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

FORM 10-Q

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

For the Quarterly Period ended September 30, 2021 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.

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 November 5, 2021, the Company had 13,868,387 shares of common stock, par value $0.01 per share, outstanding.

Capital Bancorp, Inc. and Subsidiaries
Form 10-Q
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PART I. CONSOLIDATED FINANCIAL INFORMATION
Item 1. CONSOLIDATED FINANCIAL STATEMENTS

Capital Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets

(in thousands except share data)	September 30, 2021 (unaudited)	December 31, 2020 (audited)
Assets		
Cash and due from banks	**$ 23,650**	$ 18,456
Interest bearing deposits at other financial institutions	**299,033**	126,081
Federal funds sold	**1,315**	2,373
Total cash and cash equivalents	**323,998**	146,910
Investment securities available for sale	**189,165**	99,787
Marketable equity securities	**245**	245
Restricted investments	**3,498**	3,713
Loans held for sale	**36,005**	107,154
Small Business Administration Payroll Protection Program loans receivable, net of fees	**137,178**	201,018
Portfolio loans receivable, net of deferred fees and costs and net of allowance for loan losses of $24,753 and $23,434	**1,420,373**	1,292,068
Premises and equipment, net	**3,690**	4,464
Accrued interest receivable	**7,828**	8,134
Deferred income taxes	**7,172**	6,818
Foreclosed real estate	**3,236**	3,326
Bank owned life insurance	**35,268**	—
Other assets	**1,900**	2,956
Total assets	**$ 2,169,556**	$ 1,876,593
Liabilities		
Deposits		
Noninterest-bearing, including related party balances of $38,514 and $17,848	**$ 833,187**	$ 608,559
Interest-bearing, including related party balances of $83,963 and $130,586	**1,088,051**	1,043,569
Total deposits	**1,921,238**	1,652,128
Federal Home Loan Bank advances	**22,000**	22,000
Other borrowed funds	**12,062**	14,016
Accrued interest payable	**839**	1,134
Other liabilities	**24,337**	28,004
Total liabilities	**1,980,476**	1,717,282
Stockholders' equity		
Common stock, $.01 par value; 49,000,000 shares authorized; 13,801,936 and 13,753,529 issued and outstanding	**138**	138
Additional paid-in capital	**52,123**	50,602
Retained earnings	**135,906**	106,854
Accumulated other comprehensive income	**913**	1,717
Total stockholders' equity	**189,080**	159,311
Total liabilities and stockholders' equity	**$ 2,169,556**	$ 1,876,593

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 September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Interest income				
Loans, including fees	**$ 32,840**	$ 24,836	**$ 87,549**	$ 67,520
Investment securities available for sale	**549**	273	**1,571**	929
Federal funds sold and other	**139**	80	**335**	484
Total interest income	**33,528**	25,189	**89,455**	68,933
Interest expense				
Deposits, includes payments to related parties of $41 and $167 for the three and nine months ended September 30, 2021, respectively, and $184 and $862 for the three and nine months ended September 30, 2020, respectively.	**1,285**	2,634	**4,874**	9,201
Borrowed funds	**184**	516	**559**	1,382
Total interest expense	**1,469**	3,150	**5,433**	10,583
Net interest income	**32,059**	22,039	**84,022**	58,350
Provision for loan losses	**975**	3,500	**2,259**	9,209
Net interest income after provision for loan losses	**31,084**	18,539	**81,763**	49,141
Noninterest income				
Service charges on deposits	**160**	119	**473**	378
Credit card fees	**7,554**	5,773	**21,208**	10,694
Mortgage banking revenue	**4,465**	10,690	**17,478**	20,984
Gain on sale of investment securities available for sale, net	**—**	—	**153**	—
Other fees and charges	**418**	895	**707**	2,058
Total noninterest income	**12,597**	17,477	**40,019**	34,114
Noninterest expenses				
Salaries and employee benefits	**9,962**	8,940	**27,279**	24,849
Occupancy and equipment	**998**	1,328	**3,322**	3,658
Professional fees	**2,555**	1,307	**5,542**	2,971
Data processing	**10,161**	7,880	**29,594**	17,664
Advertising	**1,027**	633	**3,153**	1,875
Loan processing	**644**	1,264	**2,670**	2,451
Foreclosed real estate expenses, net	**44**	9	**321**	137
Other operating	**3,236**	3,089	**9,718**	7,548
Total noninterest expenses	**28,627**	24,450	**81,599**	61,153
Income before income taxes	**15,054**	11,566	**40,183**	22,102
Income tax expense	**3,877**	3,128	**10,376**	5,968
Net income	**$ 11,177**	$ 8,438	**$ 29,807**	$ 16,134
Basic earnings per share	**$ 0.81**	$ 0.61	**$ 2.16**	$ 1.17
Diluted earnings per share	**$ 0.79**	$ 0.61	**$ 2.11**	$ 1.17
Weighted average common shares outstanding:				
Basic	**13,793,087**	13,794,628	**13,772,261**	13,829,341
Diluted	**14,228,497**	13,794,628	**14,110,789**	13,832,176

See Notes to Consolidated Financial Statements

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

(in thousands)	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
Net income	**$ 11,177**	$ 8,438	**$ 29,807**	$ 16,1
Other comprehensive income (loss):				
Unrealized gain (loss) on investment securities available for sale	**1,051**	37	**(1,219)**	2,4
Reclassification of realized gain on sale of investment securities available for sale	**—**	—	**153**	
	1,051	37	**(1,066)**	2,4
Income tax benefit (expense) relating to the items above	**(286)**	(10)	**262**	(6
Other comprehensive income	**765**	27	**(804)**	1,7
Comprehensive income	**$ 11,942**	$ 8,465	**$ 29,003**	$ 17,9

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	Total Stockholders' Equity
Balance, December 31, 2019	**13,894,842**	**$ 139**	**$ 51,561**	**$ 81,618**	**$ 13**	**$ 133,33**
Net income	—	—	—	2,934	—	2,93
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	754	75
Stock options exercised, net of repurchased shares	34,015	—	263	(163)	—	10
Stock-based compensation	—	—	244	—	—	24
Shares repurchased and retired	(112,134)	(1)	(1,282)	—	—	(1,28
Balance, March 31, 2020	13,816,723	$ 138	$ 50,786	$ 84,389	$ 767	$ 136,08
Net income	—	—	—	4,761	—	4,76
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	1,000	1,00
Shares issued as compensation	3,000	—	37	—	—	3
Stock-based compensation	—	—	243	1	—	24
Shares repurchased and retired	(1,500)	—	(14)	—	—	(1
Balance, June 30, 2020	13,818,223	138	51,052	89,151	1,767	142,10
Net income	—	—	—	8,438	—	**8,43**
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	27	**2**
Stock options exercised	5,175	—	57	—	—	**5**
Stock-based compensation	—	—	249	(1)	—	**24**
Shares repurchased and retired	(141,200)	(1)	(1,492)	(8)	—	**(1,50**
Balance, September 30, 2020	**13,682,198**	**$ 137**	**$ 49,866**	**$ 97,580**	**$ 1,794**	**$ 149,37**
Balance, December 31, 2020	**13,753,529**	**$ 138**	**$ 50,602**	**$ 106,854**	**$ 1,717**	**$ 159,31**
Net income	—	—	—	8,982	—	8,98
Unrealized loss on investment securities available for sale, net of income taxes	—	—	—	—	(1,699)	(1,69
Stock options exercised, net of repurchased shares	5,689	—	107	(31)	—	7
Stock-based compensation	—	—	333	—	—	33
Balance, March 31, 2021	13,759,218	$ 138	$ 51,042	$ 115,805	$ 18	$ 167,00
Net income	—	—	—	9,648	—	9,64
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	130	13
Stock options exercised, net of repurchased shares	10,301	—	121	(22)	—	9
Shares issued as compensation	2,096	—	26	—	—	2
Stock-based compensation	—	—	298	—	—	29
Balance, June 30, 2021	13,771,615	$ 138	$ 51,487	$ 125,431	$ 148	$ 177,20
Net income	—	—	—	11,177	—	11,17
Unrealized gain on investment securities available for sale, net of income taxes	—	—	—	—	765	76
Stock options exercised, net of repurchased shares	30,321	—	261	(702)	—	(44
Stock-based compensation	—	—	375	—	—	37
Balance, September 30, 2021	**13,801,936**	**$ 138**	**$ 52,123**	**$ 135,906**	**$ 913**	**$ 189,08**

See Notes to Consolidated Financial Statements

(in thousands)	Nine Months Ended September 30, 2021	2020
Operating activities		
Net income	$ **29,807**	$ 16,134
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Provision for loan losses	**2,259**	9,209
Provision for losses on mortgage loans sold	**279**	475
Provision for (reversal of) off balance sheet credit commitments	**(39)**	233
Amortization on investments, net	**358**	216
Depreciation and amortization	**1,013**	1,401
Increase in cash surrender value of bank-owned life insurance policies	**(268)**	—
Stock-based compensation expense	**1,006**	736
Director and employee compensation paid in stock	**26**	37
Deferred income tax expense (benefit)	**(92)**	(3)
Amortization of debt issuance expense	**—**	139
Gain on sale of securities available for sale	**(153)**	—
Loss on sale of foreclosed real estate	**28**	—
Mortgage banking revenue	**(17,478)**	(20,984)
Proceeds from sales of loans held for sale	**925,093**	880,942
Originations of loans held for sale	**(836,466)**	(926,645)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest receivable	**306**	(2,908)
Decrease in other assets	**1,055**	233
Decrease in accrued interest payable	**(295)**	(278)
Decrease (increase) in other liabilities	**(3,906)**	5,175
Net cash provided by (used for) operating activities	**102,533**	(35,888)
Investing activities		
Purchases of securities available for sale	**(169,672)**	(2,000)
Maturities, calls and principal paydowns of securities available for sale	**12,231**	11,078
Proceeds from sale of securities available for sale	**66,534**	—
Sales of restricted investments	**473**	8
Purchases of bank-owned life insurance	**(35,000)**	—
Decrease (increase) in SBA-PPP loans receivable, net	**63,840**	(233,349)
Increase in portfolio loans receivable, net	**(130,564)**	(74,928)
Purchases of premises and equipment, net	**(239)**	(330)
Proceeds from sales of foreclosed real estate	**62**	—
Net cash used for investing activities	**(192,335)**	(299,521)
Financing activities		
Net increase (decrease) in:		
Noninterest-bearing deposits	**224,628**	304,461
Interest-bearing deposits	**44,482**	132,328
Federal Home Loan Bank advances, net	**—**	(10,000)
(Repayment of) advances from Federal Reserve Bank	**(1,954)**	1,954
Repurchase of common stock	**—**	(2,798)
Net proceeds from exercise of stock options (repurchase of option shares)	**(266)**	157
Net cash provided by financing activities	**266,890**	426,102

See Notes to Consolidated Financial Statements

(in thousands)	Nine Months Ended September 30, 2021	2020
Net increase in cash and cash equivalents	**177,088**	90,693
Cash and cash equivalents, beginning of year	**146,910**	114,824
Cash and cash equivalents, end of period	**$ 323,998**	$ 205,517
Noncash activities:		
Loans transferred to foreclosed real estate	**$ —**	$ 942
Change in unrealized gains (losses) on investments	**$ (1,066)**	$ 2,458
Cash paid during the period for:		
Taxes	**$ 12,596**	$ 7,350
Interest	**$ 5,728**	$ 10,861

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 September 30, 2021, Church Street Capital had loans totaling $5.9 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 nine months ended September 30, 2021 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, 2020, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

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"). In recent months, COVID-19 vaccination rates have been increasing and restrictive measures have been eased in certain areas. However, uncertainty remains about the duration of the pandemic and the timing and strength of the global economy's recovery. 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

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

(“CARES Act”), which established the Small Business Administration 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 continues to evaluate processes in place to execute our business continuity plan and promote the health and safety of our employees.

Although the macroeconomic and public health outlooks improved in the U.S. during the third quarter of 2021, the future direct and indirect impact of the pandemic on the Company’s businesses, results of operations and financial condition remains uncertain. 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 carrying 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.

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

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

sales are determined by the specific-identification method. The Company's current practice is to sell residential mortgage loans on a servicing released basis, and, therefore, it has no servicing rights recorded for the value of such servicing. Interest on loans held for sale is credited to income based on the principal amounts outstanding.

