FIRST UNITED CORP/MD/
Form 10-K
March 05, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008
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 0-14237

FIRST UNITED CORPORATION
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	52-1380770 (I.R.S. Employer Identification Number)
19 South Second Street, Oakland, Maryland (Address of principal executive offices)	21550-0009 (Zip Code)

Registrant's telephone number, including area code: (800) 470-4356

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

Title of Each Class:	Name of Each Exchange on Which Registered:
Common Stock, par value $.01 per share	NASDAQ Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No x

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 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 if disclosures of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.o

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 definition of "accelerated filer", "large accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act). (check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

The aggregate market value of the registrant's outstanding voting and non-voting common equity held by non-affiliates as of June 30, 2008: $ 106,519,790.

The number of shares of the registrant's common stock outstanding as of February 28, 2009: 6,122,411

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2008 Annual Meeting of Shareholders to be filed with the SEC pursuant to Regulation 14A are incorporated by reference into Part III of this Annual Report on Form 10-K.

First United Corporation
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Forward-Looking Statements

This Annual Report of First United Corporation (the "Corporation" on a parent only basis and "we", "our" or "us", on a consolidated basis) filed on Form 10-K may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of "forward-looking statements". Statements that are not historical in nature, including those that include the words "anticipate", "estimate", "should", "expect", "believe", "intend", and similar expressions, are based on current expectat estimates and projections about, among other things, the industry and the markets in which the Corporation operates, and they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this report; general economic, market, or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in our competitive position or competitive actions by other companies; changes in the quality or composition of loan and investment portfolios; the ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond our control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on our business or operations. For a more complete discussion of these and other risk factors, see Item 1A of Part I of this report. Except as required by applicable laws, the Corporation does not intend to publish updates or revisions of forward-looking statements it makes to reflect new information, future events or otherwise.

PART I

ITEM 1. BUSINESS

General

The Corporation is a Maryland corporation chartered in 1985 and a financial holding company registered under the federal Bank Holding Company Act of 1956, as amended (the "BHC Act"). The Corporation's primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company (the "Bank"), First United Insurance Group, LLC, a Maryland insurance agency (the "Insurance Group"), OakFirst Loan Center, Inc., a West Virginia finance company, and OakFirst Loan Center, LLC, a Maryland finance company, (together with OakFirst Loan Center, Inc. the "OakFirst Loan Centers"). OakFirst Loan Center, Inc. has one subsidiary, First United Insurance Agency, Inc., which is a Maryland insurance agency.

At December 31, 2008, the Corporation had assets of approximately $1.64 billion, net loans of approximately $1.12 billion, and deposits of approximately $1.22 billion. Shareholders' equity at December 31, 2008 was approximately $73 million.

The Corporation maintains an Internet site at www.mybankfirstunited.com on which it makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the Securities and Exchange Commission (the "SEC").

Banking Products and Services

The Bank operates 26 banking offices, one call center and 32 Automated Teller Machines ("ATM's") in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Berkeley County, Mineral County, and Monongalia County in West Virginia. The Bank is an independent community bank providing a complete range of retail and commercial banking services to businesses and individuals in its market areas. Services offered are essentially the same as those offered by the regional institutions that compete with the Bank and include checking, savings, and money market deposit accounts, business loans, personal loans, mortgage loans, lines of credit, and consumer-oriented retirement accounts including individual retirement account ("IRA") and employee benefit accounts. In addition, the Bank provides full brokerage services through a networking arrangement with PrimeVest Financial Services, Inc., a full service broker-dealer. The Bank also provides safe deposit and night depository facilities, and a complete line of insurance products and trust services. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC").

Lending Activities—The majority of the Corporation's lending activities are conducted through the Bank.

The Bank's commercial loans are primarily secured by real estate, commercial equipment, vehicles or other assets of the borrower. Repayment is often dependent on the successful operation of the borrower and may be affected by adverse conditions in the local economy or real estate market. The financial condition and cash flow of commercial borrowers is therefore carefully analyzed during the loan approval process, and continues to be monitored by obtaining business financial statements, personal financial statements and income tax returns. The frequency of this ongoing analysis depends upon the size and complexity of the credit and collateral that secures the loan. It is also the Bank's general policy to obtain personal guarantees from the principals of the commercial loan borrowers.

Commercial real estate loans are primarily those secured by land for residential and commercial development, agricultural purpose properties, service industry buildings such as restaurants and motels, retail buildings and general purpose business space. The Bank attempts to mitigate the risks associated with these loans through low loan to value ratio standards, thorough financial analyses, and management's knowledge of the local economy in which the Bank lends.

The risk of loss associated with commercial real estate construction lending is controlled through conservative underwriting procedures such as loan to value ratios of 80% or less, obtaining additional collateral when prudent, and closely monitoring construction projects to control disbursement of funds on loans.

The Bank's residential mortgage portfolio is distributed between variable and fixed rate loans. Many loans are booked at fixed rates in order to meet the Bank's requirements under the Community Reinvestment Act. Other fixed rate residential mortgage loans are originated in a brokering capacity on behalf of other financial institutions, for which the Bank receives a fee. As with any consumer loan, repayment is dependent on the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy. Residential mortgage loans exceeding an internal loan-to-value ratio require private mortgage insurance. Title insurance protecting the Bank's lien priority, as well as fire and casualty insurance, are also required.

Home equity lines of credit, included within the residential mortgage portfolio, are secured by the borrower's home and can be drawn on at the discretion of the borrower. These lines of credit are at variable interest rates.

The Bank also provides residential real estate construction loans to builders and individuals for single family dwellings. Residential construction loans are usually granted based upon "as completed" appraisals and are secured by the property under construction. Site inspections are performed to determine pre-specified stages of completion before loan proceeds are disbursed. These loans typically have maturities of six to 12 months and may have a fixed or variable rate. Permanent financing for individuals offered by the Bank includes fixed and variable rate loans with three, five or seven year adjustable rate mortgages.

A variety of other consumer loans are also offered to customers, including indirect and direct auto loans, and other secured and unsecured lines of credit and term loans. Careful analysis of an applicant's creditworthiness is performed before granting credit, and on-going monitoring of loans outstanding is performed in an effort to minimize risk of loss by identifying problem loans early.

An allowance for loan losses is maintained to provide for anticipated losses from our lending activities. A complete discussion of the factors considered in determination of the allowance for loan losses is included in Item 7 of Part II of this report.

Additionally, we meet the lending needs of under-served customer groups within our market areas in part through OakFirst Loan Center, Inc., located in Martinsburg, West Virginia, and OakFirst Loan Center, LLC, located in

Hagerstown, Maryland.

Deposit Activities—The Bank offers a full array of deposit products including checking, savings and money market accounts, regular and IRA certificates of deposit, Christmas Savings accounts, College Savings accounts, and Health Savings accounts. The Bank also offers the CDARS program to municipalities, businesses, and consumers, providing them up to $50 million of FDIC insurance. In addition, we offer our commercial customers packages which include Treasury Management, Cash Sweep and various checking opportunities.

Trust Services—The Bank's Trust Department offers a full range of trust services, including personal trust, investment agency accounts, charitable trusts, retirement accounts including IRA roll-overs, 401(k) accounts and defined benefit plans, estate administration and estate planning.

Information about our income from and assets related to our banking business may be found in the consolidated statements of financial condition and the consolidated statements of income and the related notes thereto included in Item 8 of Part II of this annual report. At December 31, 2008, 2007 and 2006, the total market value of assets under the supervision of the Bank's Trust Department was approximately $472 million, $547 million and $502 million, respectively. Trust Department revenues for these years may be found in the Consolidated Statements of Income under the heading "Other operating income", which is contained in Item 8 of Part II of this annual report.

Insurance Activities

We offer a full range of insurance products and services to customers in our market areas through the Insurance Group and First United Insurance Agency, Inc. Information about income from insurance activities for each of the years ended December 31, 2008, 2007 and 2006 may be found under "Other Operating Income" in the consolidated statements of income included in Item 8 of Part II of this annual report.

COMPETITION

The banking business, in all of its phases, is highly competitive. Within our market areas, we compete with commercial banks, (including local banks and branches or affiliates of other larger banks), savings and loan associations and credit unions for loans and deposits, with consumer finance companies for loans, with insurance companies and their agents for insurance products, and with other financial institutions for various types of products and services. There is also competition for commercial and retail banking business from banks and financial institutions located outside our market areas.

The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations and office hours. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services and personalized services.

To compete with other financial services providers, we rely principally upon local promotional activities, personal relationships established by officers, directors and employees with its customers, and specialized services tailored to meet its customers' needs. In those instances in which we are unable to accommodate a customer's needs, we attempt to arrange for those services to be provided by other financial services providers with which we have a relationship.

The following table sets forth deposit data for the Maryland and West Virginia Counties in which the Bank maintains offices as of June 30, 2008, the most recent date for which comparative information is available.

	Offices (in Market)	Deposits (in thousands)	Market Share
Allegany County, Maryland:			
Susquehanna Bank	5	$ 224,368	36.72%
Manufacturers & Traders Trust Company	7	172,975	28.31%
First United Bank & Trust	4	126,714	20.74%
PNC Bank NA	3	51,300	8.39%
Standard Bank	2	35,746	5.85%

Source: FDIC Deposit Market Share Report

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Frederick County, Maryland:			
PNC Bank NA	20	1,015,594	32.82%
Branch Banking & Trust Co.	12	593,671	19.18%
Frederick County Bank	4	225,184	7.28%
Bank Of America NA	5	222,764	7.20%
Manufacturers & Traders Trust Company	6	185,296	5.99%
Chevy Chase Bank FSB	6	152,430	4.93%
Woodsboro Bank	7	150,069	4.85%
Middletown Valley Bank	4	131,044	4.23%
SunTrust Bank	3	121,831	3.94%
First United Bank & Trust	3	103,390	3.34%
Sandy Spring Bank	4	65,731	2.12%
Provident Bank of Maryland	2	34,602	1.12%
Damascus Community Bank	2	22,152	0.72%
Wachovia Bank NA	1	16,287	0.53%
Columbia Bank	2	16,197	0.52%
Sovereign Bank	3	15,887	0.51%
Graystone Bank	1	11,591	0.37%
BlueRidge Bank	1	11,166	0.36%

Source: FDIC Deposit Market Share Report

Garrett County, Maryland:			
First United Bank & Trust	5	579,636	74.84%
Manufacturers & Traders Trust Co.	5	95,043	12.27%
Susquehanna Bank	2	70,569	9.11%
Clear Mountain Bank	1	25,408	3.28%
Miners & Merchants Bank	1	3,861	0.50%

Source: FDIC Deposit Market Share Report

Washington County, Maryland:			
Susquehanna Bank	10	607,697	30.67%
Hagerstown Trust Co.	11	398,102	20.09%
Manufacturers & Traders Trust Company	12	386,594	19.51%
Sovereign Bank	4	195,022	9.84%
PNC Bank NA	6	153,804	7.76%
First United Bank & Trust	3	68,526	3.46%
First National Bank of Greencastle	3	46,069	2.33%
Centra Bank	2	37,928	1.91%
Chevy Chase Bank FSB	3	37,310	1.88%
Citizens National Bank of Berkeley Springs	1	30,892	1.56%
Orrstown Bank	1	10,706	0.54%
Jefferson Security Bank	1	5,983	0.30%
Middletown Valley Bank	1	2,777	0.14%

Source: FDIC Deposit Market Share Report

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Berkeley County, West Virginia:

Branch Banking & Trust Co.	5	311,844	30.97%
Centra Bank Inc.	3	217,491	21.60%
First United Bank & Trust	5	118,775	11.80%
City National Bank of West Virginia	4	106,957	10.62%
Susquehanna Bank	4	102,314	10.16%
Jefferson Security Bank	2	59,555	5.92%
Bank of Charles Town	2	42,352	4.21%
Citizens National Bank of Berkeley Springs	3	35,157	3.49%
Summit Community Bank	1	9,117	0.91%
MVB Bank Inc.	1	3,221	0.32%

Source: FDIC Deposit Market Share Report

Hardy County, West Virginia:

Summit Community Bank, Inc.	2	308,677	65.58%
Capon Valley Bank	3	111,206	23.63%
Pendleton Community Bank, Inc.	1	23,493	4.99%
First United Bank & Trust	1	16,188	3.44%
Grant County Bank	1	11,148	2.37%

Source: FDIC Deposit Market Share Report

Mineral County, West Virginia:

First United Bank & Trust	2	82,627	33.08%
Branch Banking & Trust Co.	2	80,665	32.29%
Manufacturers & Traders Trust Co.	2	49,596	19.85%
Grant County Bank	1	36,905	14.77%

Source: FDIC Deposit Market Share Report

Monongalia County, West Virginia:

Centra Bank, Inc.	6	461,896	28.39%
Huntington National Bank	5	389,495	23.94%
Branch Banking & Trust Co.	5	342,964	21.08%
United Bank	4	183,521	11.28%
Wesbanco Bank, Inc.	5	85,731	5.27%
Clear Mountain Bank	5	77,151	4.74%
First United Bank & Trust	2	40,264	2.48%
First Exchange Bank	2	23,804	1.46%
Citizens Bank of Morgantown, Inc.	1	21,991	1.35%

Source: FDIC Deposit Market Share Report

For further information about competition in our market areas, see the Risk Factor entitled “We operate in a competitive environment” in Item 1A of Part I of this annual report.

