loans are considered trouble debt restructured loans (“TDRs”) that may either be impaired loans that may either be in accruing status or non-accruing status. Non-accruing TDRs may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from the restructured category in the year subsequent to the restructuring if: a) the restructuring agreement specifies an interest rate equal to or greater than the rate that the creditor was willing to accept at the time of restructuring for a new loan with comparable risk; and b) the loan is not impaired based on the terms specified by the restructuring agreement.



TDRs at June 30, 2018 and December 31, 2017 are as follows:

(dollars in thousands)	June 30, 2018				
	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDRs
Construction and land	-	\$ -	1	\$ 125	\$ 125
Residential real estate - first lien	3	971	1	283	1,254
Commercial - non-owner occupied	2	2,816	-	-	2,816
Commercial loans and leases	1	514	1	192	706
	6	\$ 4,301	3	\$ 600	\$ 4,901

(dollars in thousands)	December 31, 2017				
	Number of Loans	Non-Accrual Status	Number of Loans	Accrual Status	Total TDRs
Construction and land	-	\$ -	1	\$ 125	\$ 125
Residential real estate - first lien	2	886	1	287	1,173
Residential real estate - junior lien	1	398	-	-	398
Commercial - non-owner occupied	2	2,815	-	-	2,815
Commercial loans and leases	2	599	1	208	807
	7	\$ 4,698	3	\$ 620	\$ 5,318

A summary of TDR modifications outstanding and performing under modified terms are as follows:

(in thousands)	June 30, 2018			
	Related Allowances	Not Performing to Terms	Performing to Modified Terms	Total TDRs
Construction and land				
Extension or other modification	\$-	\$ -	\$ 125	\$ 125
Residential real estate - first lien				
Extension or other modification	-	971	283	1,254
Commercial RE - non-owner occupied				
Rate modification	-	2,816	-	2,816
Commercial loans				
Extension or other modification	-	-	192	192
Forbearance	24	514	-	514
Total troubled debt restructured loans	\$ 24	\$ 4,301	\$ 600	\$ 4,901



(in thousands)	December 31, 2017		Performing to Modified Terms	Total TDRs
	Related Allowances	Not Performing Modified Terms		
Construction and land				
Extension or other modification	\$-	\$ -	\$ 125	\$ 125
Residential real estate - first lien				
Extension or other modification	-	886	287	1,173
Residential real estate - junior lien				
Forbearance	30	398	-	398
Commercial RE - non-owner occupied				
Rate modification	-	2,815	-	2,815
Commercial loans				
Extension or other modification	-	85	208	293
Forbearance	32	514	-	514
Total troubled debt restructured loans	\$62	\$ 4,698	\$ 620	\$5,318

There was one new loan restructured during the six months ended June 30, 2018. In the second quarter of 2018 the Bank extended the terms of a residential real estate loan that is currently non-performing.

As a part of the modification of the land development loan restructured during 2017, the Bank agreed to forgive \$215 thousand in debt, and recorded this amount as a loss. The pre-modification principal amount on this loan was \$340 thousand, while the post-modification principal amount was reduced to \$125 thousand. The other modifications have been only interest rate concessions and payment term extensions, not principal reductions that resulted in the recordation of a loss. Thus, the pre-modification and post-modification recorded investment amounts are the same for these TDRs.

Performing TDRs were in compliance with their modified terms and there are no further commitments associated with these loans. During the six months ended June 30, 2018 there were no TDRs that subsequently defaulted within twelve months of their modification dates.

Management routinely evaluates other real estate owned (“OREO”) based upon periodic appraisals. For the three months ended June 30, 2018 and 2017 there were no additional valuation allowances recorded as the current appraised value, less estimated cost to sell, was sufficient to cover the recorded OREO amount. For the six months ended June 30, 2018 there was one loan for \$174 thousand transferred from loans to OREO, while for the same period in 2017 there were no loans transferred to OREO. The Company sold one commercial property in Sussex County Delaware during the second quarter of 2018 with a carrying value was \$593 thousand. The Company recorded a \$45 thousand gain from the sale of this property. In conjunction with the First Mariner acquisition the Bank’s OREO balances increased \$3.0 million representing 11 properties. At June 30, 2018 there were six residential first lien loans totaling \$1.4 million in the process of foreclosure.

**Note 6: Goodwill and Other Intangible Assets**

Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset would more-likely-than-not reduce the fair value below the carrying amount.

On March 1, 2018 the Company initially recorded \$71.4 million in goodwill relating to the First Mariner merger. Based upon updated information the goodwill was adjusted downward by \$723 thousand in the second quarter 2018 to reflect revised valuations as detailed in Note 2.

The Bank has one unit, which is the core banking operation. The table below shows goodwill balances at June 30, 2018 and December 31, 2017.

	June 30,	December 31,
(in thousands)	2018	2017
Goodwill		
Banking	\$71,278	\$ 603

Core deposit intangible consists of premiums paid for the acquisition of core deposits and are amortized based upon the estimated economic benefits received. The gross carrying amount and accumulated amortization of other intangible assets are as follows:

(in thousands)	June 30, 2018		Net Carrying Amount	Weighted Average Remaining Life (Years)
	Gross Carrying Amount	Accumulated Amortization		
Amortizing intangible assets:				
Core deposit intangible	\$16,135	\$ 3,019	\$13,116	5.3

(in thousands)	December 31, 2017		Net Carrying Amount	Weighted Average Remaining Life (Years)
	Gross Carrying Amount	Accumulated Amortization		
Amortizing intangible assets:				
Core deposit intangible	\$3,540	\$ 1,797	\$ 1,743	5.6

Estimated future amortization expense for amortizing intangibles for the years ending December 31, are as follows:

(in thousands)	
2018	\$1,258
2019	3,012
2020	2,674
2021	2,326
2022	1,915
Thereafter	1,931
Total amortizing intangible assets	\$13,116

#### Note 7: Deposits

The following table details the composition of deposits and the related percentage mix of total deposits, respectively, at the dates indicated:

(dollars in thousands)	June 30, 2018	December 31, 2017
------------------------	---------------	-------------------

Edgar Filing: Howard Bancorp Inc - Form 10-Q

	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	\$469,832	30 %	\$ 218,139	26 %
Interest-bearing checking	156,680	10	71,642	8
Money market accounts	383,816	25	252,453	29
Savings	146,025	9	52,078	6
Certificates of deposit \$250,000 and over	49,120	3	9,950	1
Certificates of deposit under \$250,000	360,171	23	259,646	30
Total deposits	\$1,565,644	100 %	\$ 863,908	100 %

**Note 8: Stock Options and Stock Awards**

The Company's equity incentive plan provides for awards of nonqualified and incentive stock options as well as vested and non-vested common stock awards. Employee stock options can be granted with exercise prices at the fair market value (as defined within the plan) of the stock at the date of grant and with terms of up to ten years. Except as otherwise permitted in the plan, upon termination of employment for reasons other than retirement, permanent disability or death, the option exercise period is reduced or the options are canceled.

Stock awards may also be granted to non-employee members of the Board of Directors as compensation for attendance and participation at meetings of the Board of Directors and meetings of the various committees of the Board. For the six months ended June 30, 2018 and 2017, Bancorp issued 4,800 and 6,604 shares of common stock, respectively, to directors as compensation for their service.

The fair value of the Company's stock options granted as compensation is estimated on the measurement date, which, for the Company, is the date of grant. The fair value of stock options is calculated using the Black-Scholes option-pricing model under which the Company estimates expected market price volatility and expected term of the options based on historical data and other factors. There were no stock options granted during the first half of 2018 or the year ended December 31, 2017. The valuation of the Company's restricted stock and restricted stock units is the closing price per share of Bancorp's common stock on the date of grant.

The following table summarizes the Company's stock option activity and related information for the periods ended:

	June 30, 2018		December 31, 2017	
	Weighted Average Exercise		Weighted Average Exercise	
	Shares	Price	Shares	Price
Balance at January 1,	30,991	\$ 9.69	123,593	\$ 12.36
Granted	-	-	-	-
Exercised	(3,284 )	10.77	(27,113 )	11.67
Forfeited	(3,100 )	11.00	(65,489 )	13.92
Balance at period end	24,607	\$ 9.38	30,991	\$ 9.69
Exercisable at period end	24,607	\$ 9.38	30,991	\$ 9.69
Weighted average fair value of options granted during the year		\$ -		\$ -

The cash received from the exercise of stock options during the six months ended June 30, 2018 was \$35 thousand, while \$234 thousand was received during the six months ended June 30, 2017. The intrinsic value of a stock option is the amount that the market value of the underlying stock exceeds the exercise price of the option. Based upon a fair market value of \$18.00 at June 30, 2018, the options outstanding had an aggregate intrinsic value of \$212 thousand. At December 31, 2017, based upon fair market value of \$22.00, the outstanding options outstanding had an aggregate intrinsic value of \$382 thousand.

### **Restricted Stock Units**

Restricted stock units ("RSUs") are similar to restricted stock, except the recipient does not receive the stock immediately, but instead receives it according to a vesting plan and distribution schedule. Each RSU that vests entitles the recipient to receive one share of Bancorp common stock on a specified issuance date. The recipient does not have any stockholder rights, including voting, dividend or liquidation rights, with respect to the shares underlying awarded RSUs until the recipient becomes the record holder of those shares.

Edgar Filing: Howard Bancorp Inc - Form 10-Q

The Company granted 20,732 RSUs during the first half of 2018, all of which were immediately vested upon grant. The Company granted 18,500 RSUs during 2017, all of which are subject to a three-year vesting schedule.

The following table presents a summary of the activity in the Company's RSUs for the periods ended:

	June 30, 2018		December 31, 2017	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Balance at January 1,	52,155	\$ 15.09	65,491	\$ 13.23
Granted	20,732	19.90	18,500	17.41
Vested	(37,062)	17.14	(31,836 )	12.60
Forfeited	(3,332 )	13.81	-	-
Balance at period end	32,493	\$ 15.95	52,155	\$ 15.09



At June 30, 2018, based on RSU awards outstanding at that time, the total unrecognized pre-tax compensation expense related to unvested RSU awards was \$284 thousand. This expense is expected to be recognized through 2020 as follows.

	(in thousands)
2018	\$ 103
2019	129
2020	52
	\$284

*Stock-Based Compensation Expense:* Stock-based compensation is recognized as compensation cost in the statement of operations based on their fair values on the measurement date, which, for the Company, is the date of the grant. The amount that the Company recognized in stock-based compensation expense related to the issuance of restricted stock and RSUs and for director compensation paid in stock is presented in the following table:

	Six months ended		Three months ended	
	June 30		June 30	
(in thousands)	2018	2017	2018	2017
Stock-based compensation expense				
Related to the issuance of restricted stock and RSUs	\$ 572	\$ 236	\$ 75	\$ 149
Director compensation paid in stock	\$ 101	\$ 110	\$ -	\$ 66

## Note 9: Benefit Plans

### Profit Sharing Plan

The Company sponsors a defined contribution retirement plan through a Section 401(k) profit sharing plan. Employees may contribute up to 15% of their pretax compensation. Participants are eligible for matching Company contributions up to 4% of eligible compensation dependent on the level of voluntary contributions. Company matching contributions totaled \$587 thousand and \$381 thousand, respectively, for the six months ended June 30, 2018 and 2017. The Company's matching contributions vest immediately.