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

The Company 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 September 30, 2021 totaled $141.4 million with $4.3 million of net unearned fees. SBA-PPP loans generated interest income of $1.5 million for the three months ended September 30, 2021 and $6.3 million for the nine months ended September 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 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.

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

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 provides 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, or 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 projected beyond reasonable time frames, client bankruptcy and lack of assets, and/or collateral deficiencies.

The allowance for loan losses is estimated to adequately provide for probable future losses on existing loans. The allowance consists of specific and general components. For loans that are classified as impaired, an allowance is established when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value of that loan. The general component covers pools of nonclassified loans and is based on historical loss experience adjusted 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 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

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

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

Leases

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.

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

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

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*.

Income Taxes

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

Earnings per share:

Earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding, adjusted for the dilutive effect of stock options and restricted stock using the treasury stock method. At September 30, 2020, there were 510,550 stock options excluded from the calculation as their effect would have been anti-dilutive, whereas at September 30, 2021 there were 147 such options.

Comprehensive income:

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

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

The Company's only component of other comprehensive income is unrealized gains and losses on investment securities available for sale, net of income taxes. Information concerning the Company's accumulated other comprehensive income as of September 30, 2021 and December 31, 2020 is as follows:

(in thousands)	September 30, 2021	December 31, 2020
Unrealized gains on securities available for sale	$ 1,271	$ 2,337
Deferred tax expense	(358)	(620)
Total accumulated comprehensive income	$ 913	$ 1,717

Recently issued accounting pronouncements:

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The FASB subsequently revised ASU 2019-10, which delayed implementation and the new standard is now effective for fiscal years beginning after December 15, 2022, including the interim periods within those fiscal years. The Company expects the provisions of this standard to impact the Company's consolidated financial statements, in particular, the level of the reserve for credit losses. The Company is continuing to evaluate the extent of the potential impact and expects that portfolio composition and economic conditions at the time of adoption will be a factor.

In November 2019, the FASB issued guidance to defer the effective dates for private companies, not-for-profit organizations, and certain smaller reporting companies to apply standards on current expected loan losses ("CECL"). The new effective dates will be fiscal years beginning after December 15, 2022 including interim periods within those fiscal years. In addition, the FASB issued guidance that addresses issues raised by stakeholders during the implementation of ASU 2016-13, "Financial Instruments-loan losses (Topic 326): Measurement of Loan Losses on Financial Instruments." The amendments affect a variety of Topics in the Accounting Standards Codification. For entities that have not yet adopted the amendments in ASU 2016-13, the amendments are effective for fiscal years beginning after December 15, 2022 including interim periods within those fiscal years. Early adoption is permitted in any interim period as long as an entity has adopted the amendments in ASU 2016-13. While the Company does not expect these amendments to have a material effect on its financial statements, the Company is continuing to evaluate the extent of the potential impact and expects that portfolio composition and economic conditions at the time of adoption will be a factor.

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

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

In December 2019, the FASB issued guidance to simplify accounting for income taxes by removing specific technical exceptions that often produce information investors have a hard time understanding. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740

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

by clarifying and amending existing guidance. The amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The Company adopted the guidance during the first quarter of 2021 and it did not have a material impact on the Company's financial statements.

In March 2020, the FASB issued ASU 2020-04, ‘‘Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” This new ASU provides temporary optional expedients and exceptions to GAAP guidance with regard to contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from the London Interbank Offered Rate (“LIBOR”) and other interbank offered rates to alternative reference rates. Entities can elect not to apply certain modification accounting requirements to contracts affected by reference rate reform, if certain criteria are met. Entities that make such elections would not have to remeasure contracts at the modification date or reassess a previous accounting determination. Entities can elect various optional expedients that would allow them to continue applying hedge accounting for hedging relationships affected by reference rate reform, if certain criteria are met. This amended guidance and the ability to elect its temporary optional expedients and exceptions are effective for the Company as of March 12, 2020 through December 31, 2022. The adoption of ASU 2020-04 Topic 848 is not expected to have a material impact on the Company's financial statements.

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, or other delays in payment that are deemed 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. As of September 30, 2021, the Company has 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. It is not expected that this interagency guidance will have a material impact on the Company's financial statements; however, this impact cannot be quantified at this time.

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.

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

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 September 30, 2021 and December 31, 2020, 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 September 30, 2021 and December 31, 2020 are summarized as follows:

Investment Securities Available for Sale
(in thousands)

September 30, 2021	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available for sale				
U.S. Treasuries	**$ 132,570**	**$ 651**	**$ (191)**	**$ 133,0**
Municipal	**10,828**	**101**	**(18)**	**10,9**
Corporate	**5,000**	**12**	**(12)**	**5,0**
Asset-backed securities	**10,260**	**71**	**(2)**	**10,3**
Mortgage-backed securities	**29,236**	**797**	**(138)**	**29,8**
Total	**$ 187,894**	**$ 1,632**	**$ (361)**	**$ 189,1**
December 31, 2020				
Available for sale				
Municipal	$ 10,836	$ 108	$ (17)	$ 10,9
Corporate	5,759	30	(22)	5,7
Asset-backed securities	10,839	42	—	10,8
Mortgage-backed securities	70,016	2,208	(12)	72,2
Total	$ 97,450	$ 2,388	$ (51)	$ 99,7

There were 28 securities sold during the nine months ended September 30, 2021. Proceeds from sales of securities sold during the nine months ended September 30, 2021 were $66.5 million. The investment sales resulted in gross realized gains of $694 thousand and gross realized losses of $541 thousand for the nine months ended September 30, 2021.

Note 3 - Investment Securities (continued)

Information related to unrealized losses in the investment portfolio as of September 30, 2021 and December 31, 2020 is summarized as follows:

Investment Securities Unrealized Losses

(in thousands)	Less than 12 months		12 months or longer		Total	
September 30, 2021	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasuries	**$ 58,461**	**$ (191)**	**$ —**	**$ —**	**$ 58,461**	**$ (19**
Municipal	**3,148**	**(18)**	**—**	**—**	**3,148**	**(1**
Corporate	**1,988**	**(12)**	**—**	**—**	**1,988**	**(1**
Asset-backed securities	**3,396**	**(2)**	**—**	**—**	**3,396**	**(**
Mortgage-backed securities	**13,073**	**(138)**	**—**	**—**	**13,073**	**(13**
Total	**$ 80,066**	**$ (361)**	**$ —**	**$ —**	**$ 80,066**	**$ (36**
December 31, 2020						
Municipal	$ 3,151	$ (17)	$ —	$ —	$ 3,151	$ (1
Corporate	1,994	(6)	244	(16)	2,238	(2
Mortgage-backed securities	2,410	(12)	—	—	2,410	(1
Total	$ 7,555	$ (35)	$ 244	$ (16)	$ 7,799	$ (5

At September 30, 2021, there were no securities and at December 31, 2020 there was one security that had been in an unrealized loss position for greater than twelve months. Management believes that the unrealized loss at September 30, 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.

A summary of pledged securities at September 30, 2021 and December 31, 2020 is shown below:

Pledged Securities

	September 30, 2021		December 31, 2020	
(in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Federal Home Loan Bank	**$ —**	**$ —**	$ 1,142	$ 1,189

Contractual maturities of investment securities at September 30, 2021 and December 31, 2020 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.

ntractual Maturities

	September 30, 2021		December 31, 2020	
housands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
hin one year	**$ ~~$~~**	**~~$~~**	~~$~~	—
er one to five years	**58,652**	**58,461**	—	—
er five to ten years	**78,918**	**79,568**	5,500	5,524
er ten years	**21,088**	**21,241**	21,934	22,051
rtgage-backed securities[1]	**29,236**	**29,895**	70,016	72,212
otal	**$ 187,894**	**189,165**	97,450	99,787

[1] Mortgage-backed securities contractually repay 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.

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.

SBA-PPP gross loans receivable totaled $141.4 million at September 30, 2021, and $204.9 million at December 31, 2020, 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 $4.3 million at September 30, 2021 compared to $3.9 million at December 31, 2020. There were no outstanding commitments to extend additional SBA-PPP loans at September 30, 2021.

Note 5 - Portfolio Loans Receivable

Major classifications of portfolio loans as are as follows:

Portfolio Loan Categories

(in thousands)	September 30, 2021	December 31, 2020
Real estate:		
Residential	**$ 418,205**	$ 437,860
Commercial	**502,523**	392,550
Construction	**251,256**	224,904
Commercial and Industrial	**143,244**	157,127
Credit card	**134,979**	102,180
Other consumer	**1,425**	1,649
Portfolio loans receivable, gross	**1,451,632**	1,316,270
Deferred origination fees, net	**(6,506)**	(774)
Allowance for loan losses	**(24,753)**	(23,434)
Portfolio loans receivable, net	**$ 1,420,373**	$ 1,292,068

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%.

Note 5 - Portfolio Loans Receivable (continued)

Commercial Real Estate Loans. Commercial real estate loans are originated on owner-occupied and non-owner-occupied properties. These loans may be more adversely affected by conditions in the real estate markets or in the general economy. Commercial loans that are secured by owner-occupied commercial real estate and primarily collateralized by operating cash flows are also included in this category of loans. As of September 30, 2021, there were approximately $291.0 million of owner-occupied commercial real estate loans, representing approximately 57.9% 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 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. Our OpenSky® credit card division provides credit cards on a nationwide basis to under-banked populations and those looking to rebuild their credit scores through a fully digital and mobile platform. Most of the lines of credit are secured by a noninterest bearing demand account at the Bank in an amount equal to the full credit limit of the credit card. In addition, using a proprietary scoring model, which considers credit score and repayment history (typically a minimum of six months of on-time repayments, but ultimately determined on a case-by-case basis), the Bank offers certain existing customers an unsecured line in excess of their secured line of credit. Approximately $125.2 million and $98.5 million of the credit card balances were secured by savings deposits held by the Company as of September 30, 2021 and December 31, 2020, respectively.

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

Note 5 - Portfolio Loans Receivable (continued)

Loans acquired through acquisitions are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In estimating the fair value of loans acquired, certain factors were considered, including the remaining lives of the acquired loans, payment history, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, and the net present value of cash flows expected. Discounts on loans that were not considered impaired at acquisition were recorded as an accretable discount, which will be recognized in interest income over the terms of the related loans. For loans considered to be impaired 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 September 30, 2021 and December 31, 2020. Loans with non-accretable discounts had carrying values of $821 thousand and $836 thousand as of September 30, 2021 and December 31, 2020, respectively.

Accretable discounts on loans acquired is summarized as follows:

Accretable Discounts on Loans Acquired

(in thousands)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2021	**September 30, 2020**	**September 30, 2021**	**September 30, 2020**
Accretable discount at beginning of period	**$ 212**	$ 230	**$ 221**	$ 429
Less: Accretion and payoff of loans	**(23)**	(4)	**(32)**	(203)
Other changes, net	**—**	—	**—**	—
Accretable discount at end of period	**$ 189**	$ 226	**$ 189**	$ 226

The following tables set forth the changes in the allowance for loan losses and an allocation of the allowance for loan losses by class for the three and nine months ended September 30, 2021 and September 30, 2020.

