UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended June 30, 2022 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	**52-2083046**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
2275 Research Boulevard Suite 600 **Rockville Maryland**	**20850**
(Address of principal executive offices)	(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 x 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 x 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	☐	Accelerated Filer	☒
Non-accelerated filer	☐	Smaller reporting company	☒
		Emerging growth company	☒

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

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

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

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

As of August 5, 2022, the Company had 14,034,490 shares of common stock, par value $0.01 per share, outstanding.

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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)	June 30, 2022 (unaudited)	December 31, 2021 (audited)
Assets		
Cash and due from banks	$ 14,776	$ 42,914
Interest bearing deposits at other financial institutions	234,823	136,824
Federal funds sold	1,285	3,657
Total cash and cash equivalents	250,884	183,395
Investment securities available for sale	226,509	184,455
Marketable equity securities	245	245
Restricted investments	3,615	3,498
Loans held for sale	11,708	15,989
Small Business Administration Payroll Protection Program loans receivable, net of fees and costs	15,864	108,285
Portfolio loans receivable, net of deferred fees and costs	1,607,677	1,523,982
Less allowance for loan losses	(26,419)	(25,181)
Total portfolio loans held for investment, net	1,581,258	1,498,801
Premises and equipment, net	3,315	3,282
Accrued interest receivable	7,276	7,901
Deferred tax asset	12,929	9,793
Foreclosed real estate	—	86
Bank owned life insurance	36,011	35,506
Other assets	5,232	4,064
Total assets	$ 2,154,846	$ 2,055,300
Liabilities		
Deposits		
Noninterest-bearing	$ 842,363	$ 787,650
Interest-bearing	1,046,557	1,009,487
Total deposits	1,888,920	1,797,137
Federal Home Loan Bank advances	22,000	22,000
Other borrowed funds	12,062	12,062
Accrued interest payable	300	473
Other liabilities	24,248	25,725
Total liabilities	1,947,530	1,857,397
Stockholders' equity		
Common stock, $.01 par value; 49,000,000 shares authorized; 14,010,158 and 13,962,334 issued and outstanding	140	140
Additional paid-in capital	55,762	54,306
Retained earnings	164,750	144,533
Accumulated other comprehensive loss	(13,336)	(1,076)
Total stockholders' equity	207,316	197,903
Total liabilities and stockholders' equity	$ 2,154,846	$ 2,055,300

See Notes to Consolidated Financial Statements

Capital Bancorp, Inc. and Subsidiaries
Consolidated Statements of Income
(unaudited)

(dollars in thousands except per share data)	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021
Interest income				
Loans, including fees	$ 35,304	$ 28,641	$ 69,193	$ 54,709
Investment securities available for sale	779	544	1,149	1,021
Federal funds sold and other	473	104	615	197
Total interest income	36,556	29,289	70,957	55,927
Interest expense				
Deposits	964	1,582	1,847	3,589
Borrowed funds	192	187	379	375
Total interest expense	1,156	1,769	2,226	3,964
Net interest income	35,400	27,520	68,731	51,963
Provision for loan losses	2,035	781	2,987	1,284
Net interest income after provision for loan losses	33,365	26,739	65,744	50,679
Noninterest income				
Service charges on deposits	183	165	346	312
Credit card fees	6,210	7,715	12,134	13,655
Mortgage banking revenue	1,528	5,270	3,318	13,013
Gain on sale of investment securities available for sale, net	—	153	—	153
Other fees and charges	441	168	852	288
Total noninterest income	8,362	13,471	16,650	27,421
Noninterest expenses				
Salaries and employee benefits	10,071	8,750	20,381	17,317
Occupancy and equipment	1,313	1,195	2,339	2,324
Professional fees	2,417	1,362	4,738	2,987
Data processing	7,266	10,122	15,542	19,433
Advertising	2,223	1,293	3,862	2,126
Loan processing	335	975	727	2,026
Other operating	3,505	3,508	6,643	6,759
Total noninterest expenses	27,130	27,205	54,232	52,972
Income before income taxes	14,597	13,005	28,162	25,128
Income tax expense	3,089	3,357	6,443	6,499
Net income	$ 11,508	$ 9,648	$ 21,719	$ 18,629
Basic earnings per share	$ 0.82	$ 0.70	$ 1.55	$ 1.35
Diluted earnings per share	$ 0.80	$ 0.68	$ 1.52	$ 1.32
Weighted average common shares outstanding:				
Basic	14,007,240	13,766,318	13,997,946	13,761,676
Diluted	14,312,848	14,172,438	14,323,400	14,070,427

See Notes to Consolidated Financial Statements

Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2022**	**2021**	**2022**	**2021**
Net income	**$ 11,508**	$ 9,648	**$ 21,719**	$ 18,6
Other comprehensive loss:				
Unrealized (loss) gain on investment securities available for sale	**(7,054)**	333	**(16,342)**	(1,9
Reclassification of realized gain on sale of investment securities available for sale	**—**	(153)	**—**	(1
	(7,054)	180	**(16,342)**	(2,1
Income tax benefit (expense) relating to the items above	**1,541**	(50)	**4,082**	5
Other comprehensive (loss) income	**(5,513)**	130	**(12,260)**	(1,5
Comprehensive income	**$ 5,995**	$ 9,778	**$ 9,459**	$ 17,0

See Notes to Consolidated Financial Statements

Capital Bancorp, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
(unaudited)

(dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2020	13,753,529	$ 138	$ 50,602	$ 106,854	$ 1,717	$ 159,3
Net income	—	—	—	8,982	—	8,9
Unrealized loss on investment securities available for sale, net of income taxes	—	—	—	—	(1,699)	(1,6
Stock options exercised, net of repurchased shares	1,795	—	21	(31)	—	(
Shares issued as compensation	3,894	—	86	—	—	
Stock-based compensation	—	—	333	—	—	3
Balance, March 31, 2021	13,759,218	$ 138	$ 51,042	$ 115,805	$ 18	$ 167,0
Net income	—	—	—	9,648	—	9,6
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	130	1
Stock options exercised, net of repurchased shares	10,301	—	121	(22)	—	
Shares issued as compensation	2,096	—	26	—	—	
Stock-based compensation	—	—	298	—	—	2
Balance, June 30, 2021	13,771,615	$ 138	$ 51,487	$ 125,431	$ 148	$ 177,2
Balance, December 31, 2021	**13,962,334**	**$ 140**	**$ 54,306**	**$ 144,533**	**$ (1,076)**	**$ 197,9**
Net income	**—**	**—**	**—**	**10,211**	**—**	**10,2**
Unrealized loss on investment securities available for sale, net of income taxes	**—**	**—**	**—**	**—**	**(6,747)**	**(6,7**
Stock options exercised, net of repurchased shares	**27,028**	**—**	**339**	**(95)**	**—**	**2**
Shares issued as compensation	**11,158**	**—**	**164**	**—**	**—**	**1**
Stock-based compensation	**—**	**—**	**417**	**—**	**—**	**4**
Cash dividends to stockholders ($0.05 per share)	**—**	**—**	**—**	**(700)**	**—**	**(7**
Balance, March 31, 2022	**14,000,520**	**$ 140**	**$ 55,226**	**$ 153,949**	**$ (7,823)**	**$ 201,4**
Net income	**—**	**—**	**—**	**11,508**	**—**	**11,5**
Unrealized loss on investment securities available for sale, net of income taxes	**—**	**—**	**—**	**—**	**(5,513)**	**(5,5**
Stock options exercised, net of repurchased shares	**6,638**	**—**	**84**	**(7)**	**—**	
Shares issued as compensation	**3,000**	**—**	**37**	**—**	**—**	
Stock-based compensation	**—**	**—**	**415**	**—**	**—**	**4**
Cash dividends to stockholders ($0.05 per share)	**—**	**—**	**—**	**(700)**	**—**	**(7**
Balance, June 30, 2022	**14,010,158**	**$ 140**	**$ 55,762**	**$ 164,750**	**$ (13,336)**	**$ 207,3**

See Notes to Consolidated Financial Statements

Capital Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021
Operating activities		
Net income	**$ 21,719**	$ 18,629
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**2,987**	1,284
Provision for mortgage put-back reserve, net	**2**	210
Reversal of provision for off balance sheet credit commitments	**(105)**	(30)
Amortization on investments, net	**532**	217
Depreciation and amortization	**749**	986
Increase in cash surrender value of bank-owned life insurance policies	**(505)**	(4)
Stock-based compensation expense	**832**	631
Employee compensation paid in Company stock	**201**	26
Deferred income tax expense	**946**	243
Gain on sale of securities available for sale	**—**	(153)
Valuation allowance on derivatives	**39**	(221)
(Gain) loss on sale of foreclosed real estate	**(20)**	28
Increase in valuation of loans held for sale carried at fair value	**(3,318)**	(13,013)
Proceeds from sales of loans held for sale	**203,103**	691,510
Originations of loans held for sale	**(195,504)**	(619,277)
Changes in assets and liabilities:		
Decrease in accrued interest receivable	**625**	348
(Increase) decrease in other assets	**(1,191)**	730
Decrease in accrued interest payable	**(173)**	(175)
Decrease in other liabilities	**(1,391)**	(5,845)
Net cash provided by operating activities	**29,528**	76,124
Investing activities		
Purchases of securities available for sale	**(62,542)**	(139,318)
Proceeds from maturities, calls and principal paydowns of securities available for sale	**3,614**	9,617
Proceeds from sale of securities available for sale	**—**	66,534
(Purchases) sales of restricted investments	**(117)**	235
Purchases of bank-owned life insurance	**—**	(35,000)
Decrease (increase) in SBA-PPP loans receivable, net	**92,421**	(1,745)
Increase in portfolio loans receivable, net	**(85,444)**	(77,608)
Purchases of premises and equipment, net	**(782)**	(656)
Proceeds from sales of foreclosed real estate	**106**	61
Net cash used for investing activities	**(52,744)**	(177,880)

See Notes to Consolidated Financial Statements

(in thousands)	Six Months Ended June 30, 2022	2021
Financing activities		
Net increase (decrease) in:		
Noninterest-bearing deposits	**54,713**	219,749
Interest-bearing deposits	**37,070**	45,542
Repayment of advances from Federal Reserve Bank	**—**	(1,954)
Dividends paid	**(1,400)**	—
Net proceeds from exercise of stock options	**321**	175
Net cash provided by financing activities	**90,704**	263,512
Net increase in cash and cash equivalents	**67,488**	161,756
Cash and cash equivalents, beginning of year	**$ 183,396**	146,910
Cash and cash equivalents, end of period	**$ 250,884**	$ 308,666
Noncash activities:		
Change in unrealized losses on investments	**$ (16,342)**	$ (2,117)
Cash paid during the period for:		
Taxes	**$ 5,179**	$ 9,140
Interest	**$ 2,399**	$ 4,139

See Notes to Consolidated Financial Statements

Note 1 - Nature of Business and Basis of Presentation

Nature of operations:

Capital Bancorp, Inc. is a Maryland corporation and the 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 and Columbia, 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 ("CBHL"), the Bank's 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. At June 30, 2022, Church Street Capital had loans totaling $6.4 million.

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.

Basis of presentation:

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with rules and regulations of the Securities and Exchange Commission ("SEC") and include the activity of the Company and its wholly-owned subsidiaries, the Bank and Church Street Capital. The statements do not include all of the information and footnotes required by GAAP for complete financials statements. All adjustments have been made which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. Such adjustments are all of a normal and recurring nature. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation. The results of operations for the three and six months ended June 30, 2022 are not necessarily indicative of the results that may be expected for the full year. These consolidated financial statements should be read in conjunction with the Company's audited financial statements and the notes thereto as of December 31, 2021, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

The Company reports its activities as four business segments. 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.

Risks and uncertainties

The Company has been, and may continue to be, impacted by the coronavirus disease 2019 pandemic ("COVID-19"). The direct impacts of COVID-19 appear to be waning, but the pandemic's residual impact manifests itself in supply chain and labor market imbalances and ongoing inflationary pressures. To address the economic impact of the pandemic in the U.S., multiple stimulus packages have been enacted to provide economic relief to individuals and businesses, including the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), which established the Small Business Administration

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

Paycheck Protection Program (“SBA-PPP”) and the American Rescue Plan Act of 2021 which was enacted in March 2021.

As the pandemic evolves, the Company remains watchful of COVID-19 surges and new variants and continues to evaluate processes in place to execute our business continuity plan and promote the health and safety of our employees.

Overall economic activity appears to have increased in the U.S. during the second quarter of 2022 after a slight regression in the first quarter as the unemployment rate remained low and job gains have been robust. The future direct and indirect impact of the pandemic on the Company’s businesses, results of operations and financial condition continues to remain uncertain as inflationary concerns remain elevated due to continuing supply and demand imbalances associated with the pandemic. Should current economic conditions deteriorate or if the pandemic worsens, including as the result of the spread of the more easily communicable variants of COVID-19, the macroeconomic environment could have an adverse effect on our businesses, results of operations and financial condition.