SUPERVISION AND REGULATION

The following is a summary of the material regulations and policies applicable to the Corporation and its subsidiaries and is not intended to be a comprehensive discussion. Changes in applicable laws and regulations may have a material effect on our business.

General

The Corporation is a financial holding company registered with the Board of Governors of the Federal Reserve System (the "FRB") under the BHC Act and, as such, is subject to the supervision, examination and reporting requirements of the BHC Act and the regulations of the FRB.

The Bank is a Maryland trust company subject to the banking laws of Maryland and to regulation by the Commissioner of Financial Regulation of Maryland, who is required by statute to make at least one examination in each calendar year (or at 18-month intervals if the Commissioner determines that an examination is unnecessary in a particular calendar year). The Bank also has offices in West Virginia, and the operations of these offices are subject to West Virginia laws and to supervision and examination by the West Virginia Division of Banking. As a member of the FDIC, the Bank is also subject to certain provisions of federal law and regulations regarding deposit insurance and activities of insured state-chartered banks, including those that require examination by the FDIC. In addition to the foregoing, there are a myriad of other federal and state laws and regulations that affect, impact or govern the business of banking, including consumer lending, deposit-taking, and trust operations.

All non-bank subsidiaries of the Corporation are subject to examination by the FRB, and, as affiliates of the Bank, are subject to examination by the FDIC and the Commissioner of Financial Regulation of Maryland. In addition, OakFirst Loan Center, Inc. is subject to licensing and regulation by the West Virginia Division of Banking, OakFirst Loan Center, LLC is subject to licensing and regulation by the Commissioner of Financial Regulation of Maryland, and the Insurance Group and First United Insurance Agency, Inc. are each subject to licensing and regulation by various state insurance authorities. Retail sales of insurance products by these insurance affiliates are also subject to the requirements of the Interagency Statement on Retail Sales of Nondeposit Investment Products promulgated in 1994 by the FDIC, the FRB, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

Regulation of Financial Holding Companies

In November 1999, the federal Gramm-Leach-Bliley Act (the "GLB Act") was signed into law. The GLB Act revised the BHC Act and repealed the affiliation provisions of the Glass-Steagall Act of 1933, which, taken together, limited the securities, insurance and other non-banking activities of any company that controls an FDIC insured financial institution. Under the GLB Act, a bank holding company can elect, subject to certain qualifications, to become a "financial holding company." The GLB Act provides that a financial holding company may engage in a full range of financial activities, including insurance and securities sales and underwriting activities, and real estate development, with new expedited notice procedures. Maryland law generally permits state-chartered banks, including the Bank, to engage in the same activities, directly or through an affiliate, as national banking associations. The GLB Act permits certain qualified national banking associations to form financial subsidiaries, which have broad authority to engage in all financial activities except insurance underwriting, insurance investments, real estate investment or development, or merchant banking. Thus, the GLB Act has the effect of broadening the permitted activities of the Corporation and the Bank.

The Corporation and its affiliates are subject to the provisions of Section 23A and Section 23B of the Federal Reserve Act. Section 23A limits the amount of loans or extensions of credit to, and investments in, the Corporation and its non-bank affiliates by the Bank. Section 23B requires that transactions between the Bank and the Corporation and its non-bank affiliates be on terms and under circumstances that are substantially the same as with non-affiliates.

Under FRB policy, the Corporation is expected to act as a source of strength to the Bank, and the FRB may charge the Corporation with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. Accordingly, in the event that any insured subsidiary of the Corporation causes a loss to the FDIC, other insured subsidiaries of the Corporation could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guaranty liabilities generally are superior in priority to obligations of a financial institution to its shareholders and obligations to other affiliates.

Federal Banking Regulation

Federal banking regulators, such as the FRB and the FDIC, may prohibit the institutions over which they have supervisory authority from engaging in activities or investments that the agencies believe are unsafe or unsound banking practices. Federal banking regulators have extensive enforcement authority over the institutions they regulate to prohibit or correct activities that violate law, regulation or a regulatory agreement or which are deemed to be unsafe or unsound practices. Enforcement actions may include the appointment of a conservator or receiver, the issuance of a cease and desist order, the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution-affiliated parties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the removal of or restrictions on directors, officers, employees and institution-affiliated parties, and the enforcement of any such mechanisms through restraining orders or other court actions.

The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, and principal shareholders or any related interest of such persons, which generally require that such credit extensions be made on substantially the same terms as are available to third parties dealing with the Bank and not involve more than the normal risk of repayment. Other laws tie the maximum amount that may be loaned to any one customer and its related interests to capital levels.

As part of the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), each federal banking regulator adopted non-capital safety and soundness standards for institutions under its authority. These standards include internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. An institution that fails to meet those standards may be required by the agency to develop a plan acceptable to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. We believe that the Bank meets substantially all standards that have been adopted. FDICIA also imposes new capital standards on insured depository institutions.

The Community Reinvestment Act (“CRA”) requires the FDIC, in connection with its examination of financial institutions within its jurisdiction, to evaluate the record of those financial institutions in meeting the credit needs of their communities, including low and moderate income neighborhoods, consistent with principles of safe and sound banking practices. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank has a CRA rating of “Satisfactory”.

The Deposit Insurance Fund was created pursuant to the Federal Deposit Insurance Reform Act of 2005, which was signed into law on February 8, 2006. Under this new law, (i) the current $100,000 deposit insurance coverage will be indexed for inflation (with adjustments every five years, commencing January 1, 2011), and (ii) deposit insurance coverage for retirement accounts was increased to $250,000 per participant subject to adjustment for inflation. In addition, the FDIC will be given greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments. Effective October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the “EESA”) was enacted to temporarily raise the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The legislation states the limit will return to $100,000 after December 31, 2009. The coverage for retirement accounts did not change and remains at $250,000. The Bank is required to pay semi-annual deposit insurance premium assessments to the FDIC. The Bank paid $.5 million in FDIC premiums during 2008. Further information about deposit insurance premiums is provided in Item 7 of Part II of this report under the heading “Recent Developments”.

On October 14, 2008, the FDIC announced the creation of the Temporary Liquidity Guarantee Program (the “TLGP”) to decrease the cost of bank funding and, hopefully, normalize lending. This program is comprised of two components. The first component guarantees senior unsecured debt issued between October 14, 2008 and June 30, 2009. The guarantee will remain in effect until June 30, 2012 for such debts that mature beyond June 30, 2009. The second component provides full coverage for non-interest bearing transaction deposit accounts, IOLTAs, and NOW accounts with interest rates of 0.50 percent or less, regardless of account balance, until December 31, 2009. The Bank elected to participate in both programs and expects FDIC premiums to increase in 2009 as a result of its participation.

Capital Requirements

FDICIA established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, the federal banking regulators are required to rate supervised institutions on the basis of five capital categories: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critical undercapitalized;” and to take certain mandatory actions (and are authorized to take other discretionary actions) with respect to institutions in the three undercapitalized categories. The severity of the actions will depend upon the category in which the institution is placed. A depository institution is “well capitalized” if it has a total risk based capital ratio of 10% or greater, a Tier 1 risk based capital ratio of 6% or greater, and a leverage ratio of 5% or greater and is not subject to any order, regulatory agreement, or written directive to meet and maintain a specific capital level for any capital measure. An “adequately capitalized” institution is defined as one that has a total risk based capital ratio of 8% or greater, a Tier 1 risk based capital ratio of 4% or greater and a leverage ratio of 4% or greater (or 3% or greater in the case of a bank with a composite CAMEL rating of 1).

FDICIA generally prohibits a depository institution from making any capital distribution, including the payment of cash dividends, or paying a management fee to its holding company if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. For a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee (subject to certain limitations) that the institution will comply with such capital restoration plan.

Significantly undercapitalized depository institutions may be subject to a number of other requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized and requirements to reduce total assets and stop accepting deposits from correspondent banks. Critically undercapitalized depository institutions are subject to the appointment of a receiver or conservator; generally within 90 days of the date such institution is determined to be critically undercapitalized.

Further information about our capital resources is provided in the "Capital Resources" section of Item 7 of Part II of this annual report. Information about the capital ratios of the Corporation and of the Bank as of December 31, 2008 may be found in Note 2 to the Consolidated Financial Statements, which is included in Item 8 of Part II of this annual report.

USA PATRIOT ACT

Congress adopted the USA PATRIOT Act (the "Patriot Act") on October 26, 2001 in response to the terrorist attacks that occurred on September 11, 2001. Under the Patriot Act, certain financial institutions, including banks, are required to maintain and prepare additional records and reports that are designed to assist the government's efforts to combat terrorism. The Patriot Act includes sweeping anti-money laundering and financial transparency laws that require additional regulations, including, among other things, standards for verifying client identification when opening an account and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Federal Securities Law

The shares of the Corporation's common stock are registered with the Securities and Exchange Commission (the "SEC") under Section 12(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and listed on the NASDAQ Global Select Market. The Corporation is subject to information reporting requirements, proxy solicitation requirements, insider trading restrictions and other requirements of the Exchange Act, including the requirements imposed under the federal Sarbanes-Oxley Act of 2002. Among other things, loans to and other transactions with insiders are subject to restrictions and heightened disclosure, directors and certain committees of the Board must satisfy certain independence requirements, and the Corporation is generally required to comply with certain corporate governance requirements.

Governmental Monetary and Credit Policies and Economic Controls

The earnings and growth of the banking industry and ultimately of the Bank are affected by the monetary and credit policies of governmental authorities, including the FRB. An important function of the FRB is to regulate the national supply of bank credit in order to control recessionary and inflationary pressures. Among the instruments of monetary policy used by the FRB to implement these objectives are open market operations in U.S. Government securities, changes in the federal funds rate, changes in the discount rate of member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth of bank loans, investments and deposits and may also affect interest rates charged on loans or paid on deposits. The monetary policies of the FRB authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to have such an effect in the future. In view of changing conditions in the national economy and in the money markets, as well as the effect of actions by monetary and fiscal authorities, including the FRB, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or their effect on the business and earnings of the Corporation and its subsidiaries.