Allowance for Loan Losses

(in thousands)

Three Months Ended September 30, 2021	**Beginning Balance**	**Provision for Loan Losses**	**Charge-Offs**	**Recoveries**	**Ending Balance**
Real estate:					
Residential	**$ 6,709**	**$ (289)**	**$ —**	**$ —**	**$ 6,4**
Commercial	**7,777**	**315**	**—**	**—**	**8,0**
Construction	**4,542**	**330**	**—**	**—**	**4,8**
Commercial and Industrial	**2,536**	**(409)**	**—**	**1**	**2,1**
Credit card	**2,502**	**1,024**	**(305)**	**3**	**3,2**
Other consumer	**13**	**4**	**—**	**—**	
Total	**$ 24,079**	**$ 975**	**$ (305)**	**$ 4**	**$ 24,7**

Nine Months Ended September 30, 2021	**Beginning Balance**	**Provision for Loan Losses**	**Charge-Offs**	**Recoveries**	**Ending Balance**
Real estate:					
Residential	**$ 7,153**	**$ (733)**	**$ —**	**$ —**	**$ 6,4**
Commercial	**6,786**	**1,467**	**(161)**	**—**	**8,0**
Construction	**4,595**	**276**	**—**	**1**	**4,8**
Commercial and Industrial	**2,417**	**(256)**	**(39)**	**6**	**2,1**
Credit card	**2,462**	**1,509**	**(777)**	**30**	**3,2**
Other consumer	**21**	**(4)**	**—**	**—**	
Total	**$ 23,434**	**$ 2,259**	**$ (977)**	**$ 37**	**$ 24,7**

Note 5 - Portfolio Loans Receivable (continued)

Allowance for Loan Losses

Three Months Ended September 30, 2020	Beginning Balance	Provision for Loan Losses	Charge-Offs	Recoveries	Ending Balance
Real estate:					
Residential	$ 6,244	$ 737	$ —	$ —	$ 6,9
Commercial	5,232	1,158	—	—	6,3
Construction	3,952	537	—	—	4,4
Commercial and Industrial	1,743	671	(85)	—	2,3
Credit card	1,497	376	(85)	7	1,7
Other consumer	11	21	—	—	
Total	$ 18,679	$ 3,500	$ (170)	$ 7	$ 22,0
Nine Months Ended September 30, 2020					
Real estate:					
Residential	$ 4,135	$ 2,846	$ —	$ —	$ 6,9
Commercial	3,572	2,818	—	—	6,3
Construction	2,668	1,821	—	—	4,4
Commercial and Industrial	1,548	892	(111)	—	2,3
Credit card	1,368	810	(408)	25	1,7
Other consumer	10	22	—	—	
Total	$ 13,301	$ 9,209	$ (519)	$ 25	$ 22,0

Note 5 - Portfolio Loans Receivable (continued)

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

Allowance for Loan Loss Composition

(in thousands)	Allowance for Loan Losses Ending Balance Evaluated for Impairment:		Outstanding Portfolio Loan Balances Evaluated for Impairment:	
September 30, 2021	Individually	Collectively	Individually	Collectively
Real estate:				
Residential	**$ —**	**$ 6,420**	**$ 5,039**	**$ 413,166**
Commercial	**—**	**8,092**	**28**	**502,495**
Construction	**—**	**4,872**	**7,803**	**243,453**
Commercial and Industrial	**222**	**1,906**	**695**	**142,549**
Credit card	**—**	**3,224**	**—**	**134,979**
Other consumer	**—**	**17**	**—**	**1,425**
Total	**$ 222**	**$ 24,531**	**$ 13,565**	**$ 1,438,067**
December 31, 2020				
Real estate:				
Residential	$ —	$ 7,153	$ 4,537	$ 433,173
Commercial	—	6,786	2,358	390,192
Construction	—	4,595	1,886	223,168
Commercial and Industrial	253	2,164	1,182	155,945
Credit card	—	2,462	—	102,186
Other consumer	—	21	—	1,649
Total	$ 253	$ 23,181	$ 9,963	$ 1,306,313

Note 5 - Portfolio Loans Receivable (continued)

Past due loans, segregated by age and class of loans, as of September 30, 2021 and December 31, 2020 were as follows:

Portfolio Loans Past Due

(in thousands) September 30, 2021	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
Real estate:							
Residential	$ 1,144	$ 4,337	$ 5,481	$ 412,724	$ 418,205	$ 347	$ 5,039
Commercial	—	28	28	502,495	502,523	—	28
Construction	—	7,803	7,803	243,453	251,256	—	7,803
Commercial and Industrial	1,086	606	1,692	141,552	143,244	—	695
Credit card	17,956	14	17,970	117,009	134,979	14	—
Other consumer	—	—	—	1,425	1,425	—	—
Total	$ 20,186	$ 12,788	$ 32,974	$ 1,418,658	$ 1,451,632	$ 361	$ 13,565
Acquired loans included in total above	$ 51	$ 240	$ 291	$ 3,860	$ 4,151	$ —	$ 240
December 31, 2020							
Real estate:							
Residential	$ 1,029	$ 3,539	$ 4,568	$ 433,292	$ 437,860	$ —	$ 3,581
Commercial	36	2,583	2,619	389,931	392,550	225	2,358
Construction	1,444	442	1,886	223,018	224,904	—	1,886
Commercial and Industrial	486	741	1,227	155,900	157,127	—	1,182
Credit card	13,811	6	13,817	88,369	102,186	6	—
Other consumer	—	—	—	1,649	1,649	—	—
Total	$ 16,806	$ 7,311	$ 24,117	$ 1,292,159	$ 1,316,276	$ 231	$ 9,007
Acquired loans included in total above	$ 36	$ 565	$ 601	$ 4,675	$ 5,276	$ 225	$ 381

There were two loans secured by one-to-four family residential properties in the process of foreclosure at September 30, 2021 that amounted to $607 thousand. At December 31, 2020 there was a loan secured by a one-to-four family residential property in the process of foreclosure that amounted to $175 thousand.

Note 5 - Portfolio Loans Receivable (continued)

Impaired loans were as follows:

Impaired Loans

(in thousands)	Unpaid Contractual Principal Balance		Recorded Investment With No Allowance		Recorded Investment With Allowance		Total Recorded Investment		Related Allowance	
September 30, 2021										
Real estate:										
Residential	**$**	**5,221**	**$**	**5,039**	**$**	**—**	**$**	**5,039**	**$**	
Commercial		**90**		**28**		**—**		**28**		
Construction		**7,885**		**7,803**		**—**		**7,803**		
Commercial and Industrial		**840**		**340**		**355**		**695**		**2**
Total	**$**	**14,036**	**$**	**13,210**	**$**	**355**	**$**	**13,565**	**$**	**2**
Acquired loans included above	**$**	**441**	**$**	**291**	**$**	**—**	**$**	**291**	**$**	
December 31, 2020										
Real estate:										
Residential	$	3,960	$	4,537	$	—	$	4,537	$	
Commercial		2,490		2,358		—		2,358		
Construction		1,996		1,886		—		1,886		
Commercial and Industrial		1,344		791		391		1,182		2
Total	$	9,790	$	9,572	$	391	$	9,963	$	2
Acquired loans included above	$	548	$	381	$	—	$	381	$	

The following tables summarize interest recognized on impaired loans:

Interest Recognized on Impaired Loans

	For the Three Months Ended September 30, 2021				For the Nine Months Ended September 2021			
(in thousands)	Average Recorded Investment		Interest Recognized		Average Recorded Investment		Interest Recognized	
Real estate:								
Residential	**$**	**5,222**	**$**	**45**	**$**	**5,334**	**$**	
Commercial		**90**		**5**		**90**		
Construction		**7,885**		**127**		**7,779**		**1**
Commercial and Industrial		**1,056**		**16**		**1,058**		[illegible]
Total	**$**	**14,253**	**$**	**193**	**$**	**14,261**	**$**	**2**

Note 5 - Portfolio Loans Receivable (continued)

Interest Recognized on Impaired Loans

(in thousands)	For the Three Months Ended September 30, 2020		For the Nine Months Ended September 30, 2020	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
Real estate:				
Residential	$ 1,860	$ 1	$ 1,864	$
Commercial	1,616	8	1,618	
Construction	6,531	169	6,462	1
Commercial and Industrial	1,813	54	1,841	
Total	$ 11,820	$ 232	$ 11,785	$ 2

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

Credit quality indicators

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

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

Special Mention

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

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

Substandard

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

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

Note 5 - Portfolio Loans Receivable (continued)

Doubtful

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

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
September 30, 2021					
Real estate:					
Residential	**$ 406,197**	**$ 5,733**	**$ 6,275**	**$ —**	**$ 418,205**
Commercial	**494,355**	**8,140**	**28**	**—**	**502,523**
Construction	**238,426**	**5,027**	**7,803**	**—**	**251,256**
Commercial and Industrial	**129,890**	**11,852**	**1,502**	**—**	**143,244**
Credit card	**134,979**	**—**	**—**	**—**	**134,979**
Other consumer	**1,425**	**—**	**—**	**—**	**1,425**
Portfolio loans receivable, gross	**$ 1,405,272**	**$ 30,752**	**$ 15,608**	**$ —**	**$ 1,451,632**
December 31, 2020					
Real estate:					
Residential	$ 428,260	$ 5,150	$ 4,450	$ —	$ 437,860
Commercial	383,311	6,881	2,358	—	392,550
Construction	220,057	1,112	3,735	—	224,904
Commercial and Industrial	145,365	9,766	1,996	—	157,127
Credit card	102,186	—	—	—	102,186
Other consumer	1,649	—	—	—	1,649
Portfolio loans receivable, gross	$ 1,280,828	$ 22,909	$ 12,539	$ —	$ 1,316,276

(1) Category includes loans graded exceptional, very good, good, satisfactory and pass/watch, in addition to credit cards and consumer credits that are not 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 September 30, 2021 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)		Recorded Investment		
September 30, 2021	Number of Contracts	Performing	Nonperforming	Total
Real estate:				
Residential	**4**	**$ —**	**$ 456**	**$ 456**
Commercial and Industrial	**1**	**—**	**89**	**89**
Total	**5**	**$ —**	**$ 545**	**$ 545**
Acquired loans included in total above	**3**	**$ —**	**$ 145**	**$ 145**
December 31, 2020				
Real estate:				
Residential	3	$ —	$ 146	$ 146
Commercial and Industrial	2	—	294	294
Total	5	$ —	$ 440	$ 440
Acquired loans included in total above	3	$ —	$ 145	$ 145

There were no new TDRs added during the three months ended September 30, 2021. There was one new residential TDR during the nine months ended September 30, 2021 for $319 thousand in which the borrower was granted a rate reduction and payment recast. There were no material financial effects as a direct result of this modification. The loan is also classified as non-accrual. There was one commercial and industrial TDR that was paid off during the nine months ended September 30, 2021 for $200 thousand. The Company had no defaulted TDR loans over the last twelve months.

Outstanding loan commitments were as follows:

Loan Commitments

(in thousands)	September 30, 2021	December 31, 2020
Unused lines of credit		
Real Estate:		
Residential	**$ 12,530**	$ 15,973
Residential - Home Equity	**35,390**	32,398
Commercial	**22,192**	20,848
Construction	**104,497**	118,843
Commercial and Industrial	**50,297**	50,877
Secured credit card	**122,960**	92,452
Other consumer	**2,126**	185
Total	**$ 349,992**	$ 331,576
Commitments to originate residential loans held for sale	**$ 1,205**	$ 11,444
Letters of credit	**$ 5,132**	$ 5,102

Note 5 - Portfolio Loans Receivable (continued)

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.