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 primary reference point for the estimates is historical experience and assumptions believed to be reasonable regarding the value of certain assets and liabilities that are not readily available from other sources. Estimates are evaluated on an ongoing basis. Actual results may materially 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 are charged to income.

Marketable equity securities

Marketable equity securities are carried at fair value with realized gains and losses included in earnings. Premiums and discounts on investment securities are amortized or accreted using the interest method. Changes in the fair value of equity securities are also included in earnings as gain or loss on marketable equity securities.

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

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. 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 elects 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.

Small Business Administration Paycheck Protection Program

The SBA-PPP is one of the centerpieces of the CARES Act which was passed on March 27, 2020 in response to the outbreak of COVID-19 and was supplemented with subsequent legislation. Overseen by the United States (“U.S.”) Treasury Department, the SBA-PPP offered cash-flow assistance to nonprofit and small business employers through guaranteed loans. Borrowers are eligible for forgiveness of principal and accrued interest on SBA-PPP loans to the extent that the proceeds are used to cover eligible payroll costs, interest costs, rent, and utility costs over a period between eight and twenty four weeks after the loan is made as long as the borrower retains its employees and their compensation levels. The CARES Act authorized the SBA to fully guarantee these loans.

On December 27, 2020, the Consolidated Appropriations Act, 2021 (“CAA”) was signed into law. The CAA provides several amendments to the SBA-PPP, including additional funding for the first and second draws of PPP loans up to March 13, 2021. On March 30, 2021, the PPP Extension Act of 2021 was signed into law, which extended the program to May 31, 2021.

Due to the unique nature of these provisions, SBA-PPP loans have been disclosed as a separate balance sheet item. Origination fees received by the SBA are capitalized into the carrying amount of the loans. The deferred fee income, net of origination costs, is recognized over the life of the loan as an adjustment to yield using the effective interest method. SBA-PPP loans receivable as of June 30, 2022 totaled $16.2 million with $301 thousand of net unearned fees. SBA-PPP loans generated interest income of $1.1 million and $3.2 million for the three and six months ended June 30, 2022 and $2.3 million and $4.7 million for the three and six months ended June 30, 2021.

Loans and the allowance for loan losses

Loans are stated at the principal amount outstanding, adjusted for deferred origination fees and 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/or interest is 90 days past due, or when it is probable that

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

not all principal and interest payments will be collected, 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 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; however, the CARES Act provided financial institutions optional temporary relief from TDR and impairment accounting for certain loan modifications related to the COVID-19 pandemic. Under Section 4013 of the CARES Act, banks may suspend (1) the requirement under GAAP for certain modifications that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes. To be eligible, each loan modification must be (1) related to the COVID-19 event; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (A) 60 days after the date of termination of the National Emergency or (B) December 31, 2020. The December 31, 2020 deadline was subsequently extended to January 1, 2022, by the CAA.

All other short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not TDRs. This includes short-term modifications such as payment deferrals, fee waivers, extensions of repayment terms, and other delays in payment that are insignificant. Borrowers considered current are those that are less than 30 days past due on their contractual payments at the time a modification program is implemented.

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 extended out 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 with qualitative factors such as: trends in volume and terms of loans; levels of, and trends in, delinquencies and non-accruals; effects of any changes in lending policies, experience, ability and depth of management; national and local economic trends and conditions (with a specific evaluation of COVID-19 impact); commitments and concentrations of credit; changes in the quality of the Company’s loan review system; and the volume of loans with identified incomplete financial documentation. Actual loan performance may differ materially 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.

The Company determines the allowance for loan losses based on the accumulation of various components that are calculated independently in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 450 for pools of loans, and ASC 310 for TDRs and for individually evaluated loans. The process for determining an appropriate allowance for loan losses is

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

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. Additional disclosure on the allowance for loan losses, qualitative factors, and the potential COVID-19 impact can be found in Part II, Item 1A - Risk Factors and *Note 5 - Portfolio Loans Receivable*.

The allowance for loan losses for SBA-PPP loans was separately evaluated given the explicit government guarantee. This analysis, which incorporated historical experience with similar SBA guarantees and underwriting, concluded that the likelihood of loss was remote and therefore no allowance for loan losses was assigned to these loans.

Premises and equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related property, generally over two to seven years. Leasehold improvements are amortized over the estimated term of the respective leases, which may include renewal options where management has the positive intent to exercise such options, or the estimated useful lives of the improvements, whichever is less. The costs of major renewals and improvements are capitalized with the corresponding costs associated with amortization or depreciation included as a component of occupancy and equipment expense. Expenditures for maintenance, repairs, and minor replacements are charged to noninterest expenses as incurred.

Leases

The Company accounts for leases according to ASU 2016-02, *Leases (Topic 842),* and 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 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 elected not to apply the recognition requirements of ASC 842 to short-term leases, defined as leases with a term of 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.

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 endeavors to manage 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.

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

The Company accounts for derivative instruments and hedging activities according to guidelines established in 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 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 8 - Fair Value*.

Bank-owned life insurance

The Company had $36.0 million of bank-owned life insurance at June 30, 2022 and $35.0 million at June 30, 2021. The Company recognized income, which is included in other noninterest income, of $254 thousand and $505 thousand for the three and six months ended June 30, 2022, respectively, and $4 thousand for both the three and six months ended June 30, 2021.

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

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

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 June 30, 2022, there were 141 thousand stock options excluded from the calculation as their effect would have been anti-dilutive, whereas at June 30, 2021 there were no such options.

Comprehensive loss:

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

The Company's only component of other comprehensive loss is unrealized losses on investment securities available for sale, net of income taxes. Information concerning the Company's accumulated other comprehensive loss as of June 30, 2022 and December 31, 2021 is as follows:

(in thousands)	June 30, 2022	December 31, 2021
Unrealized losses on securities available for sale	**$ (17,846)**	$ (1,504)
Deferred tax benefit	**4,510**	428
Total accumulated comprehensive loss	**$ (13,336)**	$ (1,076)

Recently issued accounting pronouncements:

In June 2016, the FASB issued guidance to change the accounting for loan 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 loan losses. The Company engaged a consultant to assist with the implementation of this ASU and has completed various milestones so as to ensure the timely implementation of the ASU. The Company has preliminary results and has continued to refine the model in Q2 2022. The Company plans to refine assumptions, establish policy, complete model validation and identify expected financial statement impact over the next quarter. 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 was permitted, the Company did not elect that option. In addition to its allowance for loan losses, the Company will also record an allowance for credit losses on held-to-maturity 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 March 2020, the FASB released ASU 2020-04 - Reference Rate Reform, Topic 848, which provides temporary guidance to ease the potential accounting burden in accounting for, or recognizing the effects from, reference rate reform on financial reporting. The new standard is a result of London Interbank Offered Rate (“LIBOR”) likely being discontinued as an available benchmark rate. The standard is elective and provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions that reference LIBOR, or another reference rate expected to be discontinued. The amendments in the update are effective for all entities between March 12, 2020 and December 31, 2022. The Company is currently evaluating products and preparing to offer new rates. The adoption of this guidance is not expected to have a material impact on the Company’s financial statements.

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

In March 2020, various regulatory agencies, including the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (“agencies”), issued an interagency statement on loan modifications and reporting for financial institutions working with customers affected by COVID-19. The interagency statement was effective immediately and impacted accounting for loan modifications. Under ASC 310-40, “Receivables - Troubled Debt Restructurings by Creditors,” a restructuring of debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. The agencies confirmed with the FASB that short-term modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief, are not to be considered TDRs. Such modifications include short-term (e.g., six months) modifications that include payment deferrals of (i) principal and interest, (ii) interest only and (iii) principal only, fee waivers, extensions of repayment terms, and other delays in payment that are deemed insignificant. Borrowers considered current were those that were less than 30 days past due on their contractual payments at the time a modification program was implemented. As of June 30, 2022, the Company had offered payment deferrals for commercial and consumer customers for up to six months. The loan modifications offered to borrowers provided the borrower with payment relief in the form of reduced or deferred payments for up to 90 days (six months in selected instances) during which time interest is continuing to accrue.

In February 2022, the FASB issued ASU 2022-02, Financial Instruments - Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures. The ASU eliminates the accounting guidance for troubled debt restructurings by creditors and enhances disclosure requirements for certain loan re-financings and restructurings by creditors when a borrower is experiencing financial difficulty. The amendments also add requirements to disclose current-period gross write-offs by year of origination for financing receivables. The amendments in this update are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted, including in an interim period. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements and are currently evaluating the timing of adoption.

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

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. Management has reviewed events through the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

Note 2 - Cash and Cash Equivalents

Cash and cash equivalents include cash and amounts due from banks, interest-bearing deposits and federal funds sold. The Bank is required by regulations to maintain an average cash reserve balance based on a percentage of deposits. At June 30, 2022 and December 31, 2021, the requirements were satisfied by amounts on deposit with the Federal Reserve Bank and cash on hand.

Note 3 - Investment Securities

The amortized cost and estimated fair value of investment securities at June 30, 2022 and December 31, 2021 are summarized as follows:

Investment Securities Available for Sale
(in thousands)

June 30, 2022	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for sale				
U.S. Treasuries	**$ 181,808**	**$ —**	**$ (13,159)**	**$ 168,6**
Municipal	**10,820**	**—**	**(2,378)**	**8,4**
Corporate	**5,000**	**—**	**(241)**	**4,7**
Asset-backed securities	**9,606**	**—**	**(191)**	**9,4**
Mortgage-backed securities	**37,121**	**2**	**(1,879)**	**35,2**
Total	**$ 244,355**	**$ 2**	**$ (17,848)**	**$ 226,5**
December 31, 2021				
Available for sale				
U.S. Treasuries	$ 132,452	$ 45	$ (1,496)	$ 131,0
Municipal	10,825	43	(394)	10,4
Corporate	5,000	—	(66)	4,9
Asset-backed securities	10,093	59	(12)	10,1
Mortgage-backed securities	27,589	514	(197)	27,9
Total	$ 185,959	$ 661	$ (2,165)	$ 184,4

There were no securities sold during the six months ended June 30, 2022. There were 28 securities sold during the six months ended June 30, 2021. Proceeds from sales of securities sold during the six months ended June 30, 2021 were $66.5 million. The investment sales resulted in gross gains of $694 thousand and gross losses of $541 thousand for the three and six months ended June 30, 2021.

Note 3 - Investment Securities (continued)

Information related to unrealized losses in the investment portfolio as of June 30, 2022 and December 31, 2021 is summarized as follows:

Investment Securities Unrealized Losses

(in thousands)	Less than 12 months		12 months or longer		Total	
June 30, 2022	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasuries	**$ 168,649**	**$ (13,159)**	**$ —**	**$ —**	**$ 168,649**	**$ (13,15**
Municipal	**6,012**	**(1,644)**	**2,430**	**(734)**	**8,442**	**(2,37**
Corporate	**4,286**	**(214)**	**473**	**(27)**	**4,759**	**(24**
Asset-backed securities	**7,539**	**(154)**	**1,876**	**(37)**	**9,415**	**(19**
Mortgage-backed securities	**16,836**	**(1,417)**	**8,344**	**(462)**	**25,180**	**(1,87**
Total	**$ 203,322**	**$ (16,588)**	**$ 13,123**	**$ (1,260)**	**$ 216,445**	**$ (17,84**
December 31, 2021						
U.S. Treasuries	$ 110,191	$ (1,496)	$ —	$ —	$ 110,191	$ (1,49
Municipal	5,750	(248)	3,019	(146)	8,769	(39
Corporate	4,448	(52)	486	(14)	4,934	(6
Asset-backed securities	—	—	2,115	(12)	2,115	(1
Mortgage-backed securities	14,114	(189)	2,124	(8)	16,238	(19
Total	$ 134,503	$ (1,985)	$ 7,744	$ (180)	$ 142,247	$ (2,16

At June 30, 2022, there were two municipal securities, one corporate security, one asset-backed security, and two mortgage-backed securities that had been in an unrealized loss position for greater than twelve months. At December 31, 2021 there were two municipal securities, one corporate security, one asset-backed security, and one mortgage-backed security that had been in an unrealized loss position for greater than twelve months. Management believes that the unrealized losses at June 30, 2022 and December 31, 2021 resulted from changes in 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.

There were no pledged securities at June 30, 2022 or December 31, 2021.

Contractual maturities of investment securities at June 30, 2022 and December 31, 2021 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call premiums or prepayment penalties.

Contractual Maturities

	June 30, 2022		December 31, 2021	
(in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Within one year	**$ 9,981**	**$ 9,896**	$ —	$ —
Over one to five years	**98,110**	**93,339**	58,602	57,650
Over five to ten years	**78,717**	**70,173**	78,850	78,285
Over ten years	**10,820**	**8,442**	10,825	10,474
Asset-backed securities[1]	**9,606**	**9,415**	10,093	10,140
Mortgage-backed securities[1]	**37,121**	**35,244**	27,589	27,906
Total	**$ 244,355**	**$ 226,509**	$ 185,959	$ 184,455

[1] Asset-backed and Mortgage-backed securities are due in monthly installments.

