TRI COUNTY FINANCIAL CORP /MD/
Form 10-Q
August 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

¨ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2013

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 0-18279

Tri-County Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	52-1652138
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3035 Leonardtown Road, Waldorf, Maryland	20601
(Address of principal executive offices)	(Zip Code)

(301) 645-5601

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, 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 Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

Large Accelerated Filer ¨	Accelerated Filer ¨
Non-accelerated Filer ¨	Smaller Reporting Company x

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of July 31, 2013, the registrant had 3,045,543 shares of common stock outstanding.

TRI-COUNTY FINANCIAL CORPORATION

FORM 10-Q

INDEX

	Page
PART I - FINANCIAL INFORMATION	
Item 1 – Financial Statements (Unaudited)	
Consolidated Balance Sheets – June 30, 2013 and December 31, 2012	3
Consolidated Statements of Income and Comprehensive Income - Three and Six Months Ended June 30, 2013 and 2012	4
Consolidated Statements of Cash Flows - Six Months Ended June 30, 2013 and 2012	5
Notes to Consolidated Financial Statements	7
Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations	31
Item 3 – Quantitative and Qualitative Disclosures about Market Risk	51
Item 4 – Controls and Procedures	51
PART II - OTHER INFORMATION	
Item 1 – Legal Proceedings	51
Item 1A – Risk Factors	51
Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3 – Defaults Upon Senior Securities	52
Item 4 – Mine Safety Disclosures	52
Item 5 – Other Information	52
Item 6 – Exhibits	52

SIGNATURES 53

PART I FINANCIAL STATEMENTS

ITEM I. FINANCIAL STATEMENTS

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS JUNE 30, 2013 AND DECEMBER 31, 2012

	June 30, 2013 (Unaudited)	December 31, 2012
Assets		
Cash and due from banks	$ 10,768,998	$ 10,696,653
Federal funds sold	3,470,000	190,000
Interest-bearing deposits with banks	1,336,720	409,002
Securities available for sale (AFS), at fair value	54,103,851	47,205,663
Securities held to maturity (HTM), at amortized cost	99,896,483	112,619,434
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock - at cost	6,666,550	5,476,050
Loans held for sale	320,000	-
Loans receivable - net of allowance for loan losses of $8,033,553 and $8,246,957	745,251,604	747,640,752
Premises and equipment, net	19,289,816	19,782,236
Other real estate owned (OREO)	6,932,177	6,891,353
Accrued interest receivable	2,902,627	2,904,325
Investment in bank owned life insurance	19,039,007	18,730,580
Other assets	10,124,507	9,093,164
Total Assets	$ 980,102,340	$ 981,639,212
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	$ 89,565,889	$ 102,319,581
Interest-bearing deposits	695,115,348	717,910,707
Total deposits	784,681,237	820,230,288
Short-term borrowings	24,000,000	1,000,000
Long-term debt	70,501,763	60,527,208
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000,000	12,000,000
Accrued expenses and other liabilities	7,846,870	8,834,455
Total Liabilities	899,029,870	902,591,951
Stockholders' Equity		
Preferred Stock, Senior Non-Cumulative Perpetual, Series C - par value $1,000; authorized 20,000; issued 20,000	20,000,000	20,000,000
	30,455	30,524

Common stock - par value $.01; authorized - 15,000,000 shares; issued 3,045,543 and 3,052,416 shares, respectively		
Additional paid in capital	18,222,907	17,873,560
Retained earnings	44,283,597	41,986,633
Accumulated other comprehensive gain (loss)	(679,594)	139,184
Unearned ESOP shares	(784,895)	(982,640)
Total Stockholders' Equity	81,072,470	79,047,261
Total Liabilities and Stockholders' Equity	$980,102,340	$ 981,639,212

See notes to Consolidated Financial Statements

3

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

THREE AND SIX MONTHS ENDED JUNE 30, 2013 AND 2012

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest and Dividend Income				
Loans, including fees	$ 9,116,080	$ 9,286,377	$ 18,363,746	$ 18,511,260
Taxable interest and dividends on investment securities	631,347	815,101	1,221,040	1,696,918
Interest on deposits with banks	2,686	1,064	5,284	2,748
Total Interest and Dividend Income	9,750,113	10,102,542	19,590,070	20,210,926
Interest Expense				
Deposits	1,434,338	2,197,377	2,967,301	4,609,719
Short-term borrowings	15,421	15,910	37,827	31,751
Long-term debt	568,496	552,054	1,036,414	1,147,556
Total Interest Expense	2,018,255	2,765,341	4,041,542	5,789,026
Net Interest Income	7,731,858	7,337,201	15,548,528	14,421,900
Provision for loan losses	200,427	436,431	354,600	777,505
Net Interest Income After Provision For Loan Losses	7,531,431	6,900,770	15,193,928	13,644,395
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	130,721	202,127	319,149	383,441
Gain on sale of asset	11,000	-	11,000	-
Net losses on sale of OREO	-	-	-	(96,917)
Income from bank owned life insurance	156,994	159,911	308,427	319,117
Service charges	632,547	465,391	1,103,180	1,001,903
Gain on sale of loans held for sale	137,466	69,366	516,050	135,341
Total Noninterest Income	1,068,728	896,795	2,257,806	1,742,885
Noninterest Expense				
Salary and employee benefits	3,589,610	3,170,213	7,146,606	6,490,079
Occupancy expense	569,479	464,319	1,052,250	901,791
Advertising	168,843	179,083	272,731	259,091
Data processing expense	366,480	421,153	730,314	789,593
Professional fees	264,354	343,295	461,691	568,504
Depreciation of furniture, fixtures, and equipment	197,092	162,364	389,522	297,289
Telephone communications	53,781	48,312	102,729	92,086
Office supplies	46,015	71,928	109,468	133,990
FDIC Insurance	272,837	447,587	574,269	891,202
Valuation allowance on OREO	19,476	326,176	329,976	626,176
Other	558,453	729,256	1,079,688	1,211,304
Total Noninterest Expense	6,106,420	6,363,686	12,249,244	12,261,105

Income before income taxes	2,493,739	1,433,879	5,202,490	3,126,175
Income tax expense	908,290	492,727	1,898,650	1,079,770
Net Income	$ 1,585,449	$ 941,152	$ 3,303,840	$ 2,046,405
Preferred stock dividends	50,000	50,000	100,000	100,000
Net Income Available to Common Shareholders	$ 1,535,449	$ 891,152	$ 3,203,840	$ 1,946,405
Net Income	$ 1,585,449	$ 941,152	$ 3,303,840	$ 2,046,405
Net unrealized holding gains (losses) arising during period, net of tax	(743,170)	49,657	(818,778)	7,751
Comprehensive Income	$ 842,279	$ 990,809	$ 2,485,062	$ 2,054,156
Earnings Per Common Share				
Basic	$ 0.51	$ 0.29	$ 1.06	$ 0.64
Diluted	$ 0.51	$ 0.29	$ 1.05	$ 0.64
Cash dividends paid per common share	$ 0.10	$ 0.40	$ 0.20	$ 0.40

See notes to Consolidated Financial Statements

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

SIX MONTHS ENDED JUNE 30, 2013 AND 2012

	Six Months Ended June 30,	
	2013	2012
Cash Flows from Operating Activities		
Net income	$3,303,840	$2,046,405
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	354,600	777,505
Depreciation and amortization	648,119	521,935
Loans originated for resale	(17,882,950)	(3,292,600)
Proceeds from sale of loans originated for sale	17,963,029	3,402,426
Gain on sale of loans held for sale	(516,050)	(135,341)
Net losses on the sale of OREO	-	96,917
Gain on sale of asset	(11,000)	-
Net amortization of premium/discount on investment securities	327,305	204,597
Increase in OREO valuation allowance	329,976	626,176
Increase in cash surrender of bank owned life insurance	(308,427)	(319,116)
Deferred income tax benefit	(96,796)	(345,542)
Decrease (Increase) in accrued interest receivable	1,698	(51,308)
Stock based compensation	249,129	263,612
Increase (Decrease) in deferred loan fees	265,828	(11,099)
Decrease in accounts payable, accrued expenses and other liabilities	(987,585)	(9,524)
(Increase) Decrease in other assets	(505,754)	1,388,154
Net Cash Provided by Operating Activities	3,134,962	5,163,197
Cash Flows from Investing Activities		
Purchase of AFS investment securities	(13,464,967)	(10,077,772)
Proceeds from redemption or principal payments of AFS investment securities	5,234,496	11,252,526
Purchase of HTM investment securities	(10,932,813)	(849,785)
Proceeds from maturities or principal payments of HTM investment securities	23,420,169	27,246,045
Net increase of FHLB and FRB stock	(1,190,500)	(193,450)
Loans originated or acquired	(112,182,444)	(125,552,773)
Principal collected on loans	113,696,335	98,929,725
Purchase of premises and equipment	(155,699)	(3,403,294)
Proceeds from sale of OREO	-	299,302
Proceeds from disposal of asset	11,000	-
Net Cash Provided by (Used in) Investing Activities	4,435,577	(2,349,476)

5

TRI-COUNTY FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

SIX MONTHS ENDED JUNE 30, 2013 AND 2012 (continued)

	Six Months Ended June 30,	
	2013	2012
Cash Flows from Financing Activities		
Net decrease in deposits	$(35,549,051)	$(11,478,877)
Proceeds from long-term borrowings	10,000,000	-
Payments of long-term borrowings	(25,445)	(24,447)
Net increase in short term borrowings	23,000,000	3,000,000
Exercise of stock options	75,235	67,391
Dividends Paid	(709,238)	(1,321,571)
Net change in unearned ESOP shares	215,824	(1,942)
Redemption of common stock	(297,801)	(153,800)
Net Cash Used in Financing Activities	(3,290,476)	(9,913,246)
Increase (Decrease) in Cash and Cash Equivalents	$4,280,063	$(7,099,525)
Cash and Cash Equivalents - January 1	11,295,655	19,118,189
Cash and Cash Equivalents - June 30	$15,575,718	$12,018,664
Supplemental Disclosures of Cash Flow Information		
Cash paid during the six months for:		
Interest	$4,017,398	$5,797,788
Income taxes	$2,600,000	$1,020,000
Supplemental Schedule of Non-Cash Operating Activities		
Issuance of common stock for payment of compensation	$249,129	$263,612
Transfer from loans to OREO	$370,800	$1,555,770

See notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SIX MONTHS ENDED JUNE 30, 2013 AND 2012

1. BASIS OF PRESENTATION

General - The consolidated financial statements of Tri-County Financial Corporation (the "Company") and its wholly owned subsidiary, Community Bank of Tri-County (the "Bank"), and the Bank's wholly owned subsidiary, Community Mortgage Corporation of Tri-County, included herein are unaudited. However, they reflect all adjustments consisting only of normal recurring accruals that, in the opinion of management, are necessary to present fairly the Company's financial condition, results of operations, and cash flows for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The Company believes that the disclosures are adequate to make the information presented not misleading. The balances as of December 31, 2012 have been derived from audited financial statements. There have been no significant changes to the Company's accounting policies as disclosed in the 2012 Annual Report. The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results of operations to be expected for the remainder of the year or any other period. Certain previously reported amounts have been restated to conform to the 2013 presentation.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's 2012 Annual Report.

2. NATURE OF BUSINESS

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and King George, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

3. FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, "Fair Value Measurements" and FASB ASC Topic 825, "The Fair Value Option for Financial Assets and Financial Liabilities", which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction

between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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

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

Level 1 inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's monthly or quarterly valuation process.

There were no transfers between levels of the fair value hierarchy and the Company had no Level 3 fair value assets or liabilities for the three and six months ended June 30, 2013 and the year ended December 31, 2012, respectively.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities ("GSEs"), municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At June 30, 2013 and December 31, 2012, substantially all of the impaired loans were

evaluated based upon the fair value of the collateral. In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

Other Real Estate Owned ("OREO")

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value and fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of June 30, 2013 and December 31, 2012 measured at fair value on a recurring basis.

	June 30, 2013			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
Collateralized Mortgage Obligations ("CMOs")	$49,689,627	$ -	$49,689,627	$ -
Mortgage Backed Securities ("MBS")	217,102	-	217,102	-
Corporate equity securities	38,860	-	38,860	-
Bond mutual funds	4,158,262	-	4,158,262	-
Total available for sale securities	$54,103,851	$ -	$54,103,851	$ -

	December 31, 2012			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs				
CMOs	$42,655,799	$ -	$42,655,799	$ -
MBS	231,386	-	231,386	-
Corporate equity securities	37,332	-	37,332	-
Bond mutual funds	4,281,146	-	4,281,146	-
Total available for sale securities	$47,205,663	$ -	$47,205,663	$ -

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of June 30, 2013 and December 31, 2012 are included in the tables below.

	June 30, 2013			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$3,770,616	$ -	$3,770,616	$ -
Residential first mortgage	500,685	-	500,685	-
Construction and land development	1,038,300	-	1,038,300	-
Commercial loans	117,000	-	117,000	-
Total loans with impairment	$5,426,601	$ -	$5,426,601	$ -
Other real estate owned	$6,932,177	$ -	$6,932,177	$ -

	December 31, 2012			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$2,028,534	$ -	$2,028,534	$ -
Residential first mortgage	602,290	-	602,290	-
Commercial loans	94,355	-	94,355	-
Total loans with impairment	$2,725,179	$ -	$2,725,179	$ -
Other real estate owned	$6,891,353	$ -	$6,891,353	$ -

Loans with impairment have unpaid principal balances of $6,660,269 and $4,272,836 at June 30, 2013 and December 31, 2012, respectively, and include impaired loans with a specific allowance.

4. INCOME TAXES

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense.

5. EARNINGS PER COMMON SHARE (EPS)

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. As of June 30, 2013 and 2012, there were 101,549 and 187,367 shares, respectively, excluded from the diluted net income per share computation because the exercise price of the stock options were greater than the market price, and thus were anti-dilutive. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net Income	$1,585,449	$941,152	$3,303,840	$2,046,405
Less: dividends paid and accrued on preferred stock	(50,000)	(50,000)	(100,000)	(100,000)
Net income available to common shareholders	$1,535,449	$891,152	$3,203,840	$1,946,405
Average number of common shares outstanding	3,000,389	3,045,979	3,026,651	3,041,679
Effect of dilutive options	23,379	24,786	22,597	14,841
Average number of shares used to calculate diluted EPS	3,023,768	3,070,765	3,049,248	3,056,520

6. STOCK-BASED COMPENSATION

The Company has stock option and incentive arrangements to attract and retain key personnel. In May 2005, the 2005 Equity Compensation Plan (the "Plan") was approved by the shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service based awards is recognized over the vesting period. Performance based awards are recognized based on a vesting, if applicable, and the probability of achieving the goals.