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 changes 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 Nine Months Ended	
	September 30, 2021	**September 30, 2020**	**September 30, 2021**	**September 30, 2020**
Balance at beginning of period	**$ 1,745**	$ 1,271	**$ 1,775**	$ 1,226
Provision for (reversal of) off balance sheet credit commitments	**(9)**	188	**(39)**	233
Recoveries	**—**	—	**—**	—
Charge-offs	**—**	—	**—**	—
Balance at end of period	**$ 1,736**	$ 1,459	**$ 1,736**	$ 1,459

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 Nine Months Ended	
	September 30, 2021	**September 30, 2020**	**September 30, 2021**	**September 30, 2020**
Balance at beginning of period	**$ 1,369**	$ 823	**$ 1,160**	$ 575
Provision for mortgage loan put backs	**70**	213	**279**	475
Charge-offs	**—**	—	**—**	(14)
Balance at end of period	**$ 1,439**	$ 1,036	**$ 1,439**	$ 1,036

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

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

Derivatives

(in thousands)	September 30, 2021	December 31, 2020
Notional amount of open forward sales agreements	**$ 20,250**	$ 38,000
Fair value of open forward delivery sales agreements	**69**	(179)
Notional amount of open mandatory delivery commitments	**3,318**	15,531
Fair value of open mandatory delivery commitments	**(18)**	179
Notional amount of interest rate lock commitments	**16,091**	34,827
Fair value of interest rate lock commitments	**(40)**	148

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 five of its full service branches and five 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 2.23% at September 30, 2021 and December 31, 2020. 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 September 30, 2021, the Company’s lease ROU assets and related lease liabilities were $2.8 million and $3.0 million, respectively, compared to December 31, 2020 balances of $3.1 million of ROU assets and $3.4 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 September 30, 2021, the Company had not entered into any material leases that have not yet commenced. The Company’s lease information is summarized as follows:

Leases

(in thousands)	September 30, 2021	December 31, 20
Lease Right of Use Asset:		
Lease asset	**$ 5,364**	$ 5,3
Less: Accumulated amortization	**(2,611)**	(2,2
Net lease asset	**$ 2,753**	$ 3,1
Lease Liability:		
Lease liability	**$ 3,041**	$ 3,4

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

Lease Payment Obligations

(in thousands)	September 30, 2021
Amounts due in:	
2021	$ 3
2022	1,0
2023	9
2024	5
2025	1
2026	1
Total future lease payments	**3,1**
Discount of cash flows	(1
Present value of net future lease payments	**$ 3,0**

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 September 30, 2021 and December 31, 2020 as follows:

Fair Value of Financial Instruments
(in thousands)

September 30, 2021		Total		Level 1 Inputs		Level 2 Inputs		Level 3 Inputs
Investment securities available for sale								
Municipal	$	10,911		—	$	10,911		—
Corporate		5,000		—		5,000		—
Asset-backed securities		10,329		—		10,329		—
Mortgage-backed securities		29,895		—		29,895		—
U.S. Treasuries		133,030		—		133,030		
Total	$	189,165	$	—	$	189,165	$	—
Marketable equity securities	$	245	$	—	$	245	$	—
Loans held for sale	$	36,005	$	—	$	36,005	$	—
Derivative assets	$	69	$	—	$	69	$	—
Derivative liabilities	$	(58)	$	—	$	(58)	$	—
December 31, 2020								
Investment securities available for sale								
Municipal	$	10,927		—	$	10,927		—
Corporate		5,767		—		5,767		—
Asset-backed securities		10,881		—		10,881		—
Mortgage-backed securities		72,212		—		72,212		—
Total	$	99,787	$	—	$	99,787	$	—
Marketable equity securities	$	245	$	—	$	245	$	—
Loans held for sale	$	107,154	$	—	$	107,154	$	—
Derivative assets	$	327	$	—	$	327	$	—
Derivative liabilities	$	(179)	$	—	$	(179)	$	—

Financial instruments recorded using FASB ASC 825-10

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

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

Fair Value of Loans Held for Sale

(in thousands)		September 30, 2021		December 31, 2020
Aggregate fair value	$	36,005	$	107,154
Contractual principal		33,966		99,362
Difference	$	2,039	$	7,792

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 September 30, 2021 and December 31, 2020, the fair values consist of loan balances of $13.6 million and $10.0 million, with specific reserves of $222 thousand and $253 thousand, respectively.

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

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

Fair Value of Impaired Loans and Foreclosed Real Estate

(in thousands)	September 30, 2021	December 31, 2020
Impaired loans		
Level 3 inputs	**$ 13,343**	$ 9,709
Total	**$ 13,343**	$ 9,709
Foreclosed real estate		
Level 3 inputs	**$ 3,236**	$ 3,326
Total	**$ 3,236**	$ 3,326

The following table provides information describing the unobservable inputs used in Level 3 fair value measurements at September 30, 2021 and December 31, 2020:

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)	September 30, 2021 Carrying Amount	September 30, 2021 Fair Value	December 31, 2020 Carrying Amount	December 31, 2020 Fair Value
Financial assets				
Level 1				
Cash and due from banks	**$ 23,650**	**$ 23,650**	$ 18,456	$ 18,456
Interest bearing deposits at other financial institutions	**299,033**	**299,033**	126,081	126,081
Federal funds sold	**1,315**	**1,315**	2,373	2,373
Level 3				
Loans receivable, net [1]	**$ 1,557,551**	**$ 1,555,582**	$ 1,493,086	$ 1,499,073
Restricted investments	**3,498**	**3,498**	3,713	3,713
Financial liabilities				
Level 1				
Noninterest bearing deposits	**$ 833,187**	**$ 833,187**	$ 608,559	$ 608,559
Level 3				
Interest bearing deposits	**$ 1,088,051**	**$ 1,090,263**	$ 1,043,569	$ 1,048,728
FHLB advances and other borrowed funds	**34,062**	**34,609**	36,016	37,067

[1] Includes SBA-PPP loans and portfolio loans.

Note 9 - Segments

The Company's reportable segments represent product line divisions and are viewed separately for strategic planning purposes 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 September 30, 2021 and September 30, 2020.

Segments

(in thousands)	Commercial Bank	CBHL	OpenSky®	Corporate	Eliminations	Consolidatec
For the Three Months Ended September 30, 2021						
Interest income	**$ 17,109**	**$ 248**	**$ 15,635**	**$ 574**	**$ (38)**	**$ 33,5**
Interest expense	**1,160**	**177**	**—**	**170**	**(38)**	**1,4**
Net interest income	**15,949**	**71**	**15,635**	**404**	**—**	**32,0**
Provision for loan losses	**—**	**—**	**975**	**—**	**—**	**9**
Net interest income after provision	**15,949**	**71**	**14,660**	**404**	**—**	**31,0**
Noninterest income	**559**	**4,484**	**7,553**	**1**	**—**	**12,5**
Noninterest expense	**12,073**	**2,775**	**13,677**	**102**	**—**	**28,6**
Net income before taxes	**$ 4,435**	**$ 1,780**	**$ 8,536**	**$ 303**	**$ —**	**$ 15,0**
Total assets	**$ 1,956,340**	**$ 36,791**	**$ 135,612**	**$ 209,070**	**$ (168,257)**	**$ 2,169,5**
For the Three Months Ended September 30, 2020						
Interest income	$ 16,695	$ 856	$ 7,070	$ 607	$ (39)	$ 25,1
Interest expense	2,214	565	—	410	(39)	3,1
Net interest income	14,481	291	7,070	197	—	22,0
Provision for loan losses	3,123	—	377	—	—	3,5
Net interest income after provision	11,358	291	6,693	197	—	18,5
Noninterest income	164	11,540	5,773	—	—	17,4
Noninterest expense	9,148	5,243	9,974	85	—	24,4
Net income before taxes	$ 2,374	$ 6,588	$ 2,492	$ 112	$ —	$ 11,5
Total assets	$ 1,611,947	$ 138,781	$ 95,124	$ 172,269	$ (139,092)	$ 1,879,0

Note 9 - Segments

For the Nine Months Ended September 30, 2021 (in thousands)	Commercial Bank	CBHL	OpenSky®	Corporate	Eliminations	Consolidated
Interest income	$ 51,969	$ 1,037	$ 34,944	$ 1,604	$ (99)	$ 89,45
Interest expense	4,285	745	—	502	(99)	5,43
Net interest income	47,684	292	34,944	1,102	—	84,02
Provision for loan losses	433	—	1,756	70	—	2,25
Net interest income after provision	47,251	292	33,188	1,032	—	81,76
Noninterest income	1,239	17,529	21,208	43	—	40,01
Noninterest expense	31,989	9,941	39,379	290	—	81,59
Net income before taxes	$ 16,501	$ 7,880	$ 15,017	$ 785	$ —	$ 40,18
Total assets	$ 1,956,340	$ 36,791	$ 135,612	$ 209,070	$ (168,257)	$ 2,169,55
For the Nine Months Ended September 30, 2020						
Interest income	$ 49,147	$ 1,912	$ 16,151	$ 1,817	(94)	$ 68,93
Interest expense	8,536	1,161	—	980	(94)	10,58
Net interest income	40,611	751	16,151	837	—	58,35
Provision for loan losses	8,399	—	810	—	—	9,20
Net interest income after provision	32,212	751	15,341	837	—	49,14
Noninterest income	574	22,844	10,694	2	—	34,11
Noninterest expense	26,039	12,122	22,700	292	—	61,15
Net income before taxes	$ 6,747	$ 11,473	$ 3,335	$ 547	$ —	$ 22,10
Total assets	$ 1,611,947	$ 138,781	$ 95,124	$ 172,269	$ (139,092)	$ 1,879,02

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, 2020.

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.

In addition to the foregoing, the COVID-19 pandemic is adversely affecting us, our customers, counterparties, employees and third party service providers. The ultimate extent of the impact on our business, financial position, results of operations, liquidity, and prospects is uncertain. Continued deterioration in general business and economic conditions, or turbulence in domestic or global financial markets could adversely affect our revenues and the values of our assets and liabilities, reduce the availability of funding and lead to a tightening of credit. Changes to statutes, regulations, or regulatory policies or practices as a result of, or in response to COVID-19, could affect us in substantial and unpredictable ways, including the potential adverse impact of loan modifications and payment deferrals implemented consistent with recent regulatory guidance. The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

General Economic Conditions

- economic conditions (including the interest rate environment, government economic and monetary policies, the strength of global financial markets and inflation and deflation) that impact the financial services industry as a whole and/or our business;
- 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;
- the possible impact of uncertainty about the future of LIBOR on our net interest income;
- due to the Federal Reserve Board’s target federal funds rate near 0%, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread and reducing net income;
- 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;
- 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;
- we may be required to repurchase loans originated for sale by our mortgage banking division;
- 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;
- Federal Deposit Insurance Corporation premiums may increase if the agency experiences additional resolution costs;
- further government intervention in the U.S. financial system;
- 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 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, 2020 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 critical accounting and reporting policies include the Company’s accounting for the allowance for loan losses. 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 2020 Form 10-K.

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 five commercial bank branches, five mortgage offices, two loan production offices, a limited service branch and three corporate and operations facilities located in key markets throughout our operating area. We serve businesses, not-for-profit associations and entrepreneurs throughout the region by partnering with them to design tailored financial solutions supported by customized technology and “client first” advice.

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 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. 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.

COVID-19 Pandemic

The outbreak of COVID-19, which was declared a pandemic by the World Health Organization on March 11, 2020, has led to adverse impacts on economic conditions and created uncertainty in financial markets. In early March 2020, the Company began preparing for potential disruptions and government limitations on activity in the markets in which we serve. Our team activated our Business Continuity Program and was able to quickly execute on multiple initiatives to adjust our operations to protect the health and safety of our employees and clients. Currently, a significant portion of our workforce is working remotely without materially impacting our productivity while continuing to provide a high level of customer service. Since the beginning of the crisis, we have been in close contact with our clients, assessing the level of impact on their businesses, and providing relief programs according to each client's specific situation and qualifications. Currently, the Company has four branches open and one previous location has been permanently closed. We have enhanced awareness of digital banking offerings and limited the number of customers in the branch and have taken steps to comply with various government directives regarding "social distancing," as well as enhanced cleaning and disinfecting of surface areas to protect our clients and employees.

Small Business Administration's Paycheck Protection Program

We were able to quickly establish our process for participating in the Small Business Administration's Paycheck Protection Program ("SBA-PPP") that enabled our clients to utilize this valuable resource. SBA-PPP loans are designed to provide assistance for small businesses during the COVID-19 pandemic to help meet the costs associated with payroll, mortgage interest, rent and utilities. These loans are 100% guaranteed by the SBA and, under certain circumstances, forgiveness of the loan by the SBA is granted to the borrower. In general, forgiveness is predicated on the small business maintaining or quickly rehiring their employees and maintaining salary levels for their employees. SBA-PPP loans do not require any collateral or personal guarantees. As of September 30, 2021, the outstanding loan balance was approximately $141.4 million for SBA-PPP loans that were originated in the first and second rounds of the program. These efforts have allowed us to strengthen and deepen our client relationships, while positively impacting thousands of individuals.

Short-term Modifications for Borrowers

In keeping with regulatory guidance to work with borrowers during this unprecedented situation and as outlined in Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), the Company is providing loan modifications where appropriate, including potential interest only payments or payment deferrals for clients that are adversely affected by the COVID-19 pandemic. Section 4013 of the CARES Act, as amended by the Consolidated Appropriations Act, 2021, also addressed COVID-19 related modifications and specified that such modifications made between March 1, 2020 and the earlier of (i) 60 days after the date of termination of the National Emergency or (ii) January 1, 2022, on loans that were current as of December 31, 2019 are not TDRs. In accordance with interagency guidance issued in April 2020, these short-term modifications made to a borrower affected by the COVID-19 pandemic and governmental shutdown orders, such as payment deferrals, fee waivers and extensions of repayment terms, do not need to be identified as TDRs if the loans were current at the time a modification plan was implemented. Commercial and consumer loans still on COVID-19 related deferrals were $30.5 million at December 31, 2020 and have decreased to $7.3 million or approximately 0.50% of total portfolio loans receivable as of September 30, 2021.