### Supplemental Executive Retirement Plan (SERP)

In 2014, the Bank created a SERP for the Chief Executive Officer. This plan was amended in 2015. Under the defined benefit SERP, Ms. Scully will receive \$150,000 each year for 15 years after attainment of the Normal Retirement Age (as defined in the SERP). Ms. Scully will earn vesting on a graduated schedule in which she will become fully vested

on August 25, 2019, which has been established for purposes of the SERP as her retirement date. Expense related to this plan totaled \$139 thousand and \$141 thousand for the six month periods ending June 30, 2018 and 2017, respectively.

**Note 10: Income (Loss) per Common Share**

The table below shows the presentation of basic and diluted income per common share for the periods indicated:

(dollars in thousands, except per share data)	Six months ended		Three months ended	
	June 30, 2018	2017	June 30, 2018	2017
Net (loss) income available to common stockholders (numerator)	\$ (7,953	) \$ 3,604	\$ (2,277	) \$ 2,038
<b>BASIC</b>				
Basic average common shares outstanding (denominator)	16,058,092	9,295,777	19,002,851	9,779,772
Basic (loss) income per common share	\$ (0.50	) \$ 0.39	\$ (0.12	) \$ 0.21
<b>DILUTED</b>				
Average common shares outstanding	16,058,092	9,295,777	19,002,851	9,779,772
Dilutive effect of common stock equivalents	-	39,373	-	42,393
Diluted average common shares outstanding (denominator)	16,058,092	9,335,150	19,002,851	9,822,165
Diluted (loss) income per common share	\$ (0.50	) \$ 0.39	\$ (0.12	) \$ 0.21

Because the Company reported a loss for both 2018 periods common stock equivalents were excluded from the calculation of diluted average shares outstanding, as their inclusion would have resulted in a lower diluted loss per share

	25,326	-	27,245	-
--	--------	---	--------	---

**Note 11: Risk-Based Capital**

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

In July 2013, Federal Deposit Insurance Corporation (the "FDIC") and the other federal bank regulatory agencies issued a final rule that revised their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking

Supervision (“Basel III”) and certain provisions of the Dodd-Frank Act. The final rule, which became effective on January 1, 2015, applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$1 billion or more and top-tier savings and loan holding companies. The final rule created a new common equity Tier 1 (“CET1”) minimum capital requirement (4.5% of risk-weighted assets), increased the minimum Tier 1 capital ratio (from 4% to 6% of risk-weighted assets), imposed a minimum leverage ratio of 4.0%, and changed the risk-weight of certain assets to better reflect credit risk and other risk exposures. These include, among other things, a 150% risk weight for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in non-accrual status, and a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable. The final rule also requires unrealized gains and losses on certain “available-for-sale” securities holdings to be included for purposes of calculating regulatory capital unless the Company elects to opt-out from this treatment. The Company has elected to permanently opt out of this treatment in the Company’s capital calculations, as permitted by the final rule.

Additionally, subject to a transition schedule, the rule limits Bancorp’s and the Bank’s ability to make capital distributions, engage in share repurchases and pay certain discretionary bonus payments if they do not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements.

In addition, under revised prompt corrective action requirements, in order to be considered “well-capitalized,” Bancorp and the Bank must have a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a common equity Tier 1 ratio of 6.5% or greater, a leverage capital ratio of 5.0% or greater, and not be subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

There are two main categories of capital under the regulatory capital guidelines. Tier 1 capital includes common shareholders' equity, qualifying preferred stock and trust preferred securities, less goodwill and certain other deductions (including the unrealized net gains and losses, after applicable income taxes, on securities available for sale carried at fair value). Tier 2 capital includes preferred stock not qualifying as Tier 1 capital, subordinated debt, the allowance for credit losses and net unrealized gains on marketable equity securities, subject to limitations set by the guidelines. Tier 2 capital is limited to the amount of Tier 1 capital (i.e., at least half of total capital must be in the form of Tier 1 capital). Under the guidelines, capital is compared to the relative risk related to the balance sheet. To derive the risk included in the balance sheet, one of several risk weights is applied to the different balance sheet and off-balance sheet assets, primarily based on the relative credit risk of the counterparty. For example, claims guaranteed by the U.S. government or one of its agencies are risk-weighted at 0%. Off-balance sheet items, such as loan commitments, are also applied a risk weight after calculating balance sheet equivalent amounts. One of four credit conversion factors (0%, 20%, 50% and 100%) is assigned to loan commitments based on the likelihood of the off-balance sheet item becoming an asset. For example, certain loan commitments are converted at 50% and then risk-weighted at 100%. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Management believes that, as of June 30, 2018 and December 31, 2017, Bancorp and the Bank met all capital adequacy requirements to which they are subject.

The following table reflects Bancorp's and the Bank's capital at June 30, 2018 and December 31, 2017:

(dollars in thousands)	Actual		For capital adequacy purposes		To be well capitalized under the FDICIA prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2018:						
Total capital (to risk-weighted assets)						
Howard Bank	\$ 185,421	10.78 %	\$ 137,624	8.00 %	\$ 172,030	10.00 %
Howard Bancorp	\$ 187,072	10.83 %	\$ 138,245	8.00 %	<b>N/A</b>	
Common equity tier 1 capital (to risk-weighted assets)						
Howard Bank	\$ 178,802	10.39 %	\$ 77,414	4.50 %	\$ 111,820	6.50 %
Howard Bancorp	\$ 176,878	10.24 %	\$ 77,763	4.50 %	<b>N/A</b>	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	\$ 178,802	10.39 %	\$ 103,218	6.00 %	\$ 137,624	8.00 %
Howard Bancorp	\$ 176,878	10.24 %	\$ 103,684	6.00 %	<b>N/A</b>	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	\$ 178,802	8.85 %	\$ 80,791	4.00 %	\$ 100,989	5.00 %

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Howard Bancorp	\$176,878	8.76 %	\$ 80,724	4.00 %	N/A	
As of December 31, 2017:						
Total capital (to risk-weighted assets)						
Howard Bank	\$125,019	12.39 %	\$ 80,720	8.00 %	\$100,900	10.00 %
Howard Bancorp	\$139,673	13.72 %	\$ 81,456	8.00 %	N/A	
Common equity tier 1 capital (to risk-weighted assets)						
Howard Bank	\$118,860	11.78 %	\$ 45,405	4.50 %	\$65,585	6.50 %
Howard Bancorp	\$129,979	12.77 %	\$ 45,819	4.50 %	N/A	
Tier 1 capital (to risk-weighted assets)						
Howard Bank	\$118,860	11.78 %	\$ 60,540	6.00 %	\$80,720	8.00 %
Howard Bancorp	\$129,979	12.77 %	\$ 61,092	6.00 %	N/A	
Tier 1 capital (to average assets) (Leverage ratio)						
Howard Bank	\$118,860	10.70 %	\$ 44,438	4.00 %	\$55,547	5.00 %
Howard Bancorp	\$129,979	11.70 %	\$ 44,439	4.00 %	N/A	

**Note 12: Fair Value**

FASB ASC Topic 820 “Fair Value Measurements” defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These hierarchy levels are:

Level 1: Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

### Recurring Fair Value Measurements

All classes of investment securities available for sale are recorded at fair value using an industry-wide valuation service and therefore fall into a Level 2 of the fair value hierarchy. The service uses evaluated pricing models that vary based on asset class and include available trade, bid and other market information. Various methodologies include broker quotes, propriety models, descriptive terms and conditions databases, and quality control programs.

Fair value of loans held for sale is based upon outstanding investor commitments or, in the absence of such commitments, based on current investor yield requirements or third party pricing models and are considered Level 2. Gains and losses on loan sales are determined using specific identification method. Changes in fair value are recognized in the Consolidated Statement of Operations as part of realized and unrealized gain on mortgage banking activities.

Interest rate lock commitments are recorded at fair value determined as the amount that would be required to settle each of these derivatives at the balance sheet date. In the normal course of business, the Company enters into contractual interest rate lock commitments to extend credit to borrowers with fixed expiration dates. The commitment becomes effective when the borrowers lock in a specified interest rate within the time frames established by the mortgage division. All borrowers are evaluated for credit worthiness prior to the extension of the commitment. Market risk arises if interest rates move adversely between the time interest rate is locked by the borrower and the sale date of the loan to an investor. To mitigate this interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into best effort forward sales contracts to sell loans to investors. The forward sales contracts lock in an interest rate price for the sale of loans similar to the specific rate lock commitment. Rate lock commitments to the borrowers through to the date the loan closes are undesignated derivatives and accordingly, are marked to fair value in earnings. These valuations fall into a Level 3 of the fair value hierarchy. The rate lock commitments are deemed as Level 3 inputs because the Company applies an estimated pull-through rate, which is deemed an unobservable measure. The pull-through rate utilized is based upon historic pull-through rates that ranged from 70 percent to 80 percent.

For loans held for investment that were originally intended to be sold and previously included as loans held for sale, fair value is determined by discounting estimated cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.



Edgar Filing: Howard Bancorp Inc - Form 10-Q

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis at June 30, 2018 and December 31, 2017.

June 30, 2018	Carrying Value	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	(Fair Value)	(Level 1)	(Level 2)	(Level 3)
Available for sale securities:				
U.S. Government agencies	\$ 74,584	\$ -	\$ 74,584	\$ -
U.S. Government treasuries	1,496	-	1,496	-
Mortgage-backed securities	48,325	-	48,325	-
Other investments	3,126	-	3,126	-
Loans held for sale	55,956	-	55,956	-
Loans held for investment	1,345	-	1,345	-
Rate lock commitments	244	-	-	244

December 31, 2017	Carrying Value	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)	(Fair Value)	(Level 1)	(Level 2)	(Level 3)
Available for sale securities:				
U.S. Government agencies	\$ 67,740	\$ -	\$ 67,740	\$ -
U.S. Government treasuries	1,494	-	1,494	-
Mortgage-backed securities	2,479	-	2,479	-
Other investments	2,543	-	2,464	79
Loans held for sale	42,153	-	42,153	-
Loans held for investment	1,509	-	1,509	-
Rate lock commitments	451	-	-	451

The following table presents a reconciliation of the assets that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the periods presented:

	June 30 2018	December 31 2017
Balance, beginning of period	\$ 530	\$ 528
Privately held equity investment	(42 )	79
Net gains (losses) included in realized and unrealized gains on mortgage banking activity in noninterest income	(244 )	(77 )

Balance, end of period \$ 244    \$ 530

Assets under fair value option:

June 30, 2018 (in thousands)	Carrying Fair Value Amount	Aggregate Unpaid Principal	Difference
Loans held for sale	\$ 55,956	\$ 54,733	\$ 1,223
Loans held for investment	1,345	1,374	(29 )

December 31, 2017 (in thousands)	Carrying Fair Value Amount	Aggregate Unpaid Principal	Difference
Loans held for sale	\$ 42,153	\$ 40,990	\$ 1,163
Loans held for investment	1,509	1,476	33

The Company elected to measure the loans held for sale and the loans held for investment that were originally intended for sale, but instead were added to the Bank's portfolio at fair value, to better align reported results with the underlying economic changes in value of the loans on the Company's balance sheet.