Stock-based compensation expense totaled $146,965 and $81,189 for the six months ended June 30, 2013 and 2012, respectively, which consisted of grants of restricted stock and restricted stock units. Stock-based compensation for the six months ended June 30, 2013 and 2012 included director compensation of $3,320 and $12,640, respectively, for stock granted in lieu of cash compensation. All outstanding options are fully vested and the Company has not granted

any stock options since 2007.

The fair value of the Company’s outstanding employee stock options is estimated on the date of grant using the Black-Scholes option pricing model. The Company estimates expected market price volatility and expected term of the options based on historical data and other factors.

The exercise price for options granted is set at the discretion of the committee administering the Plan, but is not less than the market value of the shares as of the date of grant. An option’s maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize outstanding and exercisable options at June 30, 2013 and December 31, 2012.

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2013	236,059	$ 18.49	$ 164,304	
Granted at fair value	-	-		
Exercised	(12,863)	13.08	64,517	
Expired	-			
Forfeited	(2)	13.05		
Outstanding at June 30, 2013	223,194	$ 18.80	$ 415,264	1.0
Exercisable at June 30, 2013	223,194	$ 18.80	$ 415,264	1.0

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2012	264,156	$ 17.90	$ 175,911	
Granted at fair value	-	-		
Exercised	(24,780)	12.25	88,607	
Expired	-			
Forfeited	(3,317)	18.25		
Outstanding at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0
Exercisable at December 31, 2012	236,059	$ 18.49	$ 164,304	1.0

Options outstanding are all currently exercisable and are summarized as follows:

Shares Outstanding June 30, 2013	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
39,668	1 years	$ 12.97
81,977	2 years	15.89
80,138	3 years	22.29
21,411	4 years	27.70
223,194		$ 18.80

The aggregate intrinsic value of outstanding stock options and exercisable stock options was $415,264 and $164,304 at June 30, 2013 and December 31, 2012, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was $18.35 and $15.98 per share at June 30, 2013 and December 31, 2012, respectively, and the exercise price multiplied by the number of options outstanding.

The Company has outstanding restricted stock and stock units granted in accordance with the Plan. The following tables summarize the unvested restricted stock awards and units outstanding at June 30, 2013 and December 31, 2012, respectively.

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at December 31, 2012	23,569	$ 15.64	5,211	$ 15.98
Granted	13,656	18.00	2,105	16.87
Vested	(16,678)	16.35	(3,106)	15.98
Nonvested at June 30, 2013	20,547	$ 16.63	4,210	$ 18.35

	Restricted Stock		Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Units	Fair Value
Nonvested at January 1, 2012	8,113	$ 16.47	6,845	$ 15.00
Granted	23,281	15.21	2,105	15.98
Vested	(7,825)	15.20	(3,739)	14.80
Nonvested at December 31, 2012	23,569	$ 15.64	5,211	$ 15.98

7. GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES (TRUPs)

On June 15, 2005, Tri-County Capital Trust II ("Capital Trust II"), a Delaware business trust formed, funded and wholly owned by the Company, issued $5,000,000 of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5,155,000 of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I ("Capital Trust I"), a Delaware business trust formed, funded and wholly owned by the Company, issued $7,000,000 of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company's $217,000 capital contribution for Capital Trust I's common securities, to purchase $7,217,000 of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

8. PREFERRED STOCK

Small Business Lending Fund Preferred Stock

On September 22, 2011, the Company entered into a Securities Purchase Agreement (the “Purchase Agreement”) with the Secretary of the Treasury (the “Secretary”), pursuant to which the Company issued 20,000 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series C (the “Series C Preferred Stock”), having a liquidation amount per share equal to $1,000, for a total purchase price of $20,000,000. The Purchase Agreement was entered into, and the Series C Preferred Stock was issued, as authorized by the Small Business Lending Fund program.

The Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL” (as defined in the Purchase Agreement) by the Bank. Based upon the increase in the Bank’s level of QSBL over the baseline level calculated under the terms of the Purchase Agreement, the dividend rate for the initial dividend period was set at one percent (1%). For the second through ninth calendar quarters, the dividend rate may be adjusted to between one percent (1%) and five percent (5%) per annum, to reflect the amount of change in the Bank’s level of QSBL. If the level of the Bank’s qualified small business loans declines so that the percentage increase in QSBL as compared to the baseline level is less than 10%, then the dividend rate payable on the Series C Preferred Stock would increase. For the tenth calendar quarter through four and one half years after issuance, the dividend rate will be fixed at between one percent (1%) and seven percent (7%) based upon the increase in QSBL as compared to the baseline. After four and one half years from issuance, the dividend rate will increase to nine percent (9%). In addition, beginning on January 1, 2014, and on all Series C Preferred Stock dividend payment dates thereafter ending on April 1, 2016, if the Company has not increased its QSBL from the baseline as of the quarter ending September 30, 2013, the Company will be required to pay to the Secretary, on each share of Series C Preferred Stock, but only out of assets legally available, a fee equal to 0.5% of the liquidation amount per share of Series C Preferred Stock.

The Series C Preferred Stock is non-voting, except in limited circumstances. If the Company misses five dividend payments, whether or not consecutive, the holder of the Series C Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Company’s Board of Directors. The Series C Preferred Stock may be redeemed at any time at the Company’s option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of our federal banking regulator. The Company is permitted to repay its SBLF funding in increments of 25% or $5.0 million, subject to the approval of its federal banking regulator.

The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. The Company has agreed to register the Series C Preferred Stock under certain circumstances set forth in Annex E to the Purchase Agreement. The Series C Preferred Stock is not subject to any contractual restrictions on transfer.

9. OTHER REAL ESTATE OWNED

OREO assets are presented net of the allowance for losses. The Company considers OREO as classified assets for regulatory and financial reporting. An analysis of the activity follows.

	Six Months Ended June 30,		Year Ended December 31,
	2013	2012	2012
Balance at beginning of year	$ 6,891,353	$ 5,028,513	$ 5,028,513
Additions of underlying property	370,800	1,555,770	4,020,494
Disposals of underlying property	-	(395,949)	(1,483,449)
Valuation allowance	(329,976)	(626,176)	(674,205)
Balance at end of period	$ 6,932,177	$ 5,562,158	$ 6,891,353

During the six months ended June 30, 2012, the Bank disposed of two OREO properties resulting in proceeds of $299,032 and recognized net losses of $96,917. There were no disposals during the six months ended June 30, 2013.

Expenses applicable to OREO assets include the following.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Valuation allowance	$19,476	$326,176	$329,976	$626,176
Operating expenses	23,226	32,546	64,088	30,845
	$42,702	$358,722	$394,064	$657,021

Operating expenses for the six months ended June 30, 2012 included $7,600 in deposits refunded on sold foreclosed real estate.

10. SECURITIES

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$188,407	$ 28,695	$ -	$217,102
Residential CMOs	50,618,010	119,451	1,047,834	49,689,627
Corporate equity securities	37,310	1,725	175	38,860
Bond mutual funds	4,056,354	101,908	-	4,158,262
Total securities available for sale	$54,900,081	$ 251,779	$ 1,048,009	$54,103,851
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$25,259,406	$ 663,874	$ 204,768	$25,718,512
Residential CMOs	70,262,142	479,231	518,964	70,222,409
Asset-backed securities issued by Others:				
Residential CMOs	3,524,982	160,767	459,895	3,225,854
Total debt securities held to maturity	99,046,530	1,303,872	1,183,627	99,166,775
U.S. government obligations	849,953	-	-	849,953
Total securities held to maturity	$99,896,483	$ 1,303,872	$ 1,183,627	$100,016,728

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs				
Residential MBS	$198,400	$ 32,986	$ -	$231,386
Residential CMOs	42,507,542	266,775	118,518	42,655,799
Corporate equity securities	37,310	306	284	37,332
Bond mutual funds	4,012,609	268,537	-	4,281,146
Total securities available for sale	$46,755,861	$ 568,604	$ 118,802	$47,205,663
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs:				
Residential MBS	$31,239,176	$ 1,237,277	$ -	$32,476,453
Residential CMOs	76,191,199	715,620	97,998	76,808,821
Asset-backed securities issued by Others:				-
Residential CMOs	4,439,118	197,028	484,343	4,151,803
Total debt securities held to maturity	111,869,493	2,149,925	582,341	113,437,077
U.S. government obligations	749,941	-	-	749,941

Total securities held to maturity	$112,619,434	$ 2,149,925	$ 582,341	$114,187,018

At June 30, 2013 certain asset-backed securities with a carrying value of $10.6 million were pledged to secure certain deposits. At June 30, 2013, asset-backed securities with a carrying value of $3.3 million were pledged as collateral for advances from the Federal Home Loan Bank of Atlanta.

At June 30, 2013, 98% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs had an average life of 4.12 years and an average duration of 3.78 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 3.93 years and an average duration of 3.67 years and are guaranteed by their issuer as to credit risk.

At December 31, 2012, 97% of the asset-backed securities portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs had an average life of 3.43 years and average duration of 3.26 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs had an average life of 3.43 years and average duration of 3.24 years and are guaranteed by their issuer as to credit risk.

We believe that AFS securities with unrealized losses will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity. We believe that the losses are the result of general perceptions of safety and creditworthiness of the entire sector and a general disruption of orderly markets in the asset class.

Management has the ability and intent to hold the HTM securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. Because our intention is not to sell the investments and it is not more likely than not that we will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, management considers the unrealized losses in the held-to-maturity portfolio to be temporary.

No charges related to other-than-temporary impairment were made during the three and six months ended June 30, 2013 and for the year ended December 31, 2012. During the year ended December 31, 2009, the Company recorded a charge of $148,000 related to other-than-temporary impairment on a single HTM CMO issue. At June 30, 2013, the CMO issue had a par value of $925,000, a market fair value of $704,000 and a carrying value of $543,000.

During the fourth quarter of the year ended December 31, 2012, the Company recognized net losses on the sale of securities of $3,736. The Company sold one AFS security with a carrying value of $1,469,911 and three HTM securities with aggregate carrying values of $3,796,011, recognizing a gain of $153,417 and losses of $157,153, respectively. The sale of HTM securities was permitted under ASC 320 "Investments - Debt and Equity Securities." ASC 320-10-25-6 permits the sale of HTM securities for certain changes in circumstances. The Company sold the HTM positions due to a significant deterioration in the issues' creditworthiness and the increase in regulatory risk weights mandated for risk-based capital purposes. There were no sales of AFS and HTM securities during the three and six months ended June 30, 2013 and 2012, respectively.

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at June 30, 2013 are as follows:

June 30, 2013	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$31,329,612	$789,262	$4,690,434	$258,572	$36,020,046	$1,047,834
Asset-backed securities issued by other	135	175	-	-	135	175
	$31,329,747	$789,437	$4,690,434	$258,572	$36,020,181	$1,048,009

At June 30, 2013, the AFS investment portfolio had an estimated fair value of $54,103,851, of which $36,020,181 or 67% of the securities had some unrealized losses from their amortized cost. The securities with unrealized losses are predominantly mortgage-backed securities issued by GSEs.

AFS securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $1,047,834 or 2.06% of the portfolio amortized cost of $50,806,417. AFS asset-backed securities issued by GSEs with unrealized losses have an average life of 4.76 years and an average duration of 4.29 years. We believe that the securities will either recover in market value or be paid off as agreed.

At December 31, 2012, the AFS investment portfolio had a fair value of $47,205,663 with unrealized losses from their amortized cost of $118,802. Asset-backed securities and corporate securities with unrealized losses had a fair value of $11,956,182 and all unrealized losses were for less than twelve months.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at June 30, 2013 are as follows:

June 30, 2013	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$31,299,839	$721,673	$3,796,303	$2,059	$35,096,142	$723,732
Asset-backed securities issued by other	-	-	2,408,611	459,895	2,408,611	459,895
	$31,299,839	$721,673	$6,204,914	$461,954	$37,504,753	$1,183,627

At June 30, 2013, the HTM investment portfolio had an estimated fair value of $100,016,728, of which $37,504,753 or 37%, of the securities had some unrealized losses from their amortized cost. Of these securities, $35,096,142 or 94%, are mortgage-backed securities issued by GSEs and the remaining $2,408,611 or 6%, were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $723,732 or 0.76% of the portfolio amortized cost of $95,521,548. HTM asset-backed securities issued by GSEs with unrealized losses have an average life of 4.31 years and an average duration of 3.97 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $459,895, or 13.05% of the portfolio amortized cost of $3,524,982. HTM asset-backed securities issued by others with unrealized losses have an average life of 3.50 years and an average duration of 2.61 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2012 are as follows:

December 31, 2012	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs	$14,253,558	$ 89,638	$6,132,036	$8,360	$20,385,594	$97,998
Asset-backed securities issued by other	-	-	3,057,666	484,343	3,057,666	484,343
	$14,253,558	$ 89,638	$9,189,702	$492,703	$23,443,260	$582,341

At December 31, 2012, the HTM investment portfolio had an estimated fair value of $114,187,018, of which $23,443,260, or 21% of the securities, had some unrealized losses from their amortized cost. Of these securities, $20,385,594, or 87%, were mortgage-backed securities issued by GSEs and the remaining $3,057,666, or 13%, were asset-backed securities issued by others.

HTM securities issued by GSEs are guaranteed by the issuer. Total unrealized losses on the asset-backed securities issued by GSEs were $97,998 or 0.09% of the portfolio amortized cost of $107,430,375. HTM asset-backed securities issued by GSEs with unrealized losses have an average life of 1.85 years and an average duration of 1.72 years. We believe that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. All of the securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $484,343, or 10.91% of the portfolio amortized cost of $4,439,118. HTM asset-backed securities issued by others with unrealized losses have an average life of 3.17 years and an average duration of 2.40 years.

Credit Quality of Asset-Backed Securities

The tables below present the Standard & Poor’s or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and others at June 30, 2013 and December 31, 2012 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed security downgrades by Standard and Poor’s were treated as AAA based on regulatory guidance.