SEASONALITY

Management does not believe that our business activities are seasonal in nature. Deposit, loan, and insurance demand may vary depending on local and national economic conditions, but management believes that any variation will not have a material impact on our planning or policy-making strategies.

EMPLOYEES

At December 31, 2008, we employed approximately 485 individuals, of whom 380 were full-time employees.

ITEM 1A. RISK FACTORS

Our financial condition and results of operations are subject to numerous risks and uncertainties and could be materially and adversely affected by any of these risks and uncertainties. The risks and uncertainties that we believe are the most significant are discussed below. You should carefully consider these risks before making an investment decision with respect to any of the Corporation’s securities. This annual report also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this report.

Risks Relating to the Corporation and its Affiliates

The Corporation’s future depends on the successful growth of its subsidiaries.

The Corporation’s primary business activity for the foreseeable future will be to act as the holding company of the Bank and its other direct and indirect subsidiaries. Therefore, the Corporation’s future profitability will depend on the success and growth of these subsidiaries. In the future, part of the Corporation’s growth may come from buying other banks and buying or establishing other companies. Such entities may not be profitable after they are purchased or established, and they may lose money, particularly at first. A new bank or company may bring with it unexpected liabilities, bad loans, or bad employee relations, or the new bank or company may lose customers.

Interest rates and other economic conditions will impact our results of operations.

Our results of operations may be materially and adversely affected by changes in prevailing economic conditions, including declines in real estate values, rapid changes in interest rates and the monetary and fiscal policies of the federal government. Our profitability is in part a function of the spread between the interest rates earned on assets and the interest rates paid on deposits and other interest-bearing liabilities (i.e., net interest income), including advances from the Federal Home Loan Bank (the “FHLB”) of Atlanta. Interest rate risk arises from mismatches (i.e., the interest sensitivity gap) between the dollar amount of repricing or maturing assets and liabilities and is measured in terms of the ratio of the interest rate sensitivity gap to total assets. More assets repricing or maturing than liabilities over a given time period is considered asset-sensitive and is reflected as a positive gap, and more liabilities repricing or maturing than assets over a given time period is considered liability-sensitive and is reflected as negative gap. An asset-sensitive position (i.e., a positive gap) could enhance earnings in a rising interest rate environment and could negatively impact earnings in a falling interest rate environment, while a liability-sensitive position (i.e., a negative gap) could enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable. There can be no assurance that our attempts to structure our asset and liability management strategies to mitigate the impact on net interest income of changes in market interest rates will be successful in the event of such changes.

The majority of our business is concentrated in Maryland and West Virginia; a significant amount of our business is concentrated in real estate lending.

Most of our loans are made to Western Maryland and Northeastern West Virginia borrowers, and many of these loans are secured by real estate, including construction and land development loans. Accordingly, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose loan portfolios are geographically diverse. Moreover, the national and local economies have significantly weakened during the past two years in part due to the widely-reported problems in the sub-prime mortgage loan market. As a result, real estate values across the country, including in our market areas, have decreased and the general availability of credit, especially credit to be secured by real estate, has also decreased. These conditions have made it more difficult for real estate owners and owners of loans secured by real estate to sell their assets at the times and at the prices they desire. In addition, these conditions have increased the risk that the market values of the real estate securing our loans may deteriorate, which could cause us to lose money in the event a borrower fails to repay a loan and we are forced to foreclose on the property. There can be no guarantee as to when or whether economic conditions will improve.

Additionally, the FRB and the FDIC, along with the other federal banking regulators, issued final guidance on December 6, 2006 entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" directed at institutions that have particularly high concentrations of commercial real estate loans within their lending portfolios. This guidance suggests that institutions whose commercial real estate loans exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk and may be required to maintain higher capital ratios than institutions with lower concentrations in commercial real estate lending. Based on our commercial real estate concentration as of December 31, 2008, we may be subject to further supervisory analysis during future examinations. We cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management cannot predict the extent to which this guidance will impact our operations or capital requirements.

The Bank may experience loan losses in excess of its allowance.

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. Management of the Bank maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and judgments about the ultimate collectability of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectability is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the bank regulatory authorities require us to increase the allowance for loan losses as a part of its examination process, our earnings and capital could be significantly and adversely affected. Although management continually monitors our loan portfolio and makes determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to our non-performing or performing loans. Material additions to the allowance for loan losses could result in a material decrease in our net income and capital, and could have a material adverse effect on our financial condition.

The market value of our investments could decline.

As of December 31, 2008, we had classified 100% of our investment securities as available-for-sale pursuant to Statement of Financial Accounting Standards ("SFAS") No. 115 relating to accounting for investments. SFAS No. 115 requires that unrealized gains and losses in the estimated value of the available-for-sale portfolio be "marked to market" and reflected as a separate item in shareholders' equity (net of tax) as accumulated other comprehensive income. There can be no assurance that future market performance of our investment portfolio will enable us to realize income from sales of securities. Shareholders' equity will continue to reflect the unrealized gains and losses (net of tax) of these investments. Moreover, there can be no assurance that the market value of our investment portfolio will not decline, causing a corresponding decline in shareholders' equity.

Our investments include stock issued by the FHLB of Atlanta. As a member of the FHLB of Atlanta, we are required to purchase stock of that bank based on how much we borrow from it and the quality of the collateral that we pledge to secure that borrowing. In recent months, the banking industry has become concerned about the financial strength of the banks in the FHLB system, and some FHLB banks have stopped paying dividends on and redeeming FLHB stock. On January 30, 2009, the FHLB of Atlanta announced that it was deferring the declaration of a dividend on its stock for the quarter ended December 31, 2008 until it completes its year-end analysis of other-than-temporary impairment which is critical to its net income determination. The FHLB of Atlanta stated that it anticipates a decision regarding the dividend to be made in March 2009. Accordingly, there can be no guaranty that the FHLB of Atlanta will declare a dividend on its stock for the quarter ended December 31, 2008 or for any future quarter.

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Management believes that several factors will affect the market values of our investment portfolio. These include, but are not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates). Also, the passage of time will affect the market values of our investment securities, in that the closer they are to maturing, the closer the market price should be to par value. These and other factors may impact specific categories of the portfolio differently, and management cannot predict the effect these factors may have on any specific category.

We operate in a competitive environment.

We operate in a competitive environment, competing for loans, deposits, and customers with commercial banks, savings associations and other financial entities. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market and mutual funds and other investment alternatives. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions and other financial intermediaries. Competition for other products, such as insurance and securities products, comes from other banks, securities and brokerage companies, insurance companies, insurance agents and brokers, and other non-bank financial service providers in our market area. Many of these competitors are much larger in terms of total assets and capitalization, have greater access to capital markets, and/or offer a broader range of financial services than those that we offer. In addition, banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers.

In addition, current banking laws facilitate interstate branching, merger activity among banks, and expanded activities. Since September 1995, certain bank holding companies have been authorized to acquire banks throughout the United States. Since June 1, 1997, certain banks have been permitted to merge with banks organized under the laws of different states. As a result, interstate banking is now an accepted element of competition in the banking industry and the Corporation may be brought into competition with institutions with which it does not presently compete. Moreover, the GLB Act revised the BHC Act in 2000 and repealed the affiliation provisions of the Glass-Steagall Act of 1933, which, taken together, limited the securities, insurance and other non-banking activities of any company that controls an FDIC insured financial institution. These laws may increase the competition we face in our market areas in the future, although management cannot predict the degree to which such competition will impact our financial conditions or results of operations.

The banking industry is heavily regulated; significant regulatory changes could adversely affect our operations.

Our operations will be impacted by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. The Corporation is subject to supervision by the FRB. The Bank is subject to supervision and periodic examination by the Maryland Commissioner of Financial Regulation, the West Virginia Division of Banking, and the FDIC. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution’s growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. The Corporation and the Bank are also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that either is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Management also cannot predict the nature or the extent of the effect on our business and earnings of future fiscal or monetary policies, economic controls, or new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

Our regulatory expenses will likely increase due to the enactment of the Emergency Economic Stabilization Act and related government programs.

Among other things, the EESA included a provision to increase the amount of deposits insured by FDIC to $250,000. The TLGP provides, until December 31, 2009, unlimited deposit insurance on funds in non-interest-bearing transaction deposit accounts and certain IOLTAs and NOW accounts not otherwise covered by the existing deposit insurance limit of $250,000, as well as a 100% guarantee of the newly issued senior debt of all FDIC-insured institutions and their holding companies issued between October 14, 2008 and June 30, 2009. All eligible institutions will be covered under the TLGP for the first 30 days without incurring any costs. After the initial period, participating institutions will be assessed a charge of 10 basis points per annum for the additional insured deposits and a charge of 75 basis points per annum for guaranteed senior unsecured debt. We elected to participate in both portions of the TLGP, so we expect to incur additional regulatory fees associated with our participation.

Customer concern about deposit insurance may cause a decrease in deposits held at the Bank.

With recent increased concerns about bank failures, customers increasingly are concerned about the extent to which their deposits are insured by the FDIC. Customers may withdraw deposits from the Bank in an effort to ensure that the amount they have on deposit with us is fully insured. Decreases in deposits may adversely affect our funding costs and net income.

Our funding sources may prove insufficient to replace deposits and support our future growth.

We rely on customer deposits, advances from the FHLB, lines of credit at other financial institutions and brokered funds to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, no assurance can be given that we would be able to replace such funds in the future if our financial condition or the financial condition of the FHLB or market conditions were to change. Our financial flexibility will be severely constrained and/or our cost of funds will increase if we are unable to maintain our access to funding or if financing necessary to accommodate future growth is not available at favorable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our profitability would be adversely affected.

The loss of key personnel could disrupt our operations and result in reduced earnings.

Our growth and profitability will depend upon our ability to attract and retain skilled managerial, marketing and technical personnel. Competition for qualified personnel in the financial services industry is intense, and there can be no assurance that we will be successful in attracting and retaining such personnel. Our current executive officers provide valuable services based on their many years of experience and in-depth knowledge of the banking industry. Due to the intense competition for financial professionals, these key personnel would be difficult to replace and an unexpected loss of their services could result in a disruption to the continuity of operations and a possible reduction in earnings.

We may lose key personnel because of our participation in the Troubled Asset Relief Program Capital Purchase Program.

On January 30, 2009, we participated in the Troubled Asset Relief Program ("TARP") Capital Purchase Program (the "CPP") adopted by the U.S. Department of Treasury ("Treasury") by selling $30 million in shares of our Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") to Treasury and issuing a 10-year common stock purchase warrant (the "Warrant") to Treasury. As part of these transactions, we adopted Treasury's standards for executive compensation and corporate governance for the period during which Treasury holds any shares of the Series A Preferred Stock and/or any shares of common stock that may be acquired upon exercise of the Warrant. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the "Recovery Act") was signed into law, which, among other things, imposes additional executive compensation restrictions on institutions that participate in TARP for so long as any TARP assistance remains outstanding. Among these restrictions is a prohibition against making most severance payments to our "senior executive officers", which term includes our Chairman and Chief Executive Officer, our Chief Financial Officer and, generally, the three next most highly compensated executive officers, and to the next five most highly compensated employees. The restrictions also limit the type, timing and amount of bonuses, retention awards and incentive compensation that may be paid to certain employees. These restrictions, coupled with the competition we face from other institutions, including institutions that do not participate in TARP, may make it more difficult for us to attract and/or retain exceptional key employees.

Our lending activities subject us to the risk of environmental liabilities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

We may be adversely affected by other recent legislation.

As discussed above, the GLB Act repealed restrictions on banks affiliating with securities firms and it also permitted bank holding companies that become financial holding companies to engage in additional financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities that are currently not permitted for bank holding companies. Although the Corporation is a financial holding company, this law may increase the competition we face from larger banks and other companies. It is not possible to predict the full effect that this law will have on us.