Non-recurring Fair Value Measurements

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used.

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or market value. Market value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of real estate collateral is determined based on appraisal by qualified licensed appraisers hired by the Company. The value of business equipment, inventory and accounts receivable collateral is based on the net book value on the business' financial statements and, if necessary, discounted based on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above.

Other real estate owned acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to noninterest expense subsequent to foreclosure. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. There were no valuation losses recognized during the six months ended June 30, 2018, and \$96 thousand recognized during the six months ended June 30, 2017. OREO is classified within Level 3 of the hierarchy.

The following table sets forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a nonrecurring basis at June 30, 2018 and December 31, 2017. OREO is carried at fair value less anticipated costs to sell. Impaired loans are measured using the fair value of collateral, if applicable.

June 30, 2018	Carrying Value	Quoted Price in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
---------------	-------------------	--	--	---------------------------------------

Edgar Filing: Howard Bancorp Inc - Form 10-Q

(in thousands)	(Fair Value)	(Level 1)	(Level 2)	(Level 3)
Other real estate owned	\$ 4,115	\$ -	\$ -	\$ 4,115
Impaired loans:				
Construction and land	1,409	-	-	1,409
Residential - first lien	16,065	-	-	16,065
Residential - junior lien	884	-	-	884
Commercial - owner occupied	1,757	-	-	1,757
Commercial - non-owner occupied	6,081	-	-	6,081
Commercial loans and leases	2,358	-	-	2,358
Consumer	151	-	-	151

December 31, 2017	Carrying Value	Quoted Price in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
(in thousands)	(Fair Value)	(Level 1)	(Level 2)	(Level 3)
Other real estate owned	\$ 1,549	\$ -	\$ -	\$ 1,549
Impaired loans:				
Construction and land	559	-	-	559
Residential - first lien	2,009	-	-	2,009
Residential - junior lien	367	-	-	367
Commercial - owner occupied	508	-	-	508
Commercial - non-owner occupied	5,856	-	-	5,856
Commercial loans and leases	3,056	-	-	3,056
Consumer	-	-	-	-

At June 30, 2018, OREO consisted of the outstanding balance of \$7.5 million, less valuation allowance of \$3.4 million. Related allowance on impaired loans was \$25 thousand and \$910 thousand at June 30, 2018 and December 31, 2017 respectively.

Various techniques are used to value OREO and impaired loans. All loans for which the underlying collateral is real estate, either construction, land, commercial, or residential, an independent appraisal is used to identify the value of the collateral. The approaches within the appraisal report include sales comparison, income, and replacement cost analysis. The resulting value will be adjusted by a selling cost of 9.5% and the residual value will be used to determine if there is an impairment. Commercial loans and leases and consumer loans utilize a liquidation approach to the impairment analysis.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are based on quoted market prices where available or calculated using present value techniques. Since quoted market prices are not available on many of our financial instruments, estimates may be based on the present value of estimated future cash flows and estimated discount rates.

Management has made estimates of fair value discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, management has no basis to determine whether the fair value presented for loans would be indicative of the value negotiated in an actual sale.

The following table presents the estimated fair value of the Company's financial instruments at the dates indicated:

(in thousands)	June 30, 2018		Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value			
<b>Financial Assets</b>					
Available for sale securities	\$ 127,530	\$ 127,530	\$ -	\$ 127,530	\$ -
Held to maturity securities	9,250	9,417	-	-	9,417
Nonmarketable equity securities	14,485	14,485	-	14,485	-
Loans held for sale	55,956	55,956	-	55,956	-
Loans held for investment	1,345	1,345	-	1,345	-
Rate lock commitments	244	244	-	-	244
Loans and leases <sup>1</sup>	1,602,014	1,578,707	-	-	1,578,707

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Financial Liabilities

Deposits	1,565,644	1,566,981	-	1,566,981	-
Short-term borrowings	189,112	189,112	-	189,112	-
Long-term borrowings	127,575	127,744	-	127,744	-

(in thousands)	December 31, 2017		Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value			
<b>Financial Assets</b>					
Available for sale securities	\$74,256	\$74,256	\$ -	\$ 74,177	\$ 79
Held to maturity securities	9,250	9,421	-	-	9,421
Nonmarketable equity securities	6,492	6,492	-	6,492	-
Loans held for sale	42,153	42,153	-	42,153	-
Loans held for investment	1,509	1,509	-	1,509	-
Rate lock commitments	451	451	-	-	451
Loans and leases <sup>1</sup>	928,940	925,510	-	-	925,510
<b>Financial Liabilities</b>					
Deposits	863,908	865,182	-	865,182	-
Short-term borrowings	130,385	130,385	-	130,385	-
Long-term borrowings	18,535	18,538	-	18,538	-

Carrying amount is net of unearned income and allowance for loan and lease losses. In accordance with the (1) prospective adoption of ASU No. 2016-01, the fair value of loans as of June 30, 2018 was measured using an exit price notion. The fair value of loans as of December 31, 2017 was measured using an entry price notion.

### Note 13: Revenue Recognition

#### *Service Charges on Deposit Accounts*

Service charges on deposit accounts consist of account analysis fees, monthly service fees, check orders, and other deposit account related fees. The Banks's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Banks's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

#### *Other Operating Income*

Other operating income is primarily comprised of debit and credit card income, ATM fees, merchant services income, revenue streams such as safety deposit box rental fees, and other miscellaneous service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Banks's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Bank's cardholder uses a non-Bank ATM or a non-Bank cardholder uses a Bank ATM. Merchant services income mainly represents fees

charged to merchants to process their debit and credit card transactions, in addition to account management fees. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Bank determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Bank's performance obligation for fees, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.



The following presents noninterest income, segregated by revenue streams in scope and out of scope of Topic 606, for the six and three months ended June 30, 2018 and 2017.

(in thousands)	Unaudited			
	For the six months ended June 30,		For the three months ended June 30,	
	2018	2017	2018	2017
<b>NONINTEREST INCOME</b>				
Service charges on deposit accounts	\$247	\$136	\$ 152	\$ 83
Fees and other services charges	1,094	454	689	246
Other	39	32	20	14
Noninterest income in scope of Topic 606	1,380	622	861	343
Noninterest income out of scope of Topic 606	8,941	9,129	4,756	4,949
Total noninterest income	\$10,321	\$9,751	\$ 5,617	\$ 5,292

#### *Contract Balances*

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Bank's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals. Consideration is often received immediately or shortly after the Bank satisfies its performance obligation and revenue is recognized. The Bank does not typically enter into long term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018 and December 31, 2017, the Bank did not have any significant contract balances.

#### *Contract Acquisition Costs*

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Bank did not capitalize any contract acquisition cost.

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

This section is intended to help our stockholders and potential investors understand our financial performance through a discussion of the factors affecting our consolidated financial condition at June 30, 2018 and December 31, 2017 and our consolidated results of operations for the periods ended June 30, 2018 and 2017. This section should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements.

### **Overview**

Howard Bancorp was incorporated in April 2005 under the laws of the State of Maryland and is a bank holding company registered under the Bank Holding Company Act of 1956. Howard Bancorp is a single bank holding company with one subsidiary, Howard Bank, which operates as a state trust company with commercial banking powers regulated by the Maryland Office of the Commissioner of Financial Regulation (the “Commissioner”). The Company is a diversified financial services company providing commercial banking, mortgage banking and consumer finance through banking branches, the internet and other distribution channels to businesses, business owners, professionals and other consumers located primarily in the Greater Baltimore metropolitan area. Howard Bank was formed in 2004. Howard Bank’s business has consisted primarily of originating both commercial and real estate loans secured by property in our market area. Typically, commercial real estate and business loans involve a higher degree of risk and carry a higher yield than one-to-four-family residential loans. We plan to continue to focus both on commercial customers and our origination of one- to four-family residential mortgage loans going forward, maintaining our portfolio of mortgage lending and also selling select loans into the secondary markets.

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

Our core business strategy is to deliver superior customer service that is supported by an extremely high level of banking sophistication. Our specialized community banking focus on both local markets and small business related market segments is combined with a broad array of products, new technology and seasoned banking professionals which positions the Bank differently than most competitors. Our experienced executives establish a relationship with each client and bring value to all phases of a client’s business and personal banking needs.

Our results of operations depend mainly on our net interest income, which is the difference between the interest income we earn on our loan and investment portfolios and the interest expense we pay on deposits and borrowings.

## Edgar Filing: Howard Bancorp Inc - Form 10-Q

Results of operations are also affected by provisions for credit losses, noninterest income and noninterest expense. Our noninterest expense consists primarily of compensation and employee benefits, as well as office occupancy, loan production expense, deposit insurance and general administrative and data processing expenses. Our operations are significantly affected by general economic and competitive conditions, particularly with respect to changes in interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may materially affect our financial condition and results of operations.

On March 1, 2018, we completed our acquisition of First Mariner Bank (“First Mariner”) through the merger of First Mariner with and into Howard Bank. As a result of the merger, each outstanding share of common stock of First Mariner was converted into 1.6624 shares of Howard Bancorp common stock, provided that cash was paid in lieu of any fractional shares. The aggregate merger consideration of \$173.8 million included \$9.2 million of cash and 9,143,222 shares of our common stock, which was valued at approximately \$164.6 million based on Howard Bancorp’s closing stock price of \$18.00 on February 28, 2018.

On February 1, 2017, Bancorp closed an underwritten public offering, including the exercise in full by the underwriters of their option to purchase an additional 360,000 shares, at the public offering price of \$15.00 per share. The exercise of the option to purchase additional shares brought the total number of shares of common stock sold by Bancorp to 2,760,000 shares and increased the amount of gross proceeds raised in the offering to approximately \$41.4 million, and after underwriting discounts and estimated expenses, net proceeds raised in the offering was \$38.4 million.

Financial highlights during the six months ended June 30, 2018 are as follows:

As a result of the First Mariner merger we acquired:

Assets - \$1.0 billion, primarily from:

Investment securities - \$130.3 million

Loans - \$692.5 million

Liabilities - \$897.6 million, primarily from:

Deposits - \$706.4 million

Borrowings - \$185.0 million

Goodwill recorded - \$70.7 million

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

Net interest income - \$30.0 million

Pretax loss of \$10.5 million, after the recording of \$15.7 million in merger related expenses.