June 30, 2013		December 31. 2012	
Credit Rating	Amount	Credit Rating	Amount
AAA	$145,428,310	AAA	$150,317,560
A+	-	A+	-
A	-	A	110,780
BBB	701,888	BBB	978,043
BBB-	113,154	BBB-	322,329
BB+	-	BB+	-
BB	887,302	BB	1,069,517
BB-	-	BB-	68,604
B+	67,454	B+	1,008,126
CCC+	929,835	CCC+	-
CCC	825,349	CCC	881,719
Total	$148,953,292	Total	$154,756,678

11. LOANS

Loans consist of the following:

	June 30, 2013	December 31, 2012
Commercial real estate	$434,616,482	$ 419,667,312
Residential first mortgages	165,433,554	177,663,354
Construction and land development	29,119,080	31,818,782
Home equity and second mortgage	21,769,081	21,982,375
Commercial loans	84,992,780	88,157,606
Consumer loans	937,147	995,206

Commercial equipment	17,347,472	16,267,684
	754,215,596	756,552,319
Less:		
Deferred loan fees	930,439	664,610
Allowance for loan loss	8,033,553	8,246,957
	8,963,992	8,911,567
	$ 745,251,604	$ 747,640,752

18

At June 30, 2013, the Bank's allowance for loan losses totaled $8,033,553, or 1.07% of loan balances, as compared to $8,246,957, or 1.09% of loan balances, at December 31, 2012. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

At June 30, 2013 and December 31, 2012, gross loans included $1,437,828 and $1,454,757, respectively, from the sale of an OREO property that the Bank financed during 2011 that did not qualify for full accrual sales treatment under ASC Topic 360-20-40 "Property Plant and Equipment – Derecognition". The Bank utilized the cost recovery method and deferred a gain of $225,000. The deferred gain balance was $225,000 at June 30, 2013 and December 31, 2012, respectively.

Risk Characteristics of Portfolio Segments

The Company manages its credit products and exposure to credit losses (credit risk) by the following specific portfolio segments (classes), which are levels at which the Company develops and documents its allowance for loan loss methodology. These segments are:

Commercial Real Estate ("CRE")

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were below 5% of the CRE portfolio at June 30, 2013 and December 31, 2012. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank's capital. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

Loans secured by commercial real estate are larger and involve greater risks than one-to-four family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy.

Residential First Mortgages

Residential first mortgage loans made by the Bank are generally long term loans, amortized on a monthly basis, with principal and interest due each month. The initial contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank's experience indicates that real estate loans remain outstanding for significantly

shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank originates both fixed-rate and adjustable-rate residential first mortgages.

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also unquantifiable credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower.

Construction and Land Development

The Bank offers loans for the construction of one-to-four family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals.

A decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank’s risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project’s value might be insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk has been heightened as the market value of residential property has declined.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business, the viability of the industry in which the consumer operates, the value of the collateral, and the borrower's ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable, or other security as determined by the Bank.

Commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself.

Consumer Loans

The Bank has developed a number of programs to serve the needs of its customers with primary emphasis upon loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer's equipment. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

Non-accrual and Past Due Loans

Non-accrual loans as of June 30, 2013 and December 31, 2012 were as follows:

	June 30, 2013 90 or Greater Days Delinquent	Number of Loans	Non-accrual Performing Loans	Number of Loans	Total Dollars	Total Number of Loans
Commercial real estate	$3,163,457	8	$3,727,138	2	$6,890,595	10
Residential first mortgages	2,979,534	9	562,994	3	3,542,528	12
Construction and land development	-	-	-	-	-	-
Home equity and second mortgage	-	-	-	-	-	-
Commercial loans	6,009,421	11	-	-	6,009,421	11
Consumer loans	-	-	41,498	1	41,498	1
Commercial equipment	151,793	2	-	-	151,793	2
	$12,304,205	30	$4,331,630	6	$16,635,835	36

	December 31, 2012					
	90 or Greater Days Delinquent	Number of Loans	Non-accrual Performing Loans	Number of Loans	Total Dollars	Total Number of Loans
Commercial real estate	$1,527,844	7	$3,802,947	2	$5,330,791	9
Residential first mortgages	3,169,404	10	569,693	3	3,739,097	13
Construction and land development	-	-	-	-	-	-
Home equity and second mortgage	71,296	2	-	-	71,296	2
Commercial loans	3,732,090	11	-	-	3,732,090	11
Consumer loans	-	-	51,748	1	51,748	1
Commercial equipment	216,383	4	-	-	216,383	4
	$8,717,017	34	$4,424,388	6	$13,141,405	40

The Bank categorized six performing loans totaling $4,331,630 and $4,424,388 as non-accrual loans at June 30, 2013 and December 31, 2012, respectively. These six loans represent one well-secured commercial relationship with no specific reserves in the allowance due to the Bank's superior credit position with underlying collateral. It is management’s belief that there is no current risk of loss to the Bank for this relationship. These loans were classified as non-accrual loans due to the customer’s operating results. In accordance with the Company’s policy, interest income is recognized on a cash-basis for these loans.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $14,549,064 and $11,371,542 at June 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at June 30, 2013 and December 31, 2012 was $518,722 and $443,856, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $2,086,771 and $1,769,863 at June 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at June 30, 2013 and December 31, 2012 was $207,561 and $182,106, respectively.

An analysis of past due loans as of June 30, 2013 and December 31, 2012 was as follows:

June 30, 2013	Current	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$431,168,815	$-	$284,210	$3,163,457	$3,447,667	$434,616,482
Residential first mortgages	161,686,085	-	767,935	2,979,534	3,747,469	165,433,554
Construction and land dev.	29,119,080	-	-	-	-	29,119,080
Home equity and second mtg.	21,617,047	94,710	57,324	-	152,034	21,769,081
Commercial loans	78,893,319	90,040	-	6,009,421	6,099,461	84,992,780
Consumer loans	936,737	410	-	-	410	937,147

Commercial equipment	17,144,025	26,656	24,998	151,793	203,447	17,347,472
Total	$740,565,108	$211,816	$1,134,467	$12,304,205	$13,650,488	$754,215,596
December 31, 2012						
Commercial real estate	$416,721,658	$-	$1,417,810	$1,527,844	$2,945,654	$419,667,312
Residential first mortgages	173,593,886	97,307	802,757	3,169,404	4,069,468	177,663,354
Construction and land dev.	31,818,782	-	-	-	-	31,818,782
Home equity and second mtg.	21,499,018	350,715	61,346	71,296	483,357	21,982,375
Commercial loans	84,384,426	-	41,090	3,732,090	3,773,180	88,157,606
Consumer loans	983,094	9,363	2,749	-	12,112	995,206
Commercial equipment	15,659,007	371,921	20,373	216,383	608,677	16,267,684
Total	$744,659,871	$829,306	$2,346,125	$8,717,017	$11,892,448	$756,552,319

21

There were no accruing loans 90 days or greater past due at June 30, 2013 and December 31, 2012, respectively.

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the three and six months ended June 30, 2013 and June 30, 2012, respectively, and the year ended December 31, 2012 and loan receivable balances at June 30, 2013 and June 30, 2012, respectively, and at December 31, 2012. An allocation of the allowance to one category of loans does not prevent the Company’s ability to utilize the allowance to absorb losses in a different category. The loan receivables are disaggregated on the basis of the Company’s impairment methodology.

	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Three Months Ended June 30, 2013 Allowance for loan losses:								
Balance at April 1,	$3,539,930	$1,985,165	$497,078	$318,271	$1,823,540	$17,086	$168,930	$8,350,00
Charge-offs	-	(98)	(59)	(110,883)	(405,573)	(15)	(21,977)	(538,605
Recoveries	-	9,908	-	-	10,899	990	(66)	21,731
Provisions	(181,929)	(34,093)	103,506	156,893	90,466	(4,089)	69,673	200,427
Balance at June 30,	$3,358,001	$1,960,882	$600,525	$364,281	$1,519,332	$13,972	$216,560	$8,033,55
At and For the Six Months Ended June 30, 2013 Allowance for loan losses:								
Balance at January 1,	$4,089,834	$1,083,228	$533,430	$279,819	$1,949,024	$19,341	$292,281	$8,246,95
Charge-offs	-	(58,938)	(35,962)	(110,883)	(405,573)	(8,991)	(21,977)	(642,324
Recoveries	-	10,900	-	-	11,891	1,982	49,547	74,320
Provisions	(731,833)	925,692	103,057	195,345	(36,010)	1,640	(103,291)	354,600
Balance at June 30,	$3,358,001	$1,960,882	$600,525	$364,281	$1,519,332	$13,972	$216,560	$8,033,55

Ending balance: individually evaluated for impairment	$613,757	$406,966	$169,710	$-	$39,871	$-	$3,364	$1,233,66
Ending balance: collectively evaluated for impairment	$2,744,244	$1,553,916	$430,815	$364,281	$1,479,461	$13,972	$213,196	$6,799,88
Loan receivables: Ending balance	$434,616,482	$165,433,554	$29,119,080	$21,769,081	$84,992,780	$937,147	$17,347,472	$754,215.
Ending balance: individually evaluated for impairment	$20,473,659	$5,236,064	$5,705,211	$214,000	$11,387,777	$41,498	$155,157	$43,213,3
Ending balance: collectively evaluated for impairment	$414,142,823	$160,197,490	$23,413,869	$21,555,081	$73,605,003	$895,649	$17,192,315	$711,002.

22

	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment
At and For the Year Ended December 31, 2012							
Allowance for loan losses:							
Balance at January 1,	$2,525,199	$539,205	$354,385	$143,543	$3,850,294	$19,119	$223,296
Charge-offs	(486,431)	(10,987)	(140,835)	(210,753)	(1,003,824)	(4,994)	(168,802)
Recoveries	-	37,524	-	-	51,350	987	-
Provisions	2,051,066	517,486	319,880	347,029	(948,796)	4,229	237,787
Balance at December 31,	$4,089,834	$1,083,228	$533,430	$279,819	$1,949,024	$19,341	$292,281
Ending balance: individually evaluated for impairment	$785,878	$403,475	$-	$-	$353,883	$-	$4,421
Ending balance: collectively evaluated for impairment	$3,303,956	$679,753	$533,430	$279,819	$1,595,141	$19,341	$287,860
Loan receivables:							
Ending balance	$419,667,312	$177,663,354	$31,818,782	$21,982,375	$88,157,606	$995,206	$16,267,684
Ending balance: individually evaluated for impairment	$21,618,890	$3,367,827	$4,877,868	$291,000	$8,778,681	$51,748	$4,421
Ending balance: collectively evaluated for impairment	$398,048,422	$174,295,527	$26,940,914	$21,691,375	$79,378,925	$943,458	$16,263,263

	Commercial Real Estate	Residential First Mortgage	Construction and Land Development	Home Equity and Second Mtg.	Commercial Loans	Consumer Loans	Commercial Equipment	Total
At and For the Three Months Ended June 30, 2012								
Allowance for loan losses:								
Balance at April 1,	$3,385,036	$644,008	$448,406	$265,138	$2,793,049	$18,350	$361,811	$7,915,7
Charge-offs	(85,381)	-	-	(41,942)	(649,699)	(14)	(149,794)	(926,8

Recoveries	-	37,247	-	-	1,491	-	-	38,738
Provisions	178,803	220,250	148,448	(10,405)	(176,350)	(20)	75,705	436,43
Balance at June 30,	$3,478,458	$901,505	$596,854	$212,791	$1,968,491	$18,316	$287,722	$7,464,1
At and For the Six Months Ended June 30, 2012								
Allowance for loan losses:								
Balance at January 1,	$2,525,199	$539,205	$354,385	$143,543	$3,850,294	$19,119	$223,296	$7,655,0
Charge-offs	(121,833)	-	-	(41,942)	(693,048)	(999)	(149,794)	(1,007,
Recoveries	-	37,247	-	-	1,960	-	-	39,207
Provisions	1,075,092	325,053	242,469	111,190	(1,190,715)	196	214,220	777,50
Balance at June 30,	$3,478,458	$901,505	$596,854	$212,791	$1,968,491	$18,316	$287,722	$7,464,1
Ending balance: individually evaluated for impairment	$604,063	$247,408	$134,500	$47,200	$484,937	$-	$-	$1,518,1
Ending balance: collectively evaluated for impairment	$2,874,395	$654,097	$462,354	$165,591	$1,483,554	$18,316	$287,722	$5,946,0
Loan receivables:								
Ending balance	$398,017,392	$178,459,492	$32,405,839	$22,525,909	$93,096,685	$1,007,453	$17,151,518	$742,66
Ending balance: individually evaluated for impairment	$38,727,469	$6,328,588	$7,812,520	$409,348	$18,536,881	$68,192	$803,700	$72,686
Ending balance: collectively evaluated for impairment	$359,289,923	$172,130,904	$24,593,319	$22,116,561	$74,559,804	$939,261	$16,347,818	$669,97

Credit Quality Indicators

A risk grading scale is used to assign grades to commercial real estate, construction and land development, commercial loans and commercial equipment loans. Loans are graded at inception, annually thereafter when financial statements are received and at other times when there is an indication that a credit may have weakened or improved. Only commercial loan relationships with an aggregate exposure to the Bank of $750,000 or greater are subject to being risk rated.

Residential first mortgages, home equity and second mortgages and consumer loans are evaluated for creditworthiness in underwriting and are monitored based on borrower payment history. These loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned (“OAEM”) or higher risk rating due to a delinquent payment history.

Management regularly reviews credit quality indicators as part of its individual loan reviews and on a monthly and quarterly basis. The overall quality of the Bank’s loan portfolio is assessed using the Bank’s risk grading scale, the level and trends of net charge-offs, nonperforming loans and delinquencies, the performance of troubled debt restructured loans and the general economic conditions in the Company’s geographical market. This review process is assisted by frequent internal reporting of loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Credit quality indicators and allowance factors are adjusted based on management’s judgment during the monthly and quarterly review process.

Loans subject to risk ratings are graded on a scale of one to 10. The Company considers loans classified substandard, doubtful and loss as classified assets for regulatory and financial reporting.

Ratings 1 thru 6 - Pass

Ratings 1 thru 6 have asset risks ranging from excellent low risk to adequate. The specific rating assigned considers customer history of earnings, cash flows, liquidity, leverage, capitalization, consistency of debt service coverage, the nature and extent of customer relationship and other relevant specific business factors such as the stability of the industry or market area, changes to management, litigation or unexpected events that could have an impact on risks.

Rating 7 - OAEM (Other Assets Especially Mentioned) – Special Mention

These credits, while protected by the financial strength of the borrowers, guarantors or collateral, have reduced quality due to economic conditions, less than adequate earnings performance or other factors which require the lending officer to direct more than normal attention to the credit. Financing alternatives may be limited and/or command higher risk interest rates. OAEM loans are the first adversely classified assets on our watch list. These relationships will be

reviewed at least quarterly.

Rating 8 - Substandard

Substandard assets are assets that are inadequately protected by the sound worth or paying capacity of the borrower or of the collateral pledged. These assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. The loans may have a delinquent history or combination of weak collateral, weak guarantor strength or operating losses. When a loan is assigned to this category the Bank may estimate a specific reserve in the loan loss allowance analysis. These assets listed may include assets with histories of repossessions or some that are non-performing bankruptcies. These relationships will be reviewed at least quarterly.

