

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 September 30, 2019 OR

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

For the Transition Period from to

Commission file number 001-38671



**CAPITAL BANCORP, INC.**  
(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of incorporation or organization)

**2275 Research Boulevard, Suite 600,  
Rockville, Maryland 20850**

(Address of principal executive offices)

**52-2083046**

(IRS Employer Identification No.)

**20850**

(Zip Code)

**(301) 468-8848**

Registrant's telephone number, including area code

**Not Applicable**

(Former Name or Former Address, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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

Non-accelerated filer

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

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

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	CBNK	NASDAQ Stock Market

As of October 31, 2019, the Company had 13,809,558 shares of common stock, par value \$0.01 per share, outstanding.

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# Capital Bancorp, Inc. and Subsidiaries

Form 10-Q

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**PART I. CONSOLIDATED FINANCIAL INFORMATION**  
**Item 1. CONSOLIDATED FINANCIAL STATEMENTS**

**Capital Bancorp, Inc. and Subsidiaries**

**Consolidated Balance Sheets**

(in thousands except share data)	September 30, 2019 (unaudited)	December 31, 2018 (audited)
<b>Assets</b>		
Cash and due from banks	\$ 11,093	\$ 10,431
Interest bearing deposits at other financial institutions	40,521	22,007
Federal funds sold	3,464	2,285
Total cash and cash equivalents	55,078	34,723
Investment securities available for sale	37,073	46,932
Restricted investments	4,007	2,503
Loans held for sale	68,982	18,526
Loans receivable, net of allowance for loan losses of \$12,808 and \$11,308 at September 30, 2019 and December 31, 2018, respectively	1,127,502	988,960
Premises and equipment, net	6,667	2,975
Accrued interest receivable	4,636	4,462
Deferred income taxes	3,556	3,654
Foreclosed real estate	149	142
Prepaid income taxes	353	90
Other assets	3,403	2,091
Total assets	<u>\$ 1,311,406</u>	<u>\$ 1,105,058</u>
<b>Liabilities</b>		
Deposits		
Noninterest-bearing, including related party balances of \$12,128 and \$11,214 at September 30, 2019 and December 31, 2018, respectively	\$ 293,378	\$ 242,259
Interest-bearing, including related party balances of \$127,964 and \$144,624 at September 30, 2019 and December 31, 2018, respectively	819,066	712,981
Total deposits	1,112,444	955,240
Securities sold under agreements to repurchase	—	3,332
Federal funds purchased	—	2,000
Federal Home Loan Bank advances	35,556	2,000
Other borrowed funds	15,416	15,393
Accrued interest payable	2,113	1,565
Other liabilities	18,048	10,964
Total liabilities	1,183,577	990,494
<b>Stockholders' equity</b>		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; no shares issued or outstanding at September 30, 2019 and December 31, 2018	—	—
Common stock, \$.01 par value; 49,000,000 shares authorized; 13,782,538 and 13,672,479 issued and outstanding at September 30, 2019 and December 31, 2018, respectively	138	137
Additional paid-in capital	50,585	49,321
Retained earnings	77,095	65,701
Accumulated other comprehensive income (loss)	11	(595)
Total stockholders' equity	127,829	114,564
Total liabilities and stockholders' equity	<u>\$ 1,311,406</u>	<u>\$ 1,105,058</u>

See Notes to Consolidated Financial Statements

# Capital Bancorp, Inc. and Subsidiaries

## Consolidated Statements of Income (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
(dollars in thousands except per share data)				
<b>Interest income</b>				
Loans, including fees	\$ 21,900	\$ 16,955	\$ 59,548	\$ 49,455
Investment securities available for sale	215	272	707	786
Federal funds sold and other	239	220	706	649
Total interest income	22,354	17,447	60,961	50,890
<b>Interest expense</b>				
Deposits, includes payments to related parties of \$479 and \$1,448 for the three and nine months ended September 30, 2019, respectively, and \$453 and \$1,142 for the three and nine months ended September 30, 2018, respectively.				
	3,449	2,616	9,887	6,876
Borrowed funds	721	339	1,615	1,015
Total interest expense	4,170	2,955	11,502	7,891
<b>Net interest income</b>	18,184	14,492	49,459	42,999
Provision for loan losses	1,071	495	1,869	1,640
<b>Net interest income after provision for loan losses</b>	17,113	13,997	47,590	41,359
<b>Noninterest income</b>				
Service charges on deposits	146	123	382	365
Credit card fees	2,059	1,592	5,521	4,609
Mortgage banking revenue	4,900	2,451	10,991	7,379
Gain (loss) on sale of investment securities available for sale	—	—	26	(2)
Other fees and charges	116	74	320	306
Total noninterest income	7,221	4,240	17,240	12,657
<b>Noninterest expenses</b>				
Salaries and employee benefits	9,238	6,571	24,136	19,083
Occupancy and equipment	1,111	1,070	3,307	3,241
Professional fees	724	520	1,952	1,365
Data processing	4,193	3,636	11,222	10,858
Advertising	584	358	1,557	1,113
Loan processing	634	202	1,279	811
Other real estate owned expenses, net	7	7	57	38
Other operating	1,737	1,536	5,258	4,519
Total noninterest expenses	18,228	13,900	48,768	41,028
Income before income taxes	6,106	4,337	16,062	12,988
Income tax expense	1,625	1,190	4,239	3,706
<b>Net income</b>	\$ 4,481	\$ 3,147	\$ 11,823	\$ 9,282
Basic earnings per share	\$ 0.33	\$ 0.27	\$ 0.86	\$ 0.80
Diluted earnings per share	\$ 0.32	\$ 0.26	\$ 0.85	\$ 0.77
Weighted average common shares outstanding:				
Basic	13,727,519	11,719,946	13,714,260	11,631,927
Diluted	13,986,382	12,102,692	13,921,995	12,033,175

See Notes to Consolidated Financial Statements



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## Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income  
(unaudited)

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(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
<b>Net income</b>	<b>\$ 4,481</b>	<b>\$ 3,147</b>	<b>\$ 11,823</b>	<b>\$ 9,282</b>
<b>Other comprehensive income (loss):</b>				
Unrealized gain (loss) on investment securities available for sale	57	(157)	867	(860)
Reclassification of realized (gain) loss on sale of investment securities available for sale	—	—	(26)	2
Unrealized gain (loss) on cash flow hedging derivative	—	(4)	(5)	2
	<u>57</u>	<u>(161)</u>	<u>836</u>	<u>(856)</u>
Income tax (expense) benefit relating to the items above	(16)	44	(230)	235
Other comprehensive income (loss)	<u>41</u>	<u>(117)</u>	<u>606</u>	<u>(621)</u>
<b>Comprehensive income</b>	<b>\$ 4,522</b>	<b>\$ 3,030</b>	<b>\$ 12,429</b>	<b>\$ 8,661</b>

See Notes to Consolidated Financial Statements

## Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity  
(unaudited)

(dollars in thousands)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount				
<b>Balance, December 31, 2017</b>	11,537,196	\$ 115	\$ 27,051	\$ 53,200	\$ (247)	\$ 80,119
Net income	—	—	—	2,990	—	2,990
Unrealized loss on investment securities available for sale, net of income taxes	—	—	—	—	(297)	(297)
Unrealized gain on cash flow hedging derivative, net of income taxes	—	—	—	—	5	5
Stock options exercised, including tax benefit	10,408	—	285	—	—	285
Shares issued as compensation	4,068	—	122	—	—	122
Stock-based compensation	—	—	143	—	—	143
<b>Balance, March 31, 2018</b>	11,551,672	\$ 115	\$ 27,601	\$ 56,190	\$ (539)	\$ 83,367
Net income	—	—	—	3,145	—	3,145
Unrealized loss on investment securities available for sale, net of income taxes	—	—	—	—	(212)	(212)
Unrealized loss on cash flow hedging derivative, net of income taxes	—	—	—	—	(1)	(1)
Stock options exercised, including tax benefit	63,124	1	198	—	—	199
Shares issued as compensation	36,076	1	199	—	—	200
Stock-based compensation	—	—	142	—	—	142
Shares issued	16,000	—	198	—	—	198
Shares repurchased and retired	(5,500)	—	(44)	—	—	(44)
<b>Balance, June 30, 2018</b>	11,661,372	\$ 117	\$ 28,294	\$ 59,335	\$ (752)	\$ 86,994
Net income	—	—	—	3,147	—	3,147
Unrealized loss on investment securities available for sale, net of income taxes	—	—	—	—	(114)	(114)
Unrealized loss on cash flow hedging derivative, net of income taxes	—	—	—	—	(2)	(2)
Stock options exercised, including tax benefit	29,652	—	156	—	—	156
Shares issued as compensation	—	—	—	—	—	—
Stock-based compensation	—	—	143	—	—	143
Shares issued	—	—	—	—	—	—
Shares repurchased and retired	—	—	—	—	—	—
Initial public offering, common stock issued, net of costs and underwriting discount of \$2.4 million	1,500,000	15	16,318	—	—	16,333
<b>Balance, September 30, 2018</b>	13,191,024	\$ 132	\$ 44,911	\$ 62,482	\$ (868)	\$ 106,657

See Notes to Consolidated Financial Statements



## Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity  
(unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
(dollars in thousands)						
<b>Balance, December 31, 2018</b>	13,672,479	\$ 137	\$ 49,321	\$ 65,701	\$ (595)	\$ 114,564
Net income	—	—	—	3,319	—	3,319
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	270	270
Unrealized loss on cash flow hedging derivative, net of income taxes	—	—	—	—	(5)	(5)
Stock options exercised, including tax benefit	21,706	—	155	(48)	—	107
Shares issued as compensation	18,380	—	150	—	—	150
Stock-based compensation	—	—	199	—	—	199
Adoption of lease standard	—	—	—	(54)	—	(54)
<b>Balance, March 31, 2019</b>	13,712,565	\$ 137	\$ 49,825	\$ 68,918	\$ (330)	\$ 118,550
Net income	—	—	—	4,023	—	4,023
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	300	300
Stock options exercised, including tax benefit	6,100	—	47	(1)	—	46
Stock-based compensation	—	—	199	—	—	199
<b>Balance, June 30, 2019</b>	13,718,665	\$ 137	\$ 50,071	\$ 72,940	\$ (30)	\$ 123,118
Net income	—	—	—	4,481	—	4,481
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	41	41
Stock options exercised, including tax benefit	85,003	1	578	(326)	—	253
Stock-based compensation	—	—	199	—	—	199
Shares repurchased and retired	(21,130)	—	(263)	—	—	(263)
<b>Balance, September 30, 2019</b>	13,782,538	\$ 138	\$ 50,585	\$ 77,095	\$ 11	\$ 127,829

See Notes to Consolidated Financial Statements

# Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Cash Flows  
(unaudited)

(in thousands)	Nine Months Ended September 30,	
	2019	2018
<b>Cash flows from operating activities</b>		
Net income	\$ 11,823	\$ 9,282
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan losses	1,869	1,640
Provision for losses on mortgage loans sold	128	83
Provision for off balance sheet credit risk	138	56
Net amortization on investments	113	183
Depreciation	844	795
Stock-based compensation expense	597	428
Director and employee compensation paid in Company stock	150	323
Deferred income tax benefit (expense)	(132)	(94)
Amortization of debt issuance expense	23	25
(Gain) loss on sale of securities available for sale	(26)	2
Loss on sale of foreclosed real estate	—	17
Mortgage banking revenue	(10,991)	(7,379)
Proceeds from sales of loans held for sale	367,986	278,436
Originations of loans held for sale	(407,451)	(266,299)
Changes in assets and liabilities:		
Accrued interest receivable	(174)	(294)
Prepaid income taxes and taxes payable	(263)	1,003
Other assets	(1,312)	(1,298)
Accrued interest payable	548	588
Other liabilities	1,601	412
Net cash provided (used) by operating activities	(34,529)	17,909
<b>Cash flows from investing activities</b>		
Purchases of securities available for sale	(8,202)	—
Maturities, calls and principal paydowns of securities available for sale	15,535	4,573
Proceeds from sale of securities available for sale	3,280	345
Purchases of restricted investments	(1,504)	(756)
Net increase in loans receivable	(140,468)	(69,200)
Net disposals (purchases) of premises and equipment	622	(1,036)
Proceeds from sales of foreclosed real estate	50	257
Net cash used by investing activities	(130,687)	(65,817)

See Notes to Consolidated Financial Statements

# Capital Bancorp, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows (unaudited)

	Nine Months Ended September 30,	
	2019	2018
<b>Cash flows from financing activities</b>		
Net increase (decrease) in:		
Noninterest-bearing deposits	\$ 51,119	\$ 37,459
Interest-bearing deposits	106,085	(31,242)
Securities sold under agreements to repurchase	(3,332)	(21)
Federal funds purchased	(2,000)	—
Federal Home Loan Bank advances, net	33,556	15,000
Other borrowed funds	—	(2,000)
Repurchase of common stock	(263)	(44)
Proceeds from exercise of stock options	406	640
Proceeds from shares issued	—	16,530
Net cash provided by financing activities	185,571	36,322
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>20,355</b>	<b>(11,586)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>34,723</b>	<b>52,311</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 55,078</b>	<b>\$ 40,725</b>
<b>Noncash activities:</b>		
Loans transferred to foreclosed real estate	\$ 57	\$ 427
Change in unrealized gains (losses) on investments	\$ 841	\$ (858)
Change in fair value of cash flow hedging derivative	\$ (5)	\$ 2
Establishment of lease right-of-use asset	\$ 5,158	\$ —
Establishment of lease liability	\$ 5,358	\$ —
<b>Cash paid during the period for:</b>		
Taxes	\$ 4,406	\$ 1,955
Interest	\$ 10,954	\$ 7,303

See Notes to Consolidated Financial Statements

# Capital Bancorp, Inc. and Subsidiaries

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## Capital Bancorp, Inc. and Subsidiaries

### *Notes to Consolidated Financial Statements*

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#### **Note 1 - Nature of Business and Basis of Presentation**

##### **Nature of operations:**

Capital Bancorp, Inc. is a Maryland corporation and bank holding company (the "Company") for Capital Bank, N.A. (the "Bank"). The Company's primary operations are conducted by the Bank, which operates branches in Rockville, Columbia and North Bethesda, Maryland, Reston, Virginia, and the District of Columbia. The Bank is principally engaged in the business of investing in commercial, real estate, and credit card loans and attracting deposits. The Company originates residential mortgages for sale in the secondary market through Capital Bank Home Loans, our residential mortgage banking arm; and issues credit cards through OpenSky®, a secured, digitally-driven nationwide credit card platform.

The Company formed Church Street Capital, LLC ("Church Street Capital") in 2014 to provide short-term secured real estate financing to Washington, D.C. area investors and developers that may not meet all Bank credit criteria.

In addition, the Company owns all of the stock of Capital Bancorp (MD) Statutory Trust I (the "Trust"). The Trust is a special purpose non-consolidated entity organized for the sole purpose of issuing trust preferred securities.

In October 2018, the Company completed its initial public offering ("IPO") of 2,563,046 shares of its common stock at a price to the public of \$12.50 per share, 1,834,310 shares of which were sold by the Company and 728,736 shares of which were sold by certain of the Company's shareholders (the "selling shareholders"). The net proceeds to the Company from the IPO were \$19.8 million after deducting the underwriting discount and offering expenses of \$3.2 million. The Company did not receive any proceeds from the sales of shares by the selling shareholders.

##### **Basis of presentation:**

The accompanying consolidated financial statements include the activity of the Company and its wholly-owned subsidiaries, the Bank and Church Street Capital. All intercompany transactions have been eliminated in consolidation. The Company reports its activities as a single business segment. In determining the appropriateness of segment definition, the Company considers components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), and conform to general practices within the banking industry.

On August 15, 2018, the Company completed a four-for-one stock split of the Company's authorized, issued, and outstanding common stock, par value \$0.01 per share (the "Stock Split"). At the effective time of the Stock Split, each share of the Company's issued and outstanding common stock was automatically increased to four shares issued and outstanding. No fractional shares were issued in connection with the Stock Split. All share and share-related information presented in these consolidated financial statements have been retroactively adjusted to reflect the increased number of shares resulting from the Stock Split.

##### **Significant Accounting Policies:**

The preparation of consolidated financial statements in accordance with GAAP requires estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. The basis of the estimates is on historical experience and on various other assumptions that are believed to be reasonable under current circumstances, results of which form the basis for making judgments about the carrying value of certain assets and liabilities that are

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1 - Nature of Business and Basis of Presentation (continued)

not readily available from other sources. Estimates are evaluated on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

##### Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from financial institutions, interest bearing deposits with financial institutions and federal funds sold. Generally, federal funds are sold for one-day periods.