Liquidity

We are monitoring our liquidity position on an ongoing basis as the circumstances surrounding the pandemic continue to evolve. The Company has several available sources of on and off-balance sheet liquidity. Currently, the Company has not needed to tap into these available liquidity sources. The potential for increased reliance on available liquidity sources may be required based on the effects of the pandemic and their impact on the level of deposits and other factors. Additional discussion on our liquidity as of the report date is reflected in the "Liquidity" section of management's discussion and analysis.

Capital

As of September 30, 2021, 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 are closely monitoring 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.

	Three Months Ended September 30,		
(in thousands)	2021	2020	% Change
Interest income	**$ 33,528**	$ 25,189	33.1
Interest expense	**1,469**	3,150	(53.4)
Net interest income	**32,059**	22,039	45.5
Provision for loan losses	**975**	3,500	(72.1)
Net interest income after provision	**31,084**	18,539	67.7
Noninterest income	**12,597**	17,477	(27.9)
Noninterest expenses	**28,627**	24,450	17.1
Net income before income taxes	**15,054**	11,566	30.2
Income tax expense	**3,877**	3,128	23.9
Net income	**$ 11,177**	$ 8,438	32.5

Net income for the three months ended September 30, 2021 increased 32.5 percent to $11.2 million from $8.4 million for the three months ended September 30, 2020. The increase was primarily due to increases in interest income and credit card fees of $8.3 million and $1.8 million, respectively, and decreases in interest expense and the provision for loan losses of $1.7 million and $2.5 million, respectively. The decrease in the quarterly provision for loan losses was a result of the improving economic environment from the COVID-19 worldwide pandemic when comparing third quarter 2020 to third quarter 2021. Noninterest expense was $28.6 million for the three months ended September 30, 2021, compared to $24.5 million for the three months ended September 30, 2020, an increase of $4.1 million, or 17.1 percent. The increase was primarily due to an increase of $2.3 million, or 28.9 percent, in data processing expenses, a $1.0 million, or 11.4 percent, increase in salaries and employee benefits, and a $1.2 million, or 95.5 percent, increase in professional fees. The increase in data processing expenses was a result of a 32.4 percent increase in the number OpenSky® accounts, to 700 thousand from 529 thousand, when comparing the three months ended September 30, 2021 to the three months ended September 30, 2020.

	Nine Months Ended September 30,		
(in thousands)	2021	2020	% Change
Interest income	**$ 89,455**	$ 68,933	29.8 %
Interest expense	**5,433**	10,583	(48.7) %
Net interest income	**84,022**	58,350	44.0 %
Provision for loan losses	**2,259**	9,209	(75.5) %
Net interest income after provision	**81,763**	49,141	66.4 %
Noninterest income	**40,019**	34,114	17.3 %
Noninterest expenses	**81,599**	61,153	33.4 %
Net income before income taxes	**40,183**	22,102	81.8 %
Income tax expense	**10,376**	5,968	73.9 %
Net income	**$ 29,807**	$ 16,134	84.7 %

Net income for the nine months ended September 30, 2021 was $29.8 million, an increase of approximately $13.7 million, or 84.7%, from net income for the nine months ended September 30, 2020 of $16.1 million. The increase was primarily due to increases in interest income and credit card fees of $20.5 million and $10.5 million, respectively, and decreases in interest expense and the provision for loan losses of $5.1 million and $6.9 million, respectively. The decrease in the provision for loan losses when comparing the nine months ended September 30, 2020 to the nine months ended September 30, 2021 reflects improvement in overall economic conditions from the comparable prior year period. Noninterest expense was $81.6 million for the nine months ended September 30, 2021, compared to $61.2 million for the nine months ended September 30, 2020, an increase of $20.4 million, or 33.4 percent. The increase was primarily due to an increase of $11.9 million, or 67.5 percent, in data processing expenses, a $2.4 million, or 9.8 percent, increase in salaries and employee benefits, a $2.6 million, or 86.5 percent, increase in professional fees, a $2.2 million, or 28.7 percent, increase in other operating expenses, and a $1.3 million, or 68.2 percent, increase in advertising. The increase in data processing expenses was a result of a 32.4 percent increase in OpenSky® accounts, to 700 thousand from 529 thousand, when comparing the nine months ended September 30, 2021 to the nine months ended September 30, 2020.

Net Interest Income and Net Margin Analysis

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

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

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

AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

	Three Months Ended September 30,					
	2021			2020		
($ 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	**$ 250,326**	**$ 98**	**0.15 %**	$ 119,279	$ 29	0.10 %
Federal funds sold	**2,421**	**—**	**0.00**	3,980	—	0.01
Investment securities	**171,506**	**549**	**1.27**	54,989	273	1.97
Restricted investments	**3,480**	**41**	**4.64**	4,007	51	5.04
Loans held for sale	**32,660**	**248**	**3.02**	112,890	856	3.02
SBA-PPP loans receivable	**162,217**	**1,525**	**3.73**	235,160	1,470	2.49
Portfolio loans receivable[2]	**1,404,006**	**31,067**	**8.78**	1,218,589	22,510	7.35
Total interest earning assets	**2,026,616**	**33,528**	**6.55**	1,748,894	25,189	5.73
Noninterest earning assets	**58,156**			22,768		
Total assets	**$ 2,084,772**			$ 1,771,662		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand accounts	**$ 301,272**	**45**	**0.06**	$ 218,415	156	0.28
Savings	**7,025**	**1**	**0.05**	5,126	1	0.05
Money market accounts	**495,534**	**335**	**0.27**	532,973	1,186	0.89
Time deposits	**250,836**	**904**	**1.43**	267,970	1,291	1.92
Borrowed funds	**36,384**	**184**	**2.01**	41,069	516	5.01
Total interest bearing liabilities	**1,091,051**	**1,469**	**0.53**	1,065,553	3,150	1.18
Noninterest bearing liabilities:						
Noninterest bearing liabilities	**21,138**			22,702		
Noninterest bearing deposits	**786,784**			539,220		
Stockholders' equity	**185,799**			144,187		
Total liabilities and stockholders' equity	**$ 2,084,772**			$ 1,771,662		
Net interest spread			**6.02 %**			4.55 %
Net interest income		**$ 32,059**			$ 22,039	
Net interest margin [3]			**6.27 %**			5.01 %

(1) Annualized.
(2) Includes nonaccrual loans.
(3) For the three months ended September 30, 2021 and 2020 , SBA-PPP loans and credit card loans collectively accounted for 275 and 117 basis points of the reported net interest margin, respectively.

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

ANALYSIS OF CHANGES IN NET INTEREST INCOME

	Three Months Ended September 30, 2021 Compared to the Three Months Ended September 30, 2020			Nine Months Ended September 30, 2021 Compared to the Nine Months Ended September 30, 2020		
	Change Due To			Change Due To		
(in thousands)	Volume	Rate	Interest Variance	Volume	Rate	Interest Variance
Interest Income:						
Interest bearing deposits	$ (157)	$ 226	$ 69	$ (190)	$ 95	$ (9
Federal funds sold	—	—	—	2	(6)	(
Investment securities	332	(56)	276	814	(172)	64
Restricted stock	(6)	(4)	(10)	(16)	(34)	(5
Loans held for sale	(608)	—	(608)	(621)	(246)	(86
SBA-PPP loans receivable	55	—	55	3,784	—	3,78
Portfolio loans receivable	3,754	4,803	8,557	7,870	9,242	17,11
Total interest income	3,370	4,969	8,339	11,643	8,879	20,52
Interest Expense:						
Interest bearing demand accounts	103	(213)	(110)	800	(1,191)	(39
Savings	—	—	—	3	(5)	(
Money market accounts	(78)	(774)	(852)	(72)	(2,865)	(2,93
Time deposits	(78)	(309)	(387)	179	(1,176)	(99
Borrowed funds	(53)	(279)	(332)	(257)	(566)	(82
Total interest expense	(106)	(1,575)	(1,681)	653	(5,803)	(5,15
Net interest income	$ 3,476	$ 6,544	$ 10,020	$ 10,990	$ 14,682	$ 25,67

For the three months ended September 30, 2021, net interest income increased $10.0 million, or 45.5 percent, to $32.1 million from the same period in 2020, primarily due to an increase in interest earning assets, an increase in rates on portfolio loans receivable and a decrease in rates on interest bearing liabilities. The net interest margin increased 126 basis points to 6.27% for the three months ended September 30, 2021 from the same period in 2020. Net interest margin, excluding credit card and SBA-PPP loans, was 3.52% for the third quarter of 2021 compared to 3.84% for the same period in 2020.

For the three months ended September 30, 2021, average interest earning assets increased $277.7 million, or 15.9 percent, to $2.0 billion as compared to the same period in 2020. The average yield on interest earning assets increased 82 basis points, from 5.73% for the three months ended September 30, 2020 to 6.55% for the three months ended September 30, 2021. The largest increase in interest income when comparing these two time periods related to the income generated by the average portfolio loans receivable, which grew $185.4 million, from $1.2 billion at September 30, 2020 to $1.4 billion at September 30, 2021. This growth in average balances for the three month period ended September 30, 2021 compared to the three month period ended September 30, 2020, along with the average rate increase for portfolio loans when comparing the same time periods in 2021 and 2020 of 143 basis points, generated $8.6 million in additional interest income, 43.9 percent due to the increase in average balances and 56.1 percent due to the increase in the average interest rate.

For the three months ended September 30, 2021, average interest-bearing liabilities increased $25.5 million, or 2.4 percent when compared to the three month period ended September 30, 2020. Average interest bearing deposits grew $30.2 million, or 2.9 percent, and was partially offset by a decrease in the average balance of borrowed funds of $4.7 million, or 11.4 percent. The average cost of interest bearing liabilities decreased 65 basis points to 0.53% from 1.18% when comparing the three months ended September 30, 2021 to the three months ended September 30, 2020. The decreases in the interest rates primarily reflect market interest rate decreases in 2021.

AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

	Nine Months Ended September 30,					
	2021			2020		
(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	**$ 238,648**	**$ 211**	**0.12 %**	$ 98,661	$ 306	0.41 %
Federal funds sold	**3,121**	**—**	**0.00**	2,319	4	0.22
Investment securities	**139,643**	**1,571**	**1.50**	58,071	929	2.14
Restricted investments	**3,620**	**124**	**4.59**	4,025	174	5.78
Loans held for sale	**49,775**	**1,043**	**2.80**	77,878	1,909	3.27
SBA-PPP loans receivable	**215,524**	**6,266**	**3.89**	134,130	2,482	2.47
Portfolio loans receivable[2]	**1,339,010**	**80,240**	**8.01**	1,197,719	63,129	7.04
Total interest earning assets	**1,989,341**	**89,455**	**6.01**	1,572,803	68,933	5.85
Noninterest earning assets	**36,245**			21,779		
Total assets	**$ 2,025,586**			$ 1,594,582		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest bearing demand accounts	**$ 280,305**	**$ 163**	**0.08**	$ 181,597	$ 555	0.41
Savings	**6,435**	**2**	**0.05**	4,686	4	0.13
Money market accounts	**475,875**	**1,217**	**0.34**	484,412	4,153	1.15
Time deposits	**295,705**	**3,492**	**1.58**	284,844	4,489	2.11
Borrowed funds	**34,265**	**559**	**2.18**	43,823	1,382	4.21
Total interest bearing liabilities	**1,092,585**	**5,433**	**0.66**	999,362	10,583	1.41
Noninterest bearing liabilities:						
Noninterest bearing liabilities	**23,327**			21,401		
Noninterest bearing deposits	**735,509**			433,381		
Stockholders' equity	**174,165**			140,438		
Total liabilities and stockholders' equity	**$ 2,025,586**			$ 1,594,582		
Net interest spread			**5.35 %**			4.44 %
Net interest income		**$ 84,022**			$ 58,350	
Net interest margin [3]			**5.65 %**			4.96 %

(1) Annualized
(2) Includes nonaccrual loans.
(3) For the nine months ended September 30, 2021 and 2020, SBA-PPP loans and credit card loans collectively accounted for 208 and 104 basis points of the reported net interest margin, respectively.