The federal Sarbanes-Oxley Act of 2002 requires management of publicly traded companies to perform an annual assessment of their internal controls over financial reporting and to report on whether the system is effective as of the end of the Company’s fiscal year. Disclosure of significant deficiencies or material weaknesses in internal controls could cause an unfavorable impact to shareholder value by affecting the market value of our stock.

The federal USA PATRIOT Act requires certain financial institutions, such as the Bank, to maintain and prepare additional records and reports that are designed to assist the government’s efforts to combat terrorism. This law includes sweeping anti-money laundering and financial transparency laws and required additional regulations, including, among other things, standards for verifying client identification when opening an account and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. If we fail to comply with this law, we could be exposed to adverse publicity as well as fines and penalties assessed by regulatory agencies.

We may be subject to claims and the costs of defensive actions.

Our customers may sue us for losses due to alleged breaches of fiduciary duties, errors and omissions of employees, officers and agents, incomplete documentation, our failure to comply with applicable laws and regulations, or many other reasons. Also, our employees may knowingly or unknowingly violate laws and regulations. Management may not be aware of any violations until after their occurrence. This lack of knowledge may not insulate us from liability. Claims and legal actions may result in legal expenses and liabilities that may reduce our profitability and hurt our financial condition.

We may not be able to keep pace with developments in technology.

We use various technologies in conducting our businesses, including telecommunication, data processing, computers, automation, internet-based banking, and debit cards. Technology changes rapidly. Our ability to compete successfully with other financial institutions may depend on whether we can exploit technological changes. We may not be able to exploit technological changes, and any investment we do make may not make us more profitable.

Risks Relating to the Corporation’s Securities

The Corporation’s shares of common stock, Series A Preferred Stock, and the Warrant are not insured.

The shares of the Series A Preferred Stock, the warrant, and the shares of common stock for which the warrant may be exercised are not deposits and are not insured against loss by the Federal Deposit Insurance Corporation or any other governmental or private agency.

The Corporation’s ability to pay dividends is limited by applicable banking and corporate law.

The Corporation's ability to pay dividends to shareholders is largely dependent upon the receipt of dividends from the Bank. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. Federal law generally prohibits the payment of a dividend by a troubled institution. Under Maryland law, a state-chartered commercial bank may pay dividends only out of undivided profits or, with the prior approval of the Commissioner, from surplus in excess of 100% of required capital stock. If however, the surplus of a Maryland bank is less than 100% of its required capital stock, cash dividends may not be paid in excess of 90% of net earnings. In addition to these specific restrictions, bank regulatory agencies also have the ability to prohibit proposed dividends by a financial institution which would otherwise be permitted under applicable regulations if the regulatory body determines that such distribution would constitute an unsafe or unsound practice. Because of these limitations, there can be no guarantee that we will declare dividends in any fiscal quarter.

Because of the Corporation's participation in TARP, it is subject to several restrictions relating to shares of its capital stock, including restrictions on its ability to declare or pay dividends on and repurchase its shares.

As stated above, the Corporation recently issued 30,000 shares of the Series A Preferred Stock and the Warrant to purchase 326,323 shares of common stock. Under the terms of the transaction documents, the Corporation's ability to declare or pay dividends on shares of its capital stock is limited. Specifically, the Corporation is unable to declare dividends on common stock, other stock ranking junior to the Series A Preferred Stock ("Junior Stock"), or preferred stock ranking on a parity with the Series A Preferred Stock ("Parity Stock") if the Corporation is in arrears on the dividends on the Series A Preferred Stock. Further, the Corporation is not permitted to increase dividends on its common stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 without Treasury's approval until January 30, 2012 unless all of the Series A Preferred Stock has been redeemed or transferred. In addition, the Corporation's ability to repurchase its capital stock is restricted. Treasury's consent generally is required for the Corporation to make any stock repurchase until January 30, 2012 unless all of the Series A Preferred Stock has been redeemed or transferred. Further, shares of common stock, Junior Stock or Parity Stock may not be repurchased if the Corporation is in arrears on the Series A Preferred Stock dividends.

The Corporation's ability to pay dividends on its securities is also subject to the terms of its outstanding debentures.

In March 2004, the Corporation issued approximately $30.9 million of junior subordinated debentures to First United Statutory Trust I and First United Statutory Trust II (the "Trusts"). The Trusts are Connecticut statutory business trusts, with all outstanding common stock owned by the Corporation, that issued mandatorily redeemable preferred capital securities to third party investors. In December 2004, the Corporation issued an additional $5.0 million of debentures. The terms of the debentures require the Corporation to make quarterly payments of interest to the holders of the debentures, although the Corporation has the ability to defer payments of interest for up to 20 consecutive quarterly periods. Should the Corporation make such a deferral election, however, it would be prohibited from paying dividends or distributions on, or from repurchasing, redeeming or otherwise acquiring any shares of its capital stock, including the common stock and the Series A Preferred Stock. Although the Corporation has no present intention of deferring payments of interest on its debentures, there can be no assurance that the Corporation will not elect to do so in the future.

There is no market for the Series A Preferred Stock or the Warrant, and the common stock is not heavily traded.

There is no established trading market for the shares of the Series A Preferred Stock or the Warrant. The Corporation does not intend to apply for listing of the Series A Preferred Stock on any securities exchange or for inclusion of the Series A Preferred Stock in any automated quotation system unless requested by Treasury. The Corporation's common stock is listed on the NASDAQ Global Select Market, but shares of the common stock are not heavily traded. Securities that are not heavily traded can be more volatile than stock trading in an active public market. Factors such as our financial results, the introduction of new products and services by us or our competitors, and various factors affecting the banking industry generally may have a significant impact on the market price of the shares the common stock. Management cannot predict the extent to which an active public market for any of the Corporation's securities will develop or be sustained in the future. Accordingly, holders of the Corporation's securities may not be able to sell such securities at the volumes, prices, or times that they desire.

The Corporation's Articles of Incorporation and Bylaws and Maryland law may discourage a corporate takeover.

The Corporation's Amended and Restated Articles of Incorporation and Amended and Restated Bylaws, as amended, contain certain provisions designed to enhance the ability of the Corporation's Board of Directors to deal with attempts to acquire control of the Corporation. First, the Board of Directors is classified into three classes. Directors of each class serve for staggered three-year periods, and no director may be removed except for cause, and then only by the affirmative vote of either a majority of the entire Board of Directors or a majority of the outstanding voting stock. Second, the Board has the authority to classify and reclassify unissued shares of stock of any class or series of stock by setting, fixing, eliminating, or altering in any one or more respects the preferences, rights, voting powers, restrictions and qualifications of, dividends on, and redemption, conversion, exchange, and other rights of, such securities. The Board could use this authority, along with its authority to authorize the issuance of securities of any class or series, to issue shares having terms favorable to management to a person or persons affiliated with or otherwise friendly to management. In addition, the Bylaws require any shareholder who desires to nominate a director to abide by strict notice requirements.

Maryland law also contains anti-takeover provisions that apply to the Corporation. Maryland's Business Combination Act generally prohibits, subject to certain limited exceptions, corporations from being involved in any "business combination" (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities) with any "interested shareholder" for a period of five years following the most recent date on which the interested shareholder became an interested shareholder. An interested shareholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% percent or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock. Maryland's Control Share Acquisition Act applies to acquisitions of "control shares", which, subject to certain exceptions, are shares the acquisition of which entitle the holder, directly or indirectly, to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors within any of the following ranges of voting power: one-tenth or more, but less than one-third of all voting power; one-third or more, but less than a majority of all voting power or a majority or more of all voting power. Control shares have limited voting rights.

Although these provisions do not preclude a takeover, they may have the effect of discouraging, delaying or deferring a tender offer or takeover attempt that a shareholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the common stock. Such provisions will also render the removal of the Board of Directors and of management more difficult and, therefore, may serve to perpetuate current management. These provisions could potentially adversely affect the market price of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The headquarters of the Corporation and the Bank occupies approximately 29,000 square feet at 19 South Second Street, Oakland, Maryland, a 30,000 square feet operations center located at 12892 Garrett Highway, Oakland Maryland and 8,500 square feet at 102 South Second Street, Oakland, Maryland. These premises are owned by the Corporation. The Bank owns 19 of its banking offices and leases seven. During the fourth quarter 2008, the Corporation entered into a lease agreement for an office building to house specialists for lending and insurance and a retail branch site, both in Frederick, Maryland. The Corporation also leases eight offices of non-bank subsidiaries. Total rent expense on the leased offices and properties was $.54 million in 2008.

ITEM 3. LEGAL PROCEEDINGS

We are at times, in the ordinary course of business, subject to legal actions. Management, upon the advice of counsel, believes that losses, if any, resulting from current legal actions will not have a material adverse effect on our financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Shares of the Corporation's common stock are listed on the NASDAQ Global Select Market under the symbol "FUNC". As of February 28, 2009, the Corporation had 1,988 shareholders of record. The high and low sales prices for, and the cash dividends declared on, the shares of the Corporation's common stock for each quarterly period of 2008 and 2007 are set forth below. On March 3, 2009, the closing sales price of the common stock was $8.98 per share.

2008	High	Low	Dividends Declared
1st Quarter	$ 20.85	$ 17.01	$ .200
2nd Quarter	19.98	18.04	.200
3rd Quarter	20.73	16.01	.200
4th Quarter	20.00	13.00	.200

2007	High	Low	Dividends Declared
1st Quarter	$ 23.49	$ 21.72	$ .195
2nd Quarter	24.00	19.26	.195
3rd Quarter	21.50	17.95	.195
4th Quarter	21.95	18.70	.200

Cash dividends are typically declared on a quarterly basis and are at the discretion of the Corporation's Board of Directors. Dividends to shareholders are generally dependent on the ability of the Corporation's subsidiaries, especially the Bank, to declare dividends to the Corporation. The ability of these entities to declare dividends is limited by federal and state banking laws, state corporate laws, and the terms of our other securities. Further information about these limitations may be found in Note 13 to the Consolidated Financial Statements and in the risk factors contained in Item 1A of Part I under the heading "Risks Relating to the Corporation's Securities", which are incorporated herein by reference. There can be no guarantee that dividends will be declared in any fiscal quarter.

Market makers for the Corporation's common stock are:

SCOTT AND STRINGFELLOW, INC.

909 East Main Street
Richmond, VA 23219
(804)643-1811
(800)552-7757

First United Corporation Stock Performance Graph

The following graph compares the yearly percentage change in the cumulative total return for the Corporation's common stock for the five years ended December 31, 2008. This data is compared to the NASDAQ Composite market index and the SNL $1 billion to $5 billion Bank Index during the same time period. Total return numbers are calculated as change in stock price for the period indicated with dividends being reinvested.

	Period Ending					
Index	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
First United Corporation	100.00	87.28	93.37	99.75	94.56	66.46
NASDAQ Composite	100.00	108.59	110.08	120.56	132.39	78.72
SNL Bank $1B-$5B Index	100.00	123.42	121.31	140.38	102.26	84.81

Equity Compensation Plan Information

At the 2007 Annual Meeting of Shareholders, the Corporation's shareholders approved the First United Corporation Omnibus Equity Compensation Plan (the "Omnibus Plan"), which authorizes the grant of stock options, stock appreciation rights, stock awards, stock units, performance units, dividend equivalents, and other stock-based awards. Stock compensation expense for 2008 was $.1 million. The following table contains information about the Omnibus Plan as of December 31, 2008:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (a)		Weighted-average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)(1)
Equity compensation plans approved by security holders	22,257	$	18.85	162,743
Equity compensation plans not approved by security holders	0		N/A	N/A
Total	22,257	$	18.85	162,743

(1) In addition to stock options and stock appreciation rights, the Omnibus Plan permits the grant of stock awards, stock units, performance units, dividend equivalents, and other stock-based awards. Subject to the anti-dilution provisions of the Omnibus Plan, the maximum number of shares for which awards may be granted to any one participant in any calendar year is 20,000, without regard to whether an award is paid in cash or shares.