##### Investment securities

Investment securities are classified as available for sale and carried at fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. Premiums and discounts on investment securities are amortized or accreted using the interest method. Changes in the fair value of debt securities available for sale are included in stockholders' equity as unrealized gains and losses, net of the related tax effect. Unrealized losses are periodically reviewed to determine whether the loss represents an other than temporary impairment. Any unrealized losses judged to be other than a temporary impairment will be charged to income.

##### Loans held for sale

Mortgage loans originated and intended for sale are recorded at fair value, determined individually, as of the balance sheet date. Fair value is determined based on outstanding investor commitments, or in the absence of such commitments, based on current investor yield requirements. Gains and losses on loan sales are determined by the specific-identification method. 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 Income.

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 and the Allowance for Loan Losses

Loans are stated at the principal amount outstanding, adjusted for deferred origination fees, deferred origination costs, discounts on loans acquired, and the allowance for loan losses. Interest is accrued based on the loan principal balances and stated interest rates. Origination fees and costs are recognized as an adjustment to the related loan yield using approximate interest methods. The Company discontinues the accrual of interest when any portion of the principal and interest is 90 days past due and collateral is insufficient to discharge the debt in full. Generally, interest payments on nonaccrual loans are recorded as a reduction of the principal balance.

Loans are considered impaired when, based on current information, management believes the Company

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1 - Nature of Business and Basis of Presentation (continued)

will not collect all principal and interest payments according to contractual terms. Generally, loans are reviewed for impairment when the risk grade for a loan is downgraded to a classified asset category. The loans are evaluated for appropriate classification, accrual, impairment, and troubled debt restructure ("TDR") status. If collection of principal is evaluated as doubtful, all payments are applied to principal. A modification of a loan is considered a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company may consider interest rate reductions, changes to payment terms, extensions of maturities and/or principal reductions.

Loans are generally charged-off in part or in full when management determines the loan to be uncollectible. Factors for charge-off that may be considered include: repayments deemed to be projected beyond reasonable time frames, client bankruptcy and lack of assets, and/or collateral deficiencies.

The allowance for loan losses is estimated to adequately provide for probable future losses on existing loans. The allowance consists of specific and general components. For loans that are classified as impaired, an allowance is established when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value of that loan. The general component covers pools of nonclassified loans and is based on historical loss experience adjusted for qualitative factors. There may be an unallocated component of the allowance, which reflects the margin of imprecision inherent in the underlying assumptions used in the method for estimating specific and general losses in the portfolio. Actual loan performance may differ from those estimates. A loss is recognized as a charge to the allowance when management believes that collection of the loan is unlikely. Collections of loans previously charged off are added to the allowance at the time of recovery.

We determine the allowance for loan losses based on the accumulation of various components that are calculated independently in accordance with ASC 450 for pools of loans, ASC 310 for Troubled Debt Restructuring, and ASC 310 for individually evaluated loans. The process for determining an appropriate allowance for loan losses is based on a comprehensive and consistently applied analysis of the loan portfolio. The analysis considers all significant factors that affect the collectibility of the portfolio and supports the credit losses estimated by this process. It is important to recognize that the related process, methodology, and underlying assumptions require a substantial degree of judgment.

#### Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization over two to seven years. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related property. Leasehold improvements are amortized over the estimated useful lives of the improvements, approximately ten years, or the term of the lease, whichever is less. Expenditures for maintenance, repairs, and minor replacements are charged to noninterest expenses as incurred.

#### Leases

During the first quarter of 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 applies a right-of-use ("ROU") model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. The Company has elected to apply the package of practical expedients permitting entities to not reassess: 1) whether any expired or existing contracts are or contain leases; 2) the lease classification for any expired or existing leases; and 3) initial direct costs for any existing leases. Additionally, as provided by ASU 2016-02, the Company has elected not to apply the recognition requirements of ASC 842 to short-term leases, defined as leases with a term of

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1 - Nature of Business and Basis of Presentation (continued)

12 months or less, and to recognize the lease payments in net income on short-term leases on a straight-line basis over the lease term.

We adopted the guidance using the modified retrospective approach on January 1, 2019 and elected the practical expedients for transition including the transition option provided in ASU 2018-11, *Leases (Topic 842) Targeted Improvements*, which allowed the Company to initially apply the new leases standard at the adoption date. Consequently, the reporting for the comparative periods presented continued to be in accordance with ASC Topic 840, *Leases*. Therefore, the 2018 financial results and disclosures have not been adjusted.

The Company is largely accounting for our existing operating leases consistent with prior guidance except for the incremental balance sheet recognition for leases. The adoption of this standard resulted in the Company recognizing lease right-of-use assets and related lease liabilities totaling \$5.2 million and \$5.4 million, respectively, as of January 1, 2019. The difference between the lease assets and the lease liabilities was \$146 thousand of deferred rent, which was reclassified to lease liabilities, and the remainder was recorded as an adjustment to retained earnings in the amount of \$54 thousand. The adoption of this ASU did not have a significant impact on the Company's consolidated statement of income. Additional information is included in Note 5 - Leases.

#### Derivative Financial Instruments

The Company enters into commitments to fund residential mortgage loans (interest rate locks) with the intention of selling them in the secondary market. The Company also enters into forward sales agreements for certain funded loans and loan commitments. The Company records unfunded commitments intended for loans held for sale and forward sales agreements at fair value with changes in fair value recorded as a component of mortgage banking revenue. Loans originated and intended for sale in the secondary market are carried at fair value. For pipeline loans which are not pre-sold to an investor, the Company manages the interest rate risk on rate lock commitments by entering into forward sale contracts, whereby the Company obtains the right to deliver securities to investors in the future at a specified price. Such contracts are accounted for as derivatives and are recorded at fair value as derivative assets or liabilities, with changes in fair value recorded in mortgage banking revenue.

The Company accounts for derivative instruments and hedging activities according to guidelines established in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815-10, *Accounting for Derivative Instruments and Hedging Activities*, as amended. The Company recognizes all derivatives as either assets or liabilities on the balance sheet and measures those instruments at fair value. Changes in fair value of derivatives designated and accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income, net of deferred taxes. Any hedge ineffectiveness would be recognized in the income statement line item pertaining to the hedged item.

#### Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market inputs. For financial instruments that are traded actively and have quoted market prices or observable market inputs, there is minimal subjectivity involved in measuring fair value. However, when quoted market prices or observable market inputs are not fully available, significant management judgment may be necessary to estimate fair value. In developing our fair value estimates, we endeavor to maximize the use of observable

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 1 - Nature of Business and Basis of Presentation (continued)

inputs and minimize the use of unobservable inputs.

The fair value hierarchy defines Level 1 valuations as those based on quoted prices (unadjusted) for identical assets or liabilities in active markets. Level 2 valuations include inputs based on quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 3 valuations are based on at least one significant assumption not observable in the market, or significant management judgment or estimation, some of which may be internally developed.

Financial assets that are recorded at fair value on a recurring basis include investment securities available for sale, loans held for sale, and derivative financial instruments. Financial liabilities that are recorded at fair value on a recurring basis are comprised of derivative financial instruments. Additional information is included in Note 6 - Fair Value.

#### Income Taxes

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are recognized when it is deemed more likely than not that the benefits of such deferred income taxes will be realized.

#### Earnings per share:

Earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding, adjusted for the dilutive effect of stock options and restricted stock using the treasury stock method. At September 30, 2019 and 2018, there were 273,600 and 266,600 stock options, respectively, that were not included in the calculation as their effect would have been anti-dilutive. The following is a reconciliation of the numerators and denominators used in computing basic and diluted earnings per common share as adjusted for the Stock Split:

	For the Three Months Ended September 30,					
	2019			2018		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<small>(dollars in thousands, except per share information)</small>						
<b>Basic EPS</b>						
Net income available to common stockholders	\$ 4,480	13,727,519	\$ 0.33	\$ 3,147	11,719,946	\$ 0.27
Effect of dilutive securities	—	258,863	—	—	382,746	
Dilutive EPS per common share	\$ 4,480	13,986,382	\$ 0.32	\$ 3,147	12,102,692	\$ 0.26



**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 1 - Nature of Business and Basis of Presentation (continued)**

	For the Nine Months Ended September 30,					
	2019			2018		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
<i>(dollars in thousands, except per share information)</i>						
<b>Basic EPS</b>						
Net income available to common stockholders	\$ 11,822	13,714,260	\$ 0.86	\$ 9,282	11,631,927	\$ 0.80
Effect of dilutive securities	—	207,735	—	—	401,248	—
Dilutive EPS per common share	\$ 11,822	13,921,995	\$ 0.85	\$ 9,282	12,033,175	\$ 0.77

***Comprehensive income:***

The Company reports as comprehensive income all changes in stockholders' equity during the year from sources other than stockholders. Other comprehensive income refers to all components (income, expenses, gains, and losses) of comprehensive income that are excluded from net income.

The Company's only two components of other comprehensive income are unrealized gains and losses on investment securities available for sale, net of income taxes, and unrealized gains and losses on cash flow hedges, net of income taxes. Information concerning the Company's accumulated other comprehensive income (loss) as of September 30, 2019 and December 31, 2018 are as follows:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Unrealized gains (losses) on securities available for sale	\$ 16	\$ (825)
Deferred tax (expense) benefit	(4)	227
Other comprehensive income (loss), net of tax	12	(598)
Unrealized gains on cash flow hedges	—	5
Deferred tax expense	—	(2)
Other comprehensive income, net of tax	—	3
Total accumulated comprehensive income (loss)	\$ 12	\$ (595)

***Recently issued accounting pronouncements:***

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. In October 2019, the FASB voted to delay implementation and the new standard is now effective for fiscal years beginning after December 15, 2022, including the interim periods within those fiscal years. The Company expects the provisions of this standard to impact the Company's consolidated financial statements, in particular, the level of the reserve for credit losses. The Company is continuing to evaluate the extent of the potential impact and expects that portfolio composition and economic conditions at the time of adoption will be a factor.

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 1 - Nature of Business and Basis of Presentation (continued)

The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, the Company does not expect to elect that option. The Company is evaluating the impact of the ASU on our consolidated financial statements. In addition to our allowance for loan losses, the Company will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In August 2018, the FASB amended the Fair Value Measurement Topic 820 disclosure framework. These amendments include additions, removals and modifications to the fair value disclosure requirements in Topic 820, and are effective for the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted on removed or modified disclosures. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2019, the FASB issued codification improvements to ASU Topic 842 - Leases, which clarifies fair value of leases, cash presentation and accounting change disclosures. These codification improvements were adopted to coincide with the adoption of ASU Topic 842 Leases. The adoption of this ASU did not have a material impact on the Company's Consolidated Financial Statements.

In April 2019, the FASB issued codification improvements to ASU Topic 326 - Financial Instruments - Credit Loss, Topic 815 - Derivatives and Hedging, and Subtopic 825-10 - Financial Instruments. This codification provides technical corrections and clarifies issues related to fair value hedges. The Company early adopted this guidance upon issuance, and it did not have a material impact on the Company's Consolidated Financial Statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

#### **Reclassifications:**

Certain reclassifications have been made to the amounts reported in prior periods to conform to the current period presentation. The reclassifications had no effect on net income or total stockholders' equity.

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**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

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**Note 2 - Investment Securities**

The amortized cost and estimated fair value of investment securities at September 30, 2019 and December 31, 2018 are summarized as follows:

**Investment Securities Available for Sale**

(in thousands)

September 30, 2019	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<i>Available for sale</i>				
U.S. government-sponsored enterprises	\$ 6,000	\$ —	\$ (8)	\$ 5,992
Municipal	515	13	—	528
Corporate	2,663	41	(32)	2,672
Mortgage-backed securities	27,879	86	(84)	27,881
	\$ 37,057	\$ 140	\$ (124)	\$ 37,073
December 31, 2018				
<i>Available for sale</i>				
U.S. government-sponsored enterprises	\$ 17,496	\$ —	\$ (136)	\$ 17,360
Municipal	517	—	(16)	501
Corporate	2,908	28	(51)	2,885
Mortgage-backed securities	26,836	46	(696)	26,186
	\$ 47,757	\$ 74	\$ (899)	\$ 46,932

Proceeds from sales of securities sold during the nine months ended September 30, 2019 and 2018 were \$3.3 million and \$345 thousand, respectively. The investment sales resulted in realized gains of \$26 thousand for the nine months ended September 30, 2019 period. Investment sales resulted in losses of \$2 thousand for the nine months ended September 30, 2018 period. There were no securities sold during the three months ended September 30, 2019 or 2018.

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 2 - Investment Securities (continued)

Information related to unrealized losses in the investment portfolio as of September 30, 2019 and December 31, 2018 are as follows:

#### Investment Securities Unrealized Losses

(in thousands)

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>September 30, 2019</b>						
U.S. government-sponsored enterprises	\$ —	\$ —	\$ 5,992	\$ (8)	\$ 5,992	\$ (8)
Municipal	—	—	—	—	—	—
Corporate	—	—	631	(32)	631	(32)
Mortgage-backed securities	3,786	(9)	8,346	(75)	12,132	(84)
	<u>\$ 3,786</u>	<u>\$ (9)</u>	<u>\$ 14,969</u>	<u>\$ (115)</u>	<u>\$ 18,755</u>	<u>\$ (124)</u>
<b>December 31, 2018</b>						
U.S. government-sponsored enterprises	\$ 496	\$ (2)	\$ 16,864	\$ (134)	\$ 17,360	\$ (136)
Municipal	—	—	501	(16)	501	(16)
Corporate	—	—	857	(51)	857	(51)
Mortgage-backed securities	2,294	(7)	21,037	(689)	23,331	(696)
	<u>\$ 2,790</u>	<u>\$ (9)</u>	<u>\$ 39,259</u>	<u>\$ (890)</u>	<u>\$ 42,049</u>	<u>\$ (899)</u>

At September 30, 2019, there were three U.S. government-sponsored enterprises securities, two corporate securities, and six mortgage-backed securities that had been in a loss position for greater than twelve months. At December 31, 2018, there were nine U.S. government-sponsored enterprises securities, two corporate securities, and fifteen mortgage-backed securities that had been in a loss position for greater than twelve months. Management believes that all unrealized losses have resulted from changes in the interest rates and current market conditions and not as a result of credit deterioration. Management has the ability and the intent to hold these investment securities until maturity or until they recover in value.

A summary of pledged securities at September 30, 2019 and December 31, 2018 are shown below:

#### Pledged Securities

	September 30, 2019		December 31, 2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(in thousands)				
Securities sold under agreements to repurchase	\$ —	\$ —	\$ 16,032	\$ 15,862
Federal Home Loan Bank advances	1,587	1,596	6,713	6,662
	<u>\$ 1,587</u>	<u>\$ 1,596</u>	<u>\$ 22,745</u>	<u>\$ 22,524</u>

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**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

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**Note 2 - Investment Securities (continued)**

Contractual maturities of U.S. government-sponsored enterprises, municipals and corporate securities at September 30, 2019 and December 31, 2018 are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

**Contractual Maturities**

(in thousands)	September 30, 2019		December 31, 2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 6,000	\$ 5,992	\$ 16,496	\$ 16,377
Over one to five years	—	—	1,000	983
Over five to ten years	2,000	2,041	2,000	2,028
Over ten years	1,178	1,159	1,425	1,358
Mortgage-backed securities <sup>(1)</sup>	27,879	27,881	26,836	26,186
	<u>\$ 37,057</u>	<u>\$ 37,073</u>	<u>\$ 47,757</u>	<u>\$ 46,932</u>

<sup>(1)</sup> Mortgage-backed securities are due in monthly installments.

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3 - Loans Receivable

Major classifications of loans as are as follows:

#### Loan Categories

(in thousands)	September 30, 2019	December 31, 2018
Real estate		
Residential	\$ 443,961	\$ 407,844
Commercial	339,448	278,691
Construction	182,224	157,586
Commercial	132,935	122,264
Credit card	44,058	34,673
Other consumer	1,148	1,202
	<u>1,143,774</u>	<u>1,002,260</u>
Deferred origination fees, net	(3,464)	(1,992)
Allowance for loan losses	(12,808)	(11,308)
Loans receivable, net	<u>\$ 1,127,502</u>	<u>\$ 988,960</u>

The Company makes loans to customers located primarily in the Washington, D.C. and Baltimore metropolitan areas. Although the loan portfolio is diversified, its performance is influenced by the regional economy. The Company's loan categories are described below.

*Residential Real Estate Loans.* One-to-four family mortgage loans are primarily secured by owner-occupied primary residences and, to a lesser extent, investor owned residences. Residential loans are originated through the commercial sales teams and Capital Bank Home Loans division. Residential loans also include home equity lines of credit. One-to-four family residential loans have a relatively small balance spread between many individual borrowers compared to our other loan categories. Owner-occupied residential real estate loans usually have fixed rates for five or seven years and adjust on an annual basis after the initial term based on a typical maturity of 30 years. Investor residential real estate loans are generally based on 25-year terms with a balloon payment due after five years. The required minimum debt service coverage ratio is 1.15. Residential real estate loans have represented a stable and growing portion of our loan portfolio. The emphasis will continue to be on residential real estate lending.