A loss of \$0.50 per common share for the first half of 2018 compared to earnings per share of \$0.39 for the first half of 2017.

Tangible book value of \$10.79 per share at June 30, 2018 compared to \$12.84 per share at June 30, 2017.

### **Critical Accounting Policies**

Our accounting and financial reporting policies conform to GAAP and general practice within the banking industry. Accordingly, preparation of the financial statements requires management to exercise significant judgment or discretion or make significant assumptions and estimates based on the information available that have, or could have, a material impact on the carrying value of certain assets or on income. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the periods presented. In reviewing and understanding financial information for us, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. The accounting policies we view as critical are those relating to the allowance for credit losses, goodwill and other intangible assets, business combinations, income taxes and share based compensation. Significant accounting policies are discussed in detail in “Notes to Consolidated Financial Statements - Note 1: Summary of Significant Account Policies” in our Annual Report on Form 10-K for the year ended December 31, 2017. There have been no material changes to the significant accounting policies as described in the Annual Report. Disclosures regarding the effects of new accounting pronouncements are included in Note 1 of our Consolidated Financial Statements included in this report.

### **Balance Sheet Analysis and Comparison of Financial Condition**

A comparison between the June 30, 2018 and December 31, 2017 balance sheets is presented below.

## General

All aspects of our financial condition were greatly impacted by the First Mariner merger. Total assets increased \$1.0 billion, or 90.0%, to \$2.2 billion at June 30, 2018 compared to \$1.1 billion at December 31, 2017. This asset growth consisted primarily of increases in our loan portfolio of \$673.4 million, cash and cash equivalents of \$79.0 million, and investment securities of \$53.3 million. Increases in assets were funded from increases in customer deposits of \$701.7 million and borrowings of \$167.8 million. Deposits consisted of noninterest-bearing deposits of \$469.8 million and interest-bearing deposits of \$1.1 billion. Stockholders' equity increased \$157.2 million primarily as a result of the issuance of 9.1 million shares representing \$165 million in stock in conjunction with the merger.

## Investment Securities

### Available for sale

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

### Held to maturity

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

### Nonmarketable equity

At June 30, 2018 and December 31, 2017 we held an investment in stock of the Federal Home Loan Bank ("FHLB") of \$14.5 million and \$6.5 million, respectively. This investment is required for continued FHLB membership and is based partially upon the amount of borrowings outstanding from the FHLB. This FHLB stock is carried at cost.

The following tables set forth the composition of our investment securities portfolio at the dates indicated.

(in thousands)	June 30, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for sale				
U.S. Government				
Agencies	\$75,007	\$74,584	\$68,082	\$67,740
Treasuries	1,502	1,496	1,505	1,494
Mortgage-backed	48,445	48,325	2,541	2,479
Other investments	3,077	3,126	2,579	2,543
	\$128,030	\$127,530	\$74,707	\$74,256
Held to maturity				
Corporate debentures	\$9,250	\$9,417	\$9,250	\$9,421

All acquired First Mariner investment securities were classified as available for sale, and were acquired at their fair values. For interest rate sensitivity reasons, we elected to immediately liquidate a portion of acquired securities portfolio. Because we sold these securities acquired within days of the closing of the transaction we did not record any gain or loss on the sale. We sold approximately \$69.7 million of the acquired securities and retained nearly \$51.0 million in our portfolio. Additionally, the Bank took the opportunity to reposition a portion of its pre-acquisition portfolio through the sale of primarily shorter duration agency debenture bonds with maturities over one year. In the first quarter of 2018, the Bank sold \$33.0 million of securities at a loss of \$139 thousand. There were no sales in the second quarter of 2018.

We had securities available for sale of \$127.5 million and \$74.3 million at June 30, 2018 and December 31, 2017, respectively, which were recorded at fair value. This represents an increase of \$53.2 million, or 72.0%, from year-end 2017.

We had securities held to maturity of \$9.3 million at June 30, 2018 and December 31, 2017, which were recorded at amortized cost. There were two investments that were in an unrealized loss position at June 30, 2018.

With respect to our portfolio of securities available for sale, the portfolio contained 45 securities with unrealized losses of \$570 thousand and 38 securities with unrealized losses of \$451 thousand at June 30, 2018 and December 31, 2017, respectively. Changes in the fair value of these securities resulted primarily from interest rate fluctuations. We do not intend to sell these securities nor is it more likely than not that we would be required to sell these securities before their anticipated recovery, and we believe the collection of the investment and related interest is probable. Based on this analysis, we do not consider any of the unrealized losses to be other than temporary impairment losses.

## **Loan and Lease Portfolio**

Total loans and leases increased \$673.4 million, or 71.9%, to \$1.6 billion at June 30, 2018 from \$937 million at December 31, 2017. The fair value of loans acquired of \$632.1 million represented the majority of the growth in the first half of 2018, with the remainder in organic growth. Organic growth was primarily on commercial loans and leases, increasing \$28.9 million and commercial real estate loans, increasing \$15.3 million from December 31, 2017 as we continue to focus on the needs of small to mid-size businesses in our market area.

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

(in thousands)	June 30, 2018					December 31, 2017	
	Legacy	Acquired	Total	% of Total	%	Total	% of Total
Real estate							
Construction and land	\$74,136	\$40,767	\$114,903	7.1	%	\$74,398	7.9 %
Residential - first lien	190,465	182,214	372,679	23.1		194,896	20.8
Residential - junior lien	45,429	50,439	95,868	6.0		43,047	4.6
Total residential real estate	235,894	232,653	468,547	29.1		237,943	25.4
Commercial - owner occupied	180,482	35,325	215,807	13.4		170,408	18.2
Commercial - non-owner occupied	266,011	162,541	428,552	26.6		260,802	27.8
Total commercial real estate	446,493	197,866	644,359	40.0		431,210	46.0
Total real estate loans	756,523	471,286	1,227,809	76.3		743,551	79.3
Commercial loans and leases	217,649	122,447	340,096	21.1		188,729	20.2
Consumer	3,738	38,335	42,073	2.6		4,328	0.5
Total loans	\$977,910	\$632,068	\$1,609,978	100.0%		\$936,608	100.0 %

### Loan Held for Sale

We sell the majority of residential mortgage loans originated by the Bank. Loans held for sale increased \$13.8 million to \$56.0 million at June 30, 2018 from \$42.2 million at December 31, 2017. Mortgage loan origination volumes continue to be strong, with \$337.3 million in loans originated in the first half of 2018 compared to \$326.9 million for the same period of 2017. With the closing of the consumer direct unit of our mortgage division, these origination levels are likely to decline in the future.

### Deposits

Deposits increased from \$863.9 million at December 31, 2017 to \$1.6 billion at June 30, 2018, an increase of \$701.7 million or 81.2%. The fair value of deposits acquired of \$693.8 million represented the majority of the growth in the first half of 2018. The largest increase in organic deposits was in noninterest-bearing demand deposits which increased \$25.5 million and interest bearing demand deposits which increased \$14.8 million in the first half of 2018. This increase was offset by a \$39.7 million decrease in certificates of deposit which we intentionally allowed to decline given the additional levels of cash generated from the sale of the investment securities.

The following tables set forth the distribution of total deposits, by account type, at the dates indicated:



Edgar Filing: Howard Bancorp Inc - Form 10-Q

(dollars in thousands)	June 30, 2018		December 31, 2017	
	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	\$469,832	30 %	\$ 218,139	26 %
Interest-bearing checking	156,680	10	71,642	8
Money market accounts	383,816	25	252,453	29
Savings	146,025	9	52,078	6
Certificates of deposit \$250,000 and over	49,120	3	9,950	1
Certificates of deposit under \$250,000	360,171	23	259,646	30
Total deposits	\$1,565,644	100 %	\$ 863,908	100 %

### Borrowings

Customer deposits remain the primary source we utilize to meet funding needs, but we supplement this with short-term and long-term borrowings. Borrowings consist of overnight unsecured master notes, repurchase agreements, FHLB advances and a junior subordinated debenture. Repurchase agreements consist of overnight electronic sweep products that move customer excess funds from noninterest-bearing deposit accounts to an interest-bearing repurchase agreement, which is classified as a borrowing. Master notes similarly sweep funds from the Bank's customer accounts to the Company but do not require pledged collateral. Repurchase agreements sweep funds within the Bank and are secured primarily by pledges of U.S. Government Agency securities, based upon their fair value, as collateral for 100% of the principal and accrued interest of its repurchase agreements.

Patapsco Statutory Trust I, a Connecticut statutory business trust and an unconsolidated wholly-owned subsidiary of Howard Bancorp, issued \$5 million of capital trust pass-through securities to investors. The interest rate currently adjusts on a quarterly basis at the rate of the three month LIBOR plus 1.48%. Patapsco Statutory Trust I purchased \$5,155,000 of junior subordinated deferrable interest debentures from Patapsco Bancorp. The debentures are the sole asset of the Trust. Patapsco Bancorp also fully and unconditionally guaranteed the obligations of the Trust under the capital securities, which guarantee became an obligation of the Company upon our acquisition of Patapsco Bancorp. The capital securities are redeemable by the Company at par. The capital securities must be redeemed upon final maturity of the subordinated debentures on December 31, 2035.

Our borrowings totaled \$316.7 million at June 30, 2018 versus \$148.9 million at December 31, 2017, reflecting an increase of \$167.8 million. Short-term borrowings at June 30, 2018 consisted of repurchase agreements of \$16.5 million, master notes totaling \$1.1 million, fed funds purchased of \$25.0 million and short-term FHLB advances totaling \$146.5 million. Long-term borrowing totaled \$127.6 million at June 30, 2018, consisting of six long-term FHLB advances totaling \$124.0 million and junior subordinated debt totaling \$3.6 million.

### **Stockholders' Equity**

Total stockholders' equity increased \$157.2 million, or approximately 118.9%, from \$132.3 million at December 31, 2017 to \$289.5 million at June 30, 2018. As disclosed above, this increase in capital levels was the result of the issuance of 9.1 million shares representing \$165 million in stock in conjunction with the First Mariner merger. Partially offsetting the increased capital resulting from the acquisition was a net loss incurred during the first half of 2018 of \$8.0 million.

As a result of this merger, the capital position increased dramatically. Total stockholders' equity at June 30, 2018 represents a capital to asset ratio of 13.3%, compared to 11.5% at December 31, 2017. Book value per share was \$15.23 at June 30, 2018 and \$13.47 at December 31, 2017. Leverage ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio were 8.76%, 10.24% and 10.83%, respectively at June 30, 2018.

### **Average Balance and Yields**

The following tables set forth average balance sheets, average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect thereof was not material. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, and have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense.