Issuer Repurchases of Securities

The following table provides information about shares of common stock purchased by or on behalf of First United Corporation and its affiliates (as defined by Exchange Act Rule 10b-18) during the quarter ended December 31, 2008:

Issuer Purchases of Equity Securities

Period	Total Number of Shares (or Units) Purchased (1)		Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 2008	4,416		18.78	4,416	209,672
November 2008	1,471		17.12	1,471	208,201
December 2008	-		-	-	208,201
Total	5,887	$	18.50	5,887	208,201

(1) All shares were purchased under First United Corporation's repurchase plan that was adopted effective August 15, 2007. The adoption of this plan was publicly announced on August 21, 2007. The plan authorizes the repurchase of up to 307,500 shares of common stock in open market and/or private transactions at such times and in such amounts per transaction as the Chairman and Chief Executive Officer of First United Corporation determines to

be appropriate. The repurchase plan was suspended during the fourth quarter 2008 for the period of time that the Corporation is participating in the Capital Purchase Program.

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data for the five years ended December 31, 2008 and is qualified in its entirety by the detailed information and financial statements, including notes thereto, included elsewhere or incorporated by reference in this annual report.

(In thousands, except per share data)

	2008	2007	2006	2005	2004
Balance Sheet Data					
Total Assets	$ 1,639,104	$ 1,478,909	$ 1,349,317	$ 1,310,991	$ 1,233,901
Net Loans	1,120,199	1,035,962	957,126	954,545	904,635
Investment Securities	354,595	304,908	263,272	230,095	210,661
Deposits	1,222,889	1,126,552	971,381	955,854	850,661
Long-term Borrowings	277,403	178,451	166,330	128,373	175,415
Shareholders' Equity	72,690	104,665	96,856	92,039	86,356
Operating Data					
Interest Income	$ 95,216	$ 93,565	$ 80,269	$ 69,756	$ 60,682
Interest Expense	43,043	49,331	39,335	29,413	24,016
Net Interest Income	52,173	44,234	40,934	40,343	36,666
Provision for Loan Losses	12,925	2,312	1,165	1,078	2,534
Other Operating Income	13,769	15,092	14,041	14,088	12,971
Other Operating Expense	40,573	38,475	35,490	34,654	35,969
Income Before Taxes	12,444	18,539	18,320	18,699	11,134
Income Taxes	3,573	5,746	5,743	6,548	3,507
Net Income	$ 8,871	$ 12,793	$ 12,577	$ 12,151	$ 7,627
Per Share Data					
Net Income	$ 1.45	$ 2.08	$ 2.05	$ 1.99	$ 1.25
Dividends Paid	.80	.78	.76	.74	.72
Book Value	11.89	17.05	15.77	15.04	14.17
Significant Ratios					
Return on Average Assets	.55%	.90%	.96%	.95%	.65%
Return on Average Equity	9.31%	12.70%	13.07%	13.61%	8.91%
Dividend Payout Ratio	55.17%	37.50%	37.07%	37.44%	58.00%
Average Equity to Average Assets	5.95%	7.10%	7.35%	7.00%	7.28%
Total Risk-based Capital Ratio	12.18%	12.51%	12.95%	12.66%	12.24%
Tier I Capital to Risk Weighted Assets	10.59%	11.40%	11.81%	11.45%	10.81%
Tier I Capital to Average Assets	8.10%	8.91%	9.08%	8.64%	8.44%

ITEM 7.MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2008, which appear in Item 8 of Part II of this annual report.

Recent Developments

Capital Purchase Program - As discussed above, on January 30, 2009 the Corporation participated in the TARP CPP by issuing 30,000 shares of Series A Preferred Stock, having a liquidation amount of $1,000 per share, and the Warrant covering 326,323 shares of common stock to the Treasury for a total sales price of $30 million. The Warrant may be exercised at any time until January 30, 2019 at an exercise price of $13.79 per share, or an aggregate exercise price of approximately $4.5 million. The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends at a rate of 5% per annum until February 15, 2014. The Warrant counts as tangible common equity.

Holders of the Series A Preferred Stock are entitled to receive if, as and when declared by the Board of Directors, out of assets legally available for payment, cumulative cash dividends at a rate per annum of 5% per share on a liquidation amount of $1,000 per share of Series A Preferred Stock with respect to each dividend period from January 30, 2009 to, but excluding, February 15, 2014. From and after February 15, 2014, holders of Series A Preferred Stock are entitled to receive cumulative cash dividends at a rate per annum of 9% per share on a liquidation amount of $1,000 per share with respect to each dividend period thereafter. Under the terms of the Series A Preferred Stock, on and after February 15, 2012, the Corporation may, at its option, redeem shares of Series A Preferred Stock, in whole or in part, at any time and from time to time, for cash at a per share amount equal to the sum of the liquidation preference per share plus any accrued and unpaid dividends to but excluding the redemption date. The terms of the Series A Preferred Stock further provide that, prior to February 15, 2012, the Corporation may redeem shares of Series A Preferred Stock only if it has received aggregate gross proceeds of not less than $7.50 million from one or more qualified equity offerings, and the aggregate redemption price may not exceed the net proceeds received by the Company from such offerings. The redemption of the Series A Preferred Stock requires prior regulatory approval.

Until the earlier of (i) January 30, 2012 or (ii) the date on which the Series A Preferred Stock has been redeemed in full or Treasury has transferred all of the Series A Preferred Stock to non-affiliates, the terms of the Series A Preferred Securities prohibit the Corporation from increasing its quarterly cash dividend paid on common stock above $0.20 per share or repurchasing any shares of common stock or other capital stock or equity securities or trust preferred securities without the consent of the Treasury. Accordingly, the Corporation’s previously-announced common stock repurchase plan has been suspended effective January 30, 2009.

On February 17, 2009, President Obama signed the Recovery Act into law. The Recovery Act permits any institution that receives assistance under TARP (including pursuant to the CPP), after consultation with the appropriate banking regulators, to repay any such assistance at any time notwithstanding any repayment restrictions contained in the instruments defining such assistance. Recent guidance issued by Treasury states that, as a general rule, any partial repayment must equal at least 25% of the outstanding assistance. Treasury may waive this minimum repayment amount. Accordingly, the Corporation may, at any time and notwithstanding the restrictions on redemption discussed above, and assuming its regulators do not object, repay all of or a portion of (in 25% increments, unless waived by Treasury) the $30 million it received as consideration for the Series A Preferred Stock and the Warrant. If the Corporation were to repay any assistance, it could also repurchase any or all of the portion of the Warrant that relates to the repayment. Any portion of the Warrant that relates to the repayment that the Corporation chooses not to repurchase must be liquidated by Treasury, at the current market price.

FDIC Deposit Insurance Fund Restoration Plan Announced – On February 27, 2009, the FDIC announced a proposed rule outlining its plan to implement an emergency special assessment of 20 basis points on all insured depository institutions in order to restore the Deposit Insurance Fund to an acceptable level. The assessment, which would be payable on September 30, 2009, would be in addition to a planned increase in premiums and a change in the way regular premiums are assessed which the FDIC also approved on February 27, 2009. In addition, the proposed rule provides that, after June 30, 2009, if the reserve ratio of the Deposit Insurance Fund is estimated to fall to a level that that the FDIC believes would adversely affect public confidence or to a level which is close to or less than zero at the end of a calendar quarter, then an additional emergency special assessment of up to 10 basis points may be imposed on all insured depository institutions. If this rule is adopted as proposed, it could increase the Bank's FDIC premiums in 2009 by approximately $2.5 million.

Overview

The Corporation is a financial holding company which, through the Bank and its non-bank subsidiaries, provides an array of financial products and services primarily to customers in four Western Maryland counties and four Northeastern West Virginia counties. Its principal operating subsidiary is the Bank, which consists of a community banking network of 26 branch offices located throughout its market areas. Our primary sources of revenue are interest income earned from our loan and investment securities portfolios and fees earned from financial services provided to customers.

Consolidated net income for 2008 totaled $8.9 million or $1.45 per share, compared to $12.8 million or $2.08 per share for 2007. The decrease in net income resulted primarily from an increase in the provision for loan losses to $12.9 million in 2008, compared to $2.3 million for 2007 and a $2.7 million non-cash other-than-temporary impairment charge on the investment portfolio. The increase in the provision in 2008 is due to increased net charge offs, an increase in the level of non-accrual loans, loan growth during 2008, specific allocations for impaired loans and changes in the qualitative factors used in the overall assessment of the adequacy of the allowance for loan losses. Specific allocations have been provided in instances where losses may occur. Approximately $4.0 million of the recorded expense is attributable to a real estate and development loan in Hardy County, West Virginia and deterioration in a group of loan relationships outside of the Corporation's market area. Additional provision expense was also recorded because the company that services a loan in which the Bank holds a participation interest failed to remit $1.2 million in principal payments made by the borrower. The Bank is reviewing its rights with respect to its insurance carriers and the servicing company's insurance carriers and bonding companies, but there can be no assurance that the Bank will ultimately recover any of this loss.

During 2008, earnings on interest-earning assets increased primarily as a result of an investment portfolio restructuring and an overall increase in average earning assets. Interest expense on interest-bearing liabilities decreased $6.3 million due to the decline in interest rates during 2008 as well as the enhanced efforts of an internal treasury committee. As a result, the net interest margin increased to 3.68% in 2008 from 3.51% in 2007.

Operations in 2008 were impacted by the following factors and strategic initiatives:

Increased Loan and Deposit Growth/Impact on Net Interest Margin – We experienced a significant increase of $91.3 million in loans in 2008 when compared to 2007. The residential mortgage portfolio grew $21.0 million and the commercial portfolio increased $83.7 million as a result of in-house production and commercial participations with other financial institutions. We experienced growth in both fixed rate and adjustable rate products. These increases were offset by a decline of $13.4 million in the installment loan portfolio. Interest income on loans in 2008 decreased from the amount generated in 2007 by $2.7 million (on a fully taxable equivalent basis) due to the decrease in interest rates. Interest income on investment securities increased by $4.8 million (on a fully taxable equivalent basis) due to a $79 million increase in the portfolio. (Additional information on the composition of interest income is available in Table 1 that appears on page 25).

Funding costs in 2008 decreased as a result of the declining interest rate environment and the enhanced efforts of the internal treasury committee. Deposits at December 31, 2008 increased $96.3 million when compared to deposits at December 31, 2007, primarily from an $86.6 million increase in our IRA products and brokered products.

The decline in the interest rate environment decreased deposit interest expense by $7.0 million when compared to 2007. Although net borrowings increased by $94.3 million in 2008 when compared to 2007, we realized a minimal increase in interest expense on these borrowings. The combination of increased loan and deposit growth, declining interest rates on our assets and liabilities, and the increased level of debt resulted in an increase in net interest income on a tax equivalent basis of $8.1 million (18%) in 2008 when compared to 2007.

The overall net interest margin increased during 2008 to 3.68% from 3.51% in 2007 on a fully taxable equivalent basis.

Other Operating Income/Other Operating Expense — Other operating income decreased $1.3 million in 2008 when compared to 2007. Service charge income increased $.5 million, due primarily to increased customer usage of an account overdraft product. This increase was offset by decreases in trust department income, insurance commission income, and realized losses on our investment portfolio.

Trust department income is directly affected by the performance of the equity and bond markets and by the amount of assets under management. Although we have experienced favorable sales production in our trust department, unfavorable market conditions have reduced the fees and commissions on our existing accounts under management resulting in slightly lower income when compared to 2007. Declining market values negatively impacted the value of assets under management at year-end. Assets under management were $472 million, $547 million and $502 million for years 2008, 2007 and 2006, respectively.