Note 4 - SBA-PPP Loans Receivable

Pursuant to the CARES Act, the SBA-PPP provides forgivable loans to small businesses to enable them to maintain payroll, hire back employees who have been laid off, and cover applicable overhead. SBA-PPP loans have an interest rate of 1%, have two or five year terms, and carry a 100% guarantee of the SBA.

SBA-PPP gross loans receivable totaled $16.2 million at June 30, 2022, and $111.5 million at December 31, 2021, and were all rated as pass credits and were not past due, nonaccrual, TDR, or otherwise impaired. Unearned net fees associated with the SBA-PPP loans amounted to $301 thousand at June 30, 2022 compared to $1.3 million at December 31, 2021.

Note 5 - Portfolio Loans Receivable

Major classifications of portfolio loans as are as follows:

Portfolio Loan Categories

(in thousands)		June 30, 2022		December 31, 2021
Real estate:				
Residential	$	**430,244**	$	401,607
Commercial		**608,646**		556,339
Construction		**241,249**		255,147
Commercial and Industrial		**193,262**		175,956
Credit card		**142,166**		141,120
Other consumer		**856**		1,033
Portfolio loans receivable, gross		**1,616,423**		1,531,202
Deferred origination fees, net		**(8,746)**		(7,220)
Allowance for loan losses		**(26,419)**		(25,181)
Portfolio loans receivable, net	$	**1,581,258**	$	1,498,801

The Company makes loans to customers located primarily in the Washington, D.C. and Baltimore, Maryland metropolitan areas. Although the loan portfolio is diversified, its performance is influenced by the regional economy. The Company's loan categories, excluding SBA-PPP loans, previously discussed in Note 4, 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. 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. Generally, the required minimum debt service coverage ratio is 115%.

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 June 30, 2022, there were approximately $350.3 million of owner-occupied commercial real estate loans, representing approximately 58% 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 generally have initial fixed rate

Note 5 - Portfolio Loans Receivable (continued)

terms that adjust typically at five years. 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 diverse in type. This diversity may help 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. Construction loans typically have terms of 12 to 18 months. The Company frequently transitions the end purchaser to permanent financing or re-underwriting and sale 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. Exceptions are sometimes made. Semi-annual stress testing of the construction loan portfolio is conducted, and underlying real estate conditions are monitored as well as trends of sales outcomes versus underwriting valuations as part of ongoing risk management efforts. The borrowers' progress in construction buildout is monitored to enforce the original underwriting guidelines for construction milestones and completion timelines.

Commercial and Industrial. 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. Personal guaranties from the borrower or other principal are generally obtained.

Credit Cards. Through the OpenSky® credit card division, the Company offers secured, partially secured, and unsecured 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. The secured 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. For the partially secured lines of credit, the Bank offers certain customers an unsecured line in excess of their secured line of credit by 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). Partially secured and unsecured credit cards are only extended to existing secured card customers who have demonstrated sound credit behaviors. Approximately $122.5 million and $126.8 million of the $138.6 million and $140.2 million in secured and partially secured credit card balances were protected by savings deposits held by the Company as of June 30, 2022 and December 31, 2021, respectively, while $3.6 million and $951 thousand of the credit card balances were related to the unsecured credit cards for the same periods.

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

Note 5 - Portfolio Loans Receivable (continued)

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 at acquisition, the difference between the contractually required payments and expected cash flows are recorded as a non-accretable discount. The remaining non-accretable discounts on loans acquired was $285 thousand as of June 30, 2022 and December 31, 2021. Loans with non-accretable discounts had carrying values of $803 thousand and $818 thousand as of June 30, 2022 and December 31, 2021, respectively.

Accretable discounts on loans acquired is summarized as follows:

Accretable Discounts on Loans Acquired

(in thousands)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2022	June 30, 2021	June 30, 2022	June 30, 2021
Accretable discount at beginning of period	**$ 164**	$ 218	**$ 166**	$ 221
Less: Accretion and payoff of loans	**(5)**	(6)	**(7)**	(9)
Accretable discount at end of period	**$ 159**	$ 212	**$ 159**	$ 212

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 six months ended June 30, 2022 and June 30, 2021.

Allowance for Loan Losses

(in thousands)

Three Months Ended June 30, 2022	Beginning Balance	Provision for Loan Losses	Charge-Offs	Recoveries	Ending Balance
Real estate:					
Residential	**$ 5,832**	**$ 31**	**$ —**	**$ —**	**$ 5,8**
Commercial	**8,718**	**139**	**—**	**—**	**8,8**
Construction	**4,607**	**(134)**	**—**	**—**	**4,4**
Commercial and Industrial	**2,350**	**107**	**—**	**—**	**2,4**
Credit card	**3,735**	**1,892**	**(880)**	**12**	**4,7**
Other consumer	**10**	**—**	**—**	**—**	
Total	**$ 25,252**	**$ 2,035**	**$ (880)**	**$ 12**	**$ 26,4**
Six Months Ended June 30, 2022					
Real estate:					
Residential	$ 5,612	$ 251	$ —	$ —	$ 5,8
Commercial	8,566	291	—	—	8,8
Construction	4,699	(226)	—	—	4,4
Commercial and Industrial	2,637	(180)	—	—	2,4
Credit card	3,655	2,853	(1,779)	30	4,7
Other consumer	12	(2)	—	—	
Total	$ 25,181	$ 2,987	$ (1,779)	$ 30	$ 26,4

Note 5 - Portfolio Loans Receivable (continued)

Allowance for Loan Losses

Three Months Ended June 30, 2021	Beginning Balance	Provision for Loan Losses	Charge-Offs	Recoveries	Ending Balance
Real estate:					
Residential	$ 6,816	$ (107)	$ —	$ —	$ 6,7
Commercial	7,362	415	—	—	7,7
Construction	4,644	(102)	—	1	4,5
Commercial and Industrial	2,449	176	(95)	5	2,5
Credit card	2,232	432	(172)	10	2,5
Other consumer	47	(34)	—	—	
Total	$ 23,550	$ 781	$ (267)	$ 16	$ 24,0
Six Months Ended June 30, 2021					
Real estate:					
Residential	$ 7,153	$ (444)	$ —	$ —	$ 6,7
Commercial	6,786	991	—	—	7,7
Construction	4,595	(53)	—	1	4,5
Commercial and Industrial	2,417	313	(200)	5	2,5
Credit card	2,462	485	(472)	27	2,5
Other consumer	21	(8)	—	—	
Total	$ 23,434	$ 1,284	$ (672)	$ 33	$ 24,0

Note 5 - Portfolio Loans Receivable (continued)

As mentioned in Note 1, the allowance for loan losses is estimated to adequately provide for probable future losses on existing loans. A major consideration in the determination of the allowance for loan loss on the credit card portfolio is based on historical loss experience in that portfolio and is calculated using both secured and unsecured loan balances.

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 Portfolio Loan Balances Evaluated for Impairment:	
June 30, 2022	**Individually**	**Collectively**	**Individually**	**Collectively**
Real estate:				
Residential	**$ —**	**$ 5,863**	**$ 3,180**	**$ 427,0**
Commercial	**—**	**8,857**	**961**	**607,6**
Construction	**—**	**4,473**	**2,041**	**239,2**
Commercial and Industrial	**160**	**2,297**	**871**	**192,3**
Credit card	**—**	**4,759**	**—**	**142,1**
Other consumer	**—**	**10**	**—**	**8**
Total	**$ 160**	**$ 26,259**	**$ 7,053**	**$ 1,609,3**
December 31, 2021				
Real estate:				
Residential	$ —	$ 5,612	$ 2,835	$ 398,7
Commercial	—	8,566	25	556,3
Construction	—	4,699	7,803	247,3
Commercial and Industrial	218	2,419	676	175,2
Credit card	—	3,655	—	141,1
Other consumer	—	12	—	1,0
Total	$ 218	$ 24,963	$ 11,339	$ 1,519,8

Note 5 - Portfolio Loans Receivable (continued)

Past due loans, segregated by age and class of loans, as of June 30, 2022 and December 31, 2021 were as follows:

Portfolio 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 Portfolio Loans	Accruing Loans 90 or More Days Past Due	Non-accrual Loans
June 30, 2022							
Real estate:							
Residential	**$ 1,424**	**$ 2,878**	**$ 4,302**	**$ 425,942**	**$ 430,244**	**$ —**	**$ 3,180**
Commercial	**882**	**1,155**	**2,037**	**606,609**	**608,646**	**194**	**961**
Construction	**815**	**2,041**	**2,856**	**238,393**	**241,249**	**—**	**2,041**
Commercial and Industrial	**352**	**575**	**927**	**192,335**	**193,262**	**—**	**871**
Credit card	**16,586**	**90**	**16,676**	**125,490**	**142,166**	**90**	**—**
Other consumer	**—**	**—**	**—**	**856**	**856**	**—**	**—**
Total	**$ 20,059**	**$ 6,739**	**$ 26,798**	**$ 1,589,625**	**$ 1,616,423**	**$ 284**	**$ 7,053**
December 31, 2021							
Real estate:							
Residential	$ 469	$ 2,494	$ 2,963	$ 398,644	$ 401,607	$ 72	$ 2,835
Commercial	367	25	392	555,947	556,339	—	25
Construction	—	7,803	7,803	247,344	255,147	—	7,803
Commercial and Industrial	183	593	776	175,180	175,956	—	676
Credit card	19,022	10	19,032	122,088	141,120	10	—
Other consumer	—	—	—	1,033	1,033	—	—
Total	$ 20,041	$ 10,925	$ 30,966	$ 1,500,236	$ 1,531,202	$ 82	$ 11,339

There were $628 thousand and $6 thousand, respectfully, of loans secured by one-to-four family residential properties in the process of foreclosure as of June 30, 2022 and December 31, 2021.

Note 5 - Portfolio Loans Receivable (continued)

Impaired portfolio loans were as follows:

Impaired Portfolio Loans

(in thousands) June 30, 2022	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Real estate:					
Residential	$ 3,337	$ 3,180	$ —	$ 3,180	$
Commercial	1,029	961	—	961	
Construction	2,123	2,041	—	2,041	
Commercial and Industrial	1,041	516	355	871	1
Total	$ 7,530	$ 6,698	$ 355	$ 7,053	$ 1
December 31, 2021					
Real estate:					
Residential	$ 3,022	$ 2,835	$ —	$ 2,835	$
Commercial	90	25	—	25	
Construction	7,885	7,803	—	7,803	
Commercial and Industrial	832	340	336	676	2
Total	$ 11,829	$ 11,003	$ 336	$ 11,339	$ 2

The following tables summarize interest recognized on impaired loans:

Interest Recognized on Impaired Portfolio Loans

	For the Three Months Ended June 30, 2022		For the Six Months Ended June 30, 20	
(in thousands)	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
Real estate:				
Residential	$ 3,342	$ 11	$ 3,344	$
Commercial	1,030	2	1,031	
Construction	2,123	—	2,123	
Commercial and Industrial	1,266	9	1,277	
Total	$ 7,761	$ 22	$ 7,775	$

Note 5 - Portfolio Loans Receivable (continued)

Interest Recognized on Impaired Portfolio Loans

(in thousands)	For the Three Months Ended June 30, 2021		For the Six Months Ended June 30, 20	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
Real estate:				
Residential	$ 4,952	$ 15	$ 4,955	$
Commercial	1,080	3	1,094	
Construction	2,720	—	2,720	
Commercial and Industrial	1,154	31	1,155	
Total	$ 9,906	$ 49	$ 9,924	$

Impaired portfolio 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.

Note 5 - Portfolio Loans Receivable (continued)

Doubtful

A doubtful loan has all the weaknesses associated with 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.

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

Portfolio Loan Classifications

(in thousands)	Pass[1]	Special Mention	Substandard	Doubtful	Total
June 30, 2022					
Real estate:					
Residential	**$ 423,366**	**$ 1,733**	**$ 5,145**	**$ —**	**$ 430,244**
Commercial	**601,627**	**6,058**	**961**	**—**	**608,646**
Construction	**239,208**	**—**	**2,041**	**—**	**241,249**
Commercial and Industrial	**187,682**	**3,976**	**1,604**	**—**	**193,262**
Credit card	**142,166**	**—**	**—**	**—**	**142,166**
Other consumer	**856**	**—**	**—**	**—**	**856**
Portfolio loans receivable, gross	**$ 1,594,905**	**$ 11,767**	**$ 9,751**	**$ —**	**$ 1,616,423**
December 31, 2021					
Real estate:					
Residential	$ 394,488	$ 2,540	$ 4,579	$ —	$ 401,607
Commercial	548,244	8,070	25	—	556,339
Construction	243,848	3,496	7,803	—	255,147
Commercial and Industrial	164,066	10,417	1,473	—	175,956
Credit card	141,120	—	—	—	141,120
Other consumer	1,033	—	—	—	1,033
Portfolio loans receivable, gross	$ 1,492,799	$ 24,523	$ 13,880	$ —	$ 1,531,202

(1) Pass includes loans graded exceptional, very good, good, satisfactory and pass/watch, in addition to credit cards and consumer credits that are not individually graded.

Impaired loans also include certain loans that have been modified in TDRs 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 confirmation of the borrower's sustained repayment performance for a reasonable period, generally six months.