Edgar Filing: Howard Bancorp Inc - Form 10-Q

(dollars in thousands)	Six months ended June 30,			2017		
	2018 Average Balance	Income / Expense	Yield / Rate	Average Balance	Income / Expense	Yield / Rate
Earning assets						
Loans and leases: <sup>1</sup>						
Commercial loans and leases	\$290,828	\$ 7,094	4.92 %	\$169,406	\$ 3,662	4.36 %
Commercial real estate	572,846	13,448	4.73	361,313	8,511	4.75
Construction and land	97,780	2,571	5.30	78,888	1,863	4.76
Residential real estate	395,712	8,410	4.29	230,711	5,023	4.39
Consumer	31,442	860	5.52	4,528	125	5.57
Total loans and leases	1,388,608	32,383	4.70	844,846	19,184	4.58
Loans held for sale	50,857	983	3.90	29,640	558	3.79
Other earning assets <sup>2</sup>	66,322	475	1.44	51,204	208	0.82
Securities: <sup>3</sup>						
U.S. Treasury	1,494	6	0.83	1,502	6	0.83
U.S Gov agencies	58,239	487	1.69	44,157	243	1.11
Mortgage-backed	37,775	555	2.96	1,302	17	2.66
Corporate debentures	9,250	285	6.22	8,242	254	6.23
Other investments	16,886	351	4.19	5,666	106	3.77
Total securities	123,644	1,684	2.75	60,869	626	2.08
Total earning assets	1,629,431	35,525	4.40	986,559	20,576	4.21
Cash and due from banks	14,914			8,974		
Bank premises and equipment, net	41,058			19,889		
Other assets	149,283			33,926		
Less: allowance for credit losses	(5,093 )			(5,852 )		
Total assets	\$1,829,593			\$1,043,496		
Interest-bearing liabilities						
Deposits:						
Interest-bearing demand accounts	\$123,915	141	0.23 %	\$65,884	\$ 77	0.24 %
Money market	344,685	934	0.55	258,308	550	0.43
Savings	117,947	86	0.15	52,526	37	0.14
Time deposits	378,235	1,918	1.02	244,441	1,161	0.96
Total interest-bearing deposits	964,782	3,079	0.64	621,159	1,825	0.59
Short-term borrowings	181,105	1,407	1.57	76,516	336	0.88
Long-term borrowings	71,359	1,011	2.86	12,483	167	2.70
Total interest-bearing funds	1,217,246	5,497	0.91	710,158	2,328	0.66
Noninterest-bearing deposits	366,958			210,496		
Other liabilities and accrued expenses	7,106			4,209		
Total liabilities	1,591,310			924,863		
Shareholders' equity	238,283			118,633		
Total liabilities & shareholders' equity	\$1,829,593			\$1,043,496		
Net interest rate spread <sup>4</sup>		\$ 30,028	3.49 %		\$ 18,248	3.55 %
Effect of noninterest-bearing funds			0.23			0.18
Net interest margin on earning assets <sup>5</sup>			3.72 %			3.73 %

Edgar Filing: Howard Bancorp Inc - Form 10-Q

- (1) Loan fee income is included in the interest income calculation, and non-accrual loans are included in the average loan base upon which the interest rate earned on loans is calculated.
  - (2) Includes Federal funds sold and interest-bearing deposits with banks.
- (3) Available for sale securities are presented at fair value, held to maturity securities are presented at amortized cost.
- (4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
  - (5) Net interest margin represents net interest income divided by average total interest-earning assets.

Edgar Filing: Howard Bancorp Inc - Form 10-Q

(dollars in thousands)	Three months ended June 30,			2017		
	2018 Average Balance	Income / Expense	Yield / Rate	Average Balance	Income / Expense	Yield / Rate
Earning assets						
Loans and leases: <sup>1</sup>						
Commercial loans and leases	\$340,677	\$ 4,295	5.06 %	\$174,343	\$ 2,033	4.68 %
Commercial real estate	642,032	7,685	4.80	368,247	4,340	4.73
Construction and land	109,109	1,517	5.58	82,332	983	4.79
Residential real estate	469,093	5,096	4.36	232,626	2,513	4.33
Consumer	43,774	620	5.68	4,417	56	5.11
Total loans and leases	1,604,685	19,213	4.80	861,965	9,925	4.62
Loans held for sale	58,011	575	3.98	36,632	356	3.89
Other earning assets <sup>2</sup>	70,739	261	1.48	42,067	87	0.83
Securities: <sup>3</sup>						
U.S. Treasury	1,494	3	0.83	1,501	3	0.83
U.S Gov agencies	55,194	281	2.04	50,390	142	1.13
Mortgage-backed	49,166	386	3.15	1,304	9	2.62
Corporate debentures	9,250	142	6.18	8,843	137	6.21
Other investments	19,702	304	6.18	6,421	49	3.06
Total securities	134,806	1,116	3.32	68,459	340	1.99
Total earning assets	1,868,241	21,165	4.54	1,009,123	10,708	4.26
Cash and due from banks	17,703			9,373		
Bank premises and equipment, net	51,419			19,769		
Other assets	200,966			36,895		
Less: allowance for credit losses	(6,179 )			(5,330 )		
Total assets	\$2,132,150			\$1,069,830		
Interest-bearing liabilities						
Deposits:						
Interest-bearing demand accounts	\$146,549	79	0.22 %	\$68,346	\$ 41	0.24 %
Money market	386,228	579	0.60	267,921	294	0.44
Savings	147,525	53	0.14	54,093	19	0.14
Time deposits	423,841	1,018	0.96	237,188	587	0.99
Total interest-bearing deposits	1,104,143	1,729	0.63	627,548	941	0.60
Short-term borrowings	167,245	717	1.72	90,406	195	0.86
Long-term borrowings	121,299	839	2.77	9,533	75	3.15
Total interest-bearing funds	1,392,687	3,285	0.95	727,487	1,211	0.67
Noninterest-bearing deposits	443,222			212,213		
Other liabilities and accrued expenses	7,030			3,443		
Total liabilities	1,842,939			943,143		
Shareholders' equity	289,211			126,687		
Total liabilities & shareholders' equity	\$2,132,150			\$1,069,830		
Net interest rate spread <sup>4</sup>		\$ 17,880	3.59 %		\$ 9,497	3.59 %
Effect of noninterest-bearing funds			0.24			0.18
Net interest margin on earning assets <sup>5</sup>			3.83 %			3.77 %

Edgar Filing: Howard Bancorp Inc - Form 10-Q

- (1) Loan fee income is included in the interest income calculation, and non-accrual loans are included in the average loan base upon which the interest rate earned on loans is calculated.
  - (2) Includes Federal funds sold and interest-bearing deposits with banks.
- (3) Available for sale securities are presented at fair value, held to maturity securities are presented at amortized cost.
- (4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
  - (5) Net interest margin represents net interest income divided by average total interest-earning assets.

**Rate/Volume Analysis**

The following table presents the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The total of the changes set forth in the rate and volume columns are presented in the total column.

(in thousands)	Six months ended June 30, 2018 vs. 2017			Three months ended June 30, 2018 vs. 2017		
	Total	Rates	Volumes <sup>1</sup>	Total	Rates	Volumes <sup>1</sup>
Interest earned on:						
Loans and leases:						
Commercial loans and leases	\$3,432	\$470	\$ 2,962	\$ 2,262	\$ 165	\$ 2,097
Commercial real estate	4,937	(29 )	4,966	3,345	68	3,277
Construction and land	708	211	497	534	162	372
Residential real estate	3,387	(120)	3,507	2,583	14	2,569
Consumer	735	(1 )	736	564	7	557
Loans held for sale	425	15	410	219	8	211
Securities	1,058	203	855	776	226	550
Other earning assets	267	159	108	174	68	106
Total interest income	14,949	908	14,041	10,457	718	9,739
Interest paid on:						
Savings deposits	49	2	47	34	0	34
Interest bearing checking	64	(2 )	66	38	(4 )	42
Money market accounts	384	150	234	285	108	177
Time deposits	757	78	679	431	(18 )	449
Short-term borrowings	1,071	258	813	522	193	329
Long-term borrowings	844	10	834	764	(9 )	773
Total interest expense	3,169	496	2,673	2,074	270	1,804
Net interest earned	\$11,780	\$412	\$ 11,368	\$ 8,383	\$ 448	\$ 7,935

(1) Change attributed to mix (rate and volume) are included in volume variance.

**Comparison of Results of Operations**

A comparison between the six months ended June 30, 2018 and June 30, 2017 is presented below.



## **General**

Because of the timing of the merger closing on March 1, 2018, the first half of 2018 operating results included only four months' worth of combined revenues and operating expenses. For the first half of 2018, we incurred expenses relating to the closing of the merger totaling \$15.7 million. The impact of these merger-related expenses resulted in a pretax loss of \$10.5 million.

Net income decreased \$11.6 million to a net loss of \$8.0 million for the six months ended June 30, 2018 compared to net income of \$3.6 million for the six months ended June 30, 2017. As stated above, the driver of the decrease was \$15.7 million in merger related expenses. Excluding these tax effected merger expenses net income for the first half of 2018 would have been \$3.7 million, a \$154 thousand or 4.3% increase over the same period in 2017.

Because of the net loss, we incurred a loss per common share for the first six months of 2018 of \$0.50 compared to earnings per common share of \$0.39 for the same period of 2017.

## **Interest Income**

Interest income increased \$14.9 million, or 72.7%, to \$35.5 million for the three months ended June 30, 2018 compared to \$20.6 million for the same period in 2017. Interest income and fees on portfolio loans increased \$13.2 million for the first half of 2018 compared to the same period in 2017, as average portfolio loans increased by \$543.8 million, while the yield on the portfolio loans increased by 12 basis points when comparing the two periods. The loan yields were primarily impacted by the commercial real estate loans increasing on average \$211.5 million while yields on this portfolio declined 2 basis points, due to the mix of variable and fixed rate loans in the portfolio. This decrease in interest income on portfolio loans was mitigated by increases in average commercial loans and leases of \$121.4 million and an increase in its yield of 56 basis points. Other factors affecting the increase of interest income are increases in interest income from investment securities of \$1.1 million on an average balances increase of \$62.8 million, an increase in interest income from loans held for sale of \$426 thousand on an average balance increase of \$21.2 million and an increase in interest income from other earning assets of \$267 thousand on an average balance increase of \$15.1 million.

### **Interest Expense**

Interest expense increased \$3.2 million to \$5.5 million for the six months ended June 30, 2018, compared to 2.3 million for the same period in 2017. Interest expense on deposits increased by \$1.3 million or 68.7% as a result of an increase in the average rate paid on interest-bearing deposits, which increased from 59 basis points to 64 basis points and an increase in the average balance of our interest-bearing deposits for the first half of 2018 compared to the first half of 2017 as average balance increased \$343.6 million or 55%. Similar to deposits, the average balances of our borrowings increased by \$163.4 million or 184 percent, which lead to an increase in our interest expense of borrowings of \$1.9 million.