Insurance commissions also decreased in 2008 when compared to 2007 due to a soft insurance market resulting in lower premium income and a reduction in the amount of contingency income received in 2008. Contingency income is received from the insurance carriers based upon claims histories and varies from year to year. In December 2008, the insurance agency acquired substantially all of the assets of three insurance agencies, which should enable the agency to expand its business into central West Virginia. Information about these acquisitions may be found in Note 1 to the Consolidated Financial Statements included in Item 8 of Part II of this annual report under the heading "Goodwill and Other Intangible Assets". The increase in 2007 as compared to 2006 was due to the acquisition of two books of business during 2007.

Securities gains (losses) are the most variable component of other operating income. During 2008, we recorded a non-cash charge of approximately $2.7 million as a result of an other-than-temporary impairment analysis performed on our investment portfolio at year-end. This process is described more fully in the Investment Securities section of the Consolidated Balance Sheet Review. This charge was offset by gains realized from sales of investment securities and calls on fixed-income bonds.

Other operating expenses increased $2.1 million in 2008 when compared to 2007. This increase is attributable to an increase of $.9 million in salaries and wages in 2008 when compared to 2007. Other expenses such as marketing, membership fees and licenses, and information system conversion costs increased by $.7 million in 2008 when compared to 2007.

Dividends — The Corporation continued its tradition of paying dividends to shareholders during 2008, increasing them to $0.80 per share, a 2.6% increase from $0.78 per share in 2007. The Corporation has paid quarterly cash dividends consistently since 1985, the year in which it was formed. However, as noted above, the Corporation is generally prohibited from increasing this dividend, unless prior consent from Treasury is given or until the earlier of (i) January 30, 2012 or (ii) the date on which the Series A Preferred Stock has been redeemed in full or Treasury has transferred all of the Series A Preferred Stock to non-affiliates.

Looking Forward — We will continue to face risks and challenges in the future, including: changes in local economic conditions in our core geographic markets; potential yield compression on loan and deposit products from existing competitors and potential new entrants in our markets; fluctuations in interest rates and changes to existing federal and state legislation and regulations over banks and financial holding companies. For a more complete discussion of these and other risk factors, see Item 1A of Part I of this annual report.

Critical Accounting Policies and Estimates

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. (See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of Part II of this annual report.) On an on-going basis, management evaluates estimates, including those related to loan losses and intangible assets. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

Allowance for Loan Losses

One of our most important accounting policies is that related to the monitoring of the loan portfolio. A variety of estimates impact the carrying value of the loan portfolio, including the calculation of the allowance for loan losses, the valuation of underlying collateral, the timing of loan charge-offs and the placement of loans on non-accrual status. The allowance is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payment on loans. Estimates for loan losses are arrived at by analyzing risks associated with the specific loans and the loan portfolio, current and historical trends in delinquencies and charge-offs, and changes in the size and composition of the loan portfolio. The analysis also requires consideration of the economic climate and direction, changes in lending rates, political conditions, legislation impacting the banking industry and economic conditions specific to Western Maryland and Northeastern West Virginia. Because the calculation of the allowance for loan losses relies on management's estimates and judgments relating to inherently uncertain events, actual results may differ from management's estimates.

The allowance for loan losses is also discussed below in this Item 7 under the caption "Allowance for Loan Losses" and in Note 4 to Consolidated Financial Statements contained in Item 8 of Part II of this annual report.

Goodwill and Other Intangible Assets

Statement of Financial Accounting Standards (SFAS) No. 142, Accounting for Goodwill and Other Intangible Assets, establishes standards for the amortization of acquired intangible assets and the non-amortization and impairment assessment of goodwill. We have $1.0 million of core deposit intangible assets and $3.4 million related to acquisitions of insurance "books of business" which are subject to amortization. The $11.9 million in recorded goodwill is primarily related to the acquisition of Huntington National Bank branches that occurred in 2003, which is not subject to periodic amortization.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Our goodwill relates to value inherent in the banking business and the value is dependent upon our ability to provide quality, cost effective services in a highly competitive local market. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. SFAS No. 142 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments. Management has completed its annual evaluation for impairment and concluded that the recorded value of goodwill was not impaired. However, future changes in strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded asset balances.

Other-Than-Temporary Impairment of Investment Securities

Securities available-for-sale: Securities available-for-sale are stated at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income/(loss) in shareholders' equity.

The amortized cost of debt securities classified as available-for-sale is adjusted for amortization of premiums to the first call date, if applicable, or to maturity, and for accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion, plus interest and dividends, are included in interest income from investments.

Management systematically evaluates investment securities for impairment on a quarterly basis. Declines in the fair value of available for sale securities below their cost that are considered other than temporary declines are recognized in earnings as realized losses in the period in which the impairment determination is made. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. This process is described more fully in the Investment Securities section of the Consolidated Balance Sheet Review. Gains and losses on the sale of securities are recorded using the specific identification method.

Fair Value of Investments

Our entire investment portfolio is classified as available-for-sale and is therefore carried at fair value. We have determined the fair value of our investment securities in accordance with the requirements of Statement of Financial

Accounting Standards (SFAS) No. 157, "Fair Value Instruments." SFAS No. 157 defines fair value and establishes a framework for measuring fair value under GAAP and expands the disclosures about fair value measurements. The Corporation measures the fair market values of its investments based on the fair value hierarchy established in SFAS No. 157. The determination of fair value of investments and other assets is discussed further in Note 15 to Consolidated Financial Statements contained in Item 8 of Part II of this annual report.

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Pension Plan Assumptions

Our pension plan costs are calculated using actuarial concepts, as discussed within the requirements of Statement of Financial Accounting Standards (SFAS) No. 87, Employers Accounting for Pensions, SFAS No. 132 (R) and as amended by SFAS No. 158, "Employers' Accounting for Deferred Benefit Pension and Other Post Retirement Plans." Pension expense and the determination of our projected pension liability are based upon two critical assumptions: the discount rate and the expected return on plan assets. We evaluate each of these critical assumptions annually. Other assumptions impact the determination of pension expense and the projected liability including the primary employee demographics, such as retirement patterns, employee turnover, mortality rates, and estimated employer compensation increases. These factors, along with the critical assumptions, are carefully reviewed by management each year in consultation with our pension plan consultants and actuaries. Further information about our pension plan assumptions, the plan's funded status, and other plan information is included in Note 11 to the Consolidated Financial Statements, which is included in Item 8 of Part II of this annual report.

Recent Accounting Pronouncements and Developments

Note 1 to the Consolidated Financial Statements included in Item 8, Part II of this annual report discusses new accounting pronouncements that when adopted, may have an effect on our consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME REVIEW

Net Interest Income

Net interest income is our largest source of operating revenue. Net interest income is the difference between the interest earned on interest-earning assets and the interest expense incurred on interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to a taxable equivalent basis to facilitate performance comparisons between taxable and tax-exempt assets by increasing tax-exempt income by an amount equal to the federal income taxes that would have been paid if this income were taxable at the statutorily applicable rate. The table below summarizes net interest income (on a taxable equivalent basis) for the years 2006-2008 (dollars in thousands).

	2008	2007	2006
Interest income	$ 97,062	$ 95,286	$ 81,838
Interest expense	43,043	49,331	39,335
Net interest income	$ 54,019	$ 45,955	$ 42,503
Net interest margin %	3.68%	3.51%	3.52%

Net interest income increased $8.1 million (18%) in 2008 over the same period in 2007, due to a $1.8 million (1.9%) increase in interest income coupled with a $6.3 million (12.7%) decrease in interest expense. The increase in interest income resulted from an increase in average interest-earning assets of $158.9 million (12%) during 2008 when compared to 2007. The increased level of interest earning assets is attributable to the growth that we experienced in our loan and investment portfolios during 2008. The declines in the interest rates throughout 2008 contributed to the decrease in the average yield on our average earning assets of 67 basis points, from 7.29% in 2007 to 6.62% in 2008 (on a fully tax equivalent basis). The average yield on loans decreased by 81 basis points and the yield on investment securities as a percentage of interest earning assets was stable in 2008. Although we experienced an increase in average interest-bearing liabilities of $212.9 million in 2008, interest expense decreased $6.3 million due to the decline in interest rates and the enhanced efforts of the internal treasury committee. Average deposits increased in 2008 by approximately $146.7 million. Effective management of both retail and wholesale interest rates resulted in a 110 basis point decrease in the average rate paid on our average interest-bearing liabilities from 4.21% for 2007 to 3.11% for 2008. The net result of the aforementioned factors was a 17 basis point increase in the net interest margin at December 31, 2008 to 3.68% from 3.51% at December 31, 2007.

Comparing 2007 to 2006, net interest income increased $3.5 million (8%) due to a $13.4 million (16%) increase in interest income offset by a $10.0 million (25%) increase in interest expense. The increase in interest income resulted from an increase in average interest-earning assets of $100.0 million (8%) during 2007 when compared to 2006. The increased level of interest earning assets is attributable to the growth that we experienced in our loan and investment portfolios during 2007. Emphasis on adjustable rate loan products and the investment portfolio restructuring contributed to the increase in the average yield on our average earning assets of 50 basis points, from 6.78% in 2006 to 7.29% in 2007 (on a fully tax equivalent basis). The average yield on loans increased by 48 basis points and the yield on investment securities as a percentage of interest earning assets increased 90 basis points from 2006 to 2007. Interest expense increased during 2007 when compared to 2006 due to the higher interest rate environment, and an overall increase in average interest-bearing liabilities of $74.2 million. Deposits increased in 2007 by approximately $121 million due to successful retail growth in money market products and the purchase of $85 million in brokered money market funds. The combined effect of the competitive retail rate environment and the volume increases in our average interest-bearing liabilities resulted in a 62 basis point increase in the average rate paid on our average interest-bearing liabilities from 3.59% for 2006 to 4.21% for 2007. The net result of the aforementioned factors was a 1 basis point decline in the net interest margin at December 31, 2007 to 3.51% from 3.52% at December 31, 2006.

As shown below, the composition of total interest income over the three-year period from 2006 to 2008 shows a gradual increase in interest on investments and a corresponding decline in interest and fees on loans. This shift is attributable to the leverage strategies implemented throughout 2007 and 2008. Leverage strategies are the purchase of investment securities funded by borrowings of matched terms and durations. The difference between the rate earned and the rate paid has resulted in additional earnings. Management has more control over the rates, duration and structure of the investment portfolio as compared to the loan portfolio which is customized to the individual needs of each borrower. As such, the investment portfolio is used as a supplement to our asset liability management process.

	% of Total Interest Income		
	2008	2007	2006
Interest and fees on loans	78%	82%	85%
Interest on investment securities	22%	18%	15%

Table 1 sets forth the average balances, net interest income and expense and average yields and rates for our interest-earning assets and interest-bearing liabilities for 2008, 2007 and 2006. Table 2 sets forth an analysis of volume and rate changes in interest income and interest expense of our average interest-earning assets and average interest-bearing liabilities for 2008, 2007 and 2006. Table 2 distinguishes between the changes related to average outstanding balances (changes in volume created by holding the interest rate constant) and the changes related to average interest rates (changes in interest income or expense attributed to average rates created by holding the outstanding balance constant).