Rating 9 - Doubtful

Doubtful assets have many of the same characteristics of Substandard with the exception that the Bank has determined that loss is not only possible but is probable and the risk is close to certain that loss will occur. When a loan is assigned to this category the Bank will identify the probable loss and it will receive a specific reserve in the loan loss allowance analysis. These relationships will be reviewed at least quarterly.

Rating 10 - Loss

Once an asset is identified as a definite loss to the Bank, it will receive the classification of “loss”. There may be some future potential recovery; however it is more practical to write off the loan at the time of classification. Losses will be taken in the period in which they are determined to be uncollectable.

Credit quality indicators as of June 30, 2013 and December 31, 2012 were as follows:

Credit Risk Profile by Internally Assigned Grade

	Commercial Real Estate		Construction and Land Dev.	
	6/30/2013	12/31/2012	6/30/2013	12/31/2012
Unrated	$60,706,137	$59,930,126	$4,367,952	$4,330,321
Pass	343,428,754	329,882,941	16,260,390	19,752,749
Special mention	5,331,812	4,880,758	-	-
Substandard	25,149,779	24,973,487	8,490,738	7,735,712
Doubtful	-	-	-	-
Loss	-	-	-	-
Total	$434,616,482	$419,667,312	$29,119,080	$31,818,782

	Commercial Loans		Commercial Equipment	
	6/30/2013	12/31/2012	6/30/2013	12/31/2012
Unrated	$12,568,790	$11,627,726	$5,692,755	$5,082,713
Pass	57,485,149	64,436,809	8,651,353	11,180,550
Special mention	710,755	-	3,000,000	-
Substandard	14,228,086	12,093,071	3,364	4,421
Doubtful	-	-	-	-
Loss	-	-	-	-
Total	$84,992,780	$88,157,606	$17,347,472	$16,267,684

Credit Risk Profile Based on Payment Activity

	Residential First Mortgages		Home Equity and Second Mtg.		Consumer Loans	
	6/30/2013	12/31/2012	6/30/2013	12/31/2012	6/30/2013	12/31/2012
Performing	$162,454,020	$174,493,950	$ 21,769,081	$ 21,911,079	$937,147	$ 995,206
Nonperforming	2,979,534	3,169,404	-	71,296	-	-
Total	$165,433,554	$177,663,354	$ 21,769,081	$ 21,982,375	$937,147	$ 995,206

25

Impaired Loans and Troubled Debt Restructures ("TDRs")

Impaired loans, including TDRs, at June 30, 2013 and June 30, 2012, respectively, and at December 31, 2012 were as follows:

June 30, 2013	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Three Month Average Recorded Investment	Three Month Interest Income Recognized	Six Month Average Recorded Investment
Commercial real estate	$20,473,659	$16,089,286	$4,384,373	$20,473,659	$613,757	$20,560,641	$234,676	$20,624,814
Residential first mortgages	5,236,064	4,328,414	907,651	5,236,064	406,966	5,277,858	46,226	5,282,785
Construction and land dev.	5,705,211	4,497,201	1,208,010	5,705,211	169,710	5,573,948	71,379	5,295,158
Home equity and second mtg.	214,000	214,000	-	214,000	-	232,667	2,179	264,833
Commercial loans	11,387,777	11,230,906	156,871	11,387,777	39,871	11,378,533	148,950	11,320,953
Consumer loans	41,498	41,498	-	41,498	-	44,160	1,285	46,603
Commercial equipment	174,058	151,793	3,364	155,157	3,364	174,211	60	174,439
Total	$43,232,267	$36,553,098	$6,660,269	$43,213,366	$1,233,668	$43,242,018	$504,755	$43,009,585

December 31, 2012	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial real estate	$21,618,890	$18,804,478	$2,814,412	$21,618,890	$785,878	$22,501,842	$1,119,715
Residential first mortgages	3,367,827	2,362,062	1,005,765	3,367,827	403,475	3,388,867	157,595
Construction and land dev.	4,877,868	4,877,868	-	4,877,868	-	4,792,982	276,260
Home equity and second mtg.	291,000	291,000	-	291,000	-	221,000	6,783
Commercial loans	8,778,681	8,330,442	448,238	8,778,681	353,883	9,153,074	284,095
Consumer loans	51,748	51,748	-	51,748	-	64,459	5,284
Commercial equipment	4,421	-	4,421	4,421	4,421	5,112	318

Total	$38,990,435	$34,717,598	$4,272,836	$38,990,435	$1,547,657	$40,127,336	$1,850,050

June 30, 2012	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Three Month Average Recorded Investment	Three Month Interest Income Recognized	Six Month Average Recorded Investment	S M In In R
Commercial real estate	$7,809,718	$5,097,362	$2,304,706	$7,402,068	$604,063	$7,821,751	$91,009	$7,836,028	$
Residential first mortgages	2,579,409	907,147	1,672,261	2,579,409	247,408	2,583,098	26,312	2,585,146	
Construction and land dev.	1,851,415	1,716,915	134,500	1,851,415	134,500	2,020,582	12,947	2,189,748	
Home equity and second mtg.	101,518	-	101,518	101,518	47,200	101,518	-	101,518	
Commercial loans	2,670,650	1,894,390	776,260	2,670,650	484,937	2,671,025	23,628	2,664,394	
Total	$15,012,710	$9,615,814	$4,989,245	$14,605,060	$1,518,108	$15,197,974	$153,896	$15,376,834	$

26

TDRs, included in the impaired loan schedules above, as of June 30, 2013 and December 31, 2012, respectively were as follows:

	June 30, 2013		December 31, 2012	
	Dollars	Number of Loans	Dollars	Number of Loans
Commercial real estate	$3,093,043	7	$ 3,097,214	7
Residential first mortgages	1,489,247	4	1,418,229	3
	$4,582,290	11	$ 4,515,443	10

At June 30, 2013 and December 31, 2012, all TDRs were performing according to the terms of their restructured agreements. Interest income in the amount of $95,873 and $220,326 was recognized on these loans for the six months ended June 30, 2013 and the year ended December 31, 2012, respectively. The specific reserve of the allowance for loan losses included $12,000 related to TDR loans at June 30, 2013. There were no amounts specifically reserved for TDRs at December 31, 2012.

During the six months ended June 30, 2013, the Bank entered into one TDR for $77,165 for a residential first mortgage. During the year ended December 31, 2012, the Bank entered into TDRs for eight commercial real estate loans totaling $3,212,894 and three residential first mortgages totaling $1,419,657. For the year ended December 31, 2012, two commercial real estate TDR loans were charged-off in the amount of $415,995. One of the two charged-off commercial real estate loans was transferred to OREO with a balance of $382,500.

12. LOANS HELD FOR SALE

Residential mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value, in the aggregate. Fair value is derived from secondary market quotations for similar instruments. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Residential mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Company. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold, using the specific identification method.

The Company enters into contractual commitments with potential borrowers, including loan commitments and rate-lock commitments for the origination of residential mortgage loans that will be held for sale in the secondary market. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges

from 15 to 60 days. These commitments, which contain fixed expiration dates, offer the borrower an interest rate guarantee provided the loan meets underwriting guidelines and subsequently closes within the timeframe established by the Company.

The interest rate-lock commitments are derivative financial instruments. Interest rate risk arises on these commitments and subsequently closed loans held for sale if interest rates change between the time of interest rate-lock and the delivery of the loan to a secondary market investor. To mitigate interest rate risk, the Company sells certain loans forward into the secondary market at a specified price with a specified date on a best efforts basis. These forward sales, which are entered into as a result of an interest rate-lock commitment with the Bank's customer, are derivative financial instruments. The Company does not recognize gains or losses due to interest rate changes for loans sold forward on a best effort basis.

13. NEW ACCOUNTING STANDARDS

Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2011-11; "*Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities"*. ASU 2011-11 amends Topic 210 "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements, borrowing/lending arrangements and derivative instruments with a right of offset. ASU 2011-11 was effective for the Company beginning on January 1, 2013 and did have a material impact on the Company's consolidated financial statements.

ASU 2013-02 – *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*." The new guidance requires the presentation of significant amounts reclassified in a separate footnote and cross referencing to related footnote disclosures, if applicable. ASU 2013-02 was effective for the Company prospectively beginning on January 1, 2013 and did have a material impact on the Company's consolidated financial statements.

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Therefore, any aggregate unrealized gains or losses should not be interpreted as a forecast of future earnings or cash flows. Furthermore, the fair values disclosed should not be interpreted as the aggregate current value of the Company.

June 30, 2013			Fair Value Measurements		
Description of Asset	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets					
Investment securities - AFS	$54,103,851	$54,103,851	$-	$54,103,851	$ -
Investment securities - HTM	99,896,483	100,016,728	849,953	99,166,775	-
FHLB and FRB Stock	6,666,550	7,435,000	-	7,435,000	-
Loans	745,251,604	748,066,000	-	748,066,000	-
Other real estate owned	6,932,177	6,932,177	-	6,932,177	-
Liabilities					
Savings, NOW and money market accounts	$389,768,518	$389,768,518	$-	$389,768,518	$ -
Time deposits	394,912,719	39,816,500	-	39,816,500	-
Long-term debt	70,501,763	72,077,000	-	72,077,000	-
Short term borrowings	24,000,000	24,007,000	-	24,007,000	-
TRUPs	12,000,000	2,400,000	-	2,400,000	-

At December 31, 2012		Fair Value Measurements
Description of Asset	Fair Value	

	Carrying Amount		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets					
Investment securities - AFS	$47,205,663	$47,205,663	$-	$47,205,663	$ -
Investment securities - HTM	112,619,434	114,187,018	749,941	113,437,077	-
FHLB and FRB Stock	5,476,050	5,469,000	-	5,469,000	-
Loans	747,640,752	757,387,000	-	757,387,000	-
Other real estate owned	6,891,353	6,891,353	-	6,891,353	-
Liabilities					
Savings, NOW and money market accounts	$414,776,285	$414,776,285	$-	$414,776,285	$ -
Time deposits	405,454,003	410,257,000	-	410,257,000	-
Long-term debt	60,527,208	64,252,000	-	64,252,000	-
Short term borrowings	1,000,000	1,000,000	-	1,000,000	-
TRUPs	12,000,000	2,400,000	-	2,400,000	-

At June 30, 2013, the Company had outstanding loan commitments and standby letters of credit of $21.8 million and $24.5 million, respectively. Based on the short-term lives of these instruments, the Company does not believe that the fair value of these instruments differs significantly from their carrying values.

Valuation Methodology

Investment securities and FHLB and FRB stock - Fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans receivable - For conforming residential first-mortgage loans, the market price for loans with similar coupons and maturities was used. For nonconforming loans with maturities similar to conforming loans, the coupon was adjusted for credit risk. Loans that did not have quoted market prices were priced using the discounted cash flow method. The discount rate used was the rate currently offered on similar products. Loans priced using the discounted cash flow method included residential construction loans, commercial real estate loans and consumer loans. The estimated fair value of loans held for sale is based on the terms of the related sale commitments.

Other real estate owned - Fair value is based upon independent market prices, appraised value of the collateral or management’s estimation of the value of the collateral.

Deposits - The fair value of checking accounts, saving accounts and money market accounts were the amount payable on demand at the reporting date.

Time certificates - The fair value was determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

Long-term debt and other borrowed funds - These were valued using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar borrowings.

Guaranteed preferred beneficial interest in junior subordinated securities (TRUPs) - These were valued using discounted cash flows. The discount rate was equal to the rate currently offered on similar borrowings.

Off-balance sheet instruments - The Company charges fees for commitments to extend credit. Interest rates on loans for which these commitments are extended are normally committed for periods of less than one month. Fees charged on standby letters of credit and other financial guarantees are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused. It is impractical to assign any fair value to these commitments.

The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2013 and December 31, 2012, respectively. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amount presented herein.

15. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the components of comprehensive loss for securities for the three and six months ended June 30, 2013 and 2012.

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Net unrealized holding gain (loss) arising during period	$(1,126,015)	$(382,845)	$(743,170)	$ 75,238	$ 25,581	$ 49,657
Reclassification adjustments	-	-	-	-	-	-
Other comprehensive gain (loss)	$(1,126,015)	$(382,845)	$(743,170)	$ 75,238	$ 25,581	$ 49,657

29

	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Net unrealized holding gain (loss) arising during period	$(1,240,572)	$(421,794)	$(818,778)	$ 11,744	$ 3,993	$ 7,751
Reclassification adjustments	-	-	-	-	-	-
Other comprehensive gain (loss)	$(1,240,572)	$(421,794)	$(818,778)	$ 11,744	$ 3,993	$ 7,751

The following table presents the changes in each component of accumulated other comprehensive income for securities, net of tax, for the three and six months ended June 30, 2013.

	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
	Net Unrealized Gains And Losses	Net Unrealized Gains And Losses
Beginning of period	$ 63,576	$ 139,184
Other comprehensive loss before reclassifications	(743,170)	(818,778)
Amounts reclassified from accumulated other comprehensive income	-	-
Net other comprehensive loss	(743,170)	(818,778)
End of period	$ (679,594)	$ (679,594)

30

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This document may contain forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of Tri-County Financial Corporation (the “Company”) and Community Bank of Tri-County (the “Bank”). These forward-looking statements are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions.

The Company and the Bank’s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company and the Bank’s market area, changes in real estate market values in the Company and the Bank’s market area and changes in relevant accounting principles and guidelines. Additional factors that may affect our results are discussed in Part I of the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 (the “Form 10-K”). These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

GENERAL

The Company is a bank holding company organized in 1989 under the laws of the State of Maryland. It owns all the outstanding shares of capital stock of the Bank. The Company engages in no significant activity other than holding the stock of the Bank, paying its subordinated debt and preferred stock obligations, and directing the business of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Company, the Bank and its subsidiaries.

Effective October 18, 2013, Community Bank of Tri-County will change its name to become Community Bank of the Chesapeake. This new name reflects the Bank's recent expansion into the Northern Neck of Virginia. The name of the holding company will change from Tri-County Financial Corporation to The Community Financial Corporation, to better align the bank name with the parent company. The Company’s stock ticker symbol (OTCBB: TCFC) will remain the same.

The Bank has sought to increase assets through loan production. The Bank believes that its ability to offer fast, flexible, local decision-making will continue to attract significant new business relationships and enhance asset growth. The Bank's marketing is also directed towards increasing its balances of both consumer and business transaction deposit accounts. The Bank believes that increases in these account types will lessen the Bank's dependence on higher-cost funding, such as certificates of deposit and borrowings. Although management believes that this strategy will increase financial performance over time, increasing the balances of certain products, such as commercial lending and transaction accounts, may also increase the Bank's noninterest expense. It recognizes that certain lending and deposit products increase the possibility of losses from credit and other risks.