*Commercial Real Estate Loans.* Commercial real estate loans are originated on owner-occupied and non-owner-occupied properties. These loans may be more adversely affected by conditions in the real estate markets or in the general economy. Commercial loans that are secured by owner-occupied commercial real estate and primarily collateralized by operating cash flows are also included in this category of loans. As of September 30, 2019, there were approximately \$171.7 million of owner-occupied commercial real estate loans, representing approximately 51% of the commercial real estate portfolio. Commercial real estate loan terms are generally extended for 10 years or less and amortize generally over 25 years or less. The interest rates on commercial real estate loans have initial fixed rate terms that adjust typically at 5 years and origination fees are routinely charged for services. Personal guarantees from the principal owners of the business are generally required, supported by a review of the principal owners' personal financial statements and global debt service obligations. The properties securing the portfolio are located primarily throughout the Company's markets and are generally diverse in terms of type. This diversity helps reduce the exposure to adverse economic events that affect any single industry.

*Construction Loans.* Construction loans are offered within the Company's Washington, D.C. and Baltimore, Maryland metropolitan operating areas to builders primarily for the construction of single-family homes and condominium and townhouse conversions or renovations and, to a lesser extent, to individuals.

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 3 - Loans Receivable (continued)

Construction loans typically have terms of 12 to 18 months with the goal of transitioning the borrowers to permanent financing or re-underwriting and selling into the secondary market through Capital Bank Home Loans. According to underwriting standards, the ratio of loan principal to collateral value, as established by an independent appraisal, cannot exceed 75% for investor-owned and 80% for owner-occupied properties. On a case by case basis, exceptions to these limits may be granted with appropriate credit mitigants. Semi-annual stress testing of the construction loan portfolio is conducted, and underlying real estate conditions are closely monitored as well as the borrower's trends of sales valuations as compared to underwriting valuations as part of the ongoing risk management efforts. The borrowers' progress in construction buildout is monitored.

*Commercial Business Loans.* In addition to other loan products, general commercial loans, including commercial lines of credit, working capital loans, term loans, equipment financing, letters of credit and other loan products are offered, primarily in target markets, and underwritten based on each borrower's ability to service debt from income. These loans are primarily made based on the identified cash flows of the borrower and secondarily, on the underlying collateral provided by the borrower. Most commercial business loans are secured by a lien on general business assets including, among other things, available real estate, accounts receivable, promissory notes, inventory and equipment, and personal guaranties from the borrower or other principal are generally obtained.

*Credit Cards.* Our OpenSky® credit card division provides credit cards on a nationwide basis to under-banked populations and those looking to rebuild their credit scores through a fully digital and mobile platform. Substantially all of the lines of credit are secured by a noninterest bearing demand account at the Bank in an amount equal to the full credit limit of the credit card. In addition, using a proprietary scoring model, which considers credit score and repayment history (typically a minimum of six months of on-time repayments, but ultimately determined on a case-by-case basis), the Bank has recently begun to offer certain customers an unsecured line in excess of their secured line of credit. Approximately \$41.4 million and \$32.5 million of the credit card balances were secured by savings deposits held by the Company as of September 30, 2019 and December 31, 2018, respectively.

*Other Consumer Loans.* To a limited extent and typically as an accommodation to existing customers, personal consumer loans such as term loans, car loans or boat loans are offered.

Loans acquired through acquisitions are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In estimating the fair value of loans acquired, certain factors were considered, including the remaining lives of the acquired loans, payment history, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, and the net present value of cash flows expected. Discounts on loans that were not considered impaired at acquisition were recorded as an accretable discount, which will be recognized in interest income over the terms of the related loans. For loans considered to be impaired, the difference between the contractually required payments and expected cash flows was recorded as a nonaccretable discount. Generally, the nonaccretable discount will be recognized after collection of the discounted fair value of the related loan. The remaining nonaccretable discounts on loans acquired were \$345 thousand and \$354 thousand as of September 30, 2019 and December 31, 2018, respectively. Loans with nonaccretable discounts had a carrying value of approximately \$1.2 million as of both September 30, 2019 and December 31, 2018.

**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 3 - Loans Receivable (continued)**

Accretable discounts on loans acquired is summarized as follows:

**Accretable Discounts on Loans Acquired**

(in thousands)	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
Accretable discount at beginning of period	\$ 424	\$ 519	\$ 438	\$ 543
Accretion and payoff of loans	(13)	(52)	(27)	(76)
Other changes, net	22	—	22	—
Accretable discount at end of period	<u>\$ 433</u>	<u>\$ 467</u>	<u>\$ 433</u>	<u>\$ 467</u>

The following tables set forth the changes in the allowance for loan losses and an allocation of the allowance for loan losses by class for the three and nine months ended September 30, 2019 and September 30, 2018.

**Allowance for Loan Losses**

(in thousands)	Beginning Balance	Provision for Loan Losses	Charge-Offs	Recoveries	Ending Balance
<b>Three Months Ended September 30, 2019</b>					
Real estate					
Residential	\$ 3,915	\$ 269	\$ (8)	\$ —	\$ 4,176
Commercial	3,116	307	—	3	3,426
Construction	2,204	173	—	—	2,377
Commercial	1,472	140	(54)	—	1,558
Credit card	1,199	181	(120)	3	1,263
Other consumer	7	1	—	—	8
	<u>\$ 11,913</u>	<u>\$ 1,071</u>	<u>\$ (182)</u>	<u>\$ 6</u>	<u>\$ 12,808</u>

**Nine Months Ended September 30, 2019**

Real estate					
Residential	\$ 3,541	\$ 643	\$ (8)	\$ —	\$ 4,176
Commercial	3,003	413	—	10	3,426
Construction	2,093	284	—	—	2,377
Commercial	1,578	62	(82)	—	1,558
Credit card	1,084	468	(303)	14	1,263
Other consumer	9	(1)	—	—	8
	<u>\$ 11,308</u>	<u>\$ 1,869</u>	<u>\$ (393)</u>	<u>\$ 24</u>	<u>\$ 12,808</u>



**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 3 - Loans Receivable (continued)**

**Allowance for Loan Losses**

(in thousands)

Three Months Ended September 30, 2018	Beginning Balance	Provision for Loan Losses	Charge-Offs	Recoveries	Ending Balance
Real estate					
Residential	\$ 3,207	\$ 290	\$ (122)	\$ 1	\$ 3,376
Commercial	2,948	(110)	—	143	2,981
Construction	1,889	(68)	—	—	1,821
Commercial	1,396	222	—	33	1,651
Credit card	997	161	(107)	3	1,054
Other consumer	9	—	—	—	9
	<u>\$ 10,446</u>	<u>\$ 495</u>	<u>\$ (229)</u>	<u>\$ 180</u>	<u>\$ 10,892</u>

**Nine Months Ended September 30, 2018**

Real estate					
Residential	\$ 3,137	\$ 357	\$ (122)	\$ 4	\$ 3,376
Commercial	2,860	(6)	(22)	149	2,981
Construction	1,646	175	—	—	1,821
Commercial	1,497	268	(147)	33	1,651
Credit card	885	845	(715)	39	1,054
Other consumer	8	1	—	—	9
	<u>\$ 10,033</u>	<u>\$ 1,640</u>	<u>\$ (1,006)</u>	<u>\$ 225</u>	<u>\$ 10,892</u>

**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 3 - Loans Receivable (continued)**

The following tables present, by class and reserving methodology, the allocation of the allowance for loan losses and the gross investment in loans. The allowance for loan losses consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for current economic factors.

**Allowance for Loan Loss Composition**

(in thousands)	Allowance for Loan Losses Ending Balance Evaluated for Impairment:		Outstanding Loan Balances Evaluated for Impairment:	
	Individually	Collectively	Individually	Collectively
<b>September 30, 2019</b>				
Real estate				
Residential	\$ —	\$ 4,176	\$ 2,193	\$ 441,768
Commercial	—	3,426	1,036	338,412
Construction	—	2,377	2,100	180,124
Commercial	258	1,300	842	132,093
Credit card	—	1,263	—	44,058
Other consumer	—	8	—	1,148
	<u>\$ 258</u>	<u>\$ 12,550</u>	<u>\$ 6,171</u>	<u>\$ 1,137,603</u>
<b>December 31, 2018</b>				
Real estate				
Residential	\$ —	\$ 3,541	\$ 2,120	\$ 405,724
Commercial	—	3,003	1,486	277,205
Construction	—	2,093	—	157,586
Commercial	262	1,316	749	121,515
Credit card	—	1,084	—	34,673
Other consumer	—	9	—	1,202
	<u>\$ 262</u>	<u>\$ 11,046</u>	<u>\$ 4,355</u>	<u>\$ 997,905</u>

**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 3 - Loans Receivable (continued)**

Past due loans, segregated by age and class of loans, as of September 30, 2019 and December 31, 2018 were as follows:

**Loans Past Due**

(in thousands)	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due	Non accrual Loans
<b>September 30, 2019</b>							
Real estate							
Residential	\$ 2,439	\$ 1,694	\$ 4,133	\$ 439,828	\$ 443,961	\$ 124	\$ 2,193
Commercial	460	1,280	1,740	337,708	339,448	244	1,036
Construction	408	2,100	2,508	179,716	182,224	—	2,100
Commercial	13	717	730	132,205	132,935	—	842
Credit card	5,180	3	5,183	38,875	44,058	3	—
Other consumer	—	—	—	1,148	1,148	—	—
	<u>\$ 8,500</u>	<u>\$ 5,794</u>	<u>\$ 14,294</u>	<u>\$ 1,129,480</u>	<u>\$ 1,143,774</u>	<u>\$ 371</u>	<u>\$ 6,171</u>
Acquired loans included in total above	<u>\$ 719</u>	<u>\$ 646</u>	<u>\$ 1,365</u>	<u>\$ 5,291</u>	<u>\$ 6,656</u>	<u>\$ 244</u>	<u>\$ 568</u>
<b>December 31, 2018</b>							
Real estate							
Residential	\$ 1,070	\$ 2,081	\$ 3,151	\$ 404,693	\$ 407,844	\$ 235	\$ 2,207
Commercial	1,746	1,431	3,177	275,514	278,691	—	1,486
Construction	—	—	—	157,586	157,586	—	—
Commercial	612	398	1,010	121,254	122,264	—	749
Credit card	3,771	2	3,773	30,900	34,673	2	—
Other consumer	—	—	—	1,202	1,202	—	—
	<u>\$ 7,199</u>	<u>\$ 3,912</u>	<u>\$ 11,111</u>	<u>\$ 991,149</u>	<u>\$ 1,002,260</u>	<u>\$ 237</u>	<u>\$ 4,442</u>
Acquired loans included in total above	<u>\$ 521</u>	<u>\$ 488</u>	<u>\$ 1,009</u>	<u>\$ 7,275</u>	<u>\$ 8,284</u>	<u>\$ 235</u>	<u>\$ 582</u>

There were \$566 thousand and \$221 thousand, respectively, of loans secured by one to four family residential properties in the process of foreclosure as of September 30, 2019 and December 31, 2018.

**Capital Bancorp, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**

**Note 3 - Loans Receivable (continued)**

Impaired loans were as follows:

**Impaired Loans**

(in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
<b>September 30, 2019</b>					
Real estate					
Residential	\$ 2,583	\$ 2,193	\$ —	\$ 2,193	\$ —
Commercial	1,135	1,036	—	1,036	—
Construction	2,132	2,100	—	2,100	—
Commercial	972	366	476	842	258
	<u>\$ 6,822</u>	<u>\$ 5,695</u>	<u>\$ 476</u>	<u>\$ 6,171</u>	<u>\$ 258</u>
Acquired loans included above	<u>\$ 900</u>	<u>\$ 568</u>	<u>\$ —</u>	<u>\$ 568</u>	<u>\$ —</u>
<b>December 31, 2018</b>					
Real estate					
Residential	\$ 2,411	\$ 2,120	\$ —	\$ 2,120	\$ —
Commercial	1,551	1,486	—	1,486	—
Construction	32	—	—	—	—
Commercial	856	363	386	749	262
	<u>\$ 4,850</u>	<u>\$ 3,969</u>	<u>\$ 386</u>	<u>\$ 4,355</u>	<u>\$ 262</u>
Acquired loans included above	<u>\$ 775</u>	<u>\$ 497</u>	<u>\$ —</u>	<u>\$ 497</u>	<u>\$ —</u>

The following tables summarize interest recognized on impaired loans:

(in thousands)	Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
<b>Interest Recognized on Impaired Loans</b>				
Real estate				
Residential	\$ 2,612	\$ 8	\$ 2,620	\$ 11
Commercial	1,160	2	1,161	2
Construction	2,133	—	2,132	—
Commercial	1,003	8	1,005	9
	<u>\$ 6,908</u>	<u>\$ 18</u>	<u>\$ 6,918</u>	<u>\$ 22</u>

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3 - Loans Receivable (continued)

Interest Recognized on Impaired Loans	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
(in thousands)				
Real estate				
Residential	\$ 2,104	\$ 12	\$ 2,116	\$ 12
Commercial	1,116	—	1,134	—
Construction	876	24	1,020	24
Commercial	1,253	—	1,276	—
	<u>\$ 5,349</u>	<u>\$ 36</u>	<u>\$ 5,546</u>	<u>\$ 36</u>

Impaired loans include loans acquired on which management has recorded a nonaccretable discount.

#### Credit quality indicators

As part of the ongoing monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grade of loans, the level of classified loans, net charge-offs, nonperforming loans, and the general economic conditions in the Company's market.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. A description of the general characteristics of loans characterized as classified is as follows:

#### **Special Mention**

A special mention loan 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 Company's credit position at some future date. Special mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Borrowers may exhibit poor liquidity and leverage positions resulting from generally negative cash flow or negative trends in earnings. Access to alternative financing may be limited to finance companies for business borrowers and may be unavailable for commercial real estate borrowers.

#### **Substandard**

A substandard loan is inadequately protected by the current financial condition and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Borrowers may exhibit recent or unexpected unprofitable operations, an inadequate debt service coverage ratio, or marginal liquidity and capitalization. These loans require more intense supervision by Company management.

#### **Doubtful**

A doubtful loan has all the weaknesses inherent as a substandard loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3 - Loans Receivable (continued)

The following table presents the balances of classified loans based on the risk grade. Classified loans include Special Mention, Substandard, and Doubtful loans:

#### Loan Classifications

(in thousands)

	Pass <sup>(1)</sup>	Special Mention	Substandard	Doubtful	Total
<b>September 30, 2019</b>					
Real estate:					
Residential	\$ 441,694	\$ —	\$ 2,267	\$ —	\$ 443,961
Commercial	334,365	4,047	1,036	—	339,448
Construction	180,124	—	2,100	—	182,224
Commercial	125,699	5,410	1,607	219	132,935
Credit card	44,058	—	—	—	44,058
Other consumer	1,148	—	—	—	1,148
Total	\$ 1,127,088	\$ 9,457	\$ 7,010	\$ 219	\$ 1,143,774
<b>December 31, 2018</b>					
Real estate:					
Residential	\$ 405,532	\$ 118	\$ 2,194	\$ —	\$ 407,844
Commercial	274,247	2,958	1,486	—	278,691
Construction	154,643	843	2,100	—	157,586
Commercial	117,670	3,844	750	—	122,264
Credit card	34,673	—	—	—	34,673
Other consumer	1,202	—	—	—	1,202
Total	\$ 987,967	\$ 7,763	\$ 6,530	\$ —	\$ 1,002,260

<sup>(1)</sup> Category includes loans graded exceptional, very good, good, satisfactory and pass/watch

Impaired loans also include certain loans that have been modified in troubled debt restructurings where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. The status of TDRs is as follows:

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3 - Loans Receivable (continued)

##### Troubled Debt Restructurings

(in thousands)

September 30, 2019	Number of Contracts	Recorded Investment		
		Performing	Nonperforming	Total
Real estate				
Residential	3	\$ —	\$ 145	\$ 145
Commercial	2	—	320	320
	5	\$ —	\$ 465	\$ 465
Acquired loans included in total above	3	\$ —	\$ 145	\$ 145
December 31, 2018				
Real estate				
Residential	3	\$ —	\$ 145	\$ 145
Commercial	1	—	139	139
	4	\$ —	\$ 284	\$ 284
Acquired loans included in total above	3	\$ —	\$ 145	\$ 145

During the nine months ended September 30, 2019, there was one new troubled debt restructured loan, for which the scheduled payment was extended, with a pre-modification and post-modification recorded investment of \$198 thousand. The Company had no defaulted TDR loans over the last twelve months. There was one restructured loan charged off in the amount of \$15 thousand for the nine months ended September 30, 2018.