Distribution of Assets, Liabilities and Shareholders' Equity
Interest Rates and Interest Differential – Tax Equivalent Basis
(Dollars in thousands)

Table 1

	For the Years Ended December 31								
	2008			2007			2006		
	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/RATE	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/RATE	AVERAGE BALANCE	INTEREST	AVERAGE YIELD/RATE
Assets									
Loans	$ 1,081,191	$ 74,415	6.88%	$ 1,003,854	$ 77,158	7.69%	$ 957,709	$ 69,049	7.21%
Investment Securities:									
Taxable	285,382	16,848	5.90	215,756	12,474	5.78	171,720	7,699	4.48
Non taxable	82,844	5,229	6.31	73,467	4,847	6.60	65,902	4,399	6.67
Total	368,226	22,077	6.00	289,223	17,321	5.99	237,622	12,098	5.09
Federal funds sold	368	4	1.09	285	11	3.86	463	1	.21
Interest-bearing deposits with other banks	3,691	77	2.09	5,135	241	4.69	2,811	165	5.88
Other interest earning assets	13,235	489	3.69	9,363	555	5.93	9,231	525	5.68
Total earning assets	1,466,711	97,062	6.62%	1,307,860	95,286	7.29%	1,207,836	81,838	6.78%
Allowance for loan losses	(9,002)			(6,584)			(6,245)		
Non-earning assets	142,076			118,780			110,098		
Total Assets	$ 1,599,785			$ 1,420,056			$ 1,311,689		
Liabilities and Shareholders' Equity									
Interest-bearing demand deposits	$ 414,750	$ 6,906	1.67%	$ 333,443	$ 9,752	2.92%	$ 285,250	$ 6,405	2.25%
Savings deposits	80,812	1,035	1.28	42,123	1,445	3.43	47,779	462	.97
Time deposits:									
Less than $100	239,211	10,220	4.27	234,439	10,429	4.45	229,829	8,439	3.67
$100 or more	339,110	12,621	3.72	317,219	16,132	5.09	273,305	12,043	4.41
Short-term borrowings	55,243	1,022	1.85	70,474	2,903	4.12	107,430	4,429	4.12
Long-term borrowings	254,680	11,239	4.41	173,208	8,670	5.01	153,089	7,557	4.94
Total interest-bearing liabilities	1,383,806	43,043	3.11%	1,170,906	49,331	4.21%	1,096,682	39,335	3.59%
Non-interest-bearing Deposits	106,124			133,509			107,595		
Other liabilities	14,595			14,885			11,189		
Shareholders' Equity	95,260			100,756			96,223		

Total Liabilities and Shareholders' Equity	$ 1,599,785		$ 1,420,056		$ 1,311,689	
Net interest income and Spread	$ 54,019	3.51%	$ 45,955	3.08%	$ 42,503	3.19%
Net interest margin		3.68%		3.51%		3.52%

NOTES:
—The above table reflects the average rates earned or paid stated on a tax equivalent basis assuming a tax rate of 35% for 2008, 2007 and 2006. The fully taxable equivalent adjustments for the years ended December 31, 2008, 2007, and 2006 were $1,846, $1,721, and $1,569, respectively.
—The average balances of non-accrual loans for the years ended December 31, 2008, 2007 and 2006, which were reported in the average loan balances for these years, were $23,517, $4,167, and $2,705, respectively.
—Net interest margin is calculated as net interest income divided by average earning assets.
—The average yields on investments are based on amortized cost.

Interest Variance Analysis (1)
(In thousands and tax equivalent basis)

Table 2

	2008 Compared to 2007			2007 Compared to 2006		
	Volume	Rate	Net	Volume	Rate	Net
INTEREST INCOME:						
Loans	$ 5,323	$ (8,066)	$ (2,743)	$ 3,547	$ 4,562	$ 8,109
Taxable Investments	4,111	264	4,375	2,546	2,229	4,775
Non-taxable Investments	592	(210)	382	499	(51)	448
Federal funds sold	1	(8)	(7)	(7)	17	10
Other interest earning assets	140	(370)	(230)	261	(155)	106
Total interest income	10,167	(8,390)	1,777	6,846	6,602	13,448
INTEREST EXPENSE:						
Interest-bearing demand deposits	1,354	(4,200)	(2,846)	1,058	1,873	2,931
Savings deposits	495	(905)	(410)	(194)	1,177	983
Time deposits less than $100	204	(413)	(209)	205	1,785	1,990
Time deposits $100 or more	815	(4,326)	(3,511)	2,233	1,856	4,089
Short-term borrowings	(282)	(1,598)	(1,880)	(1,019)	(91)	(1,110)
Long-term borrowings	3,595	(1,026)	2,569	1,007	106	1,113
Total interest expense	6,181	(12,468)	(6,287)	3,290	6,706	9,996
Net interest income	$ 3,986	$ 4,078	$ 8,064	$ 3,556	$ (104)	$ 3,452

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Provision for Loan Losses

The provision for loan losses was $12.9 million for 2008, compared to $2.3 million for 2007. The increase in the provision in 2008 was due to increased net charge offs, an increase in the level of non-accrual loans, loan growth during 2008, specific allocations for impaired loans and changes in the qualitative factors used in the overall assessment of the adequacy of the allowance for loan losses. We have closely reviewed and applied sensitivity analysis to the collateral values related to our loan portfolio to adequately measure potential future losses. Specific allocations have been provided in instances where loans have been considered impaired and collateral analysis indicates that losses may occur. Approximately $4.0 million of the recorded expense is attributable to a real estate and development loan in Hardy County, West Virginia and deterioration in a group of loan relationships outside of the

Corporation’s market area. Additional provision expense was also recorded because the company that services a commercial loan in which the Bank holds a participation interest failed to remit $1.2 million in principal payments made by the borrower that were due to the Bank. The Bank is reviewing its rights with respect to its insurance carriers and the servicing company’s insurance carriers and bonding companies, but there can be no assurance that the Bank will ultimately recover any of this loss.

The provision for loan losses was $2.3 million for 2007, compared to $1.2 million for 2006. The increase in the provision in 2007 was due to increased net charge offs, an increase in the level of non-accrual loans, loan growth during 2007, and changes in the qualitative factors used in the overall assessment of the adequacy of the allowance for loan losses.

Other Operating Income

The following table shows the major components of other operating income for the past three years (dollars in thousands) and the percentage changes during these years:

	2008	2007	2006	2008 VS. 2007 % CHANGE	2007 VS. 2006 % CHANGE
Service charges on deposit accounts	$ 5,835	$ 4,955	$ 4,630	17.8%	7.0%
Other service charge income	1,639	1,994	1,637	-17.8%	21.8%
Trust department income	3,912	4,076	3,671	-4.0%	11.0%
Insurance commissions	2,143	2,529	1,573	-15.3%	60.8%
Securities (losses)/gains	(1,997)	(1,605)	4	-24.4%	*
Bank owned life insurance (BOLI)	704	1,114	848	-36.8%	31.4%
Brokerage commissions	745	734	501	1.5%	46.5%
Other income	788	1,295	1,177	-39.2%	10.0%
Total other operating income	$ 13,769	$ 15,092	$ 14,041	-8.8%	7.5%

* not meaningful

As the table above illustrates, other operating income decreased by $1.3 million in 2008 when compared to 2007. This compares to a $1.05 million (7.5%) increase in 2007 over 2006.

Service charges on deposit accounts increased in 2008 versus 2007 and in 2007 versus 2006. These increases are due primarily to increased customer usage of an account overdraft product. Service charge related income constitutes 54%, 46%, and 45% of other operating income in 2008, 2007, and 2006, respectively.

Trust department income is directly affected by the performance of the equity and bond markets and by the amount of assets under management. Although we have experienced favorable sales production in our trust division, unfavorable market conditions have reduced the fees and commissions on our existing accounts under management resulting in slightly lower income when compared to 2007. Declining market values negatively impacted the value of assets under management at year-end. Assets under management were $472 million, $547 million and $502 million for years 2008, 2007 and 2006, respectively.

Insurance commissions also decreased in 2008 when compared to 2007 due to a soft insurance market resulting in lower premium income and a reduction in the amount of contingency income received in 2008. Contingency income is received from the insurance carriers based upon claims histories and varies from year to year. The increase in 2007 as compared to 2006 was due to the acquisition of two books of business during 2007.

Securities gains (losses) are the most variable component of other operating income. During 2008, we recorded a non-cash charge of approximately $2.7 million as a result of an other-than-temporary impairment analysis performed on our investment portfolio at year-end. This process is described more fully in the Investment Securities section of the Consolidated Balance Sheet Review. This charge was offset by gains realized from sales of investment securities and calls on fixed-income bonds.

During 2007, we recorded a non-recurring pre-tax charge of approximately $1.6 million ($1.0 million or $.18 per share, net of tax) associated with the transfer of certain investment securities from the available-for-sale category to the trading category during the first quarter of 2007 and the subsequent sale of those securities during the second quarter. This sale of securities was part of our overall restructuring of the investment portfolio designed to improve overall earnings from the portfolio.

We experienced a decline in other income during 2008 primarily due to reduced secondary market fees as a result of a shift to in-house portfolio loans. The decline in the earnings on our bank owned life insurance (BOLI) is attributable to the overall decrease in the interest rate environment throughout 2008.

Other Operating Expense

Other operating expense for 2008 increased $2.1 million (5.5%) when compared to 2007, compared to an increase in 2007 of $3.0 million (8%) over 2006. The following table shows the major components of other operating expense for the past three years (in thousands) and the percentage changes during these years:

	2008	2007	2006	2008 VS. 2007 % CHANGE	2007 VS. 2006 % CHANGE
Salaries and employee benefits	$ 21,531	$ 20,628	$ 19,084	4.4%	8.1%
Other expenses	11,264	10,563	9,900	6.6%	6.7%
Equipment	3,364	3,224	3,011	4.3%	7.1%
Occupancy	2,693	2,388	2,043	12.8%	16.9%
Data processing	1,721	1,672	1,452	2.9%	15.2%
Total other operating expense	$ 40,573	$ 38,475	$ 35,490	5.5%	8.4%

Salaries and employee benefits represent approximately 53% of total other operating expenses in 2008 compared to 54% in 2007 and 2006. Salaries and wages increased slightly by $.9 million in 2008 over 2007, and $1.5 million in 2007 over 2006. The increase in 2008 when compared to 2007 is primarily attributable to normal merit increases and new hires to support on-going operations and production. This increase was offset slightly because no executive bonuses were paid for 2008.

Other expenses increased slightly by $.7 million in 2008 when compared to 2007 due to increases in marketing, membership fees and licenses and miscellaneous conversion costs as a result of our core processor conversion completed in April. Comparing 2007 to 2006, other expenses increased by $.7 million due to increases in marketing, insurance, and contribution expenses.

Occupancy and equipment expenses increased by $.4 million from 2007 to 2008 and $.6 million from 2006 to 2007. These increases relate to the growth and expansion of the Bank's retail network and the opening of our operations center during 2007.

Applicable Income Taxes

Income tax expense amounted to $3.6 million in 2008 and $5.7 million in 2007 and 2006. The resulting effective tax rates were 28.7%, 31.0% and 31.3% for 2008, 2007 and 2006, respectively. The decrease in the effective tax rate from 2007 to 2008 is due primarily from reduced income and the proportionate share of tax-exempt income to total income.

CONSOLIDATED BALANCE SHEET REVIEW

Overview

Our total assets reached $1.64 billion at December 31, 2008, representing an increase of $160 million (10.8%) from year-end 2007.

The total interest-earning asset mix at December 31, 2008 shows a comparable percentage of loans and investments as a percentage of total assets over the past three years, as illustrated below:

	Year End Percentage of Total Assets		
	2008	2007	2006
Net loans	68%	70%	71%
Investments	22%	21%	20%

[31]

The year-end total liability mix has remained consistent during the three-year period as illustrated below.

	Year End Percentage of Total Liabilities		
	2008	2007	2006
Total deposits	78%	82%	78%
Total borrowings	21%	17%	21%

Loan Portfolio

Through the Bank and the OakFirst Loan Centers, we are actively engaged in originating loans to customers primarily in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Berkeley County, Hardy County, Mineral County, and Monongalia County in West Virginia; and the surrounding regions of West Virginia and Pennsylvania. We have policies and procedures designed to mitigate credit risk and to maintain the quality of our loan portfolio. These policies include underwriting standards for new credits as well as continuous monitoring and reporting policies for asset quality and the adequacy of the allowance for loan losses. These policies, coupled with ongoing training efforts, have provided effective checks and balances for the risk associated with the lending process. Lending authority is based on the type of the loan, and the experience of the lending officer.