The Bank conducts business through its main office in Waldorf, Maryland, and ten branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland, and King George, Virginia. The Bank is the largest overall deposit holder in the Southern Maryland Tri-County area, which includes Charles, Calvert and St. Mary's counties, according to the most recent June 2012 FDIC Summary of Deposit Survey.

The Company's results are influenced by local and national economic conditions. These conditions include the level of short-term interest rates such as the federal funds rate, the differences between short- and long-term interest rates, the value of real estate in our markets, the prospects for economic growth or decline, and the rates of anticipated and current inflation. Local conditions, including employment growth or declines, may have direct or indirect effects on our borrowers' ability to meet their obligations.

The Bank continues to evaluate its allowance for loan losses and the associated provision to compensate for the inherent risk in the loan portfolio. Any evaluation of the allowance for loan losses is inherently subjective and reflects management's expectations as to future economic conditions in the region as well as individual borrowers' circumstances. Management believes that its allowance for loan losses is adequate. For further information on the Bank's allowance for loan losses see the discussion in the sections captioned "Financial Condition" and "Critical Accounting Policies" as well as the relevant discussions in the Form 10-K and Annual Report for the year ended December 31, 2012.

On September 23, 2011, the U.S. Department of Treasury purchased $20.0 million in the Company's preferred stock under the Small Business Lending Fund (the "SBLF"). The SBLF is a program intended to encourage small business lending by providing capital to qualified community banks at favorable rates. SBLF dividend rates can fluctuate between 1% and 7% during the first four and one half years, depending on the level of the Bank's small business lending. As of June 30, 2013 and December 31, 2012, the Company's dividend rate on the SBLF funds was 1%. For additional information regarding SBLF, refer to Note 18 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

SELECTED FINANCIAL DATA

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Condensed Income Statement				
Interest and Dividend Income	$9,750,113	$10,102,542	$19,590,070	$20,210,926
Interest Expense	2,018,255	2,765,341	4,041,542	5,789,026
Net Interest Income	7,731,858	7,337,201	15,548,528	14,421,900
Provision for Loan Loss	200,427	436,431	354,600	777,505
Noninterest Income	1,068,728	896,795	2,257,806	1,742,885
Noninterest Expense	6,106,420	6,363,686	12,249,244	12,261,105
Income Before Income Taxes	2,493,739	1,433,879	5,202,490	3,126,175
Income Tax Expense	908,290	492,727	1,898,650	1,079,770
Net Income (NI)	1,585,449	941,152	3,303,840	2,046,405
Preferred Stock Dividends	50,000	50,000	100,000	100,000
NI Available to Common Shareholders	1,535,449	891,152	3,203,840	1,946,405
Comprehensive Income	842,279	990,809	2,485,062	2,054,156
Per Common Share				
Basic Earnings	$0.51	$0.29	$1.06	$0.64
Diluted Earnings	$0.51	$0.29	$1.05	$0.64
Cash Dividends Paid [(1)]	$0.10	$0.40	$0.20	$0.40
Book Value	$20.05	$18.49	$20.05	$18.49

Return On Average Assets	0.66	%	0.39	%	0.69	%	0.43	%
Return On Average Common Equity	9.92	%	6.23	%	10.47	%	6.82	%
Return On Average Equity	7.74	%	4.88	%	8.14	%	5.31	%
Interest Rate Spread	3.35	%	3.14	%	3.37	%	3.07	%
Net Interest Margin	3.47	%	3.28	%	3.50	%	3.22	%
Efficiency Ratio	69.39	%	77.29	%	68.79	%	75.85	%

(1) Beginning with the first quarter of 2013, the Company moved to paying a quarterly dividend in place of its annual dividend. The total dividends expected to be paid during 2013 are expected to remain at $0.40 per share.

RESULTS OF OPERATIONS – SIX MONTHS ENDED JUNE 30, 2013 AND JUNE 30, 2012

Consolidated net income available to common shareholders for the six months ended June 30, 2013 increased $1,257,435, or 64.60%, to $3,203,840, or $1.05 per common share (fully diluted), compared to $1,946,405, or $0.64 per common share (fully diluted), for the six months ended June 30, 2012. The year to date increase of $0.41 per share was attributable to increases in net interest income of $1,126,628 and noninterest income of $514,921 and decreases in the provision for loan losses of $422,905, partially offset by increased income tax expense of $818,880. Noninterest expense remained flat at $12,249,244 for the six months ended June 30, 2013, an $11,861 decrease or 0.10%, from the comparable six month period in 2012.

32

	Six Months Ended June 30,			
	2013	2012	$ Change	% Change
Interest and Dividend Income				
Loans, including fees	$18,363,746	$18,511,260	$(147,514)	(0.80 %)
Taxable interest and dividends on investment securities	1,221,040	1,696,918	(475,878)	(28.04 %)
Interest on deposits with banks	5,284	2,748	2,536	92.29 %
Total Interest and Dividend Income	19,590,070	20,210,926	(620,856)	(3.07 %)
Interest Expenses				
Deposits	2,967,301	4,609,719	(1,642,418)	(35.63 %)
Short-term borrowings	37,827	31,751	6,076	19.14 %
Long-term debt	1,036,414	1,147,556	(111,142)	(9.69 %)
Total Interest Expenses	4,041,542	5,789,026	(1,747,484)	(30.19 %)
Net Interest Income (NII)	15,548,528	14,421,900	1,126,628	7.81 %
Provision for loan losses	354,600	777,505	(422,905)	(54.39 %)
NII After Provision For Loan Losses	$15,193,928	$13,644,395	$1,549,533	11.36 %

Net interest income increased from the comparable six months in 2012 due primarily to reduced funding costs and the Company's ability to hold the line on loan yields. An important component of lowering the Company's cost of funds was the increase in average noninterest-bearing deposits of $15.7 million for the first six months of 2013 to $83.1 million compared to $67.4 million for the first six months of 2012. The Company's 2013 year to date cost of funds, which includes debt and interest and non-interest bearing deposits, decreased 39 basis points to 0.93% from 1.32% for the six months ended June 30, 2012. The positive trend in interest expense is currently expected to continue during the third quarter of 2013 due to repricing of maturing time deposits to current market rates which are significantly lower than original rates. During the same comparable period average loan yields decreased 15 basis points from 5.20% for the six months ended June 30, 2012 to 5.05% for the six months ended June 30, 2013. See the rate/volume analysis in the tables that follow this narrative.

Net interest income increased to $15,548,528 for the six months ended June 30, 2013 compared to $14,421,900 for the six months ended June 30, 2012. The net interest margin was 3.50% for the six months ended June 30, 2013, a 28 basis point increase from 3.22% for the six months ended June 30, 2012. The increase was largely the result of a rapid decrease in the Company's cost of interest-bearing deposits that began during 2012 as certificates of deposit re-priced and rates declined on money market accounts. The average cost of total interest-bearing liabilities decreased 40 basis points from 1.43% for the first six months of 2012 to 1.03% for the first six months of 2013.

Interest and dividend income decreased by $620,856 to $19,590,070 for the six months ended June 30, 2013 compared to $20,210,926 for the six months ended June 30, 2012. Decreases in yields on loans and investments were partially offset by the growth in the average balance of loans. A reduction in average yields on interest-earning assets resulted in a decrease in interest income of $832,456 as rates decreased from 4.51% for the six months ended June 30, 2012 to 4.40% for the six months ended June 30, 2013. The Company has been successful over the last several years in limiting the effect of the lower interest rate environment on loan rates through pricing and interest rate floors. Interest

and dividend income was further reduced $170,237 as average interest-earning investment balances decreased $22.5 million from $184.5 million for the six months ended June 30, 2012 to $162.0 million for the six months ended June 30, 2013. These reductions were partially offset by an increase in interest income of $381,837 due to growth of $15.1 million in the average balance of loans from $712.6 million to $727.7 million.

33

Interest expense decreased $1,747,484 to $4,041,542 for the six months ended June 30, 2013 compared to $5,789,026 for the six months ended June 30, 2012 due primarily to a reduction in the average cost of funds on interest-bearing liabilities; interest expense decreased $1,580,499 due to a decrease in rates. This was principally achieved by a decrease in the average rates paid on certificates of deposits and money market accounts, which declined from 1.67% and 0.68%, respectively, for the six months ended June 30, 2012 to 1.26% and 0.32%, respectively, for the six months ended June 30, 2013. The Company has been successful in increasing its core deposits and reducing its cost of funds in the low interest rate environment over the last several years. In addition, the average rate paid on long-term debt decreased from 3.26% to 2.61% for the comparable period. Interest expense also decreased $253,126 due to a decline in average interest-bearing deposit balances of $27.3 million from $728.0 million for the six months ended June 30, 2012 to $700.7 million for the six months ended June 30, 2013. These reductions in interest expense were partially offset by an $86,141 increase in interest expense due to a $5.8 million increase in average debt balances. The positive trend in net interest income is expected to continue in the third quarter as funding costs are expected to decrease at a faster rate than asset yields.

The following table presents information on the average balances of the Company’s interest-earning assets and interest-bearing liabilities and interest earned or paid thereon for the six months ended June 30, 2013 and 2012, respectively. There are no tax equivalency adjustments.

	For the Six Months Ended June 30,							
	2013				2012			
dollars in thousands	Average **Balance**	**Interest**	Average Yield/ **Cost**		Average **Balance**	**Interest**	Average Yield/ **Cost**	
Assets								
Interest-earning assets:								
Loan portfolio (1)	$727,732	$18,364	5.05	%	$712,597	$18,511	5.20	%
Investment securities, federal funds sold and interest-bearing deposits	161,980	1,226	1.51	%	184,477	1,700	1.84	%
Total Interest-Earning Assets	889,712	19,590	4.40	%	897,074	20,211	4.51	%
Cash and cash equivalents	10,936				8,393			
Other assets	57,073				53,564			
Total Assets	$957,721				$959,031			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities:								
Savings	$36,859	$18	0.10	%	$31,716	$38	0.24	%
Interest-bearing demand and money market accounts	263,521	419	0.32	%	252,889	860	0.68	%
Certificates of deposit	400,292	2,530	1.26	%	443,425	3,711	1.67	%
Long-term debt	67,424	879	2.61	%	59,870	977	3.26	%
Short-term debt	5,459	38	1.39	%	7,228	32	0.89	%
	12,000	157	2.62	%	12,000	171	2.85	%

Guaranteed preferred beneficial interest in junior subordinated debentures								
Total Interest-Bearing Liabilities	785,555	4,041	1.03	%	807,128	5,789	1.43	%
Noninterest-bearing demand deposits	83,133				67,434			
Other liabilities	7,834				7,421			
Stockholders' equity	81,199				77,048			
Total Liabilities and Stockholders' Equity	$957,721				$959,031			
Net interest income		$15,549				$14,422		
Interest rate spread			3.37	%			3.07	%
Net yield on interest-earning assets			3.50	%			3.22	%
Ratio of average interest-earning assets to average interest bearing liabilities			113.26	%			111.14	%
Cost of funds			0.93	%			1.32	%
Cost of deposits			0.76	%			1.16	%

(1) Average balance includes non-accrual loans

34

The table below sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest earning asset and interest bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

	Six Months Ended June 30, 2013 compared to Six Months Ended June 30, 2012		
		Due to	
dollars in thousands	Volume	Rate	Total
Interest income:			
Loan portfolio (1)	$ 382	$ (529)	$ (147)
Investment securities, federal funds sold and interest bearing deposits	(170)	(304)	(474)
Total interest-earning assets	$ 212	$ (833)	$ (621)
Interest-bearing liabilities:			
Savings	3	(23)	(20)
Interest-bearing demand and money market accounts	17	(458)	(441)
Certificates of deposit	(273)	(908)	(1,181)
Long-term debt	98	(196)	(98)
Short-term debt	(12)	18	6
Guaranteed preferred beneficial interest in junior subordinated debentures	-	(14)	(14)
Total interest-bearing liabilities	$ (167)	$ (1,581)	$ (1,748)
Net change in net interest income	$ 379	$ 748	$ 1,127

(1) Average balance includes non-accrual loans

The provision for loan losses decreased $422,905 from the comparable period in 2012 to $354,600 for the six months ended June 30, 2013 and reflected a decrease in the allowance for specific nonperforming loans and a decrease in net-charge-offs. The specific allowance is based on management’s estimate of realizable value. The provision for loan losses was impacted by increasing average loan balances, economic conditions that affected the loss factors used to compute the allowance, the level of delinquencies and charge-offs. Overall delinquency, which included all loans greater than 30 days past due, increased from 1.57% at December 31, 2012 to 1.81% at June 30, 2013. Nonperforming loans as a percentage of total loans were 1.63% at June 30, 2013 compared to 1.15% at December 31, 2012. Net charge-offs decreased $400,405 from $968,409 for the six months ended June 30, 2012 to $568,004 for the six months ended June 30, 2013.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Six Months Ended June 30,			
	2013	2012	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 319,149	$ 383,441	$ (64,292)	(16.77 %)
Gain on sale of asset	11,000	-	11,000	n/a
Net losses on sale of OREO	-	(96,917)	96,917	(100.00 %)
Income from bank owned life insurance	308,427	319,117	(10,690)	(3.35 %)
Service charges	1,103,180	1,001,903	101,277	10.11 %
Gain on sale of loans held for sale	516,050	135,341	380,709	281.30 %
Total Noninterest Income	$ 2,257,806	$ 1,742,885	$ 514,921	29.54 %

The increase in noninterest income was principally due to an increase in gains on loans held for sale. Gains on loan sales increased to $516,050 on sales of $17,550,257 for the six months ended June 30, 2013 compared to $135,341 on sales of $3,286,050 for the same period in 2012. Noninterest income for the first quarter of 2012 included net losses on the sale of OREO compared to none for the comparable period in 2013. During the six months ended June 30, 2012, the Bank disposed of three OREO properties resulting in proceeds of $299,032 and recognized net losses of $96,917. The increase in service charge income for the six months ended June 30, 2013 was principally the result of the Company's waiver of certain service charge fees during its conversion to a new data processing system during the second quarter of 2012.

The following table shows the components of noninterest expense and the dollar percentage changes for the periods presented.