Note 5 - Portfolio Loans Receivable (continued)

Modifications such as payment deferrals through June 30, 2022 have been short term in nature and are included in the population of loans deferred and have not impacted TDRs. The status of TDRs is as follows:

Troubled Debt Restructurings

(in thousands)	Number of Contracts	Recorded Investment		
June 30, 2022		Performing	Nonperforming	Total
Real estate:				
Residential	**4**	**$ —**	**$ 443**	**$ 4**
Commercial and Industrial	**1**	**—**	**76**	
Total	**5**	**$ —**	**$ 519**	**$ 5**
December 31, 2021				
Real estate:				
Residential	4	$ —	$ 450	$ 4
Commercial and Industrial	1	—	83	
Total	5	$ —	$ 533	$ 5

During the three and six months ended June 30, 2022 and 2021 the Company did not have any new TDRs and no TDRs defaulted during the same periods.

Outstanding loan commitments were as follows:

Loan Commitments

(in thousands)	June 30, 2022	December 31, 2021
Unused lines of credit		
Real Estate:		
Residential	**$ 18,255**	$ 15,7
Residential - Home Equity	**37,390**	37,6
Commercial	**30,879**	17,2
Construction	**100,974**	118,5
Commercial and Industrial	**48,919**	45,1
Credit card[(1)]	**126,079**	123,8
Other consumer	**2,295**	2,2
Total	**$ 364,791**	$ 360,3
Commitments to originate residential loans held for sale	**$ 183**	$ 1,3
Letters of credit	**$ 5,085**	$ 5,1

(1) Outstanding loan commitments in the credit card portfolio include $121.3 million and $121.7 million in secured balances as of June 30, 2022 and December 31, 2021, respectively.

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, at any given time, draw upon their lines in full. Loan commitments generally have variable interest rates, fixed expiration dates, and may require payment of a fee.

Note 5 - Portfolio Loans Receivable (continued)

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 generally 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, with increases or decreases in the reserve being charged to or released from operating expense. Activity for this account is as follows for the periods presented:

Off Balance Sheet Reserve

(in thousands)	For the Three Months Ended		For the Six Months Ended	
	June 30, 2022	**June 30, 2021**	**June 30, 2022**	**June 30, 2021**
Balance at beginning of period	**$ 1,586**	$ 1,822	**$ 1,736**	$ 1,7
Provision for (reversal of) off balance sheet credit commitments	**45**	(77)	**(105)**	(
Balance at end of period	**$ 1,631**	$ 1,745	**$ 1,631**	$ 1,7

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, with changes being charged to or released from operating expense. 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 Six Months Ended	
	June 30, 2022	**June 30, 2021**	**June 30, 2022**	**June 30, 2021**
Balance at beginning of period	**$ 1,164**	$ 1,284	**$ 1,164**	$ 1,1
Provision for mortgage loan put backs	**2**	86	**2**	2
Balance at end of period	**$ 1,166**	$ 1,370	**$ 1,166**	$ 1,3

Note 6 - 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 locks the loan and rate in with an investor and commits to deliver the loan if settlement occurs (Best Efforts). 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 forward sales contracts are considered to be 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 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.

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

Derivatives

(in thousands)	June 30, 2022	December 31, 2021
Notional amount of open forward sales agreements	**$ 14,250**	$ 22,5
Fair value of open forward delivery sales agreements	**(34)**	(
Notional amount of interest rate lock commitments	**6,631**	18,0
Fair value of interest rate lock commitments	**12**	

Note 7 - Leases

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. The Company leases four 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 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 2.05% at June 30, 2022 and December 31, 2021. 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.

Note 7 - Leases (continued)

As of June 30, 2022, the Company's net lease ROU assets and related lease liabilities were $2.7 million and $2.9 million, respectively, compared to December 31, 2021 balances of $2.5 million of ROU assets and $2.7 million of lease liabilities, and have remaining terms ranging from 1 - 6 years, including extension options that the Company is reasonably certain will be exercised. As of June 30, 2022, 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)	June 30, 2022		December 31, 2021	
Lease Right of Use Asset:				
Lease asset	**$**	**5,240**	$	5,3
Less: Accumulated amortization		**(2,581)**		(2,8
Net lease asset	**$**	**2,659**	$	2,4
Lease Liability:				
Lease liability	**$**	**5,396**		5,5
Less: Accumulated amortization		**(2,485)**		(2,8
Lease liability	**$**	**2,911**	$	2,7

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

Lease Payment Obligations

(in thousands)	June 30, 2022	
Amounts due in:		
2022		5
2023		1,0
2024		7
2025		2
2026 and thereafter		3
Total future lease payments		**3,0**
Discount of cash flows		(
Present value of net future lease payments	**$**	**2,9**

Note 8 - 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

Note 8 - Fair Value (continued)

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.

Marketable equity securities - The fair value of marketable equity securities is provided by an independent pricing service. The fair value is determined based on quoted prices for similar securities using 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.

Note 8 - Fair Value (continued)

The Company has categorized its financial instruments measured at fair value on a recurring basis as of June 30, 2022 and December 31, 2021 as follows:

Fair Value of Financial Instruments
(in thousands)

June 30, 2022	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investment securities available for sale				
U.S. Treasuries	$ 168,649	$ 168,649	$ —	$ —
Municipal	8,442	—	8,442	—
Corporate	4,759	—	4,759	—
Asset-backed securities	9,415	—	9,415	—
Mortgage-backed securities	35,244	—	35,244	—
Total	$ 226,509	$ 168,649	$ 57,860	$ —
Marketable equity securities	$ 245	$ —	$ 245	$ —
Loans held for sale	$ 11,708	$ —	$ 11,708	$ —
Derivative assets	$ 12	$ —	$ 12	$ —
Derivative liabilities	$ 34	$ —	$ 34	$ —
December 31, 2021				
Investment securities available for sale				
U.S. Treasuries	$ 131,001	$ 131,001	$ —	$ —
Municipal	10,474	—	10,474	—
Corporate	4,934	—	4,934	—
Asset-backed securities	10,140	—	10,140	—
Mortgage-backed securities	27,906	—	27,906	—
Total	$ 184,455	$ 131,001	$ 53,454	$ —
Marketable equity securities	$ 245	$ —	$ 245	$ —
Loans held for sale	$ 15,989	$ —	$ 15,989	$ —
Derivative assets	$ 34	$ —	$ 34	$ —
Derivative liabilities	$ 16	$ —	$ 16	$ —

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)	June 30, 2022	December 31, 2021
Aggregate fair value	$ 11,708	$ 15,989
Contractual principal	10,851	14,504
Difference	$ 857	$ 1,485

Note 8 - 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 June 30, 2022 and December 31, 2021, the fair values consist of loan balances of $7.1 million and $11.3 million, with specific reserves of $160 thousand and $218 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)	June 30, 2022	December 31, 2021
Impaired loans		
Level 3 inputs	**$ 6,893**	$ 11,121
Total	**$ 6,893**	$ 11,121
Foreclosed real estate		
Level 3 inputs	**$ —**	$ 86
Total	**$ —**	$ 86

The following table provides information describing the unobservable inputs used in Level 3 fair value measurements at June 30, 2022 and December 31, 2021:

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 market information. Financial instruments include cash, evidence of ownership in an entity, or contracts that convey or impose on an entity the 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

Note 8 - Fair Value (continued)

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.

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.

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.

Note 8 - Fair Value (continued)

Fair Value of Selected Financial Instruments

(in thousands)	June 30, 2022		December 31, 2021	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Level 1				
Cash and due from banks	**$ 14,776**	**$ 14,776**	$ 42,914	$ 42,914
Interest bearing deposits at other financial institutions	**234,823**	**234,823**	136,824	136,824
Federal funds sold	**1,285**	**1,285**	3,657	3,657
Level 3				
Loans receivable, net [1]	**$ 1,597,122**	**$ 1,568,011**	$ 1,607,086	$ 1,598,228
Marketable equity securities	**245**	**245**	245	245
Restricted investments	**3,615**	**3,615**	3,498	3,498
Financial liabilities				
Level 1				
Noninterest bearing deposits	**$ 842,363**	**$ 842,363**	$ 787,650	$ 787,650
Level 3				
Interest bearing deposits	**$ 1,046,557**	**$ 1,047,194**	$ 1,009,487	$ 1,011,121
FHLB advances and other borrowed funds	**34,062**	**32,979**	34,062	34,263

(1) Includes SBA-PPP loans and portfolio loans.

Note 9 - Segments

The Company's reportable segments represent business units with discrete financial information whose results are regularly reviewed by management. The four segments include Commercial Banking, Capital Bank Home Loans (the Company's mortgage loan division), OpenSky® (the Company's credit card division) and the Corporate Office. The following schedule presents financial information for each reportable segment at June 30, 2022 and June 30, 2021.

Segments

(in thousands)	Commercial Bank	CBHL	OpenSky®	Corporate[2]	Eliminations	Consolidated
For the Three Months Ended June 30, 2022						
Interest income	$ 18,912	$ 134	$ 16,780	$ 758	$ (28)	$ 36,5
Interest expense	952	64	—	168	(28)	1,1
Net interest income	17,960	70	16,780	590	—	35,4
Provision for loan losses	—	—	2,035	—	—	2,0
Net interest income after provision	17,960	70	14,745	590	—	33,3
Noninterest income	526	1,626	6,210	—	—	8,3
Noninterest expense[1]	12,859	2,217	11,940	114	—	27,1
Net income before taxes	$ 5,627	$ (521)	$ 9,015	$ 476	$ —	$ 14,5
Total assets	$ 1,958,893	$ 12,257	$ 137,180	$ 226,950	$ (180,434)	$ 2,154,8
For the Three Months Ended June 30, 2021						
Interest income	$ 17,297	$ 313	$ 11,114	$ 600	$ (35)	$ 29,2
Interest expense	1,413	221	—	170	(35)	1,7
Net interest income	15,884	92	11,114	430	—	27,5
Provision for loan losses	349	—	432	—	—	7
Net interest income after provision	15,535	92	10,682	430	—	26,7
Noninterest income	260	5,454	7,715	42	—	13,4
Noninterest expense[1]	10,489	3,283	13,328	105	—	27,2
Net income before taxes	$ 5,306	$ 2,263	$ 5,069	$ 367	$ —	$ 13,0
Total assets	$ 1,943,106	$ 49,110	$ 128,009	$ 197,071	$ (165,446)	$ 2,151,8

[1] Noninterest expense includes $6.7 million and $9.3 million in data processing expense in OpenSky's® segment for the three months ended June 30, 2022 and 2021, respectively.
[2] The Corporate segment invests idle cash in revenue producing assets including interest-bearing cash accounts, loan participations and other appropriate investments for the Company.

Note 9 - Segments

(in thousands)	Commercial Bank	CBHL	OpenSky®	Corporate[2]	Eliminations	Consolidated
For the Six Months Ended June 30, 2022						
Interest income	**$ 37,412**	**$ 245**	**$ 31,720**	**$ 1,645**	**$ (65)**	**$ 70,957**
Interest expense	**1,805**	**145**	**—**	**341**	**(65)**	**2,226**
Net interest income	**35,607**	**100**	**31,720**	**1,304**	**—**	**68,731**
Provision for loan losses	**—**	**—**	**2,987**	**—**	**—**	**2,987**
Net interest income after provision	**35,607**	**100**	**28,733**	**1,304**	**—**	**65,744**
Noninterest income	**1,083**	**3,433**	**12,134**	**—**	**—**	**16,650**
Noninterest expense[1]	**24,922**	**4,316**	**24,822**	**172**	**—**	**54,232**
Net income before taxes	**$ 11,768**	**$ (783)**	**$ 16,045**	**$ 1,132**	**$ —**	**$ 28,162**
Total assets	**$ 1,958,893**	**$ 12,257**	**$ 137,180**	**$ 226,950**	**$ (180,434)**	**$ 2,154,846**
For the Six Months Ended June 30, 2021						
Interest income	$ 34,861	$ 789	$ 19,309	$ 1,029	(61)	$ 55,927
Interest expense	3,124	569	—	332	(61)	3,964
Net interest income	31,737	220	19,309	697	—	51,963
Provision for loan losses	729	—	485	70	—	1,284
Net interest income after provision	31,008	220	18,824	627	—	50,679
Noninterest income	498	13,227	13,655	41	—	27,421
Noninterest expense[1]	19,888	7,202	25,702	180	—	52,972
Net income before taxes	$ 11,618	$ 6,245	$ 6,777	$ 488	$ —	$ 25,128
Total assets	$ 1,943,106	$ 49,110	$ 128,009	$ 197,071	$ (165,446)	$ 2,151,850

(1) Noninterest expense includes $14.3 million and $17.9 million in data processing expense in OpenSky's® segment for the six months ended June 30, 2022 and 2021, respectively.
(2) The Corporate segment invests idle cash in revenue producing assets including interest-bearing cash accounts, loan participations and other appropriate investments for the Company.

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, 2021.

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,” “endeavor,” “plan,” “estimate,” “could,” “project,” “seek,” “should,” “will,” or “would,” or the negative of these words and phrases or similar words and phrases.