### **Net Interest Income**

Net interest income is our largest source of operating revenue. Net interest income is affected by various factors including changes in interest rates and the composition of interest-earning assets and interest-bearing liabilities and maturities. Net interest income is determined by the interest rate spread (i.e., the difference between the yields earned on interest-earning assets and the rates paid on interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. As a result of the changes to interest income and interest expense described above, net interest income increased \$11.8 million, or 64.6%, during the six months ended June 30, 2018 compared to the six months ended June 30, 2017.

### **Provision for Credit Losses**

We establish a provision for credit losses, which is a charge to earnings, in order to maintain the allowance for credit losses at a level we consider adequate to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. In determining the level of the allowance for credit losses, management considers past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the levels of nonperforming loans. The amount of the allowance is based on estimates and actual losses may vary from such estimates as more information becomes available or economic conditions change. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as circumstances change as more information becomes available. The allowance for credit losses is assessed on a quarterly basis and provisions are made for credit losses as required in order to maintain the allowance.

Based on management's evaluation of the above factors, we had a provision for credit losses of \$2.5 million for the six months ended June 30, 2018 compared to \$540 thousand for the same period in 2017, an increase of \$2.0 million. This increase was primarily a result of charging off loans that previously had specific reserves held against them, and the charge offs increased our cumulative historic loss experience, which increased the levels of allowance needed. Further impacting the provision was an increase in the Bank's legacy nonperforming loans mostly in our commercial real estate portfolio. The provision for the 2018 period reflects general provisions that are required given our continued growth in the size of the loan portfolio, as well as any specific provisions required on loans that are individually evaluated and deemed to be impaired.

Management analyzes the allowance for credit losses as described in the section entitled “Allowance for Credit Losses.” The provision that is recorded is sufficient, in management’s judgment, to bring the allowance for credit losses to a level that reflects the losses inherent in our loan portfolio relative to loan mix, economic conditions and historical loss experience. Management believes, to the best of its knowledge, that all known losses as of the balance sheet dates have been recorded. However, although management uses the best information available to make determinations with respect to the provisions for credit losses, additional provisions for credit losses may be required to be established in the future should economic or other conditions change substantially. In addition, as an integral part of their examination process, the Commissioner and the FDIC will periodically review the allowance for credit losses. The Commissioner and the FDIC may require us to recognize additions to the allowance based on their analysis of information available to them at the time of their examination.

### **Noninterest Income**

Noninterest income was \$10.3 million for the six months ended June 30, 2018 compared to \$9.8 million for the six months ended June 30, 2017, a \$570 thousand or 5.8% increase. Noninterest income continue to be primarily driven by our mortgage banking activities. With \$352 million in mortgage loans sold for the first half of 2018 and \$324 million for the same period in 2017, the income recorded on the sales of loans produced approximately \$7.2 million in noninterest revenues for the first half of 2018, down from \$8.3 million for the first half of 2017. These declines represent the intended de-emphasis of mortgage banking announced at the time of the acquisition as well as the discontinuation of the national leads-based Consumer Direct mortgage unit in April 2018. We account for both our loans held for sale as well as our interest rate locks using the fair value approach, and under this methodology, revenues are negatively impacted when the levels of either loans held for sale or the levels of interest rate locks decline. In the first quarter of 2018, these levels included the contributions of both our retail purchase money group and our Consumer Direct unit, as well as the levels of loans held for sale and interest rate locks issued by the prior First Mariner mortgage team. Because of the overall reduction in the desired levels of originations and the closing of our Consumer Direct unit, levels of loans held for sale and interest rate locks were declining steadily throughout the first half of 2018. These volume declines resulted in a reduction in revenues of \$1.7 million solely from fair value measurement when comparing the first half of 2018 to the same period of 2017, and are responsible for the decline in overall mortgage banking revenues. In addition, noninterest income declined due to a \$139 thousand loss on the sale of investment securities from the repositioning of the portfolio in the first quarter of 2018 in comparison to no loss recorded in the same period of 2017. Offsetting this decrease were increases in loan fees derived from mortgage banking processing and underwriting as well as other portfolio loan fees, of \$1.3 million; service charges on deposit accounts of \$462 thousand and other operating income, which consists mainly of non-depository account fees such as wire, merchant card and ATM services, of \$985 thousand.

### **Noninterest Expenses**

Noninterest expenses increased \$26.6 million to \$48.3 million for the six months ended June 30, 2018 from \$21.7 million for the six months ended June 30, 2017. The greatest impact on the noninterest expense increase was \$15.7 million in merger related expenses associated with the First Mariner acquisition in the first half of 2018 with no merger related expenses reflected in the same period of 2017. Without these expenses, noninterest expenses would have increased \$10.9 million period over period. Compensation-related expenses accounted for over half of the core noninterest expense increase. Compensation and benefits increased \$5.9 million, primary as a result of the expanded size of our staff, impacted by four months of joint merger employee expenses. Occupancy and equipment expenses increased \$2.1 million period over period. The increase in occupancy and equipment costs for the first half of 2018 was prompted by eight additional branch locations related to the merger. Further increases in noninterest expense influenced by the merger were the amortization of core deposit intangible of \$1.0 million and data processing cost of temporarily running two systems of \$692 thousand. Other noninterest expenses such as marketing and business development, professional fees, and loan and other operating expenses increased period over period by \$1.3 million or 20.5%.

### **Income Tax Expense**

For the first half of 2018, because of the pretax loss generated from the merger expenses, we had a net tax benefit of \$2.5 million compared to an income tax expense of \$2.1 million for same period of 2017. The effective tax rate is influenced by the sources of non-taxable income, such as the income from our BOLI program, and also by certain non-deductible expense items. Some of our merger and acquisition costs are deemed not deductible for income tax purposes, which impacts the effective tax rate.

Income tax expense for 2018 was also impacted the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. As a result of these effects, our effective tax rate decreased to 24.2% for the first half of 2018 from 37.3% for the first half of 2017.

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

A comparison between the three months ended June 30, 2018 and June 30, 2017 is presented below.

**General**

The First Mariner merger closing on March 1, 2018 had the greatest impact on our operating results when comparing the three months ended June 30, 2018 compared to the same period of 2017.

Net income decreased \$4.3 million to a net loss of \$2.3 million for the three months ended June 30, 2018 compared to net income of \$2.0 million for the three months ended June 30, 2017. As stated above, the driver of the decrease was \$5.7 million in merger related expenses

**Interest Income**

Interest income increased \$10.5 million to \$21.2 million for the three months ended June 30, 2018 compared to \$10.7 million for the same period in 2017. Interest income and fees on portfolio loans increased \$9.3 million for the second quarter compared to the same period in 2017, as average portfolio loans increased by \$742.7 million. The remaining quarter over quarter increase in interest income resulted from increases of interest on our securities portfolio of \$776 thousand and other short-term investments totaling \$174 thousand as the average balances of these investment nearly doubled.

### **Interest Expense**

Interest expense increased \$2.1 million to \$3.3 million for the three months ended June 30, 2018, compared to \$1.2 million for the same period in 2017. Interest expense on deposits increased by \$788 thousand as a result of an increase in the average balance of \$476.6 million on our interest-bearing deposits for the second quarter of 2018 compared to the same period in 2017. In addition, our interest expense on borrowings increased by \$1.3 million for the second quarter of 2018 compared to the second quarter of 2017 as average balance increased \$188.6 million and average rate paid on such borrowings increased 108 basis points.

### **Net Interest Income**

As a result of the changes in our interest income and interest expense as discussed above, our net interest income increased \$8.4 million during the three months ended June 30, 2018 compared to the three months ended June 30, 2017.

### **Provision for Credit Losses**

Based on management's evaluation of all of the relevant loan loss methodology factors, we had a provision for credit losses of \$1.4 million for the three months ended June 30, 2018 compared to \$340 thousand for the same period in 2017, an increase of \$1.1 million. This increase was primarily a result of charging off loans that previously had specific reserves held against them, and the charge offs increased our cumulative historic loss experience, which increased the levels of allowance needed.

### **Noninterest Income**

Noninterest income was \$5.6 million for the three months ended June 30, 2018 compared to \$5.3 million for the three months ended June 30, 2017, a \$325 thousand or 6.1% increase. Noninterest income from realized and unrealized gains on mortgage banking activity declined \$1.5 million period over period. This decrease was offset by increases primarily due to \$647 thousand in other loan fees, \$496 thousand in other operating income and \$344 thousand in service charges on deposit accounts.

### **Noninterest Expenses**

Noninterest expenses increased \$13.9 million during the three months ended June 30, 2018 compared to the three months ended June 30, 2017. The greatest impact on the noninterest expense increase was \$5.7 million in merger related expenses associated with the First Mariner acquisition in the second quarter of 2018 with no merger related expenses reflected in the same period of 2017. Further reasons for this increase was a \$3.8 million increase in compensation and employee benefits and a \$1.6 million increase in occupancy and equipment, which increased for the same reasons as discussed above with respect to the six month period. Additional increases in core deposit intangible

expense of \$727 thousand data processing cost \$567 thousand, loan production cost \$359 thousand and other operating expenses increases of \$836 thousand quarter over quarter, again for the reasons discussed with respect to the six-month period.

### **Income Tax Expense**

Income taxes for the three months ended June 30, 2018 was also impacted the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. Because of the pre-tax loss in the second quarter we had an income tax benefit of \$791 thousand compared to an income tax expense of \$1.2 million for the same period in 2017.

### **Nonperforming and Problem Assets**

Management performs reviews of all delinquent loans and our loan officers contact customers to attempt to resolve potential credit issues in a timely manner. When in the best interests of the Bank and the customer, we will do a troubled debt restructuring with respect to a particular loan. When not possible, we are aggressively moving loans through the legal and foreclosure process within applicable legal constraints.

Loans are generally placed on non-accrual status when payment of principal or interest is 90 days or more past due and the value of the collateral securing the loan, if any, is less than the outstanding balance of the loan. Loans are also placed on non-accrual status if management has serious doubt about further collectability of principal or interest on the loan, even though the loan is currently performing. When loans are placed on non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received. The loan may be returned to accrual status if the loan is brought current, has performed in accordance with the contractual terms for a reasonable period of time and ultimate collectability of the total contractual principal and interest is no longer in doubt.

The table below sets forth the amounts and categories of our nonperforming assets, which consist of non-accrual loans, troubled debt restructurings and OREO (which includes real estate acquired through, or in lieu of, foreclosure), at the dates indicated.