	Six Months Ended June 30,			
	2013	2012	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 7,146,606	$ 6,490,079	$ 656,527	10.12 %
Occupancy expense	1,052,250	901,791	150,459	16.68 %
Advertising	272,731	259,091	13,640	5.26 %
Data processing expense	730,314	789,593	(59,279)	(7.51 %)
Professional fees	461,691	568,504	(106,813)	(18.79 %)
Depreciation of furniture, fixtures, and equipment	389,522	297,289	92,233	31.02 %
Telephone communications	102,729	92,086	10,643	11.56 %
Office supplies	109,468	133,990	(24,522)	(18.30 %)
FDIC Insurance	574,269	891,202	(316,933)	(35.56 %)
Valuation allowance on OREO	329,976	626,176	(296,200)	(47.30 %)
Other	1,079,688	1,211,304	(131,616)	(10.87 %)
Total Noninterest Expense	$ 12,249,244	$ 12,261,105	$ (11,861)	(0.10 %)

	Six Months Ended			
	June 30, 2013	June 30, 2012	Variance	% Variance
Compensation and Benefits	$7,146,606	$6,490,079	$656,527	10.12 %
OREO Valuation Allowance and Expenses	394,064	657,021	(262,957)	(40.02 %)
Other Operating Expenses	4,708,574	5,114,005	(405,431)	(7.93 %)
Total Noninterest Expense	$12,249,244	$12,261,105	$(11,861)	(0.10 %)

36

For the six months ended June 30, 2013, noninterest expense decreased 0.10% or $11,861 to $12,249,244 from $12,261,105 for the comparable period in 2012. Year to date increases in compensation and benefits were offset by decreases in OREO expenses and other operating expenses. Employee compensation and data processing continue to be impacted by greater regulatory compliance costs for both existing regulation and the initial impact of the Dodd-Frank Act. Other operating expenses for the six months ended June 30, 2013 decreased from the comparable period in 2012 due to one-time conversion costs for a change of the Bank's data processing system in the first six months of 2012 and reductions in FDIC insurance. Depreciation and occupancy expense increased primarily due to the Company's opening during the second half of 2012 a new operations center in Waldorf, Maryland and its 11th branch in King George, Virginia.

Increased revenues and a moderate decrease in noninterest expenses have improved the Company's efficiency ratio to 68.79% (66.58% without OREO revenues and expenses) for the six months ended June 30, 2013 from 75.85% (71.36% without OREO revenues and expenses) for the six months ended June 30, 2012.

The Company recorded income tax expense of $1,898,650 or 36.50%, of pretax earnings of $5,202,490, for the six months ended June 30, 2013 compared with $1,079,770 or 34.54%, of pretax earnings of $3,126,175, for the six months ended June 30, 2012. The increase in the effective tax rate was the result of tax exempt income being relatively lower to total income in 2013 than the comparable period in 2012.

RESULTS OF OPERATIONS – THREE MONTHS ENDED JUNE 30, 2013 AND JUNE 30, 2012

Consolidated net income available to common shareholders for the three months ended June 30, 2013 increased $644,297, or 72.30%, to $1,535,449, or $0.51 per common share (fully diluted), compared to $891,152, or $0.29 per common share (fully diluted), for the three months ended June 30, 2012. The quarter increase of $0.22 per share was attributable to increases in net interest income of $394,657 and noninterest income of $171,933 and decreases in noninterest expense of $257,266 and the provision for loan losses of $236,004 partially offset by increased income tax expense of $415,563.

	Three Months Ended June 30,			
	2013	2012	$ Change	% Change
Interest and Dividend Income				
Loans, including fees	$ 9,116,080	$ 9,286,377	$ (170,297)	(1.83 %)
Taxable interest and dividends on investment securities	631,347	815,101	(183,754)	(22.54 %)
Interest on deposits with banks	2,686	1,064	1,622	152.44 %
Total Interest and Dividend Income	9,750,113	10,102,542	(352,429)	(3.49 %)
Interest Expenses				
Deposits	1,434,338	2,197,377	(763,039)	(34.72 %)

Short-term borrowings	15,421	15,910	(489)	(3.07%)
Long-term debt	568,496	552,054	16,442	2.98%
Total Interest Expenses	2,018,255	2,765,341	(747,086)	(27.02%)
Net Interest Income (NII)	7,731,858	7,337,201	394,657	5.38%
Provision for loan losses	200,427	436,431	(236,004)	(54.08%)
NII After Provision For Loan Losses	$ 7,531,431	$ 6,900,770	$ 630,661	9.14%

Net interest income increased from the comparable three months in 2012 due primarily to reduced funding costs and the Company's ability to hold the line on loan yields. An important component of lowering the Company's cost of funds was the increase in average noninterest-bearing deposits of $14.6 million for the second quarter of 2013 to $83.8 million compared to $69.2 million for the second quarter of 2012. The Company's 2013 second quarter cost of funds, which includes debt and interest and non-interest bearing deposits, decreased 33 basis points to 0.93% from 1.26% for the three months ended June 30, 2012. The positive trend in interest expense should continue during the third quarter due to repricing of maturing time deposits to current market rates which are significantly lower than original rates. During the same comparable period average loan yields decreased 13 basis points from 5.15% for the three months ended June 30, 2012 to 5.02% for the three months ended June 30, 2013. See the rate/volume analysis in the tables that follow this narrative.

Net interest income increased to $7,731,858 for the three months ended June 30, 2013 compared to $7,337,201 for the three months ended June 30, 2012. The net interest margin was 3.47% for the three months ended June 30, 2013, a 19 basis point increase from 3.28% for the three months ended June 30, 2012. The increase was largely the result of a rapid decrease in the Company's cost of funds that began during 2012 as certificates of deposit re-priced and rates declined on money market accounts. The average cost of total interest-bearing liabilities decreased 34 basis points from 1.37% for the second quarter of 2012 to 1.03% for the second quarter of 2013. Deposit costs decreased 37 basis points from 1.10% to 0.73% for the comparable period.

Interest and dividend income decreased by $352,429 to $9,750,113 for the three months ended June 30, 2013 compared to $10,102,542 for the three months ended June 30, 2012. Decreases in yields on loans and investments were partially offset by the growth in the average balance of loans. A reduction in average yields on interest-earning assets resulted in a decrease in interest income of $385,233 as rates decreased from 4.51% for the three months ended June 30, 2012 to 4.38% for the three months ended June 30, 2013. The Company has been successful over the last several years in limiting the effect of the lower interest rate environment on loan rates through pricing and interest rate floors. Interest and dividend income was further reduced $38,035 as average interest-earning investment balances decreased $9.8 million from $173.7 million for the three months ended June 30, 2012 to $163.9 million for the three months ended June 30, 2013. These reductions were partially offset by an increase in interest and dividend income of $70,839 due to growth of $5.7 million in the average balance of loans from $721.4 million to $727.1 million.

Interest expense decreased $747,086 to $2,018,255 for the three months ended June 30, 2013 compared to $2,765,341 for the three months ended June 30, 2012 due primarily to a reduction in the average cost of funds on interest-bearing liabilities; interest expense decreased $701,570 due to a decrease in rates. This was principally achieved by a decrease in the average rates paid on certificates of deposits and money market accounts, which declined from 1.65% and 0.61%, respectively, for the three months ended June 30, 2012 to 1.22% and 0.31%, respectively, for the three months ended June 30, 2013. The Company has been successful in increasing its core deposits and reducing its cost of funds in the low interest rate environment over the last several years. In addition, the average rate paid on long-term debt decreased from 3.16% to 2.78% for the comparable period. Interest expense was also reduced $113,713 due to a decline in average interest-bearing deposit balances of $28.5 million from $726.5 million for the three months ended June 30, 2012 to $698.0 million for the three months ended June 30, 2013. These reductions in interest expense were partially offset by a $68,198 increase in interest expense due to an $8.2 million increase in average debt balances.

The positive trend in net interest income is expected to continue in the second quarter as funding costs are expected to decrease at a faster rate than asset yields.

The following table presents information on the average balances of the Company’s interest-earning assets and interest-bearing liabilities and interest earned or paid thereon for the three months ended June 30, 2013 and 2012, respectively. There are no tax equivalency adjustments.

	For the Three Months Ended June 30,					
	2013			2012		
dollars in thousands	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets						
Interest-earning assets:						
Loan portfolio (1)	$727,059	$9,116	5.02 %	$721,400	$9,286	5.15 %
Investment securities, federal funds sold and interest-bearing deposits	163,874	634	1.55 %	173,721	817	1.88 %
Total Interest-Earning Assets	890,933	9,750	4.38 %	895,121	10,103	4.51 %
Cash and cash equivalents	10,339			10,151		
Other assets	57,179			54,370		
Total Assets	$958,451			$959,642		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Savings	$37,535	$9	0.10 %	$32,561	$5	0.06 %
Interest-bearing demand and money market accounts	261,270	205	0.31 %	255,670	387	0.61 %
Certificates of deposit	399,238	1,221	1.22 %	438,242	1,805	1.65 %
Long-term debt	70,506	490	2.78 %	59,172	467	3.16 %
Short-term debt	4,451	15	1.35 %	7,590	16	0.84 %
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	78	2.60 %	12,000	85	2.83 %
Total Interest-Bearing Liabilities	785,000	2,018	1.03 %	805,235	2,765	1.37 %
Noninterest-bearing demand deposits	83,752			69,240		
Other liabilities	7,786			7,979		
Stockholders' equity	81,913			77,188		
Total Liabilities and Stockholders' Equity	$958,451			$959,642		
Net interest income		$7,732			$7,338	
Interest rate spread			3.35 %			3.14 %
Net yield on interest-earning assets			3.47 %			3.28 %
Ratio of average interest-earning assets to average interest bearing liabilities			113.49 %			111.16 %

Cost of funds	0.93 %	1.26 %
Cost of deposits	0.73 %	1.10 %

(1) Average balance includes non-accrual loans

The table below sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest earning asset and interest bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

	Three Months Ended June 30, 2013 compared to Three Months Ended June 30, 2012		
		Due to	
dollars in thousands	Volume	Rate	Total
Interest income:			
Loan portfolio (1)	$ 71	$ (241)	$ (170)
Investment securities, federal funds sold and interest bearing deposits	(38)	(145)	(183)
Total interest-earning assets	$ 33	$ (386)	$ (353)
Interest-bearing liabilities:			
Savings	1	3	4
Interest-bearing demand and money market accounts	4	(186)	(182)
Certificates of deposit	(119)	(465)	(584)
Long-term debt	79	(56)	23
Short-term debt	(11)	10	(1)
Guaranteed preferred beneficial interest in junior subordinated debentures	-	(7)	(7)
Total interest-bearing liabilities	$ (46)	$ (701)	$ (747)
Net change in net interest income	$ 78	$ 316	$ 394

(1) Average balance includes non-accrual loans

The provision for loan losses decreased $236,004 from the comparable period in 2012 to $200,427 for the three months ended June 30, 2013 and reflected a decrease in the allowance for specific nonperforming loans and a decrease in net-charge-offs. The specific allowance is based on management’s estimate of realizable value. Net charge-offs decreased $371,218 from $888,092 for the three months ended June 30, 2012 to $516,874 for the three months ended June 30, 2013.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

Three Months Ended June 30,

	2013	2012	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 130,721	$ 202,127	$(71,406)	(35.33 %)
Gain on sale of asset	11,000	-	11,000	n/a
Income from bank owned life insurance	156,994	159,911	(2,917)	(1.82 %)
Service charges	632,547	465,391	167,156	35.92 %
Gain on sale of loans held for sale	137,466	69,366	68,100	98.17 %
Total Noninterest Income	$ 1,068,728	$ 896,795	$171,933	19.17 %

The increase in noninterest income was principally due to increases in service charge income and gains on loans held for sale partially offset by a decrease in loan appraisal, credit and miscellaneous charges. The increase in service charge income from $465,391 for the three months ended June 30, 2012 to $632,547 for the three months ended June 30, 2013 was principally the result of the Company’s waiver of certain service charge fees during its conversion to a new data processing system during the second quarter of 2012. Gains on loan sales increased to $137,466 on sales of $4,948,924 for the three months ended June 30, 2013 compared to $69,366 on sales of $1,568,416 for the same period in 2012.

The following table shows the components of noninterest expense and the dollar percentage changes for the periods presented.

	Three Months Ended June 30,			
	2013	2012	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 3,589,610	$ 3,170,213	$419,397	13.23 %
Occupancy expense	569,479	464,319	105,160	22.65 %
Advertising	168,843	179,083	(10,240)	(5.72 %)
Data processing expense	366,480	421,153	(54,673)	(12.98 %)
Professional fees	264,354	343,295	(78,941)	(23.00 %)
Depreciation of furniture, fixtures, and equipment	197,092	162,364	34,728	21.39 %
Telephone communications	53,781	48,312	5,469	11.32 %
Office supplies	46,015	71,928	(25,913)	(36.03 %)
FDIC Insurance	272,837	447,587	(174,750)	(39.04 %)
Valuation allowance on OREO	19,476	326,176	(306,700)	(94.03 %)
Other	558,453	729,256	(170,803)	(23.42 %)
Total Noninterest Expense	$ 6,106,420	$ 6,363,686	$(257,266)	(4.04 %)

	Three Months Ended			
	June 30, 2013	June 30, 2012	Variance	% Variance
Compensation and Benefits	$3,589,610	$ 3,170,213	$419,397	13.23 %
OREO Valuation Allowance and Expenses	42,702	358,722	(316,020)	(88.10 %)
Other Operating Expenses	2,474,108	2,834,751	(360,643)	(12.72 %)
Total Noninterest Expense	$6,106,420	$ 6,363,686	$(257,266)	(4.04 %)

For the three months ended June 30, 2013, noninterest expense decreased 4.04% or $257,266, to $6,106,420 from $6,363,686 for the comparable period in 2012. Increases in compensation and benefits were offset by decreases in OREO expenses and other operating expenses. Employee compensation and data processing continue to be impacted by greater regulatory compliance costs for both existing regulation and the initial impact of the Dodd-Frank Act. Other operating expenses for the three months ended June 30, 2013 decreased from the comparable period in 2012 due to one-time conversion costs for a change of the Bank’s data processing system in the first six months of 2012 and reductions in FDIC insurance. Depreciation and occupancy expense increased primarily due to the Company’s opening during the second half of 2012 a new operations center in Waldorf, Maryland and its 11th branch in King George,

Virginia.

Increased revenues and a moderate decrease in noninterest expenses have improved the Company's month efficiency ratio to 69.39% (68.90% without OREO revenues and expenses) for the three months ended June 30, 2013 from 77.29% (72.93% without OREO revenues and expenses) for the three months ended June 30, 2012.

The Company recorded income tax expense of $908,290 or 36.42%, of pretax earnings of $2,493,739, for the three months ended June 30, 2013 compared with $492,727 or 34.36%, of pretax earnings of $1,433,879, for the three months ended June 30, 2012. The increase in the effective tax rate was the result of tax exempt income being relatively lower to total income in 2013 than the comparable period in 2012.