For the nine months ended September 30, 2021, net interest income increased $25.7 million, or 44.0 percent, to $84.0 million from the same period in 2020, primarily due to an increase in interest earning assets, an increase in rates on portfolio loans receivable and a decrease in rates on interest bearing liabilities. The net interest margin increased 69 basis points to 5.65% for the nine months ended September 30, 2021 from the same period in 2020. Net interest margin, excluding credit card and SBA-PPP loans, was 3.57% for the nine months ended September 30, 2021 compared to 3.92% for the same period in 2020.

For the nine months ended September 30, 2021, average interest earning assets increased $416.5 million, or 26.5 percent, to $2.0 billion as compared to the same period in 2020, and the average yield on interest earning assets increased 16 basis points, from 5.85% for the nine months ended September 30, 2020 to 6.01% for the nine months ended September 30, 2021. The largest increase in interest income when comparing these two time periods related to the income generated by the average portfolio loans receivable, which grew $141.3 million, from $1.2 billion at September 30, 2020 to $1.3 billion at September 30, 2021. This growth in average balances for the nine month period ended September 30, 2021 compared to the nine month period ended September 30, 2020, along with the average rate increase for portfolio loans when comparing the same time periods in 2021 and 2020 of 97 basis points, generated $17.1 million in additional interest income, 46.0 percent due to the increase in average balances and 54.0 percent due to the increase in the average interest rate.

For the nine months ended September 30, 2021, average interest-bearing liabilities increased $93.2 million, or 9.3 percent when compared to the nine month period ended September 30, 2020. Average interest bearing deposits grew $102.8 million, or 10.8 percent, and was partially offset by a decrease in the average balance of borrowed funds of $9.6 million, or 21.8 percent. The average cost of interest bearing liabilities decreased 75 basis points to 0.66% from 1.41% when comparing the nine months ended September 30, 2021 to the nine months ended September 30, 2020. The decreases in the interest rates primarily reflect market interest rate decreases in 2021.

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.”

During the quarter ended September 30, 2021, credit metrics improved as the economy continued to recover from the effects of COVID-19. Primarily as a result of an improving economic environment, the provision for loan losses declined from $3.5 million for the three months ended September 30, 2020 to $975 thousand for the three months ended September 30, 2021. On an annualized basis, net charge-offs for the third quarter of 2021 were $301 thousand, or 0.09% of average loans, compared to $163 thousand, or 0.06% of average loans on an annualized basis, for the third quarter of 2020. The $301 thousand in net charge-offs during the quarter was mainly comprised of $302 thousand in net credit card charge-offs.

For the nine months ended September 30, 2021, the provision for loan losses was $2.3 million, a decrease of $6.9 million from the prior year to date period. Net charge-offs for the nine months ended September 30, 2021 were $940 thousand, or 0.09% of average portfolio loans on an annualized basis, compared to $494 thousand, or 0.05% of average portfolio loans on an annualized basis, for the same period in 2020. The $940 thousand in net charge-offs during the nine months ended September 30, 2021 was comprised of commercial real estate net charge-offs of $161 thousand, commercial loan net charge-offs of $33 thousand, and net charge-offs of $747 thousand in the credit card portfolio and was offset by construction loan net recoveries of $1 thousand, The allowance for loan losses as a percent of portfolio loans was 1.71% and 1.78% at September 30, 2021 and December 31, 2020, respectively.

Noninterest Income

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

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

NONINTEREST INCOME

	Three Months Ended September 30,			Nine Months Ended September 30,		
(in thousands)	**2021**	**2020**	**% Change**	**2021**	**2020**	**% Change**
Noninterest income:						
Service charges on deposit accounts	**$ 160**	$ 119	34.5 %	**$ 473**	$ 378	25.1
Credit card fees	**7,554**	5,773	30.9 %	**21,208**	10,694	98.3
Mortgage banking revenue	**4,465**	10,690	(58.2) %	**17,478**	20,984	(16.7)
Gain on sale of securities	**—**	—	— %	**153**	—	—
Other fees and charges	**418**	895	(53.3) %	**707**	2,058	(65.6)
Total noninterest income	**$ 12,597**	$ 17,477	(27.9) %	**$ 40,019**	$ 34,114	17.3

For the quarter ended September 30, 2021, noninterest income was $12.6 million, a decrease of $4.9 million, or 27.92 percent, from $17.5 million in the prior year quarter. The decrease was primarily the result of reduced mortgage banking revenue. The third quarter of 2021 saw mortgage origination volumes slow after a record-breaking 2020. Origination volumes declined 49.6 percent, to $217 million, in the third quarter of 2021, when compared to $431 million in the third quarter of 2020. The steepening yield curve in the third quarter of 2021 has slowed originations from the year earlier period when low interest rates fueled refinance volumes. Purchase volumes increased to 51.0 percent of total originations for the third quarter of 2021, up from 33.8 percent during the third quarter of 2020. Partially offsetting the decrease in mortgage banking revenue, credit card fees increased $1.8 million to $7.6 million for the three months ended September 30, 2021, from $5.8 million for the three months ended September 30, 2020.

For the nine months ended September 30, 2021, noninterest income was $40.0 million, an increase of $5.9 million, or 17.3 percent, from the same period in 2020. The increase was primarily driven by significant growth in credit card fees, which increased by $10.5 million, partially offset by a decrease in mortgage banking revenues of $3.5 million. The year-to-date gain on sale of mortgage loans grew modestly to $25.9 million at September 30, 2021 from $25.5 million at September 30, 2020, even as year to date origination volumes declined 8.2 percent, to $845 million at September 30, 2021 from $920 million at September 30, 2020. Gain on sale margins remained strong at 2.85% for the nine months ended September 30, 2021. The steepening yield curve in 2021 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 throughout the remainder of 2021. Purchase volume as a percentage of loan originations was 39.6 percent for the nine months ended September 30, 2021, compared to 32.69 percent for the nine months ended September 30, 2020. Proceeds from the sale of loans held for sale amounted to $925.1 million for the nine months ended September 30, 2021 compared to $880.9 million for the nine months ended September 30, 2020. OpenSky® credit card account growth led to higher credit card fees, which increased to $21.2 million compared to $10.7 million for the same nine month period last year, largely driven by the larger number of accounts in the portfolio.

Noninterest Expense

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

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

NONINTEREST EXPENSE

	Three Months Ended September 30,			Nine Months Ended September 30,		
(in thousands)	**2021**	**2020**	**% Change**	**2021**	**2020**	**% Change**
Noninterest expense:						
Salaries and employee benefits	**9,962**	8,940	11.4 %	**27,279**	24,849	9.8 %
Occupancy and equipment	**998**	1,328	(24.8) %	**3,322**	3,658	(9.2) %
Professional services	**2,555**	1,307	95.5 %	**5,542**	2,971	86.5 %
Data processing	**10,161**	7,880	28.9 %	**29,594**	17,664	67.5 %
Advertising	**1,027**	633	62.2 %	**3,153**	1,875	68.2 %
Loan processing	**644**	1,264	(49.1) %	**2,670**	2,451	8.9 %
Foreclosed real estate expense, net	**44**	9	388.9 %	**321**	137	134.3 %
Other operating	**3,236**	3,089	4.8 %	**9,718**	7,548	28.7 %
Total noninterest expense	**$ 28,627**	$ 24,450	17.1 %	**$ 81,599**	$ 61,153	33.4 %

Noninterest expense was $28.6 million for the three months ended September 30, 2021, as compared to $24.5 million for the three months ended September 30, 2020, an increase of $4.1 million, or 17.0 percent. The increase was primarily driven by a $2.3 million, or 28.9 percent, increase in data processing expenses, an increase in professional services of $1.2 million, or 95.5 percent, and an increase in salaries and employee benefits of $1.02 million, or 11.4 percent. The increase of $2.3 million in data processing expenses was mainly attributable to the higher volume of active credit cards during the third quarter of 2021, while the increases in professional services was primarily related to the preparatory activities for a possible expansion of credit card offerings.

Noninterest expense was $81.6 million for the nine months ended September 30, 2021, as compared to $61.2 million for the nine months ended September 30, 2020, an increase of $20.4 million, or 33.4 percent. The increase was primarily driven by a $2.4 million, or 9.8 percent, increase in salaries and benefits, an increase in professional fees of 86.5 percent, or $2.6 million, a $11.9 million, or 67.5 percent, increase in data processing, and a $2.2 million, or 28.7 percent, increase in other operating expenses period over period. The increase of $11.9 million in data processing expenses was primarily due to the higher volume of open credit cards during the nine month period ended September 30, 2021. Additionally, operating expenses increased $2.2 million, primarily due to increases in outside service providers.

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. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Income tax expense was $3.9 million for the three months ended September 30, 2021 compared to $3.1 million for the three months ended September 30, 2020. Our effective tax rates were approximately 25.8% and 27.0% for the 2021 and 2020 periods, respectively. For the nine months ended September 30, 2021, income tax expense was $10.4 million compared to $6.0 million for the nine months ended September 30, 2020, with effective tax rates of 25.8% and 27.0% for 2021 and 2020, respectively.

Financial Condition

Total assets increased $293.0 million, or 20.9 percent on an annualized basis, during the nine months ended September 30, 2021. The growth of earning assets on the balance sheet consisted of increases in cash equivalents of $177.1 million, portfolio loans of $128.3 million which includes OpenSky® loan growth of $32.8 million, investments available for sale of $89.4 million, and Bank Owned Life Insurance ("BOLI") of $35.3 million. Asset growth was offset by a decrease of $71.1 million in loans held for sale as well as a $63.8 million reduction in SBA-PPP loans. The asset growth was primarily funded by a $269.1 million increase in deposits.

Noninterest bearing deposits increased to $833.2 million at September 30, 2021 from $608.6 million at December 31, 2020 and interest bearing deposits increased to $1.1 billion from $1.0 billion in the period. Stockholders' equity increased $29.8 million, or 18.7%, to $189.1 million at September 30, 2021, primarily due to earnings.

Interest Bearing Deposits at Other Financial Institutions

As of September 30, 2021, interest bearing deposits at other financial institutions increased $173.0 million, or 137.2%, to $299.0 million from $126.1 million at December 31, 2020. The increase was primarily due to increased deposits from customer deposit accounts.

Securities

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

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

Our investment portfolio increased by 89.6 percent, or approximately $89.4 million, from $99.8 million at December 31, 2020, to $189.2 million at September 30, 2021 primarily due to excess liquidity resulting in purchases of $139.3 million, which were partially offset by $9.6 million of principal paydowns and a decrease in unrealized gain on securities of $2.1 million. To supplement interest income earned on our loan portfolio, we invest in mortgage-backed securities, U.S Government agency, U.S. Treasury bonds, and high quality municipal and corporate bonds.

The following tables summarize the contractual maturities and weighted-average yields of investment securities at September 30, 2021 and the amortized cost and carrying value of those securities as of the indicated dates.

INVESTMENT MATURITIES

	One Year or Less		More Than One Year Through Five Years		More Than Five Years Through 10 Years		More Than 10 Years		Total		
September 30, 2021 (in thousands)	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	$ —	— %	$ 58,652	0.56 %	$ 73,918	1.26 %	$ —	— %	$ 132,570	$ 133,030	0.95 %
Municipal	—	— %	—	— %	—	— %	10,828	1.94 %	10,828	10,911	1.94 %
Corporate bonds	—	— %	—	— %	5,000	4.31 %	—	— %	5,000	5,000	4.31 %
Asset-backed securities	—	— %	—	— %	—	— %	10,260	0.99 %	10,260	10,329	0.99 %
Mortgage-backed securities	—	— %	—	— %	10,178	2.34 %	19,058	1.37 %	29,236	29,895	1.71 %
Total	$ —	— %	$ 58,652	0.56 %	$ 89,096	1.56 %	$ 40,146	1.42 %	$ 187,894	$ 189,165	1.22 %

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. To a lesser extent, 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 following table summarizes our loan portfolio by type of loan as of the dates indicated:

COMPOSITION OF PORTFOLIO LOANS

(in thousands)	As of September 30, 2021 Amount	Percent		As of December 31, 2020 Amount	Percent
Real estate:					
Residential	$ 418,205	29	%	$ 437,860	33
Commercial	502,523	35	%	392,550	30
Construction	251,256	17	%	224,904	17
Commercial and Industrial	143,244	10	%	157,127	12
Credit card	134,979	9	%	102,186	8
Other consumer	1,425	—	%	1,649	—
Portfolio loans receivable, gross	1,451,632	100	%	1,316,276	100
Deferred origination fees, net	(6,506)			(774)	
Portfolio loans, net of unearned income	1,445,126			1,315,502	
Allowance for loan losses	(24,753)			(23,434)	
Portfolio loans receivable, net	$ 1,420,373			$ 1,292,068	

The repayment of loans is a source of additional liquidity. The following table details maturities and sensitivity to interest rate changes for our loan portfolio at September 30, 2021:

LOAN MATURITY AND SENSITIVITY TO CHANGES IN INTEREST RATES

	As of September 30, 2021			
(in thousands)	Due in One Year or Less	Due in One to Five Years	Due After Five Years	Total
Real estate:				
Residential	$ 89,474	$ 158,811	$ 169,920	$ 418,2
Commercial	118,290	186,755	197,478	502,5
Construction	233,586	17,670	—	251,2
Commercial and Industrial	47,458	65,666	30,120	143,2
Credit card	134,979	—	—	134,9
Other consumer	721	323	381	1,4
Portfolio loans receivable, gross	$ 624,508	$ 429,225	$ 397,899	$ 1,451,6
Amounts with fixed rates	$ 80,388	$ 313,842	$ 145,070	$ 539,3
Amounts with floating rates	$ 544,120	$ 115,383	$ 252,829	$ 912,3

In addition to the portfolio loans shown above, SBA-PPP loans receivable, which totaled $141.4 million at September 30, 2021, mature in the 1-5 year time-frame and carry a fixed rate of interest.