The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

General Economic Conditions

- geopolitical concerns, including the ongoing war in Ukraine; the magnitude and duration of the COVID-19 pandemic and related variants and mutations and their impact on the global economy and financial market conditions and our business, results of operations, and financial condition;
- economic conditions (including the interest rate environment, government economic and monetary policies, the strength of global financial markets and inflation/deflation) that impact the financial services industry as a whole and/or our business;
- interest rate risk associated with our business, including sensitivity of our interest earning assets and interest bearing liabilities to changes in interest rates, and the impact to our earnings from changes in interest rates;
- the concentration of our business in the Washington, D.C. and Baltimore, Maryland metropolitan areas and the effect of changes in the economic, political and environmental conditions on these markets;

General Business Operations

- 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 material risks of non-payment or other unfavorable consequences;
- strategic acquisitions we may undertake to achieve our goals;
- 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;
- fluctuations in the fair value of our investment securities that are beyond our control;
- the transition away from USD London Interbank Offering Rate ("LIBOR") and related uncertainty and costs regarding potential alternative reference rates, including the Secured Overnight Financing Rate ("SOFR");
- adequacy of reserves, including our allowance for loan losses;
- deterioration of our asset quality;
- changes in the value of collateral securing our loans;
- liquidity and operations risks associated with our business;
- the effectiveness of our internal controls over financial reporting and our ability to remediate any future material weakness in our internal controls over financial reporting;
- the adequacy of our risk management framework;
- 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;
- our dependence on our management team and board of directors and changes in management and board composition;
- our involvement from time to time in legal proceedings, examinations and remedial actions by regulators;
- risks associated with our OpenSky® credit card division, including compliance with applicable consumer finance and fraud prevention regulations;
- risks associated with our residential mortgage banking business;
- 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;
- changes in the laws, rules, regulations, interpretations or policies relating to financial institution, accounting, tax, trade, monetary and fiscal matters;
- increased competition in the financial services industry, particularly from regional and national institutions;
- the financial soundness of other financial institutions;
- further government intervention in the U.S. financial system;
- Cybersecurity threats and the cost of defending against them, including the costs of compliance with potential legislation to combat cyber risks at a state, national, or global level;

- natural disasters and adverse weather, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, and other matters beyond our control; and
- potential exposure to fraud, negligence, computer theft and cyber-crime.

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 and/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, 2021 and those referenced in other reports on file with the SEC.

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.

Critical Accounting Policies

The accounting and reporting policies of the Company are in accordance with U.S. GAAP and conform to general practices within the banking industry. The Company’s financial position and results of operations are affected by management’s application of accounting policies, including estimates, assumptions, and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses, and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company’s consolidated financial position and/or results of operations. The Company evaluates its critical accounting estimates and assumptions on an ongoing basis and updates them, as needed. Management has discussed the Company’s critical accounting policies and estimates with the Audit Committee of the Board of Directors of the Company.

The Company’s accounting policies are fundamental to understanding the Company’s consolidated financial position and consolidated results of operations. Accordingly, the Company’s significant accounting policies are discussed in detail in Note 1 “Nature of Business and Basis of Presentation” in the “Notes to the Consolidated Financial Statements” contained in Item 8 "Financial Statements and Supplementary Data" of the Company’s 2021 Form 10-K.

The critical accounting and reporting policies include the Company’s accounting for the allowance for loan losses. The Company provides additional information on its allowance for loan losses in Note 1 “Significant Accounting Policies” within Part I, Item 1 of this Quarterly Report.

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, Maryland metropolitan areas through four commercial bank branches, four mortgage offices, two loan production offices, 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.

The Company reports its activities in four business segments: commercial banking; mortgage lending; credit cards; and corporate activities. 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.

Our Commercial Banking division accounts for the majority of the Bank’s total assets. Our commercial bankers endeavor to provide quality service, customized solutions and tailored advice to commercial clients in our operating markets.

Our Capital Bank Home Loan (“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, partially secured and unsecured credit cards on a nationwide basis to under-banked populations and those looking to rebuild their credit scores. OpenSky® cards operate on a digital and mobile enabled platform with almost all marketing and application procedures conducted through website and mobile applications. For the secured credit card, 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), OpenSky® also offers certain existing customers an unsecured line in excess of their secured line of credit.

Capital

As of June 30, 2022, the Bank exceeded all the capital requirements to which it was subject and based on the most recent notification from its primary federal regulator is considered to be well-capitalized. There are no conditions or events since that notification that management believes would change the Bank’s classification. We closely monitor our capital position and intend to take appropriate steps to ensure our level of capital remains strong.

Results of Operations

Net Income

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

(in thousands)	Three Months Ended June 30, 2022	2021	% Change
Interest income	**$ 36,556**	$ 29,289	24.8
Interest expense	**1,156**	1,769	(34.7
Net interest income	**35,400**	27,520	28.6
Provision for loan losses	**2,035**	781	160.6
Net interest income after provision	**33,365**	26,739	24.8
Noninterest income	**8,362**	13,471	(37.9
Noninterest expenses	**27,130**	27,205	(0.3
Net income before income taxes	**14,597**	13,005	12.2
Income tax expense	**3,089**	3,357	(8.0
Net income	**$ 11,508**	$ 9,648	19.3

Net income for the three months ended June 30, 2022 was $11.5 million, up from net income of $9.6 million for the same period in 2021. Net interest income increased $7.9 million, or 28.6 percent, to $35.4 million when comparing the three months ended June 30, 2022 to the three months ended June 30, 2021, primarily due to an increase in interest earned on the credit card loan portfolio. For the quarter ended June 30, 2022, noninterest income was $8.4 million, a decrease of $5.1 million, or 37.9 percent, from $13.5 million in the prior year quarter. The decrease was primarily the result of reduced mortgage banking revenue. Noninterest expense was $27.1 million for the three months ended June 30, 2022, as compared to $27.2 million for the three months ended June 30, 2021, a decrease of $74 thousand, or 0.3 percent. The decrease was primarily driven by increases in salaries and employee benefits of $1.3 million, advertising expenses of $930 thousand, and professional fees of $1.1 million and were offset by decreases in data processing expenses of $2.9 million and loan processing expenses of $640 thousand.

(in thousands)	Six Months Ended June 30, 2022	2021	% Change
Interest income	**$ 70,957**	$ 55,927	26.9
Interest expense	**2,226**	3,964	(43.8
Net interest income	**68,731**	51,963	32.3
Provision for loan losses	**2,987**	1,284	132.6
Net interest income after provision	**65,744**	50,679	29.7
Noninterest income	**16,650**	27,421	(39.3
Noninterest expenses	**54,232**	52,972	2.4
Net income before income taxes	**28,162**	25,128	12.1
Income tax expense	**6,443**	6,499	(0.9
Net income	**$ 21,719**	$ 18,629	16.6

Net income for the six months ended June 30, 2022 was $21.7 million, an increase of approximately $3.1 million, or 16.6 percent, from net income for the six months ended June 30, 2021 of $18.6 million. The increase was primarily due to increases in net interest income of $16.8 million, or 32.3%, when compared to the prior year. Offsetting the net interest income increase was an increase in the provision for loan losses of $1.7 million and a decrease in noninterest income of $10.8 million. Noninterest expense was $54.2 million for the six months ended June 30, 2022, compared to $53.0 million for the six months ended June 30, 2021, an increase of $1.3 million, or 2.4 percent. The increase was primarily driven by a

$3.1 million, or 17.7 percent, increase in salaries and benefits, an increase in professional fees of 58.6 percent, or $1.8 million, and a $1.7 million, or 81.7 percent, increase in advertising expense. The increase was partially offset by a $3.9 million, or 20.0 percent, decrease in data processing and $1.3 million, or 64.1 percent, decrease in loan processing. The decrease of $3.9 million in data processing expenses was primarily due to a contract renegotiation.

Net Interest Income and Net Margin Analysis

We analyze our ability to maximize income generated 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 interest income on earning assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans, loans held for sale, investment securities, and interest bearing deposits with banks. The cost of funds represents interest expense on deposits and borrowings, which consist of federal funds purchased, advances from the FHLB, and subordinated notes. Noninterest bearing deposits and capital also provide sources of funding. Net interest margin is a ratio calculated as net interest income annualized 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 mix 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 table below presents the average balances and weighted average rates of the major categories of the Company's assets, liabilities, and stockholders' equity for the three and six months ended June 30, 2022 and 2021. Weighted average yields are derived by dividing annualized income by the average balance of the related assets, and weighted average rates are derived by dividing annualized expense by the average balance of the related liabilities, for the periods shown. Average outstanding balances are derived by utilizing average daily balances for the time period shown. The weighted average yields and rates include amortization of fees, costs, premiums and discounts, which are considered adjustments to yield/rates. Weighted average yields on tax-exempt securities are not calculated on a fully taxable equivalent basis.

AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

($ in thousands)	Three Months Ended June 30, 2022 Average Outstanding Balance	2022 Interest Income/ Expense	2022 Average Yield/ Rate(1)	2021 Average Outstanding Balance	2021 Interest Income/ Expense	2021 Average Yield/ Rate(1)
Assets						
Interest earning assets:						
Interest bearing deposits	$ 218,251	$ 429	0.79 %	$ 259,330	$ 63	0.10 %
Federal funds sold	1,655	2	0.48	3,087	—	—
Investment securities	215,172	779	1.45	139,997	544	1.56
Restricted investments	3,854	42	4.37	3,478	41	4.70
Loans held for sale	11,447	134	4.70	44,644	314	2.82
SBA-PPP loans receivable	28,870	1,120	15.56	250,040	2,272	3.64
Portfolio loans receivable(2)	1,532,671	34,050	8.91	1,316,224	26,055	7.94
Total interest earning assets	2,011,920	36,556	7.29	2,016,800	29,289	5.82
Noninterest earning assets	56,298			24,432		
Total assets	$ 2,068,218			$ 2,041,232		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand accounts	$ 259,192	38	0.06	$ 282,197	50	0.07
Savings	9,913	1	0.04	6,634	1	0.05
Money market accounts	566,303	396	0.28	460,669	352	0.31
Time deposits	160,279	529	1.32	304,519	1,179	1.55
Borrowed funds	34,062	192	2.27	35,770	187	2.10
Total interest bearing liabilities	1,029,749	1,156	0.45	1,089,789	1,769	0.65
Noninterest bearing liabilities:						
Noninterest bearing liabilities	22,647			20,111		
Noninterest bearing deposits	807,558			758,255		
Stockholders' equity	208,264			173,077		
Total liabilities and stockholders' equity	$ 2,068,218			$ 2,041,232		
Net interest spread			6.84 %			5.17 %
Net interest income		$ 35,400			$ 27,520	
Net interest margin (3)			7.06 %			5.47 %

(1) Annualized.
(2) Includes nonaccrual loans.
(3) For the three months ended June 30, 2022 and 2021, SBA-PPP loans and credit card loans collectively accounted for 320 and 192 basis points of the reported net interest margin, respectively.

The net interest margin increased 159 basis points to 7.06% for the three months ended June 30, 2022 from the same period in 2021 due in large part to the acceleration of the deferred fees associated with the SBA-PPP loan forgiveness as well as the recognition of deferred fees on credit card loans. Net interest margin, excluding credit card and SBA-PPP loans, was 3.86% for the second quarter of 2022 compared to 3.55% for the same period in 2021. For the three months ended June 30, 2022, average interest earning assets decreased $4.9 million, or 0.2 percent, to $2.0 billion as compared to the same period in 2021, and the average yield on interest earning assets increased 147 basis points. Compared to the same period in the prior year, average interest-bearing liabilities decreased $60.0 million, or 5.5 percent, while the average cost of interest-bearing liabilities decreased 20 basis points to 0.45% from 0.65%.

AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

	Six Months Ended June 30,					
	2022			2021		
(in thousands)	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate[1]	Average Outstanding Balance	Interest Income/ Expense	Average Yield/ Rate[1]
Assets						
Interest earning assets:						
Interest bearing deposits	**$ 208,043**	**$ 530**	**0.51 %**	$ 232,712	$ 113	0.10 %
Federal funds sold	**3,148**	**2**	**0.13**	3,477	—	—
Investment securities	**197,965**	**1,149**	**1.17**	123,443	1,022	1.67
Restricted investments	**3,810**	**83**	**4.39**	3,691	83	4.56
Loans held for sale	**12,467**	**245**	**3.96**	58,475	794	2.74
SBA-PPP loans receivable	**55,917**	**3,186**	**11.49**	242,619	4,741	3.94
Portfolio loans receivable[2]	**1,519,857**	**65,762**	**8.73**	1,305,973	49,174	7.59
Total interest earning assets	**2,001,207**	**70,957**	**7.15**	1,970,390	55,927	5.72
Noninterest earning assets	**61,533**			25,113		
Total assets	**$ 2,062,740**			$ 1,995,503		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand accounts	**$ 276,490**	**$ 74**	**0.05**	$ 269,647	$ 118	0.09
Savings	**9,098**	**3**	**0.07**	6,127	2	0.05
Money market accounts	**552,858**	**697**	**0.25**	465,882	881	0.38
Time deposits	**165,485**	**1,073**	**1.31**	318,512	2,588	1.64
Borrowed funds	**34,062**	**379**	**2.24**	34,699	375	2.18
Total interest bearing liabilities	**1,037,993**	**2,226**	**0.43**	1,094,867	3,964	0.73
Noninterest bearing liabilities:						
Noninterest bearing liabilities	**23,397**			22,940		
Noninterest bearing deposits	**795,221**			709,443		
Stockholders' equity	**206,129**			168,253		
Total liabilities and stockholders' equity	**$ 2,062,740**			$ 1,995,503		
Net interest spread			**6.72 %**			4.99 %
Net interest income		**$ 68,731**			$ 51,963	
Net interest margin [3]			**6.93 %**			5.32 %

(1) Annualized
(2) Includes nonaccrual loans.
(3) For the six months ended June 30, 2022 and 2021, SBA-PPP loans and credit card loans collectively accounted for 309 and 173 basis points of the reported net interest margin, respectively.