FINANCIAL CONDITION – JUNE 30, 2013 AND DECEMBER 31, 2012

Assets	June 30, 2013 (Unaudited)	December 31, 2012	$ Change	% Change
Cash and due from banks	$10,768,998	$ 10,696,653	$72,345	0.68 %
Federal funds sold	3,470,000	190,000	3,280,000	1726.32 %
Interest-bearing deposits with banks	1,336,720	409,002	927,718	226.82 %
Securities available for sale (AFS), at fair value	54,103,851	47,205,663	6,898,188	14.61 %
Securities held to maturity (HTM), at amortized cost	99,896,483	112,619,434	(12,722,951)	(11.30 %)
FHLB and FRB stock - at cost	6,666,550	5,476,050	1,190,500	21.74 %
Loans held for sale	320,000	-	320,000	n/a
Loans receivable - net of ALLL of $8,033,553 and $8,246,957	745,251,604	747,640,752	(2,389,148)	(0.32 %)
Premises and equipment, net	19,289,816	19,782,236	(492,420)	(2.49 %)
Other real estate owned (OREO)	6,932,177	6,891,353	40,824	0.59 %
Accrued interest receivable	2,902,627	2,904,325	(1,698)	(0.06 %)
Investment in bank owned life insurance	19,039,007	18,730,580	308,427	1.65 %
Other assets	10,124,507	9,093,164	1,031,343	11.34 %
Total Assets	$980,102,340	$ 981,639,212	$(1,536,872)	(0.16 %)

Total assets at June 30, 2013 of $980,102,340 decreased by $1,536,872 compared to total assets of $981,639,212 at December 31, 2012 and reflect a stable loan portfolio. The decrease in total assets was attributable to a decrease in the loan portfolio and securities, partially offset by an increase in cash and cash equivalents. The differences in allocations between the different cash and investment categories reflect operational needs.

Details of the Bank’s loan portfolio are presented below:

	June 30, 2013	%	December 31, 2012	%
Commercial real estate	$434,616,482	57.62 %	$ 419,667,312	55.47 %
Residential first mortgages	165,433,554	21.93 %	177,663,354	23.48 %
Construction and land development	29,119,080	3.86 %	31,818,782	4.21 %
Home equity and second mortgage	21,769,081	2.89 %	21,982,375	2.91 %
Commercial loans	84,992,780	11.27 %	88,157,606	11.65 %
Consumer loans	937,147	0.12 %	995,206	0.13 %
Commercial equipment	17,347,472	2.30 %	16,267,684	2.15 %
	754,215,596	100.00%	756,552,319	100.00%
Less:				
Deferred loan fees	930,439	0.12 %	664,610	0.09 %
Allowance for loan loss	8,033,553	1.07 %	8,246,957	1.09 %

	8,963,992	8,911,567
	$745,251,604	$ 747,640,752

Loans decreased $2,389,148 from $747,640,752 at December 31, 2012 to $745,251,604 at June 30, 2013, due primarily to net decreases in residential mortgages, construction and land development loans and commercial loans partially offset by increases in loans for commercial real estate and commercial equipment. First and second quarter 2013 residential loan production was focused on loans originated for sale in the secondary market.

Asset Quality	June 30, 2013	December 31, 2012	$ Change	% Change
Gross Loans	$754,215,596	$ 756,552,319	$(2,336,723)	(0.31 %)
Allowance for loan loss (ALLL)	8,033,553	8,246,957	(213,404)	(2.59 %)
Foreclosed real estate (OREO)	6,932,177	6,891,353	40,824	0.59 %
Past due loans (PDLs) 31-89 days	1,346,283	3,175,431	(1,829,148)	(57.60 %)
Nonperforming loans >= 90 days Delinquent (NPLs)	12,304,205	8,717,018	3,587,187	41.15 %
Nonperforming assets (NPLs + OREO)	19,236,382	15,608,371	3,628,011	23.24 %
Performing non-accrual loans	4,331,630	4,424,388	(92,758)	(2.10 %)
Troubled debt restructures (TDRs)	4,582,290	4,515,443	66,847	1.48 %
Allowance for loan losses (ALLL) to total loans	1.07 %	1.09 %		
Past due loans (PDLs) to total loans (31 to 89 days)	0.18 %	0.42 %		
Nonperforming loans (NPLs) to total loans (>=90 days)	1.63 %	1.15 %		
Loan delinquency (PDLs + NPLs) to total loans	1.81 %	1.57 %		
Allowance (ALLL) to nonperforming loans (NPLs)	65.29 %	94.61 %		
Nonperforming assets (NPLs +OREO) to total assets	1.96 %	1.59 %		
Nonperforming assets to gross loans + OREO	2.53 %	2.04 %		
Nonperforming assets, performing nonaccrual loans + TDRs to total assets (a)	2.87 %	2.50 %		

(a) Ratio was adjusted to remove duplication of loans that are both nonperforming and troubled debt restructures.

The allowance for loan losses decreased from 1.09% of loans at December 31, 2012 to 1.07% of loans at June 30, 2013 due to a decrease in loan balances, changes to certain general allowance factors that reflect changes in historical loss and delinquency rates and general economic conditions and a reduction in specific reserves on impaired loans. Management’s determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to: the overall loss experience; current economic conditions; size, growth and composition of the loan portfolio; financial condition of the borrowers; current appraised values of underlying collateral; and other relevant factors that, in management’s judgment, warrant recognition in providing an adequate allowance. Management believes that the allowance is adequate.

The allowance for loan losses decreased $213,404 from $8,246,957 at December 31, 2012 to $8,033,553 at June 30, 2013. The decrease in the allowance reflects an overall reduction in average loan balances and lower specific reserves partially offset by a dollar and percentage increase in the general allowance.

	June 30, 2013	December 31, 2012

		% of Gross Loans			% of Gross Loans	
General Allowance	$ 6,799,885	0.90	%	$ 6,699,300	0.89	%
Specific Allowance	1,233,668	0.17	%	1,547,657	0.20	%
Total Allowance	$ 8,033,553	1.07	%	$ 8,246,957	1.09	%

The specific allowance has decreased principally due to a trend in the overall improvement in asset quality over the past two years in the Bank's commercial portfolios, which include commercial real estate, commercial loans, commercial equipment and construction and land development. Classified loans in these portfolios decreased from $62,843,351 at December 31, 2011 compared to $44,806,691 at December 31, 2012 and $47,871,967 at June 30, 2013 (See Note 11 of the Consolidated Financial Statements). The $3,065,276 increase since December 31, 2012 in classified loans in the Bank's commercial portfolios primarily related to a line of credit on one well-secured stalled development project.

Nonperforming loans (90 days or greater delinquent) were $12,304,205 or 1.63% of total loans at June 30, 2013 compared to $8,717,018 or 1.15% of total loans at December 31, 2012. The Bank considers all nonperforming loans 90 days or greater delinquent to be non-accrual loans and in accordance with the Company’s policy all interest accrued but not collected from loans that are placed on non-accrual is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual.

The Bank had 30 nonperforming loans at June 30, 2013 compared to 34 nonperforming loans at December 31, 2012. The net increase of $3,587,187 was due to increases of 90 days or greater delinquency in commercial real estate of $1,635,613 and commercial loans of $2,227,331, partially offset by reductions in nonperforming residential first mortgages of $189,870, home equity and second mortgages of $71,296 and commercial equipment loans of $64,591. Nonperforming loans at June 30, 2013 included $5,992,123 or 49%, attributed to three well-secured customer relationships, of which $3,337,176 related to a line of credit on a stalled development project which was paid current during July 2013. Nonperforming loans increased from 1.28% to 1.63% from the first quarter of 2013 to the second quarter of 2013 due primarily to the line of credit on the stalled development project.

The Bank categorized six performing loans totaling $4,331,630 and $4,424,388 as non-accrual loans at June 30, 2013 and December 31, 2012, respectively. These six loans represent one well-secured commercial relationship with no specific reserves in the allowance due to the Bank's superior credit position with underlying collateral. It is management’s belief that there is no current risk of loss to the Bank for this relationship. These loans were classified as non-accrual loans due to the customer’s operating results. In accordance with the Company’s policy, interest income is recognized on a cash-basis for these loans.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $14,549,064 and $11,371,542 at June 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at June 30, 2013 and December 31, 2012 was $518,722 and $443,856, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $2,086,771 and $1,769,863 at June 30, 2013 and December 31, 2012, respectively. Interest due but not recognized on these balances at June 30, 2013 and December 31, 2012 was $207,561 and $182,106, respectively. Specific allowances on these balances at June 30, 2013 and December 31, 2012 were $642,960 and $732,189, respectively, and are based on management’s evaluation of the underlying collateral and utilization of the Bank’s credit evaluation criteria.

The overall delinquency rate (loans past due 31-89 days and 90 days or greater) improved 45 basis points from 2.26% at March 31, 2013 to 1.81% at June 30, 2013 and was 24 basis points higher than the December 31, 2012 delinquency rate of 1.57%.

At June 30, 2013, the Bank had 11 TDRs totaling $4,582,290 compared to 10 TDRs totaling $4,515,443 as of December 31, 2012. All TDRs were performing according to the terms of their restructured agreements with no

specific reserves in the allowance for loan losses at June 30, 2013 and at December 31, 2012, respectively.

Management continues to monitor these loans and is working to resolve these loans in a manner that will preserve the most value for the Company. Additional loan information is presented in this Quarterly Report on Form 10-Q under Note 11 and for prior years is presented in the Company’s Form 10-K for the year ended December 31, 2012.

The OREO balance was $6,932,177 at June 30, 2013 an increase of $40,824 compared to $6,891,353 at December 31, 2012. This increase consisted of additions of $370,800 offset by valuation allowances of $329,976 to adjust properties to current appraised values. OREO carrying amounts reflect management’s estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs.

At June 30, 2013, 98%, or $145,428,310, of the asset-backed securities portfolio was rated AAA by Standard & Poor’s or an equivalent credit rating from another major rating agency compared to 97%, or $150,317,560, at December 31, 2012. Debt securities are evaluated quarterly to determine whether a decline in their value is other-than-temporary (“OTTI”). No OTTI charges were recorded for the three and six months ended June 30, 2013 and the year ended December 31, 2012, respectively. Classified securities decreased $318,026 to $2,709,940 at June 30, 2013 from $3,027,966 at December 31, 2012.

The Bank's asset quality trends have been steadily improving over the last eight quarters. Loans classified as substandard, doubtful or loss, OREO assets and classified securities, have decreased $20,725,105 from $81,909,520 at September 30, 2011 to $61,184,415 at June 30, 2013

Liabilities	June 30, 2013 (Unaudited)	December 31, 2012	$ Change	% Change
Deposits				
Non-interest-bearing deposits	$89,565,889	$ 102,319,581	$(12,753,692)	(12.46 %)
Interest-bearing deposits	695,115,348	717,910,707	(22,795,359)	(3.18 %)
Total deposits	784,681,237	820,230,288	(35,549,051)	(4.33 %)
Short-term borrowings	24,000,000	1,000,000	23,000,000	2300.00 %
Long-term debt	70,501,763	60,527,208	9,974,555	16.48 %
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000,000	12,000,000	-	0.00 %
Accrued expenses and other liabilities	7,846,870	8,834,455	(987,585)	(11.18 %)
Total Liabilities	$899,029,870	$ 902,591,951	$(3,562,081)	(0.39 %)

Total liabilities decreased $3,562,081 or 0.39%, primarily due to a $35,549,051 decrease in deposits offset by a $32,974,555 increase in borrowings

Details of the Bank's deposit portfolio are presented below:

	June 30, 2013	%	December 31, 2012	%
Noninterest-bearing demand	$89,565,889	11.41 %	$ 102,319,581	12.47 %
Interest-bearing:				
Demand	65,617,584	8.36 %	67,351,757	8.21 %
Money market deposits	197,028,997	25.11 %	209,813,301	25.58 %
Savings	37,556,048	4.79 %	35,291,646	4.30 %
Certificates of deposit	394,912,719	50.33 %	405,454,003	49.43 %
Total interest-bearing	695,115,348	88.59 %	717,910,707	87.53 %
Total deposits	$784,681,237	100.00%	$ 820,230,288	100.00%

Deposits decreased $35,549,051 or 4.33%, to $784,681,237 at June 30, 2013 compared to $820,230,288 at December 31, 2012. The decrease in deposits was driven primarily by seasonal customer deposit activity consistent with normal fluctuations of customer accounts.

During the last two years, the Bank's focus has been on increasing transaction deposits, especially noninterest bearing deposits, to lower its overall cost of funds. As of June 30, 2013 the Bank's deposit funding consisted of 49.67% transaction accounts compared to 46.40% at June 30, 2012 and 50.33% at December 31, 2012. Average noninterest bearing deposits increased $15.7 million for the first six months of 2013 to $83.1 million from $67.4 million for the first six months of 2012. During the same timeframe, average time deposits decreased $43.1 million from $443.4 million to $400.3 million. Long-term debt increased $9,974,555 from $60,527,208 at December 31, 2012 to $70,501,763 at June 30, 2013. During the first quarter of 2013, the Company added $10 million in Federal Home Loan Bank advances with a four-year maturity and an interest rate of 0.87%.

The most recent FDIC Annual Summary of Deposit Survey for deposits held on June 30, 2012 indicated that the Bank is now the largest overall deposit holder with a market share of 20.00% in the Tri-County area which includes Charles, St. Mary's and Calvert counties. Increasing deposit market share and core deposit relationships contributed significantly to the Bank's reduction of funding costs.

Stockholders' Equity	June 30, 2013 (Unaudited)	December 31, 2012	$ Change	% Change
Preferred Stock at par of $1,000	$ 20,000,000	$ 20,000,000	$ -	0.00 %
Common Stock at par of $0.01	30,455	30,524	(69)	(0.23 %)
Additional paid in capital	18,222,907	17,873,560	349,347	1.95 %
Retained earnings	44,283,597	41,986,633	2,296,964	5.47 %
Accumulated other comprehensive gain (loss)	(679,594)	139,184	(818,778)	(588.27 %)
Unearned ESOP shares	(784,895)	(982,640)	197,745	(20.12 %)
Total Stockholders' Equity	$ 81,072,470	$ 79,047,261	$ 2,025,209	2.56 %

During the six months ended June 30, 2013, stockholders' equity increased $2,025,209 to $81,072,470. The increase in stockholders' equity was due to net income of $3,303,840 and net stock related activities of $249,385 partially offset by quarterly common dividends paid of $609,238, quarterly preferred stock dividends of $100,000 and adjustments to other comprehensive income of $818,778. Other comprehensive losses increased during the second quarter primarily due to market valuation adjustments of the Company's available for sale (AFS) asset-backed securities portfolio as a result of increases in long-term interest rates. The Company believes that AFS securities with unrealized losses will either recover in market value or be paid off as agreed. The Company intends to and has the ability to hold these securities to maturity. Increases in common stockholders' equity to $61,072,470 at June 30, 2013 have resulted in a book value of $20.05 per common share. The Company remains well-capitalized at June 30, 2013 with a Tier 1 capital to average asset ratio of 9.77%.