Nonperforming Assets

Non-performing assets ("NPAs") increased to $17.2 million, or 0.79 percent of total assets, at September 30, 2021 compared to $12.6 million, or 0.67 percent of total assets, at December 31, 2020 primarily due to the addition of one well-collateralized multi-family construction loan totaling $5.0 million.

Nonperforming loans increased to $13.9 million, or 0.96 percent of total portfolio loans, at September 30, 2021 compared to $9.2 million, or 0.70 percent of total portfolio loans, at December 31, 2020. The

$4.7 million, or 50.7 percent, increase during the nine months ended September 30, 2021 was primarily due to the addition of one well-collateralized multi-family construction loan totaling $5.0 million. Included in nonperforming loans at September 30, 2021 are troubled debt restructurings of $545 thousand.

Foreclosed real estate decreased to $3.2 million as of September 30, 2021 compared to $3.3 million as of December 31, 2020 due to the sale of a residential property. Management continues to focus on reducing non-performing assets as evidenced by the disposition of two OREO properties totaling $3.1 million after September 30, 2021.

As a result of the COVID-19 pandemic, we anticipate that our commercial, commercial real estate, residential and consumer borrowers could encounter economic difficulties, which could lead to increases in our levels of nonperforming assets, impaired loans and troubled debt restructurings.

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

NONPERFORMING ASSETS(1)

(in thousands)	September 30, 2021	December 31, 2020
Nonaccrual loans		
Real Estate:		
Residential	**$ 5,039**	$ 3,581
Commercial	**28**	2,358
Construction	**7,803**	1,886
Commercial and Industrial	**695**	1,182
Accruing loans 90 or more days past due	**361**	231
Total nonperforming portfolio loans	**13,926**	9,238
Foreclosed real estate	**3,236**	3,326
Total nonperforming assets	**$ 17,162**	$ 12,564
Restructured loans - nonaccrual	**$ 545**	$ 440
Ratio of nonperforming loans to portfolio loans	**0.96 %**	0.70 %
Ratio of nonperforming assets to total assets	**0.79 %**	0.67 %

(1) Excludes SBA-PPP loans receivable, none of which were nonperforming.

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

PORTFOLIO LOAN CLASSIFICATION

(in thousands)	Pass[1]	Special Mention	Substandard	Doubtful	Total
September 30, 2021					
Real estate:					
Residential	**$ 406,197**	**$ 5,733**	**$ 6,275**	**$ —**	**$ 418,205**
Commercial	**494,355**	**8,140**	**28**	**—**	**502,523**
Construction	**238,426**	**5,027**	**7,803**	**—**	**251,256**
Commercial and Industrial	**129,890**	**11,852**	**1,502**	**—**	**143,244**
Credit card	**134,979**	**—**	**—**	**—**	**134,979**
Other consumer	**1,425**	**—**	**—**	**—**	**1,425**
Portfolio loans receivable, gross	**$ 1,405,272**	**$ 30,752**	**$ 15,608**	**$ —**	**$ 1,451,632**
December 31, 2020					
Real estate:					
Residential	$ 428,260	$ 5,150	$ 4,450	$ —	$ 437,860
Commercial	383,311	6,881	2,358	—	392,550
Construction	220,057	1,112	3,735	—	224,904
Commercial and Industrial	145,365	9,766	1,996	—	157,127
Credit card	102,186	—	—	—	102,186
Other consumer	1,649	—	—	—	1,649
Portfolio loans receivable, gross	$ 1,280,828	$ 22,909	$ 12,539	$ —	$ 1,316,276

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

At September 30, 2021, the recorded investment in impaired loans was $13.6 million, of which $355 thousand required a specific reserve of $222 thousand. This compares to a recorded investment in impaired loans of $10.0 million at December 31, 2020, including $391 thousand which required a specific reserve of $253 thousand. The increase in impaired loans is largely attributable to the addition of one well-collateralized multi-family construction loan totaling $5.0 million which was offset by a reduction in commercial real estate of $2.3 million.

Impaired loans also include certain loans that have been modified as TDRs. The Company had five loans amounting to $545 thousand at September 30, 2021, and five loans totaling $440 thousand at December 31, 2020 that were considered to be TDRs.

Allowance for Loan Losses

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

ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(in thousands)		For the Nine Months Ended September 30, 2021			For the Year Ended December 31 2020	
Allowance for loan losses at beginning of period	$	23,434		$	13,301	
Charge-offs:						
Real estate:						
Residential		—			—	
Commercial		(161)			—	
Construction		—			(296)	
Commercial and Industrial		(39)			(233)	
Credit card		(777)			(637)	
Other consumer		—			—	
Total charge-offs		(977)			(1,166)	
Recoveries:						
Real estate:						
Construction		1			7	
Commercial and Industrial		6			—	
Credit card		30			50	
Total recoveries		37			57	
Net charge-offs		(940)			(1,109)	
Provision for loan losses		2,259			11,242	
Allowance for loan losses at period end	$	24,753		$	23,434	
Portfolio loans outstanding, net of unearned income	$	1,445,126		$	1,315,503	
Average portfolio loans outstanding, net of unearned income	$	1,339,010		$	1,215,049	
Allowance for loan losses to period end portfolio loans		1.71	%		1.78	%
Annualized net charge-offs to average portfolio loans		0.09	%		0.09	%
Net charge-offs to average loans, excluding PPP loans		0.09	%		0.09	%

Our allowance for loan losses at September 30, 2021 and December 31, 2020 was $24.8 million, or 1.71% of portfolio loans, and $23.4 million, or 1.78% of portfolio loans, respectively. The provision for loan losses of $2.3 million for the nine months ended September 30, 2021 was primarily due to a small number of loan charge-offs which was offset by improving overall credit metrics. 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 these loans were not assigned a reserve in the allowance for loan losses. The allowance for loan losses at September 30, 2021 included specific reserves of $222 thousand established for impaired loans. Charge-offs for the nine months ended September 30, 2021 were $977 thousand and were partially offset by recoveries of $37 thousand. At December 31, 2020, the allowance for loan losses included specific reserves of $253 thousand established for impaired loans. Charge-offs for the year ended December 31, 2020 were $1.2 million, and were partially offset by recoveries of $57 thousand. The charge-offs for the first nine months ended September 30, 2021 and for the year ended December 31, 2020 were primarily due to credit card charge-offs.

Although we believe we have established the 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 and certain other information as of the dates indicated. The total allowance is available to absorb losses from any loan category.

ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(in thousands)	September 30, 2021 Amount	September 30, 2021 Percent [1]	December 31, 2020 Amount	December 31, 2020 Percent [1]
Real estate:				
Residential	**$ 6,420**	**26 %**	$ 7,153	31 %
Commercial	**8,092**	**33 %**	6,786	29 %
Construction	**4,872**	**20 %**	4,595	20 %
Commercial and Industrial	**2,128**	**8 %**	2,417	10 %
Credit card	**3,224**	**13 %**	2,462	10 %
Other consumer	**17**	**— %**	21	— %
Total allowance for loan losses	**$ 24,753**	**100 %**	$ 23,434	100 %

(1) Loan category as a percentage of total portfolio loans.

Management continues to monitor the loan portfolio for industry concentrations that may be impacted as the economy works through the impacts of COVID-19. While the Company has negligible exposure to the energy sector, shared national credits or leveraged lending, the Bank does have exposures to affected industries such as, for example, hospitality, food service and retail businesses.

Management has been working with customers on payment deferrals to assist companies in managing through the pandemic. The following table shows the allocation of deferred loans related to COVID-19:

Loan Modifications [1]

(dollars in millions)	September 30, 2021			December 31, 2020		September 30, 2020	
		Deferred Loans					
Sector	Total Loans Outstanding	Balance	# of Loans Deferred	Balance	# of Loans Deferred	Balance	# of Loans Deferred
Accommodation & Food Services	100.6	$ 2.7	2	$ 14.7	16	$ 11.2	14
Real Estate and Rental Leasing	522.8	1.3	2	5.5	10	9.3	16
Other Services Including Private Households	170.9	0.8	2	1.1	3	5.6	11
Educational Services	16.7	—	—	—	—	—	—
Construction	259.1	—	—	—	—	0.3	1
Professional, Scientific, and Technical Services	48.1	—	—	1.4	3	1.1	2
Arts, Entertainment & Recreation	36.7	0.6	1	0.7	2	1.4	2
Retail Trade	21.6	—	—	0.3	1	—	—
Healthcare & Social Assistance	85.7	—	—	0.9	1	0.9	1
Wholesale Trade	25.0	—	—	—	—	—	—
All other [1]	295.1	1.9	2	5.9	7	0.5	2
Total	$ 1,582.3	$ 7.3	9	$ 30.5	43	$ 30.3	49

(1) Loans outstanding include PPP loans; modifications and deferrals made for OpenSky® secured card customers are excluded.

Outstanding deferred loans decreased $23.0 million, or 75.9 percent, from September 30, 2020 to September 30, 2021. Loans that have been removed from deferred status have returned to original payment terms.

Deposits

Deposits are the major source of funding for the Company. We offer a variety of deposit products including interest bearing demand, savings, money market and time accounts, all of which we actively market at competitive pricing. We generate deposits from our customers on a relationship basis and through the efforts of our commercial lending officers and our business banking officers. Our credit card customers are a significant source of noninterest bearing deposits and accounted for $242.4 million, or 29.1%, of our total noninterest bearing deposit balances as of September 30, 2021, an increase of $49.9 million from December 31, 2020. At September 30, 2021, noninterest bearing deposits amounted to $833.2 million, an increase of $224.6 million, or 36.9%, compared to the level at December 31, 2020 due in large part to an increase of $43.4 million in fiduciary accounts and the above noted increase in deposits generated by our OpenSky® secured credit card program. If needed, we supplement our deposits with wholesale funding sources such as brokered deposits.

Interest bearing deposits increased $44.5 million, or 4.3%, from December 31, 2020 to September 30, 2021 due primarily to the increases in interest bearing demand deposits of $112.7 million, or 43.8%, and money market deposits of $46.0 million, or 10.3%, which were offset by a decrease in time deposits of $116.0 million, or 34.7 percent. The Company continues to execute on its strategic initiative to improve the deposit portfolio mix from wholesale deposits to core deposits including noninterest bearing deposits. The decrease in certificates of deposit was primarily attributable to the decrease in listing service deposits of $53.1 million and brokered deposits of $29.5 million when comparing December 31, 2020 to September 30, 2021.

The average rate paid on interest bearing deposits decreased 56 basis points from 1.18% for the year ended December 31, 2020 to 0.62% for the nine months ended September 30, 2021. Rates paid on certificates of deposit decreased 46 basis points over the same period. The decrease in the average rates reflects decreases in market interest rates and the reduction of higher rate balances.