Outstanding loan commitments were as follows:

##### Loan Commitments

(in thousands)

	September 30, 2019	December 31, 2018
Unused lines of credit		
Commercial	\$ 49,278	\$ 52,083
Commercial real estate	10,677	8,980
Residential real estate	15,347	12,853
Home equity	27,715	27,243
Secured credit card	37,472	29,142
Personal	36	126
Construction commitments		
Residential real estate	98,002	72,424
Commercial real estate	11,534	6,358
Total unused lines of credit	\$ 250,061	\$ 209,209
Commitments to originate residential loans held for sale	\$ 2,306	\$ 647
Letters of credit	\$ 5,502	\$ 6,216

Lines of credit are agreements to lend to a customer as long as there is no violation of any condition of the contract. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Loan

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 3 - Loans Receivable (continued)

commitments generally have variable interest rates, fixed expiration dates, and may require payment of a fee.

The Company's maximum exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the credit commitment. Loan commitments and lines of credit are made on the same terms, including collateral, as outstanding loans. Management is not aware of any accounting loss to be incurred by funding these loan commitments. The Company maintains an estimated reserve for off balance sheet items such as unfunded lines of credit which is reflected in other liabilities. Activity for this account is as follows:

#### Off Balance Sheet Reserve

(in thousands)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
Balance at beginning of period	\$ 1,146	\$ 990	\$ 1,053	\$ 901
Provision charged to operating expense	45	(33)	138	56
Balance at end of period	\$ 1,191	\$ 957	\$ 1,191	\$ 957

The Company makes representations and warranties that loans sold to investors meet their program's guidelines and that the information provided by the borrowers is accurate and complete. In the event of a default on a loan sold, the investor may have the right to make a claim for losses due to document deficiencies, program compliance, early payment default, and fraud or borrower misrepresentations.

The Company maintains an estimated reserve for potential losses on mortgage loans sold which is reflected in other liabilities. Activity in this reserve is as follows for the periods presented:

#### Mortgage Loan Put-back Reserve

(in thousands)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2019	September 30, 2018	September 30, 2019	September 30, 2018
Balance at beginning of period	\$ 527	\$ 487	\$ 501	\$ 457
Provision charged to operating expense	61	26	128	83
Charge-offs	(48)	(22)	(89)	(49)
Balance at end of period	\$ 540	\$ 491	\$ 540	\$ 491



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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 4 - Derivative Financial Instruments

As part of its mortgage banking activities, the Company enters into interest rate lock commitments, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Company then either locks the loan and rate in with an investor and commits to deliver the loan if settlement occurs (Best Efforts) or commits to deliver the locked loan to an investor in a binding (Mandatory) delivery program. Certain loans under rate lock commitments are covered under forward sales contracts. Forward sales contracts are recorded at fair value with changes in fair value recorded in mortgage banking revenue. Interest rate lock commitments and commitments to deliver loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Company determines the fair value of rate lock commitments and delivery contracts by estimating the fair value of the underlying asset, which is impacted by current interest rates and takes into consideration the probability that the rate lock commitments will close or will be funded.

On January 7, 2015, the Company entered into an interest rate swap transaction with a notional amount of \$2 million. The swap qualifies as a derivative and is designated as a hedging instrument. The swap fixed the interest rate the Company paid on the floating rate junior subordinated debentures for four years beginning on March 16, 2015 and matured on March 16, 2019. Based on the notional amount, the Company paid FTN Financial Markets ("FTN") quarterly interest at a fixed rate, and FTN paid the Company interest at a rate of three-month LIBOR plus 1.87%. The unrealized gain (loss), net of income tax, has been recorded in other comprehensive income.

The following table reports the commitment and fair value amounts on the outstanding derivatives:

#### Derivatives

(in thousands)

	September 30, 2019	December 31, 2018
Notional amount of open forward sales agreements	\$ 112,500	\$ 25,000
Fair value of open forward delivery sales agreements	(120)	(253)
Notional amount of open mandatory delivery commitments	21,454	4,256
Fair value of open mandatory delivery commitments	46	59
Notional amount of interest rate lock commitments	87,619	18,776
Fair value of interest rate lock commitments	(45)	108
Fair value of interest rate swap	—	5

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 5 - Leases

On January 1, 2019, the Company adopted ASU 2016-02, Leases, as further explained in Note 1 - Nature of Business and Basis of Presentation. The Company's primary leasing activities relate to certain real estate leases entered into in support of the Company's branch operations and back office operations. As of January 1, 2019, the Company had leased five of its full service branches and four other locations for corporate/administration activities, operations, and loan production. All property leases under lease agreements have been designated as operating leases. The Company does not have leases designated as finance leases.

The Company determines if an arrangement is a lease at inception. Operating lease right-of-use ("ROU") assets are included in premises and equipment, and operating lease liabilities are included as other liabilities in the consolidated balance sheets. ROU assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The weighted average discount rate used was 2.24%. The operating lease ROU asset also includes any lease pre-payments. The Company's lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company has lease agreements with lease and non-lease components, which the Company has elected to account for separately as the non-lease component amounts are readily determinable under most leases.

As of September 30, 2019, the Company's lease ROU assets and related lease liabilities were \$4.2 million and \$4.6 million, respectively, and have remaining terms ranging from 1 - 6 years, including extension options that the Company is reasonably certain will be exercised. As of September 30, 2019, the Company had not entered into any material leases that have not yet commenced. The Company's lease information is summarized as follows:

#### Leases

(in thousands)

	September 30, 2019
<b>Lease Right of Use Asset</b>	
Lease asset	\$ 5,158
Less: Accumulated amortization	(927)
Net lease asset	4,231
Other premises and equipment, net	2,436
Premises and equipment, net	\$ 6,667
<b>Lease Right of Use Liability</b>	
Lease liability	\$ 5,358
Less: Accumulated amortization	(748)
Net lease liability	4,610
Other miscellaneous liabilities	13,438
Other liabilities, net	\$ 18,048

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 5 - Leases (continued)

Future minimum payments for operating leases with initial or remaining terms of one year or more are as follows:

#### Lease Payment Obligations

(in thousands)	September 30, 2019
<b>Amounts due in:</b>	
2019	\$ 322
2020	1,204
2021	1,187
2022	824
2023	712
After 2023	420
Total lease payments	<u>\$ 4,669</u>

#### Note 6 - Fair Value

Generally accepted accounting principles define fair value, establish a framework for measuring fair value, recommend disclosures about fair value, and establish a hierarchy for determining fair value measurement. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities. The three levels are as follows:

Level 1 - Inputs to the valuation method are quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 - Inputs to the valuation method include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3 - Inputs to the valuation method are unobservable and significant to the fair value measurement.

#### **Fair value measurements on a recurring basis**

*Investment securities available for sale* - The fair values of the Company's investment securities available for sale are provided by an independent pricing service. The fair values of the Company's securities are determined based on quoted prices for similar securities under Level 2 inputs.

*Loans held for sale* - The fair value of loans held for sale is determined using Level 2 inputs of quoted prices for a similar asset, adjusted for specific attributes of that loan.

*Derivative financial instruments* - Derivative instruments used to hedge residential mortgage loans held for sale and the related interest rate lock commitments include forward commitments to sell mortgage loans and are reported at fair value utilizing Level 2 inputs. The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date and the underlying value of mortgage loans for rate lock commitments.

The interest rate swap is reported at fair value utilizing Level 2 inputs. The Company obtains dealer quotations to value its swap. For purposes of potential valuation adjustments to its derivative position, the Company evaluates the credit risk of its counterparty. Accordingly, the Company has considered factors such as the likelihood of default by the counterparty and the remaining contractual life, among other things,

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 6 - Fair Value (continued)

in determining if any fair value adjustment related to credit risk is required.

The Company has categorized its financial instruments measured at fair value on a recurring basis as of September 30, 2019 and December 31, 2018 as follows:

#### Fair Value of Financial Instruments

(in thousands)

September 30, 2019	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investment securities available for sale				
U.S. government-sponsored enterprises	\$ 5,992	\$ —	\$ 5,992	\$ —
Municipal	528	—	528	—
Corporate	2,672	—	2,672	—
Mortgage-backed securities	27,881	—	27,881	—
	<u>\$ 37,073</u>	<u>\$ —</u>	<u>\$ 37,073</u>	<u>\$ —</u>
Loans held for sale	\$ 68,982	\$ —	\$ 68,982	\$ —
Derivative assets	\$ 46	\$ —	\$ 46	\$ —
Derivative liabilities	\$ 165	\$ —	\$ 165	\$ —
December 31, 2018				
Investment securities available for sale				
U.S. government-sponsored enterprises	\$ 17,360	\$ —	\$ 17,360	\$ —
Municipal	501	—	501	—
Corporate	2,885	—	2,885	—
Mortgage-backed securities	26,186	—	26,186	—
	<u>\$ 46,932</u>	<u>\$ —</u>	<u>\$ 46,932</u>	<u>\$ —</u>
Loans held for sale	\$ 18,526	\$ —	\$ 18,526	\$ —
Derivative assets	\$ 172	\$ —	\$ 172	\$ —
Derivative liabilities	\$ 253	\$ —	\$ 253	\$ —

#### Financial instruments recorded using FASB ASC 825-10

Under FASB ASC 825-10, the Company may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in net income. After the initial adoption, the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election, with respect to an item, may not be revoked once an election is made.

The following table reflects the difference between the fair value carrying amount of loans held for sale, measured at fair value under FASB ASC 825-10, and the aggregate unpaid principal amount the Company is contractually entitled to receive at maturity:

#### Fair Value of Loans Held for Sale

(in thousands)

	September 30, 2019	December 31, 2018
Aggregate fair value	\$ 68,982	\$ 18,526
Contractual principal	67,118	17,822
Difference	<u>\$ 1,864</u>	<u>\$ 704</u>

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 6 - Fair Value (continued)

The Company has elected to account for loans held for sale at fair value to eliminate the mismatch that would occur by recording changes in market value on derivative instruments used to hedge loans held for sale while carrying the loans at the lower of cost or market.

#### Fair value measurements on a nonrecurring basis

*Impaired loans* - The Company has measured impairment generally based on the fair value of the loan's collateral and discounted cash flow analysis. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values. As of September 30, 2019 and December 31, 2018, the fair values consist of loan balances of \$6.2 million and \$4.4 million, with specific reserves of \$258 thousand and \$262 thousand, respectively.

*Foreclosed real estate* - The Company's foreclosed real estate is measured at fair value less cost to sell. Fair value was determined based on offers and/or appraisals. Cost to sell the real estate was based on standard market factors. The Company has categorized its foreclosed real estate as Level 3.

The Company has categorized its impaired loans and foreclosed real estate as follows:

#### Fair Value of Impaired Loans and Foreclosed Real Estate

(in thousands)	September 30, 2019	December 31, 2018
<b>Impaired loans</b>		
Level 1 inputs	\$ —	\$ —
Level 2 inputs	—	—
Level 3 inputs	5,913	4,093
<b>Total</b>	<b>\$ 5,913</b>	<b>\$ 4,093</b>
<b>Foreclosed real estate</b>		
Level 1 inputs	\$ —	\$ —
Level 2 inputs	—	—
Level 3 inputs	149	142
<b>Total</b>	<b>\$ 149</b>	<b>\$ 142</b>

The following table provides information describing the unobservable inputs used in Level 3 fair value measurements at September 30, 2019 and December 31, 2018:

#### Unobservable Inputs

	Valuation Technique	Unobservable Inputs	Range of Inputs
Impaired Loans	Appraised Value/Discounted Cash Flows	Discounts to appraisals or cash flows for estimated holding and/or selling costs	11 to 25%
Foreclosed Real Estate	Appraised Value/Comparable Sales	Discounts to appraisals for estimated holding and/or selling costs	11 to 25%

#### Fair value of financial instruments

Fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practical to estimate the value is based upon the characteristics of the instruments and relevant

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## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

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#### Note 6 - Fair Value (continued)

market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity that contractual right or obligation to either receive or deliver cash for another financial instrument.

The information used to determine fair value is highly subjective and judgmental in nature and, therefore, the results may not be precise. Subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of the balance sheet date, the amounts that will actually be realized or paid upon settlement or maturity on these various instruments could be significantly different.

During the first quarter of 2018, the Company adopted ASU 2016-01, "Recognition and Measurement of Financial Assets and Liabilities." The amendments included within this standard, which are applied prospectively, require the Company to disclose fair value of financial instruments measured at amortized cost on the balance sheet and to measure that fair value using an exit price notion. Prior to adopting the amendments included in the standard, the Company was allowed to measure fair value under an entry price notion. The entry price notion previously applied by the Company used a discounted cash flows technique to calculate the present value of expected future cash flows for a financial instrument. The exit price notion uses the same approach, but also incorporates other factors, such as enhanced credit risk, illiquidity risk, and market factors that sometimes exist in exit prices in dislocated markets.

The fair value of the Company's loan portfolio includes a credit risk assumption in the determination of the fair value of its loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company's loan portfolio is initially fair valued using a segmented approach. The Company divides its loan portfolio into the following categories: variable rate loans, impaired loans, and all other loans. The results are then adjusted to account for credit risk as described above. However, under the new guidance, the Company believes a further credit risk discount must be applied through the use of a discounted cash flow model to compensate for illiquidity risk, based on certain assumptions included within the discounted cash flow model, primarily the use of discount rates that better capture inherent credit risk over the lifetime of a loan. This consideration of enhanced credit risk provides an estimated exit price for the Company's loan portfolio.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral.

The fair value of cash and cash equivalents and investments in restricted stocks is the carrying amount. Restricted stock includes equity of the Federal Reserve and other banker's banks.

The fair value of noninterest bearing deposits and securities sold under agreements to repurchase is the carrying amount.

The fair value of checking, savings, and money market deposits is the amount payable on demand at the reporting date. Fair value of fixed maturity term accounts and individual retirement accounts is estimated using rates currently offered for accounts of similar remaining maturities.

The fair value of certificates of deposit in other financial institutions is estimated based on interest rates currently offered for deposits of similar remaining maturities.

The fair value of borrowings is estimated by discounting the value of contractual cash flows using current market rates for borrowings with similar terms and remaining maturities.

## Capital Bancorp, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements

#### Note 6 - Fair Value (continued)

The fair value of outstanding loan commitments, unused lines of credit, and letters of credit are not included in the table since the carrying value generally approximates fair value. These instruments generate fees that approximate those currently charged to originate similar commitments.

The table below presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments.

#### Fair Value of Selected Financial Instruments

(in thousands)	September 30, 2019		December 31, 2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Level 1				
Cash and due from banks	\$ 11,093	\$ 11,093	\$ 10,431	\$ 10,431
Interest bearing deposits at other financial institutions	40,521	40,521	22,007	22,007
Federal funds sold	3,464	3,464	2,285	2,285
Restricted investments	4,007	4,007	2,503	2,503
Level 3				
Loans receivable, net	\$ 1,127,502	\$ 1,124,707	\$ 988,960	\$ 979,058
<b>Financial liabilities</b>				
Level 1				
Noninterest bearing deposits	\$ 293,378	\$ 293,378	\$ 242,259	\$ 242,259
Securities sold under agreements to repurchase	—	—	3,332	3,332
Level 3				
Interest bearing deposits	\$ 819,066	\$ 819,810	\$ 712,981	\$ 711,876
FHLB advances and other borrowed funds	50,972	51,077	19,393	19,447

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**Capital Bancorp, Inc. and Subsidiaries**  
***Notes to Consolidated Financial Statements***

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**Note 7 - Litigation**

As previously reported in the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2019, the Bank, along with two other banking institutions, was a defendant in a lawsuit with respect to which the Bank entered into a Settlement Agreement and Joint Tortfeasor Release. All amounts paid by the Bank were fully funded by its insurance carrier except for \$200,000 which was accrued at March 31, 2019 and paid in April, 2019. The Settlement includes a release of all claims in the lawsuit that were or could have been brought and precludes further proceedings.

In addition to the lawsuit described above, the Company is involved in legal proceedings occurring in the ordinary course of business. The aggregate effect of these, in management's opinion, will not materially affect the results of operations or financial condition of the Company.

**Note 8 - Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.



## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended as a review of significant factors affecting the Company's financial condition and results of operations for the periods indicated. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and the related notes and the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

### PRIVATE SECURITIES LITIGATION REFORM ACT SAFE HARBOR STATEMENT

This Quarterly Report on Form 10-Q and oral statements made from time-to-time by our representatives contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. You should not place undue reliance on such statements because they are subject to numerous risks and uncertainties relating to our operations and the business environment in which we operate, all of which are difficult to predict and many of which are beyond our control. Forward-looking statements include information concerning our possible or assumed future results of operations, including descriptions of our business strategy, expectations, beliefs, projections, anticipated events or trends, growth prospects, financial performance, and similar expressions concerning matters that are not historical facts. These statements often include words such as "may," "believe," "expect," "anticipate," "potential," "opportunity," "intend," "plan," "estimate," "could," "project," "seek," "should," "will," or "would," or the negative of these words and phrases or similar words and phrases.