The Company had paid annual cash dividends on common stock since 1994. During the first quarter of 2013, the Board of Directors announced a change to a quarterly dividend in place of its previous annual dividend and that the expected total dividend to be paid in 2013 will be $0.40 per share.

LIQUIDITY AND CAPITAL RESOURCES

The Company has no business other than holding the stock of the Bank and does not currently have any material funding requirements, except for the payment of dividends on preferred and common stock, and the payment of interest on subordinated debentures.

The Company's principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank's principal sources of funds for investment and operations are net income, deposits, sales of loans, borrowings, principal and interest payments on loans, principal and interest received on investment securities and proceeds from the maturity and sale of investment securities. Its principal funding commitments are for the origination or purchase of loans, the purchase of securities and the payment of maturing deposits. Deposits are considered the primary source of funds supporting the Bank's lending and investment activities. The Bank also uses borrowings from the Federal Home Loan Bank (FHLB) of Atlanta to supplement deposits. The amount of FHLB advances available to the Bank is limited to the lower of 30% of Bank assets or the amount supportable by eligible collateral including FHLB stock, loans and securities. In addition, the Bank has established lines of credit with the Federal Reserve Bank and commercial banks.

For additional information regarding these arrangements, including collateral, refer to Note 10 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

The Bank's most liquid assets are cash, cash equivalents and federal funds sold. The levels of such assets are dependent on the Bank's operating, financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows.

Cash, federal funds sold, and interest-bearing deposits with banks as of June 30, 2013 totaled $15,575,718, an increase of $4,280,063 or 37.89%, from the December 31, 2012 total of $11,295,655. The increase in cash was primarily due to cash generated from net income, net proceeds received from maturing investment securities, an excess of principal collected on loans over loan originations and increases in short-term and long-term borrowings. These increases to cash were partially offset by a net decrease in deposits.

During the first six months of 2013, all financing activities used $3,290,476 in cash compared to $9,913,246 in cash used for the same period in 2012. The Bank used $6,622,770 less cash for financing activities in the six months ended

June 30, 2013 compared to the six months ended June 30, 2012, primarily due to an increase in borrowings partially offset by a net decrease in deposits. The Bank borrowed $33,000,000 for the six months ended June 30, 2013 compared to $3,000,000 for the six months ended June 30, 2012. Customer deposits for the six months ended June 30, 2013 decreased $35,549,051 compared to a decrease in deposits of $11,478,877 for the six months ended June 30, 2012. The Company moved to a quarterly dividend in 2013 and as a result used $612,333 less cash to pay dividends of $709,238 during the six months ended June 30, 2013 compared to $1,321,571 for the six months ended June 30, 2012. Other financing activities increased cash provided $80,611.

Operating activities provided cash of $3,134,962 for six months ended June 30, 2013 compared to $5,163,197 of cash provided in the same period of 2012, a decrease in cash of $2,028,235 from the comparable period in 2012. Cash decreased primarily due to decreases in other assets and the provision for loan losses and a decrease in accrued expenses partially offset by an increase in net income.

Investing activities provided cash of $4,435,577 for six months ended June 30, 2013 compared to $2,349,746 of cash used for the same period of 2012. The increase in cash of $6,785,323 was primarily due to the growth in the excess of principal payments collected over loan originations which resulted in $28,136,939 of cash provided variance. For the six months ended June 30, 2012, loans originated exceeded principal collected by $26,623,048 compared to the six months ended June 30, 2013, in which loans originated were less than principal collected by $1,513,891. Additionally, net cash provided increased $3,247,595 for the six months ended June 30, 2013, as 2012 incurred costs were expended in 2012 for premises and equipment related to acquisition and construction costs for the operations center in Waldorf, Maryland and the King George, Virginia branch. These increases to cash were offset by a decrease in net cash provided from investment transactions from $27,377,564 of cash provided for the six months ended June 30, 2012 to $3,066,385 of cash provided for the six months ended June 30, 2013. Additionally cash decreased $288,032 due to a reduction in net proceeds from sales of OREO and asset disposals.

REGULATORY MATTERS

The Bank is subject to Federal Reserve Board capital requirements as well as statutory capital requirements imposed under Maryland law. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table. The Company's and the Bank's actual capital amounts and ratios at June 30, 2013 and December 31, 2012, respectively are presented in the following tables.

At June 30, 2013	Actual		Required for Capital Adequacy Purposes		To be Considered Well Capitalized Under Prompt Corrective Action	
(in thousands)						
Total Capital (to risk weighted assets)						
The Company	$101,832	13.07%	$ 62,282	8.00 %		
The Bank	$100,224	12.89%	$ 62,170	8.00 %	$ 77,712	10.00 %
Tier 1 Capital (to risk weighted assets)						
The Company	$93,752	12.03%	$ 31,141	4.00 %		
The Bank	$92,144	11.85%	$ 31,085	4.00 %	$ 46,627	6.00 %
Tier 1 Capital (to average assets)						
The Company	$93,752	9.77 %	$ 38,364	4.00 %		
The Bank	$92,144	9.62 %	$ 38,308	4.00 %	$ 47,886	5.00 %

At December 31, 2012	Actual		Required for Capital Adequacy Purposes		To be Considered Well Capitalized Under Prompt Corrective Action	
(in thousands)						
Total Capital (to risk weighted assets)						
The Company	$99,280	12.84%	$ 61,842	8.00 %		
The Bank	$96,600	12.55%	$ 61,586	8.00 %	$ 76,983	10.00 %
Tier 1 Capital (to risk weighted assets)						
The Company	$90,908	11.76%	$ 30,921	4.00 %		
The Bank	$88,228	11.46%	$ 30,793	4.00 %	$ 46,190	6.00 %
Tier 1 Capital (to average assets)						
The Company	$90,908	9.39 %	$ 38,723	4.00 %		
The Bank	$88,228	9.14 %	$ 38,595	4.00 %	$ 48,244	5.00 %

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are defined as those that involve significant judgments and uncertainties and could potentially result in materially different results under different assumptions and conditions. The Company considers its determination of the allowance for loan losses, the determination of other-than-temporarily impaired securities, the valuation of foreclosed real estate and the valuation of deferred tax assets to be critical accounting policies.

The Company’s Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and the general practices of the United States banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements. Accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When these sources are not available, management makes estimates based upon what it considers to be the best available information.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that exist in the loan portfolio. The allowance is based on two principles of accounting: (1) Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 450 “Contingencies,” which requires that losses be accrued when they are probable of occurring and are estimable and (2) FASB ASC 310 “Receivables,” which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, is determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows and values observable in the secondary markets.

The allowance for loan loss balance is an estimate based upon management’s evaluation of the loan portfolio. The allowance is comprised of a specific and a general component. The specific component consists of management’s evaluation of certain classified impaired and non-accrual loans and their underlying collateral. Management assesses the ability of the borrower to repay the loan based upon all information available. Loans are examined to determine a specific allowance based upon the borrower’s payment history, economic conditions specific to the loan or borrower and other factors that would impact the borrower’s ability to repay the loan on its contractual basis. Depending on the assessment of the borrower’s ability to pay and the type, condition and value of collateral, management will establish an allowance amount specific to the loan.

Management utilizes a risk scale to assign grades to commercial real estate, construction and land development, commercial loans and commercial equipment loans. Commercial loan relationships with an aggregate exposure to the Bank of $750,000 or greater are risk rated. Residential first mortgages, home equity and second mortgages and

consumer loans are evaluated for creditworthiness in underwriting and are monitored on an ongoing basis based on borrower payment history. Consumer loans and residential real estate loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned or higher risk rating due to a delinquent payment history.

The Bank's commercial loan portfolio is periodically reviewed by regulators and independent consultants engaged by management. These reviews validate the Bank's asset classifications and may result in adjustments to provisions based on the field examination team's assessment of information available at the time of the examination.

In establishing the general component of the allowance, management analyzes non-impaired loans in the portfolio including changes in the amount and type of loans. Management also examines historical loss experience (charge-offs and recoveries) within each loan category. The state of the local and national economy is also considered. Based upon these factors, the Bank's loan portfolio is categorized and a loss factor is applied to each category. Based upon these factors, the Bank will adjust the loan loss allowance by increasing or decreasing the provision for loan losses.

Management has significant discretion in making the judgments inherent in the determination of the allowance for loan losses, including in connection with the valuation of collateral, a borrower's prospects of repayment and in establishing loss factors on the general component of the allowance. Changes in loss factors will have a direct impact on the amount of the provision and a corresponding effect on net income. Errors in management's perception and assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs. An increase or decrease in the allowance could result in a charge or credit to income before income taxes that materially impacts earnings.

For additional information regarding the allowance for loan losses, refer to Notes 1 and 5 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

Other-Than-Temporary-Impairment ("OTTI")

Debt securities are evaluated quarterly to determine whether a decline in their value is other-than-temporary. The term "other-than-temporary" is not necessarily intended to indicate a permanent decline in value. It means that the prospects for near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Under the revised guidance, for recognition and presentation of other-than-temporary impairments the amount of other-than-temporary impairment that is recognized through earnings for debt securities is determined by comparing the present value of the expected cash flows to the amortized cost of the security. The discount rate used to determine the credit loss is the expected book yield on the security.

For additional information regarding the evaluation of OTTI, refer to Notes 4 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

Other Real Estate Owned ("OREO")

The Company maintains a valuation allowance on its other real estate owned. As with the allowance for loan losses, the valuation allowance on OREO is based on FASB ASC 450 "Contingencies," as well as the accounting guidance on impairment of long-lived assets. These statements require that the Company establish a valuation allowance when it has determined that the carrying amount of a foreclosed asset exceeds its fair value. Fair value of a foreclosed asset is measured by the cash flows expected to be realized from its subsequent disposition. These cash flows are reduced for the costs of selling or otherwise disposing of the asset.

In estimating the cash flows from the sale of OREO, management must make significant assumptions regarding the timing and amount of cash flows. For example, in cases where the real estate acquired is undeveloped land, management must gather the best available evidence regarding the market value of the property, including appraisals, cost estimates of development and broker opinions. Due to the highly subjective nature of this evidence, as well as the limited market, long time periods involved and substantial risks, cash flow estimates are highly subjective and subject to change. Errors regarding any aspect of the costs or proceeds of developing, selling or otherwise disposing of foreclosed real estate could result in the allowance being inadequate to reduce carrying costs to fair value and may require an additional provision for valuation allowances.

For additional information regarding foreclosed real estate, refer to Notes 1 and 7 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

Deferred Tax Assets

The Company accounts for income taxes in accordance with FASB ASC 740, "Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FASB ASC 740 requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

The Company periodically evaluates the ability of the Company to realize the value of its deferred tax assets. If the Company were to determine that it was not more likely than not that the Company would realize the full amount of the deferred tax assets, it would establish a valuation allowance to reduce the carrying value of the deferred tax asset to the amount it believes would be realized. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax-planning strategies that could be implemented to realize the net deferred tax assets.

Failure to achieve forecasted taxable income might affect the ultimate realization of the net deferred tax assets. Factors that may affect the Company's ability to achieve sufficient forecasted taxable income include, but are not limited to, the following: increased competition, a decline in net interest margin, a loss of market share, decreased demand for financial services and national and regional economic conditions.

The Company's provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of management judgment and are based on the best information available at the time. The Company operates within federal and state taxing jurisdictions and is subject to audit in these jurisdictions.

For additional information regarding the deferred tax assets, refer to Note 11 in the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2012.

ITEM 3. Quantitative and qualitative Disclosure about Market Risk

Not applicable as the Company is a smaller reporting company.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, management of the Company carried out an evaluation, under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, (1) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (2) is accumulated and communicated to the Company's management, including its principal executive and financial officers as appropriate to allow timely decisions regarding required disclosure. It should be noted that the design of the Company's disclosure controls and procedures is based in part upon certain reasonable assumptions about the likelihood of future events, and there can be no reasonable assurance that any design of disclosure controls and procedures will succeed in achieving its stated goals under all potential future conditions, regardless of how remote, but the Company's principal executive and financial officers have concluded that the Company's disclosure controls and procedures are, in fact, effective at a reasonable assurance level. There were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2013 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings – The Company is not involved in any pending legal proceedings. The Bank is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the financial condition and results of operations of the Company.

Item 1A - Risk Factors - In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A- Risk Factors" in the Form 10-K, which could materially affect our business, financial condition or future results. The risks described in the Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

(a)	Not applicable
(b)	Not applicable

(c) On September 25, 2008, the Company announced a repurchase program under which it would repurchase up to 5% of its outstanding common stock or approximately 147,435 shares. The program will continue until it is completed or terminated by the Company's Board of Directors. As of June 30, 2013, 80,074 shares were available to be repurchased under the repurchase program. The following schedule provides repurchases for the three months ended June 30, 2013.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1-30, 2013	1,454	$ 18.39	1,454	88,714
May 1-31, 2013	3,734	18.27	3,734	84,980
June 1-30, 2013	4,906	18.45	4,906	80,074
Total	10,094	$ 18.37	10,094	80,074

Item 3 - Default Upon Senior Securities - None

Item 4 – Mine Safety Disclosures – Not Applicable

Item 5 - Other Information - None

Item 6 - Exhibits

Exhibit	10.1 – Supplemental Executive Retirement Plan agreement, dated January 1, 2011 and First Amendment to the Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with Gregory C. Cockerham
Exhibit	10.2 – Supplemental Executive Retirement Plan agreement, dated January 1, 2011 and First Amendment to the Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with William J. Pasenelli
Exhibit	10.3 – First Amendment to the Employment Agreement, dated April 20, 2007, with William J. Pasenelli
Exhibit	31 - Rule 13a-14(a) Certifications
Exhibit	32 - Section 1350 Certifications
Exhibit	101.0* - The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Cash Flows; and (iv) the Notes to the Consolidated Financial Statements.

* Furnished, not filed.

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.

TRI-COUNTY FINANCIAL CORPORATION

Date: August 14, 2013

By: /s/ Michael L. Middleton
Michael L. Middleton
Chief Executive Officer

Date: August 14, 2013

By: /s/ William J. Pasenelli
William J. Pasenelli
President and Chief Financial Officer

53