For the six months ended June 30, 2022, net interest income increased $16.8 million, or 32.3 percent, to $68.7 million from the same period in 2021, primarily due to an increase in average balances in the portfolio loans. The net interest margin increased 161 basis points to 6.93% for the six months ended June 30, 2022 from the same period in 2021. Net interest margin, excluding credit card and SBA-PPP loans, was 3.84% for the six months ended June 30, 2022 compared to 3.59% for the same period in 2021.

For the six months ended June 30, 2022, average interest earning assets increased $30.8 million, or 1.6 percent, to $2.0 billion as compared to the same period in 2021, and the average yield on interest earning assets increased 143 basis points, from 5.72% for the six months ended June 30, 2022 to 7.15% for the six months ended June 30, 2022. The largest increase in interest income when comparing these two time periods related to the income generated by the average portfolio of loans receivable, which grew $213.9 million, from $1.3 billion at June 30, 2021 to $1.5 billion at June 30, 2022. This growth in average portfolio loan balances provided an increase of $11.7 million in interest income with $7.0 million of that growth attributable to the credit card portfolio. Increases in the yield on the credit card portfolio contributed another $5.7 million when comparing the six months ended June 30, 2022 to the same prior year period.

For the six months ended June 30, 2022, average interest-bearing liabilities decreased $56.9 million, or 5.2 percent when compared to the six month period ended June 30, 2021. The average cost of interest bearing liabilities decreased 30 basis points to 0.43% from 0.73% when comparing the six months ended June 30, 2022 to the six months ended June 30, 2022.

The rate/volume table below presents the composition of the change in net interest income for the periods indicated, as allocated between the change in net interest income due to changes in the volume of average earning assets and interest bearing liabilities, and the changes in net interest income due to changes in interest rates.

ANALYSIS OF CHANGES IN NET INTEREST INCOME

	Three Months Ended June 30, 2022 Compared to the Three Months Ended June 30, 2021			Six Months Ended June 30, 2022 Compared to the Six Months Ended June 30, 2021		
	Change Due To			Change Due To		
(in thousands)	Volume	Rate	Interest Variance	Volume	Rate	Interest Variance
Interest Income:						
Interest bearing deposits	$ (81)	$ 447	$ 366	$ (63)	$ 480	$ 4
Federal funds sold	(2)	4	2	—	2	
Investment securities	272	(37)	235	432	(305)	1
Restricted stock	4	(3)	1	3	(3)	
Loans held for sale	(389)	209	(180)	(905)	356	(5
SBA-PPP loans	(8,578)	7,426	(1,152)	(10,638)	9,083	(1,5
Portfolio loans excluding credit card loans	2,414	(298)	2,116	4,640	(758)	3,8
Credit card loans	3,168	2,711	5,879	7,029	5,677	12,7
Total interest income	(3,192)	10,459	7,267	498	14,532	15,0
Interest Expense:						
Interest bearing demand accounts	(4)	(8)	(12)	2	(46)	(
Savings	—	—	—	1	—	
Money market accounts	74	(30)	44	110	(294)	(1
Time deposits	(476)	(174)	(650)	(993)	(522)	(1,5
Borrowed funds	(10)	15	5	(7)	11	
Total interest expense	(416)	(198)	(613)	(887)	(851)	(1,7
Net interest income	$ (2,776)	$ 10,657	$ 7,880	$ 1,385	$ 15,383	$ 16,7

When comparing the three months ended June 30, 2022 to the same period in 2021, the greatest positive impact to total interest income was associated with the credit card portfolio. On a stand-alone basis, the credit card portfolio contributed an increase of $5.9 million when comparing the three months ended June 30, 2022 to the three months ended June 30, 2021 due to volume increases and an increase in late charges which impact the rate calculation. Volume increases in the portfolio loans excluding credit cards accounted for an additional $2.4 million in interest income for the three months ended June 30, 2022. Growth in portfolio loan volumes contributed $11.7 million to the increase in net interest income with $7.0 million attributable to the growth in the credit card portfolio when comparing the six months ended June 30, 2022 to the same period in the prior year. Rate reductions in interest-bearing liabilities contributed an additional $851 thousand to the net interest income growth for the same comparative period.

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.”

The provision for loan losses of $2.0 million for the three months ended June 30, 2022 was primarily related to growth in the credit card portfolio and the cycling of credit card accounts. Net charge-offs for the second quarter of 2022 were $868 thousand, or 0.23% on an annualized basis of average portfolio loans, compared to $252 thousand, or 0.08% on an annualized basis of average loans for the second quarter of 2021. All of the $868 thousand in net charge-offs during the quarter were related to the credit card portfolio and were primarily due to credit card charge-offs resulting from growth in our credit card portfolio and certain charges in excess of credit limits on our secured and partially secured credit cards, and not a general deterioration in overall credit quality.

For the six months ended June 30, 2022, the provision for loan losses was $3.0 million, an increase of $1.7 million from the prior year to date period. Net charge-offs for the six months ended June 30, 2022 were $1.7 million, or 0.23% of average portfolio loans on an annualized basis, compared to $640 thousand, or 0.10% of average portfolio loans on an annualized basis, for the same period in 2021. The $1.7 million in net charge-offs during the six months ended June 30, 2022 was comprised of credit card portfolio net charge-offs and were primarily due to the growth in our credit card portfolio and certain charges in excess of credit limits on our secured and partially secured credit cards, and not a general deterioration in overall credit quality.

The allowance for loan losses as a percent of portfolio loans was 1.64% at June 30, 2022 and 1.65% at December 31, 2021.

Noninterest Income

Our primary sources of recurring noninterest income are 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

(in thousands)	Three Months Ended June 30, 2022	Three Months Ended June 30, 2021	% Change	Six Months Ended June 30, 2022	Six Months Ended June 30, 2021	% Change
Noninterest income:						
Service charges on deposit accounts	**$ 183**	$ 165	10.9 %	**$ 346**	$ 312	10.9
Credit card fees	**6,210**	7,715	(19.5)	**12,134**	13,655	(11.1
Mortgage banking revenue	**1,528**	5,270	(71.0)	**3,318**	13,013	(74.5
Gain on sale of investment securities available for sale, net	**—**	153	(100.0)	**—**	153	(100.0
Other income	**441**	168	162.5	**852**	288	195.8
Total noninterest income	**$ 8,362**	$ 13,471	(37.9)%	**$ 16,650**	$ 27,421	(39.3

For the three months ended June 30, 2022, OpenSky's® secured credit card accounts decreased by 14 thousand net compared to 65 thousand net new accounts for the same period in 2021 as the elevated new account originations related to Covid stimulus payments subside. The decrease in active accounts led to a decrease in interchange and statement fees during the three months ended June 30, 2022 when compared to the same period in 2021.

The continued steepening of the yield curve during 2022 slowed mortgage originations from the year earlier when low interest rates fueled refinance volumes. The Bank's Capital Bank Home Loans division saw origination volumes decline 68.2 percent, to $84.4 million, in the second quarter of 2022, when compared to $265.5 million in the second quarter of 2021. Gain on sale margins are down from 2.79% for the three months ended June 30, 2021, to 2.14% for the three months ended June 30, 2022, as mortgage lenders continue to compete over a dwindling customer base. Historically-low housing inventory, shortages in new home building materials, and fluctuating interest rates are likely to continue suppressing origination volumes throughout 2022.

Mortgage loans sold are subject to repurchase in circumstances where documentation is deficient or the underlying loan becomes delinquent or pays off within a specified period following loan funding and sale. The Bank considers these potential recourse provisions to be a risk and has established a reserve under generally accepted accounting principles for possible repurchases. The reserve was $1.2 million at June 30, 2022 and December 31, 2021. The Bank did not repurchase any loans during the three months ended June 30, 2022 or the three months ended June 30, 2021. The Bank does not originate "sub-prime" mortgage loans and has no exposure to this market segment.

For the six months ended June 30, 2022, noninterest income was $16.7 million, a decrease of $10.8 million, or 39.3 percent, from the same period in 2021, and was primarily driven by the reduction in mortgage banking revenues of $9.7 million. Gain on sale margins dropped to 2.45% for the six months ended June 30, 2022, from 2.89%, when compared to the same period last year. The steepening yield curve in 2022 has slowed originations from the year earlier period when low interest rates fueled refinance volumes. Historically-low housing inventory, shortages in new home building materials, and fluctuating interest rates are likely to continue suppressing origination volumes through the remainder of 2022. Purchase volume as a percentage of loan originations was 78.4 percent for the six months ended June 30, 2022, compared to 35.7 percent for the six months ended June 30, 2021, reflecting the market shift away from refinancing due to rising interest rates. Credit card fees were down 11.1%, or $1.5 million when comparing the six months ended June 30, 2022 to the same period in the prior year due to normal customer attrition and increased competition from fintech and credit card companies offering unsecured subprime credit cards.

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 June 30,			Six Months Ended June 30,		
(in thousands)	**2022**	**2021**	**% Change**	**2022**	**2021**	**% Change**
Noninterest expense:						
Salaries and employee benefits	**$ 10,071**	8,750	15.1 %	**$ 20,381**	17,317	17.7
Occupancy and equipment	**1,313**	1,195	9.9	**2,339**	2,324	0.6
Professional services	**2,417**	1,362	77.5	**4,738**	2,987	58.6
Data processing	**7,266**	10,122	(28.2)	**15,542**	19,433	(20.0
Advertising	**2,223**	1,293	71.9	**3,862**	2,126	81.7
Loan processing	**335**	975	(65.6)	**727**	2,026	(64.1
Other operating	**3,505**	3,508	(0.1)	**6,643**	6,759	(1.7
Total noninterest expense	**$ 27,130**	$ 27,205	(0.3)	**$ 54,232**	$ 52,972	2.4

During the second quarter of 2022, salaries and employee benefits increased due to the addition of new employees in our commercial and commercial real estate lending groups as well as additional positions in executive management during the third quarter of 2021 as the Company continued to put in place the requisite human capital for its continued growth. Professional fees associated with the commercial bank segment increased as the Company continued to build out its regulatory and compliance infrastructure in anticipation of the budgeted growth for 2022. The increase in advertising was due primarily to targeted marketing campaigns for the OpenSky® division. Key contract renegotiation during the first quarter of 2022 in the Bank's OpenSky® division drove the reduction in data processing expense of $2.9 million for the three months ended June 30, 2022 when compared to the same period of 2021.

Noninterest expense was $54.2 million for the six months ended June 30, 2022, as compared to $53.0 million for the six months ended June 30, 2021, an increase of $1.3 million, or 2.4 percent. The increase was primarily driven by a $3.1 million, or 17.7 percent, increase in salaries and benefits, an increase in professional fees of 58.6 percent, or $1.8 million, and a $1.7 million, or 81.7 percent, increase in advertising expense. The increase was partially offset by a $3.9 million, or 20.0 percent, decrease in data processing and a $1.3 million, or 64.1 percent, decrease in loan processing. The decrease of $3.9 million in data processing expenses was primarily due to a contract renegotiation while the decrease in loan processing fees was due to the reduction in mortgage loan volume.

Income Tax Expense

The amount of income tax expense we incur is influenced by our pre-tax income and our 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. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized.

Income tax expense was $3.1 million for the three months ended June 30, 2022 compared to $3.4 million for the same period of 2021. Our effective tax rates for those periods were 21.2% and 25.8%, respectively. For the six months ended June 30, 2022, income tax expense was $6.4 million compared to $6.5 million for the six months ended June 30, 2021, with effective tax rates of 22.9% and 25.9% for 2022 and 2021, respectively.

Financial Condition

The following table summarizes the Company's financial condition at the dates indicated.