These forward-looking statements are subject to risks and uncertainties that could cause actual results, performance or achievements to differ materially from those projected. These risks and uncertainties, some of which are beyond our control, include, but are not limited to:

- economic conditions (including interest rate environment, government economic and monetary policies, the strength of global financial markets and inflation and deflation) that impact the financial services industry as a whole and/or our business;
- the concentration of our business in the Washington, D.C. and Baltimore metropolitan areas and the effect of changes in the economic, political and environmental conditions on these markets;
- our ability to prudently manage our growth and execute our strategy;
- our plans to grow our commercial real estate and commercial business loan portfolios which may carry greater risks of non-payment or other unfavorable consequences;
- adequacy of reserves, including our allowance for loan losses;
- deterioration of our asset quality;
- risks associated with our residential mortgage banking business;
- risks associated with our OpenSky credit card division, including compliance with applicable consumer finance and fraud prevention regulations;
- results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for loan losses or to write-down assets;
- the effectiveness of our internal control over financial reporting and our ability to remediate any future material weakness in our internal control over financial reporting;
- changes in the value of collateral securing our loans;

- our dependence on our management team and board of directors and changes in management and board composition;
- liquidity risks associated with our business;
- interest rate risk associated with our business, including sensitivity of our interest earning assets and interest bearing liabilities to interest rates, and the impact to our earnings from changes in interest rates;
- the possible impact of uncertainty about the future of *LIBOR* on our net interest income;
- our ability to maintain important deposit customer relationships and our reputation;
- operational risks associated with our business;
- strategic acquisitions we may undertake to achieve our goals;
- the sufficiency of our capital, including sources of capital and the extent to which we may be required to raise additional capital to meet our goals;
- fluctuations in the fair value of our investment securities that are beyond our control;
- potential exposure to fraud, negligence, computer theft and cyber-crime;
- the adequacy of our risk management framework;
- our dependence on our information technology and telecommunications systems and the potential for any systems failures or interruptions;
- our dependence upon outside third parties for the processing and handling of our records and data;
- our ability to adapt to technological change;
- our engagement in derivative transactions;
- volatility and direction of market interest rates;
- increased competition in the financial services industry, particularly from regional and national institutions;
- our involvement from time to time in legal proceedings, examinations and remedial actions by regulators;
- changes in the laws, rules, regulations, interpretations or policies relating to financial institution, accounting, tax, trade, monetary and fiscal matters;
- the financial soundness of other financial institutions;
- further government intervention in the U.S. financial system; and
- natural disasters and adverse weather, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, and other matters beyond our control.

As you read and consider forward-looking statements, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties and assumptions and can change as a result of many possible events or factors, not all of which are known to us or in our control. Although we believe that these forward-looking statements are based on reasonable assumptions, beliefs, and expectations, if a change occurs or our beliefs, assumptions, or expectations were incorrect, our business, financial condition, liquidity or results of operations may vary materially from those expressed in our forward-looking statements. You should be aware that many factors could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. These factors include those described under the heading "Risk Factors" under Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2018. You should keep in mind that any forward-looking statement made by us speaks only as of the date on which we make it. New risks and uncertainties arise from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, and disclaim any obligation to, update or revise any industry information or forward-looking statements after the date on which they are made. In light of these risks and uncertainties, you should keep in mind that any forward-looking statement made in this document or elsewhere might not reflect actual results.

## **Overview**

Capital Bancorp, Inc. (the "Company") was incorporated in 1998 in Maryland to act as the bank holding company for Capital Bank, N.A. (the "Bank") which received its charter in 1999 and began operations in 1999. The Bank is headquartered in Rockville, Maryland and serves the Washington, D.C. and Baltimore metropolitan areas through five commercial bank branches, five mortgage offices, two loan production offices, a limited service branch and three corporate and operations facilities located in key markets throughout our operating area. We serve businesses, not-for-profit associations and entrepreneurs throughout the region by partnering with them to design tailored financial solutions supported by customized technology and "client first" advice.

We operate through three divisions: Commercial Banking; Capital Bank Home Loans ("CBHL"), formerly Church Street Mortgage, our residential mortgage banking arm; and OpenSky®, a secured, digitally-driven nationwide credit card platform. Our Commercial Banking division accounts for the majority of the Bank's total assets. Our commercial bankers provide high quality service, customized solutions and tailored advice to commercial clients in our operating markets.

Our CBHL division originates conventional and government-guaranteed residential mortgage loans on a nationwide basis primarily for sale into the secondary market and in certain, limited circumstances for the Bank's loan portfolio.

Our OpenSky® division provides secured credit cards on a nationwide basis to under-banked populations and those looking to rebuild their credit scores. OpenSky® cards operate on a fully digital and mobile enabled platform with all marketing and application procedures conducted through website and mobile applications. A deposit equal to the full credit limit of the card is made into a noninterest-bearing demand account with the Bank when the account is opened and the deposit is required to be maintained throughout the life of the card. Using our proprietary scoring model, which considers credit score and repayment history (typically a minimum of six months of on-time repayments, but ultimately determined on a case-by-case basis), the Bank has recently begun to offer certain existing customers an unsecured line in excess of their secured line of credit .

## Results of Operations

### Net Income

The following table sets forth the principal components of net income for the periods indicated.

	Three Months Ended September 30,		
	2019	2018	% Change
(in thousands)			
Interest income	\$ 22,354	\$ 17,447	28.1%
Interest expense	4,170	2,955	41.1%
<b>Net interest income</b>	<b>18,184</b>	<b>14,492</b>	<b>25.5%</b>
Provision for loan losses	1,071	495	116.4%
<b>Net interest income after provision</b>	<b>17,113</b>	<b>13,997</b>	<b>22.3%</b>
Noninterest income	7,221	4,240	70.3%
Noninterest expenses	18,228	13,900	31.1%
<b>Net income before income taxes</b>	<b>6,106</b>	<b>4,337</b>	<b>40.8%</b>
Income tax expense	1,625	1,190	36.6%
<b>Net income</b>	<b>\$ 4,481</b>	<b>\$ 3,147</b>	<b>42.4%</b>

Net income for the three months ended September 30, 2019 was \$4.5 million, an increase of approximately \$1.3 million, or 42%, from net income for the three months ended September 30, 2018 of \$3.1 million. The increase was primarily due to increased net interest income and noninterest income, offset by higher provision for loan losses and noninterest expenses.

	Nine Months Ended September 30,		
	2019	2018	% Change
(in thousands)			
Interest income	\$ 60,961	\$ 50,890	19.8%
Interest expense	11,502	7,891	45.8%
<b>Net interest income</b>	<b>49,459</b>	<b>42,999</b>	<b>15.0%</b>
Provision for loan losses	1,869	1,640	14.0%
<b>Net interest income after provision</b>	<b>47,590</b>	<b>41,359</b>	<b>15.1%</b>
Noninterest income	17,240	12,657	36.2%
Noninterest expenses	48,768	41,028	18.9%
<b>Net income before income taxes</b>	<b>16,062</b>	<b>12,988</b>	<b>23.7%</b>
Income tax expense	4,239	3,706	14.4%
<b>Net income</b>	<b>\$ 11,823</b>	<b>\$ 9,282</b>	<b>27.4%</b>

Net income for the nine months ended September 30, 2019 was \$11.8 million, an increase of approximately \$2.5 million, or 27%, from net income for the nine months ended September 30, 2018 of \$9.3 million. The increase was primarily due to increased net interest income and noninterest income, offset by higher noninterest expenses.

### Net Interest Income and Net Margin Analysis

We analyze our ability to generate income from interest earning assets and control the interest expenses of our liabilities, measured as net interest income, through our net interest margin and net interest spread. Net interest income is the difference between the interest and fees earned on interest earning assets, such as loans and securities, and the interest expense incurred in connection with interest bearing liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest margin is a ratio calculated as net interest income divided by average interest earning assets for the same period. Net interest spread is the difference between average interest rates earned on interest earning assets and average interest rates paid on interest bearing liabilities.

Changes in market interest rates and the interest rates we earn on interest earning assets or pay on interest bearing liabilities, as well as in the volume and types of interest earning assets, interest bearing and

noninterest bearing liabilities and stockholders' equity, are usually the largest drivers of periodic changes in net interest income, net interest margin and net interest spread. Fluctuations in market interest rates are driven by many factors, including governmental monetary policies, inflation, deflation, macroeconomic developments, changes in unemployment, the money supply, political and international conditions and conditions in domestic and foreign financial markets. Periodic changes in the volume and types of loans in our loan portfolio are affected by, among other factors, economic and competitive conditions in the Washington, D.C. and Baltimore metropolitan areas, as well as developments affecting the real estate, technology, government services, hospitality and tourism and financial services sectors within our target markets and throughout the Washington, D.C. and Baltimore metropolitan areas. Our ability to respond to changes in these factors by using effective asset-liability management techniques is critical to maintaining the stability of our net interest income and net interest margin as our primary sources of earnings.

The following table shows the average outstanding balance of each principal category of our assets, liabilities and stockholders' equity, together with the average yields on our assets and the average costs of our liabilities for the periods indicated. Such yields and cost are calculated by dividing income or expense by the average daily balances of the corresponding assets or liabilities for the same period.

### AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

Three Months Ended September 30,

	2019			2018		
	Average Outstanding Balance	Interest Income/Expense	Average Yield/Rate <sup>(1)</sup>	Average Outstanding Balance	Interest Income/Expense	Average Yield/Rate <sup>(1)</sup>
<i>(in thousands)</i>						
<b>Assets</b>						
Interest earning assets:						
Interest bearing deposits	\$ 35,723	\$ 164	1.83%	\$ 42,734	\$ 176	1.63%
Federal funds sold	1,325	7	2.12%	1,354	6	1.76%
Investment securities	38,389	215	2.22%	49,159	272	2.20%
Restricted investments	5,629	68	4.77%	2,604	38	5.79%
Loans held for sale	56,301	896	6.31%	18,671	412	8.75%
Loans <sup>(2)(3)</sup>	1,099,191	21,004	7.58%	919,759	16,543	7.14%
Total interest earning assets	1,236,558	22,354	7.17%	1,034,281	17,447	6.69%
Noninterest earning assets	15,908			11,924		
Total assets	\$ 1,252,466			\$ 1,046,205		
<b>Liabilities and Stockholders' Equity</b>						
Interest bearing liabilities:						
Interest bearing demand accounts	\$ 116,820	\$ 191	0.65%	\$ 74,854	\$ 55	0.29%
Savings	3,913	3	0.35%	4,062	4	0.39%
Money market accounts	339,751	1,484	1.73%	270,697	972	1.42%
Time deposits	286,605	1,771	2.45%	338,005	1,585	1.86%
Borrowed funds	89,746	721	3.19%	32,248	339	4.17%
Total interest bearing liabilities	836,835	4,170	1.98%	719,866	2,955	1.63%
Noninterest bearing liabilities:						
Noninterest bearing liabilities	17,163			10,250		
Noninterest bearing deposits	271,851			224,877		
Stockholders' equity	126,617			91,212		
Total liabilities and stockholders' equity	\$ 1,252,466			\$ 1,046,205		
<b>Net interest spread<sup>(4)</sup></b>						
			5.19%			5.06%
Net interest income	\$ 18,184			\$ 14,492		
<b>Net interest margin<sup>(5)</sup></b>						
			5.83%			5.56%
Net interest margin excluding credit card portfolio			4.37%			4.26%

(1) Annualized.

(2) Includes nonaccrual loans.

(3) Interest income includes amortization of deferred loan fees, net of deferred loan costs.

(4) Net interest spread is the difference between interest rates earned on interest earning assets and interest rates paid on interest bearing liabilities.

(5) Net interest margin is a ratio calculated as annualized net interest income divided by average interest earning assets for the same period.

The following table presents information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest earning assets and interest bearing liabilities and distinguishes between the changes attributable to changes in volume and changes attributable to changes in interest rates. For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been proportionately allocated to both volume and rate.

### ANALYSIS OF CHANGES IN NET INTEREST INCOME

	Three Months Ended September 30, 2019		
	Compared to the		
	Three Months Ended September 30, 2018		
	Change Due To		Interest Variance
	Volume	Rate	
<i>(in thousands)</i>			
<b>Interest Income:</b>			
Interest bearing deposits	\$ (41)	\$ 29	\$ (12)
Federal funds sold	—	1	1
Investment securities	(61)	4	(57)
Restricted stock	35	(5)	30
Loans held for sale	562	(78)	484
Loans	3,380	1,081	4,461
Total interest income	\$ 3,875	\$ 1,032	\$ 4,907
<b>Interest Expense:</b>			
Interest bearing demand accounts	\$ 43	\$ 93	\$ 136
Savings	—	(1)	(1)
Money market accounts	277	235	512
Time deposits	(171)	357	186
Borrowed funds	440	(58)	382
Total interest expense	589	626	1,215
Net interest income	\$ 3,286	\$ 406	\$ 3,692

Net interest income increased by \$3.7 million to \$18.2 million for the third quarter of 2019 compared to the third quarter of 2018. The Company's annualized net interest margin excluding credit cards was 4.37% for the three months ended September 30, 2019, up 11 basis points from 4.26% for the three months ended September 30, 2018. Average total interest earning assets were \$1.24 billion for the third quarter of 2019 compared with \$1.03 billion for the third quarter of 2018. The annualized yield on those interest earning assets increased 48 basis points from 6.69% for the three months ended September 30, 2018 to 7.17% for the three months ended September 30, 2019. The increase in the average balance of interest earning assets was driven almost entirely by growth in the average balance of the loan portfolio of \$179.4 million, or 20%, to \$1.10 billion for the three months ended September 30, 2019 compared to \$919.8 million for the three months ended September 30, 2018.

Average interest bearing liabilities increased by \$117.0 million from \$719.9 million for the third quarter of 2018 to \$836.8 million for the third quarter of 2019. The increase was due to an increase in the average balance of interest bearing deposits of \$59.5 million, or 9%, and an increase in the average balance of borrowed funds of \$57.5 million, or 178%. Deposits are our primary funding source. The annualized average interest rate paid on interest bearing liabilities increased to 1.98% for the third quarter of 2019 compared to 1.63% for the third quarter of 2018, with the annualized average interest rate paid on interest bearing deposits increasing 32 basis points, offset by the decrease in annualized average interest rate paid on borrowed funds of 98 basis points. The increases in annualized average interest rates reflect several interest rate changes during 2018 and 2019.

For the three months ended September 30, 2019, the Company's annualized net interest margin was 5.83% and net interest spread was 5.19%. For the three months ended September 30, 2018, annualized net interest margin was 5.56% and net interest spread was 5.06%. The year over year net interest margin

increase of 27 basis points was primarily due to increased volume of interest earning assets offset by the increased rate on interest bearing liabilities.

### AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

Nine Months Ended September 30,

	2019			2018		
	Average Outstanding Balance	Interest Income/Expense	Average Yield/Rate <sup>(1)</sup>	Average Outstanding Balance	Interest Income/Expense	Average Yield/Rate <sup>(1)</sup>
<i>(in thousands)</i>						
<b>Assets</b>						
Interest earning assets:						
Interest bearing deposits	\$ 35,164	\$ 518	1.97%	\$ 44,525	\$ 526	1.58%
Federal funds sold	1,685	28	2.23%	1,546	18	1.56%
Investment securities	42,281	707	2.24%	50,987	786	2.06%
Restricted investments	4,276	160	4.99%	2,554	105	5.50%
Loans held for sale	35,229	1,928	7.32%	18,047	1,182	8.76%
Loans <sup>(2)(3)</sup>	1,041,364	57,620	7.40%	904,279	48,273	7.14%
Total interest earning assets	1,159,999	60,961	7.03%	1,021,938	50,890	6.66%
Noninterest earning assets	15,115			10,419		
Total assets	\$ 1,175,114			\$ 1,032,357		
<b>Liabilities and Stockholders' Equity</b>						
Interest bearing liabilities:						
Interest bearing demand accounts	\$ 97,325	\$ 387	0.53%	\$ 73,129	\$ 154	0.28%
Savings	3,613	9	0.35%	3,690	8	0.29%
Money market accounts	330,086	4,203	1.70%	286,349	2,678	1.25%
Time deposits	294,693	5,288	2.40%	328,139	4,036	1.64%
Borrowed funds	59,816	1,615	3.61%	31,233	1,015	4.34%
Total interest bearing liabilities	785,533	11,502	1.96%	722,540	7,891	1.46%
Noninterest bearing liabilities:						
Noninterest bearing liabilities	14,971			9,765		
Noninterest bearing deposits	252,353			215,133		
Stockholders' equity	122,257			84,919		
Total liabilities and stockholders' equity	\$ 1,175,114			\$ 1,032,357		
Net interest spread <sup>(4)</sup>						
			5.07%			5.20%
Net interest income						
	\$ 49,459			\$ 42,999		
Net interest margin <sup>(5)</sup>						
			5.70%			5.63%
Net interest margin excluding credit card portfolio						
			4.35%			4.27%

<sup>(1)</sup> Annualized.