(in thousands)	June 30, 2018	December 31, 2017
Non-accrual loans:		
Real estate loans:		
Construction and land	\$ 1,284	\$ 637
Residential - first lien	15,782	1,722
Residential - junior lien	884	396
Commercial	7,838	6,375
Commercial loans and leases	2,133	3,438
Consumer	151	-
Total non-accrual loans	28,072	12,568
Accruing troubled debt restructured loans:		
Real estate loans:		
Construction and land	125	125
Residential - first lien	283	287
Commercial loans and leases	192	208
Total accruing troubled debt restructured loans	600	620
Total non-performing loans	28,672	13,188
Other real estate owned:		
Land	1,978	956
Residential - first lien	318	-
Commercial	1,819	593
Total other real estate owned	4,115	1,549
Total non-performing assets	\$ 32,787	\$ 14,737
Ratios:		
Non-performing loans to total gross loans	1.78	% 1.41
Non-performing assets to total assets	1.50	% 1.28
Loans past due 90 days still accruing:		
Real estate loans:		
Construction and land	\$ -	\$ -
Residential - first lien	721	328
Residential - junior lien	259	50
Commercial	-	3,094
Commercial loans and leases	-	-
Consumer	16	-
	\$ 996	\$ 3,472

Included in non-accrual loans at June 30, 2018 are \$12.5 million in purchase credit impaired loans and six troubled debt restructured loans (“TDRs”) totaling \$4.3 million that were not performing in accordance with their modified



terms, and the accrual of interest has ceased. Further, there were three TDRs totaling \$600 thousand performing subject to their modified terms at June 30, 2018. There was one additional residential real estate first lien loan totaling \$99 thousand restructured during the first half of 2018.

Under GAAP, we are required to account for certain loan modifications or restructurings as “troubled debt restructurings.” In general, the modification or restructuring of a debt constitutes a troubled debt restructuring if the Bank, for economic or legal reasons related to the borrower’s financial difficulties, grants a concession, such as a reduction in the effective interest rate, to the borrower that we would not otherwise consider. A debt restructuring or loan modification for a borrower, however, does not necessarily constitute a troubled debt restructuring.

Nonperforming assets amounted to \$32.8 million, or 1.50% of total assets, at June 30, 2018 compared to \$14.7 million, or 1.28% of total assets, at December 31, 2017. Total nonperforming assets increased \$18.1 million during the first half of 2018 primarily as a result of one legacy credit and the First Mariner acquisition.

The composition of our nonperforming assets at June 30, 2018 is further described below:

Non-Accrual Loans:

- Three construction and land loans.
- 47 residential first lien loans, six with a combined fair value of \$1.4 million in the process of foreclosure.
- 18 residential junior lien loans.
- Four commercial owner occupied loans.
- 16 commercial non-owner occupied loans, representing eight separate relationships.
- 26 commercial loans, five with a Small Business Administration (“SBA”) guarantee and one that includes specific aggregate reserves of \$25 thousand.
- Two consumer loans.

Accruing Troubled Debt Restructured Loans:

- One construction and land loan in the amount of \$125 thousand.
- One residential real estate loan in the amount of \$283 thousand.
- One commercial loan in the amount of \$192 thousand.

Other Real Estate Owned:

- Several parcels of unimproved land in Maryland.
- Several lots of non-residential property in Maryland.
- One non-residential lot in Virginia
- Four commercial buildings in Maryland.
- One residential lot in Maryland.
- Three residential 1-4 family properties in Maryland totaling.

We had OREO of \$4.1 million at June 30, 2018 and \$1.5 million December 31, 2017. Costs relating to OREO recorded in noninterest expenses were \$63 thousand and \$40 thousand for the six months ended June 30, 2018 and 2017, respectively. There was no valuation allowance recorded in 2018 as the current appraised value, less estimated cost to sell, was sufficient to cover the recorded OREO amount and \$96 thousand recorded in the first six months of 2017. In the second quarter of 2018 we sold one commercial building in Sussex County Delaware and recorded a gain on the sale of \$45 thousand. Additionally we added a residential real estate first lien property totaling \$173.8 thousand in the second quarter of 2018.

## Allowance for Credit Losses

We provide for credit losses based upon the consistent application of our documented allowance for credit loss methodology. All credit losses are charged to the allowance for credit losses and all recoveries are credited to it. Additions to the allowance for credit losses are provided by charges to income based on various factors which, in our judgment, deserve current recognition in estimating probable losses. We regularly review the loan portfolio and make provisions for credit losses in order to maintain the allowance for credit losses in accordance with GAAP. The allowance for credit losses consists primarily of two components:

Specific allowances are established for loans classified as Substandard or Doubtful. For loans classified as impaired, the allowance is established when the net realizable value (collateral value less costs to sell) of the impaired loan is lower than the carrying amount of the loan. The amount of impairment provided for as a specific allowance is

- 1) represented by the deficiency, if any, between the underlying collateral value and the carrying value of the loan. Impaired loans for which the estimated fair value of the loan, or the loan's observable market price or the fair value of the underlying collateral, if the loan is collateral dependent, exceeds the carrying value of the loan are not considered in establishing specific allowances for credit losses; and

- 2) General allowances established for credit losses on a portfolio basis for loans that do not meet the definition of impaired loans. The portfolio is grouped into similar risk characteristics, primarily loan type and regulatory classification. We apply an estimated loss rate to each loan group. The loss rates applied are based upon our loss experience adjusted, as appropriate, for the qualitative factors discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions.

The allowance for credit losses is maintained at a level to provide for losses that are probable and can be reasonably estimated. Management's periodic evaluation of the adequacy of the allowance is based on past credit loss experience, known and inherent losses in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

A loan is considered past due or delinquent when a contractual payment is not paid on the day it is due. A loan is considered impaired when, based on current information and events, it is probable that Howard Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. The impairment of a loan may be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided by the collateral. Generally, Howard Bank's impairment on such loans is measured by reference to the fair value of the collateral. Interest income on impaired loans is recognized on the cash basis.

Our loan policies state that after all collection efforts have been exhausted, and the loan is deemed to be a loss, then the remaining loan balance will be charged to the established allowance for credit losses. All loans are evaluated for loss potential once it has been determined by the Watch Committee that the likelihood of repayment is in doubt. When a loan is past due for at least 90 days or a deterioration in debt service coverage ratio, guarantor liquidity, or loan-to-value ratio has occurred that would cause concern regarding the likelihood of the full repayment of principal and interest, and the loan is deemed not to be well secured, the loan should be moved to non-accrual status and a specific reserve is established if the net realizable value is less than the principal value of the loan balance(s). Once the actual loss value has been determined a charge-off against the allowance for credit losses for the amount of the loss is taken. Each loss is evaluated on its specific facts regarding the appropriate timing to recognize the loss.

The adjustments to historical loss experience are based on our evaluation of several qualitative factors, including:

- changes in lending policies, procedures, practices or personnel;
- changes in the level and composition of construction portfolio and related risks;
- changes and migration of classified assets;
- changes in exposure to subordinate collateral lien positions;
- levels and composition of existing guarantees on loans by SBA or other agencies;
- changes in national, state and local economic trends and business conditions;
- changes and trends in levels of loan payment delinquencies; and
- any other factors that managements considers relevant to the quality or performance of the loan portfolio.

We evaluate the allowance for credit losses based upon the combined total of the specific and general components. Generally when the loan portfolio increases, absent other factors, the allowance for credit loss methodology results in a higher dollar amount of estimated probable losses than would be the case without the increase. Generally when the loan portfolio decreases, absent other factors, the allowance for credit loss methodology results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

Commercial and commercial real estate loans generally have greater credit risks compared to the one- to four-family residential mortgage loans we originate, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment experience on loans secured by income-producing properties typically depends on the successful operation of the related business and thus may be subject to a greater extent to adverse conditions in the real estate market and in the general economy. Actual credit losses may be significantly more than the allowance for credit losses we have established, which could have a material negative effect on our financial results.

Generally, we underwrite commercial loans based on cash flow and business history and receive personal guarantees from the borrowers where appropriate. We generally underwrite commercial real estate loans and residential real estate loans at a loan-to-value ratio of 85% or less at origination. Accordingly, in the event that a loan becomes past due and, randomly with respect to performing loans, we will conduct visual inspections of collateral properties and/or review publicly available information, such as online databases, to ascertain property values. We will also obtain formal appraisals on a regular basis even if we are not considering liquidation of the property to repay a loan. It is our practice to obtain updated appraisals if there is a material change in market conditions or if we become aware of new or additional facts that indicate a potential material reduction in the value of any individual property collateral.

For impaired loans, we utilize the appraised value or present value of expected cash flows in determining the appropriate specific allowance for credit losses attributable to a loan. In addition, changes in the appraised value of multiple properties securing our loans may result in an increase or decrease in our general allowance for credit losses as an adjustment to our historical loss experience due to qualitative and environmental factors, as described above.

At June 30, 2018 and December 31, 2017, nonperforming loans amounted to \$28.7 million and \$13.2 million, respectively. [The primary reason for the increase in nonperforming loans was the acquisition of nonperforming loans in connection with the First Mariner acquisition.] The amount of impaired loans requiring specific reserves totaled \$514 thousand at June 30, 2018 and \$6.1 million at December 31, 2017, with the reduction primarily driven by charging off loans that previously had specific reserves held against them, which increased the levels of allowance needed. The amount of impaired loans without a specific valuation allowance totaled \$28.2 million and \$7.1 million, respectively, at such dates.

Nonperforming loans are evaluated and valued at the time the loan is identified as impaired on a case by case basis, at the lower of cost or market value. Market value is measured based on the value of the collateral securing the loan. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by us. Appraised values may be discounted based on management's historical experience, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. The difference between the appraised value and the principal balance of the loan will determine the specific allowance valuation required for the loan, if any. Nonperforming loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

We evaluate the loan portfolio on at least a quarterly basis, more frequently if conditions warrant, and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of their examination process, the Maryland Office of the Commissioner of Financial Regulation (the "Commissioner") and the FDIC will periodically review the allowance for credit losses. The Commissioner and the FDIC may require us to recognize additions to the allowance based on their analysis of information available to them at the time of their examination.

The following table sets forth activity in our allowance for credit losses for the periods ended:

(in thousands)	June 30, 2018	December 31, 2017
Balance at beginning of year	\$ 6,159	\$ 6,428
Charge-offs:		
Real estate		
Construction and land loans	(202 )	(155 )
Residential first lien loans	(102 )	(133 )
Residential junior lien loans	(149 )	(31 )
Commercial owner occupied loans	(1 )	(235 )
Commercial non-owner occupied loans	(746 )	-
Commercial loans and leases	(912 )	(1,605 )
Consumer loans	(49 )	(108 )
	(2,161 )	(2,267 )

Edgar Filing: Howard Bancorp Inc - Form 10-Q

Recoveries:

Real estate

Construction and land loans	-		6	
Residential first lien loans	1		-	
Residential junior lien loans	-		1	
Commercial owner occupied loans	-		6	
Commercial non-owner occupied loans	2		6	
Commercial loans and leases	68		113	
Consumer loans	5		35	
	76		167	
Net charge-offs	(2,085	)	(2,100	)
Provision for credit losses	2,545		1,831	
Balance at end of year	\$ 6,619		\$ 6,159	
Net charge-offs to average loans and leases	0.15	%	0.24	%

### Allocation of Allowance for Credit Losses

The following tables set forth the allowance for credit losses allocated by loan category and the percent of loans in each category to total loans at the dates indicated. The allowance for credit losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

(dollars in thousands)	June 30, 2018		December 31, 2017		
	Amount	Percent <sup>1</sup>	Amount	Percent <sup>1</sup>	
Real estate					
Construction and land loans	\$661	7.1	% \$ 735	7.9	%
Residential first lien loans	680	23.1	668	20.8	
Residential junior lien loans	213	6.0	177	4.6	
Commercial owner occupied loans	726	13.4	617	18.2	
Commercial non-owner occupied loans	1,623	26.6	1,410	27.8	
Commercial loans and leases	2,667	21.1	2,529	20.2	
Consumer loans	49	2.6	23	0.5	
Total	\$6,619	100.0	% \$ 6,159	100.0	%

<sup>1)</sup> Represents the percent of loans in each category to total loans, not the composition of the allowance for credit losses.

### Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations. Our primary sources of funds consist of deposit inflows, loan repayments, advances from the FHLB, and the sale of securities available for sale. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Committee (“ALCO”) is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We believe that we have enough sources of liquidity to satisfy our short- and long-term liquidity needs as of June 30, 2018 and December 31, 2017.

We regularly monitor and adjust our investments in liquid assets based upon our assessment of:



Expected loan demand;  
Expected deposit flows and borrowing maturities;  
Yields available on interest-earning deposits and securities; and  
The objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits and short-term securities.

Our most liquid assets are cash and cash equivalents. The level of these assets is dependent on our operating, financing, lending and investing activities during any given period. At June 30, 2018 and December 31, 2017, cash and cash equivalents totaled \$108.0 million and \$29.0 million, respectively.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our statements of cash flows included in our financial statements.

At June 30, 2018 and December 31, 2017, we had \$343.4 million and \$219.6 million, respectively, in loan commitments outstanding, derived of commitments issued to originate loans of \$97.7 million and \$81.1 million at June 30, 2018 and December 31, 2017, respectively, and \$245.7 million and \$138.5 million in unused lines of credit to borrowers at June 30, 2018 and December 31, 2017, respectively. In addition to commitments to originate loans and unused lines of credit we had \$14.6 million and \$10.8 million in letters of credit at June 30, 2018 and December 31, 2017, respectively. Certificates of deposit of \$189.9 million or 46% of our CD's are scheduled to mature during the remainder of 2018. If we do not retain these deposits, we may be required to seek other sources of funds, including loan and securities sales, and FHLB advances. Depending on market conditions, we may be required to pay higher rates on our deposits or other borrowings than we currently pay on the certificates of deposit. We believe, however, based on historical experience and current market interest rates that we will retain upon maturity a large portion of our certificates of deposit with maturities of one year or less as of June 30, 2018.

Our primary investing activity is originating loans. During the six months ended June 30, 2018, and 2017 cash used to fund net loan growth was \$10.7 million and \$63.8 million, respectively. During the first half of 2018 we purchased \$44.5 million in additional securities while receiving \$112.0 million as a result of securities sales and maturing. For the same period in 2017 we purchased additional securities totaling \$30.9 million and we received \$14.5 million in security maturities. Additionally, in 2017 we received \$9.8 million in cash from the maturities of interest bearing deposits with banks.

Financing activities consist primarily of activity in deposit accounts and FHLB advances. We experienced a net decrease in deposits of \$4.7 million during the six months ended June 30, 2018. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLB that provide an additional source of funds. FHLB advances were \$295.5 million at June 30, 2018 compared to \$131.0 million at December 31, 2017. At June 30, 2018, we had the ability to borrow up to a total of \$402.9 million based upon our credit availability at the FHLB, subject to collateral requirements.

The Company and the Bank are subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At June 30, 2018 and December 31, 2017, we exceeded all regulatory capital requirements. We are considered “well capitalized” under regulatory guidelines.

### **Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements**

We are party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of our customers. These financial instruments are limited to commitments to originate loans and involve, to varying degrees, elements of credit, interest rate, and liquidity risk. These do not represent unusual risks, and management does not anticipate any losses that would have a material effect on us.

Outstanding loan commitments and lines of credit at June 30, 2018 and December 31, 2017 are as follows:

## Edgar Filing: Howard Bancorp Inc - Form 10-Q

(in thousands)	June 30, 2018	December 31, 2017
Unfunded loan commitments	\$ 97,745	\$ 81,074
Unused lines of credit	245,670	138,526
Letters of credit	14,564	10,839

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. We generally require collateral to support financial instruments with credit risk on the same basis as we do for balance sheet instruments. Management generally bases the collateral required on the credit evaluation of the counterparty. Commitments generally have interest rates at current market rates, expiration dates or other termination clauses and may require payment of a fee. Available credit lines represent the unused portion of lines of credit previously extended and available to the customer so long as there is no violation of any contractual condition. These lines generally have variable interest rates. Since we expect many of the commitments to expire without being drawn upon, and since it is unlikely that all customers will draw upon their lines of credit in full at any one time, the total commitment amount or line of credit amount does not necessarily represent future cash requirements. We evaluate each customer's credit-worthiness on a case-by-case basis. Because we conservatively underwrite these facilities at inception, we have not had to withdraw any commitments. We are not aware of any loss that we would incur by funding our commitments or lines of credit.

The credit risk involved in these financial instruments is essentially the same as that involved in extending loan facilities to customers. No amount has been recognized in consolidated balance sheets at June 30, 2018 or December 31, 2017 as a liability for credit loss related to these commitments.

### **Impact of Inflation and Changing Prices**

Our financial statements and related notes have been prepared in accordance with GAAP. GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration of changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

**Liquidity and Funding**

The objective of effective liquidity management is to ensure that the Company can meet customer loan requests, customer deposit maturities/withdrawals, and other cash commitments efficiently under both normal operating conditions as well as under unforeseen and unpredictable circumstances of industry or market stress. To achieve this objective, ALCO establishes and monitors liquidity guidelines requiring sufficient asset based liquidity to cover potential funding requirements and to avoid over-dependence on volatile, less reliable funding markets. The Company manages liquidity at both the parent and subsidiary levels through active management of the balance sheet.

The additional information called for by this item is incorporated herein by reference to the “Liquidity and Capital Resources” section of Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” of this Quarterly Report on Form 10-Q.

**Interest Rate Risk**

Interest rate risk, one of the more prominent risks in terms of potential earnings impact, is an inevitable part of being a financial intermediary. It can occur for any one or more of the following reasons: (a) assets and liabilities may mature or reprice at different times (for example, if assets reprice faster than liabilities and interest rates are generally falling, the Company’s earnings will initially decline); (b) assets and liabilities may re-price at the same time but by different amounts (when the general level of interest rates is falling, the Company may choose for customer management, competitive, or other reasons to reduce the rates paid on checking and savings deposit accounts by an amount that is less than the general decline in market interest rates); (c) short-term and long-term market interest rates may change by different amounts (i.e. the shape of the yield curve may impact new loan yields and funding costs differently); or (d) the remaining maturity of various assets or liabilities may shorten or lengthen as interest rates change (for example, mortgage-backed securities held in the securities available for sale portfolio may prepay significantly earlier than anticipated – with an associated reduction in portfolio yield and income – if long-term mortgage rates decline sharply). In addition to the direct impact of interest rate changes on net interest income through these categories, interest rates indirectly impact earnings through their effect on loan demand, credit losses, mortgage origination fees, and other sources of the Company’s earnings.

In determining the appropriate level of interest rate risk, the Company considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The Company uses a number of tools to measure interest rate risk including a model to simulate the impact of changes in interest rates on our net interest income, monitoring the sensitivity of the net present

value of the balance sheet and monitoring the difference or gap between maturing or rate-sensitive assets and liabilities over various time periods.

Management believes that short term interest rate risk is best measured by simulation modeling. This analysis calculates expected net interest income based upon historical trends, spreads to market rates, historical market relationships, prepayment behavior and current and expected product offerings using base market rates and using a rising and a falling interest rate scenario. For example, if rates were to rise 1.00% or 2.00% over the next 12 months, net interest income might decline respectively. Conversely, if rates were to decline over the next 12 months, net interest income might increase respectively.

These estimates are highly assumption-dependent, and may change regularly as the Company's asset/liability structure and business evolves from one period to the next, results will vary as different interest rate scenarios are used and are measured relative to a base net interest income scenario that may change.

For the rising and falling interest rate scenarios, the base market interest rate forecast was increased and decreased over twelve months by 200 and 100 basis points, respectively. At June 30, 2018 and December 31, 2017, our net interest income exposure related to these hypothetical changes in market interest rates was within the current guidelines established in our governing policies.

#### **Item 4.**

#### **Controls and Procedures**

As required by SEC rules, the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report on Form 10-Q. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of June 30, 2018. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

There were no material changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II - Other Information**

### **Item 1.**

### **Legal Proceedings**

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

#### Item 1A. Risk Factors

There have been no material changes in the risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on March 15, 2018.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

#### Item 3. Defaults Upon Senior Securities

None

#### Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

**Item 6.**

**Exhibits**

- Agreement and Plan of Reorganization, dated August 14, 2017 by and among Howard Bancorp, Inc., Howard Bank and First Mariner Bank (the schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Howard Bancorp undertakes to furnish supplemental copies of any of the omitted schedules or exhibits upon request by the Securities and Exchange Commission) (incorporated by reference to Exhibit 2.1 of the Company's Form 8-K filed on August 18, 2017).
- Articles of Incorporation of Howard Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Form S-1 filed on November 28, 2011).
- Articles of Amendment to Articles of Incorporation of Howard Bancorp, Inc. (incorporated by reference to Exhibit 3.2 of the Company's Form S-1 filed November 28, 2011).
- Amended and Restated Articles Supplementary of Senior Non-Cumulative Perpetual Preferred Stock, Series AA (incorporated by reference to Exhibit 3.3 of the Company's Form S-1 filed November 28, 2011).
- Articles of Amendment to Articles of Incorporation of Howard Bancorp, Inc. (incorporated by reference to Exhibit 3.3 of the Company's Form 8-K filed January 24, 2017).
- Amended and Restated Bylaws of Howard Bancorp, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed January 25, 2018).
- Separation Agreement and General Release, dated June 15, 2018, by and between Robert A. Altieri and Howard Bank (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed June 15, 2018).
- Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - filed herewith
- Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Exchange Act pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - filed herewith
- Certifications pursuant to 18 U.S.C. Section 1350, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith
- 101 Extensible Business Reporting Language (“XBRL”) – filed herewith
- 101.INS XBRL Instance File
- 101.SCHXBRL Schema File
- 101.CALXBRL Calculation File
- 101.DEF XBRL Definition File
- 101.LAB XBRL Label File
- 101.PRE XBRL Presentation File

**Signatures**

Pursuant to the requirements 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.

HOWARD BANCORP, INC.  
(Registrant)

August 9, 2018 /s/ Mary Ann Scully  
Date MARY ANN SCULLY  
Chief Executive Officer

August 9, 2018 /s/ George C. Coffman  
Date GEORGE C. COFFMAN  
Executive Vice President and Chief Financial Officer