	June 30,		Change expressed in:	
(in thousands)	2022	2021	Dollars	Percent
Total assets	$ 2,154,846	$ 2,151,850	$ 2,996	0.1
AFS securities	226,509	160,515	65,994	41.1
Portfolio loans receivable, net	1,607,677	1,392,471	215,206	15.5
Deposits	1,888,920	1,917,419	(28,499)	(1.5
Borrowings	34,062	34,062	—	—
Stockholders' equity	207,316	177,204	30,112	17.0
Equity to total assets at end of period	9.6 %	8.2 %		17.1
Average number of basic shares outstanding	13,998	13,762		1.7
Average number of diluted shares outstanding	14,323	14,070		1.8

Total assets at June 30, 2022 were comparable to the balance at June 30, 2021. Increases in the portfolio loans receivable were offset by decreases in the loans held for sale portfolio as well as a reduction in SBA-PPP loans when comparing the period end balances at June 30, 2022 to June 30, 2021.

Securities

The Company uses its 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.

To supplement interest income earned on our loan portfolio, the Company invests in U.S. Treasuries, high quality mortgage-backed securities, government agency bonds, asset-backed securities and high quality municipal and corporate bonds.

The following tables summarize the contractual maturities, without consideration of call features or pre-refunding dates, and weighted-average yields of investment securities at June 30, 2022 and the amortized cost and carrying value of those securities as of the indicated dates. The weighted average yields were calculated by multiplying the book value of each individual security by its yield, dividing that figure by the portfolio total, and then summing the value of these results to arrive at the weighted average yield. Yields on tax-exempt investments are not calculated on a fully tax equivalent basis.

INVESTMENT MATURITIES

June 30, 2022 (in thousands)	One Year or Less		More Than One Year Through Five Years		More Than Five Years Through Ten Years		More Than Ten Years		Total		
	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Weighted Average Yield	Book Value	Fair Value	Weighted Average Yield
Securities Available for Sale:											
U.S. Treasuries	$ 9,981	1.86 %	$ 98,110	1.36 %	$ 73,717	1.27 %	$ —	— %	$ 181,808	$ 168,649	1.35 %
Municipal	—	—	—	—	—	—	10,820	1.94	10,820	8,442	1.94
Corporate bonds	—	—	—	—	5,000	4.31	—	—	5,000	4,759	4.31
Asset-backed securities	—	—	—	—	—	—	9,606	1.51	9,606	9,415	1.51
Mortgage-backed securities	—	—	10,062	5.18	13,101	2.94	13,958	(2.70)	37,121	35,244	1.43
Total	$ 9,981	1.86 %	$ 108,172	1.72 %	$ 91,818	1.67 %	$ 34,384	(0.06)%	$ 244,355	$ 226,509	1.45 %

Portfolio Loans Receivable

Our primary source of income is derived from interest earned on loans. Our portfolio loans consist 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 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 commercial real estate loans, residential construction loans and commercial business and investment 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. Our credit card portfolio supplements our traditional lending products with enhanced yields. Our lending activities, outside of credit cards, are principally directed to our market area consisting of the Washington, D.C. and Baltimore, Maryland metropolitan areas.

The repayment of loans is a source of additional liquidity for us. The following table details contractual maturities of our portfolio loans, along with associated weighted average yields and an analysis of loans maturing after one year categorized by rate characteristic. Loans with adjustable interest rates are shown as maturing in the period during which the contract is due. The table does not reflect the effects of possible prepayments.

LOAN MATURITY AND SENSITIVITY TO CHANGES IN INTEREST RATES

	As of June 30, 2022								
(in thousands)	One Year or Less		One to Five Years		Over Five Years to Fifteen Years		After Fifteen Years		Total
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	
Real estate:									
Residential	$ 90,067	5.43 %	$ 159,541	4.76 %	$ 97,231	4.41 %	$ 83,405	4.14 %	$ 430,24
Commercial	81,638	5.20	283,423	4.58	239,871	4.17	3,714	3.67	608,64
Construction	218,781	5.79	11,980	5.97	10,488	3.75	—	—	241,24
Commercial	65,410	5.29	60,106	4.38	62,186	5.39	5,560	4.74	193,26
Credit card	142,166	52.74	—	—	—	—	—	—	142,16
Other consumer	235	2.78	212	4.61	409	4.89	—	—	85
Total portfolio loans, gross	$ 598,297	16.76 %	$ 515,262	4.64 %	$ 410,185	4.40 %	$ 92,679	4.16 %	$ 1,616,42

Loans above maturing after one year categorized by rate characteristic:	Predetermined Interest Rates	Floating or Variable Rates	Total
Real estate:			
Residential	$ 170,569	$ 169,608	$ 340,17
Commercial	350,571	176,437	527,00
Construction	11,283	11,185	22,46
Commercial	57,925	69,927	127,85
Other consumer	608	13	62
Total portfolio loans, gross	$ 590,956	$ 427,170	$ 1,018,12

In addition to the portfolio loans shown above, gross SBA-PPP loans receivable, which totaled $16.2 million at June 30, 2022, mature in the 1-5 year time-frame and carry a fixed rate of interest.

Nonperforming Assets

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. In general, we place loans on nonaccrual status when they become 90 days past due. We also place loans on nonaccrual status if they are less than 90 days past due if the collection of principal or interest is in doubt. When interest accrual is discontinued, all unpaid accrued interest is reversed from income. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are, in management's opinion, reasonably assured. Any loan which the Bank deems to be uncollectible, in whole or in part, is charged off to the extent of the anticipated loss. Consumer credit card balances are moved into the charge off queue after they become more than 90 days past due and are charged off not later than 120 days after they become past due. Loans that are past due for 180 days or more are charged off unless the loan is well secured and in the process of collection.

The Company believes its disciplined lending approach and focused management of nonperforming assets has resulted in sound asset quality and timely resolution of problem assets. There are several procedures in place to assist the Company in maintaining the overall quality of our loan portfolio. The Company has established underwriting guidelines to be followed by our bankers, and monitor our delinquency levels for any negative or adverse trends. There can be no assurance, however, that our loan portfolio will not become subject to increasing pressures from deteriorating borrower credit.

Potential Problem Loans

From a credit risk standpoint, we grade watchlist and problem loans into one of five categories: pass/watch, special mention, substandard, doubtful or loss. The classifications of loans reflect a judgment about the risks of default and loss associated with the loan. Credits ratings are reviewed regularly. Ratings are adjusted regularly to reflect the degree of risk and loss that our management believes to be appropriate for each credit. Our methodology is structured so that specific reserve allocations are increased in accordance with deterioration in credit quality (and a corresponding increase in risk and loss) or decreased in accordance with improvement in credit quality (and a corresponding decrease in risk and loss). Our lending policy requires the routine monitoring of weekly past due reports, daily overdraft reports, monthly maturing loans, monthly risk rating reports and internal loan review reports. The lending and credit management of the Bank meet periodically to review loans rated pass/watch. The focus of each meeting is to identify and promptly determine any necessary required action with this loan population, which consists of loans that, although considered satisfactory and performing to terms, may exhibit special risk features that warrant management's attention.

Loans that are deemed special mention, substandard, doubtful or loss are listed in the Bank's Problem Loan Status Report. The Problem Loan Status Report provides a detailed summary of the borrower and guarantor status, loan accrual status, collateral evaluation and includes a description of the planned collection and administration program designed to mitigate the Bank's risk of loss and remove the loan from problem status. The Special Asset Committee reviews the Problem Loan Status Report on a quarterly basis for borrowers with an overall loan exposure in excess of $250,000.

The Bank uses the following definitions for watch list risk ratings:

• *Pass/Watch.* Borrowers who are considered satisfactory and performing to terms, however exhibiting special risk features such as declining earnings, strained cash flow, increasing leverage, and/or weakening fundamentals that indicate above average risk.

• *Special Mention.* A special mention loan has potential weaknesses deserving of management's attention. If uncorrected, such weaknesses may result in deterioration of the repayment prospects for the asset or in our credit position at some future date.

• *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. Assets so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that we will sustain some loss if deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets that are classified as substandard.

• *Doubtful.* A doubtful loan has all weaknesses inherent in one classified as substandard, with the added characteristic that weaknesses make collection or liquidation in full, on the basis of existing facts, conditions, and values, highly questionable and improbable. The probability of loss is extremely high, but certain important and reasonably specific factors that may work to the advantage and strengthening of the asset exist. Therefore, its classification as an estimated loss is deferred until a more precise status may be determined by management. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

• *Loss.* Credits rated as loss are charged-off. We have no expectation of the recovery of any payments in respect of credits rated as loss.

Loans not meeting the criteria above are considered to be pass-rated loans. No assets were classified as loss during the periods presented.

At June 30, 2022, the recorded investment in impaired loans was $7.1 million, $355 thousand of which required a specific reserve of $160 thousand compared to a recorded investment in impaired loans of $11.3 million including $336 thousand requiring a specific reserve of $218 thousand at December 31, 2021. Of the $7.1 million of impaired loans, $1.4 million was related to one construction loan relationship believed to be well-collateralized and $2.0 million was related to one home equity line of credit loan relationship believed to be well-collateralized.

Impaired loans also include certain loans that have been modified as troubled debt restructurings (“TDRs”). At June 30, 2022, the Company had five loans amounting to $519 thousand that were considered to be TDRs, compared to five loans amounting to $533 thousand at December 31, 2021.

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 key ratios for the allowance for loan losses and nonaccrual loans for the periods indicated:

(in thousands)	Allowance for loan losses to period end portfolio loans [(1)]		Nonaccrual loans to total portfolio loans		Allowance for loan losses to nonaccrual loans [(1)]	
	June 30, 2022	**December 31, 2021**	**June 30, 2022**	**December 31, 2021**	**June 30, 2022**	**December 31, 2021**
Real estate:						
Residential	1.36 %	1.40 %	0.74 %	0.71 %	184 %	198 %
Commercial	1.46	1.54	0.16	—	922	34,606
Construction	1.85	1.84	0.85	3.06	219	60
Commercial	1.27	1.50	0.45	0.38	282	390
Credit card	3.35	2.59	—	—	—	—
Other consumer	1.13	1.13	—	—	—	—
Total	1.64 %	1.65 %	0.44 %	0.75 %	375 %	222 %

(1) Allowance calculation excludes SBA-PPP loans.

In determining the allowance for loan loss on the credit card portfolio, management uses the historical loss experience of the credit card portfolio as a major consideration and applies that factor to both the secured and unsecured credit card loan balances.

The following tables present a summary of the net charge-off (recovery) of loans as a percentage of average loans for the periods indicated:

	For the Three Months Ended					
	June 30, 2022			June 30, 2021		
(in thousands)	Net Charge-offs	Average Loans	Percent of average portfolio loans	Net Charge-offs	Average Loans	Percent of average portfolio loans
Real estate:						
Residential	$ —	$ 420,984	— %	$ —	$ 420,106	—
Commercial	—	571,131	—	—	436,943	—
Construction	—	241,278	—	(1)	219,768	—
Commercial	—	173,706	—	90	137,192	0.07
Credit card	868	124,548	0.70	162	100,456	0.16
Other consumer	—	1,024	—	—	1,759	—
Total	$ 868	$ 1,532,671	0.06 %	$ 251	$ 1,316,224	0.02

	For the Six Months Ended					
	June 30, 2022			June 30, 2021		
(in thousands)	Net Charge-offs	Average Loans	Percent of average portfolio loans	Net Charge-offs	Average Loans	Percent of average portfolio loans
Real estate:						
Residential	$ —	$ 413,088	— %	$ —	$ 414,917	—
Commercial	—	563,071	—	—	427,270	—
Construction	—	247,572	—	(1)	225,146	—
Commercial	—	170,638	—	195	140,719	0.14
Credit card	1,749	124,735	1.40	445	96,326	0.46
Other consumer	—	753	—	—	1,595	—
Total	$ 1,749	$ 1,519,857	0.12 %	$ 639	$ 1,305,973	0.05

Total charge-offs for the quarter and year to date periods ended June 30, 2022 were primarily due to credit card charge-offs resulting from growth in our credit card portfolio and certain charges in excess of credit limits on our secured and partially secured credit cards, and not a general deterioration in overall credit quality.

As the loan portfolio and allowance for loan losses review processes continue to evolve, there may be changes to elements of the allowance and this may have an effect on the overall level of the allowance maintained. Historically, the Bank has enjoyed a high quality loan portfolio with relatively low levels of net charge-offs and low delinquency rates. The maintenance of a high quality portfolio will continue to be a high priority.

Management is intent on maintaining a strong credit review function and risk rating process. The Company has an experienced Credit Administration function, which provides independent analysis of credit requests and the management of problem credits. The Credit Department has developed and implemented analytical procedures for evaluating credit requests, has refined the Company's risk rating system, and continues to adapt and enhance the monitoring of the loan portfolio. The loan portfolio analysis process is intended to contribute to the identification of weaknesses before they become more severe.

Although we believe we have established our allowance for loan losses in accordance with 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 as of the dates indicated. The total allowance is available to absorb losses from any loan category.

ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

	June 30, 2022		December 31, 2021	
(in thousands)	Amount	Percent [1]	Amount	Percent [1]
Real estate:				
Residential	**$ 5,863**	**22 %**	$ 5,832	23 %
Commercial	**8,857**	**34**	8,718	35
Construction	**4,473**	**17**	4,607	18
Commercial and Industrial	**2,457**	**9**	2,350	9
Credit card	**4,759**	**18**	3,735	15
Other consumer	**10**	**—**	10	—
Total allowance for loan losses	**$ 26,419**	**100 %**	$ 25,252	100 %

(1) Loan category as a percentage of total portfolio loans which excludes SBA-PPP loans.