<sup>(2)</sup> Includes nonaccrual loans.

<sup>(3)</sup> Interest income includes amortization of deferred loan fees, net of deferred loan costs.

<sup>(4)</sup> Net interest spread is the difference between interest rates earned on interest earning assets and interest rates paid on interest bearing liabilities.

<sup>(5)</sup> Net interest margin is a ratio calculated as annualized net interest income divided by average interest earning assets for the same period.



## ANALYSIS OF CHANGES IN NET INTEREST INCOME

	Nine Months Ended September 30, 2019		
	Compared to the		
	Nine Months Ended September 30, 2018		
	Change Due To		
	Volume	Rate	Interest Variance
<i>(in thousands)</i>			
<b>Interest Income:</b>			
Interest bearing deposits	\$ 44	\$ (52)	\$ (8)
Federal funds sold	2	8	10
Investment securities	(157)	78	(79)
Restricted stock	63	(8)	55
Loans held for sale	902	(156)	746
Loans	7,533	1,814	9,347
Total interest income	<u>\$ 8,387</u>	<u>\$ 1,684</u>	<u>\$ 10,071</u>
<b>Interest Expense:</b>			
Interest bearing demand accounts	\$ 63	\$ 170	\$ 233
Savings	—	1	1
Money market accounts	453	1,072	1,525
Time deposits	(357)	1,609	1,252
Borrowed funds	736	(136)	600
Total interest expense	<u>895</u>	<u>2,716</u>	<u>3,611</u>
Net interest income	<u>\$ 7,492</u>	<u>\$ (1,032)</u>	<u>\$ 6,460</u>

Net interest income increased by \$6.5 million to \$49.5 million for the nine months ended September 30, 2019 compared to the same period in 2018. The Company's annualized net interest margin excluding credit cards was 4.35% for the nine months ended September 30, 2019, up 8 basis points from 4.27% for the nine months ended September 30, 2018. Average total interest earning assets were \$1.16 billion for the nine months ended September 30, 2019 compared with \$1.02 billion for the same period of the prior year. The annualized yield on those interest earning assets increased 37 basis points from 6.66% for the nine months ended September 30, 2018 to 7.03% for the nine months ended September 30, 2019. The increase in the average balance of interest earning assets was driven almost entirely by growth in the average balance of the loan portfolio of \$137.1 million, or 15%, to \$1.04 billion for the nine months ended September 30, 2019 compared to \$904.3 million for the nine months ended September 30, 2018.

Average interest bearing liabilities increased by \$63.0 million from \$722.5 million for the nine months ended September 30, 2018 to \$785.5 million for the nine months ended September 30, 2019. The increase was due to an increase in the average balance of interest bearing deposits of \$34.4 million and an increase in the average balance of borrowed funds of \$28.6 million, or 92%. Deposits are our primary funding source. The annualized average interest rate paid on interest bearing liabilities increased to 1.96% for the nine months ended September 30, 2019 compared to 1.46% for the nine months ended September 30, 2018. The annualized average interest rate paid on interest bearing deposits increased 56 basis points while the annualized average interest rate paid on borrowed funds decreased by 36 basis points for these nine month periods. The increases in annualized average interest rates reflects several interest rate changes since September 2018.

For the nine months ended September 30, 2019, the Company's annualized net interest margin was 5.70% and net interest spread was 5.07%. For the nine months ended September 30, 2018, annualized net interest margin was 5.63% and net interest spread was 5.20%. The year over year net interest spread decrease of 13 basis points was primarily due to a more rapid adjustment to market rate increases of our interest bearing liabilities relative to our interest earning assets.

## Provision for Loan Losses

The provision for loan losses is a charge to income in order to bring our allowance for loan losses to a level deemed appropriate by management. For a description of the factors taken into account by our management in determining the allowance for loan losses see "Financial Condition—Allowance for Loan Losses."

Our provision for loan losses amounted to \$1.1 million for the three months ended September 30, 2019, and \$495 thousand for the three months ended September 30, 2018. The provision for loan losses was \$1.9 million and \$1.6 million for the nine months ended September 30, 2019 and 2018, respectively. The increase for the three and nine month periods in 2019 compared to the same periods in 2018 was primarily due to larger loan volumes in the 2019 period. Our allowance for loan losses as a percent of total loans was 1.12% and 1.13% at September 30, 2019 and December 31, 2018, respectively. Net charge-offs amounted to \$369 thousand for the nine months ended September 30, 2019, compared to \$781 thousand for the nine months ended September 30, 2018.

## Noninterest Income

Our primary sources of recurring noninterest income are service charges on deposit accounts, certain credit card fees, such as interchange fees and statement fees, and mortgage banking revenue. Noninterest income does not include (i) loan origination fees to the extent they exceed the direct loan origination costs, which are generally recognized over the life of the related loan as an adjustment to yield using the interest method or (ii) annual, renewal and late fees related to our credit card portfolio, which are generally recognized over the twelve month life of the related loan as an adjustment to yield using the interest method.

The following table presents, for the periods indicated, the major categories of noninterest income:

### NONINTEREST INCOME

	Three Months Ended September 30,		
	2019	2018	% Change
<i>(in thousands)</i>			
Noninterest income:			
Service charges on deposit accounts	\$ 146	\$ 123	18.7%
Credit card fees	2,059	1,592	29.3%
Mortgage banking revenue	4,900	2,451	99.9%
Other fees and charges	116	74	56.8%
Total noninterest income	\$ 7,221	\$ 4,240	70.3%

Noninterest income increased \$3.0 million, or 70%, to \$7.2 million for the three months ended September 30, 2019 compared to \$4.2 million for the three months ended September 30, 2018. The primary increase was due to mortgage banking revenue, which increased by \$2.4 million, or 100%, during the third quarter of 2019 compared to the third quarter of 2018. Our focus for the CBHL division continues to be purchase transactions over refinances, which have slightly higher rates and prices. However, the recent decreases in market rates have resulted in a larger ratio of refinances over purchase transactions. Purchase volume as a percentage of loan originations was 44% for the third quarter of 2019, compared to 79% for the second quarter of 2019. Net proceeds from the sale of loans held for sale amounted to \$171.9 million for the three months ended September 30, 2019 compared to \$81.0 million for the three months ended September 30, 2018.

OpenSky® credit card issuances continue at higher levels, totaling 31 thousand for the three months ended September 30, 2019, compared to 20 thousand for the three months ended September 30, 2018. Credit card fees correspondingly increased \$467 thousand from the three months ended September 30, 2018.

	Nine Months Ended September 30,		
	2019	2018	% Change
<i>(in thousands)</i>			
<b>Noninterest income:</b>			
Service charges on deposit accounts	\$ 382	\$ 365	4.7 %
Credit card fees	5,521	4,609	19.8 %
Mortgage banking revenue	10,991	7,379	48.9 %
Gain (loss) on sale of securities	26	(2)	(1,400.0)%
Other fees and charges	320	306	4.6 %
<b>Total noninterest income</b>	<b>\$ 17,240</b>	<b>\$ 12,657</b>	<b>36.2 %</b>

Noninterest income increased \$4.6 million, or 36%, to \$17.2 million for the nine months ended September 30, 2019 compared to \$12.7 million for the nine months ended September 30, 2018. The increase was primarily due to mortgage banking revenue, which increased by \$3.6 million, or 49%, during the nine months ended September 30, 2019 compared to the nine months ended September 30, 2018. Net proceeds from the sale of loans held for sale amounted to \$370.0 million for the nine months ended September 30, 2019 compared to \$278.4 million for the same period in 2018.

OpenSky® credit card fees increased \$912 thousand from the three months ended September 30, 2018 primarily due to an increase in credit card accounts.

#### *Noninterest Expense*

Generally, noninterest expense is composed of all employee expenses and costs associated with operating our facilities, obtaining and retaining customer relationships and providing bank services. The largest component of noninterest expense is salaries and employee benefits. Noninterest expense also includes operational expenses, such as occupancy and equipment expenses, professional fees, advertising expenses, loan processing expenses and other general and administrative expenses, including FDIC assessments, communications, travel, meals, training, supplies and postage.

The following table presents, for the periods indicated, the major categories of noninterest expense:

#### **NONINTEREST EXPENSE**

	Three Months Ended September 30,		
	2019	2018	% Change
<i>(in thousands)</i>			
<b>Noninterest expense:</b>			
Salaries and employee benefits	\$ 9,238	\$ 6,571	40.6%
Occupancy and equipment	1,111	1,070	3.8%
Professional services	724	520	39.2%
Data processing	4,193	3,636	15.3%
Advertising	584	358	63.1%
Loan processing	634	202	213.9%
Other real estate expense, net	7	7	—%
Other	1,737	1,536	13.1%
<b>Total noninterest expense</b>	<b>\$ 18,228</b>	<b>\$ 13,900</b>	<b>31.1%</b>

Noninterest expense amounted to \$18.2 million for the three months ended September 30, 2019, an increase of \$4.3 million, or 31%, compared to \$13.9 million for the three months ended September 30, 2018. The increase was primarily due to increases in salaries and employee benefits, which include commissions paid on mortgage originations, data processing expenses, advertising, and other expenses. Other operating expenses were also impacted by a \$216 thousand credit to our FDIC assessment expense in the third quarter of 2019 as a result of the FDIC Deposit Insurance Fund exceeding its targeted level of insured deposits for the previous quarter.

**Nine Months Ended September 30,**

	<b>2019</b>	<b>2018</b>	<b>% Change</b>
<i>(in thousands)</i>			
<b>Noninterest expense:</b>			
Salaries and employee benefits	\$ 24,136	\$ 19,083	26.5%
Occupancy and equipment	3,307	3,241	2.0%
Professional services	1,952	1,365	43.0%
Data processing	11,222	10,858	3.4%
Advertising	1,557	1,113	39.9%
Loan processing	1,279	811	57.7%
Other real estate expense, net	57	38	50.0%
Other	5,258	4,519	16.4%
<b>Total noninterest expense</b>	<b>\$ 48,768</b>	<b>\$ 41,028</b>	<b>18.9%</b>

Noninterest expense amounted to \$48.8 million for the nine months ended September 30, 2019, an increase of \$7.7 million, or 19%, compared to \$41.0 million for the nine months ended September 30, 2018. The increase was primarily due to increases in salaries and employee benefits, which include commissions paid on mortgage originations, professional fees, and other expenses.

*Income Tax Expense*

The amount of income tax expense we incur is influenced by our pre-tax income and our other nondeductible expenses. Deferred tax assets and liabilities are reflected at current income tax rates in effect for the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Income tax expense was \$1.6 million for the three months ended September 30, 2019 compared to \$1.2 million for the three months ended September 30, 2018. Our effective tax rates for those periods were approximately 27%. Income tax expense was \$4.2 million for the nine months ended September 30, 2019 compared to \$3.7 million for the nine months ended September 30, 2018, with effective tax rates of 26.4% and 28.5% for the 2019 and 2018 periods, respectively. The decrease in the effective tax rate was primarily due to overall lower blended state and federal tax rates.

**Financial Condition**

As of September 30, 2019, our total assets increased \$206.3 million from December 31, 2018 to approximately \$1.3 billion. Loans receivable, interest bearing deposits at other financial institutions, loans held for sale, and premises and equipment increased while investment securities decreased over that period. Both noninterest bearing and interest bearing deposits increased. Securities sold under repurchase agreements and federal funds purchased decreased, while Federal Home Loan Bank advances increased. Stockholders' equity increased \$13.3 million, or 12%, to \$127.8 million at September 30, 2019, primarily due to earnings.

*Interest Bearing Deposits at Other Financial Institutions*

As of September 30, 2019, interest bearing deposits at other financial institutions increased \$18.5 million, or 84%, to \$40.5 million from \$22.0 million at December 31, 2018. The increase was primarily due to increased deposits from fiduciary accounts.

*Securities*

We use our securities portfolio to provide a source of liquidity, provide an appropriate return on funds invested, manage interest rate risk, meet collateral requirements and meet regulatory capital requirements.

Management classifies investment securities as either held to maturity or available for sale based on our intentions and the Company's ability to hold such securities until maturity. In determining such classifications, securities that management has the positive intent and the Company has the ability to hold until maturity are classified as held to maturity and carried at amortized cost. All other securities are designated as available for sale and carried at estimated fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. For the years presented, all securities were classified as available for sale.

Our investment portfolio decreased 21%, or approximately \$9.9 million, from \$46.9 million at December 31, 2018, to \$37.1 million at September 30, 2019 due to \$15.5 million of paydowns received on mortgage-backed securities and \$3.3 million in sales offset by \$8.2 million in investment purchases. To supplement interest income earned on our loan portfolio, we invest in high quality mortgage-backed securities, government agency bonds, and high quality municipal and corporate bonds.

The following tables summarize the contractual maturities and weighted-average yields of investment securities at September 30, 2019 and the amortized cost and carrying value of those securities as of the indicated dates.

#### INVESTMENT MATURITIES

September 30, 2019	One Year or Less		More Than One Year Through Five Years		More Than Five Years Through 10 Years		More Than 10 Years		Total		Weighted Average Yield
	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Fair Value	
(in thousands)											
Securities Available for Sale:											
U.S. government-sponsored agencies	\$ 6,000	1.30%	\$ —	—%	\$ —	—%	\$ —	—%	\$ 6,000	\$ 5,992	1.30%
Municipal	—	—%	—	—%	—	—%	515	2.50%	515	528	2.50%
Corporate bonds	—	—%	—	—%	2,000	5.50%	663	5.21%	2,663	2,672	5.43%
Mortgage-backed securities	—	—%	—	—%	8,761	1.77%	19,118	2.53%	27,879	27,881	2.29%
Total	<u>\$ 6,000</u>	<u>1.30%</u>	<u>\$ —</u>	<u>—%</u>	<u>\$ 10,761</u>	<u>2.46%</u>	<u>\$ 20,296</u>	<u>2.62%</u>	<u>\$ 37,057</u>	<u>\$ 37,073</u>	<u>2.36%</u>

#### Loan Portfolio

Our primary source of income is derived from interest earned on loans. Our loan portfolio consists of loans secured by real estate as well as commercial business loans, credit card loans, substantially all of which are secured by corresponding deposits at the Bank and, to a very limited extent, other consumer loans. Our loan customers primarily consist of small- to medium-sized businesses, professionals, real estate investors, small residential builders and individuals. Our owner-occupied and investment commercial real estate loans, residential construction loans and commercial business loans provide us with higher risk-adjusted returns, shorter maturities and more sensitivity to interest rate fluctuations, and are complemented by our relatively lower risk residential real estate loans to individuals. To a lesser extent, our credit card portfolio supplements our traditional lending products with enhanced yields. Our lending activities are principally directed to our market area consisting of the Washington, D.C. and Baltimore metropolitan areas.

The following table summarizes our loan portfolio by type of loan as of the dates indicated:

### COMPOSITION OF LOAN PORTFOLIO

(in thousands)	September 30, 2019		December 31, 2018	
	Amount	Percent	Amount	Percent
Real estate:				
Residential	\$ 443,961	38%	\$ 407,844	41%
Commercial	339,448	30%	278,691	28%
Construction	182,224	16%	157,586	16%
Commercial	132,935	12%	122,264	12%
Credit card	44,058	4%	34,673	3%
Other consumer	1,148	—%	1,202	—%
Total gross loans	1,143,774	100%	1,002,260	100%
Unearned income	(3,464)		(1,992)	
Total loans, net of unearned income	1,140,310		1,000,268	
Allowance for loan losses	(12,808)		(11,308)	
Total net loans	\$ 1,127,502		\$ 988,960	

The repayment of loans is a source of additional liquidity for us. The following table details maturities and sensitivity to interest rate changes for our loan portfolio at September 30, 2019:

### LOAN MATURITY AND SENSITIVITY TO CHANGES IN INTEREST RATES

(in thousands)	As of September 30, 2019			
	Due in One Year or Less	Due in One to Five Years	Due After Five Years	Total
Real estate:				
Residential	\$ 110,030	\$ 131,719	\$ 202,212	\$ 443,961
Commercial	70,732	186,093	82,623	339,448
Construction	151,679	28,445	2,100	182,224
Commercial	59,633	57,328	15,974	132,935
Credit card	44,058	—	—	44,058
Other consumer	783	365	—	1,148
Total loans	\$ 436,915	\$ 403,950	\$ 302,909	\$ 1,143,774
Amounts with fixed rates	\$ 110,655	\$ 256,463	\$ 55,059	\$ 422,177
Amounts with floating rates	\$ 326,260	\$ 147,487	\$ 247,850	\$ 721,597

#### Nonperforming Assets

Nonperforming loans increased to \$6.5 million, or 0.57% of total loans, at September 30, 2019 compared to \$4.7 million, or 0.47% of total loans, at December 31, 2018. The \$1.9 million, or 40%, increase during the nine months ended September 30, 2019 was primarily due to an increase of \$2.1 million in nonperforming construction loans. The increase is attributable to a single borrower relationship that is well secured and on which no impairment is expected. As such, there have been no losses related to the increase in non-performing assets. Foreclosed real estate increased to \$149 thousand as of September 30, 2019 compared to \$142 thousand as of December 31, 2018 due to the foreclosure of a residential loan.

Total nonperforming assets were \$6.7 million at September 30, 2019 compared to \$4.8 million at December 31, 2018, or 0.51% and 0.44%, respectively, of corresponding total assets.

The following table presents information regarding nonperforming assets at the dates indicated:

### NONPERFORMING ASSETS

(in thousands)	September 30, 2019	December 31, 2018
<b>Nonaccrual loans</b>		
<b>Real Estate:</b>		
Residential	\$ 2,193	\$ 2,207
Commercial	1,036	1,486
Construction	2,100	—
Commercial	842	749
Accruing loans 90 or more days past due	371	237
<b>Total nonperforming loans</b>	<b>6,542</b>	<b>4,679</b>
Other real estate owned	149	142
<b>Total nonperforming assets</b>	<b>\$ 6,691</b>	<b>\$ 4,821</b>
Restructured loans-nonaccrual	\$ 465	\$ 284
Restructured loans-accruing	\$ —	\$ —
Ratio of nonperforming loans to total loans	0.57%	0.47%
Ratio of nonperforming assets to total assets	0.51%	0.44%

The following table presents the loan balances by category as well as risk rating at the dates indicated. No assets were classified as loss during the periods presented.

### LOAN CLASSIFICATION

(in thousands)	Pass <sup>(1)</sup>	Special Mention	Substandard	Doubtful	Total
<b>September 30, 2019</b>					
<b>Real estate:</b>					
Residential	\$ 441,694	\$ —	\$ 2,267	\$ —	\$ 443,961
Commercial	334,365	4,047	1,036	—	339,448
Construction	180,124	—	2,100	—	182,224
Commercial	125,699	5,410	1,607	219	132,935
Credit card	44,058	—	—	—	44,058
Other consumer	1,148	—	—	—	1,148
<b>Total</b>	<b>\$ 1,127,088</b>	<b>\$ 9,457</b>	<b>\$ 7,010</b>	<b>\$ 219</b>	<b>\$ 1,143,774</b>
<b>December 31, 2018</b>					
<b>Real estate:</b>					
Residential	\$ 405,532	\$ 118	\$ 2,194	\$ —	\$ 407,844
Commercial	274,247	2,958	1,486	—	278,691
Construction	154,643	843	2,100	—	157,586
Commercial	117,670	3,844	750	—	122,264
Credit card	34,673	—	—	—	34,673
Other consumer	1,202	—	—	—	1,202
<b>Total</b>	<b>\$ 987,967</b>	<b>\$ 7,763</b>	<b>\$ 6,530</b>	<b>\$ —</b>	<b>\$ 1,002,260</b>

<sup>(1)</sup> Category includes loans graded exceptional, very good, good, satisfactory and pass / watch.

At September 30, 2019, the recorded investment in impaired loans was \$6.2 million, of which \$476 thousand required a specific reserve of \$258 thousand. This compares to a recorded investment in impaired loans of \$4.4 million at December 31, 2018, including \$386 thousand which required a specific reserve of \$262 thousand. Impaired loans at both dates presented included one borrower relationship totaling \$2.1 million that is well secured and on which no impairment is expected.

Impaired loans also include certain loans that have been modified as TDR's. The Company had five loans amounting to \$465 thousand at September 30, 2019, and four loans totaling \$284 thousand at December 31, 2018 that were considered to be TDRs.

#### Allowance for Loan Losses

We maintain an allowance for loan losses that represents management's best estimate of the loan losses and risks inherent in our loan portfolio. The amount of the allowance for loan losses should not be interpreted as an indication that charge-offs in future periods will necessarily occur in those amounts, or at all. In determining the allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the nature of our loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates. The following table presents a summary of changes in the allowance for loan losses for the periods and dates indicated:

#### ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

	For the Nine Months Ended September 30, 2019	For the Year Ended December 31, 2018
<i>(in thousands)</i>		
Allowance for loan losses at beginning of period	\$ 11,308	\$ 10,033
Charge-offs:		
Real estate:		
Residential	(8)	(121)
Commercial	—	(22)
Commercial	(82)	(147)
Credit card	(303)	(806)
Total charge-offs	(393)	(1,096)
Recoveries:		
Real estate:		
Residential	—	3
Commercial	10	152
Commercial	—	34
Credit card	14	42
Total recoveries	24	231
Net charge-offs	(369)	(865)
Provision for loan losses	1,869	2,140
Allowance for loan losses at period end	\$ 12,808	\$ 11,308
Loans outstanding, net of unearned income (end of period)	\$ 1,140,310	\$ 1,000,268
Average loans outstanding, net of unearned income	\$ 1,041,364	\$ 937,822
Allowance for loan losses to period end loans	1.12%	1.13%
Net charge-offs to average loans	0.04%	0.09%



Our allowance for loan losses at September 30, 2019 and December 31, 2018 was \$12.8 million, or 1.12% of loans, and \$11.3 million, or 1.13% of loans, respectively. The allowance for loan losses at September 30, 2019 included specific reserves of \$258 thousand set aside for impaired loans. Charge-offs for the nine months ended September 30, 2019 were \$393 thousand and were partially offset by recoveries of \$24 thousand. The allowance for loan losses at December 31, 2018 included specific reserves of \$262 thousand set aside for impaired loans. Our charge-offs for the year ended December 31, 2018 were \$1.1 million and were partially offset by recoveries of \$231 thousand. The charge-offs for the first nine months ended September 30, 2019 and for the year ended December 31, 2018 were primarily due to credit card charge-offs.

Although we believe that we have established our allowance for loan losses in accordance with generally accepted accounting principles (“GAAP”) and that the allowance for loan losses was adequate to provide for known and inherent losses in the portfolio at all times shown above, future provisions for loan losses will be subject to ongoing evaluations of the risks in our loan portfolio.

The following table shows the allocation of the allowance for loan losses among loan categories and certain other information as of the dates indicated. The total allowance is available to absorb losses from any loan category.

#### ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

	September 30, 2019		December 31, 2018	
	Amount	Percent <sup>(1)</sup>	Amount	Percent <sup>(1)</sup>
<i>(in thousands)</i>				
Real estate:				
Residential	\$ 4,176	33%	\$ 3,541	30%
Commercial	3,426	26%	3,003	27%
Construction	2,377	19%	2,093	19%
Commercial	1,558	12%	1,578	14%
Credit card	1,263	10%	1,084	10%
Other consumer	8	—%	9	—%
Total allowance for loan losses	\$ 12,808	100%	\$ 11,308	100%

<sup>(1)</sup> Loan category as a percentage of total loans.

#### Deposits

Deposits are the major source of funding for the Company. We offer a variety of deposit products including interest bearing demand, savings, money market and time accounts all of which we actively market at competitive pricing. We generate deposits from our customers on a relationship basis and through the efforts of our commercial lending officers and our business banking officers. Our credit card customers are also a significant source of low cost deposits. New fiduciary deposits contributed \$33.6 million to our \$51.1 million increase in noninterest bearing deposits. In addition, our credit card customers accounted for \$77.7 million, or 26%, of our total noninterest bearing deposit balances, and increased by \$11.9 million during the first nine months of 2019. We supplement our deposits with wholesale funding sources such as the Certificate of Deposit Account Registry Service (“CDARS”) and brokered deposits.

Interest bearing deposits increased \$106.1 million, or 15%, from December 31, 2018 to September 30, 2019 and included increases in interest bearing demand and money market accounts offset by a reduction in certificates of deposits. The Company continues to execute on its strategic initiative to improve the deposit portfolio mix from wholesale deposits to core deposits including noninterest bearing deposits. During the same period, certificates of deposit decreased \$20.0 million, or 6%, with brokered deposits representing a

majority of that decrease. Money market accounts increased \$24.2 million, or 8% from December 31, 2018 to September 30, 2019.

The average rate paid on interest bearing deposits increased 40 basis points from 1.42% for the year ended December 31, 2018 to 1.82% for the nine months ended September 30, 2019. Rates paid on certificates of deposit increased 63 basis points over the same period. The increase in the average rates was primarily due to increases in market interest rates in 2018. The recent decreases in market interest rates have not yet been reflected in our overall cost of deposits.

The following table presents the average balances and average rates paid on deposits for the periods indicated:

#### COMPOSITION OF DEPOSITS

	For the Nine Months Ended September 30, 2019		For the Year Ended December 31, 2018	
	Average Balance	Average Rate	Average Balance	Average Rate
(in thousands)				
Interest bearing demand accounts	\$ 97,325	0.53%	\$ 72,523	0.29%
Money market accounts	330,086	1.70%	286,257	1.33%
Savings accounts	3,613	0.35%	3,704	0.32%
Certificates of deposit	294,693	2.40%	326,827	1.77%
Total interest bearing deposits	725,717	1.82%	689,311	1.42%
Noninterest bearing demand accounts	252,353		220,445	
Total deposits	\$ 978,070	1.35%	\$ 909,756	1.08%

The following table presents the maturities of our certificates of deposit as of September 30, 2019.

#### MATURITIES OF CERTIFICATES OF DEPOSIT

	Three Months or Less	Over Three Through Six Months	Over Six Through Twelve Months	Over Twelve Months	Total
(in thousands)					
\$100,000 or more	\$ 75,954	\$ 26,476	\$ 58,699	\$ 119,058	\$ 280,187
Less than \$100,000	15,003	6,828	5,744	7,758	35,333
Total	\$ 90,957	\$ 33,304	\$ 64,443	\$ 126,816	\$ 315,520

#### Borrowings

We primarily utilize short-term and long-term borrowings to supplement deposits to fund our lending and investment activities, each of which is discussed below.

*FHLB Advances.* The FHLB allows us to borrow up to 25% of our assets on a blanket floating lien status collateralized by certain securities and loans. As of September 30, 2019, approximately \$219.0 million in real estate loans and \$1.6 million in investment securities were pledged as collateral for our FHLB borrowings. We utilize these borrowings to meet liquidity needs and to fund certain fixed rate loans in our portfolio. As of September 30, 2019, we had \$35.6 million in outstanding advances and \$162.5 million in available borrowing capacity from the FHLB. The \$33.6 million increase compared to \$2.0 million of outstanding advances at December 31, 2018 resulted from a principal reducing advance taken out in May 2019.

The following table sets forth certain information on our FHLB borrowings during the periods presented:

**FHLB ADVANCES**

	<b>For the Nine Months Ended September 30, 2019</b>	<b>For the Year Ended December 31, 2018</b>
<small>(in thousands)</small>		
Amount outstanding at period-end	\$ 35,556	\$ 2,000
Weighted average interest rate at period-end	2.40%	4.26%
Maximum month-end balance during the period	\$ 72,778	\$ 17,000
Average balance outstanding during the period	\$ 42,690	\$ 8,101
Weighted average interest rate during the period	2.52%	2.83%

*Other borrowed funds.* The Company has also issued a senior promissory note, junior subordinated debentures and other subordinated notes. At September 30, 2019, these other borrowings amounted to \$15.4 million.

At September 30, 2019, our junior subordinated debentures amounted to \$2.1 million. The junior subordinated debentures were issued in June of 2006, mature on June 15, 2036, and may be redeemed prior to that date under certain circumstances. The principal amount of the debentures has not changed since issuance, and they accrue interest at a floating rate equal to the three-month LIBOR plus 1.87%.

On November 24, 2015, the Company issued \$13.5 million in aggregate principal amount of subordinated notes with a maturity date of December 1, 2025. The notes may be redeemed prior to the maturity date under certain circumstances. The notes bear interest at 6.95% for the first five years, then adjust to the three-month LIBOR plus 5.33%.

*Federal Reserve Bank of Richmond.* The Federal Reserve Bank of Richmond has an available borrower in custody arrangement which allows us to borrow on a collateralized basis. The Company's borrowing capacity under the Federal Reserve's discount window program was \$12.1 million as of September 30, 2019. Certain commercial loans are pledged under this arrangement. We maintain this borrowing arrangement to meet liquidity needs pursuant to our contingency funding plan. No advances were outstanding under this facility as of September 30, 2019.

The Company also has available lines of credit of \$28.0 million with other correspondent banks at September 30, 2019, as well as access to certificate of deposit funding through a financial network which is limited to 15% of the Bank's assets.

## *Liquidity*

Liquidity is defined as the Bank's capacity to meet its cash and collateral obligations at a reasonable cost. Maintaining an adequate level of liquidity depends on the Bank's ability to meet both expected and unexpected cash flows and collateral needs efficiently without adversely affecting either daily operations or the financial condition of the Bank. Liquidity risk is the risk that we will be unable to meet our obligations as they become due because of an inability to liquidate assets or obtain adequate funding. The Bank's obligations, and the funding sources used to meet them, depend significantly on our business mix, balance sheet structure and the cash flow profiles of our on- and off-balance sheet obligations. In managing our cash flows, management regularly confronts situations that can give rise to increased liquidity risk. These include funding mismatches, market constraints on the ability to convert assets into cash or in accessing sources of funds (i.e., market liquidity) and contingent liquidity events. Changes in economic conditions or exposure to credit, market, operation, legal and reputational risks also could affect the Bank's liquidity risk profile and are considered in the assessment of liquidity and asset/liability management.

Management has established a management process for identifying, measuring, monitoring and controlling liquidity risk. Because of its critical importance to the viability of the Bank, liquidity risk management is fully integrated into our risk management processes. Critical elements of our liquidity risk management include: corporate governance consisting of oversight by the board of directors and active involvement by management; strategies, policies, procedures, and limits used to manage and mitigate liquidity risk; liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds) that are believed to be commensurate with the complexity and business activities of the Bank; active management of intraday liquidity and collateral; a diverse mix of existing and potential future funding sources; adequate levels of highly liquid marketable securities, free of legal, regulatory or operational impediments, that can be used to meet liquidity needs in stressful situations; contingency funding plans that address potential adverse liquidity events and emergency cash flow requirements; and internal controls and internal audit processes sufficient to determine the adequacy of the institution's liquidity risk management process.

We expect funds to be available from a number of basic banking activity sources, including the core deposit base, the repayment and maturity of loans and investment security cash flows. Other potential funding sources include brokered certificates of deposit, deposit listing services, CDARS, borrowings from the FHLB and other lines of credit.

There were no borrowings outstanding with the Federal Reserve Bank of Richmond at September 30, 2019 or December 31, 2018, and our borrowing capacity is limited only by eligible collateral. As of September 30, 2019, we had \$162.5 million of available borrowing capacity from the FHLB, \$12.1 million of available borrowing capacity from the Federal Reserve Bank of Richmond and available lines of credit of \$28.0 million with other correspondent banks. Cash and cash equivalents were \$55.1 million at September 30, 2019 and \$34.7 million at December 31, 2018. Accordingly, our liquidity resources were at sufficient levels to fund loans and meet other cash needs as necessary.

## Capital Resources

Stockholders' equity increased \$13.3 million at September 30, 2019 compared to December 31, 2018. Net income for the nine months ended September 30, 2019 increased retained earnings by \$11.8 million. Stock options exercised, shares issued as compensation, and stock-based compensation increased common stock and additional paid-in capital aggregately by \$1.3 million. These increases were supplemented by a decrease in net unrealized losses on available for sale securities of \$606 thousand. As part of the Company's stock repurchase program, shares repurchased and retired for the nine months ended September 30, 2019 totaled 21,130 shares at a weighted average price of \$12.44, for a total cost of \$263 thousand including commissions.

The Company uses several indicators of capital strength. The most commonly used measure is average common equity to average assets (computed as average equity divided by average total assets), which was 10.40% at September 30, 2019 and 8.76% at December 31, 2018.

The following table shows the return on average assets (computed as net income divided by average total assets), return on average equity (computed as net income divided by average equity) and average equity to average assets ratios for the nine months ended September 30, 2019 and for the year ended December 31, 2018.

	September 30, 2019	December 31, 2018
Return on Average Assets <sup>(1)</sup>	1.35%	1.22%
Return on Average Equity <sup>(1)</sup>	12.93%	13.94%
Average Equity to Average Assets	10.40%	8.76%

(1) These ratios are annualized for the nine months ended September 30, 2019.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company 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. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum ratios of common equity Tier 1, Tier 1, and total capital as a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 1250%. The Company and the Bank are also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio.

In July 2013, federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by Basel III and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions and bank holding companies and savings and loan holding companies with total consolidated assets of more than \$1 billion. The Bank was required to implement the new Basel III capital standards (subject to the phase-in for certain parts of the new rules) as of January 1, 2015. In August of 2018 the Regulatory Relief Act directed the Federal Reserve Board to revise the Small BHC Policy Statement to raise the total consolidated asset limit in the Small BHC Policy Statement from \$1 billion to \$3 billion. The Company was previously required to comply with the minimum capital requirements on a consolidated basis; however, the Company continues to meet the conditions of the revised Small BHC Policy Statement and was, therefore, exempt from the consolidated capital requirements for the periods reflected.

As of September 30, 2019, the Company and the Bank were in compliance with all applicable regulatory capital requirements to which they were subject, and the Bank was classified as “well capitalized” for purposes of the prompt corrective action regulations. As we deploy our capital and continue to grow our operations, our regulatory capital levels may decrease depending on our level of earnings. However, we intend to monitor and control our growth in order to remain in compliance with all regulatory capital standards applicable to us. See “Supervision and Regulation—Capital Adequacy Guidelines” for additional discussion regarding the regulatory capital requirements applicable to the Company and the Bank.

The following table presents the regulatory capital ratios for the Company and the Bank as of the dates indicated.

(in thousands)	Actual		Minimum capital adequacy		To be well capitalized		Full Phase In of Basel III	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2019								
<b>The Company</b>								
Tier 1 leverage ratio (to average assets)	\$ 129,880	10.37%	\$ 50,109	4.00%	N/A	N/A	\$ 50,109	4.00%
Tier 1 capital (to risk-weighted assets)	129,880	12.21%	90,381	8.50%	N/A	N/A	90,381	8.50%
Common equity tier 1 capital ratio (to risk-weighted assets)	127,829	12.02%	74,431	7.00%	N/A	N/A	74,431	7.00%
Total capital ratio (to risk-weighted assets)	143,180	13.47%	111,647	10.50%	N/A	N/A	111,647	10.50%
<b>The Bank</b>								
Tier 1 leverage ratio (to average assets)	\$ 104,547	8.60%	\$ 48,641	4.00%	\$ 60,801	5.00%	\$ 48,641	4.00%
Tier 1 capital (to risk-weighted assets)	104,547	10.19%	87,173	8.50%	82,045	8.00%	87,173	8.50%
Common equity tier 1 capital ratio (to risk-weighted assets)	104,547	10.19%	71,789	7.00%	66,661	6.50%	71,789	7.00%
Total capital ratio (to risk-weighted assets)	117,375	11.44%	107,684	10.50%	102,556	10.00%	107,684	10.50%
December 31, 2018								
<b>The Company</b>								
Tier 1 leverage ratio (to average assets)	\$ 117,220	10.76%	\$ 43,575	4.00%	N/A	N/A	\$ 43,575	4.00%
Tier 1 capital (to risk-weighted assets)	117,220	12.95%	71,259	7.875%	N/A	N/A	76,914	8.50%
Common equity tier 1 capital ratio (to risk-weighted assets)	115,158	12.73%	57,686	6.375%	N/A	N/A	63,341	7.00%
Total capital ratio (to risk-weighted assets)	128,544	12.96%	89,356	9.875%	N/A	N/A	95,012	10.50%
<b>The Bank</b>								
Tier 1 leverage ratio (to average assets)	\$ 96,122	9.06%	\$ 42,445	4.00%	\$ 53,056	5.00%	\$ 42,445	4.00%
Tier 1 capital (to risk-weighted assets)	96,122	11.00%	68,822	7.875%	69,914	8.00%	74,284	8.50%
Common equity tier 1 capital ratio (to risk-weighted assets)	96,122	11.00%	55,713	6.375%	56,805	6.50%	61,175	7.00%
Total capital ratio (to risk-weighted assets)	107,061	12.25%	86,301	9.875%	87,393	10.00%	91,763	10.50%

## Contractual Obligations

We have contractual obligations to make future payments on debt agreements. While our liquidity monitoring and management consider both present and future demands for and sources of liquidity, the following table of contractual commitments focuses only on future obligations and summarizes our contractual obligations as of September 30, 2019.

## CONTRACTUAL OBLIGATIONS

As of September 30, 2019

(in thousands)	Due in One Year or Less	Due After One Through Three Years	Due After Three Through Five Years	Due After 5 Years	Total
FHLB advances	\$ —	\$ 35,556	\$ —	\$ —	\$ 35,556
Certificates of deposit \$100,000 or more	161,129	118,433	625	—	280,187
Certificates of deposit less than \$100,000	27,575	7,570	148	40	35,333
Subordinated debt	—	—	—	15,416	15,416
<b>Total</b>	<b>\$ 188,704</b>	<b>\$ 161,559</b>	<b>\$ 773</b>	<b>\$ 15,456</b>	<b>\$ 366,492</b>

### Off-Balance Sheet Items

In the normal course of business, we enter into various transactions that, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and issue letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in our consolidated balance sheets. Our exposure to credit loss is represented by the contractual amounts of these commitments. The same credit policies and procedures are used in making these commitments as for on-balance sheet instruments. We are not aware of any accounting loss to be incurred by funding these commitments; however, we maintain an allowance for off-balance sheet credit risk which is recorded in other liabilities on the consolidated balance sheet.

Our commitments associated with outstanding letters of credit and commitments to extend credit expiring by period as of the date indicated are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements.

### CREDIT EXTENSION COMMITMENTS

(in thousands)	As of September 30, 2019	As of December 31, 2018
Unfunded lines of credit	\$ 250,061	\$ 209,209
Commitments to originate residential loans held for sale	2,306	647
Letters of credit	5,502	6,216
<b>Total credit extension commitments</b>	<b>\$ 257,869</b>	<b>\$ 216,072</b>

Unfunded lines of credit represent unused credit facilities to our current borrowers. Letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Lines of credit generally have variable interest rates. In the event of nonperformance by the customer in accordance with the terms of the agreement with the third party, we would be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek recovery from the client from the underlying collateral, which can include commercial real estate, physical plant and property, inventory, receivables, cash and/or marketable securities. Our policies generally require that letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements and our credit risk associated with issuing letters of credit is believed to be substantially the same as the risk involved in extending loan facilities to our customers.

We seek to minimize our exposure to loss under letters of credit and credit commitments by subjecting them to the same credit approval and monitoring procedures as we do for on-balance sheet instruments. The effect on our revenue, expenses, cash flows and liquidity of the unused portions of these letters of credit commitments cannot be precisely predicted because there is no guarantee that the lines of credit will be used.

Commitments to extend credit are agreements to lend funds to a customer, as long as there is no violation of any condition established in the contract, for a specific purpose. Commitments generally have variable interest rates, fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn, the total commitment amounts disclosed above do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by us, upon extension of credit is based on management's credit evaluation of the customer.

We enter into forward commitments for the delivery of mortgage loans in our current pipeline. Interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from our commitments to fund the loans. These commitments to fund mortgage loans, to be sold into the secondary market, (interest rate lock commitments) and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives.



### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **Interest Rate Sensitivity and Market Risk**

As a financial institution, our primary component of market risk is interest rate volatility. Our asset liability and funds management policy provides management with the guidelines for funds management, and we have established a measurement system for monitoring our net interest rate sensitivity position. We manage our sensitivity position within our established guidelines.

Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of our assets and liabilities, and the market value of all interest earning assets and interest bearing liabilities, other than those that have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

We manage our exposure to interest rates by structuring our balance sheet in the ordinary course of business. We do not enter into instruments such as leveraged derivatives, financial options or financial futures contracts for the purpose of reducing interest rate risk. We do hedge the interest rate risks of our available for sale mortgage pipeline by using mortgage-backed securities short positions, and of our subordinated debentures by utilizing an interest rate swap. Based on the nature of our operations, we are not subject to foreign exchange or commodity price risk. We do not own any trading assets.

Our exposure to interest rate risk is managed by the Bank's Asset/Liability Management Committee ("ALCO") in accordance with policies approved by our board of directors. The committee formulates strategies based on perceived levels of interest rate risk. In determining the appropriate level of interest rate risk, the committee considers the impact on earnings and capital on the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The committee meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the committee reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management employs methodologies to manage interest rate risk, which include an analysis of relationships between interest earning assets and interest bearing liabilities and an interest rate shock simulation model.

The following table indicates that, for periods less than one year, rate-sensitive assets exceeded rate-sensitive liabilities, resulting in an asset-sensitive position. For a bank with an asset-sensitive position, or positive gap, rising interest rates would generally be expected to have a positive effect on net interest income, and falling interest rates would generally be expected to have the opposite effect.

## INTEREST SENSITIVITY GAP

September 30, 2019	Within One Month	After One Month Through Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Non- Sensitive	Total
(in thousands)						
<b>Assets</b>						
Interest earning assets						
Loans <sup>(1)</sup>	\$ 631,627	\$ 61,626	\$ 173,346	\$ 866,599	\$ 342,693	\$ 1,209,292
Securities	2,897	3,268	1,000	7,165	29,908	37,073
Interest bearing deposits at other financial institutions	40,521	—	—	40,521	—	40,521
Federal funds sold	3,464	—	—	3,464	—	3,464
<b>Total earning assets</b>	<b>\$ 678,509</b>	<b>\$ 64,894</b>	<b>\$ 174,346</b>	<b>\$ 917,749</b>	<b>\$ 372,601</b>	<b>\$ 1,290,350</b>
<b>Liabilities</b>						
Interest bearing liabilities						
Interest bearing deposits	\$ 503,546	\$ —	\$ —	\$ 503,546	\$ —	\$ 503,546
Time deposits	26,720	27,494	133,938	188,152	127,368	315,520
<b>Total interest bearing deposits</b>	<b>530,266</b>	<b>27,494</b>	<b>133,938</b>	<b>691,698</b>	<b>127,368</b>	<b>819,066</b>
FHLB Advances	—	—	—	—	35,556	35,556
Other borrowed funds	—	—	—	—	15,416	15,416
<b>Total interest bearing liabilities</b>	<b>\$ 530,266</b>	<b>\$ 27,494</b>	<b>\$ 133,938</b>	<b>\$ 691,698</b>	<b>\$ 178,340</b>	<b>\$ 870,038</b>
Period gap	\$ 148,243	\$ 37,400	\$ 40,408	\$ 226,051	\$ 194,261	\$ 420,312
Cumulative gap	\$ 148,243	\$ 185,643	\$ 226,051	\$ 226,051	\$ 420,312	
Ratio of cumulative gap to total earning assets	11.49%	14.39%	17.52%	17.52%	32.57%	

(1) Includes loans held for sale.

We use quarterly Earnings at Risk (“EAR”) simulations to assess the impact of changing interest rates on our earnings under a variety of scenarios and time horizons. These simulations utilize both instantaneous and parallel changes in the level of interest rates, as well as non-parallel changes such as changing slopes and twists of the yield curve. Static simulation models are based on current exposures and assume a constant balance sheet with no new growth. Dynamic simulation models are also utilized that rely on assumptions regarding changes in existing lines of business, new business, and changes in management and client behavior.

We also use economic value-based methodologies to measure the degree to which the economic values of the Bank’s positions change under different interest rate scenarios. The economic-value approach focuses on a longer-term time horizon and captures all future cash flows expected from existing assets and liabilities. The economic value model utilizes a static approach in that the analysis does not incorporate new business; rather, the analysis shows a snapshot in time of the risk inherent in the balance sheet.

Many assumptions are used to calculate the impact of interest rate fluctuations on our net interest income, such as asset prepayments, non-maturity deposit price sensitivity and decay rates, and key rate drivers. Because of the inherent use of these estimates and assumptions in the model, our actual results may, and most likely will, differ from our static EAR results. In addition, static EAR results do not include actions that our management may undertake to manage the risks in response to anticipated changes in interest rates or client behavior. For example, as part of our asset/liability management strategy, management has the ability to increase asset duration and decrease liability duration in order to reduce asset sensitivity, or to decrease asset duration and increase liability duration in order to increase asset sensitivity.

The following table summarizes the results of our EAR analysis in simulating the change in net interest income and fair value of equity over a 12-month horizon as of September 30, 2019:

**IMPACT ON NET INTEREST INCOME UNDER A STATIC BALANCE SHEET, PARALLEL INTEREST RATE SHOCK**

<b>Earnings at Risk</b>	<b>-200 bps</b>	<b>-100 bps</b>	<b>Flat</b>	<b>+100 bps</b>	<b>+200 bps</b>	<b>+300 bps</b>
September 30, 2019	(8.2)%	(5.8)%	0.0%	8.2%	16.4%	24.6%

Utilizing an economic value of equity (“EVE”) approach, we analyze the risk to capital from the effects of various interest rate scenarios through a long-term discounted cash flow model. This measures the difference between the economic value of our assets and the economic value of our liabilities, which is a proxy for our liquidation value. While this provides some value as a risk measurement tool, management believes EAR is more appropriate in accordance with the going concern principle.

The following table illustrates the results of our EVE analysis as of September 30, 2019.

**ECONOMIC VALUE OF EQUITY ANALYSIS UNDER A STATIC BALANCE SHEET, PARALLEL INTEREST RATE SHOCK**

<b>Economic Value of Equity</b>	<b>-200 bps</b>	<b>-100 bps</b>	<b>Flat</b>	<b>+100 bps</b>	<b>+200 bps</b>	<b>+300 bps</b>
September 30, 2019	(9.9)%	(4.1)%	0.0%	1.7%	1.6%	1.0%

**Item 4. CONTROLS AND PROCEDURES.**

*Evaluation of Disclosure Controls and Procedures*

The Company's management, including our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our 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 report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There has been no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that has materially affected, or is 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 are a party to various litigation matters incidental to our ordinary conduct of our business. We are not presently a party to any material legal proceedings.

### Item 1A. RISK FACTORS.

There have been no material changes to the risk factors that appeared under "Part I, ITEM 1A. Risk Factors" of our 2018 Annual Report and as supplemented under "Part II, Item 1A. Risk Factors" of our Quarterly Report for the quarter ended September 30, 2019.

### Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

On April 25, 2019, the Company announced a stock repurchase program. The program enables the Company to repurchase up to \$5.0 million of its outstanding common stock, and expires on December 31, 2020. During the three months ended September 30, 2019, the Corporation repurchased shares under the recently approved stock repurchase program, as reflected in the following table.

Period	Total Number of Shares Purchased	Average price paid per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 2019 to July 31, 2019	—	\$ —	—	\$ 5,000,000
August 1, 2019 to August 31, 2019	21,130	\$ 12.44	21,130	4,736,805
September 1, 2019 to September 30, 2019	—	—	—	4,736,805
Total	21,130	\$ 12.44	21,130	\$ 4,736,805

**Item 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**Item 5. OTHER INFORMATION.**

None.

**Item 6. EXHIBITS.**

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed in the Index to Exhibits attached hereto and are incorporated herein by reference.

## INDEX TO EXHIBITS

Exhibit Number	Description
31.1	<a href="#">Rule 13a-14(a) Certification of the Principal Executive Officer.</a>
31.2	<a href="#">Rule 13a-14(a) Certification of the Principal Financial Officer.</a>
32	<a href="#">Section 1350 Certification of Chief Executive Officer and Chief Financial Officer.</a>
101	The following materials from the Quarterly Report on Form 10-Q of Capital Bancorp, Inc. for the quarter ended September 30, 2019, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statement of Changes in Shareholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) Notes to Unaudited Consolidated Financial Statements.

## 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.

CAPITAL BANCORP. INC.  
Registrant

Date: November 13, 2019     /s/ Ed Barry  
Ed Barry  
Chief Executive Officer (Principal Executive Officer)

Date: November 13, 2019     /s/ Alan W. Jackson  
Alan W. Jackson  
Chief Financial Officer (Principal Financial and Accounting Officer)



**Section 2: EX-31.1 (RULE 13A-14(A) CERTIFICATION OF THE PRINCIPAL EXECUTIVE OFFICER)**

**Exhibit 31.1**

Rule 13a-14(a) Certification of the Principal Executive Officer.

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**Exhibit 31.1**

Rule 13a-14(a) Certification of the Principal Executive Officer.

I, Ed Barry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2019

By: /s/ Ed Barry  
Ed Barry  
Chief Executive Officer

**Section 2: EX-31.2 (RULE 13A-14(A) CERTIFICATION OF THE PRINCIPAL FINANCIAL OFFICER)**

**Exhibit 31.2**

Rule 13a-14(a) Certification of the Principal Financial Officer.

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**Exhibit 31.2**

Rule 13a-14(a) Certification of the Principal Financial Officer.

I, Alan W. Jackson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital Bancorp, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2019

By: /s/ Alan W. Jackson  
Alan W. Jackson  
Chief Financial Officer

**Section 2: EX-32 (Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)**

**Exhibit 32**

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

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**Exhibit 32**

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

In connection with the Quarterly Report of Capital Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the undersigned's best knowledge and belief:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 13, 2019

By: /s/ Ed Barry

Ed Barry  
Chief Executive Officer

By: /s/ Alan W. Jackson

Alan W. Jackson  
Chief Financial Officer