Commercial loans are collateralized primarily by real estate and, to a lesser extent, equipment and vehicles. Unsecured commercial loans represent an insignificant portion of total commercial loans. Residential mortgage loans are collateralized by the related property. Any residential mortgage loan exceeding a specified internal loan-to-value ratio requires private mortgage insurance. Installment loans are typically collateralized, with loan-to-value ratios which are established based on the financial condition of the borrower. We will also make unsecured consumer loans to qualified borrowers meeting our underwriting standards. Additional information about our loans and underwriting policies can be found in Item 1 of Part I of this annual report under the caption “Banking Products and Services”.

Table 3 sets forth the composition of our loan portfolio. Historically, our policy has been to make the majority of our loan commitments in our market areas. We had no foreign loans in our portfolio as of December 31 for all of the periods presented.

Summary of Loan Portfolio
(Dollars in thousands)

Table 3

	Loans Outstanding as of December 31				
	2008	2007	2006	2005	2004
Commercial	$ 575,962	$ 492,302	$ 408,361	$ 404,681	$ 373,893
Real Estate – Mortgage	403,768	384,420	359,601	337,559	319,033
Consumer Installment	140,234	153,593	181,574	193,275	199,862
Real Estate – Construction	14,582	12,951	14,120	25,446	18,196
Lease Financing	—	—	—	—	466
Total Loans	$ 1,134,546	$ 1,043,266	$ 963,656	$ 960,961	$ 911,450

During 2008, gross loans increased by $91 million, or 8.8%, over 2007. This growth was focused in our commercial ($84 million) and residential mortgage ($21 million) loan portfolios, offset by a decline in installment ($13 million) and remains consistent with management’s objectives over the past several years. Continued efforts were made to increase the percentage of loans in the portfolio with adjustable interest rates. At December 31, 2008, adjustable interest rate loans maturing within one to five years were 60% of total loans, compared to 55% at December 31, 2007.

Commercial loans increased 17% in 2008, following a 20.6% increase in 2007. The growth in the commercial portfolio is a result of both in-house production and participations with other institutions. Commercial loans secured by real estate were 74% of total commercial loans at December 31, 2008, compared to 81% and 82% at December 31, 2007 and 2006, respectively.

Residential mortgage loans increased by $21 million, or 5%, in 2008 when compared to 2007. This follows a 7% increase in 2007 over 2006. The growth in the residential portfolio consists of both adjustable and fixed rate products.

Fixed–interest rate loans made up 38% of the total loan portfolio at December 31, 2008, compared to 42% and 59% of total loans at December 31, 2007 and 2006, respectively.

Consumer installment loans in 2008 decreased by $13 million, or 8.7%, when compared to 2007. This decrease reflects management's continued shift toward more commercial loans with less emphasis on the highly competitive consumer loan market and indirect car dealer loans. Indirect auto loans comprise the largest percentage of installment loans, 74% at December 31, 2008, and 85% at December 31, 2007 and 2006.

The following table sets forth the remaining maturities, based upon contractual dates, for selected loan categories as of December 31, 2008 (in thousands):

Maturities of Loan Portfolio at December 31, 2008

Table 4

	Maturing Within One Year	After One But Within Five Years	Maturing After Five Years	Total
Commercial	$ 299,951	$ 238,281	$ 37,730	$ 575,962
Real Estate – Mortgage	121,824	106,595	175,349	403,768
Installment	6,511	101,428	32,295	140,234
Real Estate – Construction	—	14,582	—	14,582
Total Loans	$ 428,286	$ 460,886	$ 245,374	$ 1,134,546
Classified by Sensitivity to Change in Interest Rates				
Fixed-Interest Rate Loans	$ 39,868	$ 166,462	$ 229,440	$ 435,770
Adjustable-Interest Rate Loans	388,418	294,424	15,934	698,776
Total Loans	$ 428,286	$ 460,886	$ 245,374	$ 1,134,546

Our policy is to place loans on non-accrual status, except for consumer loans, whenever there is substantial doubt about the ability of a borrower to pay principal or interest on the outstanding credit. Management considers such factors as payment history, the nature of the collateral securing the loan, and the overall economic situation of the borrower when making a non-accrual decision. Management closely monitors the status of all non-accrual loans. A non-accruing loan is restored to accrual status when principal and interest payments have been brought current, it becomes well secured, or is in the process of collection and the prospects of future contractual payments are no longer in doubt. Generally, consumer installment loans are not placed on non-accrual status, but are charged off after they are 120 days contractually past due. Table 5 sets forth the historical amounts of non-accrual, past-due and restructured loans (in thousands) for the past five years:

Risk Elements of Loan Portfolio

Table 5

	At December 31				
	2008	2007	2006	2005	2004
Non-Accrual Loans	$ 24,553	$ 5,443	$ 3,190	$ 2,393	$ 3,439
Accruing Loans Past Due 90 Days or More	3,476	3,260	619	989	1,105
Restructured Loans	468	0	522	532	544
Other Real Estate Owned	2,424	825	23	133	226

Interest income not recognized as a result of placing loans on a non-accrual status was $.4 million during 2008 and $.2 million during 2007 and 2006.

Allowance for Loan Losses

An allowance for loan losses is maintained to absorb losses from the loan portfolio. The allowance for loan losses is based on management's continuing evaluation of the quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

We use the methodology outlined in FDIC Statement of Policy on Allowance for Loan Losses. The starting point for this methodology is to segregate the loan portfolio into two pools, non-homogeneous (i.e., commercial) and homogeneous (i.e., consumer and residential mortgage) loans. Each loan pool is analyzed with general allowances and specific allocations being made as appropriate. For general allowances, the previous eight quarters of loss activity are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by the following qualitative factors: levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of management; national and local economic trends and conditions; and concentrations of credit in the determination of the general allowance. The qualitative factors are updated each quarter by information obtained from internal, regulatory, and governmental sources. Specific allocations of the allowance for loan losses are made for those loans on the "Watchlist" in which the collateral value is less than the outstanding loan balance with the allocation being the dollar difference between the two. The Watchlist represents loans, identified and closely monitored by management, which possess certain qualities or characteristics that may lead to collection and loss issues. Allocations are not made for loans that are cash secured, for the Small Business Administration and Farm Service Agency guaranteed portion of loans, or for loans that are sufficiently collateralized.

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. These estimates are reviewed quarterly, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the allowance for loan losses. The methodology used to determine the adequacy of the allowance for loan losses is consistent with prior years. An estimate for probable losses related to unfunded lending commitments, such as letters of credit and binding but unfunded loan commitments is also prepared. This estimate is computed in a manner similar to the methodology described above, adjusted for the probability of actually funding the commitment.

The balance of the allowance for loan losses increased to $14.3 million at December 31, 2008, from $7.3 million at December 31, 2007. Several factors contributed to the $7 million increase in the balance of the allowance in 2008, including: a significant increase in the balance of non-accrual loans, from $5.4 million in 2007 to $24.6 million in 2008; changes to the qualitative factors which are reviewed quarterly; an increase in impaired loans from $6.9 million in 2007 to $83.3 million in 2008; and an increase in the percentage of net charge-offs to average outstanding loans from .15% in 2007 to .54% in 2008. Non-accrual loans and impaired loans consist primarily of real estate development loans and commercial real estate that have experienced a slowdown in the level of sales activity during the current year. All of these types of credit facilities were thoroughly reviewed by management during the fourth quarter of 2008 as to the adequacy of the collateral, the valuation of collateral, secondary sources of repayment, and other credit quality attributes. Collateral valuations were also subject to a sensitivity and shock analysis in order to identify loans that may not have sufficient collateral in the event of a significant decline in the market value of the collateral. As a result of this extensive review, some specific allocations of the allowance were made to several of these loans. At December 31, 2008, the balance of the allowance was equal to 1.26% of total loans, which was 2.4 times the amount of net charge-offs for the year.

Performing loans considered impaired loans, as defined and identified by management, amounted to $56.5 million at December 31, 2008. Loans are identified as impaired when the loan is classified as substandard and management determines that it is probable that the borrower will not be able to pay principal and interest according to the contractual terms of the loan. These loans consist primarily of acquisition and development loans. The fair values are generally determined based upon independent third party appraisals of the collateral or discounted cash flows based upon the expected proceeds. Specific allocations have been made where management believes there is insufficient collateral and no secondary source of repayment is available.

During 2008, there was significant coverage in the media regarding the topic of "sub-prime" loans and the resulting increase in loan delinquencies and foreclosures. A sub-prime loan is defined generally as a loan to a borrower with a weak credit record or a reduced repayment capacity. These borrowers typically pose a higher risk of default and foreclosure. We generally do not make sub-prime loans. If credit is extended to a sub-prime borrower, the decision to lend is based on the presence of facts and circumstances that management believes mitigate the risks inherent in this type of loan. As of December 31, 2008, management believes that our exposure to sub-prime loans is very minimal.

The balance of the allowance for loan losses increased to $7.3 million at December 31, 2007, from $6.5 million at December 31, 2006. Several factors contributed to the $.8 million increase in the balance of the allowance in 2007, including: a 71% increase in the balance of non-accrual loans (from $3.2 million in 2006 to $5.4 million in 2007); changes to the qualitative factors which are reviewed quarterly; an increase in impaired loans from $.1 million in 2006 to $6.9 million in 2007; and an increase in the percentage of net charge-offs to average outstanding loans from .11% in 2006 to .15% in 2007. Non-accrual loans and impaired loans consist primarily of real estate acquisition and development loans that have experienced a slowdown in the level of sales activity during the current year. All of these types of credit facilities were thoroughly reviewed by management during the fourth quarter of 2007 as to the adequacy of the collateral, the valuation of collateral, and other credit quality attributes. Collateral valuations were also subject to a sensitivity and shock analysis in order to identify loans that may not have sufficient collateral in the event of a significant decline in the market value of the collateral. As a result of this extensive review, some specific allocations of the allowance were made to several A&D loans. At December 31, 2007, the balance of the allowance was equal to .70% of total loans, which was five times the amount of net charge-offs for the year.

As a result of management's evaluation of the loan portfolio using the factors and methodology described above, management believes the allowance for loan losses is adequate as of December 31, 2008.

Table 6 presents the activity in the allowance for loan losses by major loan category for the past five years.

Analysis of Activity in the Allowance for Loan Losses
(Dollars in thousands)

Table 6

	For the Years Ended December 31				
	2008	2007	2006	2005	2004
Balance at Beginning of Period	$ 7,304	$ 6,530	$ 6,416	$ 6,814	$ 5,974
Loans Charged Off:					
Commercial	3,936	540	359	557	808
Real Estate – Mortgage	743	103	89	162	153
Installment	1,408	1,171	1,127	1,171	1,244
Deposit Overdrafts	508	408	—	—	—
Total Charged Off	6,595	2,222	1,575	1,890	2,205
Recoveries of Loans:					
Commercial	147	45	110	8	22
Real Estate – Mortgage	39	17	11	59	67
Installment	375	380	403	347	422
Deposit Overdrafts	152	242	—	—	—
Total Recoveries	713	684	524	414	511
Net Loans Charged Off	5,882	1,538	1,051	1,476	1,694
Provision for Loan Losses	12,925	2,312	1,165	1,078	2,534
	$ 14,347	$ 7,304	$ 6,530	$ 6,416	$ 6,814

Balance at the End of Period									
Loans at End of Period	$	1,134,546	$	1,043,266	$	963,656	$	960,961	$