Total Liabilities

Total liabilities at June 30, 2022 saw an increase from the December 31, 2021 balance primarily due to growth in the deposit portfolio.

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. The Company continues to execute on its strategic initiative to improve the deposit portfolio mix by reducing reliance on wholesale time deposits. At June 30, 2022 and December 31, 2021, the Company had no balances pertaining to wholesale time deposits. Our credit card customers are a significant source of low cost deposits. As of June 30, 2022 and December 31, 2021, our credit card customers accounted for $214.1 million and $229.5 million, or 25.4% and 29.1%, respectively, of our total noninterest bearing deposit balances.

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

COMPOSITION OF AVERAGE DEPOSITS

	For the Six Months Ended June 30, 2022		For the Year Ended December 31, 2021	
(in thousands)	**Average Balance**	**Average Rate**	Average Balance	Average Rate
Interest-bearing demand accounts	**$ 276,490**	**0.05 %**	$ 289,285	0.07
Money market accounts	**552,858**	**0.25**	482,225	0.31
Savings accounts	**9,098**	**0.07**	6,470	0.05
Certificates of deposit	**165,485**	**1.31**	269,262	1.53
Total interest-bearing deposits	**1,003,931**	**0.37**	1,047,242	0.55
Noninterest-bearing demand accounts	**795,221**		750,760	
Total deposits	**$ 1,799,152**	**0.21**	$ 1,798,002	0.32

The following table presents the maturities of our certificates of deposit as of June 30, 2022.

MATURITIES OF CERTIFICATES OF DEPOSIT

(in thousands)	**Three Months or Less**	**Over Three Through Six Months**	**Over Six Through Twelve Months**	**Over Twelve Months**	**Total**
$250,000 or more	$ 12,463	$ 84,926	$ 8,344	$ 3,296	$ 109,02
Less than $250,000	12,261	16,488	16,018	7,008	51,77
Total	$ 24,724	$ 101,414	$ 24,362	$ 10,304	$ 160,80

As of June 30, 2022 and December 31, 2021, based on the methodologies and assumptions used for the Bank's regulatory reporting requirements, approximately $1.0 billion or 55.2% and $972.4 million or 54.1%, respectively, of our deposit portfolio was uninsured. Uninsured deposits are comprised of the portion of account balances that are in excess of FDIC insurance limits.

Borrowings

We 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 June 30, 2022, approximately $523.8 million in real estate loans were pledged as collateral for our FHLB borrowings. Of the $523.8 million in loans pledged to the FHLB, our total borrowing capacity at June 30, 2022 was $326.2 million. None of our investment securities were pledged with the FHLB as of June 30, 2022. We utilize these borrowings to meet liquidity needs and to fund certain fixed rate loans in our portfolio. As of June 30, 2022, we had $22.0 million in outstanding advances and $304.2 million in available borrowing capacity from the FHLB.

Other Borrowed Funds. The Company has also issued junior subordinated debentures and other subordinated notes. At June 30, 2022, these other borrowings amounted to $12.1 million.

At June 30, 2022, 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 30, 2020, the Company issued $10.0 million in subordinated notes due in 2030 to repay the higher yielding subordinated notes amounting to $13.5 million. The notes have a ten year term and have a fixed rate of 5.00% for the first five years; thereafter, the rate resets quarterly to a benchmark rate plus 490 basis points. The notes may be redeemed in part or in whole, upon the occurrence of certain events.

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 $27.8 million as of June 30, 2022. 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 June 30, 2022.

The Company also has available lines of credit of $76.0 million with other correspondent banks at June 30, 2022, as well as access to certificate of deposit funding through a financial network and wholesale brokers. Our funding policy limits use of this funding source to 30% of the Bank's deposits. These lines were not utilized at June 30, 2022.

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 addresses 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, operational, 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 risk 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; holding liquid marketable securities, free of legal, regulatory or operational impediments, that can be used to meet liquidity needs in situations of stress; contingency funding plans that address potential adverse liquidity events and emergency cash flow requirements; and internal controls and internal audit processes believed to be 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.

As of June 30, 2022, we had $304.2 million of available borrowing capacity from the FHLB, $27.8 million of available borrowing capacity from the Federal Reserve Bank of Richmond and available lines of credit of $76.0 million with other correspondent banks. Cash and cash equivalents were $250.9 million at June 30, 2022. We believe our liquidity resources are at sufficient levels to fund loans and meet other cash needs as necessary.

Capital Resources

Stockholders’ equity increased $9.4 million for the period ended June 30, 2022 compared to December 31, 2021 largely due to net income of $21.7 million for the second quarter of 2022 that was offset by a $12.3 million unrealized loss, net of tax, in available for sale securities.

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 9.99% at June 30, 2022 and 8.82% at December 31, 2021.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can precipitate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company’s financial condition. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its 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.

Quantitative measures established by regulation to ensure capital adequacy require 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 Bank is 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 is currently exempt from the consolidated capital requirements.

The ability of the Company to continue to grow is dependent on its earnings and those of the Bank, the ability to obtain additional funds for contribution to the Bank’s capital, through additional borrowings, through the sale of additional common or preferred stock, or through the issuance of additional qualifying capital instruments, such as subordinated debt. The capital levels required to be maintained by the Company and Bank may be impacted as a result of the Bank’s concentrations in commercial real estate loans. See "Risks Related to the Regulation of Our Industry” in Part I, Item 1A - Risk Factors in the Annual Report on Form 10-K for the year ended December 31, 2021.

As of June 30, 2022, the Bank was in compliance with all applicable regulatory capital requirements to which it was 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 relative to our earnings in order to remain in compliance with all regulatory capital standards applicable to us.

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	
June 30, 2022	Amount	Ratio	Amount	Ratio	Amount	Ratio
The Company						
Tier 1 leverage ratio (to average assets)	$ 222,714	10.93 %	$ 81,527	4.00 %	N/A	I
Tier 1 capital (to risk-weighted assets)	222,714	15.70	85,124	6.00	N/A	I
Common equity tier 1 capital ratio (to risk-weighted assets)	220,652	15.55	63,843	4.50	N/A	I
Total capital ratio (to risk-weighted assets)	250,570	17.66	113,498	8.00	N/A	I
The Bank						
Tier 1 leverage ratio (to average assets)	$ 185,644	9.11 %	$ 81,527	4.00 %	$ 101,909	5.0
Tier 1 capital (to risk-weighted assets)	185,644	13.09	85,124	6.00	113,498	8.0
Common equity tier 1 capital ratio (to risk-weighted assets)	185,644	13.09	63,843	4.50	92,217	6.5
Total capital ratio (to risk-weighted assets)	203,499	14.34	113,498	8.00	141,873	10.0
December 31, 2021						
The Company						
Tier 1 leverage ratio (to average assets)	$ 201,040	9.73 %	$ 82,683	4.00 %	N/A	I
Tier 1 capital (to risk-weighted assets)	201,040	14.43	83,596	6.00	N/A	I
Common equity tier 1 capital ratio (to risk-weighted assets)	198,978	14.28	62,697	4.50	N/A	I
Total capital ratio (to risk-weighted assets)	228,574	16.41	111,462	8.00	N/A	I
The Bank						
Tier 1 leverage ratio (to average assets)	$ 169,384	8.36 %	$ 81,070	4.00 %	$ 101,338	5.0
Tier 1 capital (to risk-weighted assets)	169,384	12.53	81,097	6.00	108,130	8.0
Common equity tier 1 capital ratio (to risk-weighted assets)	169,384	12.53	60,823	4.50	87,856	6.5
Total capital ratio (to risk-weighted assets)	186,397	13.79	108,130	8.00	135,162	10.0

Contractual Obligations

We have contractual obligations to make future payments on debt agreements. Our liquidity monitoring and management consider both present and future demands for and sources of liquidity.

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 generally 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 actual future cash funding requirements.

CREDIT EXTENSION COMMITMENTS

(in thousands)		As of June 30, 2022		As of December 31, 2021
Unfunded lines of credit	$	**364,791**	$	376,30
Commitments to originate residential loans held for sale		**183**		8,76
Letters of credit		**5,085**		5,13
Commitment to fund other investments		**5,305**		-
Total credit extension commitments	$	**375,364**	$	390,20

Unfunded lines of credit represent unused credit facilities to our current borrowers. Lines of credit generally have variable interest rates. Letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. 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.

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 we do not control the extent to which the lines of credit may 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. 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, along with the interest rate lock commitments and forward commitments for the future delivery of mortgage loans to third party investors, are considered derivatives.

The commitment to fund other investments reflects an obligation to make an investment in a Small Business Investment Company.

Impact of Inflation

Our consolidated financial statements and related notes included elsewhere in this report have been prepared in accordance with GAAP. GAAP requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation.

Unlike many industrial companies, substantially all of our assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates may not necessarily move in the same direction or in the same magnitude as do the prices of goods and services. However, other operating expenses do reflect general levels of inflation.

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 endeavor to 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 endeavor to 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 endeavor to hedge the interest rate risks of our available for sale mortgage pipeline by using mortgage-backed securities, and short positions. 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 of 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

June 30, 2022 (in thousands)	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
Assets						
Interest earning assets						
Loans [1]	$ 595,208	$ 107,965	$ 262,872	$ 966,045	$ 669,204	$ 1,635,249
Securities	20,969	927	14,104	36,000	190,509	226,509
Interest bearing deposits at other financial institutions	234,823	—	—	234,823	—	234,823
Federal funds sold	1,285	—	—	1,285	—	1,285
Total earning assets	$ 852,285	$ 108,892	$ 276,976	$ 1,238,153	$ 859,713	$ 2,097,866
Liabilities						
Interest bearing liabilities						
Interest bearing deposits	$ 12,684	$ 25,367	$ 114,154	$ 152,205	$ 733,548	$ 885,753
Time deposits	6,044	18,680	125,776	150,500	10,304	160,804
Total interest bearing deposits	18,728	44,047	239,930	302,705	743,852	1,046,557
FHLB Advances	—	—	—	—	22,000	22,000
Other borrowed funds	—	—	—	—	12,062	12,062
Total interest bearing liabilities	$ 18,728	$ 44,047	$ 239,930	$ 302,705	$ 777,914	$ 1,080,619
Period gap	$ 833,557	$ 64,845	$ 37,046	$ 935,448	$ 81,799	$ 1,017,247
Cumulative gap	$ 833,557	$ 898,402	$ 935,448	$ 935,448	$ 1,017,247	
Ratio of cumulative gap to total earning assets	39.73 %	42.82 %	44.59 %	44.59 %	48.49 %	

(1) Includes loans held for sale and loans made under the SBA-PPP loan program.

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 endeavors to capture 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 very 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 June 30, 2022:

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

Earnings at Risk	-100 bps	Flat	+100 bps	+200 bps	+300 bps
June 30, 2022	(3.5)%	0.0 %	3.3 %	7.5 %	11.6

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 June 30, 2022.

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

Economic Value of Equity	-100 bps	Flat	+100 bps	+200 bps	+300 bps
June 30, 2022	(3.4)%	0.0 %	1.4 %	1.9 %	3.1

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 the ordinary conduct of our business. We are not presently a party to any material legal proceedings.

Item 1A. RISK FACTORS.

There are no material changes to the risk factors as previously disclosed under Item 1A in our Annual Report for the year ended December 31, 2021 and those referenced in other reports on file with the SEC.

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

There were no unregistered sales of the Company's stock during the year to date period ended June 30, 2022.

On July 25, 2022, the Company announced a new stock repurchase program. Under the new program, the Company is authorized to repurchase up to $10.0 million of its outstanding common stock, par value $0.01 per share ("Common Stock"). The program will expire on December 31, 2023.

The newly approved stock repurchase program follows the Company's prior stock repurchase program which was announced in April 2019, modified in December 2020, and concluded in the third quarter of 2021. Under the expired program, the Company purchased an aggregate of 332,594 shares of its Common Stock for aggregate cash consideration of $3.7 million.

Item 3. DEFAULTS UPON SENIOR SECURITIES.

None.

Item 4. MINE SAFETY DISCLOSURES.

Not applicable.

Item 5. OTHER INFORMATION.

None.

Item 6. EXHIBITS.

Exhibit Number	Description
3.1	Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Form S-1 filed on August 31, 2018).
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Form S-1 filed on August 31, 2018).
31.1	Rule 13a-14(a) Certification of the Principal Executive Officer.
31.2	Rule 13a-14(a) Certification of the Principal Financial Officer.
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer.
101	The following materials from the Quarterly Report on Form 10-Q of Capital Bancorp, Inc. for the quarter ended June 30, 2022, 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.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

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: August 9, 2022 /s/ Ed Barry
Ed Barry
Chief Executive Officer
(Principal Executive Officer)

Date: August 9, 2022 /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.

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: August 9, 2022 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.

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: August 9, 2022 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.

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 June 30, 2022, 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: August 9, 2022 By: /s/ Ed Barry
Ed Barry
Chief Executive Officer

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