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

COMPOSITION OF AVERAGE DEPOSITS

(in thousands)	**For the Nine Months Ended September 30, 2021**		For the Year Ended December 31, 2020	
	Average Balance	**Average Rate**	Average Balance	Average Rate
Interest bearing demand accounts	**$ 280,305**	**0.08 %**	$ 195,794	0.34
Money market accounts	**475,875**	**0.34 %**	480,218	1.00
Savings accounts	**6,435**	**0.05 %**	4,722	0.11
Certificates of deposit	**295,705**	**1.58 %**	297,997	2.04
Total interest bearing deposits	**1,058,320**	**0.62 %**	978,731	1.18
Noninterest bearing demand accounts	**735,509**		473,301	
Total deposits	**$ 1,793,829**	**0.36 %**	$ 1,452,032	0.79

The following table presents the maturities of our certificates of deposit as of September 30, 2021.

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
$100,000 or more	$ 48,658	$ 23,483	$ 29,661	$ 83,237	$ 185,03
Less than $100,000	10,407	9,210	8,984	4,888	33,48
Total	$ 59,065	$ 32,693	$ 38,645	$ 88,125	$ 218,52

Borrowings

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

FHLB Advances. The FHLB allows us to borrow up to 25% of our assets on a blanket floating lien status collateralized by certain securities and loans. As of September 30, 2021, approximately $199.5 million in real estate loans pledged as collateral to the FHLB support a $530.1 million line of credit. We utilize these borrowings to meet liquidity needs and to fund certain fixed rate loans in our portfolio. As of September 30, 2021, we had $22.0 million in outstanding advances and our available borrowing capacity at the FHLB was $177.5 million.

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

FHLB ADVANCES

(in thousands)	For the Nine Months Ended September 30, 2021	For the Year Ended December 31, 20
Amount outstanding at period-end	**$ 22,000**	$ 22,000
Weighted average interest rate at period-end	**0.93 %**	0.93
Maximum month-end balance during the period	**$ 22,000**	$ 31,111
Average balance outstanding during the period	**$ 22,000**	$ 25,917
Weighted average interest rate during the period	**0.94 %**	2.15

The Company has also issued junior subordinated debentures and other subordinated notes. At September 30, 2021, these other borrowings amounted to $12.1 million.

At September 30, 2021, 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 noted amounting to $13.5 million, reducing interest expense. 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 $16.3 million as of September 30, 2021. Certain commercial loans are pledged under this arrangement. We maintain this borrowing arrangement to meet liquidity needs pursuant to our contingency funding plan. No advances were outstanding under this facility as of September 30, 2021.

The Company also has available lines of credit of $76.0 million with other correspondent banks at September 30, 2021, 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 September 30, 2021.

Liquidity

Liquidity is defined as the Bank's capacity to meet its cash and collateral obligations at a reasonable cost. Maintaining an adequate level of liquidity depends on the Bank's ability to meet both expected and unexpected cash flows and collateral needs efficiently without adversely affecting either daily operations or the financial condition of the Bank. Liquidity risk is the risk that we will be unable to meet our obligations as they become due because of an inability to liquidate assets or obtain adequate funding. The Bank's obligations, and the funding sources used to meet them, depend significantly on our business mix, balance sheet structure and the cash flow profiles of our on- and off-balance sheet obligations. In managing our cash flows, management regularly confronts situations that can give rise to increased liquidity risk. These include funding mismatches, market constraints on the ability to convert assets into cash or in accessing sources of funds (i.e., market liquidity) and contingent liquidity events. Changes in economic conditions or exposure to credit, market, 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 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 stressful situations; 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 September 30, 2021, we had $177.5 million of available borrowing capacity from the FHLB, $16.3 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 $324.0 million at September 30, 2021 and $146.9 million at December 31, 2020. We believe our liquidity resources are at sufficient levels to fund loans and meet other cash needs as necessary.

Capital Resources

Stockholders' equity increased $29.8 million at September 30, 2021 compared to December 31, 2020. Net income for the nine months ended September 30, 2021 increased retained earnings by $29.8 million. Stock options exercised and stock-based compensation increased common stock and additional paid-in capital in the aggregate by $766 thousand. These increases were partially offset by the change in net unrealized gains on available for sale securities of $804 thousand.

The Company uses several indicators of capital strength. The most commonly used measure is the Common Equity Tier 1 ("CET1") capital ratio (common equity tier 1 capital divided by risk weighted assets), which was 14.34% at September 30, 2021 and 12.94% at December 31, 2020. The Company has above-average levels of capital and has taken steps to navigate COVID-19 related disruptions, including taking higher levels than normal of loan loss provisions and maintaining higher than normal levels of liquidity on the balance sheet.

The following table shows the return on average assets (computed as net income divided by average total assets), return on average equity (computed as net income divided by average equity) and common equity tier 1 capital ratios for the nine months ended September 30, 2021 and for the year ended December 31, 2020.

	For the Three Months Ended September 30, 2021	For the Nine Months Ended September 30, 2021	For the Year Ended December 31, 2020
Return on Average Assets[(1)]	**2.13 %**	**1.97 %**	1.56 %
Return on Average Equity[(1)]	**23.87 %**	**22.88 %**	18.00 %
Common Equity Tier 1 Capital	**14.34 %**	**14.34 %**	12.94 %

(1) These ratios are annualized for the nine months ended September 30, 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 statements. 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 about components, risk weightings and other factors.

As of September 30, 2021, 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 (as if applicable to the Company) and the Bank as of the dates indicated.

(in thousands)	Actual			Minimum Capital Adequacy			To Be Well Capitalized		
September 30, 2021	**Amount**	**Ratio**		**Amount**	**Ratio**		**Amount**	**Ratio**	
The Company									
Tier 1 leverage ratio (to average assets)	**$ 190,230**	**9.13**	**%**	**$ 83,337**	**4.00**	**%**	**N/A**	**N/A**	
Tier 1 capital (to risk-weighted assets)	**190,230**	**14.49**	**%**	**111,573**	**8.50**	**%**	**N/A**	**N/A**	
Common equity tier 1 capital ratio (to risk-weighted assets)	**188,168**	**14.34**	**%**	**91,883**	**7.00**	**%**	**N/A**	**N/A**	
Total capital ratio (to risk-weighted assets)	**206,762**	**15.75**	**%**	**137,825**	**10.50**	**%**	**N/A**	**N/A**	
The Bank									
Tier 1 leverage ratio (to average assets)	**$ 160,223**	**7.83**	**%**	**$ 81,833**	**4.00**	**%**	**$ 102,291**	**5.00**	**%**
Tier 1 capital (to risk-weighted assets)	**160,223**	**12.60**	**%**	**108,063**	**8.50**	**%**	**101,706**	**8.00**	**%**
Common equity tier 1 capital ratio (to risk-weighted assets)	**160,223**	**12.60**	**%**	**88,993**	**7.00**	**%**	**82,636**	**6.50**	**%**
Total capital ratio (to risk-weighted assets)	**176,239**	**13.86**	**%**	**133,489**	**10.50**	**%**	**127,133**	**10.00**	**%**
December 31, 2020									
The Company									
Tier 1 leverage ratio (to average assets)	$ 159,656	8.78	%	72,770	4.00	%	N/A	N/A	
Tier 1 capital (to risk-weighted assets)	159,656	13.10	%	103,559	8.50	%	N/A	N/A	
Common equity tier 1 capital ratio (to risk-weighted assets)	157,594	12.94	%	85,284	7.00	%	N/A	N/A	
Total capital ratio (to risk-weighted assets)	185,008	15.19	%	127,926	10.50	%	N/A	N/A	
The Bank									
Tier 1 leverage ratio (to average assets)	$ 135,527	7.45	%	72,770	4.00	%	$ 90,962	5.00	%
Tier 1 capital (to risk-weighted assets)	135,527	11.34	%	101,619	8.50	%	95,642	8.00	%
Common equity tier 1 capital ratio (to risk-weighted assets)	135,527	11.34	%	83,686	7.00	%	77,709	6.50	%
Total capital ratio (to risk-weighted assets)	150,593	12.60	%	125,530	10.50	%	119,552	10.00	%

Contractual Obligations

We have contractual obligations to make future payments on debt agreements. While our liquidity monitoring and management consider both present and future demands for and sources of liquidity, the following table of contractual commitments focuses only on future obligations and summarizes our contractual obligations as of September 30, 2021.

CONTRACTUAL OBLIGATIONS

	As of September 30, 2021				
(in thousands)	**Due in One Year or Less**	**Due After One Through Three Years**	**Due After Three Through Five Years**	**Due After 5 Years**	**Total**
FHLB advances	$ —	$ —	$ 22,000	$ —	$ 22,000
Certificates of deposit $100,000 or more	101,802	82,322	915	—	185,039
Certificates of deposit less than $100,000	28,601	4,333	535	20	33,489
Lease payments	1,164	1,724	234	20	3,142
Subordinated debt	—	—	—	12,062	12,062
Total	$ 131,567	$ 88,379	$ 23,684	$ 12,102	$ 255,732

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 September 30, 2021		As of December 31, 2020
Unfunded lines of credit	**$**	**344,859**	$	326,47
Commitments to originate residential loans held for sale		**1,205**		11,44
Letters of credit		**5,132**		5,10
Commitment to fund other investments		**8,000**	$	-
Total credit extension commitments	**$**	**359,196**	$	343,02

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.

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 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

September 30, 2021 (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]	$ 774,333	$ 59,825	$ 208,824	$ 1,042,982	$ 575,327	$ 1,618,309
Securities	15,626	—	—	15,626	173,539	189,165
Interest bearing deposits at other financial institutions	299,033	—	—	299,033	—	299,033
Federal funds sold	1,315	—	—	1,315	—	1,315
Total earning assets	$ 1,090,307	$ 59,825	$ 208,824	$ 1,358,956	$ 748,866	$ 2,107,822
Liabilities						
Interest bearing liabilities						
Interest bearing deposits	$ 869,523	$ —	$ —	$ 869,523	$ —	$ 869,523
Time deposits	28,240	30,825	71,338	130,403	88,125	218,528
Total interest bearing deposits	897,763	30,825	71,338	999,926	88,125	1,088,051
FHLB Advances	—	—	—	—	22,000	22,000
Other borrowed funds	—	—	—	—	12,062	12,062
Total interest bearing liabilities	$ 897,763	$ 30,825	$ 71,338	$ 999,926	$ 122,187	$ 1,122,113
Period gap	$ 192,544	$ 29,000	$ 137,486	$ 359,030	$ 626,679	$ 985,709
Cumulative gap	$ 192,544	$ 221,544	$ 359,030	$ 359,030	$ 985,709	
Ratio of cumulative gap to total earning assets	9.13 %	10.51 %	17.03 %	17.03 %	46.76 %	

(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 September 30, 2021:

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
September 30, 2021	(2.6) %	0.0 %	3.9 %	9.4 %	15.3 %

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

The following table illustrates the results of our EVE analysis as of September 30, 2021.

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
September 30, 2021	(4.9) %	0.0 %	7.7 %	13.9 %	19.8 %

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, 2020 and those referenced in other reports on file with the SEC.

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

On February 2, 2021, the Company announced a new stock repurchase program. Under the new program, the Company is authorized to repurchase up to $7.5 million of its outstanding common stock. During the nine months ended September 30, 2021, the Company did not repurchase any shares under the stock repurchase program.

The new program replaces the previous $5.0 million stock repurchase program approved by the Board in April 2019, which concluded in the fourth quarter of 2020. In connection with the prior repurchase program, the Company purchased an aggregate of 304,114 shares of its common stock at an average price of $10.81 per share during the twelve months ended December 31, 2020, as reflected in the following table.

Periods	Total Number of Shares Purchased	Average price paid per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
For the year ended December 31, 2020	304,114	$ 10.81	304,114	$ 1,340,875
For the three months ended March 31, 2021	—	$ —	—	$ 7,500,000
For the three months ended June 30, 2021	—	$ —	—	$ 7,500,000
For the three months ended September 30, 2021	—	$ —	—	$ 7,500,000

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 September 30, 2021, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements o 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: November 9, 2021 /s/ Ed Barry
Ed Barry
Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2021 /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: November 9, 2021 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: November 9, 2021 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 September 30, 2021, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the undersigned's best knowledge and belief:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 9, 2021 By: /s/ Ed Barry
Ed Barry
Chief Executive